



# **Sustainable Finance: The European Commission publishes Guidelines to disclose non-financial information related to climate and presents three reports from the Technical Expert Group on taxonomy, green bonds standards and benchmarks. October 2019.**

## **Background: European Commission Action Plan**

On 18 June 2019, the European Commission published Guidelines to disclose non-financial climate information and submitted three reports from the Technical Expert Group, two of them on legislative proposals regarding taxonomy and benchmarks and a third on green bonds standards.

These Guidelines and reports are framed within the **Commission's Action Plan** for a greener and more sustainable economy. This Plan was presented in March 2018 and is part of the efforts by the Capital Markets Union (CMU) to link finance with the specific needs of the European economy for the benefit of the planet and our society. It is also one of the main measures for the implementation of the 2015 Paris Agreement on Climate Change and the United Nations 2030 Agenda for Sustainable Development.

One of the pillars of the Action Plan is the development of a **classification system (taxonomy)** with the objective of establishing a common language for sustainable finance that defines which activities and products can be considered sustainable and, at the same time, identifies the areas in which sustainable investment can have the greatest impact.

Another essential element of the Action Plan is the improvement of the **transparency of corporate reports**, therefore the Guidelines on non-financial information have been revised to include specific recommendations on the disclosure of **climate-related information**.

Another point is the publication of an **EU green bond standard** that provide legal security to the investor and that help avoid practices such as "greenwashing".

Finally, the Commission considers it important to modify the **Benchmarks Regulation** to increase the transparency of the methods and characteristics of the reference indices referring to sustainability factors so that users can receive more accurate information. In addition, this initiative aims to harmonise criteria and establish clear standards for those benchmarks whose members are committed to the objectives of the Paris Agreement to mitigate climate change.

The Guidelines and other documents presented in June have been prepared by a Technical Expert Group (TEG) designated by the Commission to develop the legislative proposals planned to develop the Plan. The expectation is to finish work by December 2019.

## Guidelines on reporting climate-related information

These Guidelines are intended to guide companies to present non-financial climate-related information in a relevant, useful, consistent and comparable manner. Its purpose is to complement the Guidelines on non-financial reporting adopted by the Commission in 2017 and contain non-binding recommendations, that is, they do not create new legal obligations. In addition, they integrate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), set up by the Financial Stability Board.

Companies that make use of these guidelines can also continue to use existing recommendations, principles and standards in different international frameworks, such as: the Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC), as well as the EU Eco-Management and Audit Scheme (EMAS).

It is estimated that around 6000 companies, banks and insurance companies that are publicly traded in the EU and are required to disclose non-financial information under the Non-Financial Information Directive may benefit from these recommendations.

Likewise, the Commission Guidelines on non-financial reporting that contain six key principles for good non-financial information must be taken into account, namely that the information disclosed is:

- 1) material;
- 2) fair, balanced and understandable;
- 3) comprehensive but concise;
- 4) strategic and forward-looking;
- 5) stakeholder-orientated; and
- 6) consistent and coherent.

Finally, companies that follow these Guidelines will take into account the supplementary guidelines for the financial sector and companies that operate in the energy, transport, material and construction, agriculture, food and forest products sectors, as well as the corresponding sector legislation.

It is worth highlighting the recommendation regarding the principle of double materiality, already included in the 2017 Commission Guidelines on non-financial reporting, which must be taken into account when assessing the significance of non-financial data and considering a double perspective:

- a) The financial significance of climate-related information: How the evolution, the results and the situation of the company are affected by the climate. Information related to the weather should be presented if necessary to understand the evolution, results and situation of the company. This perspective is usually of the greatest interest to investors.
- b) The environmental and social significance, that is, the impact of the company's activities. Climate-related information should be presented if necessary to understand the external impacts of the company.

Companies should consider using the information that these Guidelines propose to disclose if they decide that the climate is a significant issue from either of these two perspectives.

Both risk perspectives already overlap in some cases and are likely to do so more and more in the future. As markets and public policies evolve in response to climate change, the positive or negative effects of a company on the climate will increasingly translate into business opportunities or risks that will be financially significant and from which, therefore, companies must also inform.

According to the Directive on non-financial information, information on environmental matters should, to the

extent necessary, include both the main risks to the evolution, the results and the company's situation arising from climate change, such as **main risks** of a negative impact on the climate stemming from the company's activities. The information proposed in these Guidelines reflects both risk perspectives.

It is also recommended to report the dependence of the **natural, human and social capital**, given that if, for example, the company has a strong dependence on natural capital (for example, agricultural production companies) because it is threatened by climate change, the company will be exposed to climate-related risks, especially those of a material nature. The same applies to companies with dependence on human or social capital.

As for the **proposed information structure**, the Guidelines propose to publish a series of climate-related data in each of the five areas listed in the Directive on Non-Financial Information: a) business model, b) due diligence policies and procedures, c) policy outcomes, d) principal risks and their management and e) non-financial key performance indicators.

In each area of information, the Guidelines recommend publishing a limited amount of data. Companies should consider applying the publication recommendations to the extent that the corresponding information is necessary in order to understand their evolution, their results, their situation and the impact of their activities.

### **Interim Report on Taxonomy**

Within the framework of the legislative proposal on a single taxonomy or classification system, the Technical Expert Group has developed a series of recommendations on technical indicators that allow the identification of economic activities that contribute to mitigate or adapt to climate change, while avoiding significant damage to other environmental objectives (protection of water and marine resources, transition to a circular economy, waste prevention and recycling, pollution prevention and control, protection of healthy ecosystems).

