

MSCI Japan ESG Select Leaders Index Methodology

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Introduction

The MSCI Japan ESG Select Leaders Index (the “Index”) is a free float-adjusted market capitalization-weighted index designed to represent the performance of companies that have high Environmental, Social and Governance (“ESG”) ratings relative to their sector peers, to ensure the inclusion of the best-in-class companies from an ESG perspective. The Index aims to target sector weights that reflect the relative sector weights of the MSCI Japan Investable Market Index (IMI) (the “Parent Index”) to limit the systematic risk introduced by the ESG selection process. Overall, the Index targets coverage of 50% of the Parent Index.

MSCI ESG Research

The MSCI ESG Select Leaders Index uses company ratings and research provided by MSCI ESG Research. The Index uses the following MSCI ESG Research products: MSCI ESG Ratings and MSCI ESG Controversies.

For details on MSCI ESG Research’s full suite of ESG products, please refer to: <https://www.msci.com/esg-investing>

2.1 MSCI ESG Ratings

MSCI ESG Ratings provides research, analysis and ratings of how well companies manage environmental, social and governance risks and opportunities.

MSCI ESG Ratings provides an overall company ESG rating - a seven point scale from ‘AAA’ to ‘CCC’. In addition, the product provides scores and percentiles indicating how well a company manages each key issue relative to industry peers.

For more details on MSCI ESG Ratings, please refer to: <https://www.msci.com/esg-ratings>

2.2 MSCI ESG Controversies

MSCI ESG Controversies (formerly known as MSCI Impact Monitor) provides assessments of controversies concerning the negative environmental, social, and/or governance impact of company operations, products and services. The evaluation framework used in MSCI ESG Controversies is designed to be consistent with international norms represented by the UN Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, and the UN Global Compact. MSCI ESG Controversies Score falls on a 0-10 scale, with “0” being the most severe controversy.

For more details on MSCI ESG Controversies, please refer to : <https://www.msci.com/documents/10199/acbe7c8a-a4e4-49de-9cf8-5e957245b86b>

Constructing the MSCI Japan ESG Select Leaders Index

3.1 Underlying Universe

The selection universe for the Index is defined by the constituents of the Parent Index.

3.2 Eligibility Criteria

The Index uses company ratings and research provided by MSCI ESG Research to determine eligibility for index inclusion.

3.2.1 ESG Ratings Eligibility

The Index uses MSCI ESG Ratings to identify companies that have demonstrated an ability to manage their ESG risks and opportunities. Companies are required to have an MSCI ESG Rating of 'BB' or above to be eligible for inclusion in the Index.

3.2.2 ESG Controversies Score Eligibility

The Index uses MSCI ESG Controversies Scores to identify companies that are involved in very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services. Companies are required to have an MSCI ESG Controversies Score of 3 or above to be eligible for inclusion in the Index.

3.3 Market Capitalization Targeting

The Index targets 50% of the free float-adjusted market capitalization within each Global Industry Classification Standard (GICS®) sector of the Parent Index.

Maintaining the MSCI Japan ESG Select Leaders Index

4.1 Semi-Annual Index Review

The Index is reviewed on a semi-annual basis in May and November to coincide with the May and November Semi-Annual Index Reviews of the Parent Index, and the changes are implemented at the end of May and November. In general, the pro forma index is announced nine business days before the effective date.

In general, MSCI uses MSCI ESG Research data (including MSCI ESG Ratings and MSCI ESG Controversies Scores) as of the end of the month preceding the Index Reviews for the rebalancing of the Index. For some securities, such data may not be published by MSCI ESG Research by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the Index.

At each Semi-Annual Index Review, the eligible universe is updated, and the composition of the Index is reassessed in order to target 50% free float-adjusted cumulative market capitalization of each sector of the Parent Index.

4.1.1 Updating the Eligible Universe

The eligible universe is updated during each Semi-Annual Index Review.

Companies that are currently not constituents of the Index are evaluated using the same eligibility criteria described in Section 3.2.

Existing constituents of the Index are maintained in the eligible universe if they meet all the following conditions:

- MSCI ESG Rating of 'B' or above
- MSCI ESG Controversies Score of 1 or above

4.1.2 Ranking of Eligible Securities

For each sector, eligible securities of the Parent Index are ranked based on the following criteria:

- ESG Rating
- Current index membership (existing constituents above non-constituents)
- Industry-adjusted ESG scores
- Decreasing free float-adjusted market capitalization

4.1.3 Selection of Eligible Securities

For each sector, eligible securities of the Parent Index are then selected from the ranked universe in the following order until the target 50% coverage by cumulative free float-adjusted market capitalization is reached:

- Securities in the top 35% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 35%
- 'AAA' and 'AA' rated securities in the top 50% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 50%
- Current index constituents in the top 65% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 65% if that security is a current index constituent
- Remaining eligible securities in the ranked universe

Please see Appendix 1 for additional details on the ranking and selection rules.

