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Driving Green Finance With Europe's New Label

- *As the European Green Bond Standard takes effect, the label will become a prominent subset of the green bond market.*
- *In 2023, investments aligned with the European Union taxonomy reached a quarter of a trillion euros, indicating strong potential for applying the green bond label.*
- *Public issuers should proactively adopt the label, leading a concerted effort to promote credibility and transparency in broader sustainable finance.*
- *Large corporate issuers, which have significant eligible investment pipelines, may find it almost effortless to align with the label for raising funds.*

The European Green Bond Standard (EUGBS), a landmark regulatory framework for sustainable bonds, will take effect on 21 December 2024. Issuers may then use the "European green bond" or "EuGB" designation for their bond issuances.

EuGB issuances worth hundreds of billions of euros could be on the way from various issuer types such as supranational entities, government agencies, sovereigns, financial institutions and corporates, forming a prominent subset of the green bond market. This will also improve overall market credibility.[1]

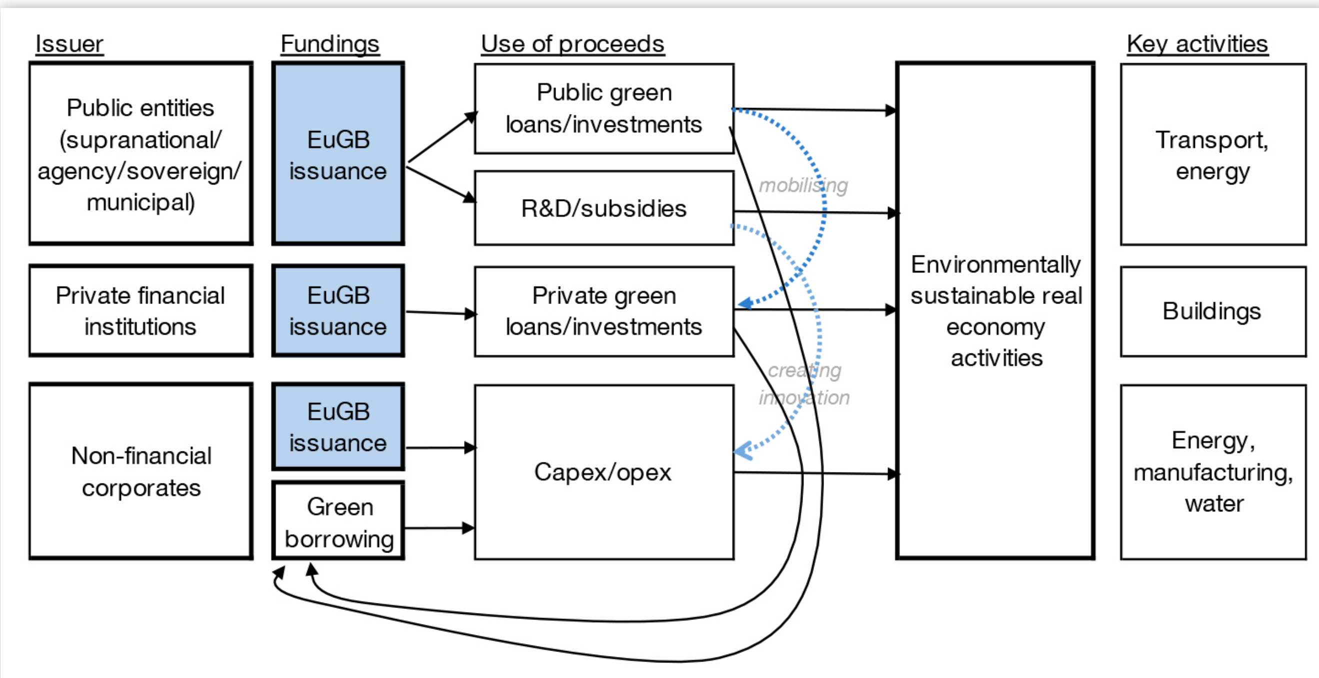
EuGB issuance is a natural home for funding European Union (EU) taxonomy-aligned investments: The standard requires use of proceeds to be aligned with the EU taxonomy, which defines "environmentally sustainable" activities in sectors such as energy, transport, building and manufacturing. These investments are expected to grow over time to support climate objectives, creating an increasingly significant candidate pool for EuGB issuances.

