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Index Methodology

# MSCI Global Socially Responsible Indices Methodology

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## 1. Introduction

Globally, investors are increasingly seeking to invest in accordance with their values—such as religious beliefs, moral standards, or ethical views. Examples of such beliefs are avoidance of sin stocks, respect for human rights, adherence to an international normative standard such as UN Global Compact, etc.

The MSCI Global Socially Responsible indices exclude companies that are inconsistent with specific values based criteria. Additionally, these indices target companies with high Environmental, Social and Governance (ESG) ratings relative to their sector peers, to ensure the inclusion of the best-of-class companies from an ESG perspective. Further, these Indices aim to target sector weights that reflect the relative sector weights of the underlying MSCI Global Investable Market Indices to limit the systematic risk introduced by the ESG selection process. Overall the MSCI Global Socially Responsible indices target coverage of 25% of the underlying index.

Currently MSCI constructs MSCI Global Socially Responsible Indices for the Standard size-segment in all Developed Markets. The indices are free float-adjusted market capitalization weighted.

## 2. ESG Research Framework

The MSCI Global Socially Responsible Indices are based on MSCI's ESG research framework, which generates a rating of each company's management of its environmental, social and governance performance. To determine a company's ESG ranking, MSCI ESG Research examines extensive data collected from various sources, such as company filings, media, governments, third-party data providers and NGOs. Each company is assigned to one of more than 80 industry groups, each of which has a unique set of ESG rating data and weightings. The research model generates numerous sub-scores for the company across each data category applicable to the industry group. The model aggregates the sub-scores to generate separate environmental, social and governance scores for the company, which are ultimately expressed as a single composite ESG score. A company's ESG score is mapped to a 9-point letter scale, with ratings from AAA (highest) to C (lowest).

More information on MSCI ESG Research can be found at

[http://www.msci.com/products/indices/thematic/esg/esg\\_research\\_methodology.html](http://www.msci.com/products/indices/thematic/esg/esg_research_methodology.html)

## 3. Values Based Criteria

The MSCI Global Socially Responsible Indices exclude companies that are inconsistent with the following values based criteria:

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

Please refer to [Appendix 1](#) for more details on these criteria

## 4. Constructing the MSCI Global Socially Responsible Indices

### 4.1. Underlying universe

The selection universe for the MSCI Global Socially Responsible Indices is defined by the constituents of the MSCI Global ESG Indices. The MSCI Global ESG Indices target the highest ESG rated companies, making up 50% of the free float adjusted market capitalization in each sector in each region of the MSCI World Index. Only companies with an ESG rating of “B” or above are eligible for inclusion in the MSCI Global ESG Indices. This choice of universe ensures that only the best-of-class ESG companies in each region and sector are included in the MSCI Global Socially Responsible Indices.

### 4.2. Exclusion Criteria

Companies that are inconsistent with the values based criteria described in Section 3 are excluded from the MSCI Global Socially Responsible Indices. Additionally, any company that has an ESG rating of “BB” or lower is not eligible for inclusion in the MSCI Global Socially Responsible Indices. This rating criterion ensures a high minimum level of ESG performance, consistent with the aim of including only the best-of-class companies in the index.

### 4.3. Index Construction

Currently MSCI constructs MSCI Global Socially Responsible Indices for the Standard size-segment in all Developed Markets. These indices are constructed at a regional level with the regions being defined as follows:

- USA

- Canada
- Europe and Middle East
- Pacific

Each regional Socially Responsible index targets 50% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the underlying MSCI regional ESG Index. These regional Socially Responsible indices are then aggregated together to construct the MSCI World Socially Responsible Index.

## 5. MAINTAINING THE MSCI GLOBAL SOCIALLY RESPONSIBLE INDICES

### 5.1. Annual Index Review

The composition of the MSCI Global Socially Responsible Indices is reviewed on an annual basis in May to coincide with the annual index review of the underlying MSCI Global ESG Indices. The changes are implemented at the end of May. Ratings used for the annual index review are taken as of the end of April.

