

MSCI ESG Ratings Methodology: Human Capital Development Key Issue

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Introduction

This document provides essential information on the components of the Human Capital Development Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Human Capital Development is a Key Issue in the Social Pillar of the MSCI ESG Ratings model. Companies are evaluated on their workforce talent requirements and their ability to attract, retain and develop a highly skilled workforce.

For additional details on the MSCI ESG Ratings Model, refer to Section 2, Data, ratings and scores, of “ESG Ratings Methodology.”

Exhibit 1: MSCI ESG 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
	Product Liability	Labor Management
		Supply Chain Labor Standards
		Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
		Responsible Investment
	Stakeholder Opposition	Community Relations
		Controversial Sourcing
	Social Opportunities	Access to Finance
		Access to Health Care
Opportunities in Nutrition & Health		
Governance	Corporate Governance	Board
		Pay

3 Pillars	10 Themes	33 ESG Key Issues
		Ownership & Control
		Accounting
	Corporate Behavior	Business Ethics
		Tax Transparency

Risks associated with this Key Issue

- Inability to attract skilled talent to fill role requirements, loss of competitiveness.
- Loss of intellectual and human capital through attrition, key-person risk.
- Increased costs associated with high employee turnover (e.g., recruitment, training).
- Low workforce productivity.

Human Capital Development Key Issue Score

The Human Capital Development Key Issue Score evaluates the company’s level of exposure to, and management of, risks on this Key Issue. The Key Issue Score is based on the Exposure Score and the Management Score using the formula below. The Exposure Score and the 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.

$$KI_i = 7 - (\max (EXP_i, 2) - MGMT_i)$$

Where:

- KI_i is the Key Issue Score for company i .
- EXP_i is the Exposure Score for company i .
- $MGMT_i$ is the Management Score for company i .

Human Capital Development Management Score

The Human Capital Development Management Score evaluates the company’s ability to manage its exposure to risks on this Key Issue. It is based on an average of the scores associated with each of the Management Score categories listed below, modified by Controversies. These scores are derived from data points that are scored on a 0-10 scale, with 10 corresponding to best practice and 0 corresponding to lack of management. Refer to Section 3.3, Analyzing risk management, of “ESG Ratings Methodology” for additional details. Sources are company disclosures except where otherwise indicated. The following formula is used to calculate the Human Capital Development Management Score - Excluding Controversies:

$$MGMT_{HCD,i} = \frac{STRAT_{HCD,i} + PROI_{HCD,i} + PERF_{HCD,i}}{3}$$

Where:

- $MGMT_{HCD,i}$ is the Human Capital Development Management Score - Excluding Controversies for company i .
- $STRAT_{HCD,i}$ is the Strategy Score for company i .
- $PROI_{HCD,i}$ is the Programs & Initiatives Score for company i .
- $PERF_{HCD,i}$ is the Performance Score for company i .

The following data points, without constituting an exhaustive list, are representative of the inputs to the Management Score and are used in the Management Score calculation:

Management Score category: Strategy Score

- **Extent of human resource-related grievance reporting or escalation procedures.**
Definition: Indicates whether the company has an internal reporting channel or escalation procedures for employees to report human resource-related grievances.
- **Employee satisfaction survey frequency.**
Definition: The frequency of employee satisfaction surveys. Best practice is at least annually.

Management Score category: Programs & Initiatives Score

- **Employee equity programs.**

Definition: The extent of eligibility for an employee stock ownership plans and/or an employee stock purchase plans. Best practice is for at least 90% of employees to participate.

- **Variable performance-based component to pay.**

Definition: Indicates whether non-officer and non-sales staff are eligible for variable performance-based pay, such as bonuses.

- **Workforce eligible for non-pay benefits.**

Definition: The scope of employees eligible for non-pay benefits. Best practice is where all employees are eligible for benefits.

- **Regular performance appraisals and feedback processes.**

Definition: Indicates whether and to what extent the company undertakes programs for employee professional development, such as performance reviews, goal setting and review, or similar. Best practice is for at least 90% of employees to participate.

- **Skills and knowledge development training.**

Definition: The extent of managerial/leadership development training. Best practice is a training program in which all employees participate.

Management Score category: Performance Score

Assesses the company's performance on human capital development metrics (including employee turnover and recognition as an employer of choice) relative to its peers. Expressed as a 0-10 score, where 10 indicates the highest level of performance.

Representative performance metrics:

- Percentage annual employee turnover.
- External recognition as an employer of choice (last three years).

Controversies

A controversy deduction ranging from 0 to 5 points is subtracted from the overall Management Score, based on the severity and type of controversies facing the company on this Key Issue. The following categories of controversies are used in the assessment.

- Labor management controversies.
- Collective bargaining controversies.
- Discrimination and workforce diversity controversies.

For more details on how controversies are included in the MSCI ESG Ratings model, refer to Section 3.3.2, Controversies cases, of “ESG Ratings Methodology.”

