Feedback on the TEG interim report on an EU green bond standard (EU GBS)

We believe the concepts underpinning the H2020 project 'Moving Towards Adaptive Governance in Complexity: Informing Nexus Security' (MAGIC[1][2]), of which Climate Analytics is a consortium partner, may be useful to this important initiative.

MAGIC has been looking into interlinkages between the financial system and the biosphere in a case study on the development of green bonds as a policy innovation. This case study has been following the development of the Action Plan on Sustainable Finance and included interviews with members of the Technical Expert Group (TEG) and Members of the European Parliament (MEPs) involved in the legislative process (ECON Committee). Focus has been on two specific subtasks from the European Commission's legislative proposal of May 2018: (a) the development of an EU classification system (the 'taxonomy') and (b) an EU Green Bond Standard.

Feedback

- The risks of "greenwashing" are *reputational* for firms and the financial sector, but the failure to properly address them exacerbate the risks of *material* negative impacts to the whole European economy and society. By absorbing from markets the risks derived from deciding on potentially contestable definitions of green, the EU must ensure it's not only alleviating the burdens to reputation, but also ensuring effectiveness to the ultimate "green" objective and underlying justification of the EU GBS. Effectiveness and accountability on such a core green component cannot be downplayed and replaced by a simple shift of risk ownership away from market participants, coupled with additional incentives to those same participants. The development of a green bond market must come attached to clearer goals and mechanisms to address and monitor on the delivery of green additionality.
- Weak and unsubstantiated definitions for labelling an EU bond as "green" could also impact on the climate and environmental action in specific sectors. By publicly signalling lower levels of green expectations, not only financial actors but all other types of firms in the economy might feel justified or incentivized not to raise or erode their ambition. Even if the definition is currently being built under the 'EU taxonomy', the "green" remains the core of green bonds and measure

[1] MAGIC has received funding from the European Union's Horizon 2020 research and innovation programme under Grant Agreement No. 689669. This feedback reflects the authors' view only; the funding agency is not responsible for any use that may be made of the information it contains.

[2] MAGIC is assessing how European policies can be better integrated to address the global challenges of delivering water, energy and food security (the WEF nexus). In turn, these objectives are themselves intertwined with a robust and timely response to climate change. For this purpose, a transdisciplinary methodology is used to develop a shared understanding, between scientists and policy stakeholders, of the narratives which are shaping the debates on nexus policies. Part of these efforts have focused on the comprehension of narratives' *feasibility*, which is based on the assessment of the compatibility of the socio-economic system with the biosphere. Finance constitutes an essential part of the socio-economic system, as it can provide or fail to provide the means of implementation and thereby also influence policy decisions or outright determine viable policy options and narratives.

for its success. The Commission and the TEG should be more explicit not only about these risks, but particularly about mechanisms to prevent or overcome them.

- Albeit citing the Paris Climate Agreement as a key driver for the EU GBS, the TEG's interim report fails to explain how the development of a green bond market fits in the bigger picture of European Climate Action. For example, with an inherent and ultimate climate objective, the Technical Expert Group doesn't indicate how a green bond market can work towards the EU Long-Term Strategy and its goal of achieving net-zero greenhouse gas emissions by 2050. Is the EU GBS intended as a sufficient policy on its own or will it require additional measures in the financial system towards that long-term goal? What are the EU GBS benefits and limitations towards the Paris Climate Agreement's objective of making all financial flows consistent with a low carbon pathway and climate-resilient development (article 2.1.c)? How might an incremental change in green bond markets support the Paris Agreement goal of keeping global temperature rise below 1.5˚C?
- Climate change also brings a key and imperative *time* component which has not been factored into the proposed EU GBS' architecture. The interim report provides a broad vision under the objective to "increase the flow of finance to green and sustainable projects", but it doesn't give any clarity on how much increase and by when. A meaningful proposal must bring clearer financial and environmental goals, targets and milestones, considering the urgency to act against climate change. It should also lay down a longer-term strategy that indicates how the EU GBS intends to assess results, adapt and increase ambition over time towards full compliance with the Paris Climate Agreement and other European environmental and climate commitments.
- A credible EU GBS architecture must address all the points above: material risks to the environment, risks of negative contagion to other sectors, the lack of connection with the broader EU climate and environmental action, and absence of time in the current architecture are fundamental shortcomings. While some of them, such as material risks and clearer goals should be justified from the first proposed legislation, issues such as targets and milestones could potentially come at a later stage. An initial testing phase of 3 years could be beneficial to generate awareness, create market buy-in and foster innovation. However, even if planning to postpone the inclusion of certain essential aspects, that should be clearly stated and justified from the beginning of the standard, on the grounds of policy transparency, market predictability and accountability to European taxpayers. Accountability on green effectiveness is the only factor to justify incentives to issuers or investors of green bonds. Such incentives could also be explicitly linked to the phasing-out of overall European subsidies to fossil fuel-related activities.
- The EU GBS focuses on growing a small niche, but doesn't address the continued and potential environmental harm done by the remaining bonds issued in Europe. That should remain a crucial component of any credible strategy on sustainable finance, since even with a strong and growing green niche, unaddressed harmful structures and activities will remain responsible for pushing European financial flows away from low-carbon pathways and a climate-resilient development. While "picking losers" can be opposed on economic bases, there is no legitimate argument on political, legal and environmental terms to justify the defence of lax regulations that directly or indirectly incentivize environmental degradation. Even when the costs of pollution have been insufficiently internalised on the firm level across the economy – e.g. with a weak price on carbon -, loop-holes and underlying biases in debt markets must be addressed to prevent rational and destructive gambling that exacerbates such negative externalities to the environment. A bare minimum should be to extend the climate and environmental self-reporting of a *do-no-harm* requirement to the entirety of bond markets, also creating a level playing field for green bonds in terms of transparency and reporting practices. A more appropriate goal, autonomous from green additionality, is that no single bond issued in Europe should contribute to the creation or maintenance of polluting structures and activities, such as carbon-intensive stocks that will undermine the European long-term goal of net-zero greenhouse gas emissions by 2050.

Text prepared by: Luis Zamarioli and Jan Sindt