

# ESG RATING – JAPAN SNAPSHOT



July 2017

- The constituents of the MSCI Japan Index accounted for a larger portion of companies in the middle rating range (from A to BB) compared to MSCI Kokusai Index (i.e. MSCI World ex Japan Index), with consequently fewer companies rated in extremes (AAA and CCC).
- A large majority (62%) of constituents in the MSCI Japan IMI 200+ were rated as BBB and BB, indicating that at large they met regulatory requirements and mitigated most pressing risks, with some areas potentially requiring more attention.
- All top 3 weighted companies in MSCI Japan Index, **Toyota Motor (4.53%)**, **Mitsubishi Financial Group (2.63%)** and **Softbank Group (2.0%)**, received average or below average ratings (BBB and BB). Among top 10 portfolio weight companies, only **KDDI** received the industry’s best practice.

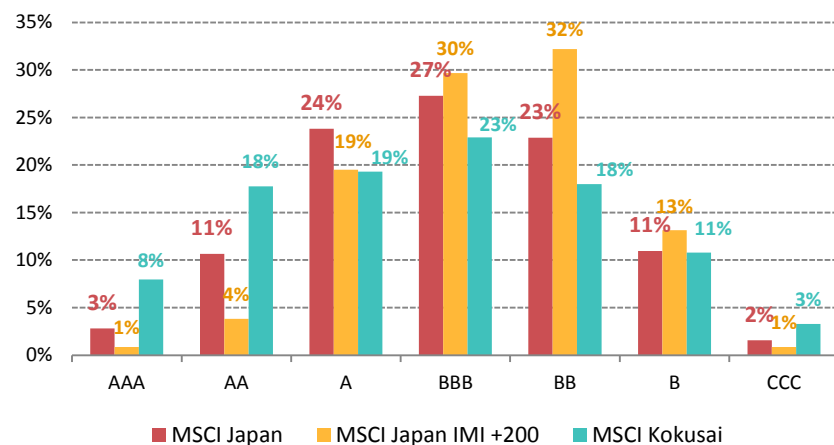
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Figure 1 | ESG Rating Distribution



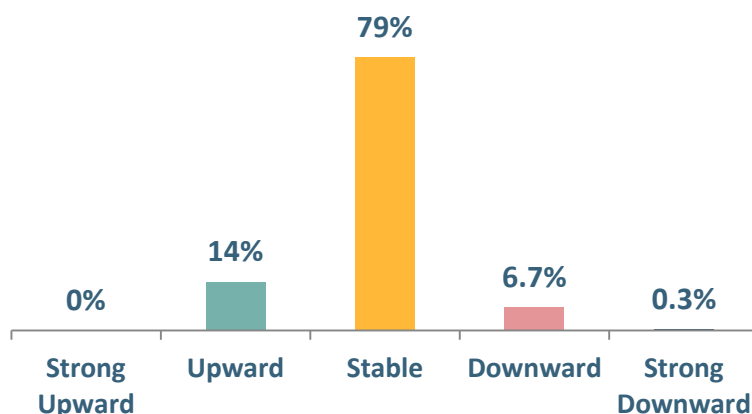
RANK	ISSUER	PORTFOLIO WEIGHT	SECTOR	RATING
1	TOYOTA MOTOR	4.53%	Consumer Discretionary	BB
2	MITSUBISHI UFJ FINANCIAL GROUP	2.63%	Financials	BB
3	SOFTBANK GROUP	2.00%	Telecommunication Services	BBB
4	SUMITOMO MITSUI FINANCIAL GROUP	1.60%	Financials	BBB
5	KDDI	1.56%	Telecommunication Services	AAA
6	HONDA MOTOR	1.48%	Consumer Discretionary	A
7	SONY	1.44%	Consumer Discretionary	A
8	MIZUHO FINANCIAL GROUP	1.43%	Financials	A
9	KEYENCE	1.31%	Information Technology	BBB
10	FANUC	1.27%	Industrials	B

*This report is based on MSCI ESG Rating Japan coverage (522 Japanese companies), including MSCI Japan Index constituents (319), and MSCI Kokusai Index (1,318) as at May 19th 2017.*

## ESG RATING MOMENTUM

Rating momentum (Upward/Downward) showed companies' ESG risk management improvement/downturn from industry relative perspective. 79% of MSCI Japan Index constituents had stable rating momentum (no rating change) from previous year's rating. Among the rest, more companies (13%) showed upward trends and 7% showed downward rating momentum from previous rating.

