European Fund and Asset Management Association

EFAMA's comments on the European Commission Proposal for a Regulation amending Regulation (EU) 2016/1011 on low-carbon benchmarks and positive carbon impact benchmarks

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rue Montoyer 47, B-1000 Bruxelles

☎ +32 2 513 39 69 • Fax +32 2 513 26 43 • e-mail : info@efama.org • www.efama.org • VAT Nr BE 0446.651.445

Executive summary

Encouraging investments in sustainable products is essential for moving towards a more sustainable environment. Low Carbon (LC) and Positive Carbon Impact (PCI) benchmarks, along with a common language and a standardised framework for disclosures, have the potential to help make the transition towards a more sustainable environment. It is essential that the right balance be found between creating the environment for sustainable investments to flourish and ensuring the market is given space to grow at its own pace. Many benchmarks currently in use today are bespoke benchmarks that have been specifically tailored to the investment objectives of the investor. We believe that the most effective measures should empower investors to choose the most suitable benchmark for their investment objective through enhanced disclosure, thereby allowing continued innovation in this space.

In terms of the European Commission proposal on LC and PCI benchmarks, EFAMA would like to make the following recommendations:

1. While we support the goal of developing a harmonised approach to ensure robust methodologies for LC and PCI benchmarks, this proposal **should ensure it sets the right incentives, without seeking to dictate how capital is directed**.

2. It should be clarified that asset managers **can continue to use non-sustainability benchmarks,** as well as using all kinds of sustainability benchmarks for investment funds integrating sustainability considerations.

3. Enhanced transparency on the methodology used by index administrators **should apply to all indices,** not only to benchmarks defined as LC or PCI.

4. The benchmark statement foreseen by the Benchmark Regulation needs to become a **user friendly document** providing users of benchmarks, including those of LC/PCI benchmarks, easy and simple access to information necessary for their investment decisions.

5. Methodologies to **assess companies' contribution to 2 degree objective are still work in progress** and should seek to align with some commonly accepted integrated assessment model for 2 degrees.

6. It should be ensured that this process and decision on implementing measures is **open to consultation** with a broad set of stakeholders.

7. An **implementation timeline** should be included to allow sufficient time for benchmark providers concerned to put these processes in place.

1. A BALANCED APPROACH AND A HOLISTIC VIEW ON SUSTAINABILITY

We support the goal of developing a harmonised approach to enhance disclosure by benchmark administrators to allow users understand the methodologies for LC and PCI benchmarks. However, any approach should recognise that this is an evolving area, which relies on the availability and reliability of corporate disclosures (LC benchmarks today largely rely on Scope 1 and Scope 2 emissions, but could include Scope 3 data in the future when such data becomes available) and investor preferences.

We see merit in calling for a distinction between fossil-free strategies, low carbon strategies, 2 degree alignment strategies and positive carbon impact strategies (and for transparency as to the extent to which Scope 1, 2 and 3 emissions have been taken into account). We support there being a place for different, innovative types of climate benchmarks. For example, we encourage climate benchmarks that reflect forward looking efforts of corporates to reduce emissions and take account business risk of higher carbon emissions rights prices in the EU. Only climate strategies that will have broad client and investor appeal will attract investments and contribute effectively to the EU's objectives of climate risk mitigation and adaption over the long-term.

However, directing capital into sustainable investments with the help of LC/PCI benchmarks may potentially crowd out investments or even cause systemic risks to the real economy, so any regulatory initiative must be based on a thorough assessment of potential outcomes. We would also advise against a prescriptive approach which could trigger potential liability issues and lead to a tick-the-box compliance exercise. LC/PCI benchmarks have the potential to set the right incentives, but the legal power for the investment decision must remain with the end investor.

