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Perspectives Podcast

“Ladies and Gentlemen, the MSCI Sustainability Institute”

Transcript, 28 September, 2023

Adam Bass (00:03):

This is MSCI Perspectives, your source for insights for global investors, and access to research and expertise from across the investment industry. I'm your host, Adam Bass, and today is September 28th, 2023, and it's also our 100th episode. Thanks for being here. Last week was Climate Week in New York City. The event is hosted by the UN and representatives from around the world came together to debate and discuss what many have referred to as the greatest existential threat of our lives. While the competition to be heard on climate change above the throng was quite fierce, MSCI took the opportunity to launch the MSCI Sustainability Institute, founded and led by Linda-Eling Lee.

(00:54):

The launch event, it was attended by some of the most highly respected members of the ESG investment community, and we here at Perspectives we're lucky enough to be a fly on the wall, so to speak. So what is the Sustainability Institute all about? For the answer to that question, we start with no one less than the founding director herself, Linda-Eling Lee.

Linda-Eling Lee (01:19):

What's become quite routine, I think, year after year, is that world leaders come. Leaders from across industry and finance come to New York and they make big announcements at the United Nations or across stages large and small throughout the city. They say things like, "We will cut emissions drastically, we're going to invest in a rapid energy and whole economy transition, and we will do all of this equitably."

(01:44):

Now, delivering on these promises, of course, is a monumental task, and we've made so little progress so far that our children actually now suffer from widespread climate anxiety. A survey of 10,000 youths in over 10 countries found that nearly six in 10 were very or extremely worried about climate change, and four in 10 fear that governments are not doing enough. And that same proportion, and this one really gets me, that four in 10 young people between ages 18 and 25 now hesitate to have children of their own in the future due to the climate crisis.

(02:26):

I happen to have some of those anxious children. I have three of them, in fact, and I have watched quite sadly, them go from being really passionate as young children about demanding climate action to now being really just resigned to the fact that they live on a burning planet. And if we, the adults in this room, want to prove them wrong, and we actually want to deliver on the promises that we've

already made and actually even raise our ambitions, I think we know we have to make huge investments.

(02:57):

And those huge investments, of course, do come with colossal opportunity. We know, though, that meeting the challenges of a global crisis like climate change, as well as parallel crises such as with inequality and with biodiversity collapse, those things demand more than just money chasing after the latest opportunities. It really demands intention. It demands new knowledge to guide capital to do what it can actually do at its very best. At its very best capital catalyzes innovations that will revolutionize how we actually run our economies and our societies to the greatest benefit for everyone, to create value that is sustainable.

(03:42):

And that is where the MSCI Sustainability Institute comes in. We're building this institute because we really believe that capital markets can create more value, and it can create more sustainable value through knowledge and collaboration from leaders across domains. We're really excited to work not just with investors, but academics and policy makers, think tanks, NGOs, and companies in every industry, leveraging MSCI's experience in developing new ways to measure both financial and non-financial value.

(04:18):

We at MSCI believe that to unleash the power of capital to really do its best, we really need research that is underpinned not just by analytical rigor, but by implementable data for practitioners. We really need policy that is not just well-intended, but practicable for the efficient allocation of capital. And we need honest debate about where our current approaches are just not working, and we need to seed experimentation with new approaches.

(04:53):

So the MSCI Sustainability Institute will be drawing on decades of experience in making sense of sustainability data. We're going to be drawing on our expertise in developing blueprints for investability to pursue a series of novel collaborations that can drive action by capital markets that includes but is not limited to making data, metrics and know-how available to sustainability researchers beyond finance, and conversely, to highlight important studies and contribute to important studies that can help capital allocators across finance to really sharpen their decision making.

Adam Bass (05:33):

MSCI's chairman and CEO, Henry Fernandez, picked up that thread.

Henry Fernandez (05:38):

If you were a young person in the 1960s, you were told that the future was in plastics. In today's world, the future is in climate. And when I wake up every day, I think about that, because clearly all of us think about the enormity of the challenge ahead of us. But if you think about it that way, it's very hard to motivate yourself. But if you wake up every day and say, "My goodness, this is the biggest opportunity of our lifetime. How could I spoil it?" that gets you going.

