

# EU Climate Benchmarks Factsheet

Technical analysis of key elements of the climate  
benchmark standards & potential solutions

May 2020



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**ABOUT:** 2° Investing Initiative (2°ii) is a not-for-profit think-tank working to integrate long-term risks and societal goals into financial markets. With offices in Paris, London, Berlin and New York, 2°ii engages a global network of over partners and members, including financial institutions, investment researchers, asset managers, policymakers, research institutions, academics and NGOs. Our work primarily focuses on three pillars of finance – metrics and tools, investment processes, and financial regulation.

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**DISCLAIMER:** This report reflects the authors' views only. The European Commission are not responsible for any use that may be made of the information it contains. Funding does not imply endorsement of the messages or findings of the material.

## 1. INTRODUCTION

This document forms part of 2° Investing Initiative's response to the European Commission consultation on the draft delegated regulation for minimum standards for climate benchmarks ([Link](#)). It seeks to outline key technical issues with the guidance from the EU Technical Expert Group on Sustainable Finance (TEG) on which the draft delegated regulation is predicated. It is therefore based on the guidance outlined in the following documents:

- TEG Final Report on Climate Benchmarks and Benchmarks' ESG Disclosures (Sep. 2019, [Link](#));
- Handbook of Climate Transition Benchmarks, Paris-Aligned Benchmark and Benchmarks' ESG Disclosures (Dec 2019, [Link](#));
- Draft delegated regulation from the European Commission (Apr 2020, [Link](#)).

There is still some ambiguity as to the extent that the outputs of the TEG will fully or partially inform the actual implementation of this policy area. Recognizing this, and potential future clarifications that may be needed on that, this note provides feedback to the draft delegated regulation itself *under the assumption that its implementation will follow the TEG final report and handbook guidance*. In that spirit, the feedback treats the draft delegated regulation and the TEG material together, recognizing that there may be flexibility down the line and that this issue remains open. The reference to TEG concepts in the draft delegated regulation itself suggests this is a relevant assumption for the moment.

This document is largely limited to a discussion of the technical limitations of the minimum standards and associated guidance developed by the TEG. However, independent of the technical issues discussed in this document, it should be noted that 2° Investing Initiative has previously articulated a number of concerns pertaining to development of this part of the EU Action Plan on Financing Sustainable Growth and the objectives underpinning it:

- The focus on climate disclosures of listed equity benchmarks creates a regulatory category for a marginal financial product for which there is currently no evidence as to its contribution to reducing emissions in the real economy.<sup>1</sup> Such a regulatory category thus represents an opportunity cost for potentially more effective instruments, and risks misleading retail investors as to the potential real world impact of these products;
- It is unclear how any conflict of interest of TEG members has been managed. A small group of individuals of which a significant minority represent financial interests have effectively been delegated the responsibility of designing this guidance. Their outcome appears to align 100% with their financial interests, while being inconsistent for example with previous attempts at standardization put forward by the Financial Stability Board Task Force on Climate-related Financial Disclosures.<sup>2</sup>
- The pursuit of an approach directly contravened by the evidence of a research programme funded by the European Commission since 2015. This issue will be discussed in one section of the consultation response as a way to illustrate that alternatives to the guidance developed by the TEG exist and are actionable. The authors – given their involvement in these alternatives – appreciate that referencing this work may appear as a lobbying attempt to displace one approach with another. However, the objective here is to flag questions of process, rather than make the case for or against one or the approach.

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<sup>1</sup> [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3289544](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3289544)

<sup>2</sup> <https://www.fsb-tcfd.org/publications/final-recommendations-report/>

The purpose of raising these issues is not to re-open the strategic discussions on this dossier, but rather to clarify that beyond the technical issues outlined in this document, there are broader concerns about the extent to which the policymaking process on the sustainable finance agenda has been genuinely evidence-based to date. For example, there is only one representative from an EU academic institution on the TEG, who stands in personal capacity.

The EU should be applauded for its courage in driving forward this ambitious agenda. As we move into the next phase, however, it is critical to recognise the lessons of the work to date. Learning from these experiences represents a key opportunity for the new Parliament and Commission to establish an evidence-based approach for continuing the agenda and developing the Renewed Sustainable Finance Strategy.

**This approach should include (but not be limited to):**

- **an independent process for evaluating the effects of policy to date**
- **more rigorous safeguards for managing conflicts of interest**
- **broader consideration of citizens' wants and needs**
- **an agenda based on existing scientific evidence on ways to reduce emissions and improve the sustainability of the EU economy**

2° Investing Initiative looks forward to supporting and accompanying this process in the future.

