Frankfurt am Main,
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European Commission's Sustainable Finance Initiative – Establishment of a framework to facilitate sustainable investment:
Proposal to amend Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

Encouraging investments in sustainable products is a core element in the strive towards a more sustainable environment. BVI[1] in general welcomes the European Commission's Action Plan and the legislative proposals on Low Carbon ("LC") and Positive Carbon Impact ("PCI") Benchmarks ("BM"), besides a common language (Taxonomy) and disclosure. Being part of a broader initiative, the LC/PCI-BM proposal has the potential to provide a valuable tool for Sustainable Finance, if sufficiently improved.

Generally, directing capital into de-carbonised sustainable investments with inter alia the help of LC/PCI-BMs bears the risk of creating crowding of investments out of both brown industries as well as non carbon-related sustainable investments and may increase investment risk due to less diversification. The regulatory interference must therefore be based on a thorough assessment of potential outcomes. A too simple approach can also be easily used to exclude certain activities with potentially detrimental effects. Too descriptive regulation and regulation needs to be avoided as it may trigger potential liability issues which in turn lead to a tick-the-box compliance exercise and are therefore detrimental to a move towards a more sustainable environment. We suggest a forward-looking approach that focuses on climate transition risk and opportunities across industry sectors to truly facilitate the move to a more sustainable, low-carbon economy. In any case, the carbon benchmark regulation should set the ground for stimulation of innovation, wide adoption and commercial success without limiting other sustainable investments

Key messages

- **Regulation should cover all sustainable BMs.** We would question the limited focus of the proposal. Interaction of all elements of sustainability (environmental, social, governance) as well as within the elements (climate, waste prevention, ecosystem, etc.) needs to be taken into account. The same is true for different types of activities, industries, asset classes etc. Sustainability considerations should be reflected in all BMs with a sustainability objective or according to investor preferences.
- **Focus should be on adequate disclosure.** A harmonised approach should not limit flexibility or discriminate different approaches in the field of sustainable investments. In particular, the index

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

regulation should not be used to restrict the investment options. Furthermore, like sustainable investment strategies, BMs today reflect different approaches and are used depending on market participants' needs. Measures need to allow for continued product innovation both for the BM provider as well as the BM user. Therefore, the focus should be on ensuring adequate disclosure by benchmark administrators rather than prescribing in law the methodologies to be used in benchmark construction.

- **Approach should be globally harmonised.** We would see a merit in pursuing a global harmonised approach to establish a framework to facilitate sustainable investment including setting minimum standards for sustainability indices.

Balanced and holistic approach

We would prefer a **regulatory concept of sustainability that includes all sectors** and not be limited to carbon reduction. For example, the Commission's Impact Assessment[2] recognises a nuclear power company as "low carbon electricity distributor". Such approach, however, ignores the overall negative sustainability implications of nuclear energy with respect to nuclear waste which in the long term might have more impact on humanity than the impact of traditional carbon based electricity producers. Only a comprehensive concept of sustainability across all indices will avoid giving advantages to specific sustainable activities while providing disadvantages to others. Interaction of all elements of sustainability (environmental, social, governance) as well as within the elements (climate, waste prevention, ecosystem, etc.) needs to be taken into account. The same is true for different types of activities, industries, asset classes etc. This means that the Benchmark Regulation ("BMR") should also include other sustainable BMs.

Despite the positives behind developing a harmonised approach for LC/PCI-BMs and their methodologies, BVI considers that there would be more merit in **pursuing a global harmonised approach** to establish a framework to facilitate sustainable investment, including setting minimum standards for sustainability indices. Such framework could be based on a global private-public partnership in order to leverage all sectors. The standardisation efforts by ISO, including but not limited to the ISO 14031:2013 and ISO 14024 standards, could be a good starting point for aligning public and private interests in the field globally.[3]

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[2] See the discussion on Carbon Impact Ratio (CIR) with the reference to EDF at p. 189, download at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD:2018:264:FIN.

[3] A successful role model is the global standardisation of legal entity data by the G20. Based on a G20 mandate the Financial Stability Board set up a governance structure with public oversight (FSB LEI ROC) and largely private sector standard setting and implementation (GLEIF) based on specifically developed open, global International Standards Organisation (ISO) standards (for details, please see www.gleif.org).
A similar structure, i.e. a G20 or UN mandated public coordination and oversight body and a private organisation working on the basis of globally agreed ISO standards, could be envisaged for setting sustainability standards in financial services. The ISO standards system offers a readily available global solution with a standard setting process and an infrastructure in place which is acceptable to both the regulators and industry. A new ISO standards segment for sustainability standards in financial services and green bonds has been proposed (cf. ISO/TS/P 274 dd. 2018-05-31) and will be voted on until 2018-08-23. The suggested ISO programme of work will promote the integration of sustainability considerations and environmental, social and governance (ESG) practices into institutional investment decision-making and wider finance management. It will ultimately look to support the alignment of the global financial system with sustainable development goals. Based on the positive example of GLEIF we firmly believe that international coordination can yield better and less fragmented results to establish a framework to facilitate sustainable investment, including index standardisation.