(06:15):

Let me describe to you the three or four priorities that we have in climate within MSCI and then what the role of the institute is. In the theory of needs, you always start by saying, "I need water." No water, after seven days, who cares about food? Then once you get water, you get food, then you get clothing, and then you get shelter and all the things that... So in the same way, we look at the climate problem and we said, the first thing that you need to master is getting the data. So we've been a massive collector of data to be able to then model climate emissions of every financial instrument and every company, every issuer in the world.

(06:59):

So that was the first order of business, trying to get a lot of the data. And we went around looking for the people who could supply the data and we didn't find too many. So we said, "Okay, we got to do it ourselves." Right now we have model data, carbon emission data on about four million financial instruments, aggregating to some 70,000 issuers: public equity, private equity issuers, public debt, private debt. And about 70,000 funds: mutual funds, ETFs, private equity funds, private debt funds, et cetera.

(07:37):

And underlying all of that is in order to calculate these emissions, we have climate data on 1.1 million asset locations: manufacturing plants, office building, warehouses, mines, et cetera. Then the second thing is, okay, that's great, but what about the trajectory of emissions? So we created models to then say, what will the emissions look like seven years from now, 10 years from now, 15 years from now? That led us to the implied temperature rise metrics that some of you know about.

(08:13):

But then providers of capital say, "How do I value these assets?" So we created with our partners, Climate Value at Risk, which are basically valuation models. Then other people say, "What about the riskiness? What's the skewness of the distribution of risk?" So we created climate risk models. But sooner or later, we got to really work on the process of decarbonizing. And then the measurements are not about the data and not about the models. The measurements will be about what is your plan to decarbonize? Are you getting any better? Are you not? For many, many years now, I have been thinking about how do we create an institute, that MSCI, that would help connect the big thinkers in academia and think tanks and NGOs and the regulatory bodies, et cetera, to try to solve this problem.

(09:12):

Now, I get heavily involved in academia. I am a trustee of Stanford University. And one of the real benefits of a place like that is the multidisciplinary, the interdisciplinary approach to solving problems, which is the direction of academia. Because the world is a complex place and it requires scientists from very different walks of life to solve a problem. And that's what we're trying to do with the institute. And what we're going to do is create a lot of things, is get a number of people from different walks of life, from academia, from business, from the corporate world, from the pension fund world, the asset management world, and see if we can get everyone in a room together, trying to solve these problems and connecting all the dots.

(10:04):

For academia and the think tanks, we're going to do something that is totally unthinkable at MSCI. We're going to give them free data. Free models, free software applications. Only them, though, not you. Only them. We're going to sign a contract, we're going to make sure they protect our IP. But we are going to make ourselves totally available for them to be able to write research in whatever they want to say.

Adam Bass (10:38):

So what will they say? That's the real question, right? The launch event offered an opportunity for those in attendance, and now you, our listeners, a preview of the type of discussion and debate that the institute will seek to promote. This started with Simon Stiell, Executive Secretary of the UN Framework Convention on Climate Change, and Simon got straight to the point.

Simon Stiell (11:05):

We're in the midst of a climate emergency. Possibly, I think, records will show it is the hottest year on record, with extreme weather events wreaking death, devastation and misery all across the world. And yet this could just be the sign of worse to come, and what we are seeing today is what the scientists have been telling us for years. Our recently released synthesis reports on the global stocktake, the first comprehensive assessment of how far we've progressed in implementing the Paris Agreement, shows we are far off track in limiting warming to 1.5 degrees Celsius.

(11:52):

The science is clear. We need to cut emissions by 43% by 2030. That's less than seven years from now. However, the current level of climate commitments by governments, the nationally determined contributions, the NDCs, will lead to emission cuts of only 0.3% by 2030. So we're short of action and we're short of ambition. We can recalibrate our efforts to get back on track, to scale up our efforts across all areas, increase ambition in the next round of nationally determined contributions due in 2025 so we can accelerate action in what's remaining of this critical decade of action.

(12:48):

We need to map out key steps and milestones to decarbonize our economies while ensuring sustainable development and just transitions. This will require massive investments and shifts in financial flows, but if done in a way that supports pathways towards low emissions and climate resilient development, we can create opportunities to unlock trillions of dollars and shift investment to climate action at the scale that's needed. Colleagues, friends, finance is foundational within the UN Climate Talks. As we look ahead to COP28, we must progress on goals such as the delivery of the long-pledged $100 billion, a doubling of adaptation finance, a substantial replenishment of the Green Climate Fund and the Adaptation Fund.