In 2023, total reported EU taxonomy-aligned investments reached **€249 billion.**[2] The figure corresponds to about 80% of green bond issuances from Europe and nearly half of global issuances during the same year. This meaningful amount indicates adequate projects are already in place to support a decent uptake in EuGB supply.

Prominent existing green bond issuers should be able to easily embrace the EuGB label, which goes hand in hand with advancing their environmental strategies and transition plans. By showing increased attractiveness for investors and establishing overall market momentum, benchmark bonds could motivate wider participation from other issuers that may initially face proportionately higher hurdles to meet the standard's requirements.

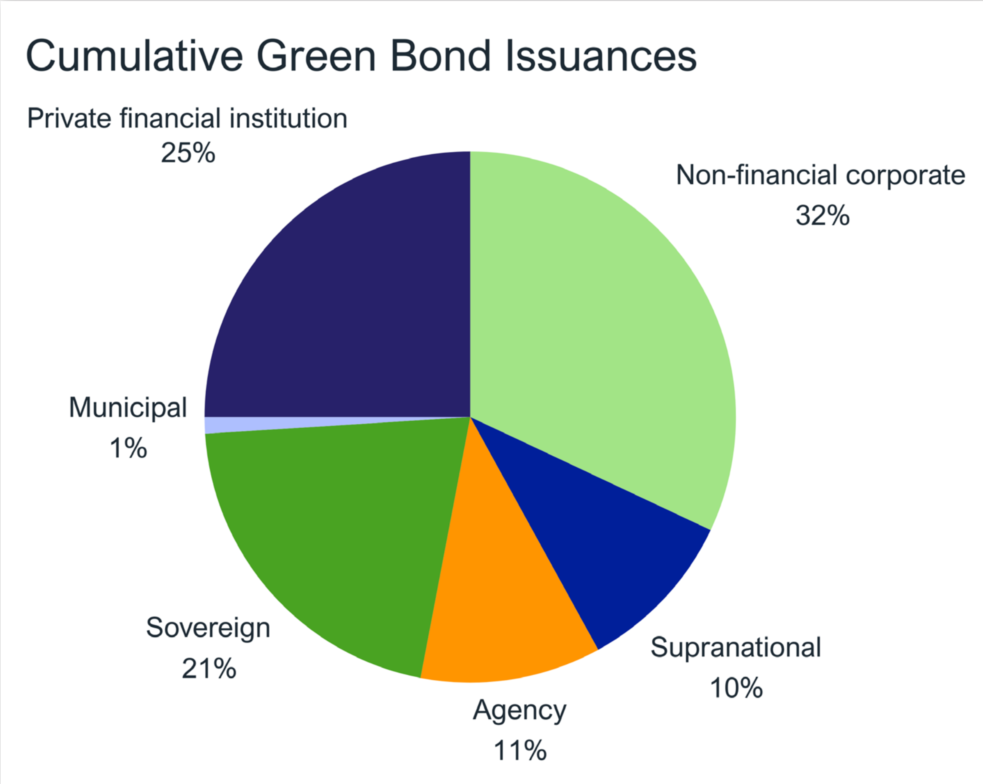
All key types of issuers can be potential EuGB issuers (see Figure 1). Companies may access capital markets directly or through public and private finance channels to meet investment needs for the net-zero economy. Financial sectors can match their environmentally sustainable loans and investments with EuGB liability instruments.

Figure 1: How Different Types of Issuers Could Use the EUGBS To Grow Future-Proof Economic Activities



Source: IEEFA

Figure 2: Europe Green Bond Market Breakdown by Issuer Type



Source: Environmental Finance Data,[3] IEEFA

Supranational and Government Agencies

Supranational or governmental agencies are among the issuers with higher credit ratings. They are well-positioned to issue sizeable benchmark bonds for the market. They likely have substantial pipelines of sustainable projects, with abundant resources to enhance their reporting efforts. As a result, they should make the move to lead the uptake of the EuGB label.

