MSCI USA ESG SELECT INDEX METHODOLOGY

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1 INTRODUCTION

The MSCI USA ESG Select Index is designed to maximize exposure to positive environmental, social and governance (ESG) factors while exhibiting risk and return characteristics similar to those of the MSCI USA Index. The Index is sector-diversified and targets high ESG ratings in each sector. Relative to the MSCI USA Index, the MSCI USA ESG Select Index tends to over-weight companies with higher ESG ratings and under-weight companies with lower ratings. Tobacco companies are not eligible for inclusion into the Index.

2 ESG RESEARCH FRAMEWORK

MSCI ESG Research provides in-depth research, ratings and analysis of the environmental, social and governance-related business practices of thousands of companies worldwide. It consists of an integrated suite of tools and products to efficiently manage research, analysis and compliance tasks across the spectrum of ESG factors.

2.1 MSCI ESG INTANGIBLE VALUE ASSESSMENT

MSCI ESG Intangible Value Assessment (IVA) provides research, ratings and analysis of corporate management of environmental and social risk factors. Through an in-depth comparison against sector peers, MSCI ESG IVA can reveal ESG-driven investment risks or opportunities that may not be captured by conventional analyses.

MSCI ESG IVA identifies key ESG issues that hold the greatest potential risk or opportunity for each industry sector. The product also provides analysis for any impact that these issues and risks may have on corporate financial performance

MSCI ESG IVA scores and ranks company management of key issues relative to sector peers using a best-in-class ratings system, on a seven point scale from ’AAA’ to ‘CCC’. The model also provides granular scoring on environmental, social and governance metrics.

For more details on MSCI ESG IVA, please refer to
http://www.msci.com/resources/factsheets/MSCI_ESG_IVA.pdf

2.2 MSCI ESG IMPACT MONITOR

MSCI ESG Impact Monitor is designed to provide timely, consistent and extensive assessments of ESG controversies involving publicly traded companies. The evaluation framework used in MSCI ESG Impact Monitor is consistent with international norms represented in numerous, widely accepted, global conventions, including the UN Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, and the UN Global Compact. Investors are able to assess company strategies, policies, systems, and disclosure with respect to these norms and principles.

For more details on MSCI ESG Impact Monitor, please refer to
http://www.msci.com/resources/factsheets/MSCI_ESG_Impact_Monitor.pdf

3 CONSTRUCTING THE MSCI USA ESG SELECT INDEX

Constructing the MSCI USA ESG Select Index involves the following steps:

- Defining the underlying MSCI Parent Index ('Parent Index');
- Defining the exclusion criteria;
- Defining the optimization constraints; and
- Determining the optimized portfolio

3.1 DEFINING THE PARENT INDEX

The Parent Index for the MSCI USA ESG Select Index is the MSCI USA Index, excluding any stocks with Tobacco involvement. Please refer to Appendix 1 for more details on this criterion.

3.2 DEFINING THE EXCLUSION CRITERIA

Securities having involvement in business controversies are not eligible for addition to the MSCI USA ESG Select Index. This is implemented by excluding all existing index constituents with an Impact Monitor controversy assessment of very severe (Impact Monitor score of 0 or 1) and all non-index constituents with an Impact Monitor controversy assessment of severe (Impact Monitor score of 2).

3.3 DEFINING THE OPTIMIZATION CONSTRAINTS

Constituents are selected to maximize exposure to company based ESG IVA scores, subject to maintaining risk and return characteristics similar to the MSCI USA Index. ESG scores are normalized and factored into the optimization process. Optimization is a quantitative process that considers the market capitalization weights from the MSCI USA Index, ESG scores and additional optimization constraints to select and weight the constituents in the Index.

Normalization of the ESG scores allows the optimization to assess each score in the context of the overall distribution of the ESG scores.

At each Quarterly Index Review, the following optimization constraints are used to ensure replicability and investability:

- The predicted tracking error is restricted to 1.8%
- The maximum weight of an index constituent will be 5%;

- The minimum weight of an index constituent will be 0.1%;
- The number of index constituents is constrained to a maximum of 350;
- The sector weights of the MSCI USA ESG Select Index will not deviate by more than +/- 3% from the sector weights of the MSCI USA Index;
- The one way turnover of the MSCI USA ESG Select Index is constrained to a maximum of 10% at Semi-Annual Index Reviews and 5% at Quarterly Index Reviews;
- One way transaction cost is set to 0.5% which aims to achieve a balance between turnover and ESG Scores; and
- An AS/CF (Asset Selection/Common Factor) Risk Aversion Ratio of 10 is applied.

Please refer to the Appendix 2 for the description of the handling of infeasible optimizations.

3.4 DETERMINING THE OPTIMIZED PORTFOLIO

The MSCI USA ESG Select Index is constructed using the most recent release of the Barra Open Optimizer in combination with the relevant Barra Equity Model. The optimization uses the MSCI USA Index ex stocks with Tobacco involvement as the universe of eligible securities and the specified optimization objective and constraints to determine the constituents of the MSCI USA ESG Select Index.

4 MAINTAINING THE MSCI USA ESG SELECT INDEX

4.1 QUARTERLY INDEX REVIEWS

The MSCI USA ESG Select Index is rebalanced 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 Indexes. The changes are implemented at the end of February, May, August and November. The pro forma indexes are in general announced nine business days before the effective date.

ESG scores used for the Quarterly Index Reviews will be taken as of the end of the month preceding the Index Review, i.e., January, April, July and October.

At each Index Review, the optimization process outlined in Section 3 is implemented. Companies can only be added to the MSCI USA ESG Select Index at regular Index Reviews.

4.2 ONGOING EVENT-RELATED MAINTENANCE

In general, the MSCI USA ESG Select Index follows the event maintenance of the MSCI USA Index.

New additions to the MSCI USA Index due to corporate events will not be added simultaneously to the MSCI USA ESG Select Index, but will be considered for inclusion at the following Index Review. Companies deleted from the MSCI USA Index between Index Reviews due to corporate events maintenance are also deleted at the same time from the MSCI USA ESG Select Index.

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/indexes/size/standard/methodology.html

APPENDIX 1: TOBACCO EXCLUSION CRITERIA

Companies which meet the following Tobacco involvement criteria are excluded from the MSCI USA ESG Select Index

- All companies classified as “Producer” or “Licensor”
- All companies classified as “Distributor”, “Retailer”, or “Supplier” that earn 15% or more of revenues from tobacco products
- All companies classified as “Ownership by a Tobacco Company” or “Ownership of a Tobacco Company”

APPENDIX 2: HANDLING INFEASIBLE OPTIMIZATIONS

During the Quarterly Index Review, in the event that there is no optimal solution that satisfies all the optimization constraints defined in Section 3.3, the tracking error will be relaxed in steps of 0.2% until an optimal solution is found.

APPENDIX 3: TRANSITION TO THE ENHANCED MSCI USA ESG SELECT INDEX METHODOLOGY

The MSCI USA ESG Select Index transitioned to the methodology described in the above document starting from the May 2012 Index Review. As part of the enhancements to the MSCI USA ESG Select Index Methodology, the annual turnover budget is reduced from 50% to 30% (10% at Semi-Annual Index Reviews and 5% at Quarterly Index Reviews). The lower annual turnover budget of 30% will be applied starting from the May 2012 Index Review.

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Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

MSCI serves 98 of the top 100 largest money managers, according to the most recent P&I ranking.

For more information, visit us at www.msci.com.

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