



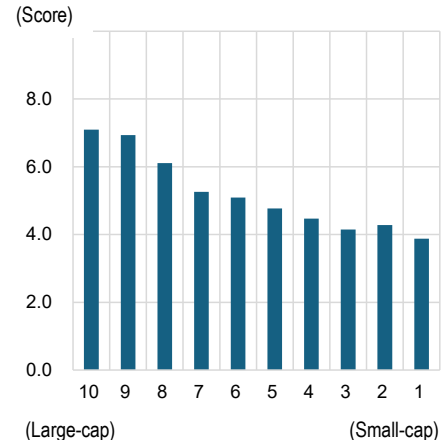
Review of an Index for ESG Passive Equity Investment

March 2024
Government Pension Investment Fund

Our Concerns and Improvement Measures

- ❑ MSCI Japan ESG Select Leaders Index, one of the domestic equity ESG indexes which is adopted by GPIF, contains relative risk (tracking error) to TOPIX, GPIF’s policy benchmark, due to 1) REIT being included, and 2) its higher exposure to large-cap stocks.* Based upon this concern, after many discussions with MSCI, they proposed the following updates to the constituent selection criteria for the index.
- ❑ The proposed measures contain the following two points: 1) REIT, which is not included in the policy benchmark, will be excluded from the parent index; and 2) the constituent selection criteria of stocks will be changed from selecting stocks with high ESG evaluations until the sum of their market capitalization reaches 50% in the same industry, to selecting stocks with high ESG evaluations until the number of such stocks reaches 50% of the same industry. There will be no changes to the ESG evaluation methodology or other matters.
- ❑ Since the above-mentioned concerns 1) and 2) are expected to be eliminated or reduced by the proposed improvement measures, we have decided on and implemented a change in the benchmark from MSCI Japan ESG Select Leaders Index, the former index, to MSCI Nihonkabu ESG Select Leaders Index, the proposed index.

Average of MSCI ESG scores by market capitalization decile



*As for the ESG scores, higher evaluation can be observed for large-cap stocks with sufficient management resources for information disclosure and other aspects, as seen in the upper right chart.

Comparison of Methodologies of New/Former Select Leaders Indexes

- Differences from the former index: 1) REIT is excluded from the parent index; 2) stocks are selected from those with higher ESG evaluations until the number of such stocks reaches 50%, rather than being selected until their market capitalization reaches 50% of the industry.
- Active risks have been reduced due to 1) above, since REIT is not included in TOPIX, the policy benchmark.
- Reflecting 2) above, the large-cap stock bias has been reduced due to an increase in stocks selected, which contributes to the reduction of active risks as in 1) above.

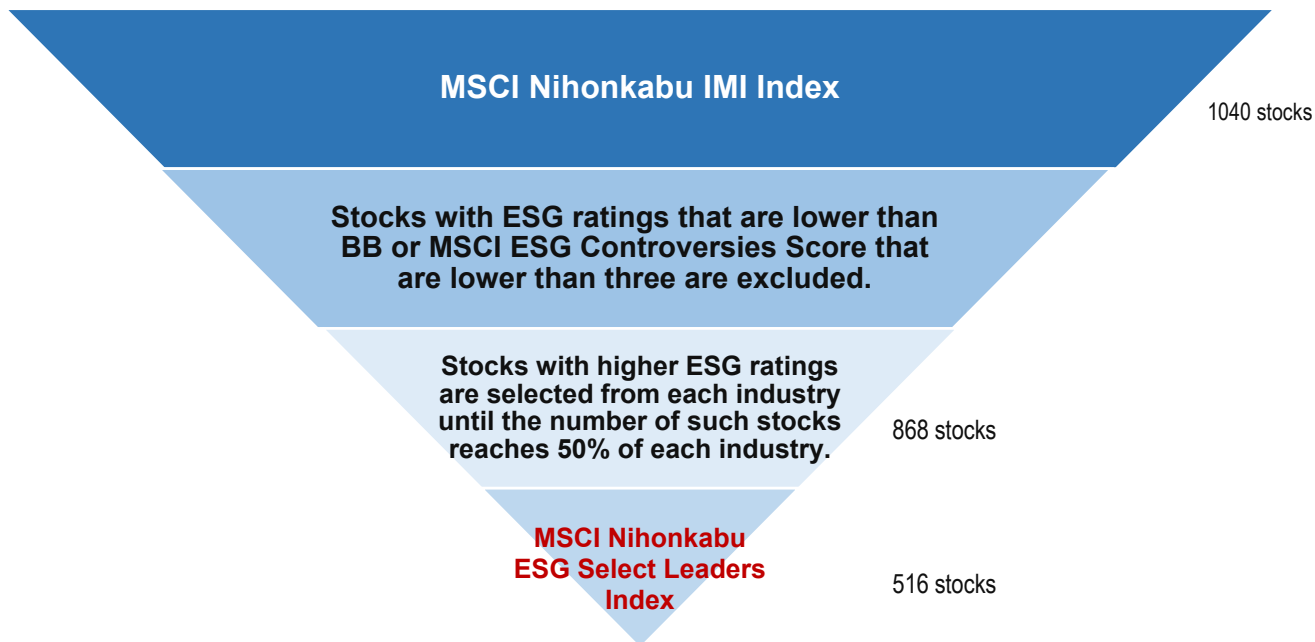
	New Index (MSCI Nihonkabu ESG Select Leaders)	Former Index (MSCI Japan ESG Select Leaders)
Parent index	MSCI Nihonkabu IMI*	MSCI Japan IMI
Eligibility criteria	ESG rating: BB or higher (B or higher for the existing stocks) Controversies score: 3 or higher (1 or higher for the existing stocks)	
Stock ranking	Ranked in the order of ESG rating, ESG score and market capitalization	
Stock selection	<u>Top 50% in ranking of each sector in terms of the number of stocks</u>	Top-ranked stocks in each sector <u>covering 50% of market capitalization of the parent index</u>
Weighting	Market capitalization	
Number of stocks selected (as of January 31, 2024)	516	239