**Note on funding and financial conflicts of interest:**

*As part of this consultation response, the 2° Investing Initiative would like to disclose the funding underpinning this feedback and the management of its own financial conflicts of interest. Notably, the 2° Investing Initiative have a zero-service contract policy, meaning 100% of its research is grant funded. To ensure unbiased research, the boards of the French and German entity – either on institutional or personal level – seek to represent the diversified interests of its stakeholders, with board members from governments, financial institutions, NGOs, and consultancies / industry experts. 2° Investing Initiative receives the majority of its funding from governments, notably the European Union and its agencies, as well as the German, Swiss, French, and Austrian government. It also receives funding from philanthropies, and a small portion of its funding from corporate memberships. 100% of 2° Investing Initiative outputs are open-source and IP-rights free, including the right for commercial reuse without licensing fees. While some financial institutions support the 2° Investing Initiative and its research through grants, 2° Investing Initiative has a strict policy that funding is not required to road-test or use its research outputs.*

## 2. MIXING IMPACT AND RISK OBJECTIVES WILL CREATE INCONSISTENCY IN THE IMPLEMENTATION OF THE BENCHMARKS IN PRACTICE

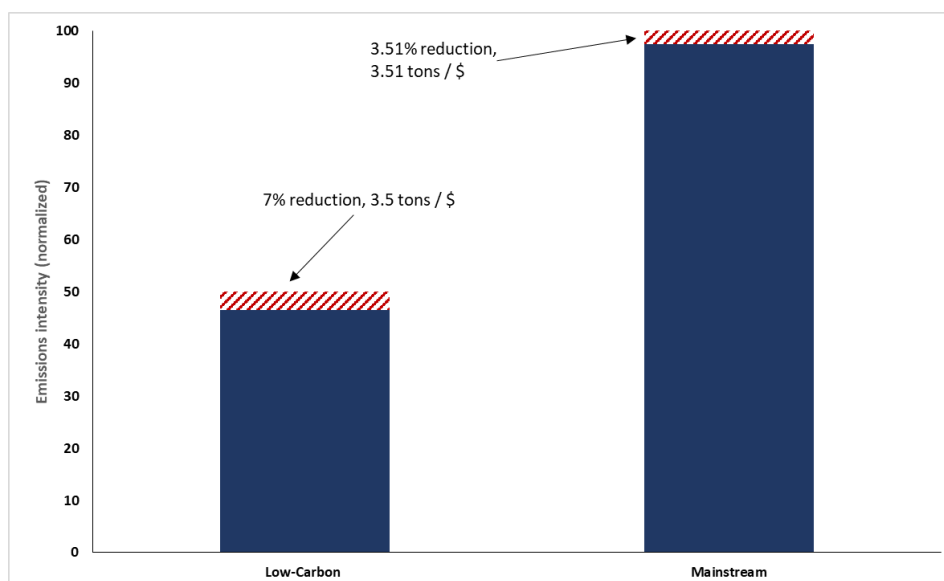
The minimum standards for both the EU Climate Transitions Benchmark and EU Paris-aligned Benchmark involve two core components, which can be understood to derive from different investment objectives:

- **7% reduction of GHG intensity year on year:** This would be consistent with an *impact objective* (assuming that emissions reductions are real and not related to trading in and out of shares);
- **Relative lower GHG intensity:** This would likely – leaving data issues aside – be compatible with a *risk objective* (since such a filter does not necessarily preference companies that contribute to emissions reduction or reduce their own emissions over time).
- **Exclusion filters:** These are linked to *do no harm objectives* and / or certain risk strategies (specific to the the EU Paris-aligned Benchmark)

By conflating these three objectives into a single set of minimum standards, this creates both ambiguity as to the underlying objective and risks creating inconsistent outcomes for some strategies (particularly those designed to contribute to real world emissions reductions, which is the self-professed objective of this regulation). Let's take the case of an investor seeking to choose an index with the objective of contributing to real world emissions reduction. Two issues arise here: First, by starting with a lower GHG intensity as a prerequisite, the 7% reduction – since it is framed as a percentage reduction – implies that index constituents, when they do reduce 7% year on year, reduce less emissions in absolute terms than an index that does not require lower GHG intensity as a starting point. That means in practice, a standard benchmark reducing emissions by 3.51% reduces more real-world emissions year on year than a climate benchmark reducing emissions by 7% (see Fig. below). Some stakeholders may claim that the index should be credited for the reduction that already took place (30% in the case of the EU Climate Transition Benchmark and 50% in the case of the EU Paris-aligned Benchmark). However, this does not represent emissions reduction over time, merely a lower emissions starting point which may be due to a range of non-climate related reasons (revenue and sector allocation etc.). Moreover, those are historical achievements and do not affect future emissions reductions.

