



22 June 2022

HM Treasury
Department for Business, Energy and Industrial Strategy (BEIS)

Submitted via email: evidence.gfs@beis.gov.uk

Dear Sir / Madam,

Update to Green Finance Strategy – Call for Evidence (“Call for Evidence”)

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 has welcomed a number of initiatives launched by the Financial Conduct Authority (FCA) such as the consultations on enhancing climate-related disclosures by asset managers, life insurers, FCA-regulated pension providers and enhancing climate-related disclosures by standard listed companies, which is expected to address some of the disclosure shortfalls in the market. MSCI currently encounters practical challenges in accessing climate-related information, stemming from inconsistent and incomparable data to overly broad boilerplate disclosure by corporates. Without consistent and comparable underlying data, new financial products and innovation will be hampered. It is therefore critical that the UK government incorporates the enhancement of climate-related disclosures into its updated strategy to require quantitative disclosures based on defined metrics of measurement. That said, MSCI foresees a positive shift towards enhanced disclosures with the FCA final rules on climate disclosures for companies and asset managers; that came into effect from 1 January 2022 (first public disclosures to be made by 30 June 2023).

For the purposes of this submission, we comment in more detail in Annex 1 on those matters where we believe MSCI’s expertise and experience to be most relevant. Please do not hesitate to contact us to discuss our submission.

Yours sincerely,

/s Neil Acres
Managing Director, Head of Government and Regulatory Affairs
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¹ MSCI ESG Ratings, research and data are produced by MSCI ESG Research LLC.

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Annex 1

Q1. Key characteristics of a leading global centre for green finance

There is no single ingredient that makes a country a global center for green finance. It requires a cohesive effort by the private and the public sector with a common goal of meeting the net zero target. We see the following as key milestones for the UK in its journey to become a global centre for green finance:

- a. Developing a Green Taxonomy
- b. Mandating disclosures of climate transition plans
- c. Sustainability disclosure requirements (SDR).

Q6. What areas for potential growth – for example emerging financial products and instruments – are there in green finance for the UK financial services sector?

MSCI foresees significant growth potential in green finance. We continue to observe ongoing interest amongst financial market participants to integrate ESG factors into their financial products.

There is a substantial and growing body of empirical research that has identified meaningful links between a company's ESG characteristics and financial performance. This research demonstrates that ESG considerations consistently have affected the valuation and performance of companies over sustained durations, including with respect to their cost of capital and profitability. Given the significant and increasing impact that ESG factors are expected to exert on the pricing of assets and the allocation of capital in the coming decades, ESG considerations will continue to be integrated throughout the investment process to achieve long-term, risk adjusted returns.

There is ample published research from numerous industry researchers who have found with precision that portfolios composed of companies with higher MSCI ESG Ratings (which are designed to measure companies' long-term resilience to ESG issues with financial relevance) historically have shown lower risk and/or higher risk-adjusted returns over time in a variety of quantitative tests.² Additionally, our own research of over 1,600 securities has shown that, over the period between December 2006 and December 2019, companies with the highest MSCI ESG Ratings showed greater gross profitability, paid more dividends and were multiple times less likely to experience significant drawdown than companies with the lowest ESG Ratings.³

