



# **MSCI'S FEEDBACK ON THE TEG INTERIM REPORT ON CLIMATE BENCHMARKS AND BENCHMARKS' ESG DISCLOSURES**

MSCI

**August 2019**



## INTRODUCTION

MSCI appreciates the opportunity to comment on the TEG INTERIM REPORT ON CLIMATE BENCHMARKS AND BENCHMARKS' ESG DISCLOSURES.

## ABOUT MSCI

MSCI is a leading provider of investment decision support tools to institutional investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indexes, ESG research and tools, and portfolio risk and performance analytics. MSCI is headquartered in New York, with research and commercial offices around the world.

### *MSCI ESG Research*

For over 40 years, MSCI ESG Research has measured and modelled Environmental, Social and Governance (ESG) risk.<sup>1</sup> MSCI is a leading provider of ESG ratings, indexes and analytical tools. We aim to help investors integrate ESG across their entire investment process; powering better investment decisions.

Our solutions:

\* MSCI ESG Research LLC is the world's largest provider of ESG ratings and research<sup>2</sup>. For over 11 years, we have rated companies on their exposure to, and management of, industry-specific ESG risks. We rate over 7,500 issuers (>13,500 including subsidiaries) linked to more than 650,000 equity and fixed income securities. Our ratings and research are used by over 1,300 institutional investors globally. Clients can use ESG ratings to support fundamental and quant analyses, portfolio construction and risk management and thought leadership and engagement.

\* MSCI ESG Indexes: MSCI is the world's largest provider of ESG indexes<sup>3</sup> with over 1,000 ESG equity and fixed Income Indexes designed to help institutional investors 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.<sup>4</sup> The indexes can also be used as the basis for exchange-traded-funds and other index-based products.

\* MSCI ESG Analytics: Our ESG research, data and indexes are available within MSCI's analytics systems. MSCI Analytics clients can explore ESG exposures on 650,000 securities and 8 million derivatives to support security selection, portfolio construction, stress testing, and risk and performance attribution analysis.

*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*

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



### ***MSCI Equity Indexes***

MSCI's flagship equity indexes include the MSCI Global Equity Indexes and MSCI as been calculating indexes for more than 50 years. MSCI Global Equity Index families include country and regional indexes, size indexes (large cap, small cap, and micro-cap), sector indexes, style (value/growth) indexes, strategy indexes, thematic indexes and ESG indexes. MSCI also calculates custom indexes at the request of clients, by applying client screens and constraints to MSCI Global Equity Indexes.

MSCI Global Equity Indexes are used worldwide by:

- assets owners to help them with their mandate decisions and with reviewing their managers' performance;
- active asset managers so that they can actively manage their funds against an index and report performance;
- passive fund managers to issue passive funds and ETFs based on the indexes;
- broker dealers for providing trading execution services, creating OTC and non-OTC derivative financial products and writing research more generally;
- stock exchanges to create equity index linked futures and options contracts; and
- CCPs to calculate the risks of its positions for index linked futures and options contracts.

During 2013 and 2014, MSCI implemented the IOSCO Principles, was externally audited during each of 2014, 2015 and 2016 for the MSCI equity indexes and select MSCI private real estate indexes, and posted the adherence statements and audit reports on the Index Regulation page of [www.msci.com](http://www.msci.com). During 2017 and 2018, MSCI devoted those resources to implementing the BMR, and MSCI posted the IOSCO adherence statements on the Index Regulation page of [www.msci.com](http://www.msci.com).

On 5 March 2018, MSCI Limited, which is a UK subsidiary of MSCI Inc., was granted authorization by the UK FCA as a UK administrator under the EU benchmark regulation ("BMR") for all of the MSCI equity indexes. MSCI was the first major global equity index provider to become authorized under the BMR. We have since added two private real estate indexes to our authorization.

## MSCI'S FEEDBACK

Below we have provided additional feedback where the full response didn't fit in the questionnaire or there were no text boxes to insert explanations.