These benchmarks should not end up excluding certain activities nor be used to restrict investment options, as this would potentially have detrimental effects. A holistic view of sustainability across all indices, instead of the focus on carbon reduction, is the best way forward to ensure certain sustainable activities are not favoured over others. Interaction between all sustainability elements (environmental, social, governance), as well as within these elements (climate, waste prevention, ecosystem, etc.) needs to be taken into account. The same is true for different types of activities, industries, and asset classes. The methodology requirements need to be flexible to reflect these aspects. For instance, some benchmarks use an exclusion approach while others select entities who have made the most progress to reflect a more forward-looking dynamic approach. Methodology requirements on benchmarks need to be open to new developments in assessing and calculating the carbon impact across all scopes. As ESG benchmarks today are based on different strategies, all of these approaches can potentially be used to facilitate the move towards a more sustainable environment, and regulation should not favour some approaches over others.

We also support the amendment to Article 13 of the Benchmarks Regulation requiring administrators of benchmarks to provide an explanation for how ESG factors are considered in a benchmark pursuing ESG objectives. We consider, however, that such transparency for users should apply not only to the narrow scope of benchmarks defined as LC and PCI, but to all benchmarks, including benchmarks which take into account ESG criteria important for the energy transition, but which do not necessarily fall within the definition of a LC or PCI benchmark. In that way, users have full transparency regarding the steps an administrator opted to take or not in this direction.

EFAMA also considers that there would be merit in pursuing a more global harmonised approach, e.g. a new ISO segment for sustainability standards in financial services and green bonds, as international coordination can yield better and less fragmented results.

2. USING ALL KINDS OF SUSTAINABILITY BENCHMARKS AND NON-SUSTAINABILITY BENCHMARKS

While we see merit in acknowledging the possibility of using all kinds of sustainability benchmarks (not limited to LC/PCI benchmarks) for investment funds integrating sustainability considerations, this should not deprive asset managers from the ability to continue using non-sustainability benchmarks. We would therefore welcome a clear statement to this end in the Benchmarks Regulation placing the selection of LC and PCI benchmarks solely on an optional basis and leaving the final decision to the discretion of users of the benchmark. We also consider that the use of PCI benchmarks is one of the criteria, but not the only or the minimum one, for asset and portfolio managers pursuing an investment strategy compatible with the Paris Climate Agreement. There needs to be space for different types of investment strategies reflecting climate risk and opportunity objectives including passive and active investment strategies. This also applies to the Disclosures proposal, which presupposes that sustainable products should have a LC benchmark consistent with this Regulation as their benchmark.

3. ENHANCING TRANSPARENCY FOR ALL TYPES OF BENCHMARKS ON ESG OBJECTIVES

We support the amendment to Article 13 of the Benchmarks Regulation requiring administrators of benchmarks to provide an explanation for how ESG factors are considered in a benchmark pursuing ESG objectives. The scope of transparency should include the investment objective of the benchmark, the biases in benchmark construction, the data sources used (for example the extent to which greenhouse gas emissions such as Scope 1, 2 and 3 carbon emissions or others GHG such as methane have been taken into account) and how this data is used for benchmark construction and computing carbon footprints. In addition, the disclosure should provide a clear comparison with the parent benchmark in terms of carbon intensity, sector bias and tracking error. The transparency requirements on ESG objectives should be focused on disclosures of relevant elements, such as the rationale of the adopted methodology, the procedures and criteria of the methodology and the limitations of the benchmark.

We consider, however, that increased transparency on the methodology used by index administrators should apply to all indices, not only to benchmarks defined as LC or PCI. A solo application for a restricted category of indices would unnecessarily narrow the positive effects of such transparency and limit the overall objective of assessing ESG efficiency of an index. We would therefore reiterate support for full transparency for all types of benchmarks on whether ESG objectives are used or not in the methodology of a benchmark. This information is key for enabling users make well-informed decisions, not only on the selection of the appropriate index, but also on their investment strategy.

4. IMPROVING DISCLOSURES TO USERS/INVESTORS

We welcome that information on the methodology is required to be provided via the benchmark statement. For users of benchmarks, the statement foreseen in the Benchmarks Regulation is a useful source of information. We regret however that in practice the benchmark statement has not been to date a user-friendly document, as it is often difficult for users to acquire relevant information on a specific benchmark. The requirement for transparency without an easy and simple access to information for investors can be challenging. We would therefore stress the need for the clear and short benchmark statement to be more user friendly and effectively summarise and provide information on the characteristics, including the methodology information related to ESG objectives, of a specific benchmark or a family of very similar benchmarks.

