

EU Proposes Legislation to Establish Low-Carbon Financial Market Benchmarks

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Last week the European Parliament and European Union (EU) member states reached a [tentative agreement](#) on proposed legislation that would set standards for low-carbon benchmarks in the EU. In financial markets, a benchmark is essentially an index, or a standard or measure pegged to the value of a “basket” of underlying equities, bonds or other assets or prices, that is used for a variety of investment purposes, such as evaluating the performance of a security, mutual fund, or other investment. Many in the investing community rely on low-carbon benchmarks to create investment products, to measure the performance of investments and for asset allocation strategies. By establishing clear criteria that companies must meet to be included in a low-carbon benchmark, the proposed legislation aims to provide certainty and transparency to sustainable investing and reduce “greenwashing,” or the making of unsubstantiated or misleading claims about the environmental attributes of a benchmark.

The legislation proposes the creation of two new categories of low-carbon benchmarks: (a) “Paris-aligned” benchmarks, for companies in line with the Paris Agreement goal of limiting global temperature rise to 1.5° Celsius above pre-industrial levels and (b) “climate-transition” benchmarks, for companies on a trajectory to lower their carbon footprint but not yet on track to achieve Paris-level carbon reductions. As proposed, the legislation is designed to allow current unofficial benchmarks and indexes touting ESG or sustainable characteristics to continue to operate alongside the new EU-sanctioned benchmarks as long as they do not coopt the labels established by the legislation.

The draft legislation also proposes that all benchmark providers disclose how their benchmarks account for ESG factors and the extent to which their benchmarks are aligned with carbon emissions targets. The scope and nature of these disclosure obligations will depend on the legislative text, which has not been released publicly to date.

The benchmarks legislation, which is expected to be formally adopted next month, was part of a package of sustainable finance bills proposed by the European Commission in May 2018. The two other proposals include: (1) one that establishes a unified EU classification system (taxonomy) for sustainable economic activities and (2) one that improves disclosure requirements related to sustainability risks and opportunities. These additional proposals are currently being negotiated and legislators expect to reach consensus this spring.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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