This is not to say that there are not good reasons for lower GHG intensity. However these are predominantly risk based and unrelated to contributing to decarbonization, especially since there is no evidence that screening based on lower GHG intensities actually preferences “green companies” (which in many cases still have a relatively high GHG footprint relative to other industries).

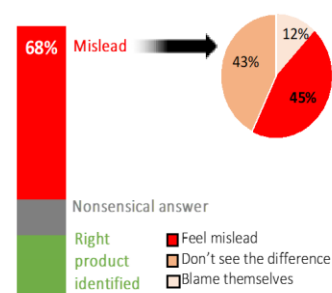
Figure 1 Stylized visualization of the real-world emissions reduction over time of two different benchmarks (Source: Authors)



Second, index turnover may render the 7% year on year reduction meaningless as a proxy for real world emissions reduction. Since there is no way to control for ‘emissions leakage’, the index design is likely to be incompatible with target-setting frameworks currently under development and will incentivize companies to sell high-carbon assets rather than make a meaningful reduction to taking carbon out of the atmosphere. Again, there may be good reasons for selling such assets from a risk perspective. There may even be a theory of change related to the real-world impact of divestment. However, by tracking only the emissions of the index constituents, there is no way to establish any real-world emissions reduction.

Crucially, while out of scope of the Benchmark Regulation, there is ample evidence that such products will systematically mislead retail investors, and thus risk a backlash for the sustainable finance agenda and the underlying objectives. A recent analysis of marketing claims by a sample of investment funds highlights that the majority of consumers felt misled when confronted with environmental claims associated with financial products established under the framework currently endorsed by the Benchmark Regulation.<sup>3</sup>

*Claim: “The Equity Fund” allows investors to have a real impact on climate change. The design of the fund aims at generating a real impact on the environment and create solutions for climate change: For example, a 5 million Euro investment in the fund, for one year would reduce polluting emissions by 4,200 tons of CO<sub>2</sub>, which is equivalent to taking 1,900 cars off the road for a year. These figures are reported every year and audited.”*



This challenge relates to a broader problem relating to the Commission’s choice to develop regulation inconsistent with the recommendations of the High-Level Expert Group. Here the focus is on regulating a marginal financial product with <1% of market in an asset class where most existing research suggests redirection of capital is more efficiently achieved through either signalling (e.g. divestment approaches) or engagement, rather than a rebalancing of the portfolio. This is however not related to the specific TEG guidance.

**Solution:** *Right now, index categories are distinguished based on “ambition”. It seems appropriate to either distinguish them based on the underlying objectives, or, if the objective is mobilizing capital, then to assure the guidance is consistent and focused on that component, rather than mixing potentially inconsistent criteria that may undermine that objective. In addition, where the objective is real world impact, it should be required the track and distinguish virtual emissions reductions due to reweighting of index versus real-world emissions reduction of current and former index constituents, in parallel to the emissions reduction pathway of the index constituents at any given point in time. This will prevent retail and institutional investors from assuming that the two are the same, which many retail investors currently believe based on our survey*

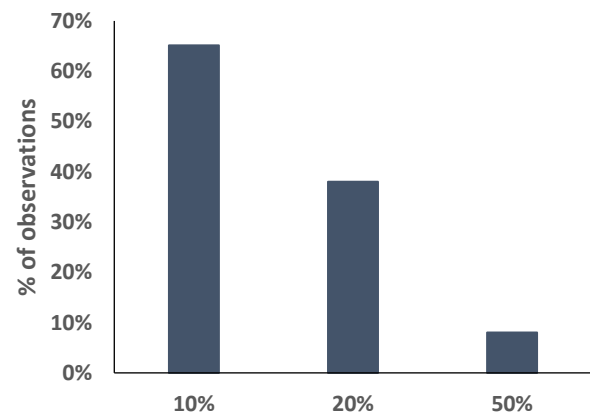
<sup>3</sup> <https://2degrees-investing.org/wp-content/uploads/2020/03/EU-Retail-Funds-Environmental-Impact-Claims-Do-Not-Comply-with-Regulatory-Guidance.pdf>

### 3. ENTERPRISE VALUE – SUGGESTED AS A REFERENCE POINT FOR CALCULATING GHG INTENSITY – IS A HIGHLY VOLATILE AND NOT ALWAYS AVAILABLE DATA POINT.

