

CONSULTATION ON POTENTIAL ENHANCEMENTS TO THE MSCI JAPAN ESG SELECT LEADERS INDEX METHODOLOGY

October 2018

Note that 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 final results of the consultation.

OVERVIEW

Proposed enhancements to the MSCI Japan ESG Select Leaders Index Methodology

– **Proposal 1:**

- Change the parent index from the MSCI Japan IMI **Top 500** to the MSCI Japan IMI **Top 700** to provide enhanced coverage of the MSCI Japan IMI universe, following the increased availability of ESG data
- Implement a full reconstitution of the index at the November 2018 Semi Annual Index Review to appropriately reflect the enhanced opportunity set

– **Proposal 2:**

- Increase the frequency of index reconstitution from **Annual** (in May) to **Semi-Annual** (in May and November)

MSCI welcomes feedback from market participants until November 02, 2018 and will announce the results of the consultation on or before November 9, 2018

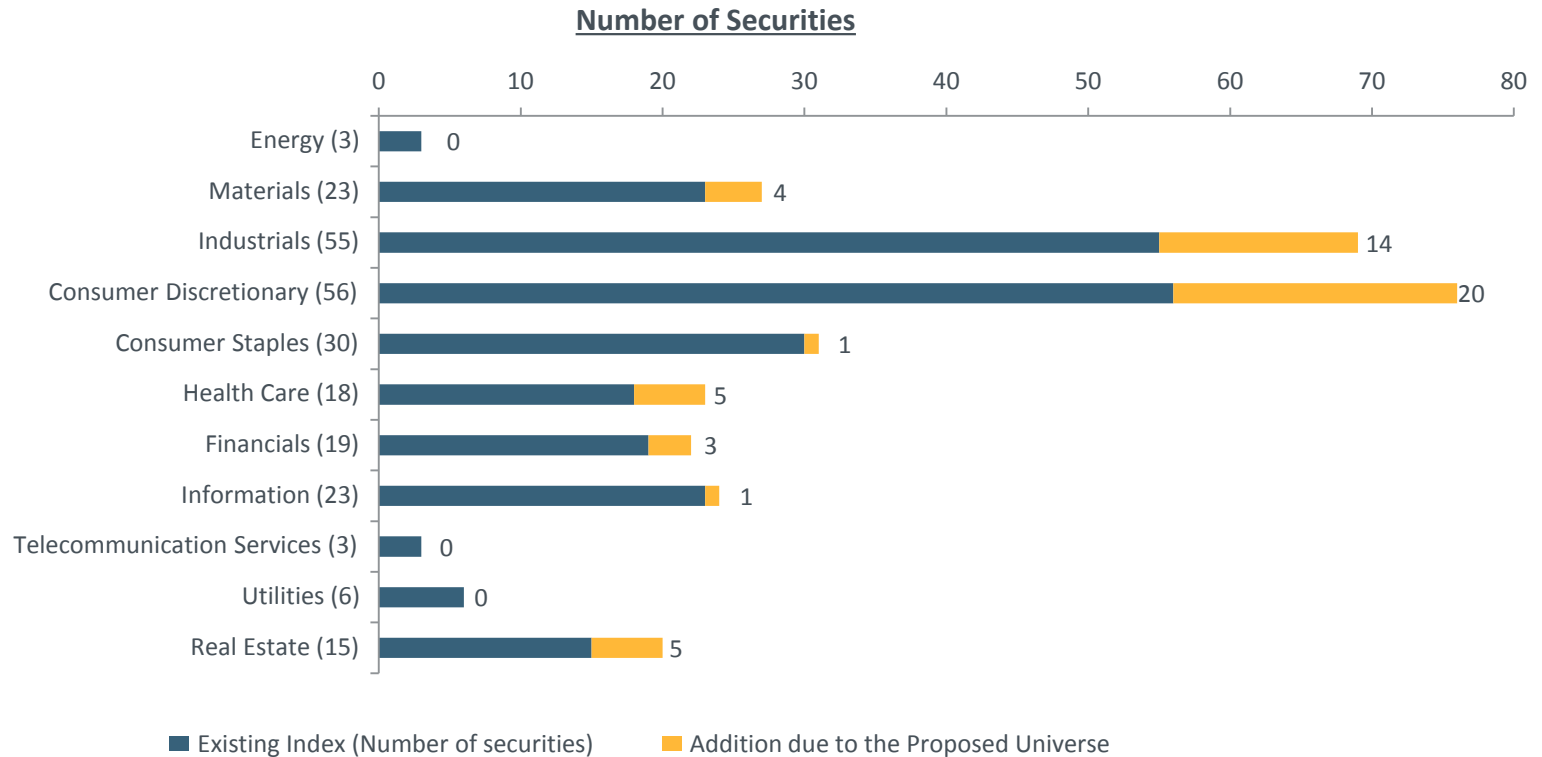
METHODOLOGY ENHANCEMENT

Parameters	Current Methodology	Proposed Methodology
Initial Universe	MSCI Japan IMI	
Eligible Universe	Top 500 securities ranked by their free float adjusted market capitalization (buffer 20%)	Top 700 securities ranked by their free float adjusted market capitalization (buffer 20%)
ESG Screening	Exclude companies with: <ul style="list-style-type: none"> • ESG Rating below 'BB' (buffer 'B') • ESG Controversy Score below '3' (buffer '1') 	
ESG Selection	Within each sector, target 50% of the free-float adjusted market capitalization, ranked on ESG criteria	
Weighting	Each security is weighted by its corresponding free float adjusted market capitalization	
Index Reconstitution	Annual (coinciding with the May Semi-Annual Index Review)	Semi-Annual (coinciding with the May and November Semi-Annual Index Reviews)

