# MSCI World Small Cap Custom ESG Low Carbon Index

**November 2023**

# Contents

# 1 Introduction

The MSCI World Small Cap Custom ESG Low Carbon Index (the “Index”) aims to represent the performance of a strategy that is designed to increase the Index’s exposure to positive environmental, social and governance (ESG) factors as well as exhibit lower carbon exposure than the MSCI World Small Cap Index (the “Parent Index”) by applying exclusions based on various ESG criteria[1].

[1] The Index is governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document. The Methodology Set for the Index can be accessed from MSCI’s webpage https://www.msci.com/index-methodology in the section ‘Search Methodology by Index Name or Index Code’.

The Methodology Set includes a document ‘ESG Factors in Methodology’ that contains the list of environmental, social, and governance factors considered, and how they are applied in the methodology (e.g., selection, weighting or exclusion).

# 2 Constructing the Index

The Index is constructed by applying the following steps to the Parent Index[2].

- ESG Screening
- Carbon Screening
- Governance Issue Screening
- Weighting

## 2.1 ESG Screened Universe

The ESG Screened Universe includes all constituents of the Parent Index that meet the below mentioned screening criteria:

### 2.1.1 ESG Controversies Eligibility

The Index uses MSCI ESG Controversies Scores to identify companies that are involved in very serious environmental, social or governance controversies related to their operations and/or products and services. Companies are required to have an MSCI ESG Controversies Score of 1 or above to be eligible for inclusion in the Index.

In addition, companies are also excluded based on the following criteria:

1. Environment Controversies (MSCI Environment Controversy Score of 0)
2. Governance Controversies (MSCI Governance Controversy Score of 0)
3. Human Rights Controversies (MSCI Human Rights Controversy Score of 0)
4. Labor Rights Controversies (MSCI Labor Rights Controversy Score of 0)

A Score of zero is a 'red flag' controversy, defined as an ongoing, Very Severe ESG controversy implicating a company directly through its actions, products, or operations.

Companies not assessed by MSCI ESG Research on MSCI ESG Controversies are not eligible for inclusion in the Index.

[2] Please refer to Section 4 for further information regarding the ESG and climate data used in the Index that MSCI Limited sources from MSCI ESG Research LLC, a separate subsidiary of MSCI Inc. MSCI ESG Research is solely responsible for the creation, determination, and management of such data. MSCI Limited is the benchmark administrator for the MSCI indexes.

### 2.1.2 Controversial Business Involvement Criteria

The Index uses MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics to identify companies that are involved in the following business activities. Companies that meet the business involvement criteria are excluded from the Index. Please refer to Appendix 1 for more details on the implementation of these criteria.

- Civilian Firearms
- Controversial Weapons
- Conventional Weapons
- Nuclear Weapons
- Tobacco
- Thermal Coal
- For Profit Prisons

## 2.2 Carbon Screened Universe

Securities from the ESG Screened Universe that are not excluded as per the below carbon emission exclusion criteria are included in the Carbon Screened Universe.

### 2.2.1 Carbon Emission Exclusions

1. Exclude securities with any ownership of fossil fuel reserves.
2. Absolute Emission Exclusions are applied using the following steps:
    a. Compute cumulative absolute emission (Scope 1 + Scope 2 emission) of the securities in the ESG Screened Universe
    b. Sort the securities in descending order of absolute emission
    c. Exclude securities with the highest absolute emission until the cumulative absolute emission of the remaining securities is less than 50% of the total cumulative absolute emission computed previously
3. Emission Intensity Exclusions are applied using the following steps:
    a. Compute Total Carbon Emission Intensity of the securities in the eligible universe by dividing Total Scope 1+2 Emissions by Total Sales
    b. Compute the exclusion threshold as 50% of the Total Carbon Emission Intensity computed earlier

c. Calculate Carbon Emission Intensity of each security as the ratio of absolute emission to total sales of the security and sort the securities in the descending order of Carbon Emission Intensity

d. Exclude the securities with the highest Carbon Emission Intensity until the Total Carbon Emission Intensity of the remaining securities falls below the threshold set

e. Exception – Add back securities with the GICS® sub-industry Renewable Electricity (GICS code: 55105020)

## 2.3 Governance Issue Screened Universe

Companies that are identified under the following governance key issues are excluded from the Carbon Screened Universe.

- Qualified Auditor Opinion
- Controlling Shareholder Concerns

Please refer to Appendix 2 for the details on the governance screens.

## 2.4 Weighting Scheme

The remaining securities are reweighted to add up to a weight of 100% in proportion of their free float market capitalization weight in the Parent Index.

# 3 Maintaining the Index

## 3.1 Semi-Annual Index Reviews

The Index is reviewed on a semi-annual basis, coinciding with the May and November Index Reviews of the Parent Index.

