MSCI ESG Ratings Methodology: Supply Chain Labor Standards Key Issue

MSCI ESG Research LLC
October 2023
Contents

Introduction........................................................................................................... 3
Risks associated with this Key Issue................................................................. 4
Supply Chain Labor Standards Key Issue Score ......................................... 4
Supply Chain Labor Standards Management Score ..................................... 4
Management Score category: Practices Score............................................. 5
Controversies..................................................................................................... 7
Supply Chain Labor Standards Exposure Score........................................... 8
Company-Specific Exposure Score............................................................... 9
Data Sources.................................................................................................... 9
Introduction

This document provides essential information on the components of the Supply Chain Labor Standards Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Supply Chain Labor Standards is a Key Issue in the Social Pillar of the MSCI ESG Ratings model. Companies are evaluated on the management and transparency of their supply chain and the working standards in the regions in which their suppliers are located.

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
MSCI ESG Ratings Methodology: Supply Chain Labor Standards Key Issue | October 2023

Risks associated with this Key Issue

- Production delays due to labor unrest in supply chains.
- Reduced productivity and product quality.
- Loss of growth opportunities, market share or pricing power due to negative publicity and damage to brand value.

Supply Chain Labor Standards Key Issue Score

The Supply Chain Labor Standards 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.

\[ KI_i = 7 - (\max(\text{EXP}_i, 2) - \text{MGMT}_i) \]

Where:
- \( KI_i \) is the Key Issue Score for company \( i \).
- \( \text{EXP}_i \) is the Exposure Score for company \( i \).
- \( \text{MGMT}_i \) is the Management Score for company \( i \).

Supply Chain Labor Standards Management Score

The Supply Chain Labor Standards Management Score evaluates the company’s ability to manage its exposure to risks on this Key Issue. It is based on the Management Score category 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 Supply Chain Labor Standards Management Score - Excluding Controversies:

\[ M_{GSLS,i} = P_{RASLS,i} \]

Where:
- \( M_{GSLS,i} \) is the Supply Chain Labor Standards Management Score - Excluding Controversies for company \( i \).
- \( P_{RASLS,i} \) is the Practices 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: Practices Score**

- **Supply chain code of conduct covers anti-discrimination.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements forbidding suppliers from engaging in discrimination with regard to their employees.

- **Supply chain code of conduct covers child labor.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct forbids suppliers to use underage labor.

- **Supply chain code of conduct covers forced labor.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct forbids suppliers to use forced labor.

- **Supply chain code of conduct covers freedom of association.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements that suppliers respect freedom of association and allow workers to unionize if desired.
• **Supply chain code of conduct covers health and safety.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements regarding health and safety working conditions at supplier factories.

• **Supply chain code of conduct covers minimum wage.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements regarding the minimum wages that suppliers must pay their employees.

• **Supply chain code of conduct covers paid overtime.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements that suppliers pay overtime wages when employees must work overtime hours.

• **Supply chain code of conduct covers working hours.**
  
  **Definition:** Indicates whether the company’s supply chain code of conduct sets forth requirements limiting the amount of hours suppliers’ employees may be required to work in a day or a week.

• **Training of suppliers on labor-related social issues.**
  
  **Definition:** Indicates whether the company has specific training programs in place with its suppliers on its supplier code of conduct or specific labor-related issues.

• **Supplier selection based on labor management performance.**
  
  **Definition:** Indicates whether the company considers suppliers’ performance in allocating or renewing contracts, and/or placing further orders.

• **Scope of supplier audits.**
**Definition**: Indicates whether the company conducts internal and/or external audits across its supply chain.

- **Action taken to address supplier misconduct**.
  
  **Definition**: Indicates whether the company provides evidence of developing a remediation action plan when incidents of noncompliance with its code of conduct are found.

- **Extent of disclosure on instances of supplier misconduct**.
  
  **Definition**: Indicates whether the company discloses the frequency and type of noncompliance incidents found in its supply chain.

- **Tier 1 supplier audits (direct suppliers)**.
  
  **Definition**: Indicates whether some or all Tier 1 suppliers (i.e., direct suppliers) are covered by the social audit program of the company.

- **Tier 2 suppliers audits (components)**.
  
  **Definition**: Indicates whether some or all Tier 2 suppliers (i.e., components) are covered by the social audit program of the company.

- **Tier 3 suppliers audits (raw materials)**.
  
  **Definition**: Indicates whether some or all Tier 3 suppliers (i.e., raw materials) are covered by the social audit program of the company.

**Sources**: company disclosures, International Labour Organization.

**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:
• Supply chain labor standards 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.”

