

European Commission Publishes Draft Delegated Regulations on ESG Disclosures in Benchmarks

The three draft delegated regulations set out sustainability criteria and ESG disclosure requirements for benchmarks provided in accordance with the EU Benchmarks Regulation.

Key Points:

- The measures follow amendments to the EU Benchmarks Regulation introduced by the Low Carbon Benchmarks Regulation.
- All benchmark administrators are required to explain clearly how ESG criteria are reflected for each benchmark or family of benchmarks from 30 April 2020. However, as the consultation period for the draft delegated regulations does not close until 6 May 2020, ESMA has issued a no action statement directing NCAs not to take any supervisory or enforcement action against firms not compliant with these new requirements by the original implementation deadline.
- Benchmark administrators that do not produce ESG benchmarks are required to disclose that fact.
- Minimum standards have been introduced in order for benchmarks to qualify as EU Climate Transition and EU Paris-aligned benchmarks.

On 8 April 2020, the European Commission published the three draft delegated regulations (the Draft Delegated Acts) required by Regulation (EU) 2019/2089, commonly referred to as the Low Carbon Benchmarks Regulation, setting out sustainability criteria in order for a benchmark to qualify as an EU Climate Transition Benchmark (EU CTB) or EU Paris-aligned Benchmark (EU PAB) and setting out the environmental, social, and governance (ESG) disclosure requirements for benchmarks provided in accordance with the European Benchmarks Regulation (BMR).

Background

In September 2019, the EU technical expert group (known as TEG) on sustainable finance published the [TEG Final Report](#) on climate benchmarks and benchmarks' ESG disclosures. This report set out detailed recommendations made by the TEG working group on standardised disclosures that should be made in relation to the ESG factors taken into account by:

- Climate or ESG benchmarks

- EU CTBs
- EU PABs

The TEG Final Report also recommended that for benchmarks that do not pursue ESG factors, there should be disclosure of that fact.

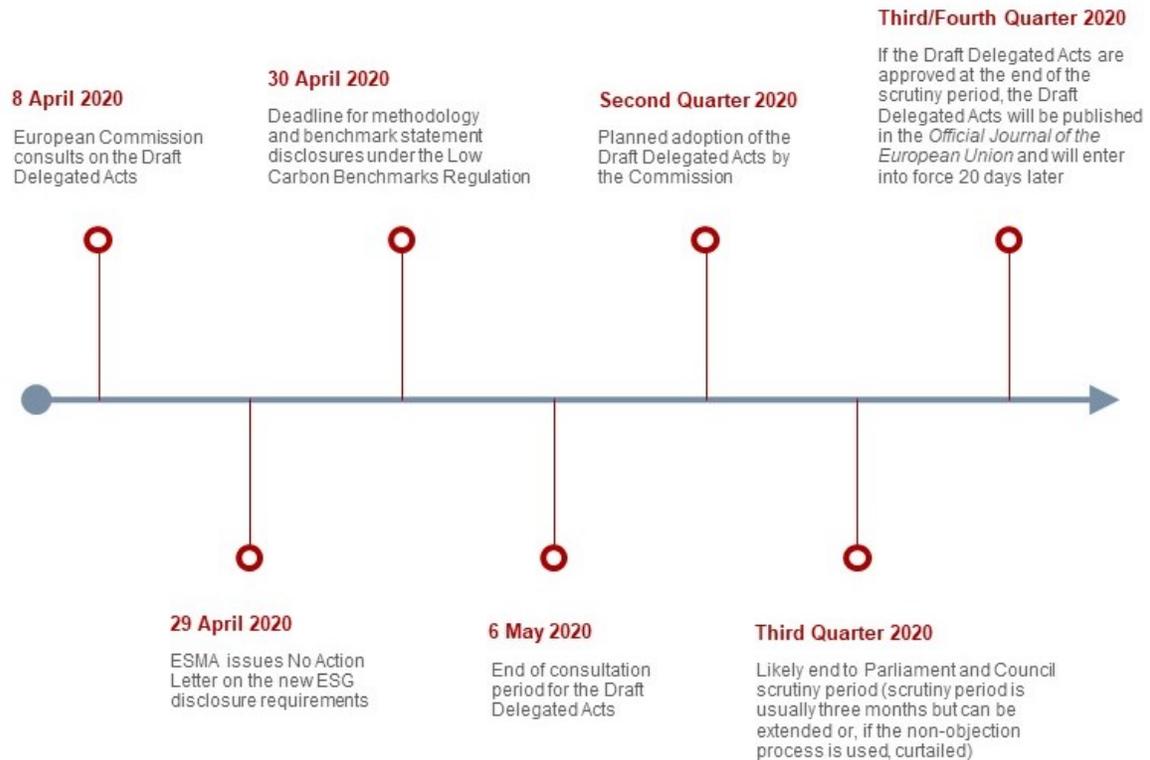
Following the TEG Final Report, amendments were made to the BMR in the Low Carbon Benchmarks Regulation (dated 27 November 2019 and which entered into force on 10 December 2019). Among other things, the Low Carbon Benchmarks Regulation requires EU benchmark administrators to make certain public disclosures in relation to the ESG factors that are taken into account by their benchmarks, in both their benchmark statements and methodology disclosures, by 30 April 2020. The Low Carbon Benchmarks Regulation provided for level 2 measures to be introduced by the European Commission laying down the content of these disclosures, taking into account the recommendations in the TEG Final Report. The Low Carbon Benchmarks Regulation is one of three legislative initiatives that form the EU's Sustainable Finance Action Plan and which aims to increase sustainable finance flows.

