

# **MSCI GLOBAL SOCIALLY RESPONSIBLE INDEXES METHODOLOGY**

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# 1 INTRODUCTION

Globally, institutional investors are increasingly seeking to invest in companies that operate in accordance with their values and meet stringent best-of-class criteria for managing their environmental, social and governance (ESG) risks and opportunities.

Examples of values driven investing include the avoidance of companies that sell products that have high negative social impact (for example – alcohol, gambling, and tobacco), a commitment to high human rights standards in a company’s supply chain, and general adherence to established international normative standards of corporate behavior as represented by organizations such as the UN Global Compact.

The MSCI Global Socially Responsible (SRI) Indexes exclude companies that are inconsistent with specific values based criteria focused on products with high negative social or environmental impact. Additionally, these indexes target companies with high Environmental, Social and Governance (ESG) ratings relative to their sector peers, to ensure the inclusion of the best-in-class companies from an ESG perspective. Further, these Indexes aim to target sector weights that reflect the relative sector weights of the underlying MSCI Global Investable Market Indexes to limit the systematic risk introduced by the ESG selection process. Overall the MSCI Global Socially Responsible Indexes target coverage of 25% of the underlying MSCI parent index (“Parent Index”).

Currently MSCI constructs MSCI Global Socially Responsible Indexes for the Standard size-segment in all Developed Markets and Emerging Markets.

## 2 MSCI ESG RESEARCH

The MSCI Global Socially Responsible Indexes use company ratings and research provided by MSCI ESG Research. In particular, these indexes use the following three MSCI ESG Research products: MSCI ESG Intangible Value Assessment, MSCI ESG Impact Monitor, and MSCI ESG Business Involvement Screening Research.

For details on MSCI ESG Research's full suite of ESG products, please refer to:  
[http://www.msci.com/products/esg/about\\_msci\\_esg\\_research.html](http://www.msci.com/products/esg/about_msci_esg_research.html)

### 2.1 MSCI ESG INTANGIBLE VALUE ASSESSMENT

MSCI ESG Intangible Value Assessment (IVA) company reports provide research, analysis and ratings of how well companies manage their most material environmental, social and governance risks and opportunities.

MSCI ESG IVA provides an overall company ESG rating a seven point scale from 'AAA' to 'CCC'. In addition, the product provides scores and percentiles indicating how well a company manages each key issue relative to industry peers.

For more details on MSCI ESG IVA, please refer to  
[http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_IVA.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_IVA.pdf)

### 2.2 MSCI ESG IMPACT MONITOR

MSCI ESG Impact Monitor company reports include assessments of controversies concerning the negative environmental, social, and/or governance impact of company operations, products and services. The evaluation framework used in MSCI ESG Impact Monitor 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.

For more details on MSCI ESG Impact Monitor, please refer to  
[http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_Impact\\_Monitor.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_Impact_Monitor.pdf)

### 2.3 MSCI ESG BUSINESS INVOLVEMENT SCREENING RESEARCH

MSCI ESG Business Involvement Screening Research (BISR) aims to enable institutional investors to manage environmental, social and governance (ESG) standards and restrictions reliably and efficiently. Investors can access the BISR data via data feeds or MSCI ESG Manager to help satisfy client investment guidelines, implement client mandates, and manage potential ESG portfolio risks.

For more details on MSCI ESG Business Involvement Screening Research, please refer to [http://www.msci.com/resources/factsheets/MSCI ESG BISR.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf)

### **3 CONSTRUCTING THE MSCI GLOBAL SOCIALLY RESPONSIBLE INDEXES**

#### **3.1 UNDERLYING UNIVERSE**

The selection universe for the MSCI Global Socially Responsible Indexes is defined by the constituents of the MSCI Global Investable Market Indexes (GIMI).

#### **3.2 ELIGIBILITY CRITERIA**

The MSCI Global Socially Responsible Indexes use company ratings and research provided by MSCI ESG Research to determine eligibility.

##### **3.2.1 VALUES-BASED EXCLUSIONS**

The MSCI Global Socially Responsible Indexes use MSCI ESG Business Involvement Screening Research to identify companies that are involved in the following business activities. Companies that meet the business involvement criteria are excluded from the MSCI Global Socially Responsible Indexes. Please refer to Appendix 1 for details on these criteria.

