

European Mortgage Federation-European Covered Bond Council (EMF-ECBC)

EMF-ECBC Response to European Commission Consultation on the Proposal for a Regulation on European Green Bonds

14 September 2021

The EMF-ECBC welcomes the opportunity to comment on the EU Green Bond Standard (EuGBs).

Covered bonds are mostly backed by mortgages on real estate and are essential to put the EU's building stock on a net-zero emissions pathway. It is important to ensure that the EU Taxonomy works in practice and can be applied to EU covered bond markets, especially considering the long-term nature of mortgages.

Grandfathering of Covered Bonds & Underlying Assets

We welcome the voluntary nature of the EuGBs and believe it has the potential to boost green bond markets. However, we are concerned about the wording of Art. 7(2) 3rd subparagraph suggesting in the case of financial assets a 5-year grandfathering. This is not in line with Recital 11 of the proposal, which is very clear on why grandfathering is necessary. To ensure that the Taxonomy works in practice and supports credit market models, the wording of Art. 7(2) should be modified in line with Recital 11. This proposal is fully aligned with the Technical Expert Group (TEG) recommendation on p.29 of its EuGBs Report and p.32 of the accompanying Usability Guide.

The rationale is to provide certainty and predictability to borrowers, lenders and investors, also in the case of financial assets refinanced through green bonds, which is crucial for the transition towards more sustainable finance. Financial assets are directly linked to economic activities, such as real estate activities. The risk of losing Taxonomy eligibility creates possible barriers to long-term investments.

Taking into account the TEG's recommendation, we consider the grandfathering of EU Green Bonds for their entire tenure to be equivalent to considering both the covered bonds and their underlying fixed and financial assets, according to Arts. 4 & 5, as taxonomy eligible throughout their lifetime. Therefore, grandfathering should apply not only to the covered bonds but also to the underlying assets e.g. mortgage loans, given the structural link between the asset and the liability side.

Use of Proceeds

Regarding the requirement that 100% of the proceeds of green bonds issuances be used to finance or refinance Taxonomy-aligned assets, it is important that there is appropriate flexibility in this area. Indeed, the Taxonomy introduces a new and significant risk for issuers in terms of validating compliance by customers – both in terms of minimum safeguards, DNSH-criteria but also the technical criteria.

In order to achieve the climate goals in the real estate sector, banks should be able to refinance Taxonomy compliant mortgage loans through EuGBs aligned covered bonds. However, this will require large volumes of such mortgage loans which would take years to accumulate to meet minimum issue size. Without appropriate

flexibility, it would take years before banks – and especially small banks - could issue an EU Green Bond, with knock-on effects for financing to borrowers and for the climate goals. We therefore propose a threshold of 80% for a transition period of at least 5 years, and the possibility to extend to categories of assets which are not included in the current Taxonomy, considering that the latter must be updated in a timely manner.

Reporting on Taxonomy Compliance

Issuers of covered bonds should be allowed to report on the greenness of the cover pool using the Taxonomy in force at the time of granting the loans backing the bond. In other words, it should be possible to label the proportion of assets in the cover pool that are aligned with the Taxonomy, as recommended by the TEG in section 3.3.4, p. 40 of its Taxonomy Report.

These covered bonds should still meet the same requirements as 100% Taxonomy aligned covered bonds i.e. verification, 2nd party opinion, allocation reporting, impact reporting etc.

Investors would still have an incentive to buy covered bonds from a cover pool with a high percentage of Taxonomy aligned assets, which would give the issuers an incentive to promote lending to green projects.