

MSCI Nihonkabu ESG Select Leaders Index Methodology

December 2025

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1. Introduction

The MSCI Nihonkabu ESG Select Leaders Index (the “Index”) is a free float-adjusted market capitalization-weighted index designed to represent the performance of companies that are selected from the MSCI Nihonkabu Investable Market Index (“Parent Index”) based on Environmental, Social and Governance (“ESG”) criteria. These criteria exclude constituents based on involvement in specific business activities, as well as ESG ratings and exposure to controversies. The Index construction has a target coverage of 50% by number of securities in each Global Industry Classification Standard (GICS®)¹ sector of the Parent Index² by selecting constituents primarily based on criteria including the ESG rating and the company’s industry adjusted ESG score.

¹ GICS, the global industry classification standard jointly developed by MSCI Inc. and S&P Dow Jones Indices.

² The Index is governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document. Please refer to Appendix 2 for more details.

2. Constructing the Index

2.1 Underlying Universe

The Underlying Universe for the Index is defined by the constituents of the Parent Index.

2.2 Eligibility Criteria

The Index uses company ratings and research provided by MSCI Solutions³ to determine eligibility for Index inclusion.

2.2.1 ESG Ratings Eligibility

The Index uses MSCI ESG Ratings to identify companies that have demonstrated an ability to manage their ESG risks and opportunities. Companies are required to have an MSCI ESG Rating of 'BB' or above to be eligible for inclusion in the Index.

2.2.2 Controversies Score Eligibility

The Index uses MSCI Controversies Scores to identify companies that are involved in very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services. Companies are required to have an MSCI Controversies Score of 3 or above to be eligible for inclusion in the Index.

2.3 Target Number of Securities

The Index has a target coverage of 50% by number of securities in each Global Industry Classification Standard (GICS®) sector of the Parent Index based on the ranking criteria as detailed in Section 3.1.2.

2.4 Treatment of Unrated Companies

Companies not assessed by MSCI Solutions on data for any of the following MSCI sustainability and climate products are not eligible for inclusion in the Index.

- MSCI ESG Ratings
- MSCI Controversies

See section 4 for further information regarding ESG and climate data used in the Index that MSCI Limited sources from MSCI Solutions LLC, a separate subsidiary of MSCI Inc. MSCI Solutions is solely responsible for the creation, determination and management of such data. MSCI Limited is the benchmark administrator for the MSCI index.

3. Maintaining the Index

3.1 Semi-Annual Index Review

The Index is reviewed on a semi-annual basis in May and November to coincide with the May and November Index Reviews of the Parent Index, and the changes are implemented at the end of May and November. In general, the pro forma index is announced nine business days before the effective date.

In general, MSCI uses MSCI Solutions data (including MSCI ESG Ratings and MSCI Controversies Scores) as of the end of the month preceding the Index Reviews for the rebalancing of the Index. For some securities, such data may not be published by MSCI Solutions by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the Index.

At each Semi-Annual Index Review, the eligible universe is updated, and the composition of the Index is reassessed to target the top 50% by number of securities within each Global Industry Classification Standard (GICS®) sector of the Parent Index based on the ranking criteria in Section 3.1.2.

3.1.1 Updating the Eligible Universe

The Eligible Universe is updated during each Semi-Annual Index Review.

Securities that are currently not constituents of the Index are evaluated using the same eligibility criteria described in Section 2.2.

Existing constituents of the Index are maintained in the Eligible Universe if they meet all the following conditions:

- MSCI ESG Rating of 'B' or above
- MSCI Controversies Score of 1 or above

3.1.2 Ranking of Eligible Securities

For each sector, eligible securities of the Parent Index are ranked based on the following criteria:

- ESG Rating
- Current index membership (existing constituents above non-constituents)
- Industry-adjusted ESG scores
- Decreasing free float-adjusted market capitalization

3.1.3 Selection of Eligible Securities

For each sector, eligible securities of the Parent Index are then selected from the Ranked Universe in the following order until the target coverage of 50% by number of securities within each sector is reached:

- Securities in the top 35% of the ranked universe, including the first security that increases the cumulative coverage by number of securities above 35%.