The European Commission notes that the establishment of EU CTBs and EU PABs, underpinned by a methodology linked to the commitments laid down in the Paris Agreement regarding carbon emissions, will contribute to increased transparency and will help prevent greenwashing. It is also important to note that the new obligations for benchmarks that label themselves as "ESG benchmarks" will also contribute to these objectives by highlighting any indices that hold themselves out as "ESG" but in reality take very few ESG factors into account. It is also hoped that by making benchmark administrators state publicly that they do not administer any ESG benchmarks, where that is the case, that this will create a drive toward the production of more ESG benchmarks which will be good for the sustainable finance agenda, as administrators may not wish to be seen to be out of step with the market by making a disclosure that they have no ESG benchmarks within their portfolio. Whether this requirement will produce the desired effect remains to be seen.

Timing

The consultation period for the Draft Delegated Acts closes on 6 May 2020. The public consultation will be followed by adoption and the start of the three-month scrutiny period (extendable once), at the end of which the Parliament and the Council can either approve or reject the text as a whole.

This creates a difficult timing problem given the implementation deadline of 30 April 2020 for the methodology and benchmark statement disclosures mandated by the Low Carbon Benchmarks Regulation. A number of industry bodies were engaged in discussions with the European Securities and Markets Authority (ESMA) in order to obtain regulatory forbearance from local regulators in relation to compliance with these disclosure obligations. On 29 April 2020, ESMA issued a No Action Letter to National Competent Authorities (NCAs), providing ESMA's opinion that NCAs should not prioritise supervisory or enforcement action against administrators regarding these new requirements until the Draft Delegated Acts apply. ESMA also issued an Opinion to the Commission on the need for prompt adoption of the Draft Delegated Acts.



Draft Delegated Acts

The three Draft Delegated Acts relate to the following:

1. The [minimum standards](#) for EU CTBs and EU PABs. The draft regulation sets out the minimum standards that these climate benchmarks should meet in order to be labelled as such, the action to be taken if standards are not met, and lays down methodology transparency requirements.
2. The minimum explanation to be provided for all benchmarks on how ESG factors are reflected in the benchmark. The [draft regulation](#) provides templates in the annexes for the required disclosures, which differ depending on the type of benchmark provided.
3. The minimum explanation to be provided for all benchmarks on how ESG factors are reflected in the benchmark methodology. The [draft regulation](#) provides a template disclosure in the annex for providing this information.

Key points to note from the Draft Delegated Acts include:

Deviation from the TEG Final Report

The Delegated Acts deviate from the TEG Final Report in a number of instances, most significantly in relation to “E”, “S” and “G” disclosure requirements. This simplifies the approach compared with the original TEG proposal, however, there remain detailed implementation considerations that benchmark administrators will need to understand before being able to comply.

The Commission has proposed additional differences between the methodology disclosures and the benchmark statement disclosures to acknowledge that investors typically use these disclosures in different ways.

Scope

In addition to excluding interest rate and currency benchmarks from the scope of the ESG disclosure requirements, the Commission notes that benchmarks structured on derivative instruments for the transfer of credit risk that refer to price developments of complex structured products, such as credit default swaps, cannot reflect ESG factors, and therefore these obligations do not apply.

In addition, the Commission notes that 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.

ESG ratings

The Commission does not intend to mandate the disclosure of ESG ratings for all benchmarks. Essentially, this has been parked until the Action Plan on Sustainable Finance is more evolved (a separate [consultation](#) on the Sustainable Finance Strategy was issued on 8 April 2020). Similarly, there is no “green to brown share ratio”, 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.

Benchmark statements

Key points to note include:

- The disclosure can be made at benchmark or at benchmark family level.
- There is a template disclosure statement in order to provide for a standard, comparable set of metrics that investors can use to compare the ESG considerations taken into account by different benchmarks.
- There is a list of specific ESG factors to be disclosed based on benchmark type, *i.e.* equity benchmarks; fixed income corporate benchmarks; sovereign debt benchmarks; commodity benchmarks; private equity benchmarks and private debt benchmarks; and “other benchmarks”. Administrators should only report on which of the listed “E”, “S” and “G” factors they actually use when pursuing ESG objectives and how they do so, *i.e.*, there is no need to cover every ESG factor if not relevant to the index.
- There are additional disclosure requirements for significant equity benchmarks, significant bond benchmarks, EU CTBs, and EU PABs.
- ESG disclosure templates should generally be annexed to the benchmark statement (rather than embedded within it).
- Benchmark administrators are not bound by the requirements when they explicitly state this in the relevant template annexed to the benchmark statement.

Benchmark methodology

Key points to note include:

- The disclosure can be made at benchmark or at benchmark family level.
- A template disclosure statement is provided, and, as for benchmark statements, there is a list of specific ESG factors to be disclosed based on the same benchmark categories as for the benchmark

statement disclosures, which should only be reported against where that particular ESG objective is relevant to the specific benchmark or family of benchmarks.

- The explanation on how key elements of the benchmark methodology reflect ESG factors should be made at an aggregated weighted average value, and not disclosed for each constituent of the benchmarks.
- Benchmarks that do not pursue ESG objectives must also state this fact in the methodology.
- The methodology statement will need to be kept under review and updated as necessary whenever there is a change to the methodology.

Mixed benchmarks

While the Draft Delegated Acts provide templates for specified categories of benchmarks (as set out above), it is not clear what administrators should do if there is a benchmark containing a mix of these categories, for example a benchmark containing both public and private equities as underliers – whether the “other benchmark” template should be used or whether each of the relevant components from the public and private equities templates should be used.

Family level disclosures

As set out above, the benchmark statement and methodology disclosures can be made at family level. This poses an issue, however, if a benchmark family contains both ESG and non-ESG benchmarks. It is not clear whether an administrator would need to list the specific ESG benchmarks within that benchmark family in the disclosure statement, or whether it would not be possible to have both ESG and non-ESG benchmarks within the same benchmark family.

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