

# **ESG Ratings Methodology**

**MSCI ESG Research LLC**

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# 1 Methodology overview

## 1.1 Objective

MSCI ESG Ratings provide an opinion of companies' management of financially relevant ESG risks and opportunities. Each rating takes into consideration the company's exposure to potentially material ESG risks, the quality of management systems and governance structures to mitigate potential ESG risks, and where applicable, positioning to meet market demand for the provision of products and services that have a positive environmental or social contribution. For additional details on the definition of rating scales, refer to "MSCI ESG and Climate Symbols and Definitions" available [here](#).

### 1.1.1 Key features

- MSCI ESG Ratings are industry-relative measures and are determined at the company level. Ratings are on a global seven-band scale from AAA (the highest ESG Rating) to CCC (the lowest ESG Rating).
- Each company is evaluated on a selection of two to seven Environmental and Social Key Issues (out of 33 total Key Issues, see Exhibit 1). The Environmental and Social Key Issues relevant for a given company are selected based on the company's exposure to potentially material ESG risks, which are driven by industry-specific and market-specific factors.
- All companies are evaluated on the Governance Pillar, which is comprised of six Key Issues in the Corporate Governance and Corporate Behavior Themes. The evaluation is based on the gap between best practice and each company's governance practices.
- Where applicable, the ESG Rating takes into consideration a company's positioning to meet market demand for the provision of products and services that have a positive environmental or social contribution.
- MSCI ESG Ratings take into consideration a company's management measures relative to their aggregate ESG risks and opportunities. Management measures are generally evaluated through companies' governance structures, policies and targets, quantitative performance metrics, and relevant controversies.

## 2 Data, ratings and scores

The core building blocks of the MSCI ESG Ratings methodology can be seen in the hierarchy shown in Exhibit 1.

**Exhibit 1: MSCI ESG Ratings Key Issue hierarchy**

| 3 Pillars     | 10 Themes                   | 33 ESG Key Issues                   |
|---------------|-----------------------------|-------------------------------------|
| Environmental | Climate Change              | Carbon Emissions                    |
|               |                             | Climate Change Vulnerability        |
|               |                             | Financing Environmental Impact      |
|               |                             | Product Carbon Footprint            |
|               | Natural Capital             | Biodiversity & Land Use             |
|               |                             | Raw Material Sourcing               |
|               |                             | Water Stress                        |
|               | Pollution & Waste           | Electronic Waste                    |
|               |                             | Packaging Material & Waste          |
|               |                             | Toxic Emissions & Waste             |
|               | Environmental Opportunities | Opportunities in Clean Tech         |
|               |                             | Opportunities in Green Building     |
|               |                             | Opportunities in Renewable Energy   |
| Social        | Human Capital               | Health & Safety                     |
|               |                             | Human Capital Development           |
|               |                             | Labor Management                    |
|               |                             | Supply Chain Labor Standards        |
|               | Product Liability           | Chemical Safety                     |
|               |                             | Consumer Financial Protection       |
|               |                             | Privacy & Data Security             |
|               |                             | Product Safety & Quality            |
|               | Stakeholder Opposition      | Responsible Investment              |
|               |                             | Community Relations                 |
|               | Social Opportunities        | Controversial Sourcing              |
|               |                             | Access to Finance                   |
|               |                             | Access to Health Care               |
| Governance    | Corporate Governance        | Opportunities in Nutrition & Health |
|               |                             | Board                               |
|               |                             | Pay                                 |
|               |                             | Ownership & Control                 |
|               | Corporate Behavior          | Accounting                          |
|               |                             | Business Ethics                     |
|               |                             | Tax Transparency                    |

## 2.1 Rating & scores

The top-level assessment is the overall **Company ESG Rating**, an industry-relative seven-point letter rating scale from AAA to CCC. These assessments are not absolute but are explicitly intended to be interpreted relative to a company's industry peers. The Company ESG Rating is derived from the final Industry-Adjusted Company Score, based on an assessment of the underlying data available at the last ESG Rating action date.

**Exhibit 2: The final Industry-Adjusted Company Score mapped to a letter rating**

| Letter Rating | Leader/Laggard | Final Industry-Adjusted Company Score |
|---------------|----------------|---------------------------------------|
| AAA           | Leader         | 8.571* - 10.0                         |
| AA            | Leader         | 7.143 – 8.571                         |
| A             | Average        | 5.714 – 7.143                         |
| BBB           | Average        | 4.286 – 5.714                         |
| BB            | Average        | 2.857 – 4.286                         |
| B             | Laggard        | 1.429 – 2.857                         |
| CCC           | Laggard        | 0.0 – 1.429                           |

*\*Appearance of overlap in the score ranges is due to rounding error. The 0-to-10 scale is divided into seven equal parts, each corresponding to a letter rating.*

- **Industry-Adjusted Company Score:** This score is calculated by normalizing the Weighted Average Key Issue Score relative to the ESG Rating industry peer group, based on score ranges set by the benchmark values in the peer set.
- **Weighted Average Key Issue Score (WAKIS):** This is calculated for each company based on the weighted average of the scores received on:
  - All the individual Environmental and Social Key Issues contributing to the rating of the company; and
  - The Governance Pillar Score.
- The **Governance Pillar Score** is an absolute assessment of a company's overall governance that uses a universally applied 0-10 scale. Starting with a 10, the Governance Pillar Score is based on the sum of deductions derived from Key Metrics included in the Corporate Governance (comprising Ownership & Control,

Board, Pay and Accounting) and Corporate Behavior (comprising Business Ethics and Tax Transparency) Themes.

- **Key Issue Scores (Environmental and Social Themes):** Each company receives a score on each selected Key Issue ranging from 0 to 10. In the Environmental and Social Pillars, the scores evaluate the company's exposure to risks or opportunities and its ability to manage that exposure. These are calculated using the Key Issue Exposure Score and Key Issue Management Score.

## 2.1.1 Interpreting Environmental and Social Key Issue Scores

### Risk-based Key Issue Scores (0-10)

|    |  |
|----|--|
| 10 | Companies with a key issue score of 10 on risk-based ESG key issues have very strong management measures relative to their exposure to the ESG risk. A company with very strong management measures may have robust governance structures, improvement targets, better performance on quantitative metrics relative to industry peers, and an absence of controversies. Companies with a key issue score of 10 do not have very high exposure to the ESG risk. |
| 5  | Companies with a key issue score of 5 on risk-based ESG key issues have moderate management measures relative to their exposure to the ESG risk.   |
| 0  | Companies with a key issue score of 0 on risk-based ESG key issues have very poor management measures relative to their exposure to the ESG risk. Typically, companies with a key issue score of 0 also have very high exposure to the ESG risk.   |

### Opportunity-based Key Issue Scores (0-10)

|    |   |
|----|---|
| 10 | Companies with a key issue score of 10 on opportunity-based ESG key issues have very strong positioning to meet market demand for the provision of products and services that have a positive environmental or social contribution. |
| 5  | Companies with a key issue score of 5 on opportunity-based ESG key issues have moderate positioning to meet market demand for the provision of products and services that have a positive environmental or social contribution.     |
| 0  | Companies with a key issue score of 0 on opportunity-based ESG key issues do not have initiatives to meet market demand for the provision of products and services that have a positive environmental or social contribution.       |



## 2.2 Supplemental scores

Supplemental scores are also calculated that do not directly contribute to the overall ESG Rating, but provide users of ESG Ratings with additional or specific insights.

### 2.2.1 Pillar Scores

Pillar Scores across the Environmental and Social Pillars are calculated based on the weighted average of Key Issue Scores underlying each Pillar, normalized by the total sum of weights underlying each Pillar.

- The **Environmental Score** represents the weighted average of all Key Issues that fall under the Environmental Pillar.
- The **Social Score** represents the weighted average of all Key Issues that fall under the Social Pillar.

### 2.2.2 Theme Scores

Theme Scores across the Environmental and Social Pillars (8 out of 10 Themes) are calculated based on the weighted average of Key Issue Scores underlying each Theme, normalized by the total sum of weights underlying each Theme.

In the Governance Pillar, for both the Corporate Governance and Corporate Behavior Themes, a Theme Score is calculated.

Theme Scores range from 0 to 10, with lower scores indicating more severe risk.

### 2.2.3 Governance Key Issue Scores

Each Key Issue represents a broad area of governance risk. For each Key Issue, an absolute score is provided. Key Issue Scores range from 0 to 10, with lower scores indicating more severe risk.

### 2.2.4 Governance Theme and Key Issue percentiles

To complement the 0-10 Theme Score and Key Issue Scores, percentile rankings are calculated and published for each Theme and Key Issue. The percentiles assess a company's relative performance against other companies, with percentile rankings ranging from 0-100. Two types of percentile rankings are published:

- Home Market: percentile rankings calculated against the constituents of a particular Home Market,<sup>1</sup> and
- Global: percentile rankings calculated against the entire coverage universe.

Percentile rankings may be interpreted as set out in Exhibit 3 below, to identify leaders and laggards.

**Exhibit 3: Interpreting percentile rankings**

| Percentile Rankings | Description    |
|---------------------|----------------|
| 96 - 100            | Best in class  |
| 76 - 95             | Above average  |
| 26 - 75             | Average        |
| 6 - 25              | Below average  |
| 0 - 5               | Worst in class |

## 2.3 Pillar, Theme and Key Issue weights

The Key Issue weights used in the calculation of the Weighted Average Key Issue Score are published for the Environmental and Social Key Issues.

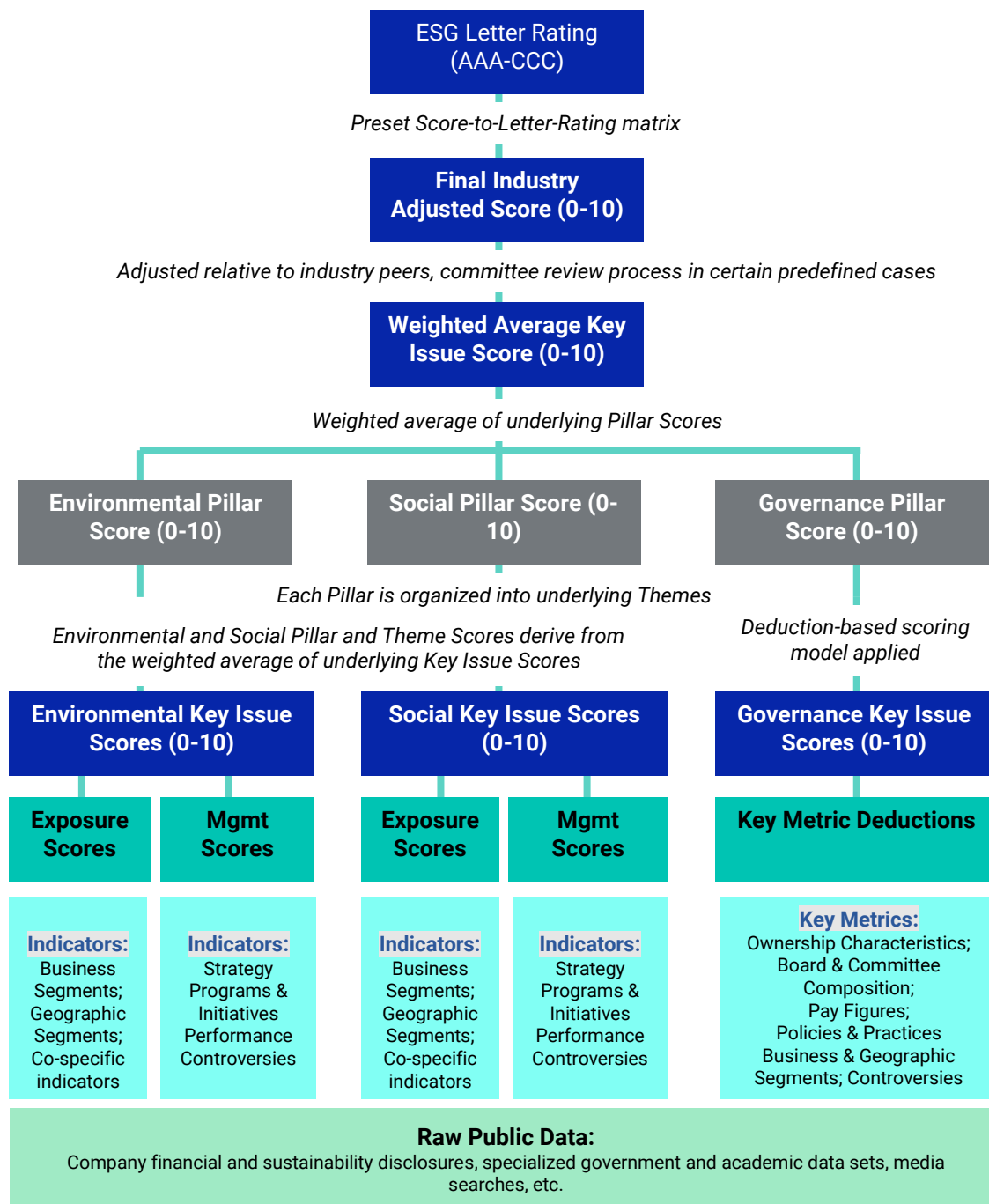
For Governance, as weight-setting is undertaken at the Pillar level, and due to the nature of the deduction-based scoring model in the Governance Pillar, Key Issue weights are not available.

In addition, weights are published for each of the three Pillars.

- The **Environmental Weight** represents the sum of the weights of all Key Issues that fall under the Environmental Pillar.
- The **Social Weight** represents the sum of the weights of all Key Issues that fall under the Social Pillar.
- The **Governance Weight** is a standalone calculation and is floored at 33%.

<sup>1</sup> Home Markets are selected as set out in Appendix 6: Home-Market selection.

**Exhibit 4: Hierarchy of ESG Scores**



## 3 Methodological steps

### 3.1 ESG Key Issues

#### 3.1.1 Determining ESG Key Issues

The research process begins with an in-depth assessment of the ESG risks and opportunities that are relevant to each industry. There are 27 Environmental and Social Key Issues, and industries are evaluated on a selection of two to seven of these key issues. Key Issue selection is based on an annual review of underlying data and review by analytical staff. This process is explained in more detail below.