**Availability of data.** Enterprise value as a data point is not readily available, even for listed companies, on financial databases. Over **100 companies out of a sample of 1574 companies represented in the MSCI World did not have an enterprise value datapoint in Bloomberg.** While this datapoint should in theory be identifiable and verifiable through further analysis, it shows that even for listed companies, it is not readily processed in all cases. Moreover, enterprise value is not a datapoint that exists for non-listed bond issuers (this will be discussed later).

**Volatility of data.** We analysed year on year volatility of enterprise value for 1,396 companies over a 4-year time span (total observations 5,584). Year on year enterprise value volatility exceeds 10% in more than half (60%) of cases. Around one in 10 times the carbon footprint intensity volatility is upwards of 50% (see Fig. on right). While the TEG guidance controls for growth, it does not control for enterprise value volatility across companies. These 8% of +50% cases can potentially by themselves generate the 7% reduction target without any real emissions reduction, given the significant impact such high volatility is likely to have on overall portfolio.

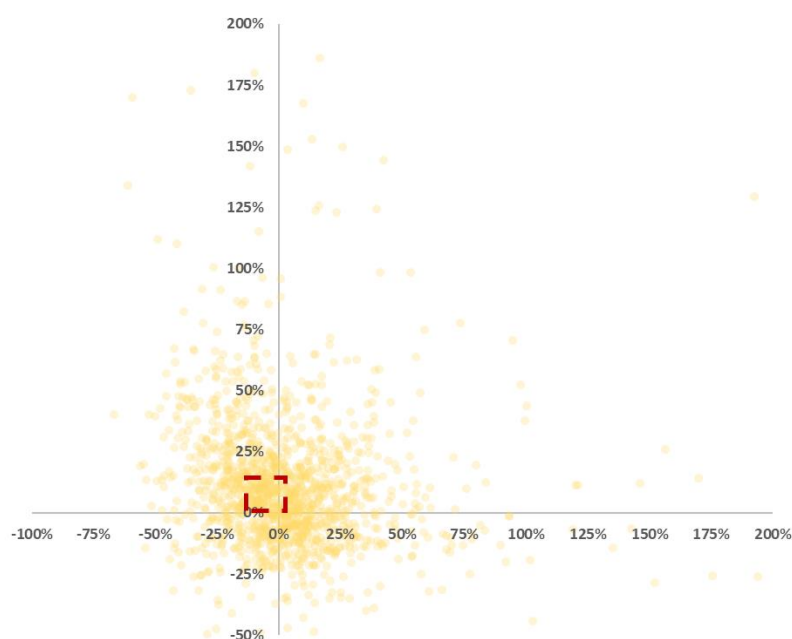
Figure 2: Year on year volatility of Enterprise value (Source: Authors, based on Bloomberg)



Another way to think about this is to analyse the number of observations that have lower volatility than +/-7% the 'market EV growth rate', essentially those observations where the delta between market and company growth rate is less than the 7% reduction target. The scatter plot below shows for 2016 / 2017 observations which companies were within that range, represented by the red box.

**Solution:** Emissions trajectories should be calculated using real economic outputs as denominators or using absolute pathways and be sector specific – in line with leading initiatives (Science-based Targets, PACTA, Katowice Banks).

Figure 3: Year on Year volatility of enterprise value of 1,396 observations 2016-2017 (Source: Authors, based on Bloomberg)



#### 4. THE USE OF ENTERPRISE VALUE CREATES A SYSTEMATIC BIAS AGAINST NON-LISTED COMPANIES, WHICH ARE MORE PROMINENT IN COUNTRIES WITH LESS DEEP CAPITAL MARKETS (NOTABLY CENTRAL AND EASTERN EUROPE).

Enterprise value is usually not available for non-listed companies and would have to be calculated ‘ad-hoc’ based on assumptions about the valuation of a company. The TEG guidance recommends using book value for non-listed companies rather than market value to address this issue.