Figure 2 | ESG Rating Momentum (MSCI Japan Index)



Ticker	Company	Sector	Rating Change	Portfolio Weights
<b>Upward Momentum</b>				
9984	SoftBank Group Corp.	Telecom Services	+1	2.0%
9433	KDDI CORPORATION	Telecom Services	+1	1.6%
8411	Mizuho Financial Group, Inc.	Financials	+1	1.4%
3382	Seven & i Holdings Co., Ltd.	Consumer Staples	+1	1.0%
6752	Panasonic Corporation	Consumer Discretionary	+1	0.9%
<b>Downward Momentum</b>				
6502	TOSHIBA CORPORATION	Consumer Discretionary	-2	0.3%
7267	HONDA MOTOR CO., LTD.	Consumer Discretionary	-1	1.5%
4503	Astellas Pharma Inc.	Health Care	-1	0.9%
6501	Hitachi, Ltd.	Information Technology	-1	0.9%
8031	MITSUI & CO., LTD.	Industrials	-1	0.8%

- Two companies in telecommunication service sector (**Softbank and KDDI**) showed upward momentum with index weight position. Softbank's upgrade was driven by improvement due to acquisition of Sprint. **KDDI** had been placed in the best practice position by 1 letter upgrade by its continuous market expansion in emerging market and providing stronger evidence of customer data privacy protection measures.
- Toshiba downgraded to CCC from BB by May 2017 due mainly to delay of filing an unaudited earnings result on 11 April 2017. This had escalated the delisting risks it had faced since Tokyo Stock Exchange designated it as a security under supervision and debt incurred by Westinghouse posed risk of insolvency.

# ENVIRONMENTAL, SOCIAL AND GOVERNANCE PILLAR AND THEME SCORE COMAPRISON

## Environment Pillar/ Theme Score (0-10)

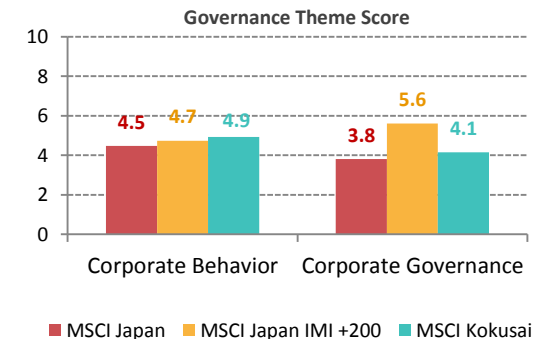
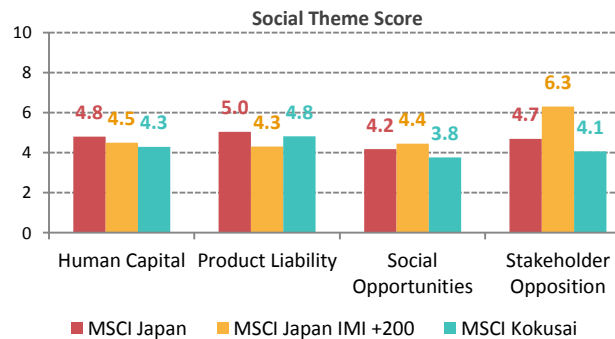
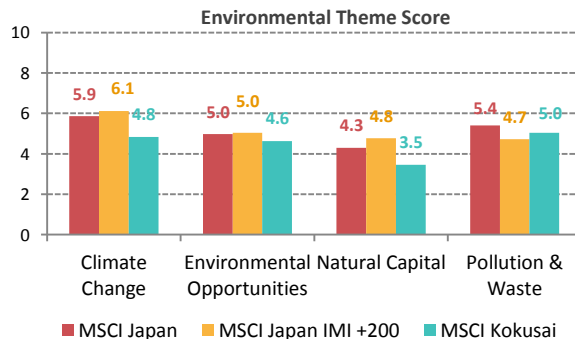
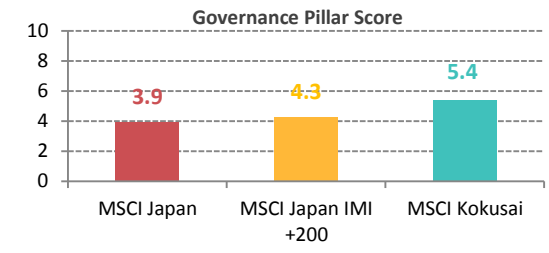
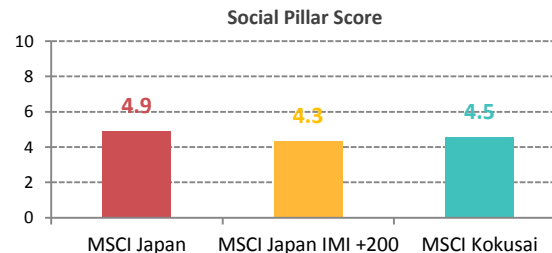
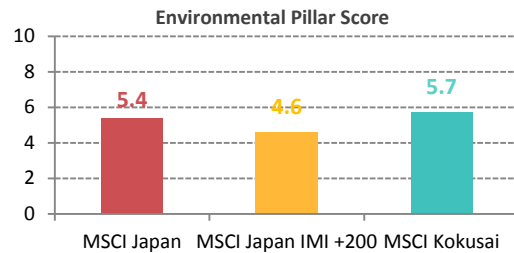
MSCI Japan Index constituents and MSCI Japan IMI +200 companies underperformed MSCI Kokusai on Environment Pillar score which was calculated by weighted average of all weighted Environment key issues. MSCI Japan outperformed MSCI Kokusai on all key issue environmental themes; Climate Change, Environmental Opportunities, Natural Capital and Pollution & Waste, given Japan’s stringent environmental standards.

