CHAPTER 13

Discussion: Green Bonds and Monetary Policy

Sarah Jane Hlásková Murphy

13.1 Introduction

In this chapter, I discuss some of the issues that have been addressed in Chapter 12 on *Green bonds and the ECB: A Tale of (Measured) Promise and (Required) Caution* by Basil Scouteris and Elli Anastopoulou. Their chapter addresses the important question of what the European Central Bank (ECB) can do in accordance with its mandate to address the risks posed by climate change when defining and implementing monetary policy. My observations are more limited in scope and do not cover all the

The views presented in this chapter are those of the author and are not of the European Central Bank. They reflect monetary policy and legal developments as at November 2022. I would like to thank Chiara Zilioli, Bram van der Eem, Marguerite O'Connell and Caoimhe Cotter for comments on a draft of this chapter.

S. J. Hlásková Murphy (✉)
European Central Bank, Frankfurt Am Main, Germany
e-mail: sarah_jane.hlaskova_murphy@ecb.europa.eu

D. Ramos Muñoz and A. Smoleńska (eds.), *Greening the Bond Market*, EBI Studies in Banking and Capital Markets Law,
https://doi.org/10.1007/978-3-031-38692-3_13

issues raised in their very comprehensive chapter.[1] Instead, these observations focus on issues that are relevant to the overarching theme of this book. Specifically, what are the implications of regulatory and market developments in relation to green bonds for monetary policy from a legal perspective? The comments are structured around the two main uses of green bonds when implementing monetary policy: (i) the purchase of green bonds in the ECB's asset purchase programme (APP) and (ii) the use of green bonds as collateral. They also touch on proposals to amend or introduce terms in refinancing operations that integrate climate change considerations.

13.2 Green Bonds and the ECB's Asset Purchase Programme

One of the points the authors make at the outset is that green bonds have been eligible for purchases and have been purchased in the APP, whether as net or reinvestment purchases. The ECB has purchased green bonds issued by governments and supra-nationals in the public sector purchase programme (PSPP) as well as those issued by the private sector in the corporate sector purchase programme (CSPP).[2] More recently, the Governing Council has communicated its intention to continue reinvesting in full the principal payments from maturing securities purchased under the APP for an extended period of time past the date on which it started raising ECB interest rates, and for as long as necessary to maintain liquidity conditions and its monetary policy stance.[3] The Governing

[1] See further Ioannidis, Michael, Hlásková Murphy, Sarah Jane and Zilioli, Chiara, 2021. The mandate of the ECB: Legal considerations in the ECB's monetary policy strategy review. Occasional Paper Series. No. 276, 21 September 2021. https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op276~3c53a6755d.en.pdf. Chiara Zilioli and Michael Ioannidis. 2022. Climate change and the mandate of the ECB: Potential and limits of monetary policy contribution to European green policies. *Common Market Law Review* 59(2):363–394. https://doi.org/10.54648/cola2022029. Accessed 30 November 2022.

[2] De Santis, Roberto A., Hettler, Katja, Roos, Madelaine and Tamburrini, Fabio. 2018. Purchases of green bonds under the Eurosystem's asset purchase programme. ECB Economic Bulletin, Issue 7/2018. https://www.ecb.europa.eu/pub/economic-bulletin/focus/2018/html/ecb.ebbox201807_01.en.html. Accessed 30 November 2022.

[3] ECB. 2022. Press release—Monetary policy decisions. 8 September. https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.mp220908~c1b6839378.en.html. Accessed 30 November 2022.

Council has also announced its decision to gradually decarbonize its corporate bond holdings on a path aligned with the goals of the Paris Agreement[4] and published further details on how it will tilt the Eurosystem's corporate bond purchases towards issuers with a better climate performance.[5] Although the monetary policy stance is subject to ongoing change, the issue of what could or should be done with respect to green bond purchases continues to be highly relevant.

