Principles for Responsible Investment

POLICY BRIEFING

EU REGULATION ON EU CLIMATE TRANSITION BENCHMARKS AND EU PARIS-ALIGNED BENCHMARKS

AT A GLANCE

Organisation	Requirements
Benchmark administrators	**For all benchmarks, and families of benchmarks, except currency and interest rate benchmarks, benchmark administrators must disclose:** ■ How the key elements of their methodology reflect ESG factors. ■ How their methodology aligns with the objective of the Paris Climate Agreement. **Benchmark administrators must respect minimum standards when marketing two new categories of benchmark:** ■ EU Climate Transition Benchmarks, and; ■ EU Paris-aligned Benchmarks.

DEVELOPMENT AND TIMELINE

The European Commission published a 'proposal[1] for a regulation amending regulation (EU) 2016/1011[2] on low carbon benchmarks and positive impact benchmark' on 24 May 2018. It implements key actions announced in its action plan on sustainable finance[3] relating to sustainability benchmarks.

A political agreement[4] between the European Parliament and the European Council was reached on 25 February 2019. The legal text, once formally approved, will enter into force the day after its publication in the Official Journal of the European Union.

The Technical Expert Group (TEG) is tasked with recommending criteria to select the companies eligible for inclusion in the new climate benchmarks and to increase the comparability of ESG disclosure. In June 2019, the TEG published an interim report[5] which sets out:

[1] Proposal for a regulation – COM(2018)355/978587
[2] Benchmark Regulation – Regulation (EU) 2016/1011
[3] Action plan on sustainable finance
[4] Final compromise text on the regulation on EU Climate Transition Benchmarks and EU Paris-Aligned Benchmarks
[5] TEG Interim Report on climate benchmarks and benchmarks' ESG disclosures, June 2019.

PRI Association
Registered office: 5th floor, 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E:info@unpri.org

- a list of ESG indicators, adjusted for each asset class, to improve transparency on and comparability of the benchmarks' methodologies to consider the Environmental, Social and Governance issues.
- technical guidance on minimum standards for EU Climate Transition Benchmarks (EU CTBs) and EU Paris-aligned Benchmarks (EU PABs).

The European Commission will then propose delegated acts specifying minimum requirements of methodology for the new benchmarks and minimum content of the ESG disclosures.

WHO IS AFFECTED?

- Benchmark administrators[6]
    - Located in the European Union, or,
    - Providing benchmarks used in the European Union,
    - Providing data used as an input in a benchmark;
- Investors should gain a better understanding of how benchmarks reflect ESG factors and align with the Paris Agreement.

SUMMARY OF THE REGULATION

Transparency requirements for benchmarks

For all benchmark, and families of benchmarks[7], except currency and interest rate benchmarks, benchmark administrators must explain:

- By 30 April 2020, how the key elements of their **methodology reflect ESG factors** (Article 1, Paragraph 2a);
- In the benchmark statement, by 31 December 2021, how their methodology **aligns with the objective of the Paris Climate Agreement** (Article 1, Paragraph 6).

For benchmarks pursuing ESG objectives, benchmark administrators must explain, by 30 April 2020, how **ESG factors are reflected in the benchmark's characteristics** including (Article 1, Paragraph 6):

- the rationale for adopting the benchmark methodology,
- the criteria and procedures used to determine the benchmark, and,
- the identification of potential limitations.

The European Commission will adopt Delegated Acts[8] specifying the minimum content and format of the explanations (Article 1, Paragraph 2b and Paragraph 6).

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[6] More information on the application of the Benchmark regulation, in and outside the EU, can be found in ESMA's Q&A on the Benchmark regulation.

[7] Benchmark providers can group benchmarks with similar methodologies into families of benchmarks when publishing the benchmark statement. More information can be found in ESMA's Q&A on the Benchmark regulation.

[8] Delegated Acts are legally binding texts adopted by the European Commission. They supplement or amend non-essential parts of EU legislative acts, setting out detailed measures. More information can be found on the European Commission's website.

Establishing EU climate benchmarks

By 30 April 2020, benchmark administrators must respect minimum standards when marketing the new categories of climate benchmarks (Article 1, Paragraph 3):

- **EU Climate Transition Benchmark**, which selects, weights or excludes underlying assets to set the resulting benchmark portfolio on a decarbonisation trajectory. To be selected, the companies must:
  - Disclose measurable and time-based carbon emission reduction objectives;
  - Disclose a carbon emission reduction objective disaggregated down to the level of relevant operating subsidiaries;
  - Disclose annual information on progress made towards those objectives;
  - Have activities which do not significantly harm other ESG objectives.
- **EU Paris-aligned Benchmark**, which selects the underlying assets to have a resulting benchmark portfolio aligned with the target of the Paris Climate Agreement and not significantly harming other ESG objectives.

The European Commission will specify, through delegated acts (Article 1, Paragraph 3):

- The criteria for the choice of the underlying assets, including, where applicable, any exclusion criteria for assets;
- The criteria and method for the weighting of the underlying assets in the benchmark;
- The determination of the decarbonisation trajectory for the EU Climate Transition Benchmarks.

POLICY CONTEXT

In 2018, the European Commission adopted an action plan on sustainable finance, building from the recommendations of the High-Level Expert Group on Sustainable Finance. The action plan included a package of legislative proposals. In addition to a proposal for new categories of low carbon benchmarks, the package included a proposal for a unified classification system of sustainable economic activities and a proposal for enhanced disclosures requirements on sustainable investment and sustainability risks for financial institutions.

PRI POSITION

Through its work with the High-Level Expert Group on sustainable finance, its response to the consultation on the legislative proposals and its work on climate issues, the PRI has demonstrated the need for reliable tools to assist investors in monitoring their performance while supporting sustainable development. The PRI welcomes the creation of the new categories of low-carbon benchmarks. These will support investors to:

- benchmark investment activities against low-carbon and Paris-aligned benchmarks;
- access more information on ESG methodologies of benchmark providers, enabling better comparison and more informed decision-making; and
- encourage development of new low-carbon and Paris aligned investment products.

For more information, contact:

Alyssa Heath
Head of EU & UK Policy
Alyssa.heath@unpri.org

Blandine Machabert
Policy Analyst
Blandine.machabert@unpri.org

- For more information on the PRI's policy activities, click here.
- To receive regular updates on global responsible investment policy, register for the PRI's global policy briefing.