Recognition of existing and future developments

It is very important that the **index regulation is not used to restrict investment options**. The investment decision as well as the decision on the use of the BM must remain with the investor. The regulation should be open to future extension to other sustainability indices by providing broad disclosure and transparency requirements on all indices to allow a detailed comparison with all traditional (so-called parent) indices in terms of returns and risk based on granular information pertaining to individual components and their weightings within an index. While we see merit in acknowledging the possibility of using all kinds of sustainability BMs (not limited to LC/PCI-BMs) for investment funds integrating sustainability considerations, this should not deprive asset managers from the ability to continue to use non-sustainability BMs to “measure the performance of an investment fund with the purpose of tracking the return of such index or of defining the asset allocation of a portfolio or of computing the performance fee besides “simply” comparing a funds’ performance with standard non-sustainability BMs, which would reflects common market practice and frequent demand by asset owners. We would therefore welcome a clear statement in the BMR to this end placing the selection of low-carbon and positive carbon impact BMs solely on an optional basis and leaving the final decision to the discretion of users of the BM. However, investors and asset managers should be incentivised to select comprehensive sustainability BMs. We also consider that the use of positive carbon impact BMs is one of the criteria, but not the only or the minimum one, for asset and portfolio managers pursuing an investment strategy compatible with the Paris Climate Agreement.

We also recognise there is no one-size fits all approach as there are differences between what is available today, largely relying on Scope 1 and Scope 2 emissions, and what will be more reliably available in the future including Scope 3 data. We see merit in calling for a distinction between LC-strategies and PCI- / 2 degree alignment strategies (and for transparency as to the extent to which Scope 1, 2 and 3 emissions, as well as avoided emissions have been taken into account). We support there being a place for both: "mainstream" low-carbon strategies will likely have broader client and investor appeal and contribute more effectively towards sustainability over the long-term. Therefore also the methodology requirements need to be flexible to allow for future development. For instance, there is a difference whether the BM excludes sectors or only entities based on a best in class approach. Some BM also use an exclusion approach while others select entities which made the best progress in order to reflect a more forward-looking dynamic approach. Methodology requirements on BMs need to be open to new developments in assessing and calculation of carbon impact across all scopes. ESG-BMs today are based on different strategies. Since all of these approaches can potentially be used to facilitate the move towards a more sustainable environment, **regulation should not discriminate different approaches**.

Interaction with Taxonomy and Disclosure proposals

Finally, we support the goal of developing a harmonised approach to ensure robust methodologies. In this respect it is decisive that the regulations regarding Taxonomy, disclosure obligations for financial market participants as well as on LC/PCI-BMs are aligned at all levels, especially recognising the impact the taxonomy will have on the PCI BMs through setting out the depth and breadth of a “positive impact”. In order to achieve this, we see a general need for a link between sustainable indices and the taxonomy.

Improving disclosures to BM users

We welcome that information on how environmental, social and governance factors are reflected in BMs which pursue or take into account ESG objectives is required in the BM statement (Art. 27 (2)(a) and (b). For users of BMs, the statement foreseen in the BMR is the best source of information. We regret however that in practice the BM statement has not been to date a user-friendly document, as it is often difficult to acquire relevant information on a specific BM. The requirement for transparency without an easy and simple access to information for investors can be challenging. We would therefore **stress the need for a clear and short BM statement** summarising the characteristics, including the methodology information related to ESG, including but not limited to LC/PCI objectives, of a specific BM or a family of very similar BMs and a user friendly format of the BM statement. Correspondingly, a statement that the BM in question does not take into account ESG objectives could be required as minimum disclosure in all other cases.

Most importantly, investors also need granular information in terms of weighting, constituents and applicable sustainability indicators for each underlying in all (parent) BMs under BMR in order to be able to do the required comparisons between the impacts of the portfolio with its reference BM and a broad market index as demanded by the Commission's proposal on disclosures relating to sustainable investments and sustainability risks and as supported in the HLEG report and reiterated in the impact statement as well as the TEG scoping document. In the context of BMR L2 implementation the buy-side repeatedly stressed that the deletion of EU Commission original proposal (Article 16) restricts users' capacity to perform their due diligence duties and to make informed choices as to the BMs they will be using. It was also proposed at the time to enhance transparency via publishing input data in the website of the administrator. This weakness needs to be addressed by amending Art 13.

