
UCITS 2023 Webinar Series

# Benchmarks – latest regulatory trends and developments


# Agenda

1. Funds & Benchmarks
2. BMR Reform
3. ESG & Benchmarks
    1. How can an “ESG fund” reference benchmarks?
    2. Focus on CTB/PABs
    3. Should an EU ESG benchmark be created?
4. Q&A

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26/06/2023

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# Funds & Benchmarks

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# Introduction

**Benchmarks – multiple possible uses for EU funds (subject to specific regimes)**

- Law of 17 December 2010 and Grand Ducal Regulation of 8 February 2008
- ESMA Guidelines on ETFs and other UCITS issues
- PRIIPs regulation as interpreted by the ESMA UCITS Q&A
- The ESMA Guidelines on performance fees
- Regulation (EU) 2016/1011) (the "**Benchmarks Regulation**" or "**BMR**")

# Focus on Benchmarks Regulation

## Regulation (EU) 2016/1011

Main focus of the BMR:

benchmark “administrators” - entities who put the benchmarks together and publish them, e.g. Thomson Reuters, MSCI Limited

Also applies to “contributors” and “users”, including funds and their managers

# What is a "benchmark" within the meaning of the BMR?

**"Benchmarks" are defined as:**

"Indices" *i.e.* figures which are:

- published or made available to the public; and
- regularly determined (i) by the application of a method of calculation (incl. formula) or by an assessment and (ii) on the basis of values / (estimated) prices / (estimated) rates / quotes and committed quotes / other values or surveys

Used within the meaning of the BMR

# When is a fund a “user” of benchmark under the BMR?

**Where a fund:**

- tracks one or several benchmarks
- computes the performance fee paid to the manager on the basis of a benchmark
- defines its asset allocation with reference to a benchmark
- enters into certain types of derivative contract

# Key obligations for users

- Obligation not to use “non-compliant benchmarks”
- Obligation to have written plans setting out action to be taken, if the benchmark used materially changes or ceases to be available (the “**Contingency Plans**”)

  *Since 1st of January 2018*
- Obligation to reflect the Contingency Plans in the contractual relationship with clients

  *Since 1st of January 2018*
- Obligation to include disclosures on the status of the administrator (UCITS only)

  *Since 1st of January 2019*

*Luxembourg*: CSSF BMR Questionnaire should be filled in and submitted for each regulated fund

# Use of non-compliant benchmarks / timeline

**Cease using benchmarks provided by EU administrators who are not authorised under the BMR or benchmarks provided by non-EU administrators who are:**

- not located in an equivalent jurisdiction (currently only Singapore and Australia); or
- not individually recognised unless the third country benchmarks are endorsed under the BMR by an EU authorised administrator:

| | |
|---|---|
| For non-EU benchmarks | *No time limit* but ***no new use*** of non-compliant benchmarks after *31st of December 2023* |

# Third country regime – state of the market

## Non-EU benchmarks widely used in the EU

What about the equivalence, endorsement and/or individual recognition regimes?

86 administrators in the ESMA register (as at 21 June 2023):

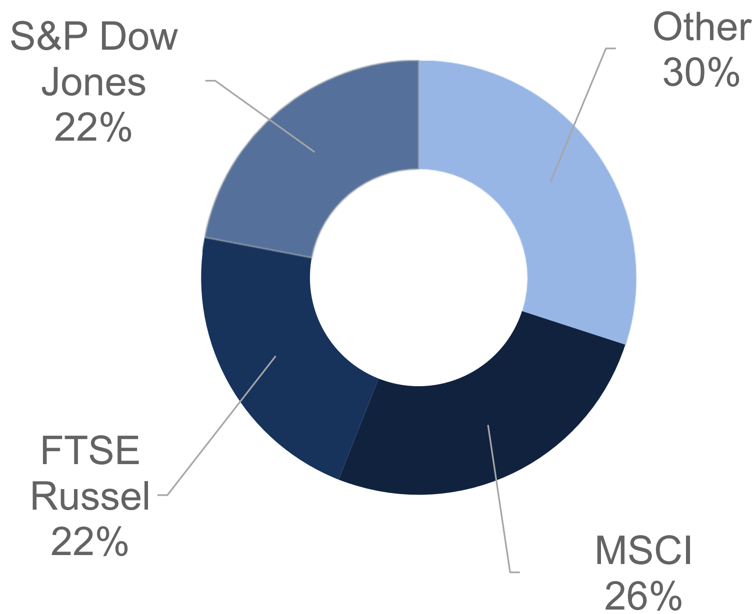
- Endorsed under Art. 33: **2**
- Equivalence: **2** (Australia and Singapore);
- Recognised under Art. 32: **10**

