

MSCI World 5-Factor Select Advanced Target Index Methodology

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1. Introduction

The MSCI World 5-Factor Select Advanced Target Index¹ (the “Index”) represents the performance of a factor investing strategy that integrates environmental, social and governance (ESG) factors and two dimensions of carbon exposure (carbon emissions and fossil fuel reserves).

The Index seeks to maximize exposure to the target style factors relative to the MSCI World Index (the “Parent Index”) by applying an optimization process. The Index also aims to achieve an ESG score improvement of 20% and a reduction in carbon exposure by at least 50% relative to the Parent Index.

¹ The Indexes are governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document. Please refer to Appendix VI for more details.

2. Constructing the Index

Constructing the Index involves the following steps:

- Defining the Eligible Universe
- Defining the Carbon Exposure of each security in the Eligible Universe
- Defining the Optimization setup
- Determining the Optimized Index
- Treatment of Unrated Companies

The Index uses company ratings and research provided by MSCI ESG Research² to determine eligibility for index construction.

2.1 Eligible Universe

The Eligible Universe is constructed from the constituents of the Parent Index by excluding securities based on the criteria below:

- **Controversial Weapons:** All companies involved in Controversial Weapons as defined by the methodology of the MSCI Ex-Controversial Weapons Indexes.
- **ESG Controversies:** All companies assessed as having involvement in ESG controversies that are classified as Red Flags (MSCI ESG Controversy Score of 0). A Red Flag indicates an ongoing, Very Severe ESG controversy implicating a company directly through its actions, products, or operations.
- **Thermal Coal Mining:** All companies deriving 1% or more revenue (either reported or estimated) from the mining of thermal coal (including lignite, bituminous, anthracite and steam coal) and its sale to external parties. It excludes revenue from metallurgical coal, coal mined for internal power generation (e.g., in the case of vertically integrated power producers), intracompany sales of mined thermal coal, and revenue from coal trading (either reported or estimated).
- **Oil Sands:** All companies deriving 5% or more revenue from oil sands extraction, which own sands reserves and disclose evidence of deriving revenue from oil sands extraction. Companies that derive revenue from non-extraction activities (e.g., exploration, surveying, processing, refining) or intra-company sales are not excluded. Additionally, companies with no associated revenue are also not excluded.

² See section 4 for further information regarding ESG and climate data used in the Indexes that MSCI Limited and MSCI Deutschland GmbH source 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 as a provider to MSCI Limited and MSCI Deutschland GmbH. MSCI Limited and MSCI Deutschland GmbH are the benchmark administrators for the MSCI indexes.

2.2 Defining the Carbon Exposure of each security in the Parent Index

The carbon exposure of a security is measured in terms of its greenhouse gas emissions and its potential carbon emissions from fossil fuel reserves. The Index uses MSCI Climate Change Metrics data from MSCI ESG Research to determine eligibility for index inclusion.

2.2.1 Greenhouse Gas Emissions

MSCI ESG Research collects company-specific direct (Scope 1) and indirect (Scope 2) greenhouse gas emissions data from company public documents and/or the Carbon Disclosure Project. If a company does not report GHG emissions, then MSCI ESG Research estimates Scope 1 and Scope 2 GHG emissions.³

MSCI ESG Research estimates company-specific indirect (Scope 3) GHG emissions from the Scope 3 Carbon Emissions Estimation Model.

The data is updated on an annual basis. Carbon emissions of a company are normalized for size by dividing annual carbon emissions by Enterprise Value including Cash (EVIC).

For newly added companies to the Index which do not report emission data and where MSCI ESG Research has not estimated the greenhouse gas emissions yet, MSCI uses the average emissions per dollar of issuer market capitalization for the companies in the same industry group, multiplied by the market capitalization of the company as the estimated emissions for the company.

2.2.2 Defining Potential Emissions from Fossil Fuels

MSCI ESG Research collects fossil fuel reserves data where relevant for companies which have reserves, typically in the Oil & Gas, Coal Mining and Electric Utilities industries. Fossil fuel reserves can be used for several applications including energy or industrial purposes (e.g., coking coal used for steel production). For the construction of the MSCI Global Low Carbon Target Core Indexes, only fossil fuel reserves used for energy purposes are taken into account. The data is updated on an annual basis based on information disclosed by companies. Sources include company publications, other public records and third-party data providers. For newly added companies to the index where data is not available yet, MSCI uses zero fossil fuel reserves. MSCI normalizes for the company's size by dividing the potential carbon emissions of the company by its EVIC.

