

Issuers' Use of Green Bond Frameworks

The Danish Financial Supervisory Authority (the Danish FSA) has conducted a survey of the application of Green Bond Frameworks (GBF) in bond issuances. A GBF is prepared by the bond issuer and describes the issuer's own set framework for its "green bonds." This report reviews Danish bond issuers' practices in the use of GBFs. In this context, the report highlights some of the elements that issuers should be aware of when preparing GBFs used in green bond issuances.

In recent years, there has been an increase in the issuance of green bonds to finance, for example, expenses for the expansion of renewable energy or energy efficiency of existing buildings. The Danish market for green bonds has a total value of €40.8 billion, which corresponds to 5.8% of the Danish bond market measured by the value of issuances¹. Green bond issuances from Danish companies include 73 bond series, consisting of 57% corporate bonds and 43% mortgage bonds.

Bonds with sustainability features can be broadly divided into two categories. The first category is green bonds (also called Use of Proceeds bonds, UoP), where the proceeds are used to finance green projects. This can either be in accordance with the EU taxonomy criteria or based on the issuer's own method as described in its GBF. The second category is Sustainability-Linked Bonds (also called SLBs), which include a specific ESG target or ESG component that the issuer commits to fulfilling. If the issuer does not meet the specified ESG target or component, the issuer typically has to pay a higher interest rate to the investors in the bond series.

For both types of bonds, issuers typically prepare and publish a GBF.

What is a GBF?

A GBF describes the issuer's own set framework and definitions for the issuer's green bonds. It includes information such as the types of projects that

¹ Bloomberg (2023)

can be financed by the bond proceeds, how projects are evaluated, and how the issuer reports on the use of the proceeds.

An issuer's GBF is not part of the prospectus for the bond issuance, but is referenced in the prospectus with a link to the issuer's website where the GBF can be accessed. The key elements of the GBF must be incorporated in the prospectus itself.

The legislation does not contain substantive requirements for a GBF. However, some international sector standards include recommendations for the content of GBFs. The most widely used international sector standard among Danish issuers is the Green Bond Principles (GBP) of the International Capital Market Association (ICMA).

About the survey

The Danish FSA reviewed GBFs from the 12 largest Danish issuers measured by issuance value and number of issuances. The selected issuers include banks, mortgage institutions, and non-financial companies. All issuers in the survey adhere to ICMA GBP.

All issuers in the survey provide information on what they characterize as a "green project." They also state that they have internal business processes that ensure that the use of bond proceeds complies with the conditions in their GBF. All issuers have had their GBF assessed by a third party to verify its content. Finally, all issuers in the survey have reported their preliminary proceeds allocation to investors through annual allocation reports. However, these reports have typically not been assessed by a third party.

In their work with GBFs going forward, issuers should focus on improving the clarity and comprehensibility of the information in their GBFs and their reporting on the proceeds allocation for ordinary investors. Issuers must also clearly indicate whether their green projects comply with the Taxonomy Regulation. Key elements from the external reviewer's assessment of a GBF should be included in the description of the third-party assessment to ensure an accurate picture. Finally, issuers must be cautious to avoid disclaimers in the GBF related to factors within the issuer's control.

1. Prospectus Regulation

The Prospectus Regulation² and the accompanying delegated regulations contain provisions regarding the information to be included in a prospectus

² Regulation of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market. Reference is also made to the Danish Financial Supervisory Authority's note on disclosure requirements for green bond prospectuses of 21 September 2021 and the European Securities and Markets

when securities are offered to the public. These provisions also apply to the offering of green bonds but do not include specific requirements for sustainability-related information.

Issuers of green bonds must therefore consider whether the GBF contains information that is material under Article 6(1) of the Prospectus Regulation and should be included in the prospectus. Information is material if it is necessary for an investor to make an informed assessment of the issuer or the securities and thus make an investment decision based on adequate information.

Issuers of green bonds must always indicate in the proceeds section of the prospectus, the main categories to which the expected proceeds from the offering will be allocated. The prospectus may also include a summary of the key information about the issuer's GBF or refer to the relevant legislation that the issuer uses to categorize the sustainability profile of the bonds. Issuers must be cautious to avoid disclaimers related to factors within the issuer's control, such as the possibility that the proceeds may be used contrary to what is stated in the prospectus or GBF. If an issuer cannot guarantee how the proceeds will be used, the issuer should elaborate on this so that investors can make an informed investment decision. Lastly, investors must indicate in the prospectus the consequences if the issuer does not meet its GBF.

2. The Danish FSA's observations and recommendations to issuers

The following describes the Danish FSA's observations from the survey and the elements that the Danish FSA believes issuers should be aware of.

2.1. Description of green bonds' use of proceeds

All the issuers in the survey specify in their GBF how they define a green project. The definitions typically rely on the projects' contributions to the UN Sustainable Development Goals. However, several issuers provide sparse or vague information about the green projects they have defined in their GBF. This makes it unclear to investors how the proceeds from the bonds will be used.