# Administrators – state of the market

Overall in 2021, 3 administrators take the majority of market share of this $5bn market (FT):

MSCI - $1.3bn – NY HQ
S&P Dow Jones - $1.1bn – NY HQ
FTSE Russel $1.1bn – London HQ

## 2021 Global Index industry market share




*Source: Financial Times*

# BMR Reform

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# BMR Reform – key elements

**2019: Public consultation by the European Commission in view of a report to the European Parliament and Council**

- Critical benchmarks
- Authorisation and registration process
- Scope of the BMR
- ESMA register
- Benchmark statement
- Supervision of climate-related benchmarks (PAB and CTB)
- Commodity benchmarks
- Third-country benchmarks

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# Third country regime – which evolution is possible?

## What next for non-EU benchmarks?

Extension of the grandfathering period to be confirmed

**2022 Proposal**: only about third country benchmarks?

- Reforming the access for non-EU administrators
- Reducing the scope of the BMR
- Introducing an ESG benchmark label

# ESG & Benchmarks

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# A bit of ESG-related data

In 2022, number of ESG benchmarks surpassed 50,000 (around 10% of the total offering).

**ESG indices are on the rise:**

- Revenue collected by ESG indices grew 123% in 2021 from the previous year
- By comparison, revenue from factor indices increased by 32%, and revenue from traditional equity indices grew by 20%

**Demand driven by several factors:**

- Increased demand for passive ESG funds
- Increasingly used by IFMs as a reference for the composition of their portfolio
- Increasingly used by IFMs for ESG performance comparison purposes
- Regulatory initiatives – EU PABs and EU CTBs

*Sources: IIA survey, November 2022; Morningstar, 2023; EC Final report on ESG BMR, December 2022*

# A bit of ESG-related data

As of March 2023, the market share of passive funds classified as Article 8 and 9 SFDR represented respectively 11,1% and 6,1%.

Market share of Article 9 passive funds shrunk from 24,1% in September 2022 to 5,1% in December 2022.

*Sources: IIA survey, November 2022; Morningstar, 2023; EC Final report on ESG BMR, December 2022* arendt

# Focus on EU PABs & EU CTBs (1/2)

| Minimum Standard | EU Climate Transition Benchmarks | EU Paris-Aligned Benchmarks |
|---|---|---|
| 1,5 °C | The 1,5 °C scenario, with no or limited overshoot, referred to in the Special Report on Global Warming of 1,5 °C from the Intergovernmental Panel on Climate Change (IPCC) should be used as the reference temperature scenario to design the methodology to construct the portfolio. | |
| Year-on-year self-decarbonization | The decarbonisation trajectory shall have a target of at least 7 % reduction of GHG intensity on average per annum. | |
| Relative decarbonization | The GHG intensity or, where applicable, absolute GHG emissions, including Scope 1, 2 and 3 GHG emissions, shall be at least 30 % lower than the GHG intensity or absolute GHG emissions of the investable universe. Scope 3 GHG emissions shall be construed in accordance with the phase-in implementation period as referred to in the article 5 of the Regulation 2020/1818. | The GHG intensity or, where applicable, absolute GHG emissions, including Scope 1, 2 and 3 GHG emissions, shall be at least 50 % lower than the GHG intensity or absolute GHG emissions of the investable universe. Scope 3 GHG emissions shall be construed in accordance with the phase-in implementation period as referred to in the article 5 of the Regulation 2020/1818. |
| Allocation constraint | Aggregated exposure to sectors highly exposed to climate change issues is at least equal to the aggregated exposure of the underlying investable universe to those sectors. (cf. sectors listed in Sections A to H and Section L of Annex I to Regulation No 1893/2006, including the oil, gas, mining and transportation sectors) | |
| | the following exclusions should be applied :<br><br>1- companies involved in any activities related to controversial weapons, as referred to in international treaties and conventions, United Nations principles and, where applicable, national legislation;<br><br>2- companies involved in the cultivation and production of tobacco;<br><br>3- companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises;<br><br>4-Companies that are found or estimated by the administrator or by external data providers to significantly harm one or more of the environmental objectives referred to in the EU Taxonomy, in accordance with the rules on estimation laid down in the article 13(2) of the Regulation 2020/1818 | the following exclusions should be applied :<br><br>1- companies involved in any activities related to controversial weapons, as referred to in international treaties and conventions, United Nations principles and, where applicable, national legislation;<br><br>2- companies involved in the cultivation and production of tobacco;<br><br>3- companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises;<br><br>4-companies that derive 1 % or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite;<br><br>5- companies that derive 10 % or more of their revenues from the exploration, extraction, distribution or refining of oil fuels;<br><br>6-companies that derive 50 % or more of their revenues from the exploration, extraction, manufacturing or distribution of gaseous fuels;<br><br>7- companies that derive 50 % or more of their revenues from electricity generation with a GHG intensity of more than 100 g $CO_2$ e/kWh.<br><br>8- Companies that are found or estimated by the administrator or by external data providers to significantly harm one or more of the environmental objectives referred to in the EU Taxonomy, in accordance with the rules on estimation laid down in the article 13(2) of the Regulation 2020/1818 |

