

# **MSCI ESG Ratings Methodology: Responsible Investment Key Issue**

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October 2023

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## Introduction

This document provides essential information on the components of the Responsible Investment Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Responsible Investment is a Key Issue in the Social Pillar of the MSCI ESG Ratings model. Companies are evaluated on their integration of environmental, social and governance considerations in the management of their own assets or the assets they manage on behalf of others.

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
		Labor Management
		Supply Chain Labor Standards
	Product Liability	Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
	Stakeholder Opposition	<b>Responsible Investment</b>
		Community Relations
	Social Opportunities	Controversial Sourcing
		Access to Finance
		Access to Health Care
		Opportunities in Nutrition & Health

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

## Risks associated with this Key Issue

- Lower security values due to unmitigated or overlooked ESG risks.
- Client attrition due to mismanagement of investment risk.
- Higher returns from ESG investments.

## Responsible Investment Key Issue Score

The Responsible Investment 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  $i$ .

## Responsible Investment Management Score

The Responsible Investment 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 Responsible Investment Management Score - Excluding Controversies:

$$MGMT_{REI,i} = \frac{EIS_{REI,i} + ENG_{REI,i}}{2}$$

Where:

- $MGMT_{REI,i}$  is the Responsible Investment Management Score - Excluding Controversies for company  $i$ .
- $EIS_{REI,i}$  is the ESG Integration Score for company  $i$ .
- $ENG_{REI,i}$  is the Engagement 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: ESG Integration Score

- **Dedicated ESG analysts responsible for analyzing ESG issues in investment process.**  
**Definition:** Indicates whether the company has a dedicated individual or team responsible for analyzing ESG issues or if the company provides ESG training to investment analysts.
- **Responsible investment policy to incorporate ESG considerations.**  
**Definition:** Indicates whether the company has policies and procedures addressing ESG considerations in the investment process.
- **Signatory or participant at Social Investment Forum (SIF).**  
**Definition:** Indicates whether the company is a signatory or participant at the Social Investment Forum (SIF).

- **Signatory or participant at the Institutional Investors Group on Climate Change (IIGCC).**

**Definition:** Indicates whether the company is a signatory or participant at the Institutional Investor Group on Climate Change (IIGCC).
- **Signatory or participant at the Investor Group on Climate Change (IGCC).**

**Definition:** Indicates whether the company is a signatory or participant at the Investor Group on Climate Change (IGCC).
- **Signatory or participant at the Investor Network on Climate Risk (INCR).**

**Definition:** Indicates whether the company is a signatory or participant at the Investor Network on Climate Risk (INCR).
- **Signatory to the Principles for Responsible Investment (PRI).**

**Definition:** Indicates whether the company is a signatory to the Principles for Responsible Investment (PRI).
- **Signatory or participant at other responsible investing initiative.**

**Definition:** Indicates whether the company is a signatory or participant at any responsible investing initiative besides the PRI IGCC, IIGCC, INCR, or SIF.
- **Extent of ESG integration into corporate fixed income investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for corporate fixed income securities. Best practice is for the company to integrate ESG factors into the investment process across all funds and investments.
- **Extent of ESG integration into non-corporate fixed income investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for non-corporate fixed income securities, including government bonds, treasuries and securitized products. Best practice is for

the company to integrate ESG factors into the investment process across all funds and investments.

- **Extent of ESG integration into hedge funds and alternative investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for hedge funds and other alternative investments. Best practice is for the company to integrate ESG factors into the investment process across all funds and investments.

- **Extent of ESG integration into listed equity investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for listed equities. Best practice is for the company to integrate ESG factors into the investment process across all funds and investments.

- **Extent of ESG integration into private equity investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for private equity. Best practice is for the company to integrate ESG factors into the investment process across all funds and investments.

- **Extent of ESG integration into real estate investments.**

**Definition:** The extent to which ESG factors are integrated into the investment process for real estate. Best practice is for the company to integrate ESG factors into the investment process across all funds and investments.

## Management Score category: Engagement Score

- **Dedicated staff responsible for ESG engagement.**

**Definition:** Indicates whether the company has a dedicated individual or team responsible for monitoring and implementing its ESG engagement policies.

- **Detailed engagement policy that addresses environmental, social and governance issues.**

**Definition:** Indicates whether the company has a detailed engagement policy that addresses environmental, social and governance issues.

## 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 investments.

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.”