Turning first to purchases of bonds issued by governments and supranationals, the authors correctly note these represent the bulk of the purchases under the APP. As such, they consider NextGenerationEU green bonds as the primary avenue for greening Eurosystem purchases. One development that warrants further consideration in this context is the EU's regulatory initiative in this field, namely, the proposal for a regulation on European green bonds (the 'proposed regulation').[6] As a key objective of the proposed regulation is to increase sustainable investment opportunities and the issuance of new green bonds, it has important implications for the implementation of monetary policy and was welcomed by the ECB in its opinion on the proposal.[7] However, two core questions arise which will influence how well the proposed regulation will serve its key objectives.

First, will the proposed standard achieve the right balance in its attempts to enhance transparency and comparability? The ECB has welcomed the alignment of the proposed regulation with the Green Taxonomy Regulation[8] as it provides a sound basis for assessing the

[4] ECB. 2022. Press release—ECB takes further steps to incorporate climate change into its monetary policy operations. 4 July. https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704~4f48a72462.en.html. Accessed 30 November 2022.

[5] ECB. 2022. Press release. ECB provides details on how it aims to decarbonise its corporate bond holdings. 19 September. https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220919~fae53c59bd.en.html. Accessed 30 November 2022.

[6] Proposal for a Regulation of the European Parliament and of the Council on European green bonds (COM(2021) 391 final). https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0391. Accessed 30 November 2022.

[7] Opinion CON/2021/30 of the European Central Bank of 5 November 2021 on a proposal for a regulation on European green bonds (OJ C 27, 19.1.2022, p. 4).

[8] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).

sustainability of the use of proceeds of issuances of green bonds.[9] But it is important to note that sovereign issuers have a privileged position, as the proposed regulation does not require external reviewers to assess the Green Taxonomy alignment of the economic activity of funding programmes. Instead, they assess the alignment of terms and conditions of the funding programmes concerned with the Green Taxonomy requirements.[10]

Second, the question also arises as to whether the proposed Regulation will enhance the credibility of the green bond market. The proposed Regulation relies on external review procedures to support the credibility of disclosures and the European Commission itself has ensured its NextGenerationEU green bond framework has been reviewed by a second party opinion provider.[11] Unlike corporate issuers, however, issuers of sovereign bonds are not subject to a duty to obtain pre-issuance and post-issuance reviews. Instead, they may opt to obtain a review from an external reviewer, a state auditor or another public entity that is mandated by the sovereign to assess its compliance.[12] The absence of a duty to obtain any external review is another example of a difference in the standards applied to corporate and sovereign bonds. This could open up the possibility for there to be a credibility gap between corporate and sovereign bonds issued in line with the proposed Regulation and reduces the comparability of the different instruments.[13] Given that sovereign bonds represent the bulk of purchases under the APP, a more level playing

[9] Para. 3.2.2 of Opinion CON/2021/30. (n 8).

[10] Recital 16 of the proposed regulation. Para. 6.3 of Badenhoop, Nikolai. 2022. Green Bonds—An assessment of the proposed EU Green Bond Standard and its potential to prevent greenwashing. European Parliament Research Service. https://www.europarl.europa.eu/RegData/etudes/STUD/2022/703359/IPOL_STU(2022)703359_EN.pdf. Accessed 30 November 2022.

[11] European Commission. 2021. Press release. NextGenerationEU: European Commission gearing up for issuing €250 billion of NextGenerationEU green bonds. 7 September. https://ec.europa.eu/commission/presscorner/detail/en/IP_21_4565. Accessed 30 November 2022.

[12] Article 11 of the proposed regulation.

[13] See arguments in favour of a single standard for corporate and sovereign bonds in Section 6 of Badenhoop, Nikolai. 2022. Green Bonds—An assessment of the proposed EU Green Bond Standard and its potential to prevent greenwashing. European Parliament Research Service. https://www.europarl.europa.eu/RegData/etudes/STUD/2022/703359/IPOL_STU(2022)703359_EN.pdf. Accessed 30 November 2022.

field in the regulation of corporate and sovereign green bonds would contribute meaningfully to the greening of monetary policy.

