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# Sustainable covered bonds: Looking beyond the taxonomy regulation

Earlier this month the European taxonomy regulation came into force. The taxonomy regulation is probably one of the most essential pieces of recent regulation impacting the green bond market. Whether the taxonomy's initial environmental focus will prove a differentiating performance factor for green over social covered bonds remains to be seen



## Executive summary

The regulatory developments reflecting Europe's climate goals have clearly accelerated in the past two years after the European Commission published its ambitious action plan on financing sustainable growth in March 2018. The European green deal presented by the European Commission in December 2019 underscores the EU's full awareness of the climate and environmental challenges still at hand.

The increase in the EU's climate ambitions for 2030 and 2050 is just one of the important driving forces of the green deal roadmap, invigorated by this year's climate law proposals to morph climate neutrality by 2050 into a legally binding target. To meet the climate-neutrality objective, EU greenhouse gas emission should by 2030 ideally be 50% to 55% lower than in 1990. Indeed, the private sector remains key to financing the

required transition. Hence, the promotion of sustainable investments by private sector actors, including via green bonds, will remain high on Europe's political agenda.

The European taxonomy regulation that came into force on 12 July 2020, is probably one of the most influential pieces of regulation of the past few years impacting the green bond market. This unified classification system for sustainable activities is the backbone to the establishment of the EU green bond standard. It is probably also one of the most essential foundations for the European Commission renewed sustainable finance strategy to be presented in 3Q20 and progressing from the 2018 action plan.

The taxonomy regulation is at first solely focused on economic activities considered environmentally sustainable but will ultimately be expanded with other sustainable objectives (including social), albeit not before the end of 2021. Hence, for the sustainable (covered) bond market the taxonomy regulation will at first primarily be of relevance to the use of proceeds allocated to green assets, not so much social assets. Over the past several years we have seen the sustainable covered bond market gradually become a little bit greener. A year ago, green issuance comprised 54% of the sustainable covered bond market. This percentage has grown to 63% by the end of 1H20. As such the share of the portfolios of assets (re)financed by sustainable covered bonds that would be in scope of the taxonomy regulation has increased.

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