In general, MSCI uses MSCI ESG Research data[3] (MSCI ESG Controversies, MSCI Climate Change Metrics and MSCI ESG Business Involvement Screening Research) 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 ESG Research 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.

The pro forma Index is typically announced nine business days before the effective date.

At each Index Review, the Index is rebalanced as described in Section 2.

## 3.2 Ongoing Event-Related Changes

The general treatment of corporate events in the Index aims to minimize turnover outside of Index Reviews. The methodology aims to appropriately represent an investor's participation in an event based on relevant deal terms and pre-event weighting of the Index constituents that are involved.

Additionally, if the frequency of Index Reviews in the Parent Index is greater than the frequency of Index Reviews in the Index, the changes made to the Parent Index during intermediate Index Reviews will be neutralized in the Index.

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.

| EVENT TYPE | EVENT DETAILS |
|---|---|
| **New additions to the Parent Index** | A new security added to the Parent Index (such as IPO and other early inclusions), will not be added to the index. |

[3] See section 4 for details of data sourced from MSCI ESG Research used in the Index.

| | |
|---|---|
| **Spin-Offs** | All securities created as a result of the spin-off of an existing index constituent will be added to the index at the time of event implementation. Reevaluation for continued inclusion in the Index will occur at the subsequent Index Review. |
| **Merger/Acquisition** | For Mergers and Acquisitions, the acquirer's post even weight will account for the proportionate amount of shares involved in deal consideration, while cash proceeds will be invested across the Index.<br><br>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 be removed as 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 ESG Research

The Index is a product of MSCI Inc. that utilizes information such as company ratings and research produced and provided by MSCI ESG Research LLC (MSCI ESG Research), a subsidiary of MSCI Inc. In particular, the Index uses the following MSCI ESG Research products: MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research, MSCI Climate Change Metrics. MSCI Indexes are administered by MSCI Limited.

## 4.1 MSCI ESG Controversies

MSCI ESG 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 ESG 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 ESG Controversies Score falls on a 0-10 scale, with "0" being the most severe controversy.

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

## 4.2 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.

For more details on MSCI ESG Business Involvement Screening Research, please refer to https://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf.

## 4.3 MSCI Climate Change Metrics

MSCI Climate Change Metrics provide climate data & tools to support institutional investors seeking to integrate climate risk & opportunities into their investment strategy and processes. This includes investors seeking to achieve a range of objectives, including measuring and reporting on climate risk exposure, implementing low carbon and fossil fuel-free strategies, alignment with temperature pathways and factoring climate change research into their risk management processes, in particular through climate scenario analysis for both transition and physical risks.

The dataset spans across the four dimensions of a climate strategy: transition risks, green opportunities, physical risks and 1.5° alignment.

For more details on MSCI Climate Change Metrics, please refer to https://www.msci.com/climate-solutions.

## Appendix 1: Business Involvement Screening Criteria

- **Controversial Weapons**
  - All companies with any tie to Controversial Weapons (cluster munitions, landmines, depleted uranium weapons, biological/chemical weapons, blinding lasers, nondetectable fragments and incendiary weapons), as defined by the methodology of the MSCI Global Ex-Controversial Weapons Indexes available at https://www.msci.com/index/methodology/latest/XCW.
- **Conventional Weapons**
  - All companies deriving 5% or more aggregate revenue from weapons systems, components, and support systems and services.
- **Civilian Firearms**
  - All companies deriving 5% or more revenue from the manufacture and retail of civilian firearms and ammunition.
- **Nuclear Weapons**
  - All companies that manufacture key nuclear weapons component.
- **Tobacco**
  - All companies that manufacture tobacco products which include cigars, blunts, cigarettes, e-cigarettes, inhalers, kreteks, smokeless tobacco, snuff, snus, dissolvable and chewing tobacco. This also includes companies that grow or process raw tobacco leaves.
  - All companies deriving 5% or more revenue from the distribution of tobacco products.
  - All companies deriving 5% or more revenue from the retail sales of tobacco products.
  - All companies deriving 5% or more revenue from supplying products essential to the tobacco industry.
- **Thermal Coal Mining and Extraction**
  - Companies that derive 5% or more of their total annual revenues from the mining of thermal coal (including lignite, bituminous, anthracite and steam coal) and its sale to external parties. It does not screen out: revenues from metallurgical coal; coal mined for internal power generation (e.g. in the case of vertically integrated power producers); intra-company sales of mined thermal coal; and revenue from coal trading.
- **Thermal Coal Power Generation**
  - Companies that derive 30% or more of their total annual revenues (either reported or estimated) from the thermal coal-based power generation.