² Lodh, A. 2020. "[ESG and the Cost of Capital](#)." MSCI Blog.; Giese, G., Lee, L.-E., Melas, D., Nagy, Z., and Nishikawa, L. 2019. "Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk and Performance." *Journal of Portfolio Management* 45 (5): 69–83; Giese, G., Lee, L.-E., Melas, D., Nagy, Z., and Nishikawa, L. 2019. "Performance and Risk Analysis of Index-Based ESG Portfolios." *The Journal of Index Investing* Spring 9 (4): 46–57; Serafeim, G., 2018. "[Public Sentiment and the Price of Corporate Sustainability](#)" Harvard Business School Working Paper; AQR 2017, '[Assessing Risk Through Environmental Social and Governance Exposures](#)'; Nordea 2017, '[Cracking the ESG Code](#)'; JP Morgan 2016, '[A Quantitative Perspective of how ESG can Enhance your Portfolio](#)'; Barclays 2016, '[The positive impact of ESG investing on bond performance](#)'; Credit Suisse 2015, '[Finding Alpha in ESG](#)'; MSCI 2015, '[Can ESG Add Alpha](#)'; Harvard Business School 2015, '[Corporate Sustainability: First Evidence on Materiality](#)' *Journal of Sustainable Finance and Investment* 2015; Friede, Gunnar, Timo Busch, and Alexander Bassen. 2015. "ESG and Financial Performance: Aggregated Evidence from More Than 2000 Empirical Studies." *Journal of Sustainable Finance and Investment*, vol. 5, no. 4:210–233 '[The Opportunity Cost of Negative Screening in Socially Responsible Investing](#)' Deutsche Bank 2013, '[The Socially Responsible Quant](#)'.

³ The MSCI ESG Ratings historical data starts in December 2006.

Q16. How can the UK government best assess the progress and development of a natural capital investment market?

To mobilise capital into natural capital assets, gauging the nature-related risks faced by each of the members in the ecosystem is of paramount importance. Actively engaging with initiatives such as the Taskforce on Nature-related Financial Disclosures (TNFD) will help facilitate a global nature related financial reporting standard. The TNFD released the first beta version of its nature-related risk-management and disclosure framework,⁴ marking an important step by the market to tackle the risk of nature-loss to the global economy and reduce the impact on nature. The beta release is an integrated approach to incorporate nature-related risk and opportunity analysis into the heart of corporate and financial decision making.

The TNFD framework would build an improved understanding of nature and nature-related risks and opportunities that would facilitate better corporate strategy, capital allocation decisions, governance, and risk management and disclosure practices.

Q27. What market barriers are there to the integration of environmental-related factors into financial decision-making?

ESG factors impact risks and opportunities in the capital market with climate change being the clearest and most pressing illustration of this reality. However, without access to consistent, comparable and timely information on climate risks facing companies, capital market participants cannot respond to the challenges presented by climate change.

A minimum disclosure standard enables a base comparison across portfolios containing companies in different sectors. The most relevant information for investors is quantitative metrics as these allow comparability. A qualitative overlay may be included but boilerplate statements should be discouraged in favor of meaningful disclosure that explains how the climate-related risks and opportunities are being managed and how they might be expected to impact the company in the foreseeable future.

ESG and climate disclosures are important inputs to understanding the future financial prospects of a company. Investors require consistent and relevant data that can help address four key dimensions of their portfolio exposure to climate change: 1) minimise transition risk; 2) capture green opportunities; 3) minimise physical risks; and 4) ensure alignment with a world that constrains global temperature rise.⁵

Q30. What steps can the UK government take to support a robust investment data ecosystem to attract green finance flows?

Please also refer to response to question 27.

There are three tiers of climate-related disclosures that MSCI views as decision-useful for investors:

(i) **Core data**

The most critical core areas of disclosure are companies' complete carbon emissions footprint, their facility locations and supply chain. Today, there is significant

⁴ [TNFD – Version v0.1 Beta Release](#) (March 2022)

⁵ [Figure 5 - MSCI analytical framework for a Net Zero journey.](#)

inconsistency in disclosure related to these data points.