- Alcohol
- Gambling
- Tobacco
- Military Weapons
- Civilian Firearms
- Nuclear Power
- Adult Entertainment
- Genetically Modified Organisms

##### **3.2.2 ESG RATINGS ELIGIBILITY**

The MSCI Global Socially Responsible Indexes use MSCI ESG Intangible Value Assessment research to identify companies that demonstrated an ability to manage their ESG risks and opportunities. Existing constituents of the MSCI Global Socially Responsible Indexes are required to have an IVA rating above B to remain in the index, while companies that are currently not constituents of the MSCI Global Socially Responsible Indexes are required to have an IVA rating above BBB to be considered eligible for addition.

### 3.2.3 ESG CONTROVERSY SCORE ELIGIBILITY

MSCI Global Socially Responsible Indexes use MSCI ESG Impact Monitor research to identify those companies that are involved in very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services. Impact Monitor overall company scores fall on a 0-10 scale, with “0” being the most severe controversy. Existing constituents of the MSCI Global Socially Responsible Indexes are required to have an Impact Monitor score above 1 to remain in the index, while companies that are currently not constituents of the MSCI Global Socially Responsible Indexes are required to have an Impact Monitor score above 3 to be considered eligible for addition.

### 3.3 INDEX CONSTRUCTION

Currently MSCI constructs MSCI Global Socially Responsible Indexes for the Standard size-segment in all Developed Markets and Emerging Markets.

The MSCI Global Socially Responsible Indexes for the Standard size segment are constructed at a regional level, with the exception of North America which is built separately for Canada and the USA. Each regional SRI index targets 25% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the underlying MSCI parent index (“Parent Index”).

The following regional SRI Indexes are aggregated to construct the MSCI World SRI Index.

MSCI Regional SRI Index	Region	Parent Index
MSCI Pacific SRI Index	Developed Asia Pacific	MSCI Pacific Index
MSCI Europe & Middle East SRI Index	Developed Europe & Middle East	MSCI Europe & Middle East Index
MSCI Canada SRI Index	Canada	MSCI Canada Index
MSCI USA SRI Index	USA	MSCI USA Index



The following regional SRI Indexes are aggregated to construct the MSCI EM SRI<sup>1</sup> Index.

MSCI Regional SRI Index	Region	Parent Index
MSCI Emerging Markets Asia SRI Index	Emerging Asia	MSCI Emerging Markets Asia Index
MSCI Emerging Markets Europe, Middle East & Africa SRI Index	Emerging Europe, Middle East & Africa	MSCI Emerging Markets Europe, Middle East & Africa Index
MSCI Emerging Markets Latin America SRI Index	Emerging Latin America	MSCI Emerging Markets Latin America Index

The MSCI World SRI Index and the MSCI EM SRI Index are aggregated to construct the MSCI ACWI SRI Index.

<sup>1</sup> Please refer to Appendix 4 for details of the initial construction of the MSCI Emerging Markets SRI Index at launch.

## 4 MAINTAINING THE MSCI GLOBAL SOCIALLY RESPONSIBLE INDEXES

### 4.1 ANNUAL INDEX REVIEW

The MSCI Global Socially Responsible Indexes are reconstituted on an annual basis in May to coincide with the May Semi-Annual Index Review of the Parent Index, and the changes are implemented at the end of May. The pro forma indexes are in general announced nine business days before the effective date. Ratings, scores and exclusionary screens provided by MSCI ESG Research (IVA, Impact Monitor, and Business Involvement Screening Research) for the Annual Index Review are taken as of the end of April.

#### 4.1.1 ANNUAL INDEX RECONSTITUTION: RANKING AND SELECTION

The composition of the index is reassessed in order to target 25% free float-adjusted cumulative market capitalization of each sector of the Parent Index.

##### 4.1.1.1 ELIGIBILITY

All securities that are part of the pro forma Parent Index and satisfy the criteria described in Section 3 are eligible for inclusion in the index.

##### 4.1.1.2 RANKING

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

- IVA Rating
- Current index membership
- IVA industry-adjusted scores
- Decreasing free float adjusted market capitalization.

##### 4.1.1.3 SELECTION

Constituents for the regional MSCI Socially Responsible Index are then selected from the ranked universe in the following order until 25% coverage by cumulative free-float adjusted market capitalization target is reached:

- Securities in the top 17.5%
- 'AAA' and 'AA' rated securities in the top 25%
- Current index constituents in the top 32.5%

- Remaining securities in the eligible universe

Please see Appendix 2 for additional details on the ranking and selection rules.

## 4.2 QUARTERLY INDEX REVIEWS

The MSCI Global Socially Responsible Indexes are also reviewed on a quarterly basis to coincide with the regular Index Reviews of the Parent Indexes. The changes are implemented at the end of February, August and November. The pro forma indexes are in general announced nine business days before the effective date.