# Focus on EU PABs & EU CTBs (2/2)

**interplay between these benchmarks and the Article 9(3) SFDR.**

## **SFDR level I – March 2021** ~ The beginning

*"Where a financial product has a reduction in carbon emissions as its objective, the information to be disclosed […] shall include the objective of low carbon emission exposure in view of achieving the long- term global warming objectives of the Paris Agreement. […] where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark […] is available, the information referred to in Article 6 shall include a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement."*

## **EC's first SFDR Q&A – July 2021** ~ A time of uncertainty

*"By virtue of Article 9(3) of Regulation (EU) 2019/2088, the objective of 'a reduction in carbon emissions' is a specific category of 'sustainable investment' and, consequently, must comply with point 17 of Article 2."*

*"It follows from Article 9(3) of Regulation (EU) 2019/2088 that the implementation of minimum standards, […], by benchmark administrators, for the construction of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, must ensure compliance with point 17 of Article 2 of Regulation (EU) 2019/2088."*

*"where an EU Climate Transition Benchmark or EU Paris-aligned Benchmark exists, a financial product must be tracking these."*

## **SFDR level II – January 2023** ~ Reality kicking in

*"asset managers noted that the underlying indexes were not designed to include only sustainable investments as defined by SFDR; therefore, the funds couldn't keep their Article 9 classification." (Morningstar, January 2023)*

## **EC's third SFDR Q&A – April 2023** ~ The clarifications

*"[…] these products are deemed to have sustainable investments as defined in Article 2, point (17) SFDR as their objective."*

## **Today** ~ Some questions remain

- If a passive fund tracking an EU PAB/CTB automatically qualifies as Article 9, what happens with the SI assessment?
- Doesn't that create an unlevel playing field with other Article 9 products?
- Isn't it confusing for retail investors?

**Majority of the market is taking a "wait and see" approach**

# ESG benchmarks and the broader SFDR framework

**Other uses of ESG benchmarks under the SFDR:**

- ETFs tracking ESG benchmarks
- Active funds relying on ESG benchmarks for the composition of their portfolio
- Active funds relying on ESG benchmark to showcase the effectiveness of their commitments

# Which obligations for benchmarks administrators?

Differences existing between disclosures required at the level of the benchmark and at the level of the fund

Art. 9.3 funds and role of the benchmark administrator with regard to the strategy

What about administrators' liability towards investors?

# Should an EU ESG Benchmark be created?

- The EC is exploring the possibility of introducing an EU ESG benchmark Label
- A feasibility study was being carried out in 2022, highlighting shortfalls and best practices
- Feedback on the relevance of creating such label was rather mixed
- The suggested approaches were designed with a view to facilitating disclosures under Article 8/9 SFDR
- The study foresees a combination of mandatory labels and a voluntary label


# Q&A

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