Question	MSCI response
Overall	<p>MSCI supports the overall goals of the transparency of ESG factors and the harmonization of disclosures to better enable institutional investors to perform "like for like" comparisons.</p> <p>MSCI also generally supports the ESG measures as they are the commonly used measures.</p> <p>While MSCI support transparency, we caution that:</p> <ul style="list-style-type: none"> <li>• There must be flexibility in the delivery mechanism for the information. While templates can be used to support harmonization, the delivery mechanism need to flexible enough to allow for proper automation and more efficient and less costly ways of presenting the ESG data.</li> <li>• Mandatory disclosures can lead to increased costs, whereas voluntary disclosures with a comply or explain regime enable and promote best in class disclosures.</li> </ul>
Question 1	<p>MSCI supports the TEG's conclusion that ESG data should only be disclosed for certain asset classes, e.g., corporate issuance-based indexes.</p>
Question 3	<p>We have several questions and comments regarding the proposed minimum ESG disclosure requirements for fixed income benchmarks. Since the majority of fixed income assets fall in non-corporate sectors,* disclosures for non-corporate sectors require further clarification.</p> <p><i>* As of June 28, 2019, corporate bonds comprised approximately 19% of the market value of the Bloomberg Barclays Global Aggregate Index. The remaining 81% was comprised of treasury, government-related, and securitized bond sectors.</i></p> <ol style="list-style-type: none"> <li>1. <b>ABS</b> – We have observed general market consensus that it is inappropriate to apply issuer-level ESG data to securitized debt (ABS, MBS, CMBS), with the exception of covered bonds, which have recourse to the issuer. Instead, ABS should be assessed based on the underlying assets that they securitize. This applies to ESG assessments (e.g. ESG Ratings), controversies and violations (e.g. UNGC violations), and revenue exposure (eg. Tobacco).       <ol style="list-style-type: none"> <li>a. Proposed: change "Corporate Credit Bonds <b>including Corporate Asset Backed Securities</b> and</li> </ol> </li> </ol>

	<p>Money Market” to “Corporate Credit Bonds <b>including Covered Bonds</b> and Money Market”</p> <p>b. Proposed: As reliable data and assessment frameworks do not currently exist for ABS, the only metric that is immediately applicable to this asset class is “% green bonds”. The other metrics should be removed from the requirement and phased in only if and when data becomes available.</p> <p>2. <b>SSAs</b> – We request further clarification regarding treatment of supranationals, sub-national agencies and municipal bonds.</p> <p>a. <b>Sub- and Supranationals:</b> The majority of metrics in the minimum disclosure requirements apply to countries. Specific guidance around treatment of sub-national entities (agencies, municipalities) and supranationals (e.g. European Investment Bank, World Bank) is required, or else these should be treated as ‘not applicable’ within the reporting framework.</p> <p>b. <b>Agencies / SOEs:</b> There is currently no commonly accepted definition of ‘agencies’. Many index providers classify state-owned enterprises as agencies (e.g. Pemex, EDF). We recommend that state-owned enterprises, even those holding a sovereign guarantee, should be assessed as ‘corporates’ as their ESG profile and carbon footprint will differ from those of other government agencies.</p> <p>3. <b>Carbon Intensity</b> - We recommend separating carbon intensity reporting between corporates (equity, corporate fixed income) vs. sovereigns. Given that these are computed in different units (e.g. revenues vs. GDP), figures are not directly comparable. This recommendation was echoed by the numerous institutional investors who participated in MSCI’s 2017 consultation on carbon footprinting of fixed income portfolios.</p> <p>4. <b>Social Violations %</b> - We express concerns around reporting on country-level social violations, given widely-varying social norms across geographies and the inherently subjective and politically-sensitive nature of that determination. Unless a commonly agreed-upon list of countries can be supplied to all index providers to ensure consistency, we do not believe it is the index provider’s place to judge which countries are violating global social norms.</p>
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	<p>5. <b>International Standards Signatories %</b> - We request clarification of which international standards should be considered for this metric as applied to sovereign and aggregate bond indexes. There are hundreds of international standards covering various topics and several different statuses for each (e.g. signed not ratified, etc.)</p> <p>6. <b>Human Rights (Index) %</b> - We request clarification regarding reporting on human rights for sovereign and aggregate bond indexes. The Universal Human Rights Index recommended in the TEG Interim Report is a database of recommendations, observations and concerns pertaining to human rights in a given country. It does not immediately lend itself to quantitative or standardized reporting at the index level.</p>
Question 13(b)	<p>We agree in principle with all the requirements proposed for CTB.</p> <p>However, based on the analysis of our data on company's carbon emission, total capital and constituent weight in MSCI's market capital weighted indexes, we think that the following requirements may be further enhanced by issuing further clarifications and considering our proposals.</p> <p>1. <b>Use of 'Total Capital' as denominator (as described under section 5.3.3)</b> - use of 'Total Capital' as denominator in calculation of asset level carbon intensity requires further clarifications on treatment of companies with very low or negative 'Total Capital'.</p> <p>We agree with TEG's recommendation to use 'Total Capital' as denominator as it is less exposed to market volatility of stock prices and the emission intensity can be calculated across asset classes. However, considering the current trend of companies buying back their shares and the 'asset light' capital structure of technology and services based companies, the 'Total Capital' of many companies are maintained at relatively low levels. An unintended result of dividing carbon emission by 'Total Capital', could result in a carbon intensity equivalence between a technology company with low emission and total capital and an energy company with high carbon emission and total capital. In such scenario it is possible that the WACI of the index doesn't change or drops if a tech company in the index is replaced with an energy company. We also think that while the book value of a company is insulated from the volatility in the stock price, the book value can change significantly over time due to changes in the capital structure of the company. The book value of a company can change abruptly – infrequent but large, and will result in increase or decrease in the carbon</p>