## Social Pillar / Theme Score (0-10)

MSCI Japan Index constituents outperform MSCI Kokusai Index but MSCI Japan IMI +200 companies underperform MSCI Kokusai on Social Pillar score which was calculated by weighted average of all weighted Social key issues. Strong performance on Stakeholder Opposition of MSCI Japan IMI +200 were due to their lower exposure to conflict mineral sourcing.

## Governance Pillar / Theme Score (0-10)

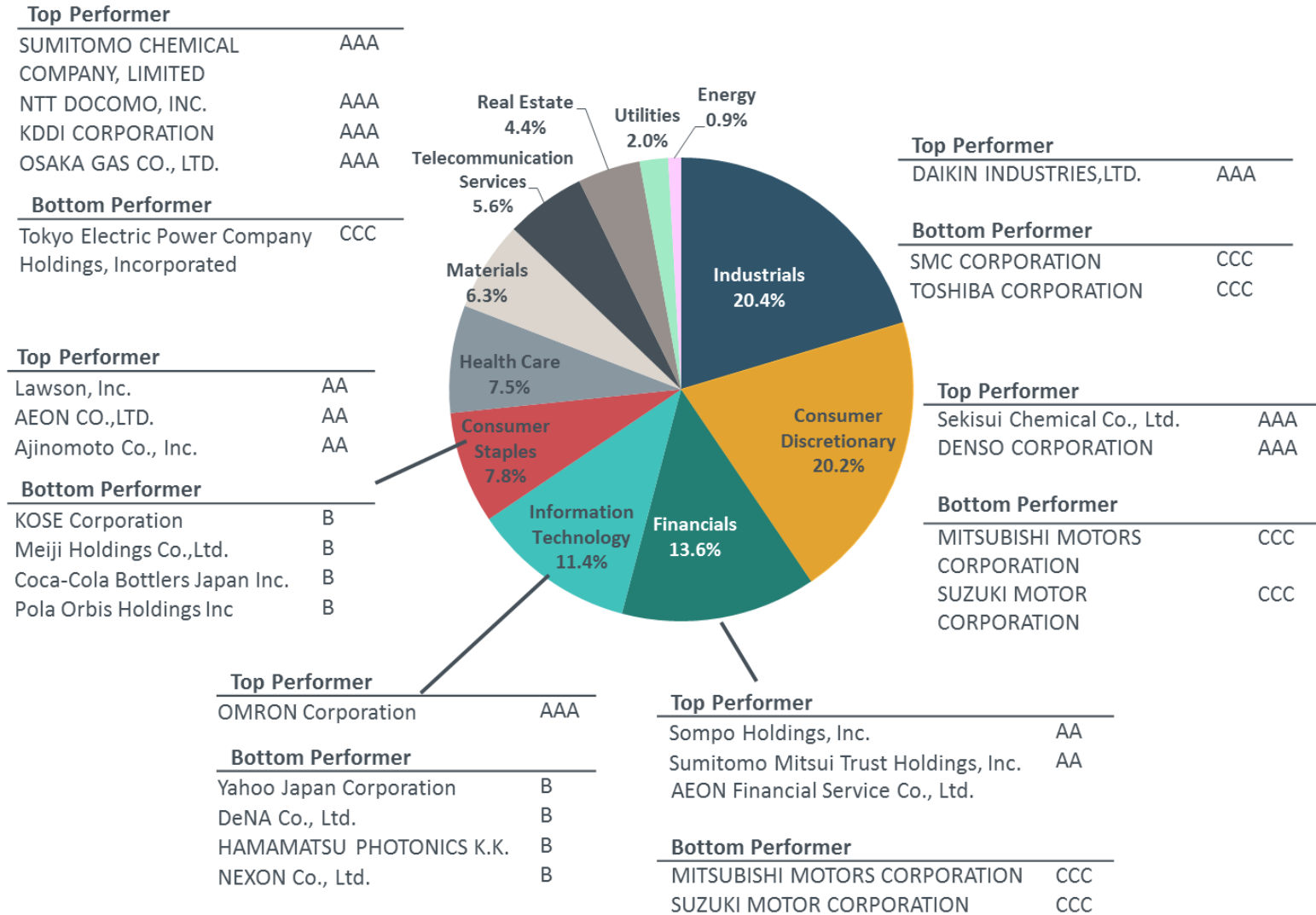
MSCI Japan Index constituents and MSCI Japan IMI +200 companies underperformed MSCI Kokusai on Governance Pillar score which was calculated by weighted average of all weighted Governance key issues. In particular, as average score, MSCI Japan IMI +200 showed better performance on Corporate Governance.