- 'AAA' and 'AA' rated securities in the top 50% of the ranked universe, including the first security that increases the cumulative coverage by number of securities above 50%.
- Current index constituents in the top 65% of the ranked universe, including the first security that increases the cumulative coverage by number of securities above 65% if that security is a current index constituent.
- Remaining eligible securities in the Ranked Universe.

Please see Appendix I for additional details on the ranking and selection rules.

3.2 Quarterly Index Reviews

The Index is also reviewed on a quarterly basis in February and August to coincide with the February and August Index Reviews of the Parent Index. The changes are implemented at the end of February and August. The pro forma index is in general announced nine business days before the effective date.

At the Quarterly Index Reviews, existing constituents are deleted from the Index if they do not meet the eligibility criteria described in Section 2.2. Existing constituents that meet the eligibility criteria are retained in the Index.

Additions from the eligible securities as per Section 2.2 are made only to those sectors where the current coverage by number of securities is less than 45%, until the 50% target is reached.

Market price movements may cause small deviations in the sector coverage between two Index Reviews. Therefore, to minimize turnover, a buffer of 10% is used on the target coverage of 50% to define under-representation.

For the Quarterly Index Reviews, MSCI ESG Ratings and MSCI Controversies Score assessments are taken as of the end of the month preceding the Index Reviews, i.e., January and July. For some securities, this data may not be published by MSCI Solutions by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the Index.

3.3 Ongoing Event-Related Maintenance

The following section briefly describes the treatment of common corporate events within the Index.

No new securities will be added (except where noted below) to the Index between Index Reviews. For cases where additions are noted below, securities will be added to the index only if added to the Parent Index.

Parent Index deletions will be reflected simultaneously.

There are no deletions from the Index between Index Reviews on account of a security becoming ineligible because of MSCI ESG Rating downgrade and/or decrease in MSCI Controversies Score.

EVENT TYPE

EVENT DETAILS

New additions to the Parent Index

New securities added to the Parent Index (such as IPOs, other early inclusions and migrations from a different size-segment) will be added to the Index on the date of security inclusion only if they meet the eligibility criteria described in Section 2.2 and the market capitalization coverage of the sector to which the security belongs is less than 45%.

Spin-Offs

All securities created as a result of the spin-off of an existing Index constituent will not be added to the Index at the time of event implementation. Reevaluation for addition in the Index will occur at the subsequent Index Review.

Merger/Acquisition

If an existing Index constituent is acquired by a non-Index constituent, the existing constituent will be deleted from the Index and the acquiring non-constituent will not be added to the Index.

Changes in Security Characteristics

A security will continue to be an Index constituent if there are changes in characteristics (country, sector, size segment, etc.). Reevaluation for continued inclusion in the Index will occur at the subsequent Index Review.

Further detail and illustration regarding specific treatment of corporate events relevant to this Index can be found in the MSCI Corporate Events Methodology book.

The MSCI Corporate Events methodology book is available at:
<https://www.msci.com/index/methodology/latest/CE>.

4. MSCI Solutions

The Index is product of MSCI Inc. that utilize information such as company ratings and research produced and provided by MSCI Solutions LLC (MSCI Solutions), a subsidiary of MSCI Inc. In particular, the Index uses the following MSCI sustainability and climate products: MSCI ESG Ratings and MSCI Controversies. MSCI Indexes are administered by MSCI Limited and MSCI Deutschland GmbH.

4.1 MSCI ESG Ratings

MSCI ESG Ratings aim to measure entities' management of environmental, social and governance risks and opportunities. MSCI ESG Ratings use a weighted average key issue calculation that is normalized by industry to arrive at an industry-adjusted ESG score (0-10), which is then translated to a seven-point scale from 'AAA' to 'CCC', indicating how an entity manages relevant key issues relative to industry peers.