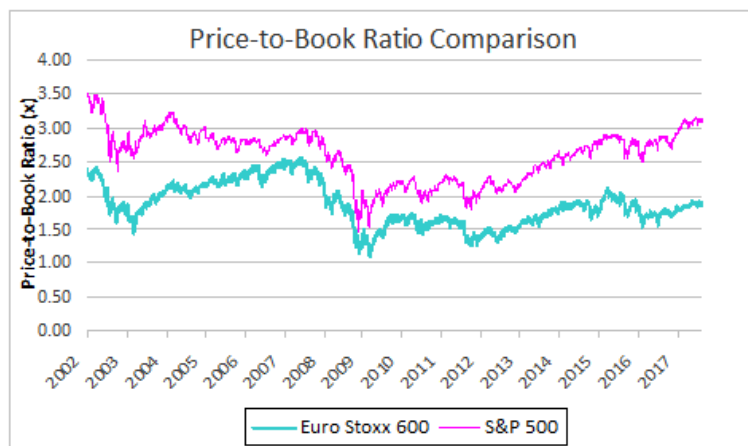
Book value however is systematically lower than market value, creating two types of indicators effectively that are not consistent (where the datapoints actually can be identified easily). Crucially, the question of which companies are listed and non-listed, is not arbitrary. For example, the stock market depth of Belgium (measured as market capitalization of domestic companies / GDP) is twice as high as that of Austria. France’s stock market depth in turn is about 50% higher than the Euro area average and three times that of Ireland.<sup>4</sup> Bond-issuing companies exposed to the standards for bond benchmarks in many EU member states will be systematically discriminated in these indexes simply as a result of operating in home markets where being listed is less attractive, relevant, or even viable.

Quantifying the exact nature of this ‘bias’ is difficult, especially since carbon data for non-listed companies in many cases is not reported nor estimated by ESG data providers. MSCI for example provides carbon data for 8,900 companies which covers a meaningful share of the market in terms of market capitalization but does not provide comprehensive coverage for fixed income markets. Moreover, the ratio between market to book value is not consistent, which again suggests that biases will systematically confuse the pictures as the market to book value spreads tighten during a crisis (like the one we face right now). In Europe, price to book ratios oscillate around a factor of 2, meaning listed companies on average would have twice the value for the equity part of the enterprise value as non-listed companies (see Fig. below).<sup>5</sup> For US shares, that delta is even higher.

The chosen indicator thus will render GHG intensities of non-listed companies – concentrated in Central and Eastern Europe – upwards of 30-50% higher purely as a result of inconsistent accounting practices, rather than the real underlying climate-friendliness. Indeed, a review of power companies revealed that emissions intensities over unit of output were almost identical between listed and non-listed power companies in Europe (n=43).

**Solution:** Emissions trajectories should be calculated using real economic outputs as denominators and be sector specific – in line with leading initiatives (Science-based Targets, PACTA, Katowice Banks).

Figure 4 Price to Book Ratio of S&P 500 and STOXX600 (Source: SeekingAlpha)



<sup>4</sup> <https://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?view=map>

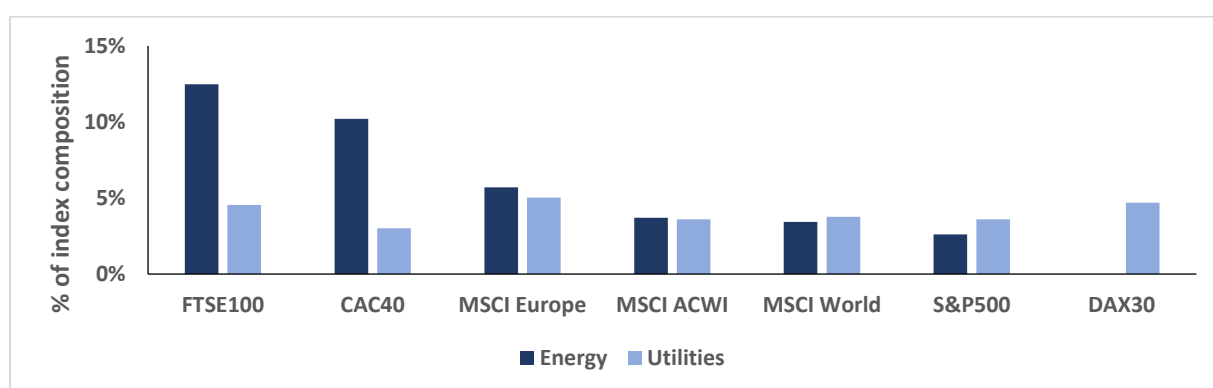
<sup>5</sup> <https://seekingalpha.com/article/4099971-europe-historically-cheap-to-u-s>



## 5. THE 7% TARGET IS NOT SCIENTIFIC AND MAY NOT LEAD TO “PARIS ALIGNMENT”.

The 7% economy decarbonization is an aggregate target in an economic scenario taking into account the entire economy. An index in capital markets does not have that exposure and thus does not necessarily share that target. For example, the industrial sector is responsible for around 18% of global CO2 emissions,<sup>6</sup> but only represents ~7% of Scope 1 +2 emissions in stock markets.<sup>7</sup> Transport is ~24% in turn, but only in low single digits in stock markets. This is obviously driven by the reality that 90% of road transport emissions are in Scope 3 and thus not captured (see next section). However, even when considering this, the reality is that the 7% reference point is inconsistent with capital markets. Even within capital markets, different compositions lead to different prominence of sectoral emissions. In the United Kingdom, fossil fuel companies represent a double-digit share in the FTSE 100, whereas in Germany, fossil fuel companies are essentially absent on the stock exchange. The picture below shows the wide variation in exposures to the energy and utility sector across a sample of major international and European indexes.

