



Brussels, 17.7.2020
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COMMISSION DELEGATED REGULATION (EU) .../...

of 17.7.2020

supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards the minimum content of the explanation on how environmental, social and governance factors are reflected in the benchmark methodology

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

1.1. General background

In 2015, the European Union signed the Paris Climate Agreement. The Paris Climate Agreement sets the objective to strengthen the response to climate change, among other means by making investments flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

The European Green Deal communication confirms the need for long-term signals to direct financial and capital flows to green investment and to avoid stranded assets. This delegated act will contribute to this specific objective. It also follows up on the earlier Action Plan ‘Financing Sustainable Growth’ of March 2018, launching an ambitious and comprehensive strategy on sustainable finance and aiming to reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth.

More broadly, the European Green Deal is the European Union’s response to the climate and environmental challenges that are this generation’s defining task. It is a new growth strategy that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050, where the environment and health of citizens are protected, and where economic growth is decoupled from resource use. Since companies and households will have to provide the bulk of the sustainable investments in the next decade, it is crucial to put in place clear long-term signals to guide investors to sustainable investment.

Regulation (EU) 2016/1011 of the European Parliament and of the Council¹ (the Benchmark Regulation) introduces a common framework to ensure the accuracy and integrity of benchmarks referenced in financial instruments, financial contracts or investment funds in the European Union. In doing so, it aims to contribute to the functioning of the internal market, while achieving a high level of consumer and investor protection.

On 24 May 2018, the Commission published its proposal to amend the benchmark regulation, in accordance with the Action Plan ‘Financing Sustainable Growth’, with the objectives to put forward standards for the methodology of low-carbon benchmarks in the Union.

Regulation (EU) 2019/2089 of the European Parliament and of the Council², amending the Benchmark Regulation, introduces a new category of benchmarks, so-called EU Climate benchmarks (the EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks), and sustainability-related disclosures for all benchmarks.

1.2. Objective of the Delegated Regulation

The objective of this Delegated Regulation is to lay down the minimum content of the explanation of how the key elements of the benchmark methodology reflect environmental, social and governance (ESG) factors for each benchmark, with the exception of interest rate and foreign exchange benchmarks, as well as the standard format to be used.

¹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

² Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (OJ L 317, 9.12.2019, p. 17).

1.3. Legal background

This Delegated Regulation is based on the empowerment set out in Article 13(2a) of the Benchmark Regulation.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In June 2018, the Commission set up a Technical Expert Group on Sustainable Finance (TEG). The mission of the TEG included the provision to the Commission of recommendations regarding the ESG disclosure requirements to form part of the benchmark statement.

In June 2019, the TEG published an interim version of the report, which was subject to a call for feedback running over the summer 2019.

On 30 September 2019, the TEG published its final report. This final report is available at https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf.

The Commission staff held meetings with stakeholders to discuss the future delegated measures in the fall of 2019 and during the first half of 2020. In accordance with Better Regulation rules, the draft delegated acts were published on the Better Regulation portal for a 4 weeks feedback period between April and May 2020. In total, 36 stakeholders answered to such consultation. Furthermore, at the meeting of the Expert Group of the European Securities Committee (EGESC) in May 2020, the draft delegated acts were presented to and discussed among Member States' experts, with observers from the European Parliament.

3. IMPACT ASSESSMENT

In accordance with the Benchmark Regulation as amended by Regulation (EU) 2019/2089, the Commission is empowered to specify sustainability-related measures for benchmarks. It includes three topics: minimum requirements for the construction of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, the minimum content of the explanation of how the key elements of the benchmark methodology reflect ESG factors and the information the benchmark administrator has to provide in the benchmark statement on how ESG factors are reflected.

The TEG was mandated by the Commission to deliver technical recommendations on all of those aspects. The TEG published its final report on climate benchmarks and benchmarks' ESG disclosures in September 2019, following numerous engagement with stakeholders via roundtables, workshops and a 6-week call for feedback that was conducted in the summer 2019.

TEG report

The TEG final report contains a set of minimum requirements for the construction of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks and minimum ESG disclosure requirements that should be applicable to all benchmarks, with some exceptions.

The Commission has considered all representations received, including the TEG's report and the responses to the TEG's call for feedback, as well as the input provided to the Commission by stakeholders during bilateral meetings or conference calls.

While the Commission generally agrees with the approach taken by the TEG, the delegated acts nevertheless deviate from the TEG report in a number of instances, in particular in relation to ESG disclosure requirements. The objective is to streamline and simplify the

TEG's approach to provide more clarity on the set of indicators and on the information that benchmark administrators are expected to disclose. The amendments are put in simple terms and clarify the technical recommendations put forward by the TEG, improve the level of transparency and provide greater predictability for benchmark administrators.