(13:50):

We need a global financial system, both public and private, that's aligned with climate action and green finance. Phasing down of unabated fossil fuels is also an inevitable step, and crucial to meeting our Paris goals as articulated in the Global Stocktake report. The cost of inaction is higher than cost of just transition, but we face some very, very difficult questions. Will asset owners divest their investments or not? How do we finance the transition away from fossil fuels? Private sectors are

moving fast to expand not only production of solar panels, wind power turbines, electric vehicles and heat pumps, but also invest in new technologies such as hydrogen.

(14:50):

The financial sector has a vital role to play in powering this transition, and it will be a collaborative effort by governments, businesses, financial institutions, civil societies, scientists, communities on the front lines. The MSCI Sustainable Institute is right to support this collaboration. Only by working together will we be able to drive the transition to a cleaner, greener, more prosperous and equitable future.

Adam Bass (15:28):

As the evening continued, Linda introduced a guest who led the audience deeper into the science of climate change, a guest who is only the third woman to have ever led the US National Oceanic and Atmospheric Administration, or NOAA, and the first to also have worked on Wall Street, specifically at JPMorgan where she served as Senior Climate Scientist and Sustainability Strategist for Asset Management. And she is...

Speaker 5 (16:00):

Dr. Sarah Kapnick.

Sarah Kapnick (16:01):

Thank you for that wonderful opening, and I'm so excited to be here today to talk to all of you. NOAA's mission for all of our science, for those of you who aren't aware of it, is from the surface of the sun's space weather coming off of the sun, to make sure your satellites and your grid are operating on time and properly, all the way to the bottom of the ocean, we're mapping the ocean floor and also doing ocean exploration. We cover the oceans, understanding and monitoring the oceans, ports, marine transportation, fisheries, marine protected species, biodiversity, weather and climate modeling, forecasting. And we also have a fleet of ships and aircraft run by one of the eight uniformed services of the US government. Our technical support and capacity building efforts through all of these programs, particularly in local communities, through Sea Grant, which is the ocean and Great Lakes' version of Land Grant, as well as climate adaptation partnerships across the nation.

(17:03):

We have offices in every single state, every territory, and even Antarctica, for over 60 years. So as NOAA's chief scientist, I get to cover all of this science. And I'm responsible [inaudible 00:17:15] for advancing our policy and program direction. But also you may not be aware, NOAA sits under the Department of Commerce. So our job is also to ensure that the science and technology that we're producing is advancing commerce in the United States. In particular, I have been working on how to make climate information more actionable for a wide range of stakeholders and shareholders, especially when it comes to understanding physical and biological risk and opportunities to enhance resilience. And working to bring more climate information to bear in financial decision making, especially when it comes to new technology investments and capital investments for environmental markets such as carbon markets and biodiversity.

(17:58):

Without good information, we risk maladaptation. That might be a new term for people. This is when you make decisions poorly on adaptation. You think you're doing something good and it actually makes things worse. So we can miss opportunities to create jobs and economic opportunities, increase community and financial resilience and demonstrate global leadership if we don't do this right with science and technology at its core. As NOAA's chief scientist housed in the Department of Commerce, I also see our science and technology advancing the future of the entire economy as we deal with climate change. As the world responds to climate change and environmental considerations, every single sector will need to respond. We are advancing the development of the climate economy and driving innovation and key solutions that the world also needs. And NOAA's also working across all of the Department of Commerce to inform on climate and science and technology. For example, IP in the US Patent and Trademark Office of how you advance and fast-track climate patents. Also trade policy on advancing the use of science in industries around the world.

(19:04):

Bottom line, climate change is creating risks for all current and future assets, but we also know enough to be able to take action to both mitigate the future greenhouse gas emissions that are driving these warming trends, but also we have so much information about what the future holds to be able to adapt and build resilience to all these impacts already baked in. And to offer some color on this statement, in recent years, the US has experienced an unprecedented rate of billion dollar weather and climate disasters. NOAA is in charge of maintaining this database since 1980. To date this year, we've already seen 23 confirmed billion dollar disasters across the United States. This is the largest number that we've ever seen, in the first eight months of the year. Additionally, every month, NOAA provides updated information on the state of the climate in the United States and worldwide.