##### *Universal Key Issues*

All companies in all industries are evaluated on the Key Issues under the Governance Pillar, with six governance Key Issues evaluated across two Themes: Corporate Governance and Corporate Behavior (See Section 3.4.5, Determining Governance Scores, for the slightly different treatment of supranationals and development banks). This is based on our view that governance is universally important and should be evaluated in an integrated way, regardless of industry.

##### *Setting industry Key Issues*

ESG Key Issues are selected for each of the 163 sub-industries defined by the Global Industry Classification Standard (GICS®).<sup>2</sup> The Environmental and Social Key Issues vary between industries and are selected based on the extent to which the business activities of the companies in each industry generate large environmental- or social-related externalities. The steps are as follows:

- For each company, reported business segments are mapped to a standard business activity. MSCI ESG Research uses the Standard Industrial Classification (SIC) system along with industry-specific adjustments to define business activities.
- Each business activity is assessed on the level of externality generated for each ESG Key Issue to derive a Business Segment Exposure Score.

For instance, we measure the externality for the Health and Safety Key Issue based on the extent to which companies' business segments are prone to injuries and fatalities. The data is based on industry statistics from the

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<sup>2</sup> GICS is the global industry classification standard jointly developed by MSCI and S&P Global Market Intelligence.

International Labour Organization (ILO) and health and safety authorities such as the Occupational Safety & Health Administration (OSHA).

For a company operating underground coal mines (SIC 1222), the average fatality rate per 1,000 employees is 0.45; for a company operating surface coal mines (SIC 1221), the average fatality rate per 1,000 employees is 0.13. These metrics are converted into a 0-10 score, based on the relative ranking of industry intensities.

- Each company's overall Business Exposure Score is the weighted average of the Segment Exposure Scores of a company's business segments, weighted by the percentage of sales, percentage of assets or percentage of operations. This constitutes the company's Business Segment Exposure score.
- We rank all 163 GICS sub-industries on each Key Issue based on the average ESG Business Segment Risk Exposure score of the underlying companies.

The example shown in Appendix 2: Example of industry Key Issue selection illustrates how the carbon intensity of each GICS sub-industry is used to determine whether the Carbon Emissions Key Issue should be considered an industry Key Issue.

Typically, we will propose changes to industry Key Issues based on the following:

- We propose the addition of an ESG Key Issue for a GICS sub-industry when the size of the externality (based on the average Business Exposure Score of the companies in that sub-industry) is at or exceeds the 80th percentile of all sub-industries and the average Business Exposure Segment Risk Exposure score is greater than or equal to 5.0.
- We propose the removal of an ESG Key Issue for a GICS sub-industry when the size of the externality (based on the average Business Exposure Score of the companies in that sub-industry) is at or below the 70th percentile of all sub-industries and the average Business Exposure Score is less than or equal to 3.3.

In Q4 of each calendar year, we institute a **30-day client consultation and comment period** during which we solicit feedback on proposed changes to the industry Key Issues.

### ***Company-Specific Key Issues***

In some cases, a company may face a unique Environmental or Social Key Issue that is not shared by other companies in its industry. This can arise from several scenarios, ranging from companies with unique or diversified business models to subsets of companies within an industry that face a unique set of risks (see Exhibit

5). In these cases, a Company-Specific Key Issue is added to the analysis and the weights on the remaining Key Issues are reduced proportionally.

In other cases, a company may not share a particular Environmental or Social Key Issue that other companies in its industry face. In such cases, the issue is removed from the analysis and the weights on the remaining Key Issues are increased proportionally.

#### Exhibit 5: Guideline for adding Company-Specific Key Issues

| Description   | Rule   | Key Issue Addition                                     | Examples   |
|---|--|--|--|
| <b>Company sources significant revenue from secondary industry</b>        | >20% revenue or earnings derived from secondary business line        | Most relevant key issue facing secondary business line | <b>Tiffany</b> (Retail) >20% revenue from fine jewelry, add Controversial Sourcing   |
| <b>Company has large footprint in secondary industry</b>                  | High absolute size of secondary business line relative to peers      | Most relevant key issue facing secondary business line | <b>Disney</b> (movies & entertainment) among world's largest toy manufacturers, add Supply-Chain Labor Standards                   |
| <b>Company has a unique business model</b>                                | Exception-based, ESG Ratings Methodology Committee approval required | Most relevant key issue                                | <b>Herbalife</b> (personal products) sells weight supplements and is regulated by food safety bodies, add Product Safety & Quality |
| <b>Company faces a severe or very severe controversy on non-Key Issue</b> | Based on severity, status, and date of controversy                   | Key Issue mapped to that controversy                   | <b>Sysco Corporation</b> faces severe controversy in Labor Management  |

| Examples of industry-based rules                                   |   |                         |   |
|--|---|-------------------------|---|
| <b>Utilities with significant hydro operations</b>                 | Based on % capacity, absolute capacity (megawatts [MW]), and geographic presence in biodiversity hotspots | Biodiversity & Land Use | <b>Eletrobras</b> has total hydro capacity > 35,000 MW, representing 85% of capacity, and operates in biodiversity hotspots in Brazil |
| <b>Casinos operating hotels in water-stressed regions</b>          | >20% revenue from hotels in water-stressed zones  | Water Stress            | <b>Las Vegas Sands</b> derives >20% from hotel operations located in highly water-stressed areas                                      |
| <b>Semiconductor companies reliant on outsourced manufacturing</b> | Reliance on outsourced production vs. in-house production   | Supply-Chain Labor      | <b>Samsung Electronics</b> outsources most of its production and has significant brand recognition                                    |

*Note: This list of exceptions is not exhaustive but is intended as illustration only*

Analysis of the Company-Specific Key Issue contributes to the company's overall rating but does not contribute to the ratings of industry peers that are not significantly affected by that particular Key Issue. All Company-Specific Key Issues are reviewed and approved by the ESG Ratings Methodology Committee.

Companies in diversified industries such as industrial conglomerates, trading companies & distributors, diversified support services, diversified consumer services, specialty retail, and specialized real estate investment trusts are the most frequently evaluated on Company-Specific Key Issues. For these industries, analysis of each company's business model is undertaken at the outset of industry research.

#### Company Specific Key Issue adoption rate:

As of January 31, 2023, approximately 20% of companies were evaluated on a Company-Specific Key Issue.

### 3.1.2 Setting ESG Key Issue weights

Once the Key Issues have been selected for a GICS sub-industry, we set the weights that determine the contribution to the overall rating of:

- Each Key Issue in the Environmental and Social Pillars; and
- The Governance Pillar.

Each Environmental and Social Key Issue typically comprises 5% to 30% of the total ESG Rating. The weights for these Key Issues are determined for each GICS sub-industry based on the sub-industry's contribution to the negative externality

associated with the Key Issue and the expected time horizon for the Key Issue to materialize, as illustrated conceptually in Exhibit 6, below.

For the Governance Pillar, the weight is set at the Pillar level rather than at the key issue level. The Governance Pillar weight is determined for all sub-industries assuming a “High Contribution/Long Term” and “Medium Contribution/Long Term” assessment on Corporate Governance and Corporate Behavior, respectively.<sup>3</sup> Additionally, the weight on the Governance Pillar is floored at a minimum value of 33%.

Company-specific Key Issues and weights are permitted, subject to committee approval, for companies with diversified business models, facing controversies or based on predefined rules that apply to certain industries.

Key Issues and weights undergo a formal review and feedback process at the end of each calendar year.

#### Exhibit 6: Framework for setting Key Issue weights

|   |  | Expected Time frame for Risk/Opportunity to Materialize |                      |
|---|--|---|----------------------|
|   |  | Short-Term (<2 years)                                   | Long-Term (5+ years) |
| Level of Contribution to Environmental or Social Impact | Industry is a <b>major</b> contributor to impact | Highest Weight  |                      |
|   | Industry is a <b>minor</b> contributor to impact |   | Lowest Weight        |

The framework is such that a Key Issue defined as “High-Impact” and “Short-Term” would be weighted three times higher than a Key Issue defined as “Low-Impact” and “Long-Term.”

- Level of contribution to social or environmental externality:** In the process outlined above, each GICS sub-industry is assigned a “High,” “Medium,” or “Low” impact for each Key Issue, based on our analysis of relevant data (e.g., average carbon emissions intensity). For Key Issues where the primary risk materializes via an event such as a controversy, we look at the severity of the controversies to determine the level of contribution to the Environmental or Social externality. For instance, occurrence of severe/very severe controversies is viewed as having a high level of contribution to the concerned externality. Conversely, occurrence of

<sup>3</sup> In cases where the Corporate Governance Score cannot be calculated for the Governance Reference Entity due to insufficient disclosure, the Governance Pillar Score is calculated solely by reference to the Corporate Behavior Key Issue.



minor controversies is viewed as having a low level of contribution to the concerned externality. Conversely, if many companies in an industry are observed to experience severe controversies in an area, then the level of contribution is determined to be High. At the same time, if many companies in an industry are observed to experience minor or no controversies in an area, then the level of contribution is determined to be Low.

- **Expected time horizon of risk/opportunity:** The time horizon of each Key Issue (Short-Term, Medium-Term, Long-Term) is classified based on the type of risk or opportunity that each Key Issue presents to companies.
- Each Key Issue is assigned a baseline time horizon (for example, depending on whether the risk is driven by pending regulations versus a slower time horizon issue, such as consumer demand shift).
- In some cases, the time horizon of a single Key Issue can vary between industries (for example, Labor Management is defined as a Medium-Term issue when its relevance is to general worker productivity but is considered Short-Term in industries where labor disruptions and stoppages are very common).

### Finalizing Weights

The final set of Key Issues and accompanying weights must be approved by the sector team leader and the ESG Methodology Committee before the research process progresses. Weights are set at the beginning of the calendar year and apply throughout that year.

Please see **Appendix 3: Weight-setting framework** for further information on this process.

### 3.1.3 Key Issue assessments

Depending on the nature of the Key Issue, one of three evaluation approaches is undertaken:

- **Risk Key Issues:** A Risk Exposure Score and a Risk Management Score are combined such that a higher level of exposure requires a higher level of demonstrated management capability in order to achieve the same overall Key Issue Score. The ESG Risk Exposure Score is calculated referencing a granular breakdown of a company's business: its core product or business segments, the locations of its assets or revenue, and other relevant measures such as

outsourced production. See Section 3.2: Analyzing Risk Exposure and Section 3.3: Analyzing Risk Management.

- **Opportunities Key Issues:** A Risk Exposure Score and a Risk Management Score are combined such that a higher level of exposure permits a wider range of outcomes, whereas a low level of exposure constrains the score closer to a value of 5 (out of 10).
- **Governance Key Issues:** For each Key Issue, an absolute score is provided. Key Issue Scores range from 0 to 10, with lower scores indicating more severe risk. See Section 3.4: Analyzing Governance.

## 3.2 Analyzing risk exposure

In the Environmental and Social Pillars, each Key Issue model consists of two components: risk exposure and risk management.<sup>4</sup> This distinction allows the model to adjust the strength of management systems required to achieve a given Key Issue Score: ***Companies facing higher risk exposure must have stronger management practices in place to mitigate their risks.***

Conversely, the model does not penalize companies with minimal risk management strategies if they face low or minimal exposure to the specific risk.

For Key Issues that assess opportunities rather than risk, we evaluate each company's exposure to assess the relevance of those particular business opportunities for a given company.

### 3.2.1 ESG Risk Exposure model

Our assessment of risk exposure may comprise three different areas of analysis, depending on the Key Issue:

---

<sup>4</sup> For Raw-Material Sourcing, risk exposure and risk management are assessed at a more granular material level (timber/paper, beef/dairy, seafood/aquaculture, palm oil, cotton, leather). For Corporate Governance (Ownership & Control, Board, Pay, Accounting) we apply a different scoring approach. See Section 3.5.4: Calculating Governance Scores, below.

- **Business Risk Exposure** – analyzes the breakdown of a company’s business in terms of revenue, assets or operations.
- **Geographic Risk Exposure** – analyzes the breakdown of a company’s geographic segments in terms of revenue, assets or operations.
- **Company-Level Risk Exposure factors** – such as number of employees, size, reliance on government contracts or reliance on outsourced production.

**Business Exposure** is a weighted average of the Business Segment Exposure Scores of a company’s business segments, adjusted for the proportion of total assets or revenue for which each segment accounts. The Business Segment Exposure score measures the extent of the externality generated by each business activity (for example, the carbon emissions generated per dollar of revenue by cement production).

MSCI ESG Research uses the Standard Industrial Classification (SIC) system along with industry-specific adjustments to define business activities. In some industries where SIC-based industries lack sufficient granularity for an accurate ESG risk assessment, MSCI ESG Research creates business activities that more accurately represent a company’s lines of business (see Exhibit 7).

#### Exhibit 7: Examples of MSCI’s business-segment mapping

| Official SIC Segment   | Additional MSCI Business Activities   | Justification   |
|--|---|---|
| 1021 Copper Ores<br>1031 Lead and Zinc Ores<br>1041 Gold Ores<br>1044 Silver Ores<br>1061 Ferroalloy Ores<br>1099 Misc. Metal Ores | Each category segmented by <b>Surface Mining</b> vs. <b>Underground Mining</b>  | Varying land disturbance, accident rates                                    |
| 1311 Crude Petroleum & Natural Gas   | <b>Oil Extraction – Onshore:</b> Conventional, Shale, Artic, Oil Sands – Mining, Oil Sands – In Situ, Oil Sands – Bitumen/SCO, Heavy Oil;<br><b>Oil Extraction – Offshore:</b> Shallow, Deepwater, Arctic<br><b>Natural Gas Extraction – Onshore:</b> Conventional, Shale, Arctic, coal-seam gas (CSG)/coalbed methane (CBM);<br><b>Natural Gas Extraction – Offshore:</b> Shallow, Deepwater, Arctic | Varying land disturbance, carbon emissions, water intensity, accident rates |
| 3674 Semiconductors  | <b>Fab</b> vs. <b>Fabless</b>   | Varying water intensity   |

| Official SIC Segment   | Additional MSCI Business Activities   | Justification  |
|--|---|--|
| 4911 Electric Services   | <b>Power Generation:</b> Hard Coal, Lignite, Liquid Fuel, Natural Gas, Nuclear, Hydroelectric, Renewables;<br><b>Transmission; Distribution</b>   | Varying land disturbance, carbon emissions, water intensity, toxic emissions |
| 6512 Operators of Buildings<br>6552 Land Sub-dividers & Developers<br>6798 Real Estate Investment Trusts | Each category segmented by:<br><b>Residential:</b> Single-Family, Multi-Family;<br><b>Retail:</b> Non-Shopping Mall, Shopping Mall;<br><b>Healthcare:</b> Inpatient, Outpatient;<br><b>Office; Recreation; Restaurants; Food &amp; Grocery Markets; Hotels &amp; Residential Care; Warehousing; Other</b> | Varying energy intensity, green building incentives and regulations          |

**Geographic Exposure** is a weighted average of the Geographic Segment Exposure Scores of the countries and regions in which a company operates. The methodology to calculate Geographic Segment Exposure Scores varies and is relevant only for certain Key Issues. Generally, each methodology relies on external data sets and assessments by MSCI ESG Research to differentiate countries on a variety of factors, including:

- Regulatory (ex: stringency of regulations, differences in subsidies).
- Natural (ex: physical hazards, resource availability)
- Social and governance (ex: perceptions of corruption, frequency of employee fatalities)

For certain Key Issues, additional factors are used to evaluate companies' risk exposure, such as the number of employees, the volume of sensitive commodities sourced, and the percentage of sales from private label goods.