## Responsible Investment Exposure Score

The Responsible Investment Exposure Score evaluates the company’s exposure to risks on this Key Issue. It is based on the average of the Business and Company-Specific Exposure Scores. The Business Exposure Score and Company-Specific Exposure Score are 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 formula is used in the Exposure Score calculation:

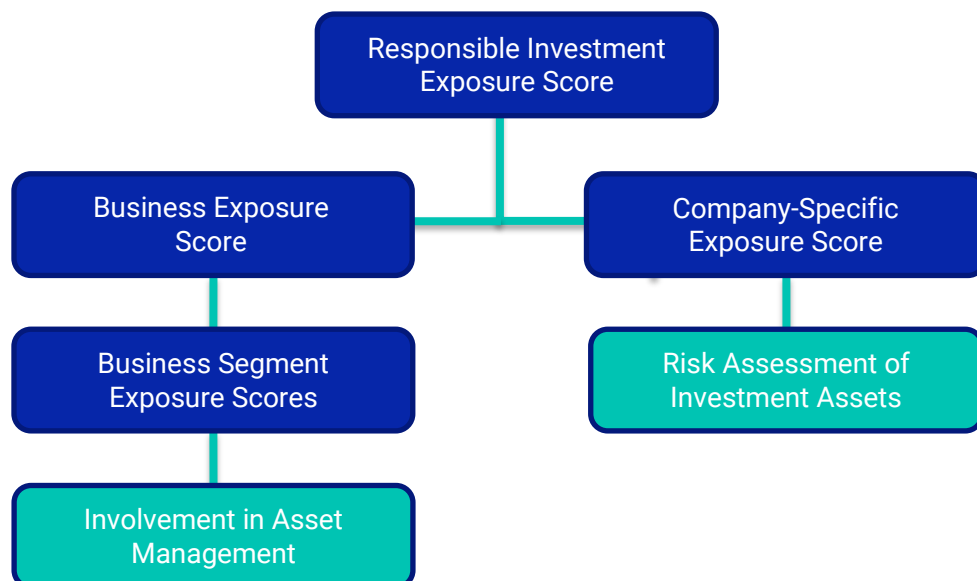
$$EXP_{REI,i} = \frac{(BUS_{REI,i} + COM_{REI,i})}{2}$$

Where:

- $EXP_{REI,i}$  is the Responsible Investment Exposure Score of company  $i$ .
- $BUS_{REI,i}$  is the Business Exposure Score of company  $i$ .
- $COM_{REI,i}$  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 revenue from each business segment, using the following formula to calculate the Business Exposure Score:

$$BUS_{REI,i} = \sum_{j=1}^{n_i} w_{Revenue,i,j} BSE_{REI,j}$$

Where:

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

## Business Segment Exposure Scores

The Business Segment Exposure Score of a business segment 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 qualitative assessment of whether a business activity has a core involvement in asset management and investment activities (property and casualty insurance, life and health insurance, asset management, investment bank and brokerage, or other). Business activities where companies are involved in managing their own investment assets, manage investment assets on behalf of their clients, or both get a higher Business Segment Exposure Score.

## Company-Specific Exposure Score

The Company-Specific Exposure Score is determined by a risk assessment of the investment assets owned and managed by a company. It is calculated as follows:

$$COM_{REI,i} = \sum_{k=1}^{n_i} PP_{k,i} * IAR_k * M_{k,x,y,z,i}$$

Where:

- $COM_{REI,i}$  is the Company-Specific Exposure Score for company  $i$ .
- $PP_{k,i}$  is the Portfolio percentage of company  $i$ 's exposure to investment asset type  $k$  (both proprietary and client investments)
- $IAR_k$  is the investment asset type risk for asset type  $k$
- $M_{k,x,y,z,i}$  is a multiplier specific to the investment in asset type  $k$  by company  $i$  based on the factors  $x, y, z$  detailed below.
  - $x$  – Whether a majority of investments are in developed or emerging markets.
  - $y$  – Whether a majority of assets under management are proprietary, managed on behalf of clients, or hybrid.
  - $z$  – Whether a majority of investments follow an active or passive investment strategy.

For companies where the breakdown of investment exposure by asset type is unknown, the Company-Specific Exposure Score is assigned as an industry-average score specific to the ESG Ratings industry of the company.

The multiplier  $M_{k,x,y,z,i}$  has the effect of increasing the Company-Specific Exposure Scores from 0% to +40% on each asset type, based on the company's majority market, ownership of investment assets, and investment strategy.

The investment asset type risk is evaluated by qualitative assessments of the liquidity risk, volatility risk and transaction cost for a given investment asset type. These factors are scored on a 0-10 scale, where a score of 10 indicates the highest risk and 0 indicates the lowest risk.

$$IAR_k = \frac{LR_k + VR_k + TC_k}{3}$$

Where:

- $LR_k$  is the liquidity risk for the asset type  $k$
- $VR_k$  is the volatility risk for the asset type  $k$
- $TC_k$  is the transaction cost for the asset type  $k$

## Data Sources

The following sources are used to determine the Responsible Investment Exposure Score:

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