

LEGISLATION AND DOCUMENTS

9348/18
COM(2018) 355

9348/18 ADD 1
COM(2018) 355

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SWD(2018) 264

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SWD(2018) 265

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

ANNEX to the Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT
Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment and Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 and Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

Submitted by HM Treasury on

19 June 2018

SUBJECT MATTER

1. The stated aim of this proposal is to enhance the transparency of sustainability benchmark methodologies and put forward standards for the methodology of low carbon benchmarks in the Union.

2. This legislative proposal is part of a package of measures which implement key actions announced in the Commission's Action Plan on Financing Sustainable Growth, published in March 2018. The action plan, which followed recommendations of the Commission-appointed High-Level Expert Group on Sustainable Finance, looks to place Environmental, Social and Governance considerations at the heart of financial system to support transforming Europe's economy into a greener system.
3. The Commission's work on sustainable finance originated in its Capital Markets Union (CMU) project. The primary objective of CMU is to create deeper and more integrated capital markets in the EU, making it quicker and easier for funds to flow around the single market, better linking investors and savers with businesses needing capital to grow.
4. Benchmarks have an indirect but important impact on investments as investors rely on them for portfolio allocation and to measure the performance of financial products. The EU Benchmarks Regulation (BMR), which has applied since 1 January 2018, introduces a common framework and consistent approach to benchmark regulation across the EU. It aims to ensure benchmarks are robust and reliable, and to minimise conflicts of interest in benchmark-setting processes.
5. Asset managers use low carbon benchmarks to reflect clients desire to make sustainable investments, or to protect against the risk of future regulatory interventions. The basic construction principle of existing low carbon benchmarks is to take a standard benchmark, such as the S&P 500 or NASDAQ 100, and remove or underweight the companies with relatively high carbon footprints.
6. The Commission states that whilst a wide range of sustainability indices exist, their significance in overall portfolio allocation remains limited. Although the BMR requires administrators to make available the key elements of the methodology used to calculate the benchmarks it provides, the Commission suggests that differing levels of transparency of methodology in sustainability indices makes it hard for market participants to compare them. Additionally, the Commission highlights a risk that the lack of a common framework for low carbon indices leads to them all being promoted as equally environmentally relevant despite having different characteristics.
7. To address these concerns, this proposal amends the EU Benchmarks Regulation to:
 - a) Define two new categories of benchmark – 'low carbon' and 'positive carbon impact' benchmarks - and introduce specific, more detailed, requirements on their administrators for disclosing elements of their methodology
 - b) Enable the Commission to prescribe a harmonised methodology for calculating these sustainability benchmarks through the adoption of delegated acts which can specify:
 - i) the criteria for the choice of the underlying assets, including, where applicable, the exclusion criteria for assets;
 - ii) the criteria and method for the weighting of the underlying assets in the benchmark

- iii) the method for the calculation of carbon emissions and carbon savings associated with the underlying assets.”

SCRUTINY HISTORY

8. None directly on this proposal.
9. EM 12420/17 on Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds was submitted on 13 October 2017. It has not been cleared from scrutiny to date.
10. EM 7216/18 on the Commission’s Sustainable Finance Action Plan was submitted on 11 April 2018. It was cleared by the House of Lords on 19 April 2018 and by the House of Commons on 2 May 2018.

MINISTERIAL RESPONSIBILITY

11. The Chancellor of the Exchequer has responsibility for United Kingdom policy on European Union financial services issues. The Foreign and Commonwealth Secretary and the Secretary of State for Exiting the EU are responsible for overall United Kingdom policy toward the European Union.

INTEREST OF THE DEVOLVED ADMINISTRATIONS

12. Financial services policy and regulation is a reserved matter under the UK’s devolution settlements and no devolved administration interests arise. The devolved administrations have therefore not been consulted in the preparation of the EM.

LEGAL AND PROCEDURAL ISSUES

- i. **Legal basis**
The legal basis for this proposal to introduce requirements for sustainability benchmarks is Article 114, of the Treaty on the Functioning of the European Union (TFEU).
- ii. **European Parliament Procedure**
Ordinary Legislative Procedure is applicable.
- iii. **Voting procedure**
Qualified majority voting
- iv. **Impact on United Kingdom Law**
The impact of the proposal on UK law will depend on whether it will apply (in part) during the proposed implementation period relating to the UK’s exit from the EU. If agreed it will apply to any financial market participants administering benchmarks which have Environmental, Social and Governance considerations.
- v. **Application to Gibraltar**
The proposal will apply to Gibraltar.

vi. **Fundamental rights analysis**

The proposal does not engage any rights contained in the European Convention on Human Rights or Protocol 1 or Protocol 13 to the Convention.

