MSCI'S FEEDBACK ON SUSTAINABLE FINANCE – ESG CRITERIA [BENCHMARKS]

MSCI

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INTRODUCTION

MSCI appreciates the opportunity to comment on the SUSTAINABLE FINANCE – ESG CRITERIA [BENCHMARKS].

About MSCI

MSCI Equity Indexes

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 has been calculating indexes for more than 45 years. The MSCI equity indexes 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 equity indexes.

MSCI 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 for Financial Benchmarks, 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. During 2017, 2018 and 2019, MSCI devoted those resources to implementing the EU benchmark regulation ("BMR"), and MSCI posted the IOSCO adherence statements on the Index Regulation page of 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 BMR for the MSCI equity indexes. MSCI was the first major global equity index provider to become authorized under the BMR. On 13 June 2019, MSCI notified the FCA in relation to specific UK MSCI Private Real Estate Indexes used as regulated benchmarks under the BMR. On 16 December 2019, MSCI notified the FCA in relation to the MSCI fixed income indexes.

MSCI ESG Research

For over 40 years, MSCI ESG Research has measured and modelled Environmental, Social and Governance (ESG) risk[1]. 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:

*First ESG provider to assess companies based on industry financial materiality, dating back to 1999. Only dataset with live history (12+ years) demonstrating economic relevance[2]. For over 11 years, we have rated companies on their exposure to, and management of, industry-specific ESG risks. We rate nearly 14,000 issuers representing more than 680,000 securities, with 90% of equity and fixed income market value. Our research is used by over 1,400 clients 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 with over 1,500 ESG equity and fixed Income Indexes leveraging MSCI ESG Research data to support ESG integration, screening and impact approaches. Several global asset owners have selected MSCI ESG Indexes, with over $180 billion allocated in recent years[3]. 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 680,000 securities and 8 million derivatives to support security selection, portfolio construction, stress testing, and risk and performance attribution analysis.

MSCI ESG Research products and services are provided by MSCI ESG Research LLC, and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research LLC. are also used in the construction of the MSCI ESG Indexes.

For the purposes of the ESG metrics for the ESG benchmarks disclosures, the ESG metrics are provided by MSCI ESG Research LLC. MSCI ESG Indexes are provided by MSCI Inc. and utilize information from, but are not provided by, MSCI ESG Research LLC. MSCI Limited is the benchmark administrator for the MSCI Indexes under the EU Benchmark Regulation. ESG ratings, data and analysis from MSCI ESG Research LLC. are also used in the construction of the MSCI ESG Indexes.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc.

1. Through MSCI ESG Research and its legacy companies KLD, Innovest, IRRC, and GMI Ratings
2. Origins of MSCI ESG Ratings established in 1999. Produced time series data since 2007
3. Based on publicly available information in press releases published from 2014 to date

MSCI'S FEEDBACK

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NA	*NA*	INCREASE CLARITY	We recommend consistency in metric definition requirements across different ESG disclosure-related regulations, considering in particular, the parallel consultation for the Draft Delegated Act supplementing Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector, where the definition, for example, for carbon intensity uses Enterprise Value instead of the prescribed Enterprise Value including Cash.
Article 2	*Benchmark administrators shall, for each type of benchmark listed in Annex II, explain in the benchmark statement how the environmental, social and governance (ESG) factors listed in that Annex are reflected in each benchmark provided and published, by using the template laid down in Annex I.*	CRITICAL	Annex II lists out the ESG factors to be considered by type of benchmark (e.g., equity benchmark, fixed income corporate benchmark, etc.). Currency and interest rate benchmarks are out of scope. However, certain benchmarks may combine multiple asset classes, for example in the case of benchmarks that reflect multi-asset-class strategies used by private investors (these typically use a combination of equity, interest rate (cash), fixed income corporates, fixed income sovereigns, etc.). Other examples include benchmarks that combine equity and currency assets (e.g., hedged benchmarks), equity and interest rate assets (e.g., short and leveraged benchmarks), etc. We kindly request that the Commission clarify the rules for multi-asset benchmark disclosures. For benchmarks that include both asset classes that are in and out of scope for the disclosure of ESG factors, we recommend to ignore the out-of-scope asset class/es (currency and/or interest rate) when calculating ESG factors, with appropriate