- **Carbon emissions** - Disclosure of Scope 1 and 2 emissions across all operations globally, plus scope 3 emissions across all categories according to the Greenhouse Gas Protocol,⁶ would significantly improve the market's ability to model and assess a portfolio's financial exposure to potential changes in climate policy, to technology displacement and to changes in market demand. Currently, many companies have not reported their carbon emissions, with the gap being particularly acute for value-chain emissions (Scope 3).⁷ Even the small set of companies that have disclosed Scope 3 emissions do so only for select categories of their own choosing, which prevents benchmarking within, and between, industry peer groups.⁸ A minimum standard of reporting across a broad range of companies would enable a base comparison across portfolios containing companies in different sectors.
- **Facility locations** – Disclosure of the precise location of the ten largest facilities (by asset value or production volume) would assist the market in assessing the extent to which a company's operations are exposed to the range of potential weather and physical hazards. The market is increasingly aware of the risks from changes in weather and climate conditions that can impact future asset value. For example, within MSCI's aggregated Climate VaR model is a physical risk model that aims to estimate the asset value gain/loss from changes in extreme heat, extreme cold, precipitation, wind, cyclones, coastal flooding, fluvial flooding, low river flow (impacting utilities) and wildfire. While climate risk modelers and data providers can access a range of academic models as inputs to project these weather-related changes, the accuracy of the resulting risk assessments depends on having granular geographic information on companies' main business operations. The disclosure of facility locations would allow investors to gain a more consistent assessment of risks that their portfolio companies may face, compared to disclosure of companies' overall assessments of their physical risks, as each company could deploy different definitions of scope or model assumptions, which prevents comparability across companies absent facility location data.
- **Supply chains** - Disclosure of a company's ten largest suppliers would be helpful for the market in understanding the risks posed by climate change to a company's supplychain. The systemic nature of climate change means that companies may be vulnerable to risks far up and down the value chain where, for example, extreme weather could constrain the supply of critical inputs and significantly disrupt operations.⁹

(ii) Industry-specific data

Climate risk exposure, physical and/or transition, varies by sector and disclosure of this data by industry would be helpful in differentiating between companies within a sector whose businesses may vary in exposure to climate risks.

⁶ GHG Protocol Corporate Standard.

⁷ [Disclosure of Carbon Emissions Data, by Scope \(Figure 11\)](#)

⁸ [Disclosure of Scope 3 Carbon Emissions Data, by Categories \(Figure 13\)](#)

⁹ As companies improve their carbon footprint data collection and calculation over time, it would be worth revisiting whether the ten largest facilities and ten largest suppliers could be reported by materiality in terms of emissions intensity.

Existing work on industry-focused standards has been proposed by the TCFD, which provides supplemental guidance for financial and non-financial sectors, accompanied by detailed “example metrics” for disclosure categorized by relevance to financial reporting aspects, i.e., revenues, expenditures, capital, and assets, if applicable. We note that the TCFD’s “example” metrics detail the unit of measure to be reported. This level of specificity is critical for furthering standardisation in quantitative disclosure.

We further note that investors have increased needs for granular information to distinguish between the types of products/services of companies in select sectors. The granular data is important for assessing exposure to high-intensity operations that could become “stranded assets” (e.g., types of fossil fuel reserves, fuel-mix in power generation) and for gauging opportunities to provide ‘solutions’ to a transitioning economy (e.g., types of alternative energy, clean technologies). At present, the market must estimate companies’ exposure to these high-intensity and “green” activities based on an analysis of companies’ financial reporting on their revenues, assets and capital expenditures as there is no direct disclosure on the production or revenue segments of interest. This lack of direct disclosure makes it necessary to rely on revenue estimation which, depending on the level of available disclosure, could lead to over- or under-estimation. Standardised reporting requirements, including specification of the unit of measure, for certain types of high intensity and “green” products and services would significantly improve the availability and quality of information for investors seeking to manage their exposures to high-intensity and “green” products/services.

(iii) **Forward-looking metrics**

In its Guidance on Metrics, Targets and Transition Plans¹⁰, the TCFD has established that managing climate-related risks through a forward-looking approach requires:

- i. the development of scenarios that illuminate the materiality of climate-related physical and/or transition risks;
- ii. the translation of such scenarios into relevant corporate metrics for a financial institution (or supervisor); and
- iii. the interpretation of such results in terms of immediate responses (e.g., changes in portfolio mix or need for new climate-related prudential regulation).

Significant developments in climate risk data analytics and modeling have enabled companies to report according to the TCFD guidance. The TCFD also contributed to advance the development of additional “forward-looking metrics” such as the use of an “Implied Temperature Rise” metric associated with companies’ future emissions.