ESG IVA ratings, ESG Impact Monitor assessments, and BISR data used for the Quarterly Index Reviews are taken as of the end of the month preceding the Index Reviews, i.e., January, July and October.

At the Quarterly Index Reviews, existing constituents are deleted from the MSCI Global Socially Responsible Indexes if they do not meet the eligibility criteria described in Section 3. Existing constituents that meet the eligibility criteria are retained in the index.

At the Quarterly Index Reviews, all companies that are currently not constituents, and meet the criteria mentioned in Section 3 are eligible for addition to the index. Additions are made only to those sectors where the current market capitalization coverage is less than 22.5%, until the 25% target is reached.

Market price movements may cause small deviations in the sector coverage between two Index Reviews and so a buffer of 10% is used on the target coverage of 25% to define under-representation, in order to minimize turnover.

## 4.3 ONGOING EVENT-RELATED MAINTENANCE

The MSCI Corporate Events Methodology is applied for the maintenance of the MSCI Global Socially Responsible Indexes between Index Reviews.

### 4.3.1 IPOs AND OTHER EARLY INCLUSIONS

IPOs and other newly listed securities, which have been added to the Parent Index, are considered for inclusion to the MSCI Global Socially Responsible Indexes at the time of their inclusion in the Parent Index. These securities are added to the MSCI Global Socially Responsible Indexes only if they meet the eligibility criteria described in Section 3 and the market capitalization coverage of the sector to which the security belongs is less than 22.5%.

#### 4.3.2 ADDITIONS AND DELETIONS DUE TO CORPORATE EVENTS

Deletions from the Parent Index following a corporate event will be simultaneously deleted from the MSCI Global Socially Responsible Indexes. Additions to the Parent Index following corporate events related to existing constituents (such as spin-offs) will not be automatically added to the MSCI Global Socially Responsible Indexes. These Parent Index additions will be considered for addition at the next index review according to the rules outlined in Sections 4.1 or 4.2.

## APPENDIX 1: VALUES BASED EXCLUSION CRITERIA

Companies whose activity is inconsistent with the following values based criteria are excluded from the MSCI Global Socially Responsible Indexes:

- **Alcohol**
  - All companies classified as a “Producer” that earn either 5% or more revenue or more than \$500 million in revenue from alcohol-related products.
- **Gambling**
  - All companies classified as involved in “Operations” and “Support” that earn 5% or more in revenue, or more than \$500 million in revenue, from gambling-related products
- **Tobacco**
  - All companies classified as a “Producer”
  - All classified as “Distributor”, “Retailer”, and “Supplier” that earn 15% or more in revenue from tobacco-related products
- **Military Weapons**
  - All companies classified as involved in manufacturing of “Nuclear Weapons”, or “Nuclear Weapons Components”
  - All companies classified as involved in manufacturing of “Chemical and Biological Weapons” or “Chemical and Biological Weapons Components
  - All companies classified as a “Manufacturer of Cluster Bombs”
  - All companies classified as a “Manufacturer of Landmines”
  - All companies classified as a “Manufacturer of Depleted Uranium Weapons”
  - All companies that earn 5% or more in revenue, or more than \$500 million in revenue, from manufacturing of Weapons, Weapons Components, and/or Weapons Support Systems and Services
- **Civilian Firearms**
  - All companies classified as a “Producer”
  - All companies classified as a “Retailer” that earn 5% or more in revenue, or more than \$20 million in revenue, from civilian firearms-related products

- **Nuclear Power**
  - All companies classified as a nuclear “Utility”
  - All companies classified as involved in uranium mining
  - All companies classified as involved in designing nuclear reactors
  - All companies classified as involved in enrichment of fuel for nuclear reactors
  - All companies classified as a “Supplier” to the nuclear power industry that earn 15% or more in revenue from nuclear-power related products.
- **Adult Entertainment**
  - All companies classified as a “Producer” that earn more than 5% in revenue, or more than \$500 million in revenue, from this adult entertainment materials
- **Genetically Modified Organisms (GMO)**
  - Companies that derive any revenue from activities like genetically modifying plants, such as seeds and crops, and other organisms intended for agricultural use or human consumption
  - Companies that are only involved in GMO Research & Development activities are not excluded

## APPENDIX 2: GUIDELINES ON ACHIEVING THE TARGET SECTOR COVERAGE OF 25%

The MSCI Global Socially Responsible Indexes target 25% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the Parent Index. The underlying principle in the construction of the index is to achieve sector coverage closest to 25%, while aiming to maintain index stability.

