**EU Climate Benchmarks Regulation**

The amendments to the EU Benchmarks regulation consist of two main parts. First, it introduces two new types of climate benchmarks: the EU Climate Transition Benchmark (EU CTB)[1] and the EU Paris-Aligned Benchmark (EU PAB), and their minimum requirements. Second, it lays out Environmental, Social, and Governance (ESG) disclosure requirements that are applicable to all investment benchmarks, with the exception of currency and interest rate indices. Specifically, the disclosure requirements apply to all registered benchmark administrators, either based in the EU or offering benchmarks within the EU[2].

The final report on climate benchmarks and the benchmarks' ESG disclosures prepared by the EU Technical Expert Group (EU TEG) was published in September 2019, and the resulting EU Regulation 2019/2089 entered into force on 10 December 2019. Once the Delegated Acts are adopted, the benchmark administrators must start complying with this Regulation. Draft Delegated Acts amending the details of the EU CTBs, the EU PABs, and the benchmarks' sustainability disclosures were published in April 2020 and were open for consultation until 6 May 2020.
These new sustainability-related amendments to the EU Benchmarks regulation have been adopted to achieve four main objectives. By creating binding legislation, the EU aims to:

- Increase the comparability between benchmarks
- Provide a tool to support climate-focused investment strategies
- Increase transparency with respect to the impacts of investments
- Disincentivize greenwashing

Comparability and transparency are both worthy ideals but have previously been proven difficult to put into practice with respect to environmental benchmarks. There are countless benchmarks on the market, many of which claim to represent similar characteristics, but actually result in contradictory outcomes. To make matters worse, the publicly reported rationale behind different benchmarks is seldom sufficiently rigorous and comprehensive for outsiders to draw their own conclusions about the benchmarks' suitability for certain purposes.

This is where the new ESG disclosure requirements for all benchmarks shine. For each benchmark, the regulation requires administrators to disclose the methodology behind it, together with a statement explaining how the ESG factors are reflected in the benchmark in a standardized and comparable way. Non-ESG-focused benchmarks have a non-disclosure option, but this nevertheless requires them to explicitly state that they do not pursue any ESG objectives, which will likely have a negative impact on the benchmark's popularity. However, all benchmarks must include a disclosure of their alignment with the Paris Climate Agreement emissions reduction goals by the end of 2021.

The EU CTB and PAB benchmarks have been designed to reorient the ESG focus in investment away from simple risk reduction to a greater emphasis on opportunity-seeking, in line with the objectives of a transition to a climate-resilient economy. Both of these benchmarks have a similar ultimate goal, but they entail different ambition levels. As their name suggests, the Paris-Aligned Benchmarks have stricter demands, including alignment with the Paris Climate Agreement global warming targets and a 50% lower weighted average GHG (greenhouse gas) intensity than the investable universe, and they are designed for institutions whose clear goal is to actively support the transition to a climate-sustainable world where global warming is limited to 1.5oC above pre-industrial levels. The EU CTBs, on the other hand, allow diversification and a focus on mitigating climate change risks, and are

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[1] https://finance.ec.europa.eu/regulation-and-supervision/financial-services-legislation/implementing-and-delegated-acts/eu-climate-transition-benchmarks-regulation_en
[2] https://kpmg.com/fi/fi/home/Pinnalla/2020/05/eu-sustainable-finance-explained-climate-benchmarks.html

primarily intended for large institutional investors and for all investments, but still require a 30% lower GHG intensity than the investable universe. The requirements of both benchmarks implicitly assume a need for diversification.

The right to use the EU PAB and CTB labels is strictly controlled. Any failure to reach annual decarbonization goals must be explicitly justified, along with explanations of the planned corrective measures. Failure to reach the set targets for two consecutive years, or failure to reach the targets three times within ten years, will result in loss of the right to use the label. These measures ensure that the prestige of these labels will not be diluted.

**What does this mean for different market participants?**

For benchmark administrators, the implications can be divided into two categories. On one hand, these new requirements will increase the administrative burden, as a result of the more demanding transparency requirements. On the other hand, this will level the playing field in the benchmark market, in that those that provide the most comprehensive, well-justified, and solid indices will come out on top, while greenwashing will become harder.

Most importantly, as the disclosure requirements apply to all benchmarks, ESG-focused benchmarks will not suffer from disproportionate disclosure costs. This also means that, for all benchmarks, environmental performance will become more relevant, regardless of what the benchmark is tracking. The disclosure requirements include, among others, construction methodology, the average and top E, S, and G ratings of constituents, carbon intensity, high-emission sector exposure, data sources, social violations, and board independence – although these will vary for different asset classes. However, as per the newly published Draft Delegated Acts amending the benchmarks' sustainability disclosures, some of these (particularly the average E, S, and G ratings) may become voluntary disclosures.

Despite not being directly obligated under the EU Benchmarks Regulation, corporates, especially public ones, will also be affected. By extension from the heightened disclosure demands placed on benchmark administrators, they will start demanding more thorough and transparent reporting from benchmark constituents in order to fulfill their own obligations. This means that companies wishing to be included in the benchmarks will need to check their current disclosures and evaluate their disclosure capabilities. This will affect not only those companies wishing to promote their sustainability by inclusion in the sustainability indices but also any company wishing to attract capital through index-tracking funds. Companies aiming at inclusion in the EU PAB or CTB benchmarks will be required not only to comprehensively report their scope 1, 2, and 3 emissions but also to compile a science-based target decarbonization trajectory.

The new sustainability-related amendments to the EU Benchmarks regulation are highly valuable for index users. First and foremost, this new legislation creates the needed transparency and standardization within the index universe. Under these conditions, it will be easier for investors (and other users) to find indices suitable for their needs and then compare their options using relatively standardized metrics. The EU PAB and CTB labels provide a collection of benchmarks for typical climate strategies as well as a requirement for standardized GHG emissions calculation and reporting including financial carbon intensity (e.g. $CO_2e$/EV). Consequently, users can make more well-informed decisions while using fewer resources. To make the most of these changes, potential users should familiarize themselves with the EU PAB and CTB criteria, as well as with the benchmark disclosure requirements. Preparing for significant changes in the benchmark market would also be sensible, as this new regulation may significantly alter the perceived prestige of many existing benchmarks.