Turning to purchases of bonds issued by corporates, a complex set of legal issues arises when considering possible changes to the CSPP to reflect climate change considerations. In this context, reference can be made to the ECB's decision to incorporate climate change considerations into the benchmark allocation that defines certain purchase limits for issuer groups.[14] By implementing this decision, the Eurosystem tilted CSPP holdings towards issuers with better climate performance through the reinvestment of the redemptions. Better climate performance is measured with reference to lower greenhouse gas emissions, more ambitious carbon reduction targets and climate-related disclosures.

The authors correctly identify many of the potential legal issues that have arisen in public discussions relating to these proposals. One such issue that warrants more careful examination in this context is compliance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.[15] The question should not only focus on whether a move away from a benchmark reflecting a market neutrality concept is justifiable. The principle of an open market economy imposes conditions and outer limits on the action of the ECB, implying that the ECB should refrain from policy measures which would unduly disrupt the functioning of markets or unduly restrict competition. In the case of the amendments to the CSPP, purchase limits that tilt CSPP holdings towards issuers with better climate performance do not contravene the open market economy principle. Indeed, the benchmark allocation continued to be based on an issuer group's market capitalization to ensure a diversified allocation of purchases across issuers and issuer groups.[16] The 'tilting' was achieved by applying objectively measurable criteria that serve to reduce exposure to climate-related financial risk, thereby counteracting distortions in the pricing of climate risks by financial markets. Any indirect effect on the functioning of corporate bond markets, including the cost

[14] Decision (EU) 2022/1613 of the European Central Bank of 9 September 2022 amending Decision (EU) 2016/948 on the implementation of the corporate sector purchase programme (ECB/2016/16) (ECB/2022/29) (OJ L 241, 19.9.2022, p. 13).

[15] Article 127(1) (third sentence) of TFEU.

[16] Article 4(3) of Decision (EU) 2016/948 of the European Central Bank of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16) (OJ L 157, 15.6.2016, p. 28).

of funding of issuers, was justified on the grounds that the measures were necessary for the price stability objective and proportionate, not going beyond what was necessary to achieve this objective. Measures that incentivize improvements in disclosure are also aligned with the open market economy principle as they enhance the availability of information necessary to assess financial risks, which can in turn be expected to favour an efficient allocation of resources.

Another issue that could be explored in this context is the incomplete regime for the disclosure of sustainability-related data on issuers. Disclosures in line with the Corporate Sustainability Reporting Directive[17] (CSRD) would provide a dataset that would significantly enhance the ECB's capability to monitor and assess the impact of climate change on monetary policy transmission and address financial risks it holds on its balance sheet.[18] As the application of the CSRD reporting requirements will take place in four stages from 2025, the ECB's methodology to incorporate climate change considerations will need to be updated over time to reflect the increasing availability of climate data, as well as future improvements in climate risk modelling and other regulatory developments. In addition, it is important to note that the CSRD is of particular importance because the reporting requirements in the Green Taxonomy Regulation, which applied from 1 January 2022, only focus on the positive contribution that certain investments or activities can make to environmental protection objectives. Although this is relevant for the use of proceeds of green bonds, it does not aid in the assessment of an issuer's climate performance, where the central bank needs information on the impairment of the value or risk profile of the assets on its balance sheet.

[17] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022, p. 15–80).

[18] Para. 2.2.3 of Opinion CON/2021/27 of the European Central Bank of 7 September 2021 on a proposal for a directive amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (OJ C 446, 3.11.2021, p. 2).

13.3 Green Bonds and the Eurosystem's Collateral Framework

Green bonds are also relevant in the context of the Eurosystem's collateral framework. As in relation to the APP, the ECB has already expanded the pool of eligible assets by accepting sustainability-linked bonds as collateral since 1 January 2021.[19]

The authors are, however, critical of proposals to afford preferential treatment to green bonds in the context of the collateral framework, via adjustments to risk control measures or eligibility criteria. They emphasize the importance of ensuring the collateral framework complies with the requirement to conduct credit operations with lending being based on adequate collateral, in line with Article 18.1 of the Statute of the European System of Central Banks and ECB. It is clear that compliance with the Green Taxonomy Regulation requirements does not ensure a green bond meets the requirements for adequate collateral. As noted above, the Green Taxonomy focuses on the positive contribution an investment makes to environmental protection objectives, rather than a possible impairment of the value or risk profile of the assets on the balance sheet that would be relevant to consider whether a green bond comprises adequate collateral. At the same time, it is also clear that measures intended to reduce the financial risks posed by climate change to the Eurosystem's credit operations, such as by limiting the share of assets issued by entities with a high carbon footprint that can be pledged as collateral or considering climate change risks when reviewing haircuts applied to corporate bonds used as collateral,[20] have a firm legal basis in Article 18.1 of the Statute.