(19:59):

Last week we announced that August was the hottest August on record in 174 years. Now, I think people are starting to get desensitized to us breaking these records, and I will say that normally we break these records by a thousandth of a degree. We broke this record by 0.5 of a degree, and so we broke this record by so much more than we ever have in the past. It left our data scientists shocked. So climate scientists are a little bit worried. I'll also note that this is also happening as we're starting to head into an El Nino. This really matters. So we have climate change increasing temperatures over time, but El Ninos are also the wiggles around that. And so an El Nino will push global temperatures up by 0.1 degrees on average for an entire year. Our seasonal forecast from last month showed that over this winter, we may actually exceed 1.5 degrees of warming in individual months in the next few months, so this winter we may have a few months that may exceed 1.5.

(21:07):

The current climate trends will significantly increase population exposure to heat waves, heat related morbidity and mortality, and that risk is further compounded by urbanization, demographic changes such as aging population, and other stressors such as migration, conflict, disaster response. Extreme temperatures and precipitation also have consequential impacts on physical assets, disrupting supply chains and impact utilities' ability to provide pulses in demand and energy security. I sit on also the National Academy of Science Macroeconomic Climate Risk Roundtable. The main work of myself and other government officials and academics is to accelerate the integration of climate information into macroeconomic forecasting. To make this more tangible, I thought I would give an example of the insurance sector. We are closely speaking with the insurance and reinsurance sectors. We've held a number of round tables. We've seen recently the insurers are starting to leave some markets.

(22:05):

This decision is both due to physical climate risk and the actual physical damage they're seeing, but also due to inflation. The two together make it too costly to operate companies that could handle one or the other, but not both. For the past two years, we've been engaging with them regularly and hearing what type of climate information is needed. As part of our commitments to service delivery in this space, we've conducted multiple engagements across the industry and to find mechanisms to build response to the pressing needs. The top one being for us that we are working with the insurance industry to bring Climate Information Inc. to catastrophe modeling with a new public private-partnership that we've set up with the National Science Foundation. In this, climate information is being incorporated now, but it is coming at a time when people are already starting to access the market because they don't have that data.

(22:56):

The goal going forward is to try and accelerate that, bring climate information into catastrophe models, and also build the future of the workforce that can handle this type of work. Another example I want to give is of energy. We've been working with EPRI on building a climate-ready nation around energy. This is both for operations of how to deal with weather shocks, but also investing in the built environment. As we're seeing all of these investments made into decarbonization, there's also a need to think about adaptation now for smart, efficient investment. And so we're seeing this also at the intersection of the energy sector and insurance. Increased costs of hail and severe storms has led to increases in insurance costs and problems with solar power production this summer. This past summer, we also saw wind droughts due to multiple heat domes coming across the United States and damping the power production, which led to losses in commodities in markets in wind producers and a lot of interest in what is the future of wind.

(23:56):

So how can science be used by investors? To wrap up, I want to say past conditions, the historical information that we have is no longer a reliable indicator of future conditions. Therefore, when making decisions and planning, it's imperative to start incorporating climate projections into this process. We need to start incorporating that into how we do our operations. Building resilience isn't also just about climate anymore. It's also about being able to deal with compounding risk factors, of which climate can be one, but can be one that amplifies other risk factors. As people recognize the risks of climate change, this also creates opportunities for innovation in the build out of a climate aware economy. I'm usually the downer at the cocktail party when I start talking about the science, but if you start thinking about what is going to happen when we have climate-related shocks and scarcity, there's going to be innovation.

(24:52):

People are going to try and come up with the climate solutions to adaptation, to building resilience. And that new demand for those solutions, that is where the innovation comes from, and that is where the investment opportunities will start to develop. So we are faced with this climate challenge, but this is physics, and so now it's a matter of figuring out where are those opportunities, besting in adaptation and resilience. And we are really excited to be... NOAA to be here, to give that science and technology out to try and support that further development of the markets, but also the new technologies that need to exist.

Adam Bass (25:25):

Those optimistic words from Sarah take us very close to the end of our program, both today and during the well-attended launch event. Henry, take us out if you will.

Henry Fernandez (25:36):

I hope that all of you join us and help us in this journey of how do we continue to move the state-of-the-art and the thinking and the policies and the actions in dealing with this existential problem in the world. Thank you very much, everyone.

Adam Bass (26:00):

That's all for this week. A big thank you from Joe and me to Linda, Henry, Simon and Sarah, and of course to all of you for listening. To learn more about the Sustainability Institute, visit msci-institute.com. Next up on the program, we turn the mic over to MSCI's Global Head of Research, Ashley Lester. Ashley will lead a panel of MSCI experts across asset classes to review the global markets and look forward to the remainder of 2023. Until then, I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe.

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