To convert reserves data to potential carbon emissions, MSCI ESG Research applies a formula from the Potsdam Institute for Climate Impact Research.⁴

2.3 Defining the Optimization Setup

The Index is constructed using an optimization process. The optimization objective is to maximize the Alpha score (representative of the exposures to the set of target factors) subject to other constraints such as an improvement in the index-level ESG score and reduction in carbon exposure

³ For more information on MSCI Climate Change Metrics, please refer to <https://www.msci.com/climate-change-solutions>

⁴ Malte Meinshausen, Nicolai Meinshausen, William Hare, Sarah C. B. Raper, Katja Frieler, Reto Knutti, David J. Frame & Myles R. Allen. *Greenhouse-gas emission Target for limiting global warming to 2 °C*. *Nature* 458, 1158-1162 (30 April 2009) | doi:10.1038/nature08017; Received 25 September 2008; Accepted 25 March 2009. Supplementary Information, p. 7.

relative to the Parent Index for a given tracking error budget. The ex-ante tracking error target for the Index is 3%. The Alpha score is defined below.

ESG scores are normalized and used in the optimization process. The normalization of the ESG scores is designed to allow the optimization process to assess each score in the context of the overall distribution of ESG scores.

The optimization is performed using a base currency. The default currency is the US Dollar. Please refer to Appendix I for the Optimization constraints.

Calculation of the Alpha score

The Alpha score of the Index is defined for each security i as follows:

$$\alpha_i = (0.2) * Value_i + (0.2) * Quality_i + (0.2) * Size_i + (0.2) * Momentum_i + (0.2) * Volatility_i$$

Please refer to Appendix IV for a description of the target factors.

2.4 Optimization Constraints

The Index is constructed using the Barra Open Optimizer in combination with the relevant Barra Equity Model⁵. The optimization uses the universe of eligible securities and the specified optimization objective and constraints to determine the Index. The details on the steps taken when an infeasible optimization takes place are provided in Appendix II.

2.5 Treatment of Unrated Companies

Companies not assessed by MSCI ESG Research on data for any of the following MSCI ESG Research products are not eligible for inclusion in the Indexes.

- MSCI ESG Controversies
- MSCI Climate Change Metrics
- MSCI Business Involvement Screening Research (BISR)

⁵ Please refer to Appendix II for the detailed information on model usage

3. Maintaining the Index

3.1 Index Reviews

The Index is rebalanced on a quarterly basis, usually as of the close of the last business day of May, August, November and February, coinciding with the Quarterly Index Reviews of the MSCI Global Investable Market Indexes.

The Barra Equity Model data as of the end of January, April, July and October are used respectively. This approach aims to capture timely updates to the risk characteristics of the companies and coincide with the rebalancing frequency of the relevant Parent Index.

Similarly, the ESG data used for the Index Reviews will be taken as of the end of the month preceding the Index Review i.e., January, April, July and October. For some securities, ESG data may not be published by MSCI ESG Research by the end of the month preceding the Index Review, so MSCI can generally use ESG data published after the end of month, when available, for the rebalancing of the Index. This approach aims to capture timely updates to ESG data of the constituents and coincides with the rebalancing of the relevant MSCI Parent Indexes.

The pro forma of the Index is in general announced nine business days before the effective date.

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. Further, changes in index market capitalization that occur as a result of corporate event implementation will be offset by a corresponding change in the Variable Weighting Factor (VWF) of the constituent.

Additionally, if the frequency of Index Reviews in the Parent Index is greater than the frequency of Index Reviews of the MSCI World 5-Factor Select Advanced Target Index, the changes made to the Parent Index during intermediate Index Reviews will be neutralized in the MSCI World 5-Factor Select Advanced Target Index.

The following section briefly describes the treatment of common corporate events within the MSCI World 5-Factor Select Advanced Target Index.

No new securities will be added (except where noted below) to the Index between Index Reviews. 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.

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 event weight will account for the proportionate amount of shares involved in deal consideration, while cash proceeds will be invested across the Index.

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 continue to be 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 under the sections detailing the treatment of events in Capped Weighted and Non-Market Capitalization Weighted indexes.

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 / Indexes use the following MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research, MSCI Climate Change Metrics. MSCI Indexes are administered by MSCI Limited and MSCI Deutschland GmbH.

4.1 MSCI Climate Change Metrics

MSCI Climate Change Metrics provides 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.

4.1.1 Fossil Fuels and Power Generation Metrics

MSCI ESG Research identifies companies involved in fossil fuel-related assets and activities including fossil fuel reserves, resource extraction, power generation and generation capacity, revenue from such assets and activities and capital investments in such assets and activities. The metrics are based on disclosed activities, disclosed revenue and estimates of revenue that are extrapolated from company disclosures and eligible third-party sources (such as NGOs).