4.2 Quarterly Index Reviews

The Index is also reviewed on a quarterly basis to coincide with the regular Index Reviews of the Parent Index. The changes are implemented at the end of February and August. The pro forma indexes are in general announced nine business days before the effective date.

For the Quarterly Index Reviews, MSCI ESG Ratings and MSCI ESG Controversies Score assessments data are taken as of the end of the month preceding the Index Reviews, i.e., January and July. For some securities, this data may not be published by MSCI ESG Research by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the Index.

At the Quarterly Index Reviews, existing constituents are deleted from the Index if they do not meet the eligibility criteria described in Section 4.1.1. Existing constituents that meet the eligibility criteria are retained in the Index.

Additions from the eligible securities as per Section 3.2 are made only to those sectors where the current market capitalization coverage is less than 45%, until the 50% target is reached.

Market price movements may cause small deviations in the sector coverage between two Index Reviews. Therefore, in order to minimize turnover, a buffer of 10% is used on the target coverage of 50% to define under-representation.

4.3 Ongoing Event-Related Maintenance

The following section briefly describes the treatment of common corporate events within the MSCI Japan ESG Select Leaders Index.

No new securities will be added (except where noted below) to the Index between Index Reviews. For cases where additions are noted below, securities will be added to the index only if added to the Parent Index.

Parent Index deletions will be reflected simultaneously.

There are no deletions from the Index between Index Reviews on account of a security becoming ineligible because of MSCI ESG Rating downgrade and/or decrease in MSCI ESG Controversies Score.

EVENT TYPE

EVENT DETAILS

New additions to the Parent Index

New securities added to the Parent Index (such as IPOs, other early inclusions and migrations from a different size-segment) will be added to the Index on the date of security inclusion only if they meet the eligibility criteria described in Section 3.2 and the market capitalization coverage of the sector to which the security belongs is less than 45%.

Spin-Offs

All securities created as a result of the spin-off of an existing Index constituent will not be added to the Index at the time of event implementation. Reevaluation for addition in the Indexes will occur at the subsequent Index Review.

Merger/Acquisition

If an existing Index constituent is acquired by a non-Index constituent, the existing constituent will be deleted from the Index and the acquiring non-constituent will not be added to the Index.

Changes in Security Characteristics

A security will continue to be an Index constituent if there are changes in characteristics (country, sector, size

segment, etc.). Reevaluation for continued inclusion in the Index will occur at the subsequent Index Review.

Further detail and illustration regarding specific treatment of corporate events relevant to this Index can be found in the MSCI Corporate Events Methodology book.

The MSCI Corporate Events methodology book is available at:

<https://www.msci.com/index-methodology>

Appendix 1: Guidelines on Achieving the Target Sector Coverage of 50%

The Index targets 50% coverage of the free float-adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the Parent Index. The underlying principle in the construction of the Index is to achieve cumulative sector coverage closest to 50%, while aiming to maintain index stability.

The following guidelines are used in achieving the target cumulative sector coverage of 50%:

- For each sector, the eligible companies of the Parent Index are first ranked based on the company level ESG Rating.
- If two companies have the same ESG Rating, the existing constituent of the Index is given priority to maintain index stability. Between two existing constituents of the Index with the same ESG Rating, the company with the higher industry-adjusted ESG Score is given priority. For two existing constituents of the Index with the same industry-adjusted ESG score, the security with the largest free float-adjusted market capitalization is given priority.
- The cumulative sector coverage at each rank is calculated.
- In each sector, companies are selected as per the rules mentioned in Section 4.1.2 until the cumulative sector coverage crosses 50% or there are no eligible securities left to be selected.
- MSCI defines the company that increases the cumulative sector coverage above 50% as the “marginal company”.
 - If the marginal company is a current constituent of the Index, then it is always selected.
 - If the marginal company is not a current constituent of the Index, then it is selected only if the cumulative sector coverage with the marginal company is closer to 50% compared to the cumulative sector coverage without the marginal company.
- The minimum cumulative sector coverage is set to 45%.
 - The marginal company is always selected if this is required to achieve cumulative sector coverage of 45%.
- Securities which are ineligible as per Section 4.1.1 will not be selected even if the cumulative sector coverage after selection of all eligible securities is below 50%.