Note: MSCI Nihonkabu IMI is an index in which REIT is excluded from MSCI Japan IMI.

Methodology of the New Index

(MSCI Nihonkabu ESG Select Leaders Index)

- The constituents of MSCI Nihonkabu ESG Select Leaders Index are selected from among those included in MSCI Nihonkabu IMI Index.
- Of those above, stocks with high ESG ratings in each industry are selected.
- The stocks are selected from companies in the order of higher ESG ratings, and included in the index until the number of such companies accounts for 50% of each industry.



Note: As of the rebalancing in November 2023

Source: MSCI



Methodology of New Index

(MSCI Nihonkabu ESG Select Leaders Index)

Name	MSCI Nihonkabu IMI Index
Stock selection	<p>Stocks with ESG ratings of lower than BB or MSCI ESG Controversies Score of lower than three are excluded.</p> <p>Semi-annual review:</p> <p>Stocks are selected from each industry in the order outlined below so the number of constituent stocks accounts for 50% of each industry of MSCI Nihonkabu IMI Index.</p> <p>◆Ranking</p> <ol style="list-style-type: none"> 1) Ranking of ESG rating 2) If, 1) is the same, the existing included stocks will be ranked higher. 3) If, 1) and 2) are the same, the stock with the highest ESG score after industry adjustment will be ranked higher. 4) If, 1) to 3) are the same, the stock with the larger free float adjusted market capitalization will be ranked higher. <p>◆Selection</p> <ol style="list-style-type: none"> 1. Stocks with higher ranking within the industry accounting for 35% in terms of the number of stocks 2. Stocks with AAA and AA ratings from the top 50% of the industry ranking in terms of the number of stocks 3. Existing constituent stocks out of the top 65% of stocks ranked within the industry in terms of the number of stocks 4. Remaining stocks in terms of the number of stocks <p>Quarterly review:</p> <ul style="list-style-type: none"> • If the coverage ratio in the relevant industry is less than 45%, new stocks will be adopted until the ratio reaches the target of 50%. However, the newly adopted stocks must be with ESG ratings of BB or higher and the controversies score of three or higher. • The constituent stocks with ESG ratings of CCC or controversies score of 0 shall be excluded.
Weighting	Market capitalization-weighted
Rebalancing	Semi-annual review (twice a year in May and November) and quarterly review

Source: MSCI

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.
- ❑ Continuously verify whether ESG investments are acting in accordance with the basic approach required for corporate investment management.

Recent Initiatives for the Improvement of ESG Investment (FY2022 and thereafter)

(1) Improvement of Index Methodology through Consultations

- ⇒ 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.

(2) Adoption of Gender Diversity Index

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

(3) 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 Indexes.

(4) Shift to MSCI Nihonkabu ESG Select Leaders Index

- ⇒ The large-cap stock bias, etc., was reduced from the former index without any change in ESG evaluation.

(5) Implementation of "Measurement of the Impacts of Stewardship Activities and ESG Investment" (Scheduled for FY2023-2024)