To enable an investor to make an informed investment decision, the issuer should provide comprehensive information on how it plans to use the proceeds from its bond issuance. This can be done, for example, by including detailed descriptions of the criteria the issuer uses to ensure that a project or project type is sustainable. If relevant, the specific projects or project types can also be listed.

Authority's (ESMA) opinion of 11 July 2023 on how issuers should meet the specific disclosure requirements under the Prospectus Regulation in relation to sustainability information.

Similarly, it is important that an issuer using a GBF that applies to the entire group makes it clear to investors which types of green projects the bond issuances from specific parts of the group may be used to finance. Otherwise, it may be unclear to an investor whether the proceeds from a bond, for example issued by a financial institution, could be used to finance the same green projects as the proceeds from mortgage bonds.

The issuers in the survey generally do not specify the timeframe for proceeds allocation in their GBFs. The purpose of green bonds is to support the green transition. Therefore, it is important for an investor to know when the investment will contribute to this transition. The Danish FSA encourages issuers to indicate as precisely as possible, the expected timeframe for proceeds allocation, possibly with specific milestones for the allocation period.

Some of the GBFs reviewed provide detailed descriptions of the issuer's environmental objectives, ESG strategy, and prioritized projects. This way, the green bonds are linked to the issuer's overall sustainability strategy.

2.2. Alignment with the Taxonomy Regulation

The Taxonomy Regulation defines when economic activities can be considered environmentally sustainable. Investors in green bonds will typically need to report the extent to which their investments comply with the regulation. Issuers must therefore describe whether the green projects that can be financed under the specific GBF comply with the Taxonomy Regulation. Some of the GBFs reviewed state that the green projects comply with the Taxonomy Regulation. However, the third-party assessments of several of these GBFs do not include an evaluation of whether the GBF meets the regulation's requirements for doing no significant harm (DNSH) and for meeting the Minimum Safeguards. The reason for the lack of evaluation is that the issuers in question have only limited documentation for ensuring DNSH and Minimum Safeguards.

In order to be in alignment with the Taxonomy Regulation, it is not sufficient for a green project to meet the requirement of significantly contributing to an environmental objective if it does not, for example, meet the DNSH requirement. Therefore, it may only be stated in the GBF that the green projects are aligned with the Taxonomy Regulation if the projects fully meet the taxonomy's requirements. Neither the prospectus nor the GBF should give the impression of being in alignment with the Taxonomy Regulation if this is not actually the case, or if only parts of the requirements of the Taxonomy Regulation are met.

2.3. Reporting on allocation of proceeds

In addition to a GBF, issuers of green bonds also publish annual allocation reports that document the preliminary use of bond proceeds. Some issuers divide their annual reporting on proceeds allocation by business areas, such

as banking and mortgage. This approach helps create transparency in the use of proceeds in loans and financing of green projects. Other issuers, however, only report on proceeds allocation in a general and aggregated manner, which reduces transparency.

It is important that issuers maintain a high standard for reporting on the use of proceeds and environmental impact. This includes precise and detailed descriptions of how the green funds are used. Effective reporting should be divided by business areas and include detailed information of an issuer's green projects to create better understanding and higher transparency in the financing of green projects. This way, investors have better opportunities to understand the environmental impact of the specific issuance and the specific projects.

2.4. Third-party assessments

All GBFs include a section on third-party assessments. The primary purpose of this section is to inform investors that such an assessment has taken place. Some issuers have also obtained a third-party assessment of their reporting on proceeds allocation.

It is important that the GBF can be read independently. If there is significant information in the external reviewer's report, this information should be included in the GBF. The Danish FSA emphasizes that material information must always be included in the prospectus.

A third-party assessment of a GBF and ongoing reporting on proceeds allocation reassures investors of the accuracy of the information in the GBF. Third-party assessments of ongoing reporting on proceeds allocation should therefore be included to a greater extent than is currently the case.

2.5. Disclaimers

Several issuers include disclaimers in their GBFs. For example, several GBFs state that the issuer cannot guarantee the accuracy of the information in the GBF, or that the issuer is not obligated to update the GBF in case of significant changes to the terms of the issuance. Additionally, several disclaimers state that the issuer cannot guarantee the timeliness, completeness, or correctness of the information in the GBF.

Such disclaimers undermine the usefulness and credibility of the framework. Furthermore, disclaimers are typically within the control of the issuer. Issuers should refrain from this type of disclaimers.

3. Upcoming regulation of the green bond market

The European Green Bond Standard Regulation (EuGBS) applies from December 2024. The regulation is voluntary for bond issuers. It establishes a range of form and content requirements for the information that issuers must

disclose in connection with the issuance of a green bond if they wish to describe the bond as a "European green bond" or "EuGB." If an issuer chooses to comply with the regulation, the companies must earmark the proceeds from the bond issuance to finance projects that comply with the Taxonomy Regulation's definition of environmentally sustainable activities.

In December 2022, the Commission presented a legislative proposal to revise the Prospectus Regulation, which will tighten the disclosure requirements for green bonds in the prospectus. The Commission proposed, among other things, that it be empowered to set disclosure requirements for all bonds marketed as having an ESG component, including bonds issued under the EuGBS. The amendments to the Prospectus Regulation are expected to take effect 2026.