

## Low carbon benchmarks

One of the aims of the EU Action Plan on Sustainable Finance is to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth in line with UN sustainable development goals.

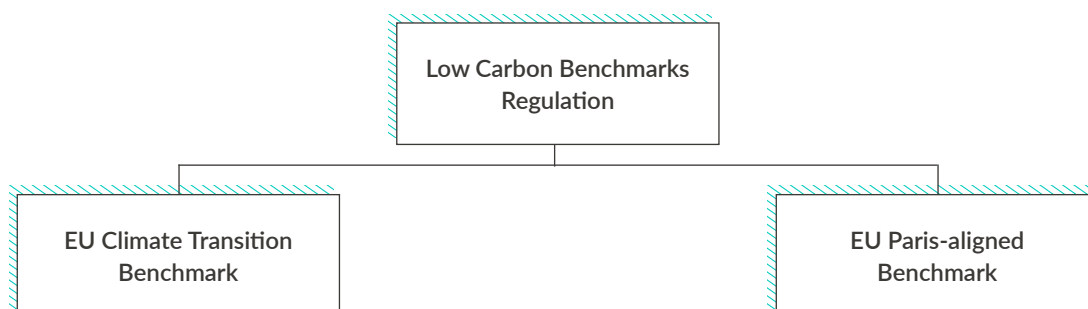
Under the action plan, several measures are being introduced to encourage financial market participants to take into account environmental, social and governance (ESG) factors.

Alongside the [EU Disclosures Regulation](#) and other initiatives, Regulation (EU) 2019/2089 (the **Low Carbon Benchmarks Regulation**) is one of these measures.

The Low Carbon Benchmarks Regulation applies to benchmark administrators, but may also have an indirect impact on UCITS or AIFs to the extent they are users of benchmarks.

### Background

The Low Carbon Benchmarks Regulation amended the Benchmarks Regulation (Regulation (EU) 2016/1011) (**BMR**) to introduce a new category of benchmarks and to provide for sustainability-related disclosures for all benchmarks. The Low Carbon Benchmarks Regulation entered into force on 10 December 2019.



The Low Carbon Benchmarks Regulation introduces a regulatory framework that lays down minimum requirements for two newly created EU benchmark 'labels', namely the 'EU Climate Transition Benchmark' and the 'EU Paris-aligned Benchmark' at the EU level. The aims of this initiative are to improve transparency and comparability, to reallocate capital towards climate-friendly investments and to prevent administrators from making misleading low-carbon claims, known as greenwashing.

The Low Carbon Benchmarks Regulation further requires benchmark administrators to include details of how their benchmarks incorporate ESG factors (or, if they do not consider ESG factors, to state this fact) in both their benchmark methodologies and benchmark statements.

It also extends the time period during which national competent authorities (NCA) can compel benchmark administrators to publish, and supervised contributors to submit to, a critical

benchmark from two years to five years. A critical benchmark is defined in the BMR.

The deadline for benchmark administrators to ensure compliance with the requirements to make ESG disclosures in their benchmark statements and methodologies was 30 April 2020. Administrators of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks were also required to comply with the Low Carbon Benchmarks Regulation by this date. However, the Commission Delegated Regulations which prescribed the standards for the required disclosures were not published until 17 July 2020.

### EU climate transition benchmark

The Low Carbon Benchmarks Regulation stipulates that the administrator of an EU Climate Transition Benchmark, when selecting or weighting underlying assets, should take into account companies that have as an objective the reduction of their carbon emissions towards alignment with the objectives of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change approved by the Union on 5 October 2016 (the Paris Agreement). Such targets should be public and credible. They should entail a genuine commitment to decarbonisation and should be sufficiently detailed and technically viable.

An EU Climate Transition Benchmark is defined as a benchmark which is labelled as an EU Climate Transition Benchmark and fulfils the following requirements:

- is an Index (as defined in the BMR) that is regularly determined on the basis of the value of its underlying assets, which are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonisation trajectory; and
- is constructed in accordance with the minimum standards laid down in delegated acts adopted by the Commission.

