Feedback on the draft delegated regulation as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks

Eumedion, representing the interests of around 50 Dutch and non-Dutch institutional investors who have more than € 5 trillion assets under management, welcomes the opportunity to give feedback. Although Eumedion supports the overall objectives of the draft delegated regulation, we would like to draw attention to several considerable issues regarding the proposed minimum standards for the new categories of EU climate benchmarks.

Safeguarding data quality

Eumedion would like to point out that the proposed composition of both the CTB and the PAB is dependent on factors for which there is not yet an independent authoritative standard setter and for which there are quite limited safeguards in terms of audit. The same issue on safeguarding data quality is also relevant also for the general ESG disclosures on benchmarks. We therefore propose to the Commission to explicitly include measures for safeguarding consistency, comparability and quality of data, both regarding the disclosure of information for the climate benchmarks and for the general ESG-disclosures.

Measuring GHG intensity with enterprise value

The EC provides a calculation method for GHG intensity, using Enterprise Value (EV) as a denominator. Eumedion favours EV as a denominator in the reporting of GHG intensity. This ratio can be seen as a 'cost / benefit' ratio, where GHG are the costs and EV is a proxy for benefit. Unlike measures like (operating) profit, EV cannot turn negative and it is a good and more stable indicator of long term value added ('benefit'). We do note that it would be more intuitive to *exclude* cash from the calculation of the EV as cash is generally regarded as non-operating and is netted with gross debt for the purpose of the calculation of enterprise values. We would like to highlight that for financial institutions (banks, insurance companies, lenders) the concept of EV is widely recognised as not resulting in meaningful outcomes. The key difference is that for non-financial institutions debt is a non-operating item, whereas for financial institutions financial assets and financial liabilities are part of their operations. This is illustrated by how financial institutions account for their gross margin which includes the difference between interest income and interest expense. Investors therefore do not calculate enterprise values for financial institutions since these are meaningless. Instead, investors take the market value of equity for financial institutions. We urge the EC to mirror this common practice of using market value of equity for financial institutions in the context of measuring GHG intensity as well. From an investor perspective, the current approach could unduly balloon the denominator by 20 times for financial institutions. This would result in excessive leverage to be rewarded with a lower carbon intensity.

We are aware of the following shortcoming of the GHG / EV ratio. It unduly favours high growth companies to the extent to which the valuation of such company is higher than a comparable low growth company. However, the shortcomings of the alternative GHG / Sales ratio are much more problematic. Sales are an inferior indication for value added ('benefit'). Valuation metrics like Price to Sales are renowned for varying greatly even within sectors and being useless for valuation purposes. Two companies that have equal sales and equal GHG emissions should not be treated equally if the value added (benefit) of the one company is minute and the other is high. We therefore favour GHG / EV. Another drawback of using GHG / EV is that it is not aligned with the TCFD reporting recommendations, which do rely on sales. We consider the problems identified with using sales as a denominator to be so fundamental that it would be appropriate for the TCFD to reconsider its methodology as well.

Y-o-y decarbonisation rates

Eumedion questions the feasibility of a yearly accurate measurement of decarbonisation year-on-year and is therefore of the opinion that the decarbonisation target of 7% should be measured as a compound annual decline rate over three years.

Avoiding confusion between EU climate benchmarks and other types of ESG-focused benchmarks

Eumedion recognises the potential value of the CTB and PAB to the transition to a low-carbon economy. However, given the 'transitional' and 'relative' character of these benchmarks and that they are not necessarily 'sustainable' or 'green' benchmarks in an absolute sense, Eumedion would like to stress the importance of maintaining a clear distinction between the new EU climate benchmarks and various other types of ESG-oriented benchmarks available in the market today. Undesirable and potentially damaging side effects due to a listed company's exclusion from the new EU climate benchmarks must be actively avoided, such as unintended reputational damage for green companies already further on the path of decarbonisation or even for investors in these companies.[1]

Such a need for a clear distinction between and/or labelling of the new EU climate benchmarks and other ESG-focused benchmarks is unfortunately also underlined by the proposed additional exclusion-criteria for a PAB, e.g. on tobacco. This approach, though with noble intentions, contributes to the perception of a PAB as an overall sustainable benchmark (e.g. not only in terms of environmental performance), while it is not per se. Eumedion would like to note that, first of all, in the absence of a clearly defined (harmful and do-no-harm) framework on social factors, the proposed addition of social exclusion-criteria seems at best a random and arbitrary selection of (potential) material sustainability factors. Secondly, Eumedion fails to understand why such exclusion criteria should ONLY apply to the PAB and not to the CTB. A higher level of ambition on environmental issues (PAB) not automatically implies a higher level of ambition regarding other, unrelated sustainability issues. In the worst case, such an approach even reduces the credibility of EU climate benchmarks as thought-through instruments for transition.

[1] The urgency of this issue is underlined by e.g. the Dutch Central Bank's review of climate risks for pension funds, which are expected to materialise not only through stranded assets but also through reputational damage.