The following guidelines are used in achieving the target sector coverage of 25%:

- For each sector, the constituents of the Parent Index are first ranked based on the company level ESG Rating and then by decreasing free float adjusted market capitalization.
- In case of two companies with the same ESG Rating, an existing index constituent is given preference to maintain index stability. Between two existing constituents with the same ESG Rating, the company with the higher ESG Score is given preference. For two existing index constituents with the same ESG score, the larger company by free-float adjusted market capitalization is given preference.
- The cumulative sector coverage at each rank is calculated.
- All companies classified in a sector for which the cumulative coverage is less than 25% will be considered for inclusion in the SRI index in order of decreasing ESG scores.
- MSCI defines the company that increases the cumulative sector coverage above 25% as the 'marginal company'.
- If the marginal company is a current SRI index constituent, then it is retained in the SRI index even though it may result in a cumulative sector coverage significantly higher compared to the 25% target. This is aimed at ensuring better index stability and lower turnover.
- If the marginal company is a non-index constituent, then the marginal company will be included in the SRI index only if the absolute difference between the resulting coverage of including the marginal company and the 25% target is lower than the absolute difference between the resulting coverage of not including the marginal company and the 25% target.
- The minimum cumulative sector coverage is set to 22.5%.
- The marginal company will be added to the SRI index if its non-inclusion would result in cumulative sector coverage of less than 22.5%.

### APPENDIX 3: METHODOLOGY TRANSITION

The MSCI Global Socially Responsible Indexes transitioned to the methodology described in this book at the May 2012 Index Review. The MSCI Global Socially Responsible Indexes were previously constructed using the Global Socrates ESG ratings. Any company that had an ESG rating of 'BB' or lower was not eligible for inclusion in the MSCI Global Socially Responsible Indexes. The underlying universe for the MSCI Global SRI was defined by the constituents of the MSCI Global ESG Indexes. The MSCI Global Socially Responsible Indexes were constructed by targeting 50% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS) sector of the underlying MSCI regional ESG Index.



## APPENDIX 4: INITIAL CONSTRUCTION OF THE MSCI EMERGING MARKETS SOCIALLY RESPONSIBLE INDEX AT LAUNCH

The MSCI Emerging Markets Socially Responsible Index was launched with an initial construction as of the November 2013 Index Review.

In order to achieve free float-adjusted market capitalization coverage close to the target of 25% at launch, the entry rules for the MSCI Emerging Markets SRI Index were slightly relaxed at the initial construction. Specifically, the IVA rating threshold was lowered to a minimum rating of 'BBB' at the initial construction instead of the threshold of a minimum ESG rating of 'A'. The Impact Monitor threshold was not relaxed and was kept at a minimum of '4'.

Note that this relaxation was done only for the initial construction. Since the November 2013 SAIR, the MSCI Emerging Markets SRI Index has been maintained using the same set of rules described in Section 4.

## APPENDIX 5: MSCI EXTENDED GLOBAL SOCIALLY RESPONSIBLE INDEX

The MSCI Extended Global Socially Responsible Indexes are constructed with an aim to reflect the performance of companies that are consistent with specific values based criteria, have high minimum level of ESG performance. The Index is also designed to more broadly cover the underlying investment universe. Extended SRI Indexes can be constructed on the Standard or the IMI size-segment in Developed and Emerging Markets.

Companies that fail the values based exclusion criteria as described in Section 3 are excluded from the MSCI Extended Global Socially Responsible Indexes. Any company that has an ESG rating of 'BB' or lower or has an Impact Monitor controversy assessment as very severe (Impact Monitor score of 1 or below) is not eligible for inclusion in the MSCI Extended Global Socially Responsible Indexes.

The MSCI Extended Global Socially Responsible Indexes target 50% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the Parent Index. The MSCI Extended Global SRI Indexes follows the same index review cycle and corporate events treatment as the MSCI SRI Indexes as described in section 4.

MSCI currently offers the following Extended SRI Indexes:

1. MSCI UK IMI Extended SRI Index

**The following sections have been modified since March 2014:**

Appendix 5: MSCI Extended Global Socially Responsible Index

- Addition of appendix 5 containing the methodology details of MSCI Extended Global Socially Responsible Indexes

**The following sections have been modified since September 2014:**

Section 2: MSCI ESG Research and Section 3: Constructing the MSCI Global Socially Responsible Indexes

- Clarification of MSCI Global Sustainability Index construction rules

Section 4: Maintaining the MSCI Global Socially Responsible Indexes

- Enhancement of treatment of corporate events

Appendix I: Values Based Exclusion Criterion

- Correction to the Values Based Exclusion Criterion

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