

MSCI ESG Ratings Methodology: Controversial Sourcing Key Issue

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October 2023

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Introduction

This document provides essential information on the components of the Controversial Sourcing Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Controversial Sourcing is a Key Issue in the Social Pillar of the MSCI ESG Ratings model. Companies are evaluated on their dependence on, and purchasing volume of, raw materials procured from conflict areas and their efforts at traceability and certification.

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
		Opportunities in Clean Tech
	Environmental Opportunities	Opportunities in Green Building
		Opportunities in Renewable Energy
Social	Human Capital	Health & Safety
		Human Capital Development
		Labor Management
		Supply Chain Labor Standards
	Product Liability	Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
		Responsible Investment
	Stakeholder Opposition	Community Relations
	Social Opportunities	Controversial Sourcing
		Access to Finance
		Access to Health Care
Governance	Corporate Governance	Opportunities in Nutrition & Health
		Board
		Pay

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

Risks associated with this Key Issue

- Reputational risk and potential loss of market share as consumer awareness grows.
- Costs to comply with new regulations (e.g., U.S. Dodd-Frank Act).

Controversial Sourcing Key Issue Score

The Controversial Sourcing 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 .

Controversial Sourcing Management Score

The Controversial Sourcing 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 Controversial Sourcing Management Score – Excluding Controversies:

$$MGMT_{COS,i} = SPC_{COS,i}$$

Where:

- $MGMT_{COS,i}$ is the Controversial Sourcing Management Score – Excluding Controversies for company i .
- $SPC_{COS,i}$ is the Sourcing Policy & Commitments Score for company i .

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

Management Score category: Sourcing Policy & Commitments Score

- **Extent of efforts to ensure compliance with controversial materials sourcing policy.**
Definition: Indicates whether the company carries out initiatives to ensure compliance with its controversial sourcing policy, or collaborates with stakeholders to promote supply chain transparency and accountability.
- **Targets for ensuring compliance with controversial materials sourcing policy.**
Definition: Indicates whether the company has targets for ensuring compliance with its controversial materials sourcing policy.
- **Extent of supplier/material certification as conflict-free by external agencies using the most stringent criteria.**
Definition: The extent of relevant products externally certified as conflict-free using the most stringent criteria, which may differ from industry to industry.
- **Commitments to address controversial sourcing practices.**

Definition: Indicates whether the company has a policy to address sourcing and use of raw materials that may originate from areas associated with human rights violations, illicit trade and/or financing of violence.

Sources: company disclosures; nongovernmental organizations including the Enough Project, GoodElectronics and makeITfair.

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:

- Controversial sourcing 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.”

Controversial Sourcing Exposure Score

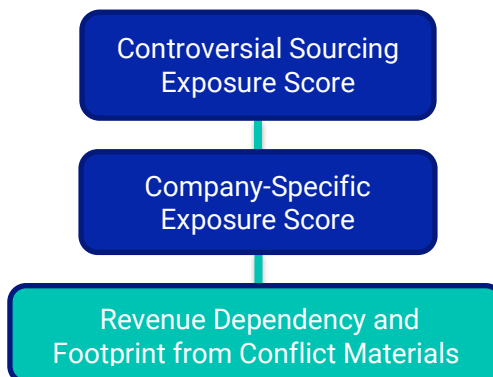
The Controversial Sourcing Exposure Score evaluates the company’s exposure to risks on this Key Issue. It is based on the Company-Specific Exposure Score only. The Company-Specific Exposure Score is scored on a 0-10 scale, with 10 corresponding to the highest risk and 0 corresponding to the lowest risk. 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:

$$EXP_{COS,i} = COM_{COS,i}$$

Where:

- $EXP_{COS,i}$ is the Controversial Sourcing Exposure Score of company i .
- $COM_{COS,i}$ is the Company-Specific Exposure Score of company i .

Exhibit 2: Exposure Score components



Company-Specific Exposure Score

The Company-Specific Exposure Score is determined by a simple average of the Dependency Score and the Footprint Score:

$$COM_{cos,i} = \frac{DS_{cos,i} + FS_{cos,i}}{2}$$

Where:

- $DS_{cos,i}$ is the Dependency Score for company i .
- $FS_{cos,i}$ is the Footprint Score for company i .

The Dependency Score is derived from the estimated percentage of the company's revenues that rely on the specific raw material of concern.¹

The Footprint Score is derived from the company's total estimated revenues (three-year average, in USD million) reliant on the specific raw material of concern.

The raw materials of concern for which the sourcing is considered controversial are conflict materials as defined by regulations like the U.S. Dodd-Frank Act, including tin, tantalum and tungsten; their ores and gold.

¹ To derive estimates of revenue reliant on a specific raw material of concern, we generally extrapolate from company disclosures to derive more granular values, using industry averages, product segments and regional criteria. For companies that have their own private-label products, we use companies' private-label product revenues derived from raw materials of concern.

Data Sources

The following sources are used to determine the Controversial Sourcing Exposure Score:

Refinitiv, MSCI ESG Research, company disclosures.

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