

Consultation on Proposed Changes to MSCI Climate Action Indexes

PROPOSAL FOR CONSULTATION

This consultation may or may not lead to the implementation of any or all of the proposed changes in the highlighted or any other MSCI indexes. Consultation feedback will remain confidential. MSCI may publicly disclose feedback if specifically requested by specific market participants. In that case, the relevant feedback would be published together with the result of the consultation.

June 2023

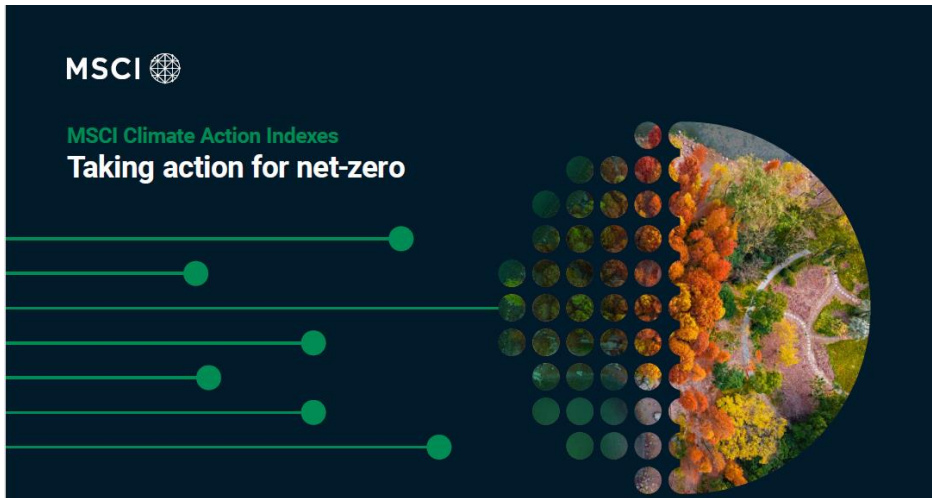
Consultation Timelines and Proposals

- This consultation contains proposals for the potential enhancement of the MSCI Climate Action Indexes.
- MSCI invites feedback from market participants on or before June 30, 2023.
- MSCI will announce the results of the consultation on or before July 31, 2023, at which time MSCI will also communicate the implementation date of changes, if any.
- In line with the climate transition objective of the MSCI Climate Action Indexes, and given the recent MSCI ESG Controversy change in methodology, we put forward our core proposals for potential enhancement:
 1. Companies that are assessed as "Orange Flag"* based on MSCI Environmental Controversy (MSCI Environmental Controversy Score = 1), should not be excluded from the MSCI Climate Action Indexes.
 2. The review of continued eligibility of constituents based on MSCI ESG Controversy Score Eligibility and ESG Business Involvement Eligibility of any MSCI Climate Action Index should be performed on a quarterly frequency.
- ***To avoid additional reverse turnover MSCI has also announced that exceptionally, effective 1st July 2023, the Monthly Index Reviews (as described in section 4.2 of the methodology document) will not be applied on any MSCI Climate Action Index until the conclusion of this consultation.***

Recap: MSCI Climate Action Indexes

The MSCI Climate Action Indexes balance companies' transition risks against their emission reduction targets and climate risk management to select the top half companies in each GICS® sector¹.

The Index range augments MSCI's offering to help institutional investors who seek to integrate climate considerations in global equity portfolios. The index is designed for institutional investors who look to finance the transition and drive change in the real economy.

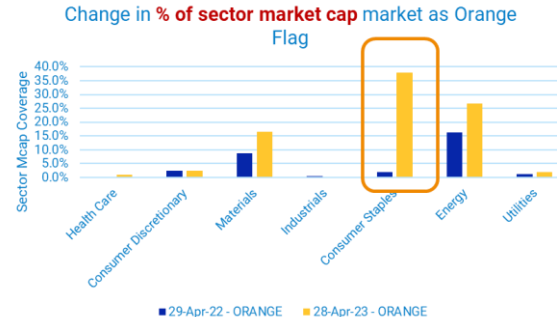
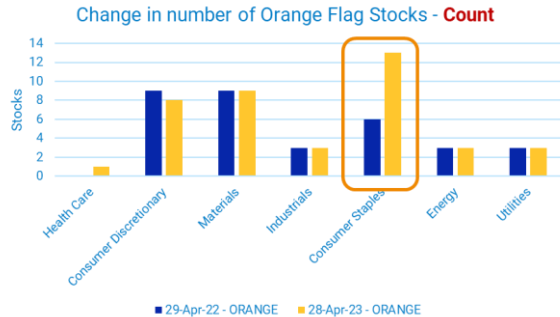


