

Client alert:

Overview of EU Framework Regulation (Taxonomy)

On 22 June 2020, the [EU regulation on the establishment of a framework to facilitate sustainable investment](#) (the [Framework Regulation](#)) was published in the Official Journal.

In light of this important milestone, this note summarises the key provisions of the Framework Regulation and draws out the requirements which will be most relevant for asset managers and their ESG implementation projects.

What is the Framework Regulation?

The Framework Regulation is part of the EU Action Plan on Financing Sustainable Growth. For more information on the EU's ESG initiative generally, please refer to our overview [note](#).

The Framework Regulation establishes a classification system (or **taxonomy**) to provide a common language to identify whether a given *economic activity* should be considered "environmentally sustainable" – this, in turn, allows it to determine how far an *investment* is environmentally sustainable. The taxonomy is intended to be used by the EU, by EU member states, by corporate issuers, and by financial services firms, when assessing, and disclosing information on, environmental sustainability.

It's worth emphasising that the taxonomy focuses only on the "E" of the ESG concepts of Environmental, Social and Governance concerns. While the Framework Regulation refers obliquely to the potential for the taxonomy to be expanded in time to cover other sustainability matters, for the moment it deals with exclusively environmental sustainability.

Much of the detail in the Framework Regulation is focused on the regulatory architecture for establishing and operating the taxonomy. For example, many of its provisions set out technical definitions of particular environmental concepts or describe how different expert bodies will contribute to the taxonomy. Level 2 technical standards will be required to further define many concepts which are established only at a high-level in the Framework Regulation.

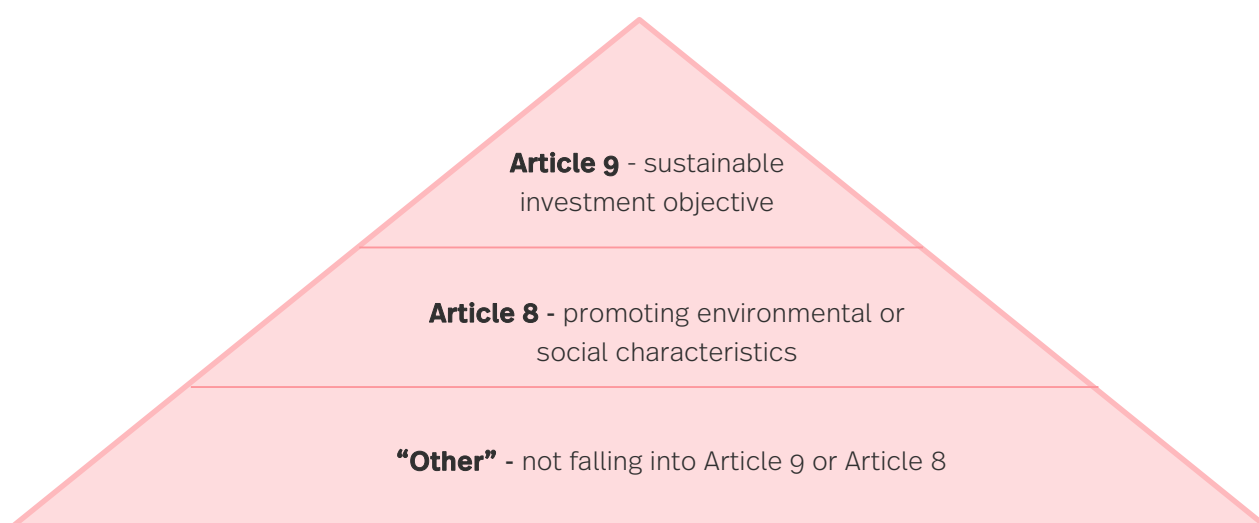
The Framework Regulation also cross-refers to, and incorporates, certain concepts which are established in the Sustainable Finance Disclosures Regulation ([SFDR](#)). For more information on

SFDR, please refer to our detailed breakdown of the [core obligations in the Level 1 regulation](#) and our note summarising the [proposals for the Draft RTS](#) which sits beneath the SFDR.