	<p>intensity of the company without any improvement in company's response towards managing its carbon emission. The abrupt changes in Book Value can distort the current value of WACI relative to its history and can cause excess turnover in a CTB.</p> <p>Our internal analysis demonstrated that Enterprise Value (EV) could be a good alternative that could be considered given that the EV of a company is less likely to drop to very low or negative values compared to the 'Total Capital'. Emission Intensity relative to EV is also applicable to different asset classes.</p> <p>2. <b>Use of average weights in calculation weighted average carbon intensity (WACI - as described under section 5.3.3 and footnote 36)</b> - use of average weights on a quarterly basis can complicate the calculation of carbon intensity. In order to meet the decarbonization targets, the down weighting of a high carbon intensity stock's current weight will be leveraged to impact the average of stock's weights over last 4 quarters. If the index weight of a stock with high emission intensity increases over time then this stock will need excessive downweighting in the CTB. In extreme cases, it may not be possible to achieve decarbonization targets without the deletion of stock from the CTB.</p> <p>We agree in principle with the TEG's objective of preventing window dressing of constituent weights on certain dates. We propose that to prevent window dressing the compliance with minimum requirements should be assessed on quarterly frequency.</p> <p>3. <b>Year-on-year self-decarbonization of the benchmark (as described in section 5.10)</b> – calculation of Year-on-year self-decarbonization requires further clarification on treatment of constituents added or deleted from the index which can have an impact of current year's carbon intensity. An addition or deletion of an index constituent with very high carbon intensity can result in large jump/drop in current year's carbon intensity and can interfere with the self decarbonization target.</p> <p>We propose that for the purpose of decarbonization</p> <ol style="list-style-type: none"> <li>i. The WACI is calculated using the current weights of index constituents.</li> <li>ii. The current year and previous year WACI is calculated only for the common constituents (after renormalizing their weight to 100%) i.e., constituents which</li> </ol>
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	<p>were included in the previous year's index and are also included in current index. An addition or deletion of an index constituent with high carbon intensity during the year can distort the current year WACI relative to previous year's WACI. In case of an addition of high carbon intensity stock in current index, the current index may struggle to achieve self decarbonization target and in case a high carbon intensity index constituent was deleted from the index during the year then the current WACI may be below the self decarbonization target without the need for decarbonization.</p> <p>Separately, in Article 6 of the proposed technical standards, the mechanism for withdrawing the label and timing around that, well as any transition is unclear and should be better defined to mitigate market disruption.</p>
Question 16	<p>MSCI disagrees with reporting decarbonization trajectory to the NCA annually and instead we recommend that benchmark administrators only report the indexes where the decarbonization trajectory is missed, otherwise there will be reports to the NCAs for thousands of benchmarks.</p>
Question 22	<p>Ultimately, we believe that there should be consistency across the EU's Sustainable Finance Package, and ideally the benchmarks regulation would have followed after the other parts of the package were agreed.</p> <p>While we believe it would be helpful that disclosures and definitions are connected to the Taxonomy over time, it should not happen automatically. If any changes are required for benchmarks disclosures, then there should first be a consultation to assess of feasibility in relation to benchmarks, and a reasonable implementation period would need to be considered.</p>
<b>Appendix D: ESG Disclosure Template #3 (overall degree of alignment with the objectives of the Paris Climate Agreement)</b>	<p>Because of the current deficiencies in data, definitions and research in Paris alignment, MSCI believes that template 3 should only include Section 1 and not Sections 2, 3 and 4.</p> <p>Sections 2, 3 and 4 can be considered in the next phase once the data, definitions and research better support Paris alignment.</p>





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Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

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