



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 explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published

(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 investment 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 objective 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 set out the explanation that benchmark are required to include in the benchmark statement about how environmental, social and governance (ESG) factors are reflected in each benchmark or, where applicable, family of benchmarks provided and published.

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).

Due to their nature and specificities, benchmarks that comprise derivative instruments for the transfer of credit risk, such as credit default swaps, cannot reflect ESG factors. In addition, there are no known indices that are structured on financial contracts for difference or emission allowances. The requirement to explain how ESG factors are reflected in each benchmark or family of benchmarks provided and published should therefore not apply to those benchmarks.

1.3. Legal background

This Delegated Regulation is based on the empowerment set out in Article 27(2b) 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 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 lays down the definitions applicable in this Regulation.
- Article 2 clarifies the content of the explanation of how ESG factors are reflected.
- Article 3 clarifies when benchmark administrators are required to update the template for the benchmark statement.

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(Text with EEA relevance)

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 27(2b) 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. That 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 in the benchmark statement how environmental, social and governance (“ESG”) factors are reflected in each benchmark or family of benchmarks provided and published.
- (4) Different ways of explaining how ESG factors are reflected 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 specify the content of that explanation and to lay down 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 ESG factors are reflected in 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.
- (6) The explanation on how ESG factors are reflected should display the corresponding score of the relevant ESG factors *vis-à-vis* the benchmark, at an aggregated weighted average value. Such score 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) Due to their characteristics and objectives, specific disclosure requirements should be set out for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, and for significant bond and equity benchmarks.
- (8) In order to provide benchmark users with accurate and up-to-date information, benchmark administrators should update the information provided to reflect any changes made to the benchmark statement, and should indicate the reason and the dates at which the information was updated,

HAS ADOPTED THIS REGULATION:

Article 1
Definitions

For the purposes of this Regulation, the following definitions shall apply:

- (a) ‘equity’ means listed shares;
- (b) ‘fixed income’ means listed debt securities, other than those issued by a sovereign issuer;
- (c) ‘sovereign debt’ means debt securities issued by a sovereign issuer.

Article 2
Explanation of how ESG factors are reflected in each benchmark or family of benchmarks

1. Benchmark administrators shall explain in the benchmark statement, using the template laid down in Annex I, how the environmental, social and governance (ESG) factors listed in Annex II are reflected in each benchmark or family of benchmarks they provide and publish.

The requirement set out in the first subparagraph shall not apply to interest rate and foreign exchange benchmarks.
2. The explanation referred to in paragraph 1 shall include the score of the ESG factors *vis-à-vis* the corresponding benchmark and family of benchmark, at an aggregated weighted average value.
3. For individual benchmarks, benchmark administrators may, rather than providing all the information required by the template laid down in Annex I to this Regulation, replace that information by a hyperlink included in the benchmark statement, to a website that contains all that information.

4. Where benchmarks blend different underlying assets, benchmark administrators shall explain how ESG factors are reflected for each of the underlying assets.
5. Benchmark administrators shall include in the explanation provided a reference to the sources of data and standards used for the ESG factors disclosed.
6. Benchmark administrators that disclose additional ESG factors in accordance with Article 1(4) of Commission Delegated Regulation (EU) .../... [*PO please insert the number and reference of Commission Delegated Regulation 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*]⁶ shall include the score of those additional ESG factors.

Article 3

Update of the explanation provided

Benchmark administrators shall update the explanation provided whenever significant changes relating to the ESG factors occur and in any case on an annual basis. They shall state the reasons for the update.

Article 4

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

⁶ Commission Delegated Regulation (EU) .../... of ... 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 (OJ L ..., ..., p. ...).