 

- Companies that derive 5% or more of their total annual revenues (either reported or estimated) from thermal coal-based power generation and:
  - have a score of 4 or less in low carbon transition management or
  - a score of 3 or 4 in low carbon transition management score quartile.

- **Unconventional Oil and Gas and Arctic Oil •**
  - Companies that derive 5% or more of their total annual revenues (either reported or estimated) from unconventional oil and gas; or
    - have a score of 4 or less in low carbon transition management; or
    - a score of 3 or 4 in low carbon transition management score quartile.
  - Companies that derive 1% or more of their total annual revenues (either reported or estimated) from arctic oil and;
    - have a score of 4 or less in low carbon transition management; or
    - a score of 3 or 4 in low carbon transition management score quartile.

- **For Profit Prisons**
  - Companies that derive 5% or more of their total annual revenues (either reported or estimated) from activities related to For Profit Prisons.

# Appendix 2: Governance Key Issues

The Index uses the screening criteria from the MSCI ESG Ratings Methodology: Governance Key Issues by MSCI ESG Research[4][5]:

- **Qualified Auditor Opinion**
  - All companies where the auditor expressed a qualified opinion or questioned the company's ability to remain a going concern as per the most recently reported period.
- **Controlling Shareholder Concerns**
  - All companies where the ownership structure or governance arrangements indicate special concerns for minority public shareholders.
    - Companies are identified as having a Controlling Shareholder if a shareholder or shareholder bloc control more than 30% of the voting rights, or is able to elect more than 50% of the company's board.

  The companies can be flagged by a number of factors or combination of factors, including where:

  - Any of the following Key Metrics (KM) are also flagged:
    - No Independent Directors
    - Leadership Concerns
    - Undersized Board
    - Cross Shareholdings
    - Poison Pill
  - or any of the following apply:
    - The issuer has issued Golden Shares
    - The issuer is controlled via a stock pyramid

[4] Please refer to Section 4 for further information regarding the ESG and climate data used in the Index that MSCI Limited sources from MSCI ESG Research LLC, a separate subsidiary of MSCI Inc. MSCI ESG Research is solely responsible for the creation, determination, and management of such data. MSCI Limited is the benchmark administrator for the MSCI indexes.

[5] The descriptions of the screening criteria in Appendix 2 is taken from the MSCI ESG Ratings: Ownership and Control Key Issue Methodology. The methodology document can be found on https://www.msci.com/esg-and-climate-methodologies.

- The issuer incorporated as a Partnership Limited by Shares
- The largest shareholder holds more than 75% of the total voting rights.

# Appendix 3: Changes to this Document

**The following sections have been modified as of May 2019:**

- Section 2.3: ESG Research Framework

Update to reflect the updated name of MSCI ESG Carbonmetrics Data as MSCI Climate Change Metrics

- Section 3.1.2: Business Involvement Screen

  Update to include screen for Thermal Coal.

- Section 4.1: Semi Annual Index Reviews

  Update to reflect the updated name of MSCI ESG Carbonmetrics Data as MSCI Climate Change Metrics

- Appendix 1: Update to include the definitions of the screens used for Thermal Coal.

**The following sections have been modified as of August 2019:**

- Section 2: ESG Research Framework

  Update to reflect the latest MSCI ESG Research LLC website links

- Section 3.1.1: Minimum MSCI ESG Controversies Standards

  Update to include a more comprehensive screening criteria with the addition of the MSCI ESG Controversy Score screen

**The following sections have been modified as of December 2021:**

- Section 3.1.1: Business Involvement Screen

  Update to include screen for For Profit Prisons

- Appendix 1: Business Involvement Screening Criteria

  Update to include the definitions of the screen used for For Profit Prisons.

**The following sections have been modified as of August 2023:**

- The methodology book was updated to reflect the transition of the MSCI Global Investable Market Indexes (GIMI) to Quarterly Comprehensive Index Reviews. All references to “Semi-Annual Index Reviews” and “Quarterly Index Reviews” of the MSCI GIMI were replaced with “Index Reviews”.
- Section 2.1.1: ESG Controversies Eligibility

  Clarified the exclusion criteria for companies involved in ESG Controversies.

- Section 4: MSCI ESG Research

  Moved section after the Section 3.

Updated the descriptions of MSCI ESG Research Products.

– Appendix 1: Business Involvement Screening Criteria

  Clarified the exclusion criteria for the 'Tobacco' and 'Thermal Coal' screens.

**The following sections have been modified as of October 2023:**

– Appendix 2: Governance Key Issues

  Clarified the exclusion criteria for the "Controlling Shareholder Concerns" screen.

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| Boston | + 1 617 532 0920 |
| Chicago | + 1 312 675 0545 |
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