While companies and investors can choose from an increasingly sophisticated range of such forward-looking metrics for reporting on their potential risks to climate change, transparency is only likely to improve when disclosures are accompanied by a clear explanation of the assumptions, inputs and analytical choices behind the models and pathways used. Transparency around key parameters, assumptions, and analytical choices will help to support comparability of results between different scenarios used by an organization and across organizations. This supports the evaluation, by analysts

¹⁰ [Guidance on Metrics, Targets, Transition Plans, TCFD, 2021.](#)

and investors, of the robustness of organizations' strategies across a range of plausible impacts, thereby supporting better risk and capital allocation decisions.¹¹

An important input into forward-looking metrics is the forward emissions trajectory of companies, which should include a consideration of decarbonization commitments that companies have made. As of January 2021, approximately 35% of the MSCI ACWI IMI Index constituents have set some type of carbon reduction target to be achieved between 2021 and 2100.¹² However, it is difficult to compare the scope and ambition of these decarbonisation targets, as companies report them in disparate ways. Standardised disclosure of companies' decarbonisation targets would greatly facilitate an assessment of their future emissions pathways and their alignment with climate scenarios.

Q31. Are Scope 3 (supply chain) emissions data important for investors to assess and manage climate-related risks and opportunities?

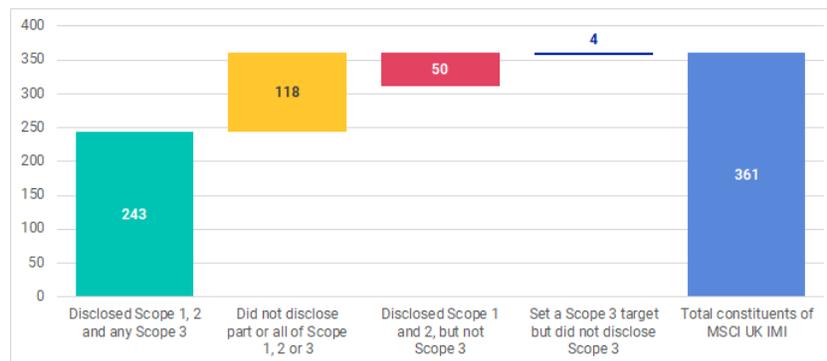
MSCI supports efforts to improve disclosure on Scope 3 emissions.

Of the 361 companies in the MSCI UK IMI, 81% disclosed Scope 1 and 2 emissions, and 61% disclosed some (and not necessarily the most material) Scope 3 emissions. Scope 3 emissions are the biggest sources of total value chain emissions for most of the MSCI UK IMI constituents (please refer to Figure 3 below).

Based on our Scope 3 estimates, 52% of constituents in the MSCI UK IMI would need to report Scope 3 emissions under a 50% materiality threshold, which increases to 55% under a 25% materiality threshold.

Disclosure of Scope 1, 2 and 3 emissions would significantly improve investors' ability to model and assess a company's financial exposure to potential changes in climate policy, to technology displacement and to changes in market demand. As the Figure 1 below shows, companies are currently providing less than the full picture of their GHG emissions. This is especially true for Scope 3 emissions, which form the largest part of many companies' total emissions.

Figure 1: Companies are providing less than full picture of their carbon footprint



Total universe includes the 361 constituents of MSCI UK Investable Market Index, as of June 1, 2022 Source: MSCI ESG Research LLC

Full disclosure of a company's GHG emissions (Scope 1-3) and emission reduction targets

¹¹ [Technical Supplement - The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities](#)