PROPOSAL 1

*Change the parent index from the **MSCI Japan IMI Top 500** to the **MSCI Japan IMI Top 700***

BROADER OPPORTUNITY SET



Changing the parent index would broaden the ESG index by > 50 securities across 8 of the 11 sectors

Simulation as of the August 2018 Index Review, assuming a full reconstitution as well as an ad-hoc rebalance for the MSCI Japan IMI Top 700 Index

IMPLEMENTATION CONSIDERATIONS

- The MSCI Japan ESG Select Leaders Index is currently reconstituted in May to coincide with the May Semi-Annual Index Review (SAIR) of the MSCI Japan IMI.
- At the Quarterly Index Reviews (including the November SAIR), additions from the eligible securities are made only to those sectors where the current market capitalization coverage is less than 45%.
- Given the possible enhancement of the eligible universe, MSCI proposes the index undergo a full reconstitution at the November SAIR:
 - ✓ Pro: **Accurate representation of the enhanced universe**
 - × Con: **Relatively higher turnover**
- In the following slide we have presented both implementation options, with their expected number of constituents and turnover.

PROPOSED IMPLEMENTATION OPTIONS

	Current Index			Additional Securities Included	
	Number of Securities	Market Capitalization Coverage (%)	Lower than 45% coverage	Full Reconstitution	Standard Quarterly Rebalance
Energy	3	45.9	x	0	0
Materials	23	51.8	x	4	0
Industrials	55	47.2	x	14	0
Consumer Discretionary	56	48.6	x	20	0
Consumer Staples	30	49.4	x	1	0
Health Care	18	48.0	x	5	0
Financials	19	49.4	x	3	0
Information Technology	23	55.7	x	1	0
Telecommunication Services	3	59.4	x	0	0
Utilities	6	61.0	x	0	0
Real Estate	15	42.4	✓	5	5
Total	251			53	5
Turnover (%)				4.4	0.9

Simulation as of the August 2018 Index Review, assuming an ad-hoc rebalance for the MSCI Japan IMI Top 700 Index

PROPOSAL 2

*Increase the frequency of index reconstitution from **Annual** (in May) to **Semi-Annual** (in May and November)*

RECONSTITUTION FREQUENCY

- The MSCI Japan ESG Select Leaders Index is reconstituted in May to coincide with the May Semi-Annual Index Review (SAIR) of the MSCI Japan IMI.
- At the Quarterly Index Reviews (including the November SAIR), additions from the eligible securities are made only to those sectors where the current market capitalization coverage is less than 45%.
- MSCI proposes reconstituting the MSCI Japan ESG Select Leaders Index on a semi-annual basis coinciding with the May and November SAIRs of the MSCI Japan IMI to reflect changes in ESG performance more frequently. There are no proposed changes to the February and August Quarterly Index Reviews.
- In the following slide we have presented a comparison of a Full Reconstitution to a Standard Quarterly Rebalance, with their ESG Score and turnover.

COMPARISON OF THE TWO PROPOSED APPROACHES

	Current Index			Number of Securities (Adds / Dels)	
	Number of Securities	Market Capitalization Coverage (%)	Lower than 45% coverage	Full Reconstitution	Standard Quarterly Rebalance
Energy	3	50	x	3 (0 / 0)	3 (0 / 0)
Materials	23	54	x	23 (1 / 1)	23 (0 / 0)
Industrials	52	50	x	54 (2 / 0)	52 (0 / 0)
Consumer Discretionary	58	46	x	56 (2 / 4)	57 (0 / 1)
Consumer Staples	32	50	x	32 (0 / 0)	32 (0 / 0)
Health Care	18	48	x	19 (1 / 0)	18 (0 / 0)
Financials	21	49	x	22 (1 / 0)	21 (0 / 0)
Information Technology	21	53	x	19 (1 / 3)	21 (0 / 0)
Telecommunication Services	3	63	x	3 (0 / 0)	3 (0 / 0)
Utilities	6	63	x	6 (0 / 0)	6 (0 / 0)
Real Estate	15	51	x	14 (0 / 1)	15 (0 / 0)
Total	252			251	251
Total Additions				8	0
Total Deletions				9	1
Turnover (%)				6.8	0.1
ESG Score	6.5			6.6	6.5

Simulation as of the November 2017 Index Review

DISCUSSION POINTS

DISCUSSION POINTS

1. Do you agree with the proposed enhancement of the investment universe to broaden and diversify the index?
2. Do you agree with the proposal to increase the frequency of full index reconstitutions, to reflect changes in ESG performance more frequently?

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