MSCI's Response on FINMA's Consultation on Climate-Related Financial Risks Disclosures for Banks And Insurers

MSCI

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INTRODUCTION

MSCI ESG Research appreciates the opportunity to comment on the FINMA's Consultation on CLIMATE RELATED FINANCIAL RISKS DISCLOSURES FOR BANKS AND INSURERS

About MSCI

MSCI ESG Research

For over 40 years, MSCI ESG Research has measured and modelled Environmental, Social and Govern-ance (ESG) risk[a]. 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[b]. 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[c]. 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 sys-tems. 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.

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

1.1 Context of the consultation

In the context of Public Disclosure requirements for banks and insurers, FINMA is seeking guidance on the disclosure of climate-related financial risks with regards to

- the institution's governance structure
- a description of how short, medium and long-terms risk are affecting the institution's business and risk strategies
- the type of criteria and valuation methods that are being used for the evaluation of climate-related risks
- and the use of quantitative information such as metrics and targets to assess climate-related financial risks as well as applied methodologies.

MSCI's response focuses on quantitative metrics and outlined below are the rationale for applying quantitative metrics and our recommended methodology for doing so.

1.2 Rationale for leveraging quantitative metrics

As a market-leading provider of ESG and climate solutions we believe that it is crucial to align climate-related analytical approaches with both voluntary and mandatory disclosure requirements. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) outline that climate scenario analysis can be both qualitative and quantitative. While a qualitative approach is better suited to frame climate risk in the context of narratives about a future world, a quantitative approach allows to measure the economic impact of climate-related risks. In this context, adopting a climate scenario approach which can quantify both climate-related costs and potential low carbon profits based on a quantitative metric may give a more accurate assessment of Value at Risk.

1.3 Recommended metric

With reference to the suggested climate scenario approach in 1.2, MSCI's Climate Value-at-Risk (Climate VaR) modelprovides investors with a quantitative, forward-looking analysis on how climate change may affect the investment return in portfolios. The metric allows both investors and creditors to assess and mitigate future risks from climate change, while at the same time helping to identify low carbon opportunities.

Climate VaR is closely aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) in that it quantifies both transition and physical impacts in a climate scenario context.

On the transition side, the model identifies future policy-related costs and future green profits linked to specific emission scenario pathways. The entirety of country emission reduction pledges (Nationally Determined Contributions, NDCs) have been quantified and normalized to align with a 3°C scenario. Based on the UNEP GAP report, the model further quantifies additional emission reduction requirements necessary to achieve the goals of the Paris Agreement which is to limit global temperatures to 2°C or less by the end of the century. In addition, on the policy side, the model incorporates a Scope 2 Electricity Use and a Scope 3 Value Chain model to capture the company's ability to pass-through the cost of electricity as well as factoring in upstream and downstream impacts, for example for the automobile and oil & gas sectors. On the opportunity side, the model assesses Clean Technology revenue market shares of companies in combination with a low carbon patent scoring methodology. Finally, on the physical side, 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 8 extreme weather hazards is computed with the help of damage and business interruption functions.

The net present value of all future climate-related costs and green profits is finally related to the current valuation of the asset to provide users with a climate stressed market valuation, assuming that climate change impacts are currently not priced in.

1.4 The methodological approach outlined

The methodology has been developed by climate and policy experts since 2015 and has gone through several development cycles in cooperation with large institutional investors such as asset owners and asset managers.

Climate Value-at-Risk provides a truly forward-looking dimension for assessing transition risks and opportunities for publicly listed companies, their issued securities as well as real assets.

The framework provides a broad number of scenarios which incorporate different scenario pathways to help assess the climate impact of investment portfolios - a total of 10 transition and 2 physical climate scenarios are available.

Furthermore, the entirety of national emission reduction pledges that countries have committed to under the goal of the Paris Agreement to limit the global temperature increase to 2° Celsius or lower have been quantified. Apart from factoring in direct emission impacts, the model also incorporates indirect impacts from electricity use (Scope 2) and the value chain (Scope 3).

On the opportunity side, Climate Value-at-Risk incorporates a score on low carbon patents to help identify the longer-term future low carbon innovation potential of companies in the transition to a low carbon economy.

Moreover, on the physical side, Climate VaR is not restricted to scoring the exposure on extreme weather hazards but goes further in that it quantifies the cost impact of these extreme weather hazards on each individual company facility in the database. This has been achieved through the development of a comprehensive vulnerability sector system that assesses cost impacts based on damage and business interruption functions for relevant sectors.

Finally, the model calculates climate-related costs and green profits on issuer level and apportions them to the equity and liability side of the business based on the Merton model, a credit risk framework. The Climate VaR for corporate bonds also considers the maturity date of individual bonds.

As such, the Climate VaR approach fully aligns with the recommendations of the Taskforce on Climate-related Financial Disclosures and future climate change regulation such as SFDR:

- The approach is fully forward-looking.
- The approach provides quantitative metrics that assess the financial impact of climate-related risks.
- The approach provides the ability to perform sophisticated quantitative scenario analysis.
- In addition to a wide variety of 2°C or lower scenarios, the approach also includes a 3°C NDC scenario.

- The approach considers both transition and physical impacts.
- The approach assesses both future risk and opportunities.
- The approach relies on emission data collected and Quality Assured when reported by companies or estimated using MSCI's own proprietary estimation model.
- The approach relies on third party verified data sets and provides a comprehensive documentation about methodology, assumptions and data sources.
- The approach provides a high degree of transparency and granular data output.
- The approach considers impacts from Scopes 1, 2 & 3.
- On the physical side, the approach considers industry-specific vulnerabilities and quantifies the cost impact from extreme weather exposure such as coastal & fluvial flooding, extreme heat & extreme precipitation.

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