Figure 5 Sector exposures of major European and international indexes (Source: Authors, based on index factsheets)



This point is not trivial. A simple simulation demonstrates this. We simulated 2,000 portfolios consisting of 5 components (industry, buildings, transport, power, other transformation), using the IEA breakdown of how much they need to decarbonize. We then used the relative year on year decarbonization required from these different components – prescribed by the IEA SD scenario and scaled to the IPCC ambition level (table on right).<sup>8</sup> The index simulation was constrained in line with the sectoral constraints prescribed by the TEG guidance to avoid misleading results. The simulation involved different assumptions about the weight of each component in the total carbon footprint of the index.

“Component”	YoY reduction
Industry	-4%
Transport	-5%
Buildings	-5%
Power	-11%
Other	-9%

In ~25% of simulated indexes, the index did not reach the required 7% aggregate reduction at index level despite the fact that it decarbonized in line with the sector decarbonization targets for each individual sector. On the other hand, over 60% of simulated indexes were able to meet the 7% goal with 0% decarbonization in the building sector. 5% of indexes were still able to meet the 7% goal without decarbonizing the transport sector. In short, indexes with higher exposure to the utilities sector are likely to find it systematically easier to achieve the reduction targets in the short-term. Indexes in turn with large exposures to industry (meaningful sectors again in Central and Eastern European stock markets in particular) will find it systematically more difficult to achieve the 7% reduction.

**Solution:** Emissions trajectories should be sector specific – in line with leading initiatives (Science-based Targets, PACTA, Katowice Banks).

<sup>6</sup> <https://www.eurotrib.com/story/2006/6/29/1163/62572>

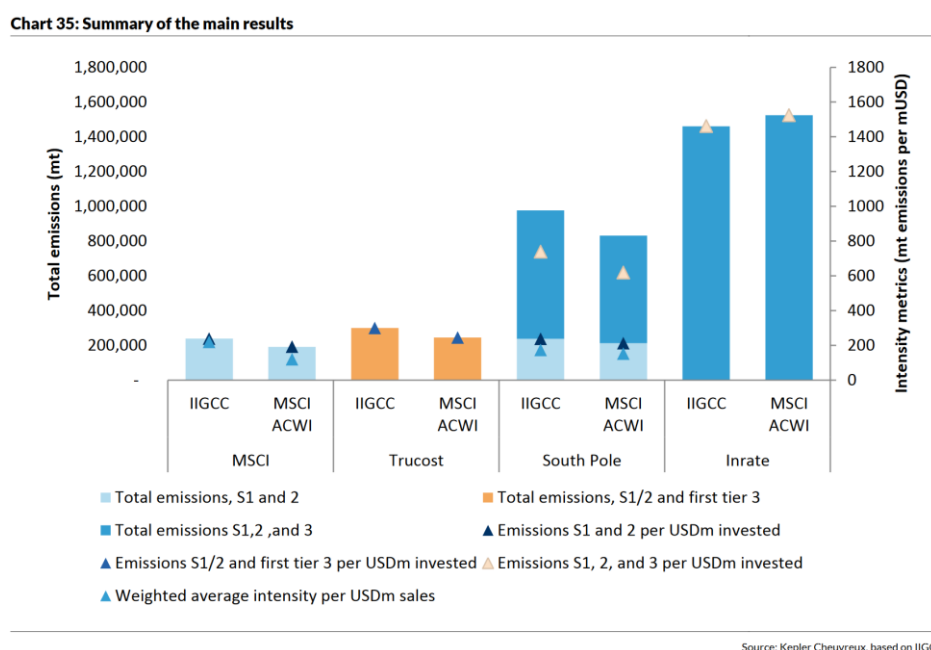
<sup>7</sup> Exane (2015) “Climate Change ‘15”

<sup>8</sup> The two scenarios are not exactly aligned in terms of overall ambitions level and year-on-year emissions reduction as a result of carbon budgets and assumptions around negative emissions, as well as speed of transition. However, they illustrate the point.

