efama

European Fund and Asset Management Association

EFAMA Feedback on TEG's interim report on EU climate transition benchmarks (EU CTBs) and EU Paris aligned benchmarks (EU PABs)

2 August 2019

2. Your opinion

1.1 Overall ESG disclosure

Disclosure requirements for all benchmarks

1. **The TEG believes that the sustainability disclosure requirements for all benchmarks in the methodology and in the benchmark statement should be distinguished by type of asset classes. Do you agree with this approach?**

We need to further understand the reasoning behind segregating equity from fixed income. Other than the green bond space, there are clear similarities between corporate bond and equities in terms of the underlying companies, their behavior and exposure to carbon related activities, hence it would make sense that the considerations are overlapping.

We also wish to draw the Commission's attention to the fact that the list of ESG factors to be considered per asset class covers a wide scope and for a lot of them there is an absence of agreed definitions and clear guidance. Some examples we could give are the absence of clear guidance as to sovereign analysis (where criteria to be considered are rule of law or inequality without further details as to how these are relevant and should be considered, indeed in our view the frameworks for sovereign ESG analysis are much less developed then they are for corporate) or the requirement for infrastructure debt funds to have the breakdown of SDG exposure, whereas in the absence of clear definitions such analysis would be highly subjective. The TEG also calls for ESG scores to be shown for sustainable benchmarks, but there is currently a wide disparity on 3rd party rating agencies on ESG scoring, a lack of transparency in this area. This absence of common understanding and definitions will necessarily lead to overreliance to the 3rd party ESG data and ESG ratings providers, which would still be subjective and also present other risks for conflicts of interest, lack of transparency and competition issues.

For these reasons, we consider it important to start by setting some concrete priorities and by focusing on getting the climate-related disclosures done in a consistent way. This would in return allow some substantial progress also in climate-related benchmarks, prior to moving to a wider scope of ESG benchmarks.

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

2. Do you believe that non-significant benchmarks should disclose less information than significant benchmarks, in line with the proportionate approach set out in the benchmark regulation (Regulation (EU) 2016/1011)?

Yes

3.a The TEG has identified different types of KPIs of the benchmarks for the respective asset classes (see Section 3 of the TEG report on climate benchmarks and ESG benchmarks' disclosures - 'the Report' - Annex I to VII). On a scale from 1 to 5, please express your view as to the level of indication for the suggested KPIs for the respective asset class of benchmarks (1 indicating the lowest level of satisfaction regarding the KPIs):

Equities – 5
Fixed Income – Corporates & Securitised (ABS) – 5
Fixed Income SSA – 5
Commodities – 3
Infrastructure – 3
Private Equity/Private Debt – 3
Hedge Funds – 5

3.b Please indicate any KPI(s) you would not favor to include from the KPIs listed in section 3 of the Report:

KPIs on alternative assets are not consistently applied (e.g. why controversial weapons for private equity but not tobacco?).

3.c) Please indicate any KPI(s) you would recommend to add to the KPIs listed in section 3 of the Report:

It would also be relevant to include disclosures related to:

a) the exposure to climate related physical risks, in relation to the Private Equity/Private Debt and Infrastructure benchmarks;
b) consolidated social rating in the Private Equity/Private Debt/Infrastructure and the Commodities benchmarks; and
c) tobacco in relation to Private Equity/Private Debt benchmarks.

4. Do you agree with the mandatory disclosure of ESG ratings for equity and fixed- income benchmarks?

Yes

5. If relevant, please explain the impact of the disclosure of ESG ratings for equity and fixed income benchmarks on you, especially in terms of the costs and benefits implied:

Based on the investment strategy of each portfolio asset managers may pursue either as the main objective or as one of the selection criteria exposure to equities meeting certain minimum ESG ratings.

6.a The TEG has drawn up templates for the disclosure of ESG information in the benchmark statement and in the methodology (see templates 1 and 2 in Appendix D of the Report).
On a scale from 1 to 5, please express your view regarding the format of these templates (1 indicating the lowest level of satisfaction regarding the format):

5 (highest level of satisfaction)

6.b Would you have any suggestions to improve the format of the templates?

N/A

6.c On a scale from 1 to 5, please express your view as to the cost of producing these templates (1 indicating the lowest level of cost of implementation):

4 – Considering the risks of passing on such costs to benchmark users, we believe there is a clear need for cost transparency.

7. Do you agree that the template for ESG factors in the benchmark statement should be updated at least on a quarterly basis?

Yes

8. Do you agree with the disclosures on overall degree of alignment with the objectives of the Paris Climate Agreement (template 3 in Appendix D)?

No

8.b Would you have any suggestions to improve this template 3 (in terms of content and format)?