## ESG RATING TOP/BOTTOM PERFORMERS

Figure 3 | ESG Top /Bottom Performers in Sectors (MSCI Japan Index)

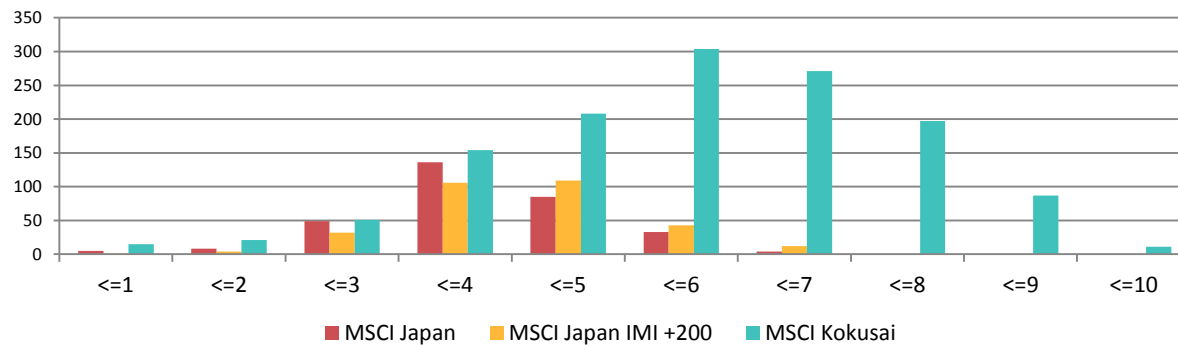
The % in the pie chart indicates market cap proportion of GICS Sector in MSCI Japan Index as of May 19, 2017. The companies and ESG Ratings (AAA-CCC) are based on ESG Ratings as of May 19, 2017.



