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Regulatory News Alert

Sustainable finance: EU reaches political agreement on 'taxonomy regulation'

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Context and objectives

On 17 December 2019, the European Parliament announced that negotiators from the European Parliament and Council of the EU had reached an **agreement concerning the so-called 'taxonomy regulation'** which sets out criteria to determine whether an economic activity is environmentally sustainable.

This classification system will **encourage private investment in sustainable growth and contribute to a climate neutral economy**. The taxonomy will enable investors to re-orient their investments towards more sustainable technologies and businesses. It will be instrumental for the **EU to become climate neutral by 2050** and achieve the Paris Agreement's 2030 targets.

At present, there is no common classification system at EU or global level that defines what meets the definition of an environmentally sustainable economic activity. The taxonomy regulation is therefore meant to address two challenges:

- **Reduce fragmentation** resulting from market-based initiatives and national practices
- **Reduce 'greenwashing'** (i.e. the practice of marketing financial products as 'green' or 'sustainable', when in fact they do not meet basic environmental standards).

The future framework will be based on six EU environmental objectives:

1. Climate **change mitigation**
2. Climate **change adaptation**
3. Sustainable use and protection of **water and marine resources**
4. Transition to a **circular economy**
5. **Pollution** prevention and control
6. Protection and restoration of **biodiversity and ecosystems**.

How it works

In order to qualify as environmentally sustainable, economic activities will have to fulfil the following requirements:

- Contribute substantively to at least one of the **environmental objectives** introduced by the regulation
- **Not** significantly **harm** any of the environmental objectives
- Be carried out in compliance with **minimum social and governance safeguards**
- Comply with specific **technical screening criteria**.

The agreement **does not preclude or blacklist any specific technologies or sectors from green activitie**s, apart from solid fossil fuels, such as coal or lignite. However, gas and nuclear energy production are not explicitly excluded from the regulation. These activities can potentially be labelled as an enabling or transitional activity in full respect of the "do not significant harm" principle.

The taxonomy will also **include two sub-categories: enabling and transitional activities**. There will be an obligation to disclose for each financial product the proportion invested in those enabling and transitional activities.

On this basis, **the Commission will be tasked with establishing the actual classification by defining technical screening criteria, in the form of delegated acts**, for each relevant environmental objective and sector respectively.

Next steps

The agreement reached by the European Parliament negotiating team will first need approval by the Environment Committee and Economic Affairs Committee and will then be put to a plenary vote. The Commission will regularly update the technical screening criteria for the transition and enabling activities. By 31 December 2021, it should review the screening criteria and define criteria for when an activity has a significant negative impact on sustainability.

How can Deloitte help?

Deloitte's advisory specialists and dedicated services will help you design and implement your business strategy in light of the future evolution of the regulatory framework and market trends.

With our Regulatory Watch Kaleidoscope service, Deloitte can also help you stay ahead of the regulatory curve to better manage and plan upcoming regulations.

Your contacts

Pascal Martino
Partner – Banking Leader
Tel : +352 45145 2119
pamartino@deloitte.lu

Lize Griffiths
Partner – Audit
Tel : +352 45145 2693
lizgriffiths@deloitte.lu

Elodie Vandewoestyne
Manager – Strategy, Regulatory & Corporate Finance
Tel : +352 45145 2627

Regulatory Watch Kaleidoscope service

Simon Ramos
Partner – Brexit Coordinator
Tel : +352 45145 2702
siramos@deloitte.lu

Benoit Sauvage
Director – RegWatch, Strategy & Consulting
Tel : +352 45145 4220
bsauvage@deloitte.lu

Jean-Philippe Peters
Partner – Risk Advisory
Tel: +352 45145 2276
jppeters@deloitte.lu

Marijana Vuksic
Manager – Regulatory & Consulting
Tel : +352 45145 2311
mvuksic@deloitte.lu

Deloitte Luxembourg
20 Boulevard de Kockelscheuer
L-1821 Luxembourg
Grand Duchy of Luxembourg

Tel: +352 451 451
Fax: +352 451 452 401
www.deloitte.lu

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