

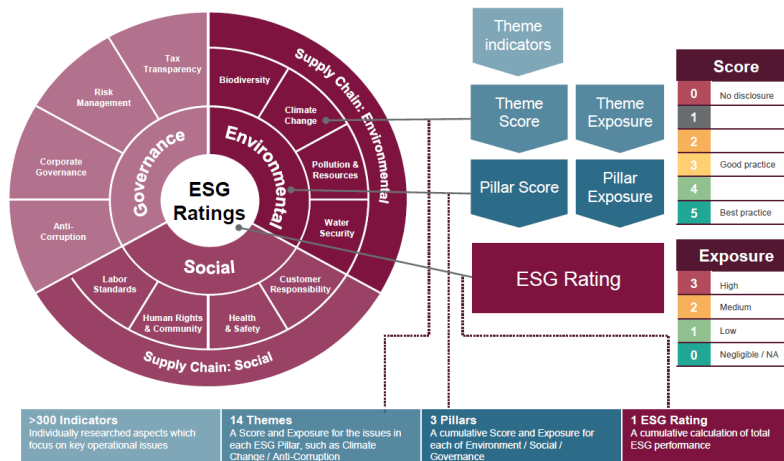
BURSA INSTI SECTORIAL SERIES

FTSE RUSSELL ESG INDICES

METHODOLOGY & TRENDS

ESG investing is a rising trend and is slowly becoming a key consideration for investors. For a better understanding of ESG Indices, Bursa Malaysia, together with CGS-CIMB, had invited FTSE Russell to provide insights into the ESG index methodology and trends. Here are some of the key takeaways from the webinar.

- ESG issues are material risks to a business
- **ESG vs CSR:** Although there can be significant overlap between the two, in general, CSR activities are typically voluntary, company-led initiatives, often linked to companies' philanthropic and business objectives related to the society or environment in which they operate. ESG, on the other hand, is about understanding and measuring the impact of relevant risks and disclosing how these risks are managed as part of the overall business strategy
- The ESG rating breaks down into 3 pillar scores, namely **Environmental, Social and Governance**, out of which, is formed by 14 thematic scores, which is then further broken into >300 indicators

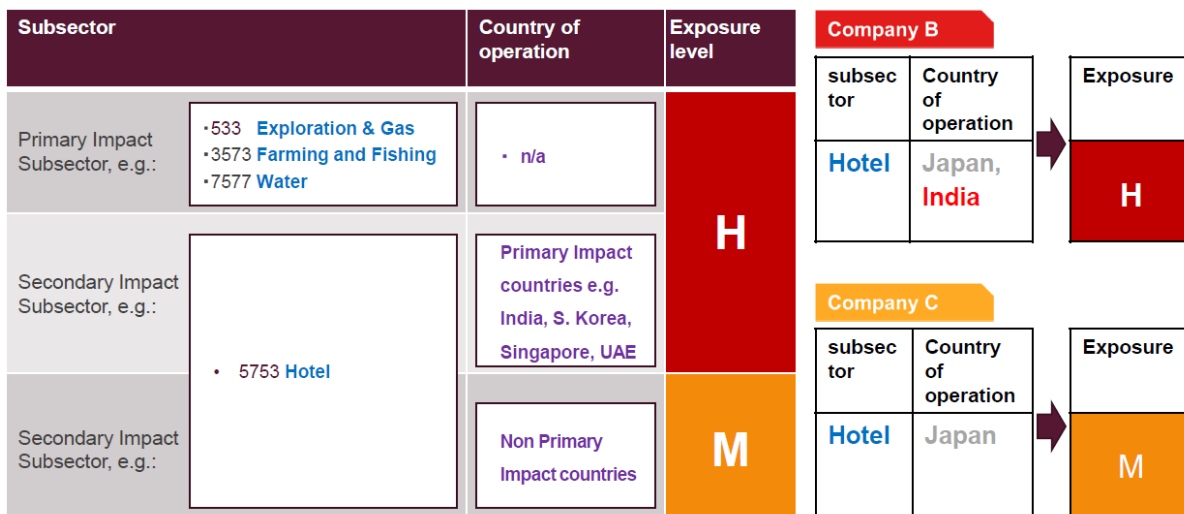


- The Key characteristics of FTSE Russell's ESG ratings are:
 - It measures the overall quality of companies' management of relevant ESG issues;
 - It has >300 indicators underpin assessment against 14 different ESG themes;
 - The applicability of ESG themes is determined by multi-subsector business characteristics, and exposure is adjusted by country of operation;
 - It is aligned with international standards and examined by an independent committee;
 - It is high in transparency as it uses public information only and it has high reproducibility in its calculation; and
 - It is assessed based on a semi-annual review cycle.