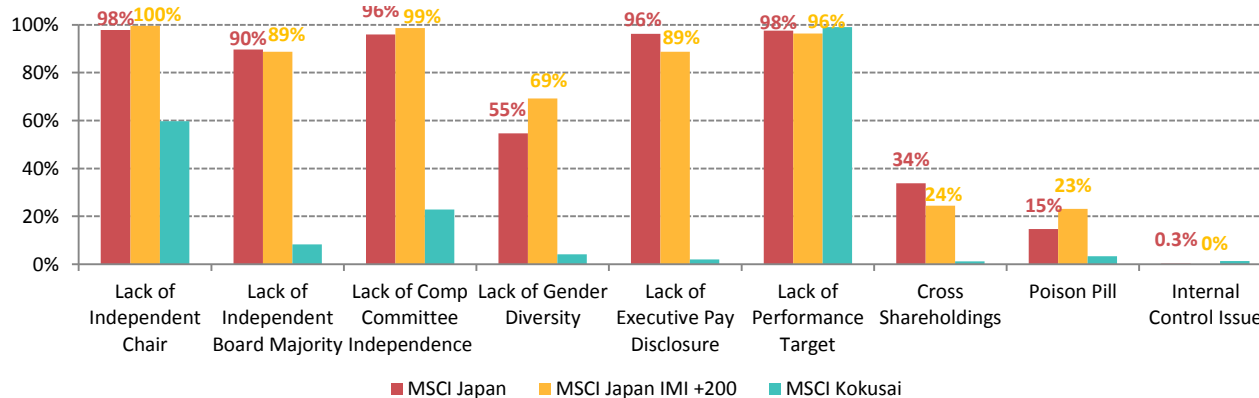
## CORPORATE GOVERNANCE SNAPSHOT

The Governance Metrics scores and rankings are designed to provide institutional investors with an effective summary of corporate governance factors that may impact investment value. The scoring model applied to MSCI ESG Research Corporate Governance score is based on 96 unique governance and accounting metrics, organized into four individual scoring themes, resulting in a 0-10 universal score scale. This Corporate Governance score is incorporated into ESG Rating with given weights. While constituents of MSCI Kokusai Index fall into 0-10 wide score range, constituents of MSCI Japan Index and MSCI Japan IMI +200 tend to fall into lower score range (0-7), indicating that despite Japan’s strong record of Corporate Governance Code compliance, Japanese companies fall short of standards applied in other developed countries.

**Figure 4 | Corporate Governance Score Distribution (# of companies)**



**Figure 5 | Corporate Governance Major Key Metrics Comparison** Governance assessment as of May 19, 2017



### Board

- 90% of MSCI Japan Index constituents lacked independent Board majority.
- 96% of MSCI Japan Index constituents lacked full independent compensation committee.
- 55% of MSCI Japan Index constituents had no female member on Board.

### Pay

- 96% of MSCI Japan Index constituents lacked executive pay disclosure of individual executive board members.
- 98% of MSCI Japan Index constituents lacked advanced target disclosure of executives.

### Ownership & Control

- 34% of MSCI Japan Index constituents had cross shareholdings with other companies with at least 0.5% of share held by each other.
- 15% of MSCI Japan Index constituents had take-over defense measure (poison pill).

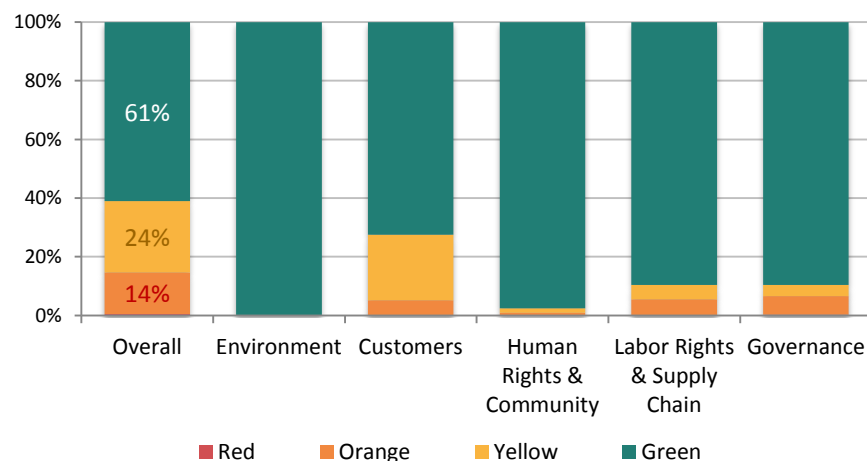
### Accounting

- 0.3% of MSCI Japan Index constituents had internal governance control issue, namely Toshiba which was under investigation of accounting fraud.

## ESG CONTROVERSIES SNAPSHOT

MSCI ESG Controversies is designed to provide timely and consistent assessments of ESG controversies involving publicly traded companies and fixed income issuers. MSCI ESG Research signals the severity of the assessment through color-coded alerts. Red indicates at least one very severe controversy. Orange indicates one or more major controversies that approach the criteria for a red flag. Yellow indicates noteworthy controversies. Green indicates either less significant controversies or none at all.