The main recommendations of the report are the following:

- Identification of defined technical criteria for 67 activities that may contribute to the mitigation of climate change in the following sectors: agriculture and forestry; manufacturing; electricity, gas, steam and air conditioning supply; water, sewerage, waste and remediation; transport; information and communication technologies; and buildings. In addition, indicators have been included to assess the absence of damage to other environmental objectives.
- A methodology with specific examples to assess the contribution to climate change adaptation.
- Guidelines and case studies to guide investors in their use of the taxonomy.

The report identifies three types of activities that may contribute significantly to mitigate climate change:

- Activities that are currently low on carbon emissions.
- Activities that may contribute to the transition to an economy with zero carbon emissions in 2050, but have not yet reached that level.
- Activities that contribute to the development of the previous two objectives.

The Technical Expert Group recommends in its Report that the taxonomy be easy to use, dynamic and flexible to adapt to market changes, to facilitate the transition to a greener economy and to be inclusive with respect to all economic sectors. The work by the Technical Expert Group on taxonomy has been extended until the end of 2019.

## **Report on EU Green Bond Standard**

This report responds to the need identified in the Action Plan to create standards and labels for green financial products. The report recommends, in particular, the adoption in the EU of a green bond standard with requirements for its issuance that allow comparability and promote the transparency of the product. It is a non-binding standard, of voluntary acceptance whose purpose is not only to achieve the comparability of green bonds, increase the transparency of the information provided to the public and the efficiency of the markets of this kind of bonds, but also the promotion of this market, both from the point of view of issuers and investors.

A broad definition of green bonds is proposed and includes any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer that is aligned with the EU Green Bond Standard.

The main elements of the report are the following:

- 1) Alignment with the taxonomy, that is to say, that green bonds must comply with the criteria established in this in such a way that they finance activities that contribute to the environmental objectives defined by the taxonomy, do not significantly harm any of it and respect minimum social safeguards.
- 2) Publication of a Green Bond Framework, that confirms the acceptance of this voluntary standard, explains how the issuer's strategy is oriented towards the fulfilment of the environmental objectives and provides information on the allocation of the funds obtained, the processes, and reporting of the green bonds.
- 3) Mandatory reporting: The obligation to publish information on the allocation of the funds obtained and the impact on the environment.
- 4) Mandatory verification: The obligation to verify the green bond framework and a final allocation report on the use of the funds obtained by an independent third party. In relation to these external verifiers, the Technical Expert Group recommends an accreditation regime (and proposes that the European Securities and Markets Authority - ESMA - be the body in charge of this function) and supervision.

The Technical Expert Group recommends and gives specific guidance for the Commission and EU governments to develop measures that favour the adoption of this green bond standard.

Since the summer, the Technical Expert Group has continued to work on this project to develop in more detail the regime of independent verifiers and to ensure the consistency of this standard with other initiatives (taxonomy, ecolabel and ISO work) and avoid any contradictions that could harm the objective of harmonisation.

## **Interim Report on Benchmarks**

Finally, the third report presented develops proposals to modify the existing legislation on EU benchmarks. Already in February, the co-legislators agreed to introduce: a) two new categories of benchmarks: the EU CTB Climate Transition Benchmarks reserved for indexes that select companies that show a reduction of carbon emissions trajectory and the EU PAB Paris-Aligned Benchmarks, a category reserved for indexes that select only companies that contribute to the limitation of long-term global warming and b) information obligations on environmental, social and good governance (ESG) factors for all indices, except those of interest rates and currencies.

In the June report, the Technical Expert Group presents its recommendations on the minimum technical requirements for the two new categories of benchmarks and on obligations to disclose ESG (environmental, social and governance)-related information. Several conditions are proposed for a benchmark to belong to any of the two new categories; the main ones are as follows:

- Ability to demonstrate a significant reduction in the intensity of total greenhouse gas emissions with respect to the underlying investments or major indices.
- Have a minimum exposure to important sectors in the fight against climate change.
- And finally, they must demonstrate their ability to reduce the intensity of their own greenhouse gas emissions on a year-on-year basis.

Regarding the obligations of information on ESG elements, the Technical Expert Group proposes that the administrators of conventional indexes explain how their methodology has taken ESG factors into account and the declaration that they must submit in accordance with Article 27 of the Benchmarks Regulation must incorporate information on how these factors have been taken into account for the different types of underlying assets.

Ultimately, it is about improving the transparency of information, in particular regarding temperature variation scenarios, the sources of information and the methodology used to assess how a specific index adapts to a given temperature variation scenario.

In September, the Technical Expert Group is expected to issue another report that includes the responses to the public consultation conducted during the summer in relation to the two new categories of indexes and information obligations. The final report will be the basis of a series of delegated acts that the Commission will prepare and adopt, initially, at the beginning of next year.

All these actions reveal the EU's commitment to the objectives of the Paris Agreement and the need to recognise the important role that financial markets have in moving towards a more sustainable economy and society.

**Links of interest:**

[Press release](#)

[Commission Guidelines on reporting climate-related information](#)

[Interim Report on the Taxonomy](#)

[Report on rules for the issue of green bonds](#)

[Interim Report on Benchmarks](#)