



Initiatives for Improving ESG Passive Equity Investment

April 2023

Government Pension Investment Fund



[GPIF's Basic Approach to ESG Investment]

- ❑ GPIF's investments are conducted by taking ESG into consideration based on its belief that the sustainable growth of investee companies and the capital market as a whole are vital in enhancing long-term investment returns. We positively implement the PDCA cycle.
- ❑ The fluctuation of performance due to factors other than ESG is undesirable, which we will avoid as much as possible.

[Initiatives for the Improvement of ESG Investment]

- ❑ Main initiatives implemented in FY2022:

(a) Improvement of Index Methodology through Consultations (Pages 3 to 5)

⇒ Change in the constituent weighting method of the MSCI Japan Empowering Women Index (WIN)

⇒ TCFD-based information disclosure is taken into consideration in the evaluation for the S&P Carbon Efficient Index series.

(b) Adoption of Gender Diversity Index (Note 1)

⇒ Adoption of Morningstar Japan ex-REIT Gender Diversity Tilt Index (GenDi J)

(c) Enhancement of Risk Management in ESG Passive Equity Portfolio (Review of Allocation of Assets under Management)

⇒ Funds equivalent to 500 billion yen were allocated to the GenDi J Index from the existing ESG Indices. (Note 2)

(d) Implementation of "Measurement of the Impacts of Stewardship Activities and ESG Investment" (Page 6)

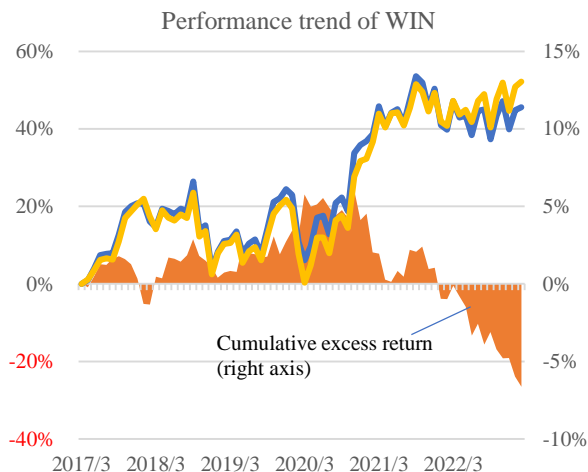
⇒ A public consultation started in FY2022, and the analysis will be carried out from FY2023 to FY2024.

Note 1: For details, please see "Adoption of ESG Index and Portfolio Adjustment"

Note 2: The estimated TE of the entire ESG portfolio of domestic equities is expected to decline by 10 bps due to the relevant rebalancing and the change in the constituent weighting method of WIN.

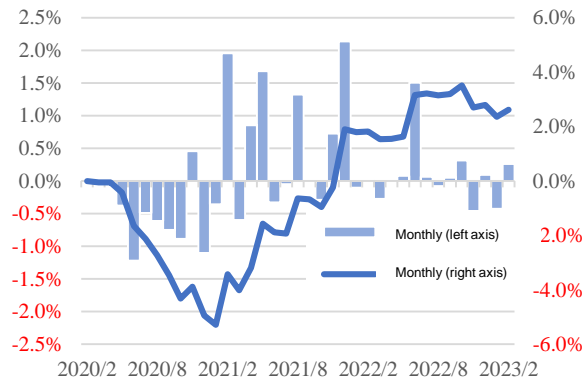
Improvement of Index Methodology: Present Status of WIN

- Regarding the MSCI Japan Empowering Women Index (WIN), the gender diversity score to evaluate corporate initiatives for women's empowerment positively contributes to stock price performance. However, the performance tends to deteriorate mainly due to the weight adjustment using the quality score.



Note: The parent index of the MSCI Empowering Women Index (WIN) was MSCI Japan IMI 500 before November 2019.

Gender Diversity score: Trend of spread and return
(Past three years after change of parent index)



Note: The constituent stocks of the MSCI Japan IMI 700 were divided into two groups of high and low scores of gender diversity score, and the average return of each group was calculated, of which difference was recorded.

[Outline of the methodology of WIN (before change)]

