MSCI'S FEEDBACK ON THE EU TAXONOMY FOR SUSTAINABLE ACTIVITIES

Supplement to online feedback

MSCI ESG Research

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INTRODUCTION

MSCI appreciates the opportunity to comment on the European Union (EU) Technical Experts Group (TEG) report on the EU Taxonomy on Sustainable Activities (hereafter 'EU Taxonomy'). This supplemental document is intended to provide additional details in support of the feedback survey MSCI submitted online.

Note that MSCI has been an active participant in the development of the EU Taxonomy, sharing our expert opinion on applicability and eligibility criteria for selected economic activities. Given our active involvement in reviewing the technical screening and Do No Significant Harm (DNSH) criteria, we have chosen not to provide additional feedback to Section 2 related to Economic Activities.

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[1] *Through MSCI ESG Research and its legacy companies KLD, Innovest, IRRC, and GMI Ratings*

[2] *P&I data and MSCI clients as of March 2018*

[3] *By number of indexes and by assets tracking the indexes compared with publicly available information produced by FTSE and S&P Dow Jones as of November 2018*

more effectively benchmark ESG investment performance and manage, measure and report on ESG mandates. Several global asset owners have selected MSCI ESG Indexes, with over $180 billion allocated in recent years.[4] The indexes can also be used as the basis for exchange-traded-funds and other index-based products.

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MSCI'S ADDITIONAL FEEDBACK

MSCI ESG Research welcomes the efforts of the European Union in developing a clear and well-defined taxonomy for sustainable activities. We share the aspiration of the European Commission and the Technical Expert Group on Sustainable Finance (TEG) to harmonize the definition of "sustainable" investing, and to enable capital allocation to activities that explicitly focus on critical issues of climate change mitigation, climate change adaptation, resource efficiency, among others.

The success of this initiative, however, is closely tied to the ability of market participants to understand, adapt, and use the Taxonomy on a continual basis. In this regard we see several aspects of the proposed Taxonomy that may warrant further review and consideration by the TEG.

Disclosure constraint

The TEG report acknowledges limitations of the current reporting practices and notes the critical role of disclosure in the successful adoption of the EU Taxonomy by investors. However, the report is not explicit on the treatment of non-disclosure of performance metrics and/or Do No Significant Harm (DNSH) criteria by corporate issuers. It is not clear what, if any, minimum eligibility criteria would apply in the absence of full and comprehensive disclosure across all criteria. Expectation for complete disclosure of all eligibility criteria, including assurance of compliance with relevant EU Directives and disclosure of performance metrics according to BREFs and other reference documents, risks exclusion of such companies from any consideration by investors.

Barriers to global adaptability

The current economic activity definitions and eligibility criteria rely heavily on European standards, regulations, and policies. The relative stringency and complexity of European regulations could adversely impact the ability and therefore the willingness of global companies to provide the required disclosures that would

[4] *Based on publicly available information in press releases published from 2014 to date*

adhere to the EU Taxonomy eligibility criteria. This could limit the investable universe for sustainable finance investors, and lead in turn to the movement of capital away from potentially eligible global activities.

Constraints to investable universe

The EU Taxonomy sets a high bar for eligibility under the proposed carbon mitigation and DNSH criteria. We understand and share the TEG's goal of enabling capital allocation towards the commercialization and adoption of best available technologies in carbon emissions management, in support of faster and more meaningful improvements. But climate change mitigation could also strongly benefit from smaller, more incremental improvements, and some such technologies (e.g., hybrid electric vehicles) may not meet the eligibility thresholds set by the proposed Taxonomy, resulting in limited financing.

Under the proposed criteria, "greening by" solutions (activities that support transition of economic activities to low-carbon technical screening criteria) are permitted, but qualifying investment mechanisms would most likely be limited to bonds.

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