Please see individual Key Issue methodology documents for a list of metrics and data sources used to assess the risk exposure of companies on each Key Issue.

### 3.2.2 Determining Exposure Scores

In the Environmental and Social Pillars, Exposure Scores ranging from 0 to 10 are calculated for each Key Issue, indicating a company's level of exposure to this specific Key Issue based on its unique mix of business and geographic segments. The 0-10 score is calculated in the following steps:

1. **Weighted average Business Exposure Score**, based on 0-10 Business Exposure Scores for each business line weighted by percentage of assets, percentage of revenue or percentage of operations;
2. Combined with **company-specific factors**, if applicable (e.g., size of workforce, percentage outsourced, etc.); and
3. Multiplied by **geographic multiplier**, if applicable. The exposure score can increase/decrease by up to 50%, based on the geographic mix of assets or revenue.

***The final result is a 0-10 Exposure Score, where 0 indicates lowest exposure to this Key Issue, and 10 indicates highest exposure to this Key Issue.***

### 3.3 Analyzing Risk Management

#### 3.3.1 Components of Risk Management assessment

In the Environmental and Social Pillars, our assessment of a company's ability to manage its risk exposure on a Key Issue typically falls into three broad categories:

- Strategy & Governance
- Initiatives & Programs
- Performance

Although specific indicators differ across Key Issues, the Strategy & Governance section typically evaluates organizational capacity and company management's level of commitment to address the key risks and opportunities, including such aspects as the level and extent of organizational responsibility for the specific risks/opportunities, strength and scope of policy commitments, and strength and scope of commitment to standards.

The Initiatives section typically evaluates the strength and scope of the initiatives, programs and targets in place to improve performance on the Key Issue.

The Performance section evaluates the company's track record on managing the specific risk or opportunity. Performance involves collecting, standardizing and benchmarking a range of quantitative indicators where applicable, as well as an evaluation of qualitative indications of performance. As part of the qualitative indication of a company's performance on an ESG Key Issue, we incorporate information on controversies in which a company has been implicated.

#### 3.3.2 Controversies cases

MSCI ESG Research has a dedicated team of analytical personnel who identify and assess on an ongoing basis the severity of controversy cases that involve companies in our ratings universe.

A controversy case is defined as an instance or ongoing situation in which company operations and/or products allegedly have a negative environmental, social and/or governance impact. Cases include alleged company violations of existing laws and/or regulations to which they are subject; or an alleged company action or event that violates commonly accepted international norms, including but not limited to norms represented by global conventions such as the United Nations (UN) Global Compact.

A case is typically a single event such as a spill, accident or regulatory action, or a set of closely linked events or allegations such as health and safety fines at the

same facility, multiple allegations of anticompetitive behavior related to the same product line, multiple community protests at the same company location or multiple individual lawsuits alleging the same type of discrimination.

Each controversy case is assessed for the severity of its impact on society or the environment and consequently rated Very Severe (reserved for “worst of the worst” cases), Severe, Moderate or Minor.

To reach these assessments, each case is analyzed along two dimensions.

- The nature of harm, on a scale ranging from Very Serious to Minimal harm.
- The scale of impact, on a scale ranging from Extremely Widespread to Low impact.

These assessments are combined in the matrix below to reach an initial determination of severity, with multiple possible scenarios able to yield the same severity assessment through various combinations of scale of impact and nature of harm.

#### Exhibit 8: Assessment of controversies

| Scale of Impact      | Nature of Harm |          |          |          |
|----------------------|----------------|----------|----------|----------|
|                      | Very Serious   | Serious  | Medium   | Minimal  |
| Extremely Widespread | Very Severe    | Severe   | Severe   | Moderate |
| Extensive            | Very Severe    | Severe   | Moderate | Moderate |
| Limited              | Severe         | Moderate | Minor    | Minor    |
| Low                  | Moderate       | Moderate | Minor    | Minor    |

#### Exacerbating circumstances:

While the initial severity assessment is determined by a controversy case’s placement on the matrix, certain circumstances may warrant a final assessment that is more severe. The following rules allow for such adjustments.

- The ESG controversy negatively impacts the most **vulnerable demographics**. The definition of vulnerable demographics is limited to national, ethnic, racial and religious groups (including indigenous people) currently subject to serious, systemic and prolonged human rights violations as defined by international bodies and standards such as UN Convention on the Prevention and Punishment of the Crime of Genocide or the United Nations Declaration on the Rights of Indigenous Peoples, and investigated by the International Criminal Court and/or

international human rights advocacy groups, such as Amnesty International and Human Rights Watch.

- The ESG controversy negatively impacts the most **vulnerable ecosystems**. MSCI ESG Research defines vulnerable ecosystems as those included on the United Nations Educational, Scientific and Cultural Organization (UNESCO) World Heritage List.
- When there are allegations that the company or company's representatives or employees are involved in activities constituting **deliberate action** with regard to social or environmental harm. These may include deliberate obstruction of investigations, attempts to cover up the event or activity or the punishment or termination of employees voicing their concerns or participating in protests against the company.
- Cases that meet the criteria for exacerbating circumstances may have a final assessment that is more severe than the initial severity assessment derived from the nature and scale of impact alone. As events unfold or additional information becomes available, the severity of a given case may be reassessed as warranted.

### Selective incorporation of controversies into the ESG Rating Model

While every controversy case may signal reputational risk, not every controversy is judged to pose material risks; therefore, not every controversy affects the company's overall rating.

MSCI ESG Ratings typically assess whether the controversy case indicates structural problems with a company's risk management capabilities. In the ESG Rating methodology, a controversy case that is deemed by analytical personnel to indicate structural problems that could pose future material risks for the company triggers a larger deduction from the Key Issue Score than a controversy case that is deemed to be an important indicator of recent performance but not a clear signal of future material risk. Conversely, if a case is brought to the ESG Ratings Methodology Committee as per predefined criteria, analytical personnel can propose to exclude a controversy case from the risk management assessment when a controversy case has been addressed by a company's management practices and deemed unlikely to pose future material risk to the company.

### 3.3.3 Standardization and benchmarking

A key component of the analytical process is to standardize the public data that analytical personnel collect with an aim to accurately gauge companies' risk management capabilities.



**Example:** ESG data experts collect historical data on health and safety rates, which are often not comparable in terms of the units reported or the scope covered (e.g., statistics cover contractors versus employees only, or joint ventures versus wholly owned subsidiaries only). Analytical personnel normalize data across companies that report differently with an aim to allow uniform industry benchmarking.

Analyzing the targets that companies commit to on a Key Issue, such as targets on reducing water consumption in response to operational risks arising from Water Stress, is another example of where analytical personnel compare the strength of companies' commitments.

While the indicators used to score companies on each Key Issue are standardized across industries that face the same Key Issue, which facilitates comparisons across industries on each Key Issue, analytical personnel delve into industry-specific or region-specific information where possible when scoring the indicators with a goal to capture the risks and opportunities companies face in each industry.

**Example:** Biodiversity & Land Use Key Issue metric: "To what extent do companies minimize disturbances from operations?"

In our Oil & Gas research, data personnel collect data on the total barrels of oil spilled and the intensity of the spills (barrels spilled per USD sales); analytical personnel rank the results on oil spills, which are then translated into 0-10 scores for this metric in the Key Issue model.

### 3.3.4 Variations in disclosure

While the ESG Rating model and analysis process encompasses in-depth analysis of industry-specific data and Key Issues, our ratings methodology has also been designed to accommodate large variations in norms of disclosure, including low to almost no ESG disclosure among companies that are smaller in market capitalization, operate in less environmentally intensive industries, and/or in regions newly aware of ESG Key Issues, without overly penalizing lack of disclosure.

The structure of the model is such that half of the contribution of Environmental and Social Key Issues to the overall ESG Rating comes from an assessment of a company's Risk Exposure. Because company-level inputs required for our assessment of Risk Exposure come from standard financial disclosure, typically, no modification in our model is necessary to accommodate companies with lower ESG disclosure.

For the Risk Management assessment, where analysis is more reliant on ESG-specific company disclosure, we have identified through testing a set of baseline indicators that meet the dual criteria of being most-often disclosed and most likely

to differentiate companies from industry peers on Risk Management capabilities on each Key Issue.

Where there is no company disclosure on an indicator falling into the Performance category of Risk Management, the ESG Ratings analytical approach does not assume that the company's performance category is "worst." Instead, the methodology assigns a performance level that is below average in the industry context.

**Example:** In the Health & Safety Key Issue, data experts collect extensive data points on injury and fatality rates that can be used to discern performance trends. Analysis of this data is used to calculate a score for the indicator: "Rate the company's performance on the above metrics (injury and fatality statistics), in the context of its industry peers?"

A score of 0 indicates worst performance in the industry context, while a score of 10 indicates best performance in the industry context. When lack of disclosure on injury or fatality rates prevents a rigorous performance analysis, the model assigns a score of 3 out of 10.

Where there is no company disclosure on an indicator falling into the Initiatives category of Risk Management on a Key Issue, the ESG Ratings analytical approach depends on where the company has the bulk of its operations and whether risk management initiatives for the Key Issue in question are common.

**Example:** In the Biodiversity & Land Use Key Issue, analytical personnel assess companies' efforts to minimize disturbances from their operations. For companies that operate primarily in highly regulated markets but lack disclosure on minimizing environmental disturbance, we assume they met at least a basic standard, leading to a score of 3 out of 10.

The existence of mitigation efforts is not assumed for companies mainly operating in markets with limited environmental protections and enforcement.

**Example:** In contrast, in the case of Supply Chain Labor Standards Key Issue, we assume that the lack of disclosure of an explicit Code of Conduct for suppliers indicates that the company may not have such a policy in place, thereby raising the risks of poor labor standards in its supply chain that can lead to operational disruptions and reputational damage.

When a company's lack of disclosure on specific Key Issues leads to uncertainty in assessing its performance relative to peers, the ESG Ratings company report explicitly points out this uncertainty in assessing the company's performance.

In certain cases, MSCI ESG Research uses estimates when a company-disclosed figure is not available. Estimates are typically derived from industry averages,

regional criteria and extrapolation from company disclosures to derive more granular values.

### 3.3.5 Determining Management Scores

In the Environmental and Social Pillars, management scores ranging from 0 to 10 are calculated for each Key Issue, indicating a company's strategy, programs and proven track record on this Key Issue. The 0-10 score is calculated in the following steps:

- Each underlying indicator collected is transformed into a 0-10 score, where 10 indicates best practice and 0 indicates a lack of management.
- Scores are equally weighted within each management category. For example, if three indicators are assessed to determine a company's Strategy, then these three indicators are equally weighted in determining a Strategy Score.
- Category-level scores are equally weighted to determine an overall management score, before taking Controversies into account. For most Key Issues, Management Score is determined as a simple average of practices (typically comprising indicators related to strategy, policies, programs, initiatives and targets) and performance (including indicators related to performance trends vis-à-vis prior years and vis-à-vis industry peers).
- A controversy deduction ranging from 0 to -5.0 points is subtracted from the overall Management Score, based on the severity and type of controversies facing the company on a particular Key Issue:

#### Exhibit 9: Controversy deductions from Management Scores

|             | Structural | Non-Structural |
|-------------|------------|----------------|
| Very Severe | -5.0       | -3.0           |
| Severe      | -2.5       | -1.7           |
| Moderate    | -1.3       | -0.8           |
| Minor       | -0.4       | -0.0           |

## 3.4 Analyzing Governance

The methodology used to evaluate a company's performance on the Governance Pillar is different from the one used to assess performance on the Environmental and Social Pillars. Environmental and social risks are typically industry-specific

(certain Key Issues only matter for certain types of companies) and a company's risk management strategy is evaluated in the context of its exposure to the environmental or social risk under consideration.

In contrast, the two Themes under the Governance Pillar, Corporate Governance and Corporate Behavior, are relevant to all companies. While some governance risks are universal, others may differ based on ownership structure, the dynamics between key stakeholders, and cultural aspects, as well as the evolution of investor protections in the relevant market.

Because Corporate Governance and Corporate Behavior are universally relevant and closely intertwined, governance is assessed through an approach that quantifies the gap between a company's governance practices and what is considered best practice, and identifies the governance risks faced by its investors.

A deduction-based scoring model is applied, whereby each company starts with a perfect 10 score and scoring deductions are applied based on the assessment of the Key Metrics.

### 3.4.1 Key Metrics

Key Metrics are the foundational unit of the corporate governance scoring model. Each Governance Key Metric evaluates a specific aspect of a company's corporate governance risk profile. A Key Metric may signify the presence of a certain type of ownership structure or governance risk factor, or the absence of a policy or practice that is seen as mitigating pertinent governance risks.

Key Metric flags are pass/fail evaluations that help users of ESG Ratings understand which Key Metrics are influencing a company's Theme Score or Key Issue Scores. In data feeds and in MSCI's Screener tool, these flags are presented as 0 or 1 values, with 1 indicating that the Key Metric is flagged.