**6. SCOPE 1 AND SCOPE 2 DATA DOES NOT EXIST COMPREHENSIVELY FOR NON-LISTED COMPANIES. EVEN FOR LISTED COMPANIES, DATA GAPS MAKE THE MEANINGFUL DISCRIMINATION OF COMPANIES BASED ON THEIR CARBON FOOTPRINT IMPOSSIBLE**

In a study from 2016, the Institutional Investors Group on Climate Change conducted a systematic review of the carbon footprint profiles across four major data providers. Across the profiles, not only did results differ dramatically, the headline result was not consistent as to which of two portfolios had a lower carbon footprint. While there have been significant further developments in the models and methodologies by data providers since, there is no evidence that the actual underlying comparability between data providers has improved. Moreover, such high degree of divergence for listed companies is likely to be even more pronounced for non-listed companies. **The variations in estimates matter since over 50% of listed companies still do not report their Scope 1 and Scope 2 emissions, with an even lower percentage reporting Scope 3.**

Figure 6: Comparison of financed emissions approaches across providers (Source: Kepler Cheuvreux 2015).<sup>9</sup>



Data providers will develop estimation models (if they do not already have them) for Scope 3 emissions and thus technically comply with the guidance. Both the quality and comparability however will be so low, that these models won't be useful for steering. For example, carbon footprint data of one major index provider suggests that Scope represents around 30-40% of Scope 3 emissions, when the actual share is closer to 80-90%.<sup>10</sup> Even if data quality improves in Europe due to regulation, this won't materially affect the landscape for global investors, in particular since data quality in Europe is already arguably highest in relative terms. Policy cannot simply mandate data to exist where it does not exist. Limiting analysis to Scope 1 and Scope 2 is permissible in the short term, suggesting that data here is at least comparable. But even here, differences between estimation models are significant, upwards of 30-50% when looking at the IIGCC analysis. As a result, even if we assume enterprise value (the "denominator") does not create biases, comparison of companies based on the numerator are not decision-useful.

**Solution:** Make data quality and error minimization a specific constraint in the index design and regulation to ensure that data gaps are not simply "estimated away" using imprecise emissions estimates, and leave the choice open to "technology indicators" where possible, which are less prone to data uncertainty.

<sup>9</sup> <https://www.iigcc.org/download/carbon-compass-investor-guide-to-carbon-footprinting/?wpdmdl=1512&refresh=5ea6a419b725e1587979289>

<sup>10</sup> [https://www.goldstandard.org/sites/default/files/documents/draft\\_-\\_scope\\_3\\_best\\_practices\\_v1.5.pdf](https://www.goldstandard.org/sites/default/files/documents/draft_-_scope_3_best_practices_v1.5.pdf)

**7. THROUGH THE PACTA PROJECT, THE EU HAS INVESTED OVER €4 MILLION IN R&D TO DEVELOP INDICATORS THAT COULD INFORM THE GUIDANCE DEVELOPED BY THE TEG, BUT THE FINAL GUIDANCE DIRECTLY CONTRAVENES THE FINDINGS OF THAT RESEARCH PROGRAMME.**

*Note: This section discusses a research programme led by the authors of this note. While introducing this aspect could be considered to represent “lobbying” for their own research, the discussion is not designed to make the case for using the author’s research per se, but rather surfacing a broader issue around EU funding for R&D that takes place on technical merits as opposed to criteria and guidance which is developed in a potentially politicised setting.*

Since 2015, the EU has funded a number of research projects led by the 2° Investing Initiative under the H2020 and LIFE Action grants, as well as more broadly through the LIFE NGO Operating Grant.<sup>11</sup> These projects are still funded by the EU with over €4 million in R&D invested to date. The EU has just recently agreed to extend funding by another three years. One explicit objective of these projects was and is to help inform Paris-aligned index design, which constitutes a deliverable across two EU-funded grants.

The outcome of these projects – the “PACTA model” – is designed to measure consistency of financial portfolios with climate scenarios. It is the leading model used by the private sector worldwide, road-tested by over 800 financial institutions around the world, applied by major financial supervisors in Europe and abroad (e.g. EIOPA, Sweden Finansinspektionen, Japanese Financial Services Agency), and supported by large industry associations (e.g. UN Principles for Responsible Investment<sup>12</sup>). It underpins a major European climate alignment initiative supported by a range of European governments (e.g. Austria, Sweden, Luxembourg). The model is endorsed by a group of leading European banks (ING, BNP Paribas, Societe General, BBVA, StandardChartered<sup>13</sup>), and supported by significant NGOs (WWF<sup>14</sup>, InfluenceMap<sup>15</sup>). The model methodology has also been published in peer-reviewed academic journals,<sup>16</sup> as have the criticisms of the approach chosen here.<sup>17</sup> However, the final guidance developed by the TEG directly contravenes the technical findings of these research programmes which were apparent as early as 2015.<sup>18</sup>

As outlined above, the authors of this note are also affiliated with and have personally led these research projects. Our intention here is not to lobby for our own research but rather identify an apparent inconsistency in EU institutional policy development and decision making whereby €4 million of EU funding for R&D to develop an open-source, IP-rights free, freely replicable and 100% comparable standard and model to measure Paris Agreement-alignment has not informed the final guidance developed by the TEG.