- FTSE Russell’s ESG ratings are consistent with international frameworks. For example:

Environment		Social		Governance	
Climate Change	CDP, EU Emission Standards SEC Rules for Reserves Reporting	Health and Safety	Global Business Coalition for Health/ IAEA, BSI	Anti-corruption	Transparency International World Bank, UNGC 10
Water Security	CDP – Water Program CEO Water Mandate	Labour Standards	UN Global Compact ILO Core Conventions	Tax Transparency	Action Aid Tax Guide for Investors Fair Tax Mark
Biodiversity	TEEB – The Economics of Ecosystems & Biodiversity	Human Rights and Community	Corporate Human Rights Benchmark; UN Guiding Principles on Business and Human Rights	Risk Management	Salz Review Institute for Risk Management
Pollution and Resources	ISO14001 EMAS	Customer Responsibility	Access to Medicine/ Nutrition CFA Lending Code	Corporate Governance	OECD Principles of Corporate Governance, ICGN, FRC
Supply Chain Environment	GRESB, BREEAM, SEDEX, RSPO	Supply Chain Social	PRI, PSI, Equator Principles GRESB, SEDEX, ETI		

- Assessment process of ESG ratings:
 - **Step 1:** Analyse the characteristics of a company, i.e. subsector, country of operation and company status;
 - **Step 2:** With subsector and country of operation information, identify which ESG Theme has potential risks to the company and then set exposure with 4 different levels from 0 to 3 for each applicable ESG theme;
 - **Step 3:** Assessment of actions taken against each exposure with 6 different Scores from 0 to 5 for each applicable ESG theme;
 - **Step 4:** Calculate an ESG rating with Exposures and Scores for each applicable ESG Theme
- Take the Water Security theme as an example.
 - **Step 1:** Analyse the characteristics of Company B and C. Company B belongs to the Hotel subsector and operates in Japan and India. Company C is in the same subsector with Company B but operates only in Japan.
 - **Step 2:** Company B’s subsector scores a 2 (Medium) on exposure, but because it has operations in India (Primary Impact Country), it is scored at level 3 (High) on exposure for the location. Meanwhile, Company C scores a 2 (Medium) for water security theme.
- For a clearer illustration, see the diagram below:



- **Step 3:** Assess the actions taken against the water security theme by each company. There are a total of 4 indicators under the water security theme. As illustrated below, 50% indicator points are awarded to Company B, while Company C is awarded 66.7%. This gives them a score of 3 (Good Practice) and 5 (Best Practice) for Company B and C respectively.

Company B (High Exposure)				
Indicator legend	Indicator description	Exposure	Max possible points	Points awarded
EWT13	Water use policy	H M	2	2
EWT24	Water management plan	H M	2	2
EWT32	Water withdrawal data	H M	2	0
EWT07	Independent verification	H	2	0
Total			8	4
% of indicator points awarded			4/8=50%	

Exposure			
Score	Low	Mid	High
0	N/A	0%	0%
1	0–5%	1–5%	1–10%
2	6–10%	6–20%	11–30%
3	11–30%	21–40%	31–50%
4	31–50%	41–60%	51–70%
5	51–100%	61–100%	71–100%

Company C (Mid Exposure)				
Indicator legend	Indicator description	Exposure	Max possible points	Points awarded
EWT13	Water use policy	H M	2	2
EWT24	Water management plan	H M	2	2
EWT32	Water withdrawal data	H M	2	0
EWT07	Independent verification	H--	n/a	n/a
Total			6	4
% of indicator points awarded			4/6=66.7%	

Indicator Legend	Indicator
EWT13	Policy or commitment on water use reduction which: a. Addresses the issue b. Includes commitment to reduce water use or improve efficiency

Points are assigned and are generally 0, 1, or 2 per indicator:

- > 0 point = no disclosure nor action
- > 1 point = disclose a)
- > 2 points = disclose b)

- **Step 4:** ESG rating will be calculated with Exposures and Scores for each applicable ESG Theme

ESG Theme	Legend	Exposure (H, M, L, n/a)	Evaluation (%)	Score (0-5)
Biodiversity	EBD	n/a(0)	n/a	n/a(0)
Water Security	EWT	H(3)	50%	3
Supply Chain : Environment	ESC	H(3)	35%	3
Pollution and Resources	EPR	H(3)	58%	4
Climate Change	ECC	M(2)	17%	2
Supply Chain : Social	SSC	H(3)	43%	3
Human Rights and Community	SHR	M(2)	3%	1
Labor Standards	SLS	H(3)	12%	2
Customer Responsibility	SCR	n/a(0)	n/a	n/a(0)
Health and Safety	SHS	n/a(0)	n/a	n/a(0)
Risk Management	GRM	n/a(0)	n/a	n/a(0)
Tax Transparency	GTX	M(2)	9%	1
Corporate Governance	GCG	M(2)	38%	3
Anti-corruption	GAC	M(2)	0%	0