While some Key Metrics will be flagged for very few companies, others will be flagged for many companies. This allows the scoring model to isolate both leaders and laggards and present a score distribution across the full 0-10 range.

For each Key Metric, we also calculate a points value that is used in the calculation of the Key Issue and Theme Scores. The Key Metric Points are converted into a Score Contribution, which is published.

### 3.4.2 Controversies and events

A controversy case is defined as an instance or ongoing situation in which company operations and/or products allegedly have a negative environmental, social and/or governance impact.

Other cases may not be classed as being controversial but may provide relevant insights into a company's governance risk profile. Examples of such events might be breaches or waivers of debt covenants, the ability to meet continuing obligations in relation to a listing of securities, or goodwill write-downs that might raise concerns over the quality of past board decisions.

Certain Key Metrics are controversy- or event-based. Some of these Key Metrics apply score deductions that vary based on the severity of the controversy evaluation or based on certain thresholds being met by the event.

### 3.4.3 Standardization and benchmarking

A key component of the analytical process is to standardize the data that data experts collect with an aim of gauging companies' governance risks.

**Example:** The independence of directors is assessed based on a standardized set of evaluation criteria that are applied globally. While these standards may differ from those applied in a given market, this approach offers more comparability across boards.

Peer-based Key Metrics use standardized data to generate rules-based peer groups for comparison and evaluation.

**Example:** The evaluation of CEO Pay uses a standardized methodology for calculating total pay figures and a standardized set of rules for peer group construction, both of which are set out in the individual Key Issue methodology document devoted to the Pay Key Issue.

### 3.4.4 Variations in disclosure

Disclosure practices vary depending on jurisdictions of incorporation or regulation, securities listings and other factors. We assess instances of non-disclosure based on the significance of that disclosure to the scoring model and based on the significance of that disclosure to an understanding of the company's corporate governance risk profile. Specifically:

- **Board members:** If the company's board members are not disclosed, no Corporate Governance Theme Score is published. This reflects the importance of an assessment of the board to the scoring model.
- **Governance policies and practices:** If the company has not disclosed whether a given policy exists or whether the board has adopted a given practice, we assume that the policy or practice does not exist and/or has not been adopted.

**Example:** If a company has not disclosed whether it has adopted a clawback policy that applies to its short- and long-term incentive pay, this non-disclosure will be interpreted as the absence of a clawback policy. The company would therefore be flagged under the Clawbacks & Malus Key Metric.

- **Quantitative data:** If the company has not disclosed quantitative data used to calculate a Key Metric's score, we may apply a mid-range score deduction based on the potential range of score deductions under that Key Metric.

**Example:** The Auditor Tenure Key Metric provides a variable score based on the disclosed tenure of the company's auditor. Where the auditor's tenure is not disclosed, a default non-disclosure deduction is applied. The value of this deduction is set at 50% of the deduction that would apply for an auditor having served for longer than 20 years.

- **Jurisdictional defaults:** Some items are scored based on mandatory rules within the company's jurisdiction of incorporation and/or relating to the company's securities listings.

**Example:** In markets outside the U.S., the "Shareholder Rights to Convene a Special Meeting" Key Metric is based on the minimum standard set out in the applicable company law, unless there is explicit evidence in the governing documents of a more permissive threshold being applied.

### 3.4.5 Determining Governance Scores

#### Key Metrics

Key Metrics are the foundational unit of the governance assessment. Each Key Metric evaluates a specific aspect of a company's governance risk profile and provides a simple pass/fail evaluation. When the metric result is a "fail" evaluation, the Key Metric is "flagged."

Some Key Metrics are relevant only to companies with specific governance characteristics stemming from ownership type, management structure or other factors.

#### Key Metric Points

For each Key Metric, we calculate a points value that is used in the calculation of the Key Issue and Theme Scores. The Key Metric Points are converted into a Score Contribution, which is published. A higher Score Contribution generally signals more-significant governance risk.

## Key Issues

Each Key Metric is assigned a Category and organized into Key Issues. Each Key Issue represents a broad area of governance risk. For each Key Issue, an absolute score is provided. Key Issue Scores range from 0 to 10, with lower scores indicating more severe risk.

## Corporate Governance and Corporate Behavior Theme Scores

The Key Metric points across all Key Issues are used to calculate the Theme Scores. Theme Scores range from 0 to 10, with lower scores indicating more severe risk.

## Governance Pillar Score

The Governance Pillar Score is an absolute assessment of a company's overall governance that uses a universally applied 0-10 scale. A similar approach is taken to the calculation of the Theme Scores, except that the Key Metric points assigned across all Key Issues in all Themes are used to calculate the Pillar Score.

## Supranationals and development banks

For supranationals and development banks, the Governance Pillar is comprised of the Corporate Behavior Theme Score (70% weight) and a Government Support Score (30% weight). The Government Support Score is based on the weighted average of member countries' Political Governance Risk Factor Scores, which are an input in MSCI ESG Government Ratings.

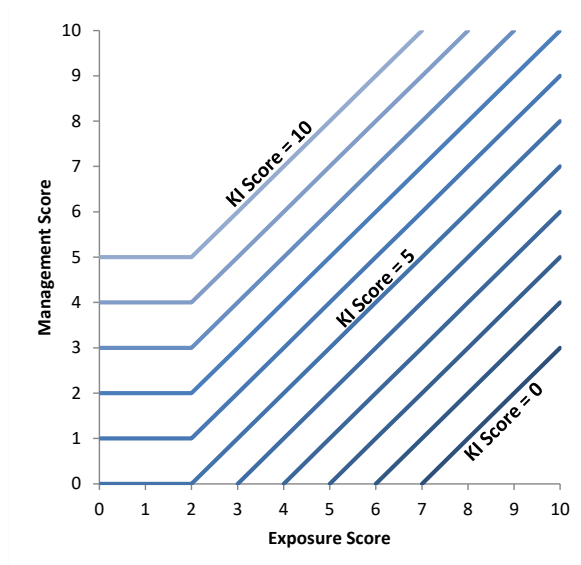
# 3.5 Calculating Key Issue, Theme and Pillar Scores

## 3.5.1 Determining Environmental and Social Key Issue Scores – risks

For Key Issues that assess risks, the Risk Exposure Score and Risk Management Score are combined such that a higher level of exposure requires a higher level of demonstrated management capability in order to achieve the same overall Key Issue Score (see Exhibit 10). The scoring model has the following additional features:

- In order to avoid situations in which a company would receive a very high overall Key Issue Score solely as a result of low exposure to that Key Issue, the model requires a minimum management threshold in order to achieve an overall Key Issue Score greater than 5 (see zone where Exposure score is 0-2 in Exhibit 10).
- Furthermore, at very high levels of exposure, the maximum possible Key Issue Score a company can achieve is lower than 10, indicating that regardless of a company's actions or programs to mitigate risk, a certain level of risk persists.

**Exhibit 10: Combining Exposure and Management – risk Key Issues**



$$\text{Key Issue Score} = 7 - (\text{MAX}(\text{exposure}, 2) - \text{management})$$

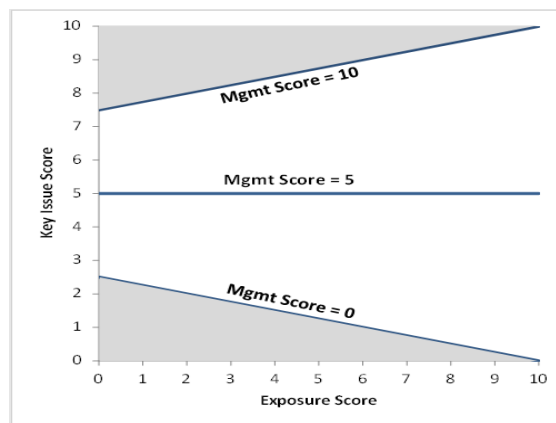
*(Constrained 0-10, rounded to one decimal)*

### 3.5.2 Determining Environmental and Social Key Issue Scores – opportunities

For Key Issues that measure opportunity (Opportunities in Clean Tech, Opportunities in Green Building, Opportunities in Renewable Energy, Opportunities in Nutrition & Health, Access to Finance, Access to Health Care, Access to Communications), the model for combining the Exposure Score and Management Score differs. Exposure indicates the relevance of this opportunity to a given company based on its current business and geographic segments. A high level of exposure permits a wider range of outcomes, whereas a low level of exposure constrains the score closer to a value of 5 (see Exhibit 11 below).



### Exhibit 11: Combining Exposure and Management – opportunities Key Issues



The reasoning is that, at higher levels of exposure, companies have more to gain from exploiting the opportunity, but they also have more to lose from a competitive standpoint if they fail to capitalize on the opportunity. At low levels of exposure, we judge the immediate opportunities the company faces to be less material; however, strong management systems, product innovation or R&D programs may indicate a stronger capacity to take advantage of future opportunities and a competitive advantage for the firm.

$$\text{Key Issue Score} = \left(0.5 + \frac{\text{exposure}}{20}\right) * \text{management} + \left(0.5 - \frac{\text{exposure}}{20}\right) * 5.0$$

*(Constrained 0-10, rounded to one decimal)*

### 3.5.3 Calculating Environmental and Social Theme and Pillar Scores

Theme Scores across the Environmental and Social Pillars (8 out of 10 Themes) are calculated based on the weighted average of Key Issue Scores underlying each Theme, normalized by the total sum of weights underlying each Theme. In the absence of a weighted Key Issue under the Climate Change, Natural Capital and Human Capital Themes, the Theme Score is populated using an unweighted Key Issue Score underlying each Theme, even if this score is not considered (weighted) in the overall ESG Rating.<sup>5</sup> For the remaining Environmental and Social Themes (Pollution & Waste, Environmental Opportunities, Product Liability, Social

<sup>5</sup> Carbon Emissions, Water Stress, and Human Capital Development Key Issue Scores are calculated for certain companies even if these Key Issues carry no weight in the overall ESG Rating. These scores will inform the Climate Change (for the entire ESG Ratings coverage universe), Natural Capital (for the MSCI ACWI Index universe), and Human Capital (for the entire ESG Ratings coverage universe) Theme Scores, respectively, if no other Key Issues are weighted within these themes.

Opportunities, and Stakeholder Opposition), Theme Scores are only calculated if one or more of the underlying Key Issues is weighted.

Pillar scores across the Environmental and Social Pillars are similarly calculated based on the weighted average of Key Issue Scores underlying each Pillar, normalized by the total sum of weights underlying each Pillar.

See **Appendix 1: ESG Ratings Model hierarchy** for more information.

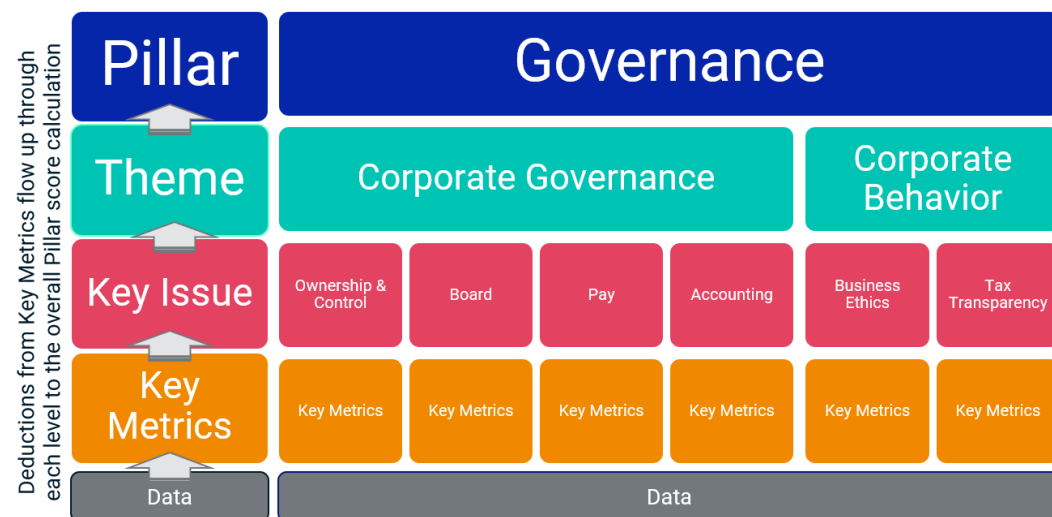
### 3.5.4 Calculating Governance Scores

Each of the Governance Pillar Scores, the Theme Scores and the Key Issue Scores are independently calculated based on a deduction-based approach in which points are deducted from a perfect 10 based on the triggering of Key Metrics across the underlying Key Issues.

#### Governance model structure

The Governance model structure is shown in Exhibit 12 below. The Key Metrics for Corporate Governance are grouped into four Key Issues: Ownership & Control, Board, Pay and Accounting. Similarly, the Key Metrics for Corporate Behavior are grouped into two Key Issues: Business Ethics and Tax Transparency.

**Exhibit 12: Governance model structure**



#### Governance scoring process

In the Corporate Governance Theme, input data is collected and reviewed by our analytical personnel on an ongoing basis. While the annual update from the

shareholder meeting documents and annual report is typically the most significant update, analytical personnel also process data such as voting results, director changes, material ownership changes and governance controversies and events throughout the year.

Upon publication of the data changes, the underlying Key Metrics that drive the overall assessments and scores are automatically updated.

### Governance scoring steps

1. Each Key Metric is evaluated with a points value, ranging from 0 to the maximum possible points value for that Key Metric. The calculation of the overarching Theme and Key Issue Scores is based on these points values,<sup>6</sup> which vary with Key Metric type, specifically:
  - a. Some Key Metrics assess quantitative data or a range of possible assessment outcomes to determine the applicable points value within a defined range.
  - b. Other Key Metrics, when flagged, always result in the allocation of a stated points value – that is, they output either zero or a defined points value allocated to that Key Metric, with no variation in between.
2. Each Key Issue's points value is calculated as the sum of the Key Metric points values under that Key Issue (after application of any category-based caps).
3. The Theme points value is calculated as the sum of all Key Issue points values.<sup>7</sup>
4. The Governance Pillar points value is calculated as the sum of the Theme points values.
5. The 0-10 Governance Pillar Score is calculated by applying a score conversion formula (see Exhibit 13 below) to the Pillar points value. Negative 0-10 scores are not permitted; therefore, where the Pillar points value is above the Maximum Value, a 0.0 score is assigned.