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			disclaimer, as the resulting ESG factor values would not reflect the reality of the entire benchmark. For benchmarks that only include assets classes that are in scope (e.g., fixed income corporates and sovereigns), we recommend the option to disclose ESG factors for one asset class only (e.g., the one that has the largest weight in the benchmark), with an appropriate disclaimer, given that the resulting ESG factor values would likewise not reflect the reality of the entire benchmark.
Article 2	*Benchmark administrators shall update the information provided in the template set out in the Annex whenever the benchmark methodology is changed.*	INCREASE CLARITY	We understand that the information in the template can be published as a separate document (outside of the methodology document) and linked to the methodology document. We recommend that benchmark administrators should be required to update such document - including the date of the document - only when the information in the template (Items 1 to 6) is changing due to a change in the benchmark methodology, and not every time the benchmark methodology is changed. This would minimize unnecessary maintenance costs. For example, when a benchmark methodology does not take into account ESG factors ("No" answer to Item 4 in the template), it should typically not be required to publish an updated document when the benchmark methodology is changed, unless the benchmark methodology starts taking into account ESG factors. Similarly, when a benchmark methodology takes into account ESG factors ("Yes" answer to Item 4 in the template), it should typically not be required to publish an updated

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			document when there is a change in the benchmark methodology but the explanation on how ESG factors are reflected in the benchmark methodology (Items 5 and 6) remains unchanged.
Article 2.1	*Benchmark administrators shall, for each type of benchmark listed in Annex II, explain in the benchmark statement how the environmental, social and governance (ESG) factors listed in that Annex are reflected in each benchmark provided and published, by using the template laid down in Annex I.*	CRITICAL	The TEG Final Report made it clear that ESG benchmarks disclosure can also be made through a portal, the link for which can be inserted into the benchmark statements. That is essential, otherwise the risk is that millions of static PDF benchmark statements will need to be produced quarterly for each benchmark and posted. This is costly, inefficient and administratively burdensome. There should be the option to allow for a much more efficient, automated, timely, less costly way to produce the disclosures, such as through a searchable portal on the benchmark administrator's website.
Annexure II (Section 1, 2 and 3 – Environmental)	*Degree of exposure of the portfolio to the sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/2006 of the European Parliament and of the Council as a percentage of the total weight in the portfolio.*	INCREASE CLARITY	We see this requirement as a metric that is consistent with that for the Climate Benchmarks pertaining to the High Impact Sector, as defined by the EU TEG. On this, we believe that a better approach is to use company-disclosed and/or analyst-assessed data. This would be more accurate and provides for a more refined approach to measuring exposure to the Fossil Fuel Sector, given that it is not dependent on assumptions using industry classification such as NACE. Using NACE classification may result in underestimation of exposure in cases where a company with diversified activities/ investments is classified under "low impact" despite ownership of fossil fuel reserves. Such is the case especially for industrial

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			conglomerates that cannot be classified into one NACE Level 4 code. Additionally, we have seen institutional investors move away from industry classification-based exclusion, to use more nuanced approaches by ESG data providers. One of such examples is to measure exposure based on companies' ties to fossil fuels (Thermal Coal, Oil & Gas), such as reserve ownership or revenue from extraction and power generation activities regardless of industry classification.
Annexure II (Section 1, 2 and 3 – Environmental)	*Greenhouse gas (GHG) intensity of the benchmark*	INCREASE CLARITY	Although there is no prescribed definition on how to measure GHG intensity, we believe that the use of Enterprise Value including Cash (consistent with the requirement in the Delegated Acts for Climate Benchmarks) for equity and fixed income corporate asset classes is a fair approach to measure ownership and is one of the most common financial metrics used by investors to determine carbon intensity. On the other hand, for Sovereign issuers, we will use emissions per GDP, which is the most commonly used approach -- specifically, GHG intensity of an economy (in kg per USD GDP nominal), wherein the higher the value, the more carbon intensive the economy is. Six greenhouse gases, considered under Kyoto Protocol, are considered for this data point. These gases are carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride. GDP is in nominal terms.

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Annexure II (Section 1, 2 and 3 – Environmental)	*Exposure of the benchmark portfolio to companies the activities of which fall under Divisions 05 to 09, 19 and 20 of Annex I to Regulation (EC) No 1893/2006*	INCREASE CLARITY	To measure exposure to "Brown" Activities / Sector, we believe that using company-disclosed and/or analyst-assessed data provides for a more refined approach for measuring exposure, given that there may be conglomerates with "Brown" activities outside of the classification. In addition, this approach enables not only identifying "Brown Sector" but also measure "Brown Revenue". As institutional investors are increasingly in favor of using nuanced ESG data, there is flexibility to define sector as per a given threshold of involvement based on revenue, and revenue can be determined by activities identified as Brown. For example, we can measure brown revenue as the weighted average of each issuer's percent of revenue generated by fossil-fuel related goods and services, including thermal coal extraction, unconventional and conventional oil and gas extraction, oil and gas refining, as well as revenue from thermal coal-, liquid fuel-, and natural gas-based power generation.
Annexure II (Section 1, 2 and 3 – Environmental)	*Exposure of the benchmark portfolio to activities included in the environmental goods and services sector, as defined in Article 2, point (5) of Regulation (EU) No 691/2011 of the European Parliament and of the Council*	INCREASE CLARITY	We note that there are no specific requirements for qualifying "environmental goods and services sector". Therefore, we would consider a best fit approach where we measure environmental protection and resource management based on revenues derived from products, services, and/or projects that contribute to or fulfill any of the following: 1) combat climate change through renewable energy and alternative fuels to reduce carbon and pollutant emissions; 2) support the maximization of productivity with minimal energy consumption;