**Figure 6 | ESG Controversies Assessment (MSCI Japan Index), May 19 2017**



Among MSCI Japan Index constituents (319 companies), approximately 60% companies were flagged Green (only minor controversies or no controversies).

- 24% of MSCI Japan Index was flagged to Yellow with Moderate to Severe level but non-Structural controversies, and 14% were flagged to Orange with Severe and Structural controversies.
- Only two constituents in MSCI Japan Index (**Tokyo Electric Power Company Holdings** and **Toshiba**) were flagged to Red with Very Severe controversies.
- Controversies related to Customers were the most frequently occurring controversies, mostly recalls and anti-competitive practice, among MSCI Japan Index constituents. Governance and Labor Rights & Supply Chain are seconds. Environment related controversies are rarely reported in MSCI Japan Index.

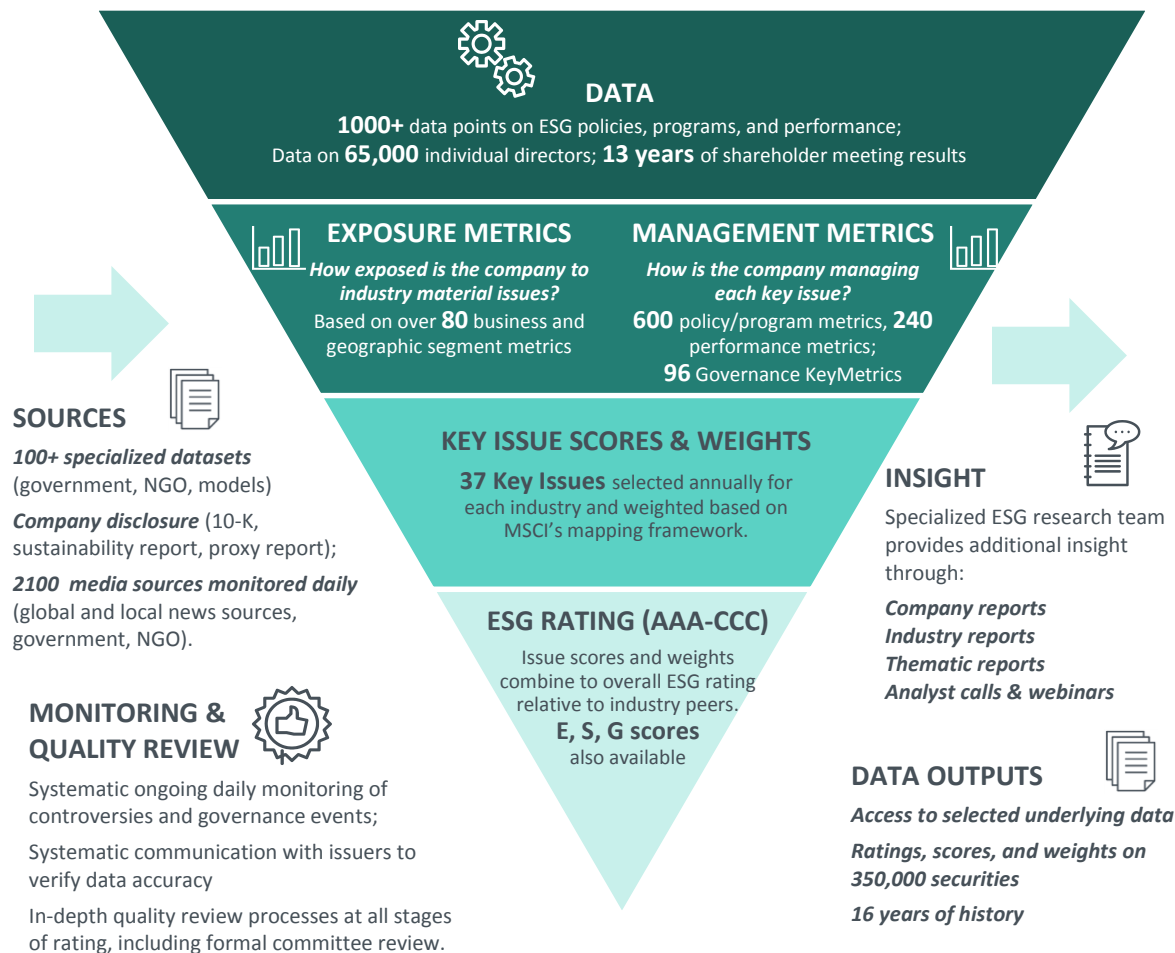
RANK*	COMPANY NAME	PORTFOLIO WEIGHT	SECTOR (GICS)	Overall	Environment	Customers	Human Rights & Community	Labor Rights & Supply Chain	Governance
1	TOKYO ELECTRIC POWER COMPANY HOLDINGS, INCORPORATED	0.19%	Utilities	●	●	●	●	●	●
2	TOSHIBA CORPORATION	0.29%	Industrials	●	●	●	●	●	●
3	HONDA MOTOR CO., LTD.	1.48%	Cons Disc	●	●	●	●	●	●
4	JAPAN TOBACCO INC.	1.17%	Cons Stap	●	●	●	●	●	●
5	ASAHI KASEI CORPORATION	0.39%	Materials	●	●	●	●	●	●
6	OLYMPUS CORPORATION	0.35%	Hlth Care	●	●	●	●	●	●
7	SEVEN & I HOLDINGS CO., LTD.	1.04%	Cons Stap	●	●	●	●	●	●
8	NOMURA HOLDINGS, INC.	0.72%	Financials	●	●	●	●	●	●
9	ITOCHU CORPORATION	0.70%	Industrials	●	●	●	●	●	●
10	FUJITSU LIMITED	0.41%	Info Tech	●	●	●	●	●	●