<sup>6</sup> Points are internal to MSCI and are not themselves published.

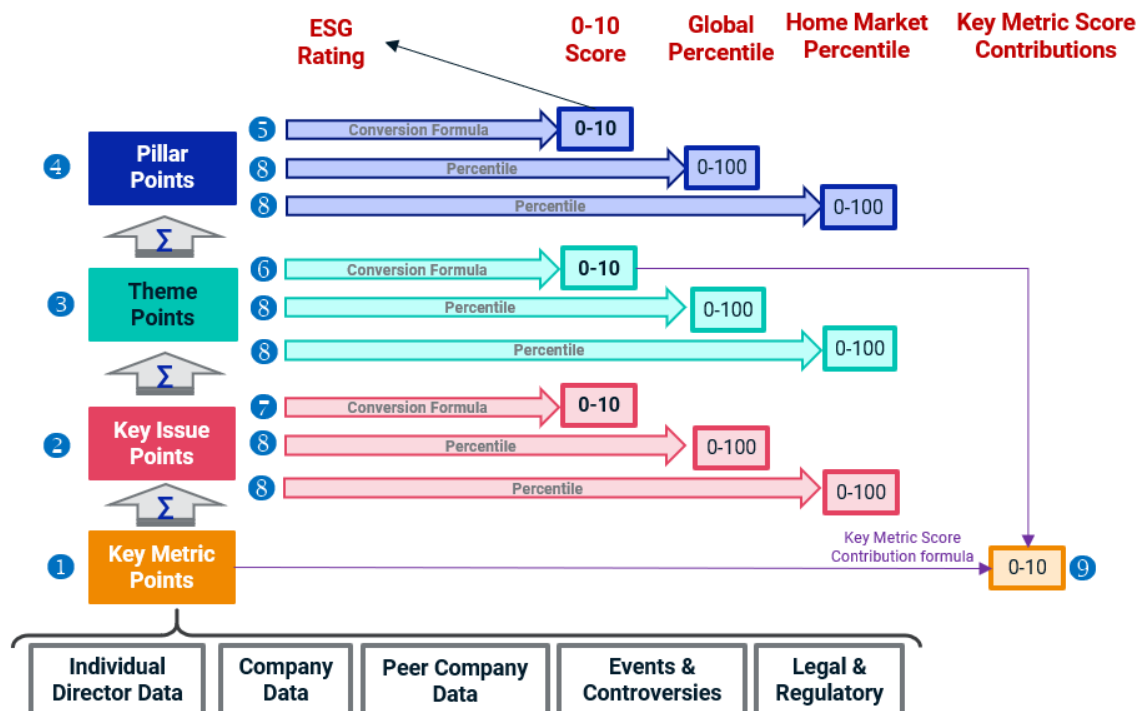
<sup>7</sup> Allegations of securities violations and executive misconduct contribute to the points value of the Business Ethics Controversies Key Metric of the Business Ethics Key Issue, which contributes to the Corporate Behavior Theme and Governance Pillar Score. To avoid duplication in the Corporate Behavior and Corporate Governance Themes, the points values for the Executive Misconduct and Securities Violations Key Metrics are not reflected in the Corporate Governance Theme Score and thus also not in the Governance Pillar Score, however these points values are reflected in the Board Key Issue Score.

6. The 0-10 Theme Scores are calculated by applying the score conversion formula set against the Theme points value. Negative 0-10 scores are not permitted; therefore, where the Theme points value exceeds the Maximum Value,<sup>8</sup> a 0.0 score is assigned.
7. The 0-10 Key Issue Scores are calculated similarly to, but independent of, the 0-10 Theme Scores, using the Key Issue points values, the score conversion formula and referencing the Maximum Value for the respective Key Issue. Negative 0-10 Scores are not permitted; therefore, where the Key Issue points value exceeds the Maximum Value, a 0.0 Score is assigned.
8. The Theme points and Key Issue points are compared against global and Home Market peers to calculate percentile ranks.
9. For each Key Metric, the Score Contribution against the Theme Score is calculated. A more negative Score Contribution generally signals more significant governance risk.

The scoring calculation process is illustrated in Exhibit 13.

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<sup>8</sup> The Maximum Value is reviewed upon major methodology changes and is based on the 99.5th percentile of the respective points values as at the time of the introduction of the 0-10 Key Issue scores, in January 2018.

**Exhibit 13: Governance Pillar scoring calculations**

**Exhibit 14: Conversion formula for 0-10 Score**

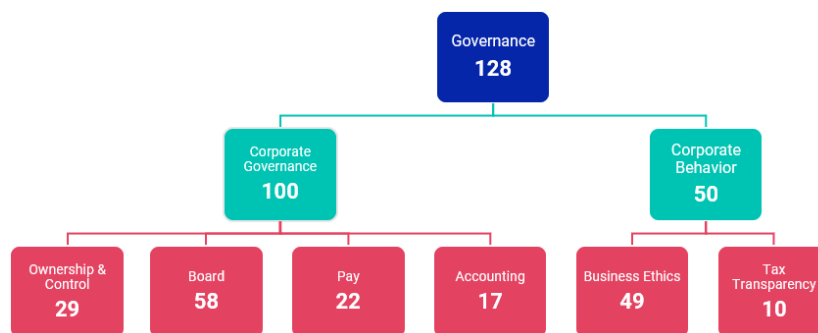
| 0-10 Score       | 0-10 Score Conversion Formula  |
|------------------|--|
| <b>Pillar</b>    | $10 - (10 * (\text{Pillar Points} / \text{Pillar Maximum Value}))$       |
| <b>Theme</b>     | $10 - (10 * (\text{Theme Points} / \text{Theme Maximum Value}))$         |
| <b>Key Issue</b> | $10 - (10 * (\text{Key Issue Points} / \text{Key Issue Maximum Value}))$ |

### Maximum value

The purpose of the Maximum Value in the Score Conversion formula above is to provide a more normalized score distribution and to avoid the long tail of poorly performing companies taking up a large part of the 0-10 score scale. The Maximum Values are obtained as the 99.5th percentile of the range of the relevant points value

across the entire coverage universe, as of the last annual calibration date.<sup>9</sup> These are shown in Exhibit 15.

#### Exhibit 15: Maximum Value<sup>10</sup>



#### Key Metric score contributions (deductions)

To help users of ESG Ratings understand the impact of an individual Key Metric on a company's overall 0-10 Theme Score, we calculate and disclose each Key Metric's individual deduction from the company's initial perfect 10 score.<sup>11,12</sup>

Each Key Metric's deduction is expressed as a negative number calculated to the first decimal place. A Key Metric's deduction is calculated using the following inputs:

- **Key Metric points:** the number of points provided by that Key Metric, based on an evaluation of the company's governance practices.
- **Theme points:** the sum of all points from all Key Metrics.
- **Theme Score:** the company's 0-10 Theme Score.

<sup>9</sup> The sum of the Theme Maximum Values is not equal to the Governance Pillar Maximum Value by design. This is because winsorization is applied independently to the unique distribution of each set of points values.

<sup>10</sup> The sum of the individual Key Issue Maximum Values does not sum to the Maximum Value used for the overall Theme Score. This is intentional and reflects the differing distributions of the points values for the individual Key Issues and is intended to provide a better alignment of the Key Issue scores with the overall Theme Score.

<sup>11</sup> Key Issue Level Key Metric Score Contributions — each Key Metric's deduction from each Key Issue's initial perfect 10 score — is neither calculated nor published. However, for the Corporate Governance Key Metrics, and except for companies with a Theme or Key Issue Score of 0.0, these deductions can be approximated by multiplying the Theme Score contribution by the appropriate multiplier: Ownership & Control: 3.42; Board: 1.72; Pay: 4.55; Accounting: 5.88.

<sup>12</sup> Pillar Key Metric Score Contributions — each Key Metric's deduction from each Key Issue's initial perfect 10 score — is neither calculated nor published. However, the contribution of each Theme and Key Issue to the Pillar score is presented in the ESG Ratings drill-down. The Governance Pillar-level deductions can be approximated by applying the following multipliers to the Theme-level deductions: For Corporate Governance: 0.78 x the Corporate Governance Theme-level deduction; For Corporate Behavior: 0.39 x the Corporate Behavior Theme-level deduction.

Using these inputs, the Score Contribution (deduction) attributable to a given Key Metric is calculated as:

- **Corporate Governance:**  $(\text{Key Metric Points}/\text{Theme Points}) \times (10 - \text{Theme Score}) \times -1$ .
- **Corporate Behavior:**  $\text{Key Metric Score Deduction} = -10 \times (\text{Key Metric Points}/\text{Theme Maximum Value})$ .

The worked example in Exhibit 16, below, demonstrates how a score deduction is derived from the Oversight for Ethics Issues Key Metric in the Corporate Behavior Theme.

#### Exhibit 16: Worked example

| Oversight for Ethics Issues                                 | Points | Conversion            | Deduction from Theme Score |
|---|--------|-----------------------|----------------------------|
| C-suite or executive committee                              | 0      | 0                     | 0                          |
| Board-level committee                                       | 0      | 0                     | 0                          |
| Special task force or risk officer                          | 3.5    | $-10 \times (3.5/50)$ | -0.7                       |
| Corporate social responsibility/sustainability team         | 3.5    | $-10 \times (3.5/50)$ | -0.7                       |
| Minimum practices expected based on domestic industry norms | 5      | $-10 \times (5/50)$   | -1.0                       |
| No evidence   | 7      | $-10 \times (7/50)$   | -1.4                       |

#### Relationship between Governance Pillar, Theme and Key Issue Scores

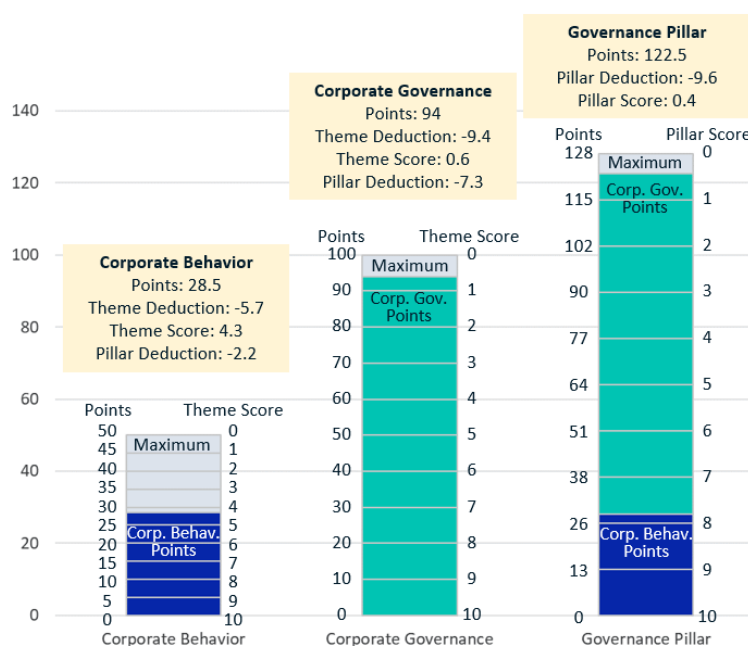
The Governance Pillar Score is not directly derived from the 0-10 Corporate Governance and 0-10 Corporate Behavior Scores, but from the conversion of the Governance Pillar Points (being the sum of the Corporate Governance points and Corporate Behavior points) to a 0-10 score using the score conversion formula. This holistic approach prevents strengths in one Theme from offsetting deficiencies in another.

Thus, it is possible for a company to have a lower Governance Pillar Score than either its Corporate Behavior or Corporate Governance Theme Score. This also holds true at the Theme level, where the Corporate Governance Theme Score can be less than all four of the underlying Key Issue Scores (Board, Pay, Ownership, and Accounting).

This is demonstrated in Exhibit 17, where the hypothetical company's Governance Pillar Score (0.4) is less than its Corporate Behavior Score (4.3) and Corporate Governance Score (0.6). The sum of the Corporate Behavior Raw Score (28.5) and

the Corporate Governance Raw Score (94) results in a Governance Pillar Raw Score (122.5) that is closer to the Maximum Value (128) than either of the underlying Themes are to their respective Maximum Values (50 and 100, respectively).

**Exhibit 17: Example calculation of the Governance Pillar Score**



### Percentile rank calculations

In calculating the percentile ranking for a Theme or Key Issue, the company with the lowest points value will be assigned a percentile rank of 100, while the company with the highest points value will be assigned a percentile rank of 0. Companies with the same points values are assigned the same percentile ranks. Percentiles are always presented as integers (i.e., rounded to the nearest decimal place).

## 3.6 Determining final Ratings

To arrive at a final ESG Rating from the selected Key Issue and Pillar scores, several steps are undertaken.



### 3.6.1 Weighted Average Key Issue Score

The Weighted Average Key Issue Score is calculated as the weighted average of the Governance Pillar Score and the individual Environmental and Social Key Issue Scores.

### 3.6.2 Industry-Adjusted Score

The Weighted Average Key Issue Score is then normalized relative to ESG Rating Industry peers. A benchmark peer set (comprising all companies rated by MSCI ESG Research within an ESG Industry — please see Appendix 4: ESG Rating Industries for details on the peer set) is used to calculate industry-relative ratings to ensure that companies' relative ratings do not change when other companies are added to or removed from the peer set. See Appendix 5: Normalizing the Weighted Average Score vs. industry peers for details of the normalization process used in the calculation for the Industry-Adjusted Score.

### 3.6.3 Committee review process

In certain predefined situations, prior to publication of the ESG Rating, additional committee review steps are initiated, as described in the "ESG Ratings Process" document.

These steps include review by the ESG Ratings Methodology Committee and, in certain cases, by the ESG Assessment Committee. The ESG Ratings Methodology Committee presides over company-specific assessments, while the ESG Assessment Committee addresses escalations from the ESG Ratings Methodology Committee and other critical methodology application cases, such as cases resulting from a significant market event.

Depending on the outcome of the committee review process, the respective committees may approve the modification of a company's Industry Adjusted Score.