We do not expect our research or any other EU- or member-state funded research to be adopted blindly. However, it is important in our eyes that deviation from EU funded research outputs needs to be evidence-based and well-justified. As governments and financial institutions in Europe and around the world are increasingly endorsing PACTA as a way to move forward on measuring Paris Agreement alignment, it begs the question why the EU as the primary funder of this work is moving away from the research it funded.

**Solution:** *Establish procedural safeguards (e.g. in Better Regulation Guidelines) to ensure all relevant EU funded research (including research funded by its member states) is considered and that any departure from these research outputs is clearly articulated and justified. Ensure that financial conflicts of interest are prevented or reduced to a minimum in technical processes and address associated potential regulatory capture.*

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<sup>11</sup> Notably the H2020-funded *SEI Metrics Project* and the LIFE Action *Paris Agreement Capital Transition Assessment* project.

<sup>12</sup> [www.transitionmonitor.com](http://www.transitionmonitor.com)

<sup>13</sup> [https://group.bnpparibas/uploads/file/katowice\\_commitment\\_letter.pdf](https://group.bnpparibas/uploads/file/katowice_commitment_letter.pdf)

<sup>14</sup> <https://www.wwf.eu/?339951/How-well-are-European-asset-owners-portfolios-aligned-with-the-Paris-Agreements-climate-goals>

<sup>15</sup> <https://influencemap.org/report/FinanceMap-Launch-Report-f80b653f6a631cec947a07e44ae4a4a7>

<sup>16</sup> <https://www.emerald.com/insight/content/doi/10.1108/JAAR-03-2018-0034/full/html> &

<https://www.tandfonline.com/doi/full/10.1080/20430795.2019.1673142>

<sup>17</sup> <https://www.mdpi.com/2071-1050/10/2/328/htm>

<sup>18</sup> [https://www.unepfi.org/fileadmin/documents/climate\\_strategies\\_metrics.pdf](https://www.unepfi.org/fileadmin/documents/climate_strategies_metrics.pdf)

## 8. WHAT IS THE SOLUTION?

In developing the guidance, the TEG largely ignored the current market standards under development or already developed (SBTi, ISO 14097, TCFD) and related leading initiatives (PCAF, PACTA, CA100), none of which endorse GHG intensity using enterprise value as a way to discriminate companies or set portfolio targets.

The current draft guidance from the SBTi for financial institutions in turn suggests target-setting should be sector-specific, something that the PCAF partner (Guidehouse) and the PACTA approach developed by 2° Investing Initiative both support. Sector-specific target-setting is also at the heart of the Science-based Targets Initiative for companies (SDA),<sup>19</sup> and the CA100+ indicators.<sup>20</sup>

The following options should be considered:

- Requiring the index to meet sector-based decarbonization targets as defined by relevant market initiatives (SDA, PACTA) across a minimum number of climate-relevant sectors to which the index is exposed.
- Leaving open the choice of indicator between technology and emissions metrics (consistent with the conclusion of the European Parliament to no longer focus on emissions, but rather the more holistic concept of Paris Agreement alignment).
- Potentially suggesting more qualitative targets for out of scope sectors or additional thresholds like those that the TEG has defined for fossil fuels.
- Require a tracking of real-world emissions reductions of current and former index constituents.

More broadly, the current policy process suggests that the next steps of the EU Sustainable Finance Action Plan would benefit from a more evidence-based approach to policymaking designed to ensure that policies maximize the impact on achieving the objectives of the Green New Deal and the Paris Agreement.

These options are actionable, do not require a phase-in of data that does not exist (and is unlikely to exist in a meaningful, steering-useful way for the timeline suggested), are consistent with the market-leading initiatives on target-setting already as well as government initiatives, and the scenario analysis work of EIOPA<sup>21</sup> and financial supervisors around the world.

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<sup>19</sup> <https://sciencebasedtargets.org/wp-content/uploads/2015/05/Sectoral-Decarbonization-Approach-Report.pdf>

<sup>20</sup> <http://www.climateaction100.org/>

<sup>21</sup> <https://www.eiopa.europa.eu/content/workshop-climate-change-related-risks>