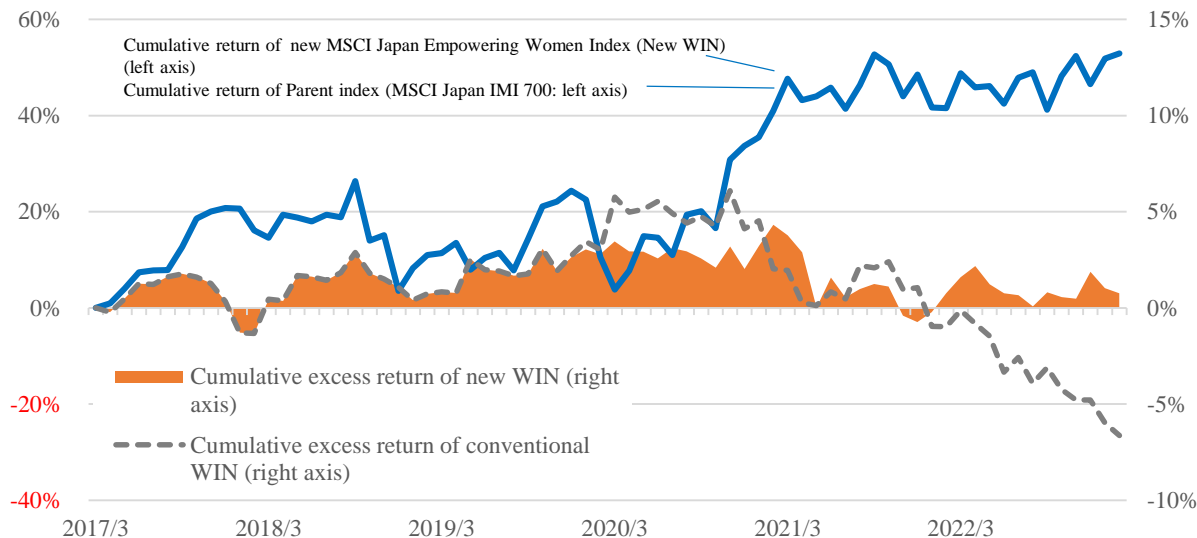
- Based on the gender diversity score which evaluates corporate initiatives for empowering women, stocks with a high score in their industry were selected as constituent stocks.
- The weighting of constituent stocks is determined by the following formula: Weighted overall market value x Gender diversity score x Quality score (a score calculated from ROE, debt ratio and profit variability)

Improvement of Index Methodology: Review of WIN

- GPIF positively conducts dialogue on the improvement of ESG evaluation methodology and index methodology with ESG ratings agencies and index providers.
- Regarding the MSCI WIN Index, the adjustment of the weighting using quality scores led to the deterioration of performance, thus GPIF had a dialogues with MSCI. MSCI decided to exclude the adjustment of weighting using quality scores through the process of consultation* (to be applied in May 2023 and thereafter).

* When ESG ratings agencies and index providers consider changing the methodology of index construction or ESG evaluation, they holds consultation to index users.

Performance of New WIN (Simulation)



Source: Prepared by GPIF based on the data of MSCI.

Improvement of Index Methodology: Carbon Efficient Index

- Under the Corporate Governance Code which was revised in June 2021, the companies listed on the Prime Market have been required to “disclose information based on TCFD or a framework equivalent to it.”
- As a result of repeated dialogues with S&P Dow Jones Indices, consultations concerning changes in the methodology of the S&P Carbon Efficient Index series were implemented, and the said company decided to reflect TCFD-based corporate disclosure in its evaluation (to be applied in June 2023 and thereafter).

[Method to determine the investment weighting in the S&P Carbon Efficient Index series (in the case of a medium-impact sector)]

Carbon emissions / Net sales Intra-industry rank	First decile (Top 10%)			Second decile (Top 20%)			Third decile (Top 30%)			Fourth to Seventh deciles			Eighth decile (Bottom 30%)			Ninth decile (Bottom 20%)			Tenth decile (Bottom 10%)		
	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed
Status of disclosure of carbon emissions	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed	Disclosed		Not disclosed
TCFD-recommended disclosure	Yes	No	—	Yes	No	—	Yes	No	—	Yes	No	—	Yes	No	—	Yes	No	—	Yes	No	—
Adjustment of investment weighting*	40%	35%	30%	30%	25%	20%	20%	15%	10%	10%	5%	0%	0%	-5%	-10%	-10%	-15%	-20%	-20%	-25%	-30%

Note: In the adjustment of investment weighting*, a three-fold value is applied in the above table for high-impact sectors, whereas a 0.5-fold value is applied to low-impact sectors.

Source: Prepared by GPIF based on the materials of S&P Dow Jones Indices, etc.

[Characteristics of S&P Carbon Efficient Index series]

- The S&P Carbon Efficient Index series, adopted by GPIF as one of the benchmarks for passive investment, evaluates carbon emissions per sales and information disclosure concerning carbon data to determine investment weighting.
- In the evaluation of information disclosure by conventional methodologies, evaluation was conducted only by the presence or absence of information disclosure concerning carbon emissions. However, from June 2023, the evaluation will be conducted based on whether disclosure is in accordance with the TCFD in addition to the disclosure of carbon data.

- A certain period of time has passed since the implementation of GPIF’s stewardship activities and ESG investments, and the relevant data have been accumulated.
- Therefore, in order to appropriately implement the PDCA cycle, we will conduct measurement of quantitative impact from FY2023 to FY2024 in collaboration with a research institute or a consulting firm which have expertise in sophisticated statistical analysis as follows.

■ Overview of the measurement of impact

	Project theme	Specific details (example)
Measurement of the impact of stewardship activities	Verification of the impact of engagement	To identify the causality of the impact of engagement on the improvement of ESG indices and corporate value
	Verification of voting rights held by asset managers	Analysis of difference when asset managers exercise voting rights in stakeholders and in non-stakeholders.
Measurement of the impact of ESG investments	Verification of impact of passive equity investments based on ESG indices	Analysis of impact of ESG investments on corporate behavior
	Study on the ESG factors that contribute to the improvement of corporate value and investment returns	Identification of the causality concerning the ESG factors and the improvement of corporate value/investment returns

* The theme of project and the timing of implementation are subject to change in the future.