### 3.6.4 ESG Rating

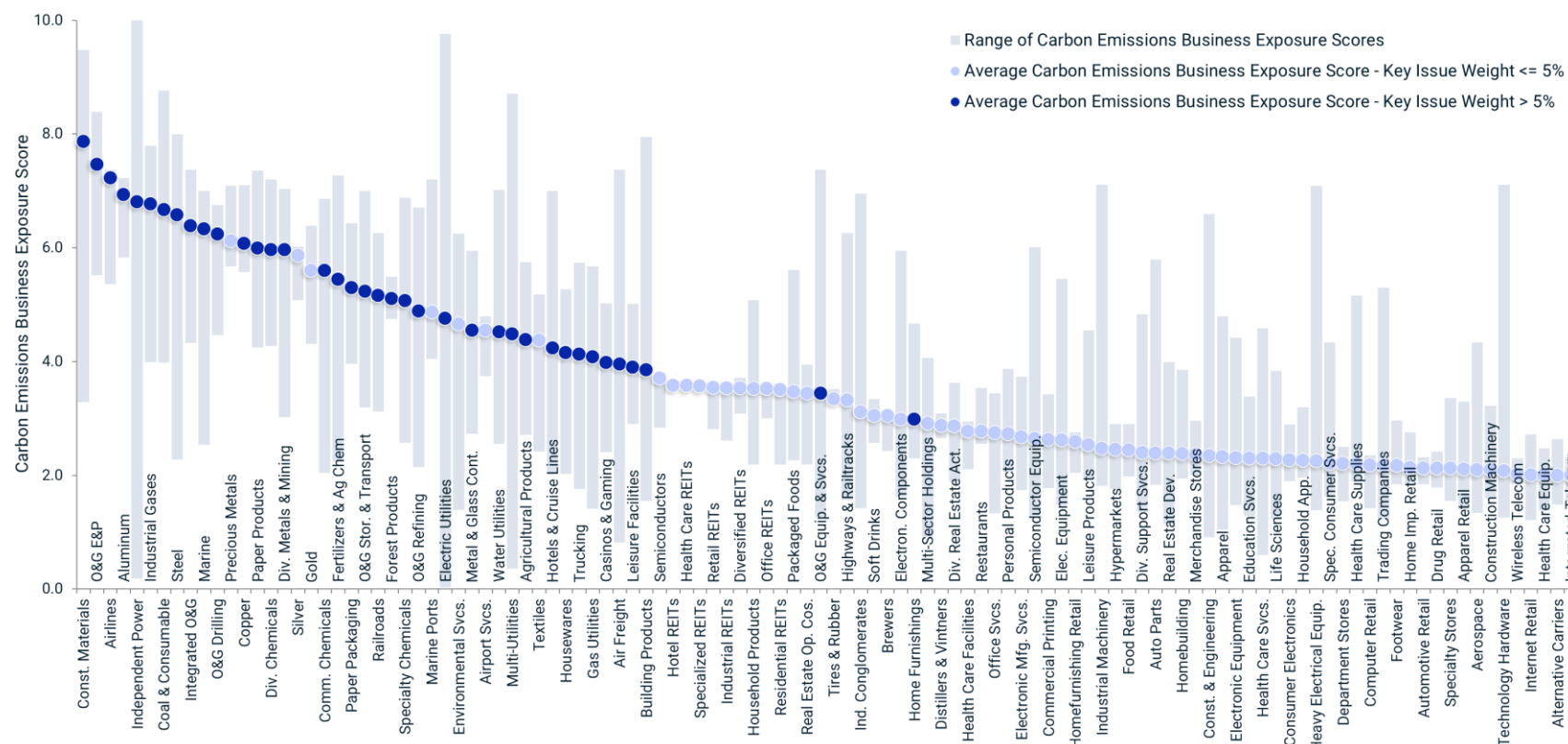
Each company's final Industry-Adjusted Score corresponds to a rating between the highest ESG Rating (AAA) and the lowest ESG Rating (CCC). The final Industry-Adjusted Company Score is mapped to a letter rating as shown in Exhibit 2, above.

These assessments of company performance are not absolute but are explicitly intended to be relative to the standards and performance of a company's industry peers. These letter ratings are relative within each ESG Industry.

## Appendix 1: ESG Ratings Model hierarchy



## Appendix 2: Example of industry Key Issue selection



Notes: Bar length denotes minimum and maximum business segment exposure scores within a GICS sub-industry. Certain GICS sub-industries (25th percentile and below) are not shown in the chart; n = 9,868 companies; Scope includes ESG Ratings coverage as of Nov 16, 2022.

Sources: IERS' Comprehensive Environmental Data Archive (CEDA) data - direct GHG emissions intensity; Eurostat – Air Emissions Accounts by Activity; Refinitiv; IEA (2020), Projected Costs of Generating Electricity 2020; UNECE, Life Cycle Assessment of Electricity Generation Options; GHG emissions intensities compiled by MSCI ESG Research; company disclosures

## Appendix 3: Weight-setting framework

| TYPE OF RISK/<br>OPPORTUNITY                    | TIME HORIZON:   |   |   |
|---|---|---|---|
|   | Short   | Med   | Long  |
| <b>Operational Event</b>                        | <b>Acute Event Risk:</b><br>Sudden operational event could limit company's ability to grow (e.g., exploit new reserves, expand to new territories), cause significant liabilities, disrupt key business units, or threaten overall business model | <b>Emerging Event Risk:</b><br>Operational event could threaten ability to grow or license to operate, but will likely manifest over extended time frame (e.g., mounting community opposition to a project; major investigations, settlements, or prosecution)                              | <b>Long-Term Event Risk:</b><br>Longer-term physical impacts of climate change could cause operational disruptions in the long run.   |
| <b>Regulatory Pressure</b>                      | <b>Imminent Regulatory Change:</b> Regulatory change is pending or imminent in key markets.   | <b>Emerging Regulatory Pressure:</b> Issue receives increasing scrutiny from mainstream stakeholders; pressure on regulators is mounting but no pending regulatory change yet.  | <b>Growing Stakeholder Awareness:</b> Issue receives scrutiny from specialized or niche stakeholders, increasing coverage in media and growing presence in public eye.  |
| <b>Resource Scarcity/<br/>Supply Constraint</b> | <b>Short-Term Supply Constraint:</b> Acute supply constraint is present or imminent, likely to cause disruption or significant cost increase for companies.   | <b>Medium-Term Supply Constraint:</b> Supply constraint is forecast, could cause disruption or significant cost increase in 2- to 5-year period.  | <b>Long-Term Resource Scarcity:</b> Key resource/input is constrained, which may lead to cost increase or operational disruption in 5+ years.   |
| <b>Demand Shift</b>                             | <b>Acute Demand Shift:</b><br>Ongoing demand shift between substitute products/services, old product/service becoming obsolete.   | <b>Demonstrated Demand Shift:</b> Growing demand in "new" area evidenced by differential growth rates <u>and</u> notable shift in market share between substitutes.<br><br><b>Incentive-Based Demand Shift:</b> Demand shift over 2- to 5-year period will be led by government incentives. | <b>Forecast Demand Shift:</b><br>Underlying social or environmental pressures (e.g., obese population, climate change) are likely to cause change in demand and consumer preference over time.<br><br><b>Competitor Response:</b> Major industry player(s) undertake strategic response to environmental or social trends, increasing competitive pressure. |

## Appendix 4: ESG Rating Industries

ESG Rating Industries are based on GICS sub-industries, where applicable, which we group to form peer sets in which companies face relatively similar Key Issues. As a result, each ESG Rating Industry can be mapped to a GICS sub-industry, a GICS Industry or several GICS sub-industries.<sup>13</sup>

Companies are assigned to ESG Rating Industries based on the company's GICS classification (if available) or based on MSCI ESG Research's determination if no GICS classification is available (e.g., private or unlisted companies).

- Key Issues and Key Issue Weights are determined at the GICS sub-industry level.
- Industry-adjusted scores and ESG letter ratings are relative within each ESG Rating Industry.
- Percentiles, quartiles, averages and score distributions on reports are calculated relative to the ESG Rating Industry.

| ESG Rating Industry                                     | GICS     | Sub-industry                                   |
|---|----------|--|
| <b>ENERGY</b>   |          |  |
| Energy Equipment & Services                             | 10101010 | Oil & Gas Drilling                             |
|   | 10101020 | Oil & Gas Equipment & Services                 |
| Integrated Oil & Gas                                    | 10102010 | Integrated Oil & Gas                           |
| Oil & Gas Exploration & Production                      | 10102020 | Oil & Gas Exploration & Production             |
| Oil & Gas Refining, Marketing, Transportation & Storage | 10102030 | Oil & Gas Refining & Marketing                 |
|   | 10102040 | Oil & Gas Storage & Transportation             |
| <b>MATERIALS</b>  |          |  |
| Metals and Mining - Non-Precious Metals                 | 10102050 | Coal & Consumable Fuels                        |
|   | 15104010 | Aluminum                                       |
|   | 15104020 | Diversified Metals & Mining                    |
|   | 15104025 | Copper   |
| Commodity Chemicals                                     | 15101010 | Commodity Chemicals                            |
| Diversified Chemicals                                   | 15101020 | Diversified Chemicals                          |
| Specialty Chemicals                                     | 15101030 | Fertilizers & Agricultural Chemicals           |
|   | 15101040 | Industrial Gases                               |
|   | 15101050 | Specialty Chemicals                            |
| Construction Materials                                  | 15102010 | Construction Materials                         |
| Containers & Packaging                                  | 15103010 | Metal, Glass & Plastic Containers              |
|   | 15103020 | Paper & Plastic Packaging Products & Materials |
| Metals and Mining - Precious Metals                     | 15104030 | Gold   |
|   | 15104040 | Precious Metals & Minerals                     |
|   | 15104045 | Silver   |
| Steel   | 15104050 | Steel  |
| Paper & Forest Products                                 | 15105010 | Forest Products                                |
|   | 15105020 | Paper Products                                 |

<sup>13</sup> With the exception of supranationals and development banks, which are not covered in the GICS framework.

| ESG Rating Industry   | GICS     | Sub-industry  |
|---|----------|---|
|   | 60108040 | Timber REITs  |
| <b>INDUSTRIALS</b>  |          |   |
| <b>Aerospace &amp; Defense</b>                              | 20101010 | Aerospace & Defense                                     |
| <b>Building Products</b>                                    | 20102010 | Building Products                                       |
| <b>Construction &amp; Engineering</b>                       | 20103010 | Construction & Engineering                              |
| <b>Electrical Equipment</b>                                 | 20104010 | Electrical Components & Equipment                       |
|   | 20104020 | Heavy Electrical Equipment                              |
| <b>Industrial Conglomerates</b>                             | 20105010 | Industrial Conglomerates                                |
| <b>Construction &amp; Farm Machinery &amp; Heavy Trucks</b> | 20106010 | Construction Machinery & Heavy Transportation Equipment |
|   | 20106015 | Agricultural & Farm Machinery                           |
| <b>Industrial Machinery</b>                                 | 20106020 | Industrial Machinery & Supplies & Components            |
| <b>Trading Companies &amp; Distributors</b>                 | 20107010 | Trading Companies & Distributors                        |
| <b>Commercial Services &amp; Supplies</b>                   | 20201010 | Commercial Printing                                     |
|   | 20201050 | Environmental & Facilities Services                     |
|   | 20201060 | Office Services & Supplies                              |
|   | 20201070 | Diversified Support Services                            |
|   | 20201080 | Security & Alarm Services                               |
| <b>Professional Services</b>                                | 20202010 | Human Resource & Employment Services                    |
|   | 20202020 | Research & Consulting Services                          |
|   | 20202030 | Data Processing & Outsourced Services                   |
| <b>Air Freight &amp; Logistics</b>                          | 20301010 | Air Freight & Logistics                                 |
| <b>Airlines</b>   | 20302010 | Passenger Airlines                                      |
| <b>Marine Transport</b>                                     | 20303010 | Marine Transportation                                   |
| <b>Road &amp; Rail Transport</b>                            | 20304010 | Rail Transportation                                     |
|   | 20304030 | Cargo Ground Transportation                             |
|   | 20304040 | Passenger Ground Transportation                         |
| <b>Transportation Infrastructure</b>                        | 20305010 | Airport Services  |
|   | 20305020 | Highways & Railtracks                                   |
|   | 20305030 | Marine Ports & Services                                 |
| <b>CONSUMER DISCRETIONARY</b>                               |          |   |
| <b>Auto Components</b>                                      | 25101010 | Automotive Parts & Equipment                            |
|   | 25101020 | Tires & Rubber  |
| <b>Automobiles</b>  | 25102010 | Automobile Manufacturers                                |
|   | 25102020 | Motorcycle Manufacturers                                |
| <b>Household Durables</b>                                   | 25201010 | Consumer Electronics                                    |
|   | 25201020 | Home Furnishings  |
|   | 25201040 | Household Appliances                                    |
|   | 25201050 | Housewares & Specialties                                |
| <b>Leisure Products</b>                                     | 25202010 | Leisure Products  |
| <b>Textiles, Apparel &amp; Luxury Goods</b>                 | 25203010 | Apparel, Accessories & Luxury Goods                     |
|   | 25203020 | Footwear  |
|   | 25203030 | Textiles  |
| <b>Casinos &amp; Gaming</b>                                 | 25301010 | Casinos & Gaming  |
| <b>Hotels &amp; Travel</b>                                  | 25301020 | Hotels, Resorts & Cruise Lines                          |
|   | 25301030 | Leisure Facilities                                      |
| <b>Restaurants</b>  | 25301040 | Restaurants   |
| <b>Diversified Consumer Services</b>                        | 25302010 | Education Services                                      |