The MSCI ESG Ratings methodology can be found at: <https://www.msci.com/esg-and-climate-methodologies>.

4.2 MSCI Controversies

MSCI Controversies provide assessments of controversies concerning the potential negative environmental, social, and/or governance impact of company operations, products and services. The evaluation framework used in MSCI Controversies is designed to be consistent with international norms represented by the UN Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, and the UN Global Compact. MSCI Controversies Score falls on a 0-10 scale, with "0" being the most severe controversy.

The MSCI Controversies methodology can be found at: <https://www.msci.com/esg-and-climate-methodologies>

Appendix 1: Guidelines on Achieving the Target Sector Coverage of 50%

The Index has a target coverage of 50% by number of securities within each Global Industry Classification Standard (GICS®) sector of the Parent Index. The underlying principle in the construction of the Index is to achieve cumulative sector coverage closest to 50% by number of securities, while aiming to maintain index stability.

The following guidelines are used in achieving the target 50% by number of securities:

- For each sector, the eligible securities of the Parent Index are first ranked based on the company level ESG Rating.
- If two securities have the same ESG Rating, the existing Index constituent is given priority to maintain index stability. Between two existing constituents of the Index with the same ESG Rating, the security with the higher industry-adjusted ESG Score is given priority. For two existing constituents of the Index with the same industry-adjusted ESG score, the security with the largest free float-adjusted market capitalization is given priority.
- The cumulative sector coverage at each rank is calculated.
- In each sector, securities are selected as per the rules mentioned in Section 3.1.3 until the sector coverage by number of securities crosses 50% or there are no eligible securities left to be selected.
- MSCI defines the security that increases the cumulative sector coverage above 50% as the “marginal security”.
 - If the marginal security is a current constituent of the Index, then it is always selected.
 - If the marginal security is not a current constituent of the Index, then it is selected only if the sector coverage with the marginal security is closer to 50% compared to the sector coverage without the marginal security.
 - If the marginal security is not a current constituent of the Index and the difference between the target (50%) and sector coverage with the marginal security included is equal to the difference between the target and sector coverage with the marginal company not included, then the marginal security will not be selected.
- The minimum cumulative sector coverage is set to 45%.
 - The marginal security is always selected if this is required to achieve cumulative sector coverage of 45%.
- Securities which are ineligible as per Section 3.1.1 will not be selected even if the cumulative sector coverage after selection of all eligible securities is below 50%.

Appendix 2: Methodology Set

The Index is governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document as mentioned below:

- Description of methodology set – <https://www.msci.com/index/methodology/latest/ReadMe>
- MSCI Corporate Events Methodology – <https://www.msci.com/index/methodology/latest/CE>
- MSCI Fundamental Data Methodology – <https://www.msci.com/index/methodology/latest/FundData>
- MSCI Index Calculation Methodology – <https://www.msci.com/index/methodology/latest/IndexCalc>
- MSCI Index Glossary of Terms – <https://www.msci.com/index/methodology/latest/IndexGlossary>
- MSCI Index Policies – <https://www.msci.com/index/methodology/latest/IndexPolicy>
- MSCI Global Industry Classification Standard (GICS) Methodology – <https://www.msci.com/index/methodology/latest/GICS>
- MSCI Global Investable Market Indexes Methodology – <https://www.msci.com/index/methodology/latest/GIMI>
- ESG Factors in Methodology*

The Methodology Set for the Index can also be accessed from MSCI’s webpage: <https://www.msci.com/index-methodology> in the section ‘Search Methodology by Index Name or Index Code’.

* ‘ESG Factors in Methodology’ contains the list of environmental, social, and governance factors considered, and how they are applied in the methodology (e.g., selection, weighting or exclusion). It can be accessed in the Methodology Set as described above.

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