A lot more of work and consensus is still necessary to understand how a benchmark leads to a concrete scenario.

It would be useful to include in this template the information on:

a) green/brown share ratio of the benchmark;
b) year-on-year self-decarburization of the benchmark; and
c) extent of the Scope 3 emissions Phase-in for the benchmark, at least for the transitional period.

9. Do you think that the CTB & PAB should disclose more information (please see section 4.1 of the Report)?

No

10. What is the overall impact of the above technical advice on ESG disclosures, especially in terms of costs to benchmark administrators and benefits to investors? Please provide clear indication to which stakeholder your answer belongs.

Please see our response Question 5.

11. Do you see a need for guidance from the TEG on ESG data related charges similar to what is set out in the shareholder rights directive II.

Yes, we would welcome further transparency on charges imposed by intermediaries.

1.2 Methodology of the climate benchmarks

12. Do you think the CTB and the PAB differ methodology-wise sufficiently from each other?

Yes

13.a Please express your agreement with the proposed minimum requirements for CTB. Use the scale from 1 to 5 (with 1 indicating no agreement):

Minimum Scope carbon intensity reduction – 3
Scope 3 phase-in – 3
Green/brown share ratio – 5 (full agreement)
Minimum exposure to sectors highly exposed to climate change – 5 (full agreement)
At least 7% of annual decarburization – 2

13.b Please provide any comments on recommended changes or additions to the minimum requirements listed in question 13.a:

The 7% decarbonisation requirement needs to be reviewed, for it is not clear what would happen to the index in 5, 10 or 15 years' time, if decarbonisation proceeds along the required path.

14.a Please express your agreement with the proposed minimum requirements for PAB. Use the scale from 1 to 5 (with 1 indicating no agreement):

Minimum Scope carbon intensity reduction – 5
Scope 3 phase-in – 5
Green/brown share ratio – 3
Minimum exposure to sectors highly exposed to climate change – 2 (it is not clear what this minimum requirement is seeking

At least 7% of annual decarburization – 2

14.b Please provide any comments on recommended changes or additions to the minimum requirements listed in question 14.a:

We are concerned that setting the green/brown share ratio of the benchmark as at least four times higher of that of the green/brown share ration of the investable universe may be too restrictive.

15. Do you think that it would be relevant to extend the minimum requirements to sovereign indices?

Yes, if sufficient data is available.

16. Do you believe that the requirement set out in the amending regulation (article 23a) for CTB & PAB to select, weight or exclude underlying asset that follow a decarbonisation trajectory should be further clarify in a minimum requirement?

Yes

17. Do you think the scenario selected to drive the decarbonisation trajectory – IPCC 1.5° with no or limited overshoot – is the most appropriate one?

Yes

18. Do you think the minimum standards suggested in the report leave enough flexibility for market players to further innovate in the field of climate indices aligned with ambitious climate trajectories?

Yes

19. Do you agree having different denominators (e.g. total capital, revenue) for the calculation of the GHG intensity depending on the use case (table 6 in Section 5.3.3 in the Report)?

No opinion

20. Do you believe that the definition of total capital (i.e. 'the sum of the book values of common stock, preferred equity, long term debt and minority interest') for the calculation of the GHG intensity is accurate?

Yes

21. What is the overall impact of the technical advice on CTBs and PABs, especially in terms of costs to benchmark administrators and benefits to investors?

No opinion.

22. Do you see merits in further aligning the proposed benchmarks methodologies with the principles of the taxonomy once the latter is approved?

Yes

3. Additional Information

In addition to the responses provided to the questions of the Commission's survey, we wish to also raise the following key points on behalf of the European asset management industry.

For the EU climate-transition benchmarks and the EU Paris-aligned benchmarks to become a useful tool for market participants and achieve their key objectives, it is important that all information provided by the benchmark's administrator is done <u>in a user-friendly way</u>.

This should apply to benchmark statements, the information about the methodology, as well as the three new ESG templates and should include

- easy and simple electronic access;
- providing the information in an appropriate way and a timely manner;
- all meaningful information with the least possible links to other sections.

Furthermore, given that asset managers have their own sectoral requirements to comply with in terms of the use of financial indices, the benchmark statement should include information as to whether a benchmark complies with the UCITS rules, as well as an indication whether the benchmark pursues or not ESG objectives. On this last point, we welcome the non-disclosure option in the form of a closed-ended question in the templates on ESG factors as it brings clarity for users, but we suggest locating this question in the benchmark statement.

Finally, in order to ensure a fair and open access to indices and avoiding abusive pricing policies, it is important to ensure that licenses of, and information related to, the benchmark are provided to all users pursuant to transparent and non-discriminatory rules, based upon objective criteria and that license fees may be based on cost basis.

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