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Index Methodology

# MSCI KLD 400 Social Index Methodology

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# 1. Introduction

The MSCI KLD 400 Social Index is a free float-adjusted market capitalization index designed to provide exposure to U.S. companies that have positive Environmental, Social and Governance (ESG) characteristics. The MSCI KLD 400 Social Index consists of 400 companies selected from the MSCI USA Investable Market Index (IMI).

This methodology book is based on the methodology used by KLD Research & Analytics, Inc. for the construction and maintenance of the FTSE KLD 400 Social Index, which has been updated to incorporate the methodology changes resulting from the transition to the MSCI ESG Indices family that occurred on September 1<sup>st</sup>, 2010. MSCI intends to review and update the methodology in the upcoming months.

# 2. ESG Research Framework

MSCI's ESG research framework generates an analysis and rating of each company's management of its environmental, social and governance performance. The rating criteria address a company's ESG performance in the context of five categories, covering key corporate stakeholders.

- **Environment** – rate a company's management of its environmental challenges, including its effort to reduce or offset the impacts of its products and operations.
- **Community and Society** – measure how well a company manages its impact on the communities where it operates, including its treatment of local population, its handling of human rights issues and its commitment to philanthropic activities.
- **Employees and Supply Chain** – assess a company's record of managing employees, contractors and suppliers. Issues of particular interest include labor-management relations, anti-discrimination policies and practices, employee safety, and the labor rights of workers throughout the company's supply chain.
- **Customers** – measure the quality and safety record of a company's products, its marketing practices, and any involvement in regulatory or anti-competitive controversies.
- **Governance and Ethics** – address a company's investor relations and management practices, including company sustainability reporting, board accountability and business ethics policies and practices.

MSCI applies its proprietary ESG rating framework to each company by selecting the ESG rating criteria most relevant to each firm. To evaluate a company, analysts review more than 500 data points and score more than 100 indicators. MSCI expresses a company's ESG performance as a numerical score and on a letter-based rating scale. The ratings fall on a nine-point scale from AAA to C. Scores and ratings are not normalized across individual industries or the overall company universe. This means that one industry may have no companies that receive any "A" ratings, while another industry may have no companies with "C" ratings.

For more details on ESG scores and ratings, please refer to [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. Constructing the MSCI KLD 400 Social Index

### 3.1 Underlying Universe

The selection universe for the MSCI KLD 400 Social Index is the MSCI USA IMI Index.

### 3.2 Eligibility Criteria

The MSCI KLD 400 Social Index excludes companies with involvement in alcohol, gambling, tobacco, firearms, weapons and nuclear power. Please refer to Appendix 1 for details of these criteria.

### 3.3 Index Construction

The MSCI KLD 400 Social Index is composed of 400 Companies with high ESG performance along with the considerations of sector and size-segment representation, as described below.

#### 3.3.1 Size-Segment Representation

The composition of the MSCI KLD 400 Social Index is maintained at approximately:

- 90% large cap companies;
- 9% mid cap companies; and
- 1% small cap companies.

#### 3.3.2 Sector Representation

The MSCI KLD 400 Social Index seeks to maintain approximately similar sector weights as the MSCI USA IMI

## 4. Maintaining the MSCI KLD 400 Social Index

### 4.1 Quarterly Index Reviews

The composition of the MSCI KLD 400 Social Index is reviewed on a quarterly basis to coincide with the regular Index Reviews (Semi-Annual Index Reviews in May and November and Quarterly Index Reviews in February and August) of the MSCI Global Investable Market Indices. The changes are implemented at the end of February, May, August and November.

Companies can only be added to the MSCI KLD 400 Social Index at regular Index Reviews. Current index constituents are reviewed to determine if any of them should be removed due to ESG performance. In addition, if a constituent is removed from the MSCI USA IMI as a result of the Index Review, it will be simultaneously removed from the MSCI KLD 400 Social Index. The deleted companies are replaced with eligible companies taking into account size-segment and sector representation. The MSCI KLD 400 Social Index will be restored to 400 companies at each Index Review.

## 4.2 Ongoing Event-Related Maintenance

The MSCI Corporate Events Methodology is applied for the maintenance of the MSCI KLD 400 Social Index between Index Reviews. New additions to the MSCI USA IMI due to corporate events will not be added simultaneously to the MSCI KLD 400 Social Index, but will be considered for inclusion at the following Index Review. However, companies deleted from the MSCI USA IMI between Index Reviews are also deleted at the same time from the MSCI KLD 400 Social Index.

When the number of securities in the MSCI KLD 400 Social Index falls below 400 due to corporate events, no additions will be made to restore the number of constituents to 400 until the next Quarterly Index Review.

The technical 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

The MSCI KLD 400 Social Index excludes companies with involvement in alcohol, gambling, tobacco, firearms, weapons and nuclear power as defined below:

- Alcohol
  - Producers: any involvement
- Gambling
  - Owner/operators of gambling facilities
  - Suppliers of key products: >50% or major player
- Tobacco
  - Producers: any involvement
- Civilian Firearms
  - Producers: any involvement
- Military Weapons
  - Controversial Weapons (NBC): any involvement
  - Conventional Weapons and key component parts: 2% or \$50 million
- Nuclear Power
  - Owner/operator: any level
  - Design nuclear reactors
  - Uranium Mining

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