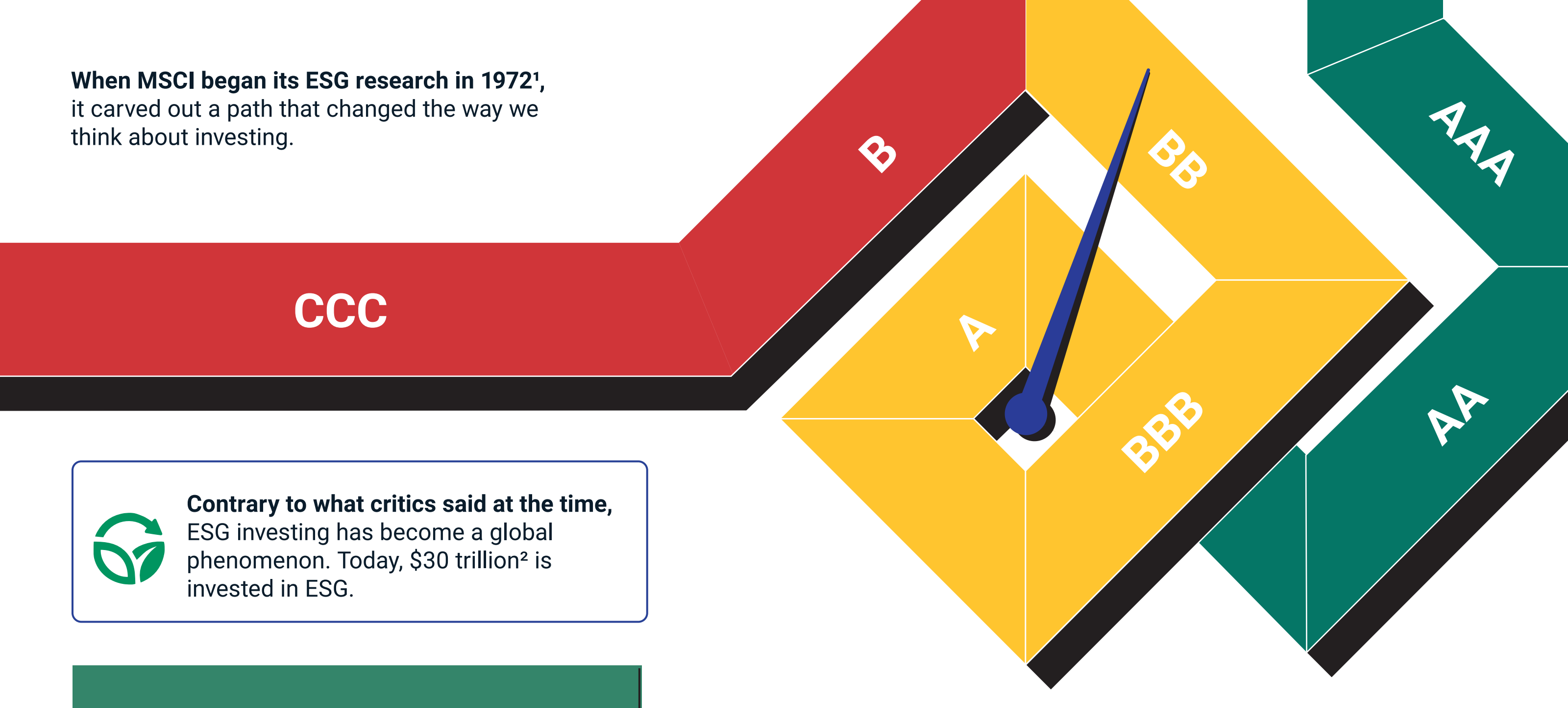
MSCI

Inside MSCI ESG Ratings

How Companies Are Scored



When MSCI began its ESG research in 1972[1], it carved out a path that changed the way we think about investing.

Contrary to what critics said at the time, ESG investing has become a global phenomenon. Today, $30 trillion[2] is invested in ESG.

U.S ESG-Focused Assets	Global ESG-Focused Assets
$12 trillion[2]	$30 trillion[2]

Thanks to its pioneering work, MSCI has emerged as a global leader in both ESG ratings and ESG indexes[3].

Source: Global Sustainable Investment Alliance (2019)

[1]Through our legacy companies KLD, Innovest, IRRC, and GMI Ratings. ESG and climate data, research and ratings are produced by MSCI ESG Research LLC and are used as an input to the MSCI ESG indexes, calculated by MSCI, Inc.

[2]2018 Global Sustainable Investment Review

[3]By coverage of companies and by number of ESG clients based on public information produced by Sustainalytics, Vigeo/EIRIS and ISS ESG as of August 2019

[4]MSCI ESG ratings and data are produced by MSCI ESG Research LLC. MSCI ESG Indexes and Analytics utilize information from, but are not provided by, MSCI ESG Research LLC. MSCI Indexes and Analytics are products of MSCI Inc. MSCI Indexes are administered by MSCI Limited (UK).

But what's behind the company ratings, and where does this vast universe of data come from?

The ESG Data Universe

MSCI ESG Research[4] aggregates over 1,000 data points from:

- Company filings
- NGOs
- Government
- Media sources
- Alternative data

Across the expansive data frontier, here are some specific sources that MSCI draws upon.

MSCI ESG Research uses industry-leading techniques—far beyond the data a company voluntarily provides.

The Fundamental Questions

How does MSCI ESG Research harness this data?

First, it asks two fundamental questions:

01 Which ESG issues could cause harm to investors?

02 Which ESG issues may create opportunities, relative to their peers?

To answer these, MSCI uses a combination of advanced technology and ESG research analysts.