When specifying the minimum criteria for the construction of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks and ESG disclosure requirements, the Commission kept in mind the overarching principle of proportionality, while maintaining a certain level of flexibility for benchmark administrators.

Proportionality

The delegated acts further specify the empowerments relating to the new EU Climate Benchmarks and the ESG disclosure requirements that are contained in the Benchmark Regulation, ensuring the proportionate application of the latter.

Taking into account the TEG report and the feedback received from stakeholders, the Commission has sought to introduce a proportionate approach to the minimum requirements for constructing EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, and minimum ESG disclosure requirements for benchmark administrators.

In accordance with the empowerments contained in the Benchmark Regulation, the Commission believes there is a need to distinguish between ESG disclosure requirements as regards the methodology and ESG disclosure requirements in the benchmark statement, as they do not pursue the same objectives for investors.

Benchmark administrators are currently not required to disclose a list of ESG factors, although a number of them already do so, within so-called 'factsheets'. Hence, this exercise will be new only to some of them. The objective of the Commission is to align to the extent possible on already existing market practices and indicators to avoid disproportionate costs. For this reason, the ESG factors are based on the recommendation of the TEG report that has been subject to extensive market consultation. The Commission also proposes to refine further the approach suggested by the TEG, streamlining in particular the list of ESG factors to be disclosed, simplifying the terminology used and referring, where applicable, to international standards, treaties and conventions.

Furthermore, the Commission does not intend to mandate the disclosure of ESG ratings for all benchmarks, as this topic is being addressed in a separate and parallel work stream under the Action Plan on Sustainable Finance.

Finally, while the TEG report recommends the use of a 'green to brown share ratio', such metric is not included in the delegated acts, as those notions have not yet been defined at EU level and are being considered in a separate and parallel work stream under the upcoming taxonomy Regulation.

Flexibility

The requirements laid down under the delegated act as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks maintain a certain degree of flexibility in the design of the methodology of benchmarks, in order to allow room for the market to develop innovative strategies and adapt to the specific need of investors.

Regarding the delegated act on the minimum content of the explanation of how ESG factors are reflected in the benchmark methodology, benchmark administrators should only report on the ESG factors that they use when pursuing ESG objectives, and how they do so.

Finally, regarding the delegated act on the benchmark statement, benchmark administrators that do not pursue ESG objectives will not be bound by the requirements when they explicitly state this in the relevant template annexed to the benchmark statement.

3.1 Analysis of costs and benefits

One of the delegated acts specifies minimum standards for designing EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. Both benchmarks are voluntary labels and therefore the requirements set out in the related delegated act only apply to benchmark administrators that choose to opt-in for the rules. Since the delegated act lays down minimum standards, benchmark administrators will be allowed to maintain a certain degree of flexibility in their design, so that compliance costs would be limited. More generally, this approach would provide clear and harmonised rules on how to design such benchmarks, which should allow to possibly reduce the costs of developing internal policies, but also allow room for the market to develop innovative strategies, and address the demand of investors willing to make climate-conscious investment strategies.

The two delegated acts on, respectively, minimum ESG disclosures on the methodology and on minimum ESG disclosures in the benchmark statement, will require benchmark administrators to adapt their IT infrastructure to accommodate the new flow of information and disclosure requirements. It is to be highlighted it is already current market practice for benchmark administrators to disclose ESG information in so-called ‘factsheets’, therefore compliance costs with the new rules are expected to be limited.

The ESG information to be disclosed by benchmark administrators will improve the level of comparability among benchmarks and provide clarity for investors willing to make informed climate related investments.

3.2 Subsidiarity

The Benchmark Regulation is binding in its entirety and directly applicable in all Member States. The Benchmark Regulation contains a transitional period for critical benchmarks and third country benchmarks that may continue to be used in the Union without authorisation until end 2021. The legal basis for the Benchmark Regulation is Article 114 of the Treaty on Functioning of the European Union and any changes to that Regulation shall comply with the same legal basis.

An increasing number of investors pursue low-carbon investment strategies and use low-carbon benchmarks to measure the performance of investment portfolios.

In order to maintain the proper functioning of the internal market for the benefit of investors and to ensure a high level of consumer and investor protection, the Benchmark Regulation as amended introduces a regulatory framework which lays down minimum requirements for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks at Union level. The establishment of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, underpinned by a methodology linked to the commitments laid down in the Paris Agreement regarding carbon emissions, will contribute to increase transparency and help prevent greenwashing.