Why does this matter for asset managers?

For an **asset management firm**, the Framework Regulation will impose **new disclosure requirements**, in addition to those already contained in the SFDR. These will likely be the most immediate concern for asset managers reviewing the Framework Regulation.

The Framework Regulation builds on the **three-tier categorisation** of financial products which is effectively established in the SFDR:



The Framework Regulation imposes different requirements for each of these products.

Product type	Taxonomy rule	Requirement
Article 9 product	Article 5 Article 25(3), 25(4)	Pre-contractual and periodic disclosures must include: (a) information on the environmental objective(s) to which the product contributes and (b) a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments which are environmentally sustainable.
Article 8 product	Article 6 Article 25(2), 25(4)	Pre-contractual and periodic disclosures must include: (a) information on the environmental characteristics which the product promotes and

		<p>(b) a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments which are environmentally sustainable.</p> <p>In addition, the disclosures must also include a prescribed disclaimer: “<i>The “do no significant harm” principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.</i>”</p>
Other products	Article 7	<p>Pre-contractual and periodic disclosures must include a prescribed disclaimer: “<i>The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.</i>”</p>

The Framework Regulation directly amends the SFDR to include the above requirements within the SFDR disclosure requirements for Article 9 products and Article 8 products.

As a practical point, firms will therefore need to be able to categorise all financial products (including separately managed accounts) into the above three categories. This is required in order to ensure that the right disclosures are included, and so firms will need to implement a workstream to categorise all financial products, and then prepare the relevant disclosures. Such categorisation of course also has a wider relevance under SFDR.

What does “environmentally sustainable” mean?

In overview, an economic activity will be considered “environmentally sustainable” where it:

- contributes substantially to any of six defined environmental objectives – see below;
- does not significantly harm any of the environmental objectives;
- complies with a series of minimum social safeguards; and
- complies with performance thresholds (known as “technical screening criteria”) - these will be developed as Level 2 measures in due course.

The environmental objectives referred to in the first two bullets above are:

- (a) climate change mitigation;
- (b) climate change adaptation;
- (c) sustainable use and protection of water and marine resources;
- (d) transition to a circular economy;
- (e) pollution prevention and control; and

(f) protection and restoration of biodiversity and ecosystems.

As noted above, much of the detail in the Framework Regulation goes to establishing the regulatory architecture to define and build-out these concepts, which is beyond the scope of this note.

When does the taxonomy come into force?

The Framework Regulation establishes a phased switch-on of the taxonomy.

- In respect of environmental objectives (a) and (b), the taxonomy applies as from **1 January 2022**. This is also the date on which the disclosure obligations noted above will apply for those objectives.
- In respect of environmental objectives (c), (d), (e) and (f), the taxonomy applies as from **1 January 2023**. This is also the date on which the disclosure obligations noted above will apply for those objectives.

While the relatively lengthy implementation period may, at first glance, appear helpful (over 18 months from publication in the Official Journal before the first rules apply), the phased-in start date may cause logistical difficulties for products which have more than one environmental objective.

In addition, the SFDR has an earlier start date of **10 March 2021**, and this also imposes pre-contractual disclosure obligations. This potentially leads to three deadlines in 2021, 2022 and 2023, for firms to update product documentation in connection with sustainability. Firms should factor this into their project planning.

How can Simmons & Simmons help?

Simmons & Simmons would be pleased to assist with scoping, advising on decision-making, advising on application, project plans and preparing policies. We are preparing templates for our clients to use.

We can support asset managers and investors seeking to draw on Simmons' ESG expertise in a number of ways. Please contact us to discuss your needs.

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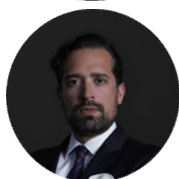


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