

February 6, 2023

Ann E. Misback Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue NW Washington, DC 20551

By email: regs.comments@federalreserve.gov

Board of Governors of the Federal Reserve System Request for Comment on Principles for Climate-Related Financial Risk Management for Large Financial Institutions (Docket OP-1793) (the "Draft Principles")

MSCI¹ is a leading provider of climate risk data and analytics to the global investment community and has collected climate and environment, social, and governance (ESG) related disclosures from thousands of companies globally for over two decades and developed tools to assist asset owners and managers in their analysis of climate and ESG risks and opportunities to their portfolios.

MSCI is pleased to provide comments on the Draft Principles which are intended to provide a high-level framework for the safe and sound management of exposures to climate-related financial risks.² We recognize that the Draft Principles are consistent with previous proposals issued by the Office of the Comptroller of the Currency (OCC)³ and the Federal Deposit Insurance Corporation (FDIC),⁴ and we welcome these efforts to provide consistency in interagency guidance on climate risk management. We focus our comments below on three specific aspects of the Draft Principles, including: (i) measures to enhance the transparency, consistency, and comparability of scenario analysis results; (ii) alignment with international standards; and (iii) whether the proposed threshold will capture macroprudential climate-related risks.

¹ MSCI ESG Ratings, research and data are produced by MSCI ESG Research LLC.

² The Draft Principles apply to Board-supervised financial institutions with over \$100 billion in assets. See RFC at 75267 (as published in Federal Register). The Draft Principles would address both the physical risks and transition risks associated with climate change, and would cover six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement and reporting; and scenario analysis. *Id.* at 75269-71.

³ See <u>OCC Principles for Climate-Related Financial Risk Management for Large Banks</u>; see also <u>MSCI</u> <u>Comments on OCC Request for Feedback on Principles for Climate-Related Financial Risk</u> <u>Management for Large Banks (February 14, 2022).</u>

See FDIC Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions; see also MSCI Comments on FDIC Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions (June 3, 2022).

1. Use a well-established set of reference scenarios for scenario analysis.

Scenario analysis provides a powerful tool for financial institutions to understand the implications of climate change for their portfolios, and MSCI agrees that climate scenario models, analysis or tools are of paramount importance to gauge the effects of climate change spread across various time horizons. However, one of the major challenges is the use of varied scenarios and tools by financial institutions, meaning that results may not be comparable, which may be particularly difficult for both supervisors and, if disclosed, investors seeking to fully understand the balance sheet exposures to climate-related risks of financial institutions and the broader sector. Financial institutions are expected to determine which climate-related and environmental risks are material in the short-, medium- and long-term regarding their business strategy by using scenario analysis. Such subjectivity in defining relevant time horizons over which material climate-related risks will manifest may further complicate the development of climate scenario analysis models as well as the evaluation of results and interpretation of banks' resilience to climate-related risks.

To enhance the transparency, consistency and comparability of results, a single set of reference scenarios over a clearly defined time horizon would be meaningful. For example, the Network for Greening the Financial System (NGFS) Climate Scenarios have been developed to provide a common starting point for analysing climate risks to the economy and financial system.⁵ They bring together a global, harmonized set of transition pathways, physical climate change impacts and economic indicators to explore a range of plausible outcomes. Recent enhancements to the NGFS scenarios also seek to promote transparency in the market, and among the NGFS' strategic objectives in its next phase of work is providing users with methodological guidance. In its third iteration, the NGFS scenarios have been updated to incorporate country commitments to reach net-zero emissions and have been enriched with more sectoral granularity.⁶

We also note that there are a range of tools and models currently available in the market to assist financial institutions with assessing their material climate risks and conducting forward-looking scenario analysis for certain lines of business. MSCI is able to support banks in this respect by providing access to over 900 climate change metrics and forward looking-indicators, such as MSCI's Climate Value-at-Risk. By calculating the financial risks from climate change per security and per scenario, Climate Value-at-Risk provides a framework that can help banks identify and understand these risks and take necessary action for effective risk management and regulatory reporting purposes. The MSCI Climate Value-at-Risk model has three main underlying components which can be used separately or in aggregate:

a) **Policy risk**: This component aggregates future policy costs based on an end of the century time horizon. By overlaying climate policy outlooks and future emission reduction price

⁵ <u>Scenarios Portal. Network for Greening the Financial System (September 6, 2022).</u>

⁶ <u>NGFS Scenarios for central banks and supervisors. Network for Greening the Financial System</u> (September 6, 2022).

estimates onto company data, the model provides insights into how current and forthcoming climate policies could affect companies.

- b) **Technology opportunities:** This component is based on company-specific data on the patents each company holds related to low-carbon technologies, providing insights into how companies' strategic investments could affect their future competitive positioning in a low carbon economy.
- c) **Physical risks:** This component estimates the impact and financial risk relating to several extreme weather hazards, such as extreme heat and cold and flood risk. An extensive asset location database comprising of over 400,000 company facilities has been overlaid with hazards maps. Based on sector-based vulnerabilities, each location's climate-related revenue loss for eight extreme weather hazards is computed with the help of damage and business interruption functions.

2. Align with international standard setters to minimize burden and optimize results.

MSCI welcomes the Draft Principles to monitor and incorporate data, risk measurement, and reporting developments into banks' climate-related financial risk management. We further support a reporting and disclosure framework that supplements quantitative disclosures with a qualitative overlay of a bank's view of its climate risks and opportunities. We specifically support the efforts of the International Sustainability Standards Board (ISSB) to standardize sustainability disclosures that aim to capture issues that could be material.⁷ The ISSB has consulted on its climate-related disclosures prototype, which build upon the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The framework published by the TCFD has already significantly advanced the convergence of climate-related reporting to be more robust and consistent. The TCFD Technical Supplement on the use of scenario analysis also provides useful baseline guidance to institutions.⁸

We also support efforts to align climate risk management principles, more broadly, with the Basel Committee on Banking Supervision's principles for the effective management and supervision of climate-related financial risks.⁹ MSCI believes it would be further useful to reference the Basel Committee's frequently asked questions on climate-related financial risks, which provide a useful set of (non-exhaustive) examples to banks on how to incorporate climate into specific risk categories, as proposed under the "Management of Risk Areas" section of the Draft Principles.¹⁰

⁷ MSCI feedback on IFRS' Exposure Draft on Climate-related Disclosures.

⁸ <u>Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and</u> <u>Opportunities. Task Force on Climate-related Financial Disclosures (June 2017)</u>.

⁹ Principles for the effective management and supervision of climate-related financial risks. Basel Committee on Banking Supervision (June 15, 2022).

¹⁰ <u>Frequently asked questions on climate-related financial risks. Basel Committee on Banking</u> <u>Supervision (December 8, 2022).</u>

3. Enhance the scope of banks covered.

MSCI supports the principle of proportionality applied by the Draft Principles. MSCI also agrees that financial institutions of all sizes may have material exposure to the physical and transition risks associated with climate change. Smaller banks with a less diversified portfolio and higher regional exposure may be more vulnerable to climate-related risks than larger banks with a wider geographical footprint and diversified loan book. Where the aim is to have a more comprehensive understanding of macroprudential climate-related risks, we believe there may be benefits of lowering the \$100bn applicability threshold to bring in scope a greater part of the U.S. banking system through a phase-in approach, as climate risk expertise increases, and climate risk management frameworks evolve.

Please do not hesitate to contact us to discuss our submission.

Sincerely,

s/ Linda-Eling Lee Managing Director, Global Head of ESG & Climate Research MSCI ESG Research LLC