KEY FEATURES

- ✓ Balanced sector weights
- ✓ Forward looking view
- ✓ Broad market coverage
- ✓ Increased weight towards companies with SBTi-approved targets²
- ✓ Includes companies navigating the energy transition
- ✓ Maintains overall characteristics of ACWI while selecting companies on the basis of climate characteristics

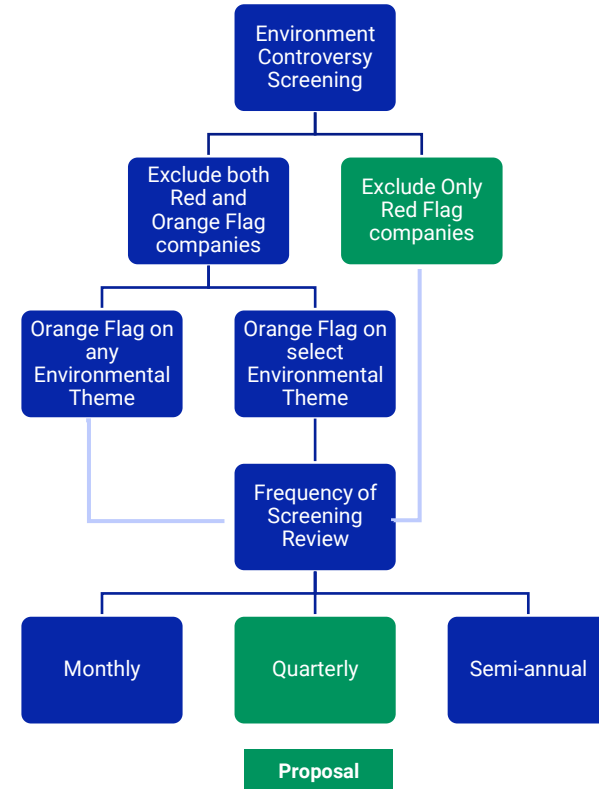
Impact of recent changes to the MSCI ESG Controversies Methodology

1. The recent enhancements of the MSCI ESG Controversies methodology have resulted in the downgrade of many companies to Orange Flag on Environmental Controversies.
 - Several companies are downgraded due to the severity assessment of existing controversies under the enhanced methodology and not due to the discovery of new controversies.
 - The review of cases under the enhanced methodology is pending for about 30% companies in MSCI ACWI which constitute about 65% of index weight (as of 28th April 2023).
2. In some cases, a large portion of the sector market cap has been downgraded to Orange Flag, which could potentially distort the sector representation and their weights in Climate Action indexes.



Rationale for the Proposals

1. Companies that are assessed as "Orange Flag" based on MSCI Environmental Controversy (Environmental Controversy Score = 1), should not be excluded from the MSCI Climate Action Indexes.
 - In our assessment, the scope of Orange Flag assessment has widened under the enhanced ESG Controversies methodology. Under the new framework, large companies, which were already generally subject to greater scrutiny and had more controversies, are now even more prone to receive an Orange Flag assessment because of the global scale of their operations.
 - A byproduct of more frequent Orange Flag assessment for several companies from the same sector is a potential distortion in sector and size exposures in the Climate Action Indexes and a reduction in the transition opportunity set. The Indexes select 50% names from each sector, which means that a stock with an Orange Flag on Environment Controversies may be replaced by a smaller cap name.
2. The review of continued eligibility of constituents based on MSCI Environmental Controversy and ESG Business Involvement of any MSCI Climate Action Index should be performed on a quarterly frequency.
 - Monthly review of eligibility may not be essential to the Index objective.
 - Monthly review may cause operational challenges for the product providers and managers replicating the index as they are required to deal with frequent turnover events.