\* Sorted by count of red flags, count of orange flags, count of yellow flags, then weight.

## ESG RATING FRAMEWORK

MSCI ESG Ratings are designed to help investors to understand **ESG risks and opportunities** and integrate these factors into their portfolio construction and management process. Our global team of 140 experienced research analysts assesses thousands of data points across 37 ESG Key Issues, focusing on the intersection between a company’s core business and the industry issues that can create significant risks and opportunities for the company. Companies are rated on a AAA-CCC scale relative to the standards and performance of their industry peers.

Figure 7 | ESG Rating Framework and Process Overview



## MATERIAL INDUSTRY ESG RISKS AND OPPORTUNITIES

Environmental, social, and governance risks and opportunities are posed by large scale trends (e.g. climate change, resource scarcity, demographic shifts) as well as by the nature of the company’s operations. Companies in the same industry generally face the same major risks and opportunities, though individual exposure can vary. We identify material risks and opportunities for each industry through a quantitative model that looks at ranges and average values for each industry for externalized impacts such as carbon intensity, water intensity, and injury rates. Companies with unusual business models for their industry may face fewer or additional key risks and opportunities. Company-specific exceptions are allowed for companies with diversified business models, facing controversies, or based on industry rules. Once identified, these Key Issues are assigned to each industry and company.

**Figure 8 | ESG Rating Framework and Process Overview**

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	Climate Change	<b>Carbon Emissions*</b> Product Carbon Footprint	Financing Environmental Impact Climate Change Vulnerability
	Natural Resources	<b>Water Stress*</b> Biodiversity & Land Use	Raw Material Sourcing
	Pollution & Waste	<b>Toxic Emissions &amp; Waste*</b> Packaging Material & Waste	Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech Opportunities in Green Building	Opp’s in Renewable Energy
Social	Human Capital	<b>Labor Management*</b> <b>Health &amp; Safety*</b>	Human Capital Development Supply Chain Labor Standards
	Product Liability	Product Safety & Quality Chemical Safety Financial Product Safety	Privacy & Data Security Responsible Investment Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications Access to Finance	Access to Health Care Opp’s in Nutrition & Health
Governance	Corporate Governance*	<b>Board**</b> <b>Pay**</b>	<b>Ownership**</b> <b>Accounting**</b>
	Corporate Behavior	<b>Business Ethics*</b> <b>Anti-Competitive Practices*</b> <b>Tax Transparency*</b>	Corruption & Instability Financial System Instability

*\* indicates “universal” issues assessed for all companies in the MSCI World Index*

*\*\* Board, Pay, Ownership, and Accounting carry weight in the ESG Rating model for all companies. Currently, they contribute to the Corporate Governance score directly and 0-10 sub-scores are not available.*

For further information, please access [MSCI ESG Rating Methodology Summary](#) or contact [esgclientservice@msci.com](mailto:esgclientservice@msci.com)



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