Calculating Ratings

MSCI calculates a company-specific ESG score founded on three pillars:

Environment

Some key issues include:

- **Climate change**
  - Carbon emissions
  - Product carbon footprint
- **Pollution & waste**
  - Toxic emissions & waste
  - Packaging material & waste
- **Environment opportunities**
  - Clean tech
  - Green building

This shows a selection of key issues. For a full list visit msci.com

Social

Some key issues include:

- **Human capital**
  - Labor management
  - Health & safety
- **Stakeholder opposition**
  - Controversial sourcing
  - Community relations
- **Social opportunities**
  - Access to communication
  - Access to finance

Governance

Some key issues include:

- **Corporate governance**
  - Board
  - Pay
- **Corporate behavior**
  - Business ethics
  - Tax transparency

These are universal key issues applicable to all industries.

For each company, MSCI identifies the level of exposure to each key issue by applying:

Exposure metrics
To identify how exposed the company is to issues relevant to its industry

Based on:
80+ geographic metrics and business metrics

Management metrics
To identify how well the company is managing key issues

Based on:
20 performance metrics
100+ governance key metrics
150 policy/program metrics

CASE STUDY:

Oil & Gas Company

Harnessing AI, an ESG analyst looks at a petroleum company to assess its impact on sustainability through a top-down approach.

They focus on the most relevant issues including:

① **Environment**

- **Climate change** Tons of CO2 emitted/ $ million annual sales
- **Pollution & waste** Tons of CO2 emitted/ $ million annual sales

② **Social**

- **Community relations** Indigenous Rights Policy
- **Supply-chain labor standards** Partnering with a diverse set of suppliers on sustainability issues

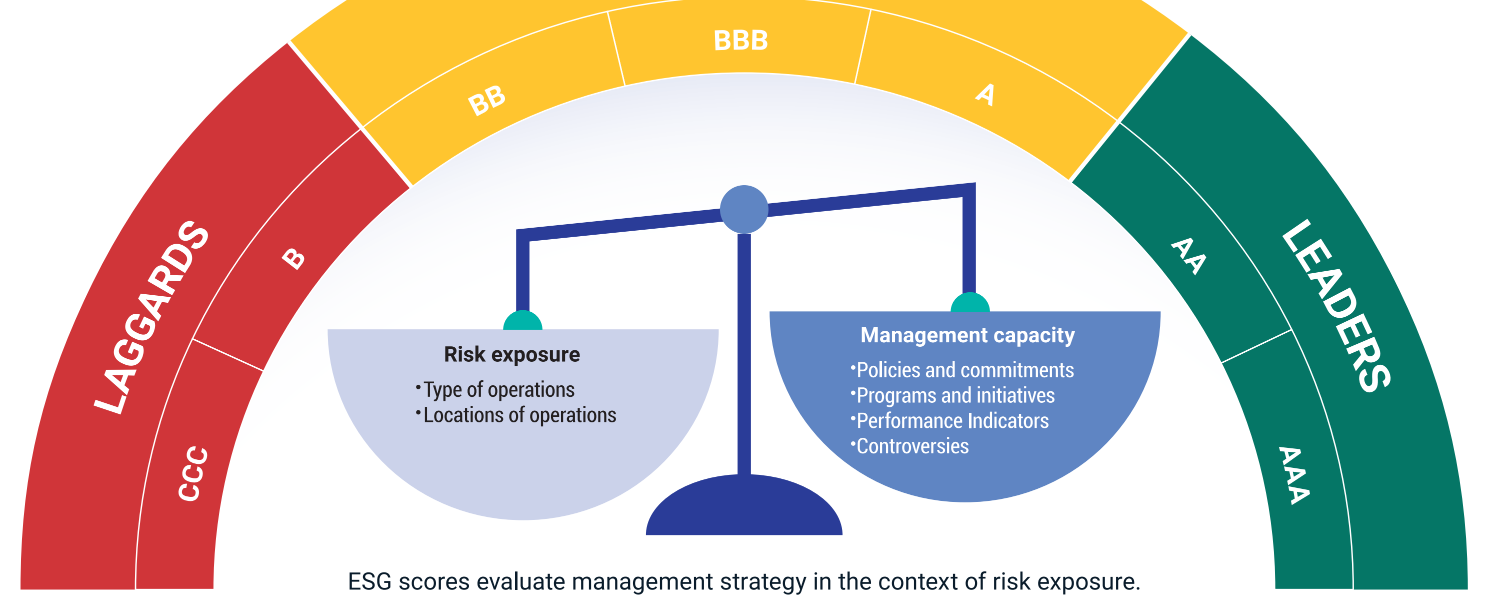
③ **Governance**

- **Pay** Executive compensation structure. E.g. How much pay depends on share price increases?
- **Business ethics** Spills, notice of violations, compliance fines

This shows just a fraction of an ESG ratings process—with MSCI ESG Research doing the heavy-lifting for investors.

The ESG Scorecard

Based on a thorough analysis of the most relevant themes and issues facing a company, the final score is assigned.



ESG scores evaluate management strategy in the context of risk exposure.

Why does this matter?

- Investors can prioritize companies' resilience to unanticipated, financially damaging ESG risks. Example: Regulatory bans on single-use plastics
- Ratings provide a launching point for shareholder engagement on ESG performance and investment product creation
- Investors can find opportunities in new and existing markets. Example: Cleantech and renewables
- Investors can make informed ESG decisions in the medium and long term

Source: MSCI (2020)

ESG: Investing Evolves as the World Evolves

The world is rapidly changing.

These significant changes require new approaches to investing that seriously take into account notions of sustainable finance.

By combining MSCI ESG Ratings and traditional financial analysis, investors can put together a more discerning picture of a company's risks and opportunities.

MSCI

Powering better investments for a better world. **msci.com**