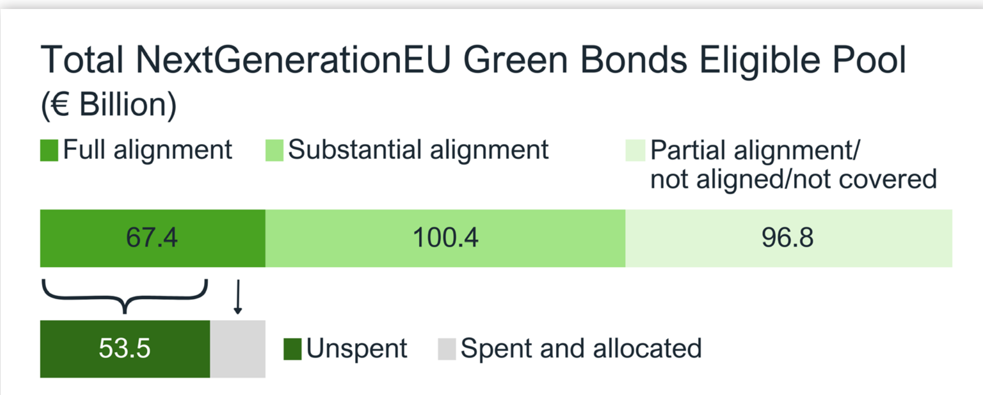
> **Supranational or governmental agencies are well-positioned to issue sizeable benchmark bonds.**

For development banks, navigating the complexity of their global portfolios may present challenges, especially when applying the EU taxonomy outside the EU. But they should champion the credibility and transparency of sustainable finance on a global scale, in light of their commitment to channelling climate finance to developing and low-income countries.[4]

By raising liabilities through the EUGBS, development institutions can facilitate concerted international efforts to enhance reporting capacity and interoperability of taxonomies. This will improve clarity on the invested assets' science-based environmental criteria for investors and in turn foster wider sustainable finance mobilisation, leading to additional social-environmental benefits in line with development institutions' mission. **The European Investment Bank**—the world's largest green bond issuer—has detailed its steps[5] to align with the standard; German development bank **KfW**'s bond proceeds are "working on gradually aligning" with the EU taxonomy.[6]

The **EU**'s €250 billion NextGeneration Green Bond programme could position the bloc as the world's largest green bond issuer—this reinforces its obligation to set an example. As of 1 August 2024, only 32% of the €44 billion of allocated proceeds from the programme is fully aligned with EU taxonomy criteria; 25% of the €265 billion total eligible pool is fully aligned.[7] This has not improved from its last reporting period.[8] Despite that, the unspent fully taxonomy-aligned eligible pool remains sizeable, at **€53.5 billion** (Figure 3)—the EU could consider adopting the EuGB label for this. The EU could in turn establish best practices and granular reporting guidance to encourage broad adoption of the standard.

Figure 3: The EU Has a Sizeable Unspent Taxonomy-Aligned Green Bond Pool by Absolute Term



Source: European Commission, IEEFA

Sovereigns

Government green bonds play an important role in funding public investments and mobilising related private investments to support national climate objectives.

Governments should proactively enter the labelled European green bond market. By stepping up their game in sustainable finance, governments can coherently present their climate and environmental goals and policies, supported by a range of industrial and technological innovation measures. By contextualising the contribution of sustainable finance to countries' net-zero plans, the countries could establish credibility that can promote the development of the overall green bond market.

Many EU member states have green budgeting practices. Numerous measures varying in scope may add costs when measuring the budgets' alignments with the EU taxonomy. However, countries such as **Austria** and **Netherlands** already commit to allocating their green bond proceeds only to expenditure that meets EU taxonomy criteria.[9,10] **Germany** is currently updating its sustainable bond framework.[11] This presents an opportunity to align its framework with the EUGBS and demonstrate global leadership in sustainable finance. Germany identified an €18.4 billion eligible green bond pool from the federal green budget 2022, of which 40% was reported to be aligned with the EU taxonomy substantial contribution criteria.[12]

Private Financial Institutions

Private credit institutions play a key role in funding EU taxonomy-aligned activities. This has come under the spotlight as EU banks are now required to report "green asset ratios", the share of their assets aligned with the taxonomy. This metric, despite controversies around its scope and methodology,[13] reflects an important aspect of the banks' transition planning,[14] as they should aim to increase their exposure to green assets that entail lower climate-related financial risks.

European green bonds are a fit-for-purpose tool to earmark banks' liabilities with EU taxonomy-aligned assets or loan portfolios. There is minimal additional burden for banks as they are already expected to detail their EU taxonomy-aligned assets, which could help form the basis of determining the eligible pool for EuGB funding. Using the EuGB label can signal strong transition planning and concrete progress if the banks demonstrate continued efforts to apply the EU taxonomy technical screening criteria to identify investment opportunities and grow their future-proof asset bases.