Supply Chain Labor Standards Exposure Score
The Supply Chain Labor Standards Exposure Score evaluates the company’s exposure to risks on this Key Issue. It is based on the Company-Specific Exposure Score only. The Company-Specific Exposure Score is scored on a 0-10 scale, with 10 corresponding to the highest risk and 0 corresponding to the lowest risk. Refer to Section 3.2, Analyzing risk exposure, of “ESG Ratings Methodology” for additional details. The following data sources and methodologies are used in the Exposure Score calculation:

\[ EXP_{SLS,i} = COM_{SLS,i} \]

Where:
• \( EXP_{SLS,i} \) is the Supply Chain Labor Standards Exposure Score of company \( i \).
• \( COM_{SLS,i} \) is the Company-Specific Exposure Score of company \( i \).

Exhibit 2: Exposure Score components
Company-Specific Exposure Score

The Company-Specific Exposure Score is a simple average of the Brand Recognition Score and the Footprint Score:

\[ \text{COM}_{\text{SLS},i} = \frac{\text{BRS}_{\text{SLS},i} + \text{FS}_{\text{SLS},i}}{2} \]

Where:

- \( \text{BRS}_{\text{SLS},i} \) is the Brand Recognition Score for company \( i \).
- \( \text{FS}_{\text{SLS},i} \) is the Footprint Score for company \( i \).

A Brand Recognition Score of 10 is assessed for companies that get featured on Interbrand’s Top 100 Best Global Brands List. Companies that do not feature on this list get a score of 0.

The Footprint Score is calculated using total estimated revenues from products manufactured in developing and frontier markets.\(^1\)

Data Sources

The following sources are used to determine the Supply Chain Labor Standards Exposure Score:

- Refinitiv, MSCI ESG Research, company disclosures, Interbrand.

---

\(^1\) Companies are assessed on revenues from their private-label products where applicable.
Contact us

msci.com/contact-us

### AMERICAS
- United States: +1 888 588 4567 *
- Canada: +1 416 687 6270
- Brazil: +55 11 4040 7830
- Mexico: +52 81 1253 4020

### EUROPE, MIDDLE EAST & AFRICA
- South Africa: +27 21 673 0103
- Germany: +49 69 133 859 00
- Switzerland: +41 22 817 9777
- United Kingdom: +44 20 7618 2222
- Italy: +39 02 5849 0415
- France: +33 17 6769 810

### ASIA PACIFIC
- China: +86 21 61326611
- Hong Kong: +852 2844 9333
- India: +91 22 6784 9160
- Malaysia: 1800818185 *
- South Korea: +82 70 4769 4231
- Singapore: +65 67011177
- Australia: +61 2 9033 9333
- Taiwan: 008 0112 7513 *
- Thailand: 0018 0015 6207 7181 *
- Japan: +81 3 4579 0333
* toll-free

### About MSCI
MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

### About MSCI ESG Research Products and Services
MSCI ESG Research products and services are provided by MSCI ESG Research LLC, and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research LLC are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc.

To learn more, please visit [www.msci.com](http://www.msci.com).
Notice and disclaimer

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or redisseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information may include "Signals," defined as quantitative attributes or the product of methods or formulas that describe or are derived from calculations using historical data. Neither these Signals nor any description of historical data are intended to provide investment advice or a recommendation to make (or refrain from making) any investment decision or asset allocation and should not be relied upon as such. Signals are inherently backward-looking because of their use of historical data, and they are not intended to predict the future. The relevance, correlations and accuracy of Signals frequently will change materially.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy. It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. The calculation of indexes and index returns may deviate from the stated methodology. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back tested performance is not actual performance, but is hypothetical. There are frequent material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of msci.com.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such, provided that applicable products or services from MSCI ESG Research may constitute investment advice. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. MSCI ESG and climate ratings, research and data are produced by MSCI ESG Research LLC, a subsidiary of MSCI Inc. MSCI ESG Indexes, Analytics and Real Estate are products of MSCI Inc. that utilize information from MSCI ESG Research LLC. MSCI Indexes are administered by MSCI Limited (UK).

Please note that the issuers mentioned in MSCI ESG Research materials sometimes have commercial relationships with MSCI ESG Research and/or MSCI Inc. (collectively, "MSCI") and that these relationships create potential conflicts of interest. In some cases, the issuers or their affiliates purchase research or other products or services from one or more MSCI affiliates. In other cases, MSCI ESG Research rates financial products such as mutual funds or ETFs that are managed by MSCI’s clients or their affiliates, or are based on MSCI Inc. Indexes. In addition, constituents in MSCI Inc. equity indexes include companies that subscribe to MSCI products or services. In some cases, MSCI clients pay fees based in whole or part on the assets they manage. MSCI ESG Research has taken a number of steps to mitigate potential conflicts of interest and safeguard the integrity and independence of its research and ratings.

More information about these conflict mitigation measures is available in our Form ADV, available at https://adviserinfo.sec.gov/firm/summary/169222.

Any use or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P Global Market Intelligence. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and S&P Global Market Intelligence.