Administrators of EU Climate Transition Benchmarks must select, weight, or exclude underlying assets issued by companies that follow a decarbonisation trajectory by 31 December 2022, in accordance with the following requirements:

- the companies disclose measurable carbon emission reduction targets to be achieved within specific timeframes

- the companies disclose a reduction in carbon emissions which is disaggregated down to the level of relevant operating subsidiaries
- the companies disclose annual information on progress made towards those targets
- the activities relating to the underlying assets do not significantly harm other ESG objectives

By 1 January 2022, administrators which are located in the Union and which provide significant benchmarks determined on the basis of the value of one or more underlying assets or prices must try to provide one or more EU Climate Transition Benchmark.

### EU Paris-aligned benchmark

EU Paris-aligned Benchmarks should be in line with the objectives of the Paris Agreement at index level.

An EU Paris-aligned Benchmark is defined as a benchmark which is labelled as an EU Climate Transition Benchmark and fulfils the following requirements:

- is an Index (as defined in the BMR) that is regularly determined on the basis of the value of its underlying assets, which are selected, weighted or excluded in such a manner that the resulting benchmark portfolio's carbon emissions are aligned with the objectives of the Paris Agreement;
- is constructed in accordance with the minimum standards laid down in delegated acts adopted by the Commission; and
- the activities relating to its underlying assets do not significantly harm other ESG objectives.

The Low Carbon Benchmarks Regulation provide that the European Commission shall adopt a delegated act by 1 January 2021 which identifies, in respect of EU Paris-aligned Benchmarks, the sectors to be excluded because they do not have measurable carbon emission reduction targets with specific deadlines that are aligned with the objectives of the Paris Agreement. The Commission shall update this delegated act every three years.

### Disclosure of ESG factors

The Low Carbon Benchmarks Regulation further amended the BMR to introduce a requirement for administrators to publish details of how the

methodologies of their benchmarks reflect ESG factors. If ESG factors are not considered, this must be stated. The minimum requirements for such disclosures in each of the benchmark methodology and benchmark statement are set out in the delegated acts adopted by the Commission.

These requirements came into effect on 30 April 2020, however ESMA issued a no-action letter to NCAs on 29 April 2020 setting out its opinion that NCAs should not prioritise supervisory or enforcement action against administrators regarding these new requirements until the final delegated regulations are in place. ESMA also issued an opinion addressed to the European Commission which expressed its view that any delay in the adoption of the delegated regulations should be avoided.

### Delegated acts

The Low Carbon Benchmark Regulation empowered the Commission to adopt delegated acts to provide supplemental details for the criteria for the two new benchmarks, for the information and format to be included in the benchmark methodology and for the statement in relation to the incorporation of ESG factors.

The following Commission Delegated Regulations were adopted on 17 July 2020:

Commission Delegated Regulation	Content
On the minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks	Sets out the minimum standards that EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks should meet in order to be labelled as such, and to lay down the transparency requirements on the methodology for both benchmarks.
On the minimum content of the explanation on how Environmental, Social and Governance (ESG) factors are reflected in the methodology	Sets out minimum content requirements and standard format for the explanation of how the key elements of the benchmark methodology reflects ESG factors for each benchmark, with the exception of interest rate and foreign exchange benchmarks.
On the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published	Sets out the explanation to be included in the benchmark statement about how ESG factors are reflected in each benchmark or, where applicable, family of benchmarks, which is provided and published. Templates for this disclosure are provided in the annexes to the delegated regulation.

### What action should UCITS management companies and AIFMS take?

UCITS Management Companies and AIFMs should consider whether the funds which they manage are users of benchmarks under the BMR, including EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. If so, they should liaise with the administrators of these benchmarks to ensure that the benchmarks will be compliant with the BMR as amended by the Low Carbon Benchmark Regulation and to ascertain whether any updates are required to be made to the offering documents of the relevant funds or any index licence agreements as a result of the new requirements. You can read more about how an investment fund could be a user of a benchmark, the contingency plans which may be required to be in place and possible prospectus disclosures in [this A&L Goodbody briefing](#) on the BMR.

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