APPLICATION TO THE EUROPEAN ECONOMIC AREA

SUBSIDIARITY

13. The Commission states that divergent standards of methodology used for low carbon benchmarks may be leading to investor confusion and suboptimal choice of indices. The Commission aims to address this through enhancing the transparency of low carbon benchmark methodologies, as well as developing a common framework for the calculation of these methodologies, which the Commission states will improve their comparability.
14. The use of benchmarks in financial contracts is often cross border and the government supported the development of a common framework for benchmark regulation across Europe. Action at national level would be inconsistent with objectives of the EU Benchmark Regulation.
15. However, we are not yet convinced whether a legislative amendment is necessary to achieve the Commission's stated aim. We should explore whether, if there was a consensus about what information should be disclosed about sustainability benchmarks, the objective could be achieved through ESMA guidance, which would be more flexible and easier to update as thinking on climate change develops.
16. We would also need to consider whether prescribing a methodology for use in low carbon benchmarks was a necessary or proportionate response to the stated issue, given the difficulties in calculating and its potential to hinder competition and innovation. We are also not convinced that the Benchmarks Regulation is an appropriate tool to prescribe a methodology for calculating carbon emissions, given that this is something which spans wider than the financial sector.

POLICY IMPLICATIONS (including exit implications where appropriate)

17. On 23 June 2016, the EU referendum was held and the people of the United Kingdom voted to leave the European Union. The Government respected the result and triggered Article 50 of the Treaty on European Union on 29th March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation.
18. It is likely that, if agreed, the level one amendments and delegated acts would come into force during the implementation period under the draft Article 50 Withdrawal Agreement between the EU and the UK.

19. The Government is supportive of having a clearer homogenous taxonomy across the Green Finance Industry and is broadly welcoming of the Action Plan on Sustainable Finance. The UK was influential in the High Level Expert Group on Sustainable Finance, with a third of its members drawn from UK institutions. The aims outlined in the Commission's Action Plan are aligned with the UK's interests in developing green finance; an area in which the UK has significant expertise and thus stands to benefit from any increased export potential in this market.
20. We are supportive of the aim to enhance the transparency of Environmental, Social and Governance considerations for the benefit of investors. The BMR already contains significant methodology disclosure requirements for all benchmark administrators, which we support, but we are not opposed to the introduction of specific ones for sustainability benchmarks if it helps investors to make more informed decisions.
21. We would however, raise initial considerations with the proposal to prescribe the components of the methodology itself. There are various methods to calculating emissions data and we would need further convincing that prescribing this in the BMR is appropriate. The Commission has cited data challenges as a 'con' of its preferred approach, which we would agree with.
22. Thinking on climate change is developing very rapidly and any legislation would need to be fluid enough to keep pace with this change. An overly prescriptive approach could hinder innovation and competition in sustainability benchmarks. We would not want burdensome requirements to discourage firms from providing these benchmarks.
23. We would also like to ensure that asset managers retain the flexibility to use or design benchmarks which fit needs of their investors – from those with a general desire to invest in firms with relatively low carbon footprints, to those aligned with the 2 degree climate change target outlined in the 2015 Paris agreement. Furthermore, if the criteria for choice of assets is too prescriptive, investment could be channelled into a much narrower range of firms than it is currently. Whilst we support the Commission's overall initiative on sustainable development, we do not believe that it is the role of the BMR to redirect investment.

CONSULTATION

24. No consultation has taken place relating to this proposal, or the Sustainable Finance Action Plan.

IMPACT ASSESSMENT

25. A joint impact assessment was prepared addressing proposals on a unified EU taxonomy, Investor Duties, Disclosures and Benchmarks.
26. In response to negative feedback on an earlier impact assessment from the Regulatory Scrutiny Board, the Commission pared down its proposal on benchmarks from a fully harmonised methodology to minimum criteria. The

Commission stated that this would leave some flexibility to benchmark administrators and that compliance costs would be limited. Since we have not seen the delegated acts which would prescribe the methodology, it is difficult to judge whether we can agree with this view. The flexibility would have to be significant in order to avoid hindering innovation and competition.

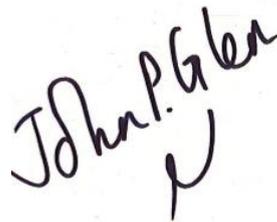
27. The Commission outlined only one negative of their proposed approach within the impact assessment – data challenges. We believe this challenge is significant – there are various methods of calculating emissions data, and thinking on climate change moves on very quickly.

FINANCIAL IMPLICATIONS

28. The Commission does not expect this to have an impact on the EU budget. Given that this is an amendment to existing regulation, the Commission does not judge that this would have a significant impact on costs incurred by supervisory authorities.

TIMETABLE

29. The amendments will come into force the day after they are published in the Official Journal of the European Union. Given that this is a relatively small amendment to an existing regulation, we would not expect negotiations to be lengthy. We would therefore expect that, if agreed, the amendments to come into force during the implementation period under the draft Article 50 Withdrawal Agreement between the EU and the UK.

A handwritten signature in black ink that reads "John P. Glen" with a stylized flourish underneath.

**JOHN GLEN MP
ECONOMIC SECRETARY TO THE TREASURY**