Human Capital Development Exposure Score

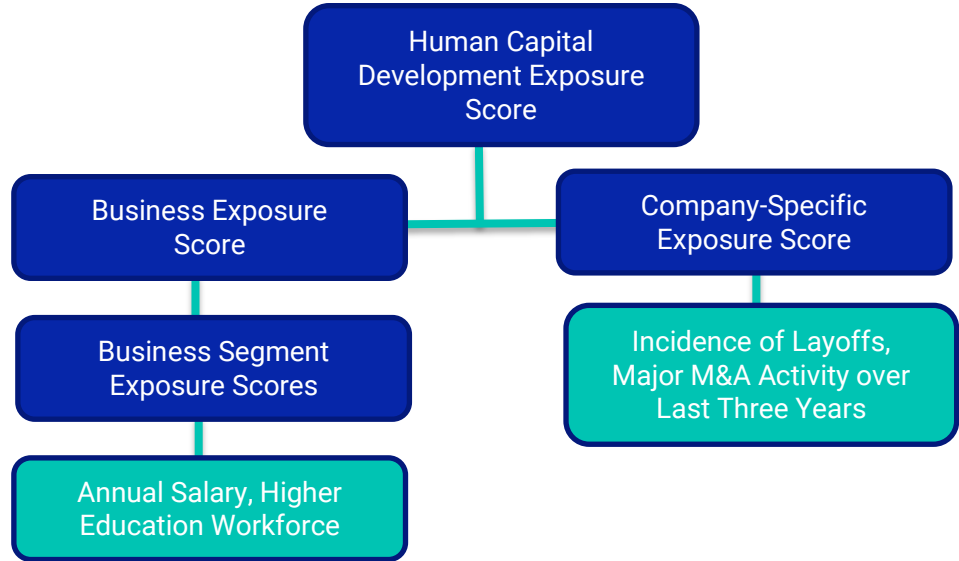
The Human Capital Development Exposure Score evaluates the company’s exposure to risks on this Key Issue. It is based on the Business and Company-Specific Exposure Scores. The Business Exposure Score is scored on a 0-10 scale, with 10 corresponding to the highest risk and 0 corresponding to the lowest risk. The Company-Specific Exposure Score functions as an addition to the Business Exposure Score, with an additive impact of 0 to 2 points. Refer to Section 3.2, Analyzing risk exposure, of “ESG Ratings Methodology” for additional details. The following formula is used in the Exposure Score calculation:

$$EXP_{HCD,i} = BUS_{HCD,i} + COM_{HCD,i}$$

Where:

- $EXP_{HCD,i}$ is the Human Capital Development Exposure Score of company i .
- $BUS_{HCD,i}$ is the Business Exposure Score of company i .
- $COM_{HCD,i}$ is the Company-Specific Exposure Score of company i .

Exhibit 2: Exposure Score components



Business Exposure Score

The Business Exposure Score is a weighted average of the Business Segment Exposure Scores of a company’s business segments. Scores are weighted by the proportion of a company’s total assets in each business segment,¹ using the following formula to calculate the Business Exposure Score:

$$BUS_{HCD,i} = \sum_{j=1}^{n_i} w_{Asset,i,j} BSE_{HCD,j}$$

Where:

- $BSE_{HCD,j}$ is the Business Segment Exposure Score for business segment j .
- $w_{Asset,i,j}$ is the weight of business segment j for company i based on the contribution to total company assets.
- n_i is the number of business segments of company i .

¹ The percentage of assets is typically calculated as the company-reported asset value of the segment divided by the total asset value. In certain cases, industry-specific metrics are used to calculate the percentage of assets, such as power generation, production volume or reserve value. In cases where neither segment assets nor a relevant industry-specific proxy is available, the percentage is calculated based on segment revenue.

Business Segment Exposure Scores

The Business Segment Exposure Score is based on a mapping of the business segment as disclosed by the company to a corresponding business activity. MSCI ESG Research uses the Standard Industrial Classification (SIC) system along with industry-specific adjustments to define business activities. The score associated with a business activity is used to calculate a Business Segment Exposure Score. Each business activity score is determined by a simple average of the Annual Salary Score and the Higher Education Workforce Score.

$$BSE_{HCD,j} = \frac{AS_j + HEW_j}{2}$$

Where:

- AS_j is the Annual Salary Score for business activity j .
- HEW_j is the Higher Education Workforce Score for business activity j .

The Annual Salary Score and Higher Education Workforce Score are based on a calculation that compares the relative ranking of a business activity on specific metrics (annual salaries and educational attainment of employees, respectively) to all other business activities on those same metrics. The Annual Salary Score of a business activity is based on the 75th percentile of the annual salaries for each business activity. The Higher Education Workforce Score is calculated based on the proportion of employees with Bachelor’s Degree or higher for each business activity.

Company-Specific Exposure Score

The Company-Specific Exposure Score is an addition to the Business Exposure Score, with an additive impact of 0 to 2 points. The following formula is used to compute the Company-Specific Exposure Score:

$$COM_{HCD,i} = ILO_{HCD,i} + IMA_{HCD,i}$$

Where:

- $ILO_{HCD,i}$ is the Incidence of Layoffs Score of company i .

- $IMA_{HCD,i}$ is the Incidence of Major Mergers and Acquisitions Score for company i .

The Incidence of Layoffs Score is assessed as 1 if layoffs in the last three years affect more than 10% of the workforce or more than 1,000 employees per company; otherwise, it is assessed as 0. The Incidence of Major Mergers and Acquisitions Score is assessed as 1 if major Mergers and Acquisitions activity in the last three years affects more than 10% of the workforce or more than 1,000 employees per company; otherwise, it is assessed as 0.

Data Sources

The following sources are used to determine the Human Capital Development Exposure Score:

Employment Projections Program, Bureau of Labor Statistics; Occupational Employment Statistics, Bureau of Labor Statistics; MSCI ESG Research; Refinitiv; company disclosures.

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