| ESG Rating Industry              | GICS     | Sub-industry                              |
|----------------------------------|----------|---|
| Retail - Consumer Discretionary  | 25302020 | Specialized Consumer Services             |
|                                  | 25501010 | Distributors                              |
|                                  | 25503030 | Broadline Retail                          |
|                                  | 25504010 | Apparel Retail                            |
|                                  | 25504020 | Computer & Electronics Retail             |
|                                  | 25504030 | Home Improvement Retail                   |
|                                  | 25504040 | Other Specialty Retail                    |
|                                  | 25504050 | Automotive Retail                         |
|                                  | 25504060 | Home furnishing Retail                    |
| CONSUMER STAPLES                 |          |   |
| Retail - Food & Staples          | 30101020 | Food Distributors                         |
|                                  | 30101030 | Food Retail                               |
|                                  | 30101040 | Consumer Staples Merchandise Retail       |
| Beverages                        | 30201010 | Brewers                                   |
|                                  | 30201020 | Distillers & Vintners                     |
|                                  | 30201030 | Soft Drinks & Non-alcoholic Beverages     |
| Food Products                    | 30202010 | Agricultural Products & Services          |
|                                  | 30202030 | Packaged Foods & Meats                    |
| Tobacco                          | 30203010 | Tobacco                                   |
| Household & Personal Products    | 30301010 | Household Products                        |
|                                  | 30302010 | Personal Care Products                    |
| HEALTHCARE                       |          |   |
| Health Care Equipment & Supplies | 35101010 | Health Care Equipment                     |
|                                  | 35101020 | Health Care Supplies                      |
|                                  | 35203010 | Life Sciences Tools & Services            |
| Health Care Providers & Services | 35102010 | Health Care Distributors                  |
|                                  | 35102015 | Health Care Services                      |
|                                  | 35102020 | Health Care Facilities                    |
|                                  | 35102030 | Managed Health Care                       |
|                                  | 30101010 | Drug Retail                               |
|                                  | 35103010 | Health Care Technology                    |
| Biotechnology                    | 35201010 | Biotechnology                             |
| Pharmaceuticals                  | 35202010 | Pharmaceuticals                           |
| FINANCIALS                       |          |   |
| Banks                            | 40101010 | Diversified Banks                         |
|                                  | 40101015 | Regional Banks                            |
| Diversified Financials           | 40201020 | Diversified Financial Services            |
|                                  | 40201030 | Multi-Sector Holdings                     |
|                                  | 40201040 | Specialized Finance                       |
|                                  | 40201050 | Commercial & Residential Mortgage Finance |
|                                  | 40201060 | Transaction & Payment Processing Services |
|                                  | 40203040 | Financial Exchanges & Data                |
|                                  | 40202010 | Consumer Finance                          |
| Asset Management & Custody Banks | 40203010 | Asset Management & Custody Banks          |
|                                  | 40204010 | Mortgage REITs                            |
| Investment Banking & Brokerage   | 40203020 | Investment Banking & Brokerage            |
|                                  | 40203030 | Diversified Capital Markets               |
| Life & Health Insurance          | 40301020 | Life & Health Insurance                   |

| ESG Rating Industry                              | GICS     | Sub-industry                                 |
|--|----------|--|
| Property & Casualty Insurance                    | 40301040 | Property & Casualty Insurance                |
| Multi-Line Insurance & Brokerage                 | 40301010 | Insurance Brokers                            |
|  | 40301030 | Multi-line Insurance                         |
|  | 40301050 | Reinsurance                                  |
| <b>INFORMATION TECHNOLOGY</b>                    |          |  |
| Software & Services                              | 45102010 | IT Consulting & Other Services               |
|  | 45102030 | Internet Services & Infrastructure           |
|  | 45103010 | Application Software                         |
|  | 45103020 | Systems Software                             |
|  | 60108050 | Data Center REITs                            |
| Technology Hardware, Storage & Peripherals       | 45201020 | Communications Equipment                     |
|  | 45202030 | Technology Hardware, Storage & Peripherals   |
| Electronic Equipment, Instruments & Components   | 45203010 | Electronic Equipment & Instruments           |
|  | 45203015 | Electronic Components                        |
|  | 45203020 | Electronic Manufacturing Services            |
|  | 45203030 | Technology Distributors                      |
| Semiconductors & Semiconductor Equipment         | 45301010 | Semiconductor Materials & Equipment          |
|  | 45301020 | Semiconductors                               |
| <b>COMMUNICATION SERVICES</b>                    |          |  |
| Telecommunication Services                       | 50101010 | Alternative Carriers                         |
|  | 50101020 | Integrated Telecommunication Services        |
|  | 50102010 | Wireless Telecommunication Services          |
|  | 60108030 | Telecom Tower REITs                          |
| Media & Entertainment                            | 50201010 | Advertising                                  |
|  | 50201020 | Broadcasting                                 |
|  | 50201030 | Cable & Satellite                            |
|  | 50201040 | Publishing                                   |
|  | 50202010 | Movies & Entertainment                       |
|  | 50202020 | Interactive Home Entertainment               |
| Interactive Media & Services                     | 50203010 | Interactive Media & Services                 |
| <b>UTILITIES</b>                                 |          |  |
| Utilities  | 55101010 | Electric Utilities                           |
|  | 55102010 | Gas Utilities                                |
|  | 55103010 | Multi-Utilities                              |
|  | 55104010 | Water Utilities                              |
|  | 55105010 | Independent Power Producers & Energy Traders |
|  | 55105020 | Renewable Electricity                        |
| <b>REAL ESTATE</b>                               |          |  |
| Real Estate Development & Diversified Activities | 25201030 | Homebuilding                                 |
|  | 60201010 | Diversified Real Estate Activities           |
|  | 60201030 | Real Estate Development                      |
| Real Estate Management & Services                | 60101010 | Diversified REITs                            |
|  | 60102510 | Industrial REITs                             |
|  | 60103010 | Hotel & Resort REITs                         |
|  | 60104010 | Office REITs                                 |
|  | 60105010 | Health Care REITs                            |
|  | 60106010 | Multi-Family Residential REITs               |
|  | 60106020 | Single-Family Residential REITs              |



| ESG Rating Industry | GICS     | Sub-industry                    |
|---------------------|----------|---------------------------------|
|                     | 60107010 | Retail REITs                    |
|                     | 60108010 | Other Specialized REITs         |
|                     | 60108020 | Self-Storage REITs              |
|                     | 60201020 | Real Estate Operating Companies |
|                     | 60201040 | Real Estate Services            |

## Appendix 5: Normalizing the Weighted Average Score vs. industry peers

As set out in section 3.6 above, each company receives a **Preliminary Industry-Adjusted Score (IAS)**, where the WAKIS is normalized based on score ranges set by the benchmark values in the peer set.

### Industry peer set benchmark values

The following criteria in setting the industry top and bottom **benchmark values** applied starting November 2020:

- The top benchmark value (“**industry maximum score**”) falls between the 95th and 100th percentile of modeled WAKIS within an ESG Rating Industry.
- The bottom benchmark value (“**industry minimum score**”) falls between the 0th and 5th percentile of modeled WAKIS within an ESG Rating Industry.

Percentiles were calculated based on the full universe of companies with ESG Ratings (10,022 companies). The MSCI ESG Ratings coverage universe continually expands to include new companies, which are often companies with low disclosures. Sometimes, such companies can distort the bottom benchmark value by lowering it, thereby leading to upgrades for the rest of the companies in the industry. For such industries, this problem is mitigated by excluding recent coverage additions (companies with less than two years of ratings history) while determining the bottom five percentile range for the WAKIS.

These values are set at the beginning of a year based on the distribution of the WAKIS of an industry until that point in time. However, the distribution of the WAKIS in an industry is expected to change during the year with new disclosures and improvements in the ESG performance of companies, resulting in unidirectional movement of rating changes in an industry. Consequently, the **industry maximum and minimum scores** for each ESG Rating Industry were selected within the aforementioned percentile ranges to meet the following objectives:

1. Minimize unidirectional changes in ESG Ratings.
2. Ensure that the selected industry minimum and maximum scores with respect to its current industry minimum and maximum scores are moving in the direction of the underlying score distribution.

### **Exceptions to the 95th and 5th percentile boundaries:**

If adherence to these boundaries results in strong unidirectional modeled rating changes (upgrade/downgrade ratio beyond 0.7 to 1.3) thereby working against objective 1 or 2 above, the range can be extended to the 90th and 10th percentile of modeled WAKIS for the industry minimum and maximum values, respectively. However, the range of the industry minimum and maximum values will only be extended to the 10<sup>th</sup> and 90<sup>th</sup> percentiles if the resulting ESG Rating distribution entails less unidirectional movement than would otherwise be achieved by keeping the minimum and maximum values constant.

### **Industry minimum and maximum scores update frequency**

The benchmark values are updated at least once a year. They are updated within a year if either of the following conditions are met:

- If there is a drift in the WAKI score distribution: the mean WAKIS and/or either of the tails are changing by  $\geq 0.2$  since the last review.
- If either of the min-max boundaries are breached: The current industry maximum score being less than 90th percentile and/or the current industry minimum score being greater than the 10th percentile of the latest distribution of WAKIS (i.e., beyond a 5% buffer around the aforementioned ranges).

The resulting industry minimum and maximum scores can be accessed in the drill-down section of each company's ESG Rating report.

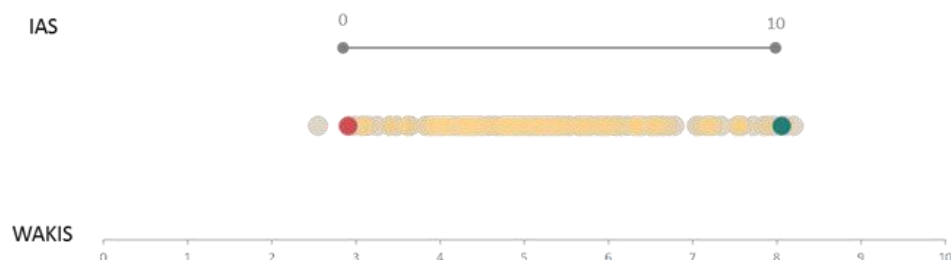
The adjusted score of 10 is defined at or above the industry maximum score, and the adjusted score of 0 is defined at or below the industry minimum score. The remaining companies' scores are linearly interpolated based on these values using the following formula:

$$\begin{aligned} \text{ind\_adj\_score} = & \\ & 10 * (\text{weighted\_avg\_score} - \text{industry\_min\_score}) / (\text{industry\_max\_score} - \\ & \text{industry\_min\_score}) \\ & (\text{constrained } 0\text{-}10, \text{ rounded to one decimal}) \end{aligned}$$

MSCI ESG Research recalibrates these benchmark values on an annual basis to reflect changes to underlying company data, methodology updates and fluctuations in industry peer sets.

The relation between the Weighted Average Score and the Industry Adjusted Score is shown in Exhibit 18, below. For instance, if the score distribution in an industry is such that the industry minimum and maximum scores are 2.9 and 8.1, respectively (on a scale of 0-10), these are given a score of 0 and 10 respectively in the Industry Adjusted Scale (IAS).

### Exhibit 18: Relation between Weighted Average Score and IAS



Additional steps designed to ensure that the letter ratings provide a consistent and reliable signal:

- Industries with a narrow range of scores may have their ranges extended:
  - If the bottom benchmark value is greater than 4, the industry minimum is truncated at 4. This could result in no companies in that industry receiving a CCC rating.
  - If the top benchmark value is less than 6, the industry maximum is truncated at 6. This could result in no companies receiving an AAA rating.
- Methodology changes are modeled in advance to limit rating volatility:
  - For example, in constructing the rating ranges for 2021, new Governance Pillar scores using the updated methodology and sources were simulated in calculating the minimum and maximum values.

## Appendix 6: Home-Market selection

The Theme and Key Issue Percentile Ranks are calculated for a company relative to all other companies within its Home Market. The allocation of a company's peers for assessing executive pay also references a company's Home Market.

Companies are classified into countries as set out in the MSCI Country Classification Standard, with Home Markets reviewed annually in October and any changes effective starting Jan. 1.<sup>14</sup>

### Determining Home-Market allocation

Countries with 30 or more companies in governance coverage as of Oct. 1 each year will be allocated their own Home Market for the following calendar year. A Home Market will be deemed to have insufficient companies when it falls to 25 companies in governance coverage or, subject to review by the Corporate Governance Methodology Committee, where it has fewer than 30 companies for two successive years.

Countries with insufficient companies will be allocated a Home Market for the following calendar year that is formed based on:

- MSCI's Markets Classification (Developed, Emerging, Frontier); and
- Geographical Regions (EMEA, Asia Pacific, Americas).

If for any combination of Market Classification and Region, there are still not at least 30 companies, pairings may be combined to form an aggregated grouping that makes the minimum size criterion for Home Markets.

If the combination of Markets Classification and Geographical Region results in insufficient companies for a Home Market for any of the pairings, the Home Market will be formed based on the Market Classification only.

### Ad hoc coverage additions

Companies added to coverage outside of the Annual Review will be assigned one of the Home Markets effective at the time of the coverage addition based on the company's MSCI Country Classification.

If an equity issuer has no MSCI Country Classification, and the country of incorporation and the country of the primary listing of the security are the same, then that country is used.

<sup>14</sup> [https://www.msci.com/eqb/methodology/meth\\_docs/MSCI\\_GIMIMethodology\\_May2021.pdf](https://www.msci.com/eqb/methodology/meth_docs/MSCI_GIMIMethodology_May2021.pdf) at Appendix III

## Fixed income – governance reference entity

The corporate governance assessment for Fixed Income Issuers is based on the Governance Reference Entity. Where the Governance Reference Entity has an equity listing, the Home Market of the equity issuer is used. If the Governance Reference Entity does not have an equity listing, then a home market of “N/A” is assigned.

## 2021 Home-Market allocation

Following the annual review of Home Markets, for 2021 Kuwait was added to Other EMEA Emerging following the MSCI Market Classification Review where it was reclassified as Emerging Markets.

For 2020, one additional Home Market was added, with Chile moved from Other Americas Emerging to Chile. For 2019, two additional Home Markets were added – Saudi Arabia and Poland. Saudi Arabia was previously allocated to Frontier, while Poland was previously allocated to Other EMEA Emerging. In addition, Argentina was moved from Frontier to Other Americas Emerging.