> **"There is minimal additional burden for banks as they are already expected to detail their EU taxonomy-aligned assets.**

For example, two Dutch banks are large green bond issuers with leading green asset ratios. **ING** reported a total eligible green loan portfolio of €52.2 billion as of December 2023,[15] 80% or **€41.9 billion** of which—relating to residential buildings—is aligned with the taxonomy. As most of this amount has not been earmarked by ING's green bond allocated proceeds as of December 2023, this presents opportunities for the bank to raise compatible funding by adopting the EUGBS. **ABN AMRO**'s green bond framework[16] shows a strong preparedness for the EUGBS. The bank's environmentally sustainable assets reached **€31.2 billion** as of 2023.

Non-Financial Corporates

The EUGBS serves as a direct capital market funding channel for non-financial corporates to transition to more sustainable activities in line with EU environmental objectives.

The utilities sector spends the most on EU taxonomy-aligned activities.[17] Many European power utilities have been ramping up renewable energy capacity, making it easier for them to meet EUGBS rules.[18] For example, **Iberdrola** has a sizeable investment plan of €41 billion over 2024-2026, with a committed EU taxonomy alignment of 90% (up to **€37 billion**).[19] The need to upgrade electric grids means many regulated utilities have large capital expenditure (capex) plans. For example, **TenneT**'s announced **€160 billion**[20] investment programme over 2024-2033 is likely to be fully aligned with the EU taxonomy's designated activity of electricity transmission. This could be funded by direct or indirect (via banks) EuGB issuances.

In other sectors, projects eligible for the EUGBS may be less readily available, but still possible. Some industries with high exposure to climate-related risks have tapped the green bond market, including fossil fuel-dependent sectors (such as chemical) and manufacturing sectors enabling downstream emissions (such as automobile). The oil and gas sector remains largely absent from the green bond market.

It's important for corporates to demonstrate prudent management of transition risks and opportunities to preserve their creditworthiness and ensure continued access to funding. As companies with a high climate risk exposure are increasingly required to invest in mitigation and adaptation, adopting the label could demonstrate seriousness in commitments, plausible green capex pipeline, green asset delivery and strong governance.[21]

Conclusion

The EUGBS still has its limitations, particularly relating to the coverage and useability of the EU taxonomy.[22] But the investments reported to be aligned with the taxonomy are meaningful, with a strong potential to continually grow.

Large-scale corporates and financial institutions—with eligible projects and assets in place—could easily become the frontrunners of the EuGB label. At the same time, it's worthwhile for public issuers to enhance their reporting efforts and project screening criteria. By aiming for a gradual alignment, they can still take the lead in EuGB issuances, even if these are earmarked with initially aligned assets, which may be significant on their own.

As investors increasingly strive for clarity and assurance in building climate-aligned portfolios, it's now up to various types of issuers to step up their sustainable finance strategies and reap the rewards.

Endnotes

1 IEEFA. Will Europe's new standard help or hinder green bond market growth? 19 February 2024.

2 European Commission. The EU Taxonomy's uptake on the ground. June 2024.

3 Accessed on xx December 2024. Please refer to Environmental Finance Data's methodology.

4 European Investment Bank. Multilateral Development Banks to Boost Climate Finance. 12 November 2024.

5 European Investment Bank. Climate Awareness Bonds Framework 2022. 19 April 2024.

6 KfW. "Green Bonds – Made by KfW" Framework 2024.

7 Based on the European Commission's NextGenerationEU Green Bonds Allocation and Impact Report 2024. The modest alignments are due to the NextGeneration Green Bond programme's eligibility criteria being set before the EU taxonomy. For example, energy efficiency projects comply with the "main substantive substantial contribution conditions, but not to the same scale". Also, the "do no significant harm" criteria under the green bond programme are applied to "specific measures and reforms related to economic recovery and resilience"; the criteria under the EU taxonomy classify "entire economic activities based on their environmental and climate sustainability".

8 IEEFA. Will Europe's new standard help or hinder green bond market growth? 19 February 2024.

9 State of the Netherlands. Green Bond Framework. 8 September 2023.

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18 IEEFA. Europe's clean power leaders: How green financing is enabling renewable growth. 20 June 2024.

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21 IEEFA. Will Europe's new standard help or hinder green bond market growth? 19 February 2024.

22 Ibid.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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Kevin Leung is a Sustainable Finance Analyst, Debt Markets, Europe at IEEFA. He has authored reports on topics relating to sustainable credits, transition finance and sustainable finance regulatory initiatives.

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