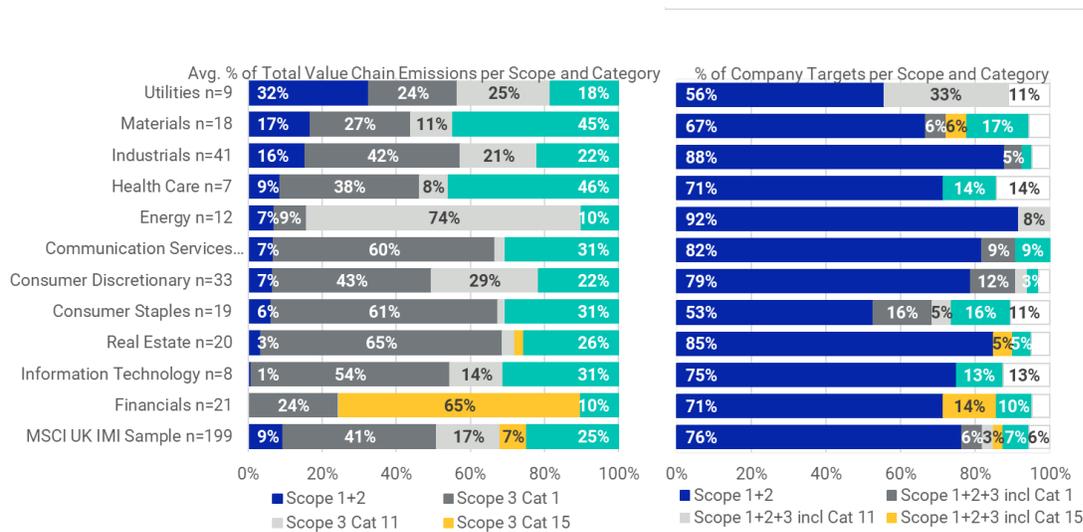
¹² MSCI. 2021. [Breaking Down Corporate Net-Zero Climate Target \(msci.com\)](#). This ACWI IMI index includes approximately 9,000 public companies across 50 developed and emerging markets and has a market value of over USD 70 trillion.

would be helpful to provide investors with a portfolio's net zero alignment score and facilitate a deeper understanding of future trajectory.

(1) Analysis of materiality of Scope 3 emissions based on self-reported data

Figure 2 shows that, on average, 90% of total emissions were attributed to Scope 3 emissions, while Scope 1 and 2 emissions contributed on average 9% of total emissions. Specifically, on average, 41% of total emissions were related to Scope 3 category 1, 17% to category 11, 7% to category 15 and 25% to other categories.¹³

Figure 2: Average Percentages of Total Emissions per Scope and Category against Scope and Category of Decarbonization Targets per GICS



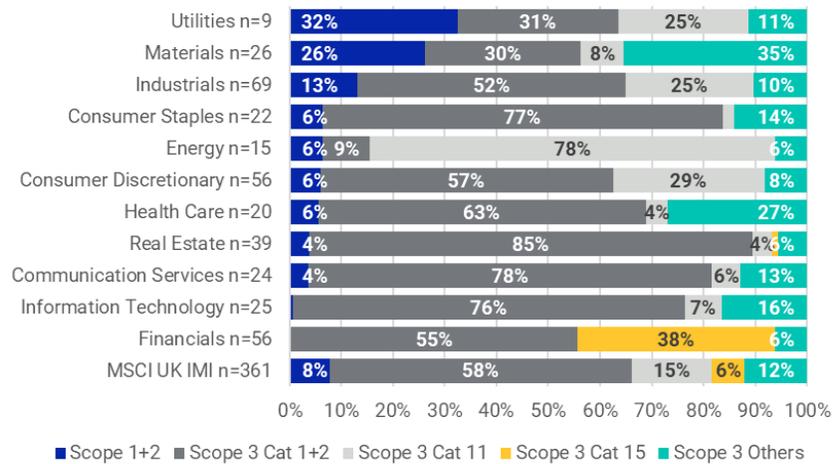
Source: CDP, MSCI ESG Research. June 1, 2022

(2) Analysis of materiality of Scope 3 emissions based on estimated data

Figure 3 shows that, on average, 91% of total emissions were attributed to Scope 3 emissions, while Scope 1 and 2 emissions contributed on average 8% of total emissions for MSCI UK IMI. Scope 3 Categories 1, 11 and 15 contributed a substantial proportion of total value chain emissions across all the Global Industry Classification System (GICS) sectors. These three categories of Scope 3 emissions contributed an average of over 79% of the total carbon footprint for constituents of the MSCI UK IMI Index.

