

Scientific Beta warns against design flaws in European Commission proposals on Climate Benchmarks and Sustainability Disclosures

This draft regulation makes the weights of stocks in the new climate indices depend more on their stock market performance than on their ecological performance

In the context of the ongoing consultation on the draft delegated acts implementing the November 2019 update of the EU Benchmarks Regulation, the smart beta index provider Scientific Beta takes exception to key provisions of the European Commission's projects and puts forward remedial proposals.

In a [letter dated May 4 addressed to the European Commission](#) in response to the call for feedback that it carried out on these draft delegated acts, and which will also be sent to the European Council and the European Parliament, Scientific Beta criticises the lack of a serious study and the significant flaws in this draft regulation. In particular, Scientific Beta worries about the substitution of enterprise value for revenues in the definition of carbon intensity, which introduces capital market biases (e.g. real estate development, software, and online retailing will be particularly favoured) and instability into carbon metric measurement. It observes that the dramatic rise in carbon intensity sustained by index products that embarked the new metric vindicates its earlier warnings that these products would fall foul of the decarbonisation trajectory of the regulatory proposal if faced with a significant fall in equity markets. Last but not least, it explains that the insistence on incorporating value-chain emissions data of insufficient quality to support security selection will lead to financial decisions that will disregard the greenhouse gas emissions reduction efforts in the real economy, which it calls a travesty of the objectives of the Regulation. Scientific Beta recommends giving administrators flexibility in sector allocations while neutralising sector effects to assess decarbonisation, to use the standard version of carbon intensity and to incorporate important value-chain considerations with metrics of sufficient granularity.

Scientific Beta questions the authority of the Commission with respect to the imposition of extensive and expensive sustainability disclosures and warns against officially condoning indicators, (ESG ratings) whose inherent divergence has been described in academic literature as an impediment to prudent decision-making. Scientific Beta calls for sustainability disclosures not only to be theoretically relevant but also to be fully specified and highly standardised to permit comparisons. In this spirit and to minimise costs to investors, it calls for the creation of an administrative body to produce the data required for sustainability disclosures, including in respect of controversies, in the manner of the Council of Ethics set up to support Nordic reserve funds. Instead of being a business opportunity for the ESG data and service providers that drove the work of the Commission, this act should be the occasion to build a stronger European Union identity on matters of sustainability.

Commenting on the company's stand, its CEO, Professor Noël Amenc, states that "Like all providers that are highly active in the area of ESG, and particularly Low Carbon, investing, we support initiatives that aim to favour the adoption of high standards. Unfortunately, this proposal does not go in the right direction and our previous criticism of the proposal from the Technical expert group on sustainable finance (TEG) remains relevant for the most part. Even though we have planned to provide versions of our flagship indices that will comply with these standards, which will be a business opportunity for us, we will not recommend that our clients adopt these indices. Scientific Beta was set up by an academic institution to advance state-of-the-art equity investing based on scientific ethics and we believe that it is our duty to highlight the flaws and risks that this draft regulation poses for the fight against climate change. In very concrete terms, the new carbon metric will allow a company that has a better stock market performance than the market average to participate proportionally more in the emission of greenhouse gases than others. Ultimately, this regulation makes the weights of stocks depend more on their stock market performance than on their ecological performance."

For more details, please refer to the following documents:

[Scientific Beta Letter to the European Commission, May 4, 2020](#)

[Unsustainable Proposals, A Critical Appraisal of the TEG Final Report, Scientific Beta Publication, February 2020](#)



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About Scientific Beta

Scientific Beta aims to be the first provider of a smart beta indices platform to help investors understand and invest in advanced beta equity strategies. Established by EDHEC-Risk Institute, one of the top academic institutions in the field of fundamental and applied research for the investment industry, Scientific Beta shares the same concern for scientific rigour and veracity, which it applies to all the services that it offers investors and asset managers. On January 31, 2020, Singapore Exchange (SGX) acquired a majority stake in Scientific Beta. SGX will maintain the strong collaboration with EDHEC Business School, and principles of independent, empirical-based academic research, that have benefited Scientific Beta's development to date.

The Scientific Beta offering covers three major services:

- **Scientific Beta Indices**

Scientific Beta Indices are smart beta indices that aim to be the reference for the investment and analysis of alternative beta strategies. Scientific Beta Indices reflect the state-of-the-art in the construction of different alternative beta strategies and allow for a flexible choice among a wide range of options at each stage of their construction process. This choice enables users of the platform to construct their own benchmark, thus controlling the risks of investing in this new type of beta (Smart Beta 2.0).

Within the framework of Smart Beta 2.0 offerings, Scientific Beta provides access to smart factor indices, which give exposure to risk factors that are well rewarded over the long term while at the same time diversifying away unrewarded specific risks. By combining these smart factor indices, one can design very high performance passive investment solutions.

- **Scientific Beta Analytics**

Scientific Beta Analytics are detailed analytics and exhaustive information on its smart beta indices to allow investors to evaluate the advanced beta strategies in terms of risk and performance. The analytics capabilities include risk and performance assessments, factor and sector attribution, and relative risk assessment. Scientific Beta Analytics also allow the liquidity, turnover and diversification quality of the indices offered to be analysed. In the same way, analytics provide an evaluation of the probability of out-of-sample outperformance of the various strategies present on the platform.

- **Scientific Beta Fully-Customised Benchmarks and Smart Beta Solutions** is a service proposed by Scientific Beta, and its partners, in the context of an advisory relationship for the construction and implementation of benchmarks specially designed to meet the specific objectives and constraints of investors and asset managers. This service notably offers the possibility of determining specific combinations of factors, considering optimal combinations of smart beta strategies, defining a stock universe specific to the investor, and taking account of specific risk constraints during the benchmark construction process.

With a concern to provide worldwide client servicing, Scientific Beta is present in Boston, London, Nice, Singapore and Tokyo. As of December 31, 2019, the Scientific Beta indices corresponded to USD 59.2bn in assets under replication. Scientific Beta has a dedicated team of 52 people who cover not only client support from Nice, Singapore and Boston, but also the development, production and promotion of its index offering. Scientific Beta signed the United Nations-supported Principles for Responsible Investment (PRI) on September 27, 2016.

On November 27, 2018, Scientific Beta was presented with the Risk Award for Indexing Firm of the Year 2019 by the prestigious professional publication Risk Magazine. On October 31, 2019, Scientific Beta received the Professional Pensions Investment Award for “Equity Factor Index Provider of the Year 2019.”



Scientific Beta
Indexing firm
of the year