In the absence of a harmonised framework to ensure the accuracy and integrity of the main categories of low-carbon benchmarks used in individual or collective investment portfolios, it is likely that differences in Member States’ approaches will create obstacles to the smooth functioning of the internal market.

4. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt delegated acts is provided for under Article 49 of Regulation (EU) 2016/1011.

- Article 1 refers to the explanation on how ESG factors are reflected in the benchmark methodology;
- Article 2 clarifies when benchmark administrators are required to update the template for the benchmark methodology.

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014³, and in particular Article 13(2a) thereof,

Whereas:

- (1) The Paris Agreement adopted under the United Nations Framework Convention on Climate Change, approved by the Union on 5 October 2016⁴ (the ‘Paris Agreement’), aims to strengthen the response to climate change, among other means by making investment flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.
- (2) On 11 December 2019, the Commission adopted its Communication to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions ‘The European Green Deal’⁵. The European Green Deal represents a new growth strategy that aims to transform the Union into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. The implementation of the European Green Deal requires that investors are offered clear, long-term signals to avoid stranded assets and to raise sustainable finance.
- (3) Regulation (EU) 2016/1011 requires benchmark administrators to explain how for each benchmark provided and published the key elements of the benchmark methodology reflect environmental, social and governance (“ESG”) factors.
- (4) Different ways of explaining for each benchmark or family of benchmarks how the key elements of the benchmark methodology reflect ESG factors, would lead to a lack of comparability between benchmarks and a lack of clarity as to the scope and objectives of the ESG factors. It is therefore necessary to set out the minimum content of such explanations as well as a template to be used.

³ OJ L 171, 29.6.2016, p. 1.

⁴ Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (OJ L 282, 19.10.2016, p. 1).

⁵ COM(2019) 640 final.

- (5) In order to better adapt the information for investors, the requirement to explain how the key elements of the methodology reflect ESG factors for each benchmark or family of benchmarks provided and published should take into account the underlying assets on which benchmarks are based. This Regulation should not apply to benchmarks which do not have underlying assets that have an impact on climate change such as interest rate benchmarks and foreign exchange benchmarks. In accordance with Article 19 of Regulation (EU) 2016/1011, this Regulation should not apply to commodity benchmarks.
- (6) The explanation on how key elements of the benchmark methodology reflect ESG factors should be made at an aggregated weighted average value, and should not be disclosed for each constituent of the benchmarks. Where relevant and appropriate, benchmark administrators should be able to provide additional ESG information.
- (7) In order to provide benchmark users with accurate and up-to-date information, benchmark administrators should update the information provided in the template to reflect any changes made to the methodology, and should indicate the reason and the dates at which the information was updated.
- (8) In order to provide investors with maximum transparency, benchmark administrators should clearly state whether they do or do not pursue ESG objectives,

HAS ADOPTED THIS REGULATION:

Article 1

Explanation on how ESG factors are reflected in the benchmark methodology

1. Benchmark administrators shall explain, using the template laid down in the Annex to this Regulation, which of the environmental, social and governance (ESG) factors referred to in Annex II to Commission Delegated Regulation (EU) .../... [*PO please insert a reference to Commission Delegated Regulation supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published*]⁶ they have taken into account when designing their benchmark methodology. They shall also explain how those factors are reflected in the key elements of that methodology, including for the selection of underlying assets, weighting factors, metrics and proxies.

The requirement set out in the first subparagraph shall not apply to commodity benchmarks.
2. For individual benchmarks, benchmark administrators may, rather than providing all the information required by the template laid down in the Annex to this Regulation, replace that information by a hyperlink in the explanation provided, to a website that contains all that information.
3. Where benchmarks blend different types underlying assets, benchmark administrators shall explain how ESG factors are reflected for each of the relevant underlying asset.

⁶ Commission Delegated Regulation (EU) .../... of ... supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published (OJ L ..., ..., p. ...).

4. Benchmark administrators may include in the explanation provided additional ESG factors and related information.
5. Benchmark administrators shall clearly state in the explanation provided whether they do or do not pursue ESG objectives.
6. Benchmark administrators shall include in the explanation provided a reference to the sources of data and standards used for each ESG factor disclosed.

Article 2

Update of the explanation provided

Benchmark administrators shall update the explanation provided whenever the benchmark methodology is changed, and in any case on an annual basis. They shall state the reasons for the update.

Article 3

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 17.7.2020

For the Commission
The President
Ursula VON DER LEYEN