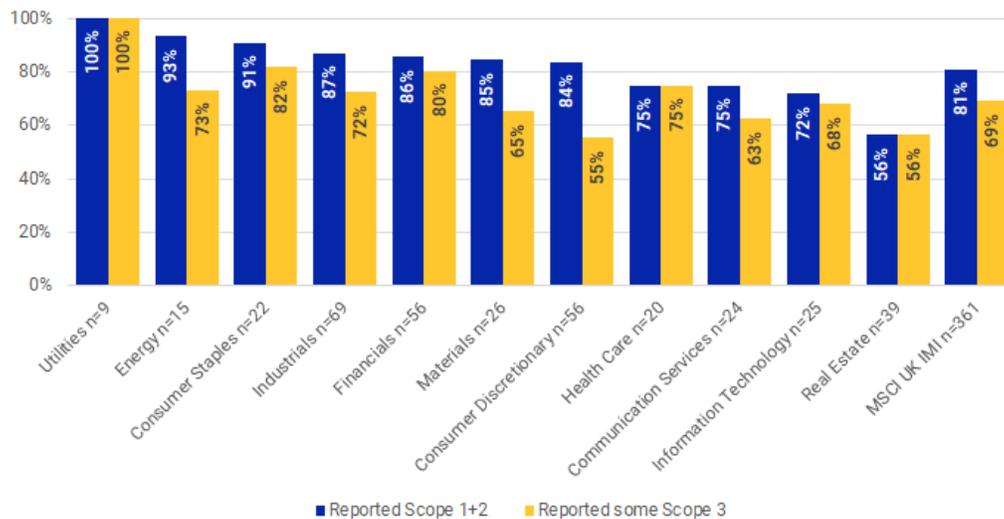
¹³ Based on our analysis of 199 constituents of the MSCI UK IMI that set decarbonization targets and reported Scope 3 emissions per category to CDP in 2021.

Figure 3: Estimated Average Percentages of Total Emissions per Scope and Category from MSCI UK IMI Index



Source: MSCI ESG Research, LLC. Notes: Total value chain emissions per scope and category were estimated based on MSCI Scope 3 emissions estimation model for 361 MSCI UK IMI constituents Data as of June 1, 2022

Figure 4: GHG-emission disclosure rates of MSCI UK IMI constituents by sector and scope



Data as of June 9, 2022. Total universe includes 361 constituents of the MSCI UK Investable Market Index (IMI), as of June 1, 2022, which are covered by MSCI ESG Research Carbon Metrics. Sectors are derived from the Global Industry Classification Standard (GICS®), which was jointly developed by MSCI and S&P Global Market Intelligence. Data includes latest disclosures, as of 2019 or 2020. Source: MSCI ESG Research LLC

Q39. Considering the key market incentives and barriers, how can the UK best support an increase in high quality, green bond issuances for emerging and developing economies?

We support a delineation of use of proceeds in the prospectus regime of the UK in alignment with existing and well-established standards such as the ICMA principles.¹⁴ The Bloomberg MSCI GreenBond Index also uses the ICMA Green Bond Principles¹⁵ as the foundation of its green

¹⁴ [The Principles, Guidelines and Handbooks \(icmagroup.org\)](https://www.icmagroup.org/Principles-Guidelines-and-Handbooks/)

¹⁵ [Green Bond Principles \(icmagroup.org\)](https://www.icmagroup.org/Green-Bond-Principles/)

bond methodology where the methodology has built upon these ICMA principles to assess self-labelled green bonds for index eligibility.

If a UK bond standard is developed, we recommend convergence with international standards, in particular, around low carbon, transitional and enabling activities. This will assist issuers across the world in issuing bonds that qualify as UK-aligned green bonds.

Figure 5