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			3) promote mechanisms for raising capacity for effective climate change mitigation and adaptation through green-certified properties; 4) resolve water scarcity and water quality issues to improve resource management in both domestic and industrial use; 5) reduce waste, minimize toxic substances, and offer remediation to address pollution in all levels and its negative effects; and/or 6) meet environmental and organic certification requirements to address biodiversity loss, pollution, land disturbance, and water overuse.
Annexure II (Section 1, 2 and 3 – Environmental)	*Exposure of the benchmark portfolio to renewable energy as measured by capital expenditures (CapEx) in those activities (as a share of total CapEx by energy companies included in the portfolio)*	CRITICAL	We agree that for some industries in transition to low-carbon solutions, green revenue measure may not be relevant or sufficient. However, we suggest that the European Commission reconsider the use of "Green CapEx vs. total CapEx" as a mandatory metric, because it may not clearly measure issuers' commitments or efforts towards transition to renewable energy. "Green CapEx vs Total CapEx" measures: 1) A portion of green investments vis-a-vis all other necessary expenditures, as opposed to reflecting deliberate green vs. non-green investment; 2) An annual capital allocation (as opposed to the aggregate green allocations) that is fluctuating and likely to be decreasing towards the completion of the project, and thus translating to a low ratio vs. Total CapEx. Additionally, while Total CapEx may be a widely available financial metric, we do not have Green CapEx data given challenges in collecting this data. Specifically, there are no

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			regulations requiring issuers/ companies to dislose Green CapEx, as well as corresponding guidelines/standards that define what constitutes as green and not green, or how to properly account/qualify capital expenditures. Given the noted data quality concerns and limited data availability, the current state of this metric is incomparable and potentially misleading. We therefore suggest that the Commission consider the use of "Green CapEx vs. Total CapEx" as a voluntary metric and allow other proxies for measuring investments into renewable energy until such time when Green CapEx data becomes more available and structured. For example, planned capacity for renewable energy as a percentage of total planned capacity, is a commonly used metric that illustrates deliberate plans in terms of increase of capacity in renewable energy.
Annexure II (Section 3 – Combined ESG Factors)	*The percentage of underlying fund management companies signed up to international standards.*	INCREASE CLARITY	There are different and multiple types of international standards and conventions that countries may join as signatories that are not applicable for corporate issuers, and vice versa. We suggest that this metric be only applicable to sovereigns and that international standards are based on commonly used United Nations conventions such as the Kyoto Protocol.
Annexure II (Section 3 – Social Factors)	*Number of benchmark constituents subject to social violations (absolute number and relative number divided by all index constituents), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law.*	CRITICAL	While this metric is applicable for corporate issuers, there is no commonly accepted international standard applied for determining country-level violations and/or a reputable agency that may provide assessment of sovereign states' compliance or violations of social norms; and as such, there is no readily available data. Additionally, we believe that

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			neither benchmark providers nor rating agencies are in the position to determine compliance or violation of social norms by governments or sovereign entities. This type of country-level assessment is outside of benchmark providers' and rating agencies' prerogative and should be considered a voluntary metric.
Annexure II (Section 3 – Social Factors)	*Average human rights performance of the issuers (including a quantitative indicator and the methodology used to calculate it).*	INCREASE CLARITY	Similar to the above, for Sovereign issuers, there is no commonly accepted international standard applied for determining country-level violations and/or a reputable agency that may provide assessment of sovereign states compliance or violations of all facets of human rights. The TEG mentions "Universal Human Rights Index (Office of the High Commissioner for Human Rights – OHCHR)", which refers to a list (index) of multiple international and national norms and conventions, but is not an aggregate reference to countries failing to meet any or all human rights provisions. Unless there are specific conventions and/or aspect/s of human rights in focus, data collection and measurement of this metric will be challenging. This type of country-level assessment is outside of benchmark providers' and rating agencies' prerogative, and we recommend that this be considered a voluntary metric.

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MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 45 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

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