Ultimately, the quality and scope of data on climate-related financial risks that will be available will be influential in determining whether specific risk reduction measures can be justified as ensuring lending is based on adequate capital. One meaningful measure to address the limited extent to which the collateral framework may take into account climate

[19] ECB. 2022. Press release. ECB to accept sustainability-linked bonds as collateral. 22 September. https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200922~482e4a5a90.en.html. Accessed 30 November 2022.

[20] ECB. 2022. Press release—ECB takes further steps to incorporate climate change into its monetary policy operations. 4 July https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704~4f48a72462.en.html. Accessed 30 November 2022.

change considerations would be to improve the availability of data on the climate-related financial risks to which a much wider range of assets eligible as collateral are exposed. The CSRD ensures that many types of issuers, guarantors or debtors of assets eligible as collateral will be covered by reporting requirements. In particular, a large majority of eligible issuers of corporate bonds and unsecured bank bonds are within scope, with limited exceptions for unlisted small and medium-sized enterprises and micro-undertakings.[21] However, there are significant gaps in coverage for certain categories of assets which are important sources of collateral.[22] Sovereigns and non-corporate public sector entities are outside the scope of reporting requirements. Special Purpose Vehicle issuers of asset-backed securities are also likely to be excluded on account of their low turnover and number of employees. Moreover, the current regulatory framework for covered bonds, which account for a large share of collateral mobilized by Eurosystem counterparties, does not require the disclosure of information on the climate performance of the underlying loans in covered bond pools to investors.[23]

13.4 Climate Change Considerations in Refinancing Operations

The authors also review the main legal issues associated with proposals to amend or introduce terms in refinancing operations to integrate climate change considerations, sometimes described as 'Green Targeted Longer-Term Refinancing Operations' (GTLTRO). These would afford more favourable interest rates for loans, depending on the climate risk exposure of the assets held by or the loans made by the borrowing bank. Green bonds are not directly relevant to an assessment of the legal issues

[21] Article 19a of Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022, p. 15–80).

[22] See ECB website. Eurosystem Collateral Data at https://www.ecb.europa.eu/paym/coll/charts/html/index.en.html. Accessed 30 November 2022.

[23] Article 14 of Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (OJ L 328, 18.12.2019, p. 29).

relating to Green TLTROs. They could comprise collateral that has to be posted for TLTRO operations, but in this case, the usual eligibility requirements for collateral would apply and the issues outlined in relation to the collateral framework above would be relevant.

Two brief remarks on proposals for GTLTROs are, however, warranted. The first is that from a legal and operational perspective, determining the eligibility of loans based on the use of the loan proceeds is at present challenging. The ECB collects over 90 data attributes concerning loans of 25,000 euro or more made by credit institutions in the euro area,[24] but these do not currently provide an insight into the environmental impact of the use of the proceeds. An effective GTLTRO would also rely on comprehensive disclosure of the climate-related impact of business activities, from which small firms and households would most likely be excluded. The lack of a verification system or external review process would also undermine credibility. At the same time, these are not insuperable obstacles and they do not suggest that a legal basis for GTLTROs would necessarily be lacking.

13.5 Concluding Remarks

In conclusion, the author's chapter on green bonds and monetary policy addresses many important questions on what the ECB can do in accordance with its mandate to address the risks posed by climate change when implementing monetary policy. When focusing on the possible uses of green bonds in this context, regulatory developments open up many other questions which will continue to engage central banks as the legal framework and market for green bonds evolves.

[24] Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13) (OJ L 144, 1.6.2016, p. 44).