- Pillar score is an exposure-weighted average of applicable theme scores. Therefore, a High Exposure score (3) will have a x3 the weight of a Theme score that is Low Exposure (x1) for the relevant issue. For example:

Environmental Pillar Score	$\frac{(ECC \text{ Score } 4)(ECC \text{ Exp } 2) + (EWT \text{ Score } 4)(EWT \text{ Exp } 2) + (EBD \text{ Score } 0)(EBD \text{ Exp } 0) + (EPR \text{ Score } 3)(EPR \text{ Exp } 3) + (ESC \text{ Score } 2)(ESC \text{ Exp } 3)}{(ECC \text{ Exp } 2) + (EWT \text{ Exp } 2) + (EBD \text{ Exp } 0) + (EPR \text{ Exp } 3) + (ESC \text{ Exp } 3)}$	3.1
Social Pillar Score	$\frac{(SHS \text{ Score } 2)(SHS \text{ Exp } 2) + (SLS \text{ Score } 1)(SLS \text{ Exp } 3) + (SHR \text{ Score } 2)(SHR \text{ Exp } 3) + (SCR \text{ Score } 0)(SCR \text{ Exp } 0) + (SSC \text{ Score } 3)(SSC \text{ Exp } 3)}{(SHS \text{ Exp } 2) + (SLS \text{ Exp } 3) + (SHR \text{ Exp } 3) + (SCR \text{ Exp } 0) + (SSC \text{ Exp } 3)}$	2.2
Governance Pillar Score	$\frac{(GAC \text{ Score } 2)(GAC \text{ Exp } 3) + (GCG \text{ Score } 5)(GCG \text{ Exp } 2) + (GRM \text{ Score } 2)(GRM \text{ Exp } 3) + (GTX \text{ Score } 1)(GTX \text{ Exp } 2)}{(GAC \text{ Exp } 3) + (GCG \text{ Exp } 2) + (GRM \text{ Exp } 3) + (GTX \text{ Exp } 2)}$	2.4

- Finally, the overall ESG rating is calculated as an Exposure-weighted average of the three Pillar scores. Example below:

Pillar	Exposure (0-3)	Score (0-5)
Environmental	2.5	3.1
Social	2.5	2.2
Governance	2.5	2.4

$$\frac{(Env\ Exp\ 2.5)(Env\ Score\ 3.1) + (Soc\ Exp\ 2.5)(Soc\ Score\ 2.2) + (Gov\ Exp\ 2.5)(Gov\ Score\ 2.4)}{(Env\ Exp\ 2.5) + (Soc\ Exp\ 2.5) + (Gov\ Exp\ 2.5)} = \text{ESG Rating } 2.6$$

FTSE4Good and ESG Index Construction

- ESG indices cater to a broad range of investors. Investors can use a variety of tools to construct sustainable investment indexes which are typically based on rules/selection-based criteria and/or tilts
- The FTSE4Good Index Series provides investors with broad exposure to companies demonstrating good ESG practices and helps align investor values with their investment portfolios
- The FTSE4Good constituent selection includes different rating thresholds for developed and emerging markets:

	Developed markets	Emerging markets
Companies newly included in the Index Series	ESG Rating of 3.3 or higher	ESG Rating of 2.9 or higher
Companies removed from the Index Series	ESG Rating of lower than 2.9	ESG Rating of lower than 2.4

- FTSE4Good standard exclusions and requirements are:
 - Manufactures/producers: tobacco, weapon systems, controversial weapons (cluster munitions, anti-personnel mines, depleted uranium, chemical/biological weapons and nuclear weapons), coal
 - High Exposure ESG themes must have a score of ≥ 2 for companies in Developed markets
 - Nuclear power must meet 16 of 17 indicators in the Health and Safety theme
 - Infant formula must meet 19 of 20 indicators in the Customer Responsibility theme
 - Companies with exposure to controversies are not eligible for the Index Series
- The FTSE4Good Bursa Malaysia Index is constructed from FTSE Bursa Malaysia EMAS companies with an overall ESG score of ≥ 2.9 and follows the FTSE4Good standard exclusion criteria. The index excludes companies manufacturing tobacco, weapons systems and components for controversial weapons
- ESG ratings for Malaysian companies scores well in emerging countries, where **Malaysia is ranked 5th** out of 16 Emerging Market countries in FTSE Emerging company scores and ranked 3rd in Governance Pillar scores.