At the annual index review, the composition of the MSCI Global Socially Responsible Indices is reassessed in order to target 50% free float-adjusted cumulative market capitalization of each sector of the underlying regional ESG Index. For each sector, the constituents of the underlying regional ESG Index are first ranked based on the company level ESG Score and then by decreasing free float adjusted market capitalization. Constituents for the Socially Responsible index are then selected in the following order till the 50% coverage by cumulative free float adjusted market capitalization target is reached.

- Companies in the top 35%
- 'AA' rated companies in the top 50%
- Current index constituents in the top 65%
- Remaining Companies in the eligible universe

The above rules are applied sequentially so that the MSCI Global Socially Responsible index includes companies with high ESG performance, while minimizing turnover.

### 5.2. Quarterly Index Reviews

The MSCI Global Socially Responsible Indices are also reviewed on a quarterly basis to coincide with the regular index reviews of the underlying regional ESG Indices. The changes are implemented at the end of February, August and November. Ratings used for the quarterly index reviews will be taken as of the end of the month preceding the index review, i.e., October, January and July.

At the quarterly index reviews, any existing index constituent whose rating falls to "BB" or lower is deleted from the MSCI Global Socially Responsible Indices. Additionally, any existing constituent that is no longer consistent with the values based criteria is also deleted from the MSCI Global Socially Responsible Indices.

Additions to the indices are only considered in those sectors where the resulting free float adjusted market capitalization coverage does not meet the 50% target. 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 50% is used to define under-representation, in order to minimize turnover. Companies are added only in those sectors where the current market capitalization coverage is less than 45%, until the 50% target is reached. A company must have a rating of “BBB” or higher to be considered for addition to the indices.

### 5.3. Ongoing Event-Related Maintenance

The MSCI Corporate Events Methodology is applied for the maintenance of the MSCI Global Socially Responsible Indices between index reviews. In general, there will be no additions to or deletions from the index between two index reviews, except when the new security results from an event affecting an existing index constituent. Companies deleted from the underlying index between index reviews are also deleted at the same time from the MSCI Global Socially Responsible Indices. The details relating to the handling of specific corporate event types can be found in the MSCI Corporate Events Methodology book available at:

<http://www.msci.com/products/indices/size/standard/methodology.html>

# Appendix 1: Values Based Exclusion Criteria

The MSCI Global Socially Responsible Indices exclude companies that are inconsistent with the following values based criteria:

- **Alcohol**
  - “Producer” companies that earn 5% or more of revenues from alcohol-related activities
- **Civilian Firearms**
  - All companies classified as “Producer”
  - “Retailer” companies that earn 15% or more from civilian firearms
- **Gambling**
  - “Operations” and “Support” companies that earn 5% or more of revenues from gambling-related activities
- **Military Weapons**
  - All companies classified as “Nuclear Weapons Systems”, “Nuclear Weapons Components”, “Chemical and Biological Weapons Systems”, and “Chemical” and “Biological Weapons Components”
  - All companies classified as a “Cluster Bomb Manufacturer”
  - All companies classified as a “Landmine Manufacturer”
  - All companies that earn 5% or more from Military Weapons - “Weapons - Global Total Maximum Percentage of Revenue”
- **Nuclear Power**
  - All companies classified as nuclear “Utility”
  - “Essential supplier”: companies that earn 5% or more of revenues from nuclear-related activities
  - All companies involved in Uranium Mining
  - All companies involved in designing nuclear reactors
- **Tobacco**
  - All companies classified as “Producer”
  - “Distributor”, “Retailer”, and “Supplier” companies that earn 15% or more from tobacco products
- **Adult Entertainment**
  - All companies classified as “Producer” that earn more than 5% of revenues from this activity
- **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 from the MSCI Global Socially Responsible Indices

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The company's flagship product offerings are: the MSCI indices which include over 148,000 daily indices covering more than 70 countries; Barra portfolio risk and performance analytics covering global equity and fixed income markets; RiskMetrics market and credit risk analytics; ISS governance research and outsourced proxy voting and reporting services; FEA valuation models and risk management software for the energy and commodities markets; and CFRA forensic accounting risk research, legal/regulatory risk assessment, and due-diligence. MSCI is headquartered in New York, with research and commercial offices around the world.