We also need granular information in terms of weighting, constituents and applicable sustainability indicators for each underlying in all (parent) benchmarks under the Benchmarks Regulation to be able to do the required comparisons between the impacts of the portfolio with its reference benchmark and a broad market index. In the context of level 2 of the Benchmarks Regulation, EFAMA has stressed that the deletion of the original Commission proposal (Article 16) restricts users' capacity to perform their due diligence duties and make informed choices regarding their use of benchmarks. This weakness can and should be addressed now.

Finally, we would recommend ensuring that benchmark licenses, based on objective criteria, are provided to all users according to transparent and non-discriminatory rules. Otherwise, there may be a legislative preference for the use of LC/PCI benchmarks by asset owners and investment managers, which would risk creating unfair commercial incentives for administrators of those benchmarks. License fees would be on a cost basis only.

5. METHODOLOGIES TO ASSESS COMPANIES' CONTRIBUTION TO 2 DEGREE OBJECTIVE ARE STILL WORK IN PROGRESS

A distinction needs to be made between a low carbon strategy and a 2 degree alignment. It should be clearly stated if the Commission's objective is to specifically target 2 degree alignment. Developing strategies aligned with the 2 degree target is very important, but methodologies to assess companies' contribution to this objective are still work in progress, as described in the Commission's proposal, the HLEG report and reiterated in the Commission's impact statement as well as the TEG scoping document. If this is the case, the methodology should align with some commonly accepted integrated assessment model for 2 degrees. The 2 degrees low carbon index should include emissions reductions in line with those sector reductions for those companies in Europe. As there are more emissions in standard benchmarks than in the real economy, these reductions would be benchmarked to the real economy (which could then be translated to comparison to existing benchmarks). Therefore, oil/gas/coal sector in Europe can have its own emission reduction target and not need to be totally excluded. Emissions do not need to be recalculated more than annually.

6. LINK WITH THE TAXONOMY

In the Benchmarks and Disclosures proposals, it is stated that the design of the LC or PCI benchmarks can be done without having to use the taxonomy. While LC/PCI benchmarks can be designed without having to use the taxonomy, at a later stage "sustainability" (ESG) indices reflecting environmental, social, and governance aspects need to be linked back to the taxonomy to provide for a consistent approach at all regulatory levels. However, it is paramount that the Commission clarifies the relationship between environmentally sustainable economic activities covered by the taxonomy and the corporate issuer, as the underlying assets of a benchmark are listed securities (equities and bonds issued by a company) rather than projects.

7. STAKEHOLDERS SHOULD BE CONSULTED

We very much welcome the Commission relying on the advice of the technical expert group on sustainable finance in relation to the preparation of delegated acts designing the methodology for selecting underlying assets for the LC and PCI indices. At the same time, we consider it necessary to open this process to the broader set of stakeholders, by carrying out public consultations with a sufficient feedback period of three months.

8. AN IMPLEMENTATION TIMELINE IS NECESSARY

An implementation timeline should be included in the Regulation to allow sufficient time for benchmark providers concerned to put these processes in place. A reasonable transition period would be one of 12 to 18 months. In addition, the transition time for benchmark administrators and users under the Benchmarks Regulation needs to also be taken into consideration. As it currently stands, supervised entity users have important challenges to ascertain whether a particular benchmark they are already using will be compliant by 2019/2020. It is already very difficult for benchmark users to determine whether a particular benchmark (which is not expressly listed as non-EU benchmark in the ESMA register) is administered by an EU administrator registered in the ESMA register (and therefore permissible for use) or is not registered at all. To prevent unintended use of unregistered benchmarks by supervised entities, all EU benchmarks should be disclosed in the ESMA register.

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