Appendix 2: Methodology Transition

June 2016

Prior to the May 2016 Annual Index Review, the MSCI Japan Index was used as the parent index. Effective from the May 2016 Annual Index Review, the parent index was changed to the MSCI Japan IMI Top 500 Index.

December 2018

Prior to the November 2018 Semi-Annual Index Review, the MSCI Japan IMI Top 500 Index was used as the parent index. Effective from the November 2018 Semi-Annual Index Review, the parent index was changed to the MSCI Japan IMI Top 700 Index.

June 2022

Prior to the May 2022 Semi-Annual Index Review (SAIR), the MSCI Japan IMI Top 700 Index was used as the parent index. Effective from the May 2022 SAIR, the parent index will be changed to the MSCI Japan IMI.

MSCI will apply a full index reconstitution for the MSCI Japan ESG Select Leaders Index at the May 2022 SAIR. Specifically, the following rules will be applied:

	Non-constituents	Existing constituents
Eligibility	<ul style="list-style-type: none"> MSCI ESG Rating of 'BB' or above MSCI ESG Controversies Score of 3 or above 	<ul style="list-style-type: none"> MSCI ESG Rating of 'BB' or above MSCI ESG Controversies Score of 1 or above
Ranking	For each sector, eligible companies of the Parent Index will be ranked based on the following criteria: <ul style="list-style-type: none"> ESG Rating Industry adjusted ESG scores Decreasing free float adjusted market capitalization 	
Selection	Securities will then be selected from the ranked universe by decreasing rank until 50% coverage by cumulative free float-adjusted market capitalization target is reached. ¹	

As shown in the above table, the ESG Controversies Score buffer for existing constituents still be applied to mitigate potential reverse turnover due to the

¹ The marginal company will be selected only if the cumulative sector coverage with the marginal company is closer to 50% compared to the cumulative sector coverage without the marginal company.

implementation of changes to the MSCI ESG Controversies methodology, which may impact the Index starting from the August 2022 Quarterly Index Review (QIR).

The transition to the new methodology will be implemented in two steps as part of the May 2022 SAIR and August 2022 QIR, respectively.

- Securities added to the Index as part of the transition will have an inclusion factor of 0.50 applied to their free float-adjusted market capitalization at the May 2022 SAIR and will be included in full at the August 2022 QIR.
- Securities deleted from the Index as part of the transition but that are still included in the MSCI Japan IMI will be maintained with an inclusion factor of 0.50 at the May 2022 SAIR and will be fully deleted at the August 2022 QIR.
- Securities deleted from the Index due to their deletion from the MSCI Japan IMI will be fully deleted at the May 2022 SAIR.

The pro forma index for the May 2022 SAIR and August 2022 QIR will be announced nine business days before the effective date. Prices as of the tenth business day before the effective date will be used to perform index maintenance activities (e.g., calculating the cumulative sector coverage).

The following sections have been modified as of September 2017:

Section 4.1: Annual Index Reviews and Section 4.2: Quarterly Index Reviews

- Clarification on use of ESG data for securities whose data would be available after the end of the month preceding Index Review.

The following sections have been modified as of November 2018:

Section 4.1: Semi-Annual Index Reviews and Section 4.2: Quarterly Index Reviews

- Changed to reflect the updated rebalancing frequency

Introduction and Appendix I:

- Changed to reflect the updated Parent Index

The following sections have been modified as of May 2022:

Introduction

- Updated to reflect the change of Parent Index

Section 3: Constructing the MSCI Japan ESG Select Leaders Index

- Removed the references to minimum ESG Rating and ESG Controversies Score for existing constituents

Section 4: Maintaining the MSCI Japan ESG Select Leaders Index

- Added references to minimum ESG Rating and ESG Controversies Score for existing constituents

Section 4.1.3: Selection of Eligible Securities

- Clarified the selection rules

Section 4.3: Ongoing Event-Related Maintenance

- Clarified the maintenance rules

Appendix 1: MSCI Japan IMI Top 700 Index:

- Removed given the change of Parent Index

Appendix 1: Guidelines on Achieving the Target Sector Coverage of 50%

- Added clarifications

Appendix 2: Methodology Transition

- Added details on the December 2018 and June 2022 transitions

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