User Licences

The BM regulation already today creates unfair commercial incentives to charge high licence fees from the BM users. We fear that the increased level of regulation for administrators of LC/PCI-administrators may lead them to charge even higher fees to cover for the increased cost of regulation. For user protection against excessive index data fees and facilitation of adaption of LC-PCI-BMS, administrator should be required to ensure that licenses of, and information related to, the BM are provided to all users pursuant to transparent and non-discriminatory rules, based upon objective criteria and that index use and index data license fees may be based on an at cost basis only.

Implementation

When implementing the L2 -regulation of the LC/PCI BM methodology criteria under Article 19 (1) (a) BMR no criteria should be prescribed which cannot be easily used in practice, i.e. the criteria should be limited to such where the availability of the underlying carbon related data and KPIs in easily accessible either directly from the companies or from ESG data vendors and without excessive costs for users.

An implementation date should be set with sufficient time for BM providers concerned to put these processes in place. A reasonable transition period would be one of 12 to 18 months after publication of the amended BMR. We very much welcome the Commission relying on the advice of the technical expert group on sustainable finance in relation to the preparation of delegated acts designing the methodology for selecting underlying assets for the low-carbon and positive carbon impact indices. At the same time, we consider it necessary to open this process to the broader set of stakeholders, by carrying out public consultations with a sufficient feedback period of three months.

Furthermore the transition time for BM administrators and users under the current BMR (Art. 51, Art. 52) need to be aligned and extended for implementation of LC/PCI-BMs. Currently, supervised entity users have to declare by beginning of 2019 which BMs they are using while BM administrators have until beginning of 2020 to register as BM administrator and publish the administrator status in case of EU administrators and the Non-EU BMs in the ESMA register (Art. 36 BMR). It is very difficult for BM users to ascertain whether a particular BM (which is not expressly listed as a Non-EU BM in the ESMA register) is administered by an EU administrator registered in the ESMA register (and therefore permissible for use, Art. 29 BMR) or is not registered at all. In order to prevent unintended use of not registered BMs by supervised entities under Art. 29 BMR, all EU BMs should be disclosed in the ESMA register. Art. 36 BMR needs to be amended accordingly.

Specific comments

The following comments suggest specific changes to BMR:

Article	Comment
Art 3 (1) point 23 (b), Art 19a	Developing strategies aligned with the 2 degree target is very important, but methodologies to assess companies' contribution to this objective are still work in progress as described in the Commission's proposal, the HLEG report and reiterated in the Commission's impact statement as well as the TEG scoping document. If this is the case, the methodology provisions to be laid down in Level 2 should be aligned with some commonly accepted integrated assessment model for 2 degree.
Article 4	For user protection and in order to facilitate the use of LC/PCI-BM a provision should be added mentioning that the administrator shall ensure that licenses of, and information related to, the BM are provided to all users pursuant to transparent and non-discriminatory rules, based upon objective criteria and that index use and index data license fees may be based on an at cost basis only.
Article 13	We also support the amendment requiring administrators of BMs to provide an explanation for how ESG factors are considered in a BM pursuing ESG objectives, and a statement that no ESG factors are considered in all other cases We consider, however, that such transparency for users should apply not only to the narrow scope of BMs defined as LC and PCI, but to all BMs, including BMs which take into account ESG criteria important for the energy transition but which do not necessarily fall within the definition of a low-carbon or positive carbon impact BM. In that way, users have full transparency regarding the steps an administrator opted to take or not towards this direction. Investors also need granular information in terms of weighting, constituents and applicable sustainability indicators for each underlying in all (parent) BMs under BMR in order to be able to do the required comparisons between the impacts of the

	portfolio with its reference BM and a broad market index as demanded by the Commission's proposal on disclosures relating to sustainable investments and sustainability risks. Today, users' capacity to perform their due diligence duties and to make informed choices are restricted. An amendment should provide for more transparency and a requirement to publish input data in the website of the administrator.
Art 19a, Art 27 para 2a BMR	BVI welcomes transparency for users of BMs regarding the extent to which a BM's methodology takes into account ESG objectives. This information is key for enabling users make well-informed decisions, not only on the selection of the appropriate index, but also on their investment strategy. However, such transparency on the methodology used by index administrators should apply to all indices, not only to BMs defined as low carbon or positive carbon impact. A solo application for a restricted category of indices would unnecessarily narrow the positive effects of such transparency and limit the overall objective of assessing ESG efficiency of an index. We would therefore reiterate support full transparency for all types of BMs on ESG objectives used or not used in the methodology of a BM. The transparency requirements on ESG objectives should be focused on disclosures of relevant elements, such as the rationale of the adopted methodology, the procedures and criteria of the methodology and the limitations of the BM. The criteria required by L2 regulation to be observed when setting a LC/PCI BM shall be limited to such criteria where the availability of the underlying carbon related data and KPIs in easily accessible either directly from the companies or from ESG data vendors and without excessive cost for users.