Exhibit 19: Home-Market classification

| Home Market                   | Classification    |
|-------------------------------|-------------------|
| <b>Developed Americas</b>     |                   |
| Canada                        | Canada            |
| United States                 | USA               |
| <b>Developed Asia Pacific</b> |                   |
| Australia                     | Australia         |
| Hong Kong                     | Hong Kong, China  |
| Japan                         | Japan             |
| New Zealand                   | New Zealand       |
| Singapore                     | Singapore         |
| <b>Developed EMEA</b>         |                   |
| Austria                       | Austria           |
| Belgium                       | Belgium           |
| Denmark                       | Denmark           |
| Finland                       | Finland           |
| France                        | France            |
| Germany                       | Germany           |
| Israel                        | Israel            |
| Italy                         | Italy             |
| Netherlands                   | Netherlands       |
| Norway                        | Norway            |
| Spain                         | Spain             |
| Sweden                        | Sweden            |
| Switzerland                   | Switzerland       |
| United Kingdom                | United Kingdom    |
| Other EMEA Developed          | Ireland, Portugal |

| Home Market                  | Classification  |
|------------------------------|---|
| <b>Emerging Americas</b>     |   |
| Brazil                       | Brazil  |
| Chile                        | Chile   |
| Mexico                       | Mexico  |
| Other Americas Emerging      | Argentina, Colombia, Peru   |
| <b>Emerging Asia Pacific</b> |   |
| China                        | China   |
| India                        | India   |
| Indonesia                    | Indonesia   |
| Korea                        | Korea   |
| Malaysia                     | Malaysia  |
| Philippines                  | Philippines   |
| Taiwan                       | Taiwan  |
| Thailand                     | Thailand  |
| Other APAC Emerging          | Pakistan  |
| <b>Emerging EMEA</b>         |   |
| Poland                       | Poland  |
| Russia                       | Russia  |
| Saudi Arabia                 | Saudi Arabia  |
| South Africa                 | South Africa  |
| Turkey                       | Turkey  |
| Other EMEA Emerging          | Czech Republic, Egypt, Greece, Hungary, Kuwait, Qatar, United Arab Emirates |
| <b>Other</b>                 |   |
| Frontier                     | All countries classed as Frontier by MSCI                                   |
| N/A                          | n/a (fixed income)  |

## Appendix 7: ESG Ratings model history

MSCI ESG Ratings uses the following numeric notation to indicate the model version: MAJOR.MINOR.MIN-MAX. All three parts are numeric and indicate a specific type of model update.

- **Major** version number indicates a major model update.
- **Minor** version number indicates a minor model update.
- **Min-Max** version number indicates an interim update to the ESG Rating industry minimum and maximum benchmark scores. Refer to Appendix 5 for more details on the industry minimum and maximum update frequency.

The following is the history of the MSCI ESG Ratings model from its beginning in 2007.

### January 1, 2007 – MSCI ESG Ratings model version 1.0

- MSCI ESG Ratings start date.

### January 1, 2009 – MSCI ESG Ratings model version 1.1

- Following the acquisition of KLD and its Global Socrates platform, the MSCI ESG Ratings model began categorizing issues based on industry relevance. Issues with high industry relevance were scored using the MSCI ESG Ratings model and set to have a combined weight of 80%. Issues with less relevance were scored using the Global Socrates model, and were equally weighted to fill the remaining 20%. All companies within a given industry were assigned the same issue weights. Prior to the change, weights were company specific.

### May 1, 2011 – MSCI ESG Ratings model version 1.2

- Key Issue weights with high industry relevance were set to account for 100% of the model weight.
- Key Issue weight assignments switched from using MSCI ESG Ratings industry to GICS subindustry.
- Companies were allowed to have different weights than the rest of their GICS subindustry in limited cases where the analysis warranted inclusion of company-specific Key Issues.

### November 30, 2011 – MSCI ESG Ratings model version 1.3

- Model set to have a minimum weight of 5% on at least one Environmental Key Issue.
- Model set to have a minimum weight of 5% on at least one Social Key Issue.



- Model set to have a minimum weight of 5% on the Corporate Governance Key Issue.

## **January 1, 2012 – MSCI ESG Ratings model version 2.0**

- Substantial revision to the MSCI ESG Key Issue structure that resulted in ten new ESG Themes, including:
  - Climate Change
  - Natural Resource Use
  - Waste Management
  - Environmental Opportunities
  - Human Capital
  - Product Safety
  - Social Opportunities
  - Corporate Governance
  - Business Ethics
  - Government & Public Policy
- Where there are no industry Key Issues under the Environment Pillar that pose both a significant environmental impact and a significant risk to companies in the industry, companies are assessed on the Energy Efficiency Key Issue, which contributes a minimum of 5% weight to the final rating.
- The Corporate Governance Key Issue Score was updated to reflect data from Institutional Shareholder Services' (ISS's) Governance Risk Indicators (GRId).
- The Corporate Governance weight was significantly increased for companies with Corporate Governance Scores less than 2.

## **April 1, 2012 – MSCI ESG Ratings model version 2.1**

- Updates to the model hierarchy:
  - Key Issues renamed:
    - E-Waste Key Issue renamed Electronic Waste.
    - Opportunities in Environmental Technologies renamed Opportunities in Clean Tech.

- Raw Material Sourcing – Environmental renamed Raw Material Sourcing.
- Toxic Releases renamed Toxic Emissions and Waste.
- Upstream Carbon Emissions renamed Product Carbon Footprint.
- Labor – Operational renamed Labor Management.
- Labor – Supply Chain renamed Supply Chain Labor Standards.
- Opportunities in Health and Nutrition renamed Opportunities in Nutrition and Health.
- Product Safety – Chemical renamed Chemical Safety.
- Product Safety – Financial renamed Financial Product Safety.
- Product and Service Quality renamed Product Safety and Quality.
- Raw Material Sourcing – Social renamed Controversial Sourcing.
- Responsible Investing renamed Responsible Investment.
- Other Ethics Issues renamed Business Ethics and Fraud.
- Financing Environmental Impact Key Issue moved from Natural Resource Use Theme to Climate Change Theme.

## **January 1, 2013 – MSCI ESG Ratings model version 2.2**

- First annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry. The mapping of Key Issues to GICS sub-industries is updated annually beginning in 2013.

## **March 1, 2013 – MSCI ESG Ratings model version 2.3**

- ISS Governance QuickScore (QuickScore) replaced GRId as the primary data input for the Corporate Governance Key Issue. For companies outside of the QuickScore coverage universe, ESG Ratings used a modified version of the QuickScore corporate governance factors.

## **January 1, 2014 – MSCI ESG Ratings model version 2.4**

- Second annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.

- A higher weight was given to the Corporate Governance Key Issue by incorporating it into the standard ESG Ratings Weight Setting model, in particular for GICS sub-industries facing fewer material Environmental and Social issues. The average industry weight on Corporate Governance was increased from 6% to 12% due to this change.
- The minimum and maximum values used to calculate the Industry Adjusted Scores are based on the Weighted Average Key Issue Scores from companies in the MSCI World Index (contributing two-thirds to the minimum and maximum value) and MSCI ACWI Index (contributing one-third). This is the first year of a 3-year transition to determine minimum and maximum values based on companies in the MSCI ACWI Index. Prior to the change, the values were determined using the MSCI World Index only.

## **January 1, 2015 – MSCI ESG Ratings model version 3.0**

- Third annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.
- Updates to the ESG Key Issue structure:
  - Government & Public Policy Theme removed.
  - Stakeholder Opposition Theme added.
  - Themes renamed:
    - Natural Resource Use renamed Natural Capital.
    - Waste Management renamed Pollution & Waste.
    - Product Safety renamed Product Liability.
    - Business Ethics renamed Corporate Behavior.
  - Key Issues renamed:
    - Insuring Climate Change Risk renamed Climate Change Vulnerability.
    - Business Ethics and Fraud Key Issue renamed Business Ethics Key Issue.
  - Controversial Sourcing Key Issue moved from Human Capital Theme to Stakeholder Opposition Theme.
  - Financial System Instability Key Issue moved from Government and Public Policy Theme to Corporate Behavior Theme.

- QuickScore replaced by MSCI Governance Metrics as the primary data input for the Corporate Governance Key Issue. The most salient differences in the new model include:
  - Transitioned to an absolute 0-10 score where each company begins with a perfect score of 10 and points are deducted based on the presence of Corporate Governance flags (vs. previous decile-based scores that rank companies relative to their peers).
  - Replaced Audit Key Issue with Accounting Key Issue.
- Increased weight placed on Corporate Governance in the weight setting model, increasing the average industry weight from 12% to 22%.
- The minimum and maximum values used to calculate Industry Adjusted Scores are based on the Weighted Average Key Issue Scores from companies in the MSCI World Index (contributing one-third to the minimum and maximum value) and MSCI ACWI Index (contributing two-thirds). This is the second year of a 3-year transition to determine minimum and maximum values based on companies in the MSCI ACWI Index.

## **January 1, 2016 - MSCI ESG Ratings model version 3.1**

- Update to the ESG Key Issue structure:
  - Energy Efficiency Key Issue removed.
- Fourth annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.
- The minimum and maximum values used to calculate Industry Adjusted Scores are based on the Weighted Average Key Issue Scores from companies in the MSCI ACWI Index. This is the third year of a 3-year transition.

## **September 27, 2016 - MSCI ESG Ratings model version 3.2**

- Update to the ESG Key Issue structure:
  - Tax Transparency Key Issue added but assessed as an unweighted Key Issue.

## **January 1, 2017 - MSCI ESG Ratings model version 3.3**

- Fifth annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.

## **January 1, 2018 - MSCI ESG Ratings model version 3.4**

- Sixth annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.

#### **January 1, 2019 - MSCI ESG Ratings model version 3.5**

- Seventh annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.

#### **January 1, 2020 - MSCI ESG Ratings model version 3.6**

- Eighth annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.

#### **November 9, 2020 – MSCI ESG Ratings model version 4.0**

- Updates to the ESG Key Issue structure.
  - Community Relations Key Issue added.
  - Financial System Instability Key Issue removed.
  - Corruption & Instability Key Issue removed.
  - Business Ethics Key Issue removed.
  - Anti-Competitive Practices Key Issue removed.
  - Key Issue renamed:
    - Financial Product Safety Key Issue renamed Consumer Financial Protection.
- Corporate Behavior Theme score methodology changed from a weighted average calculation to an absolute assessment of a company's corporate behavior on a 0-10 scale. The 0-10 Corporate Behavior Theme score is now calculated based on the total sum of raw scores arising from Key Metrics in the Business Ethics and Tax Transparency Key Issues.
- Governance Pillar score methodology changed from a weighted average calculation to a deduction-based calculation. The 0-10 Governance Pillar score is now calculated based on the total sum of raw scores arising from Key Metrics in the Corporate Governance Theme and the Corporate Behavior Theme.
- Model set to have a minimum weight of 33% on the Governance Pillar.
- Financing Environmental Impact Key Issue revised to broaden the assessment of environmental risk from just syndicated loan portfolios to the entire loan book of a bank, and to focus on climate risk analysis of lending practices and involvement in environmental opportunities.

- Consumer Financial Protection Key Issue revised to remove risk exposure as a differentiating factor for companies.
- Tax Transparency added as a weighted Key Issue. All companies, other than Real Estate Investment Trusts, are assessed on the Key Issue.

#### **March 17, 2022 – MSCI ESG Ratings model version 4.0.1**

- Interim update to the Industry Minimum and Maximum benchmark values for selected ESG Rating industries listed below:
  - Asset Management & Custody Banks.
  - Banks.
  - Construction & Engineering.
  - Diversified Consumer Services.
  - Food Products.
  - Interactive Media & Services.
  - Oil & Gas Refining, Marketing, Transportation & Storage.
  - Paper & Forest Products.
  - Road & Rail Transport.
  - Semiconductors & Semiconductor Equipment.
  - Telecommunication Services.

#### **June 13, 2022 – MSCI ESG Ratings model version 4.1**

- Ninth annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.
- Accounting Key Metrics removed from the Accounting Key Issue and new Key Metrics added to the Board Key Issue
- Company size removed as a factor in the Product Safety & Quality Key Issue.

#### **November 4, 2022 – MSCI ESG Ratings model version 4.1.1**

- Interim update to the Industry Minimum and Maximum benchmark values for selected ESG Rating industries listed below:
  - Aerospace & Defense.
  - Air Freight & Logistics.
  - Airlines.

- Casinos & Gaming.
- Construction & Farm Machinery & Heavy Trucks.
- Interactive Media & Services.
- Marine Transport.
- Trading Companies & Distributors.

## **April 3, 2023 – MSCI ESG Ratings model version 4.2**

- 10th annual update to the ESG Materiality Map, which maps the Key Issues that are relevant to each GICS sub-industry.
- Changes to ESG Rating peer sets as a result of revisions to the GICS structure.
- Updates to the ESG Key Issue structure.
  - Access to Communication Key Issue removed.
  - Insuring Health and Demographic Risks Key Issue removed.

## **August 3, 2023 – MSCI ESG Ratings model version 4.2.1**

- Interim update to the Industry Minimum and Maximum benchmark values for selected ESG Rating industries listed below:
  - Building Products.
  - Oil & Gas Exploration & Production.
  - Oil & Gas Refining, Marketing, Transportation & Storage.
  - Retail - Consumer Discretionary.
  - Tobacco.

## **October 11, 2023 – MSCI ESG Ratings model version 4.2.2**

- Interim update to the Industry Minimum and Maximum benchmark values for selected ESG Rating industries listed below:
  - Airlines.
  - Auto Components.
  - Automobiles.

- Commodity Chemicals.
- Construction Materials.
- Containers & Packaging.
- Health Care Providers & Services.
- Health Care Technology.
- Household & Personal Products.
- Integrated Oil & Gas.
- Leisure Products.
- Metals and Mining - Precious Metals.
- Property & Casualty Insurance.
- Restaurants.
- Road & Rail Transport.
- Semiconductors & Semiconductor Equipment.
- Specialty Chemicals.
- Steel.
- Technology Hardware, Storage & Peripherals.
- Telecommunication Services.
- Textiles, Apparel & Luxury Goods.

## **December 6, 2023 – MSCI ESG Ratings model version 4.2.3**

- Interim update to the Industry Minimum and Maximum benchmark values for selected ESG Rating industries listed below:
  - Air Freight & Logistics.
  - Consumer Finance.
  - Diversified Chemicals.
  - Electrical Equipment.
  - Electronic Equipment, Instruments & Components.
  - Energy Equipment & Services.
  - Industrial Machinery.





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