Consultation Question

- Do you agree that companies assessed as Orange Flag on Environmental Controversies **should not be excluded** from the Eligible Universe of Climate Action Indexes ?
- Do you agree that Monthly Index reviews are not required for Climate Action Indexes ?
 - Monthly Index reviews currently result in the deletion of constituents which fail the
 - ESG Controversy Score Eligibility* i.e., Red Flag on ESG Controversies (including Red Flag on Environmental Controversies) **OR** Orange Flag on Environmental Controversies
 - Certain ESG Business Involvement Eligibility*
- Do you agree that the review of ESG Controversy Score Eligibility and ESG Business Involvement Eligibility of the constituents should be reviewed at quarterly frequency ?

*The exact eligibility criteria are mentioned in the sections 3.2.1 and 3.2.2 of the MSCI Climate Action indexes methodology document available at https://www.msci.com/eqb/methodology/meth_docs/MSCI_Climate_Action_Indexes_Methodology_20230306.pdf

Appendix



What are the MSCI Environmental Controversy thematic indicators that may be flagged as Orange?

- MSCI ESG Environmental controversies are mapped to at least one of the underlying themes shown below.
- The enhanced MSCI ESG Controversies methodology has resulted in the downgrade of many companies to Orange Flag based on their involvement in Land related controversies.
 - Land related controversies include involvement in natural resource-related and environmental impact-related cases. It also covers impacts due to direct or indirect use of the firm’s products or services, resistance to improved practices and criticism by NGOs and/or other third-party observers.
 - For example, several major Consumer Staples companies were recently downgraded to Orange Flags due to their long-standing involvement in plastic pollution, which is included under the Land theme.
- Biodiversity and Land Use is a relevant key issue for the calculation of the Climate Risk Management Score as described in MSCI Climate Action Indexes methodology. However, not all land-related controversies have a direct link with Climate Transition risks and their mitigation, which is most relevant to the Index objective.
- No company is currently assessed as Orange Flags on controversies related to Climate, Waste and Other themes.

Environmental Controversy	Climate	Land	Waste	Supply	Toxic	Water	Others	Total
Number of Orange Flag*	0	23	0	2	14	1	0	38

MSCI ACWI Climate Action Index Methodology*

Parameter	MSCI ACWI Climate Action Index
Parent Index	MSCI ACWI
Eligible Universe	<p>Eligible Universe is constructed by excluding companies which fail following eligibility tests</p> <ul style="list-style-type: none"> • ESG CONTROVERSY SCORE ELIGIBILITY <ul style="list-style-type: none"> - Red Flag - Orange Flag on Environmental Issues • ESG BUSINESS INVOLVEMENT ELIGIBILITY <ul style="list-style-type: none"> - Controversial Weapons Companies : Any Tie - Tobacco Producers : Producer or production/distribution Revenue \geq 5% - Thermal Coal Mining : Revenue \geq 1% - Oil Sands extraction : Revenue \geq 5% • EMISSION ELIGIBILITY - Securities which either have higher Emission Intensity than the High Emission Threshold or higher total potential emission than the High Potential Emission Threshold and do not yet have approved science-based targets are excluded. • CLIMATE RISK MANAGEMENT ELIGIBILITY - Securities which are in the lowest quartile of their GICS sector based on their Climate Risk Management Score are excluded
Security Selection	<ul style="list-style-type: none"> • Sort Stocks in each sector in ascending order of SECURITY-LEVEL ASSESSMENT* and descending order of float adjusted market capitalization. • Select top 50% stocks by count from each sector.
Weighting	<ul style="list-style-type: none"> • Selected Stocks are Market Cap Weighted • Max Issuer Weight capped at 5% • Active Sector Weights are capped at +/-5%.
Rebalancing Frequency	<ul style="list-style-type: none"> • Semi-annual Index Reviews – index is fully reconstituted. • Monthly Index Reviews – ESG Controversy Eligibility and ESG Business Involvement Eligibility of existing constituents is reviewed.



*More details on Index methodology are available in the Climate Action Indexes methodology document.

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