4.1.2 Greenhouse Gas (GHG) Emissions

MSCI ESG Research collects reported emissions and uses proprietary estimation methodologies that follows the GHG Protocol in including carbon dioxide (CO₂) and the five other principal GHGs: hydrofluorocarbons (HFCs), methane (CH₄), nitrous oxide (N₂O), perfluorocarbons (PFCs), and sulfur hexafluoride (SF₆). Emissions of these other gases are accounted for in terms of the quantity of CO₂ that has an equivalent global warming potential.

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

4.2 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/legal/disclosures/esg-disclosures>.

4.3 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.

The MSCI Business Involvement Screening Research methodology can be found at:
<https://www.msci.com/legal/disclosures/esg-disclosures>.

Appendix I: Optimization Constraints

At each Quarterly Index Review, the Indexes are constructed using an optimization process that aims to achieve replicability and investability as well as maximize the Alpha score relative to the Parent Index subject to the constraints in the below table:

No.	Parameter	Values
1	Ex-Ante Tracking Error	4.0%
2	Weighted Average industry adjusted ESG Score improvement relative to the Parent Index	20%
3	Minimum Reduction in the Carbon Emissions Intensity and Potential Emissions per dollar of Market Capitalization, relative to the Parent Index	50%
4	Minimum weight of Index constituents	Max (weight of constituent in the Parent Index – 2%, 0%)
5	Maximum weight of Index constituents	Min (weight of constituent in the Parent Index + 2%, 10 times the weight in the Parent Index)
8	Active Exposure to the target Barra Style factors (Book-to-Price, Earnings Yield, Earnings Quality, Investment Quality, Profitability & Momentum) relative to the Parent Index	Between 0.15 and 0.75
9	Active Exposure to the target Barra Style factors (Size, Earnings Variability, Leverage, Earnings Variability, Beta and Residual Volatility) relative to the Parent Index	Between -0.75 and -0.15
10	Active Exposure to the non-target Barra Style factors (Growth, Liquidity)	+/- 0.25 standard deviation relative to the Parent Index
11	Active Sector Weights	+/-5%
12	Active Country Weights ⁶	+/-5%
13	One Way Turnover during each Index Review	5%
14	Specific Risk Aversion	0.015
15	Common Factor Risk Aversion	0.0015

⁶ For countries with weight greater than 2.5% in the Parent Index, the weight in the Index is restricted to +/- 5% relative to the Parent Index. For countries with weight less than 2.5% in the Parent Index, the weight in the Index will be capped at 3 times the weight of the specific country in the Parent Index.

Appendix II: Handling Infeasible Optimizations

During the Index Review, in the event that there is no optimal solution that satisfies all the optimization constraints defined in Section 3.3, the following constraints are relaxed, until an optimal solution is found:

- Relax the turnover constraint in steps of 1% up to a maximum of 10%
- Relax the asset upper bound multiple (default is 10) constraint in steps of 2, up to a maximum of 20
- The turnover and the asset upper bound multiple constraints are alternately relaxed until a feasible solution is achieved. For example, constraints relaxation is executed in the sequence as illustrated below:

Order of Relaxation	Turnover Limit	Asset Upper Bound Multiple Constraint
1	6.0%	10 times the weight of the security in the Parent Index
2	6.0%	12 times the weight of the security in the Parent Index
3	7.0%	12 times the weight of the security in the Parent Index
4	7.0%	14 times the weight of the security in the Parent Index

In the event that no optimal solution is found after the above constraints have been relaxed over all the iterations, the Index will not be rebalanced for that Index Review.

Appendix III: New Release of Barra® Equity Model or Barra® Optimizer

The methodology presently uses MSCI Barra Global Equity Model for Long-Term Investors (“GEMTL”) for the optimization. A new release of the relevant Barra Equity Model or Barra Optimizer may replace the former version within a suitable timeframe.

Appendix IV: Target Factor Definition Summary

The style factor groups targeted in the Index are the five style factor groups and their combinations: Value, Quality, Size, Momentum and Low Volatility. These factor groups are described using individual factor scores from the relevant Barra Equity Model. The choice of factors used within each factor group is governed by the current model used for the optimization, which may change with a new release of the Barra Equity Model. The model data will be used from previous end-of-month, prior to the rebalancing date. Following are the definitions of factor groups currently used in the Index.

Value:

The value score for each security is calculated by combining the security-level exposures to two factors, Book-to-Price and Earnings Yield, from the relevant Barra Equity Model. A sector-relative score is derived from the combined score by standardizing the latter within each sector and winsorizing at +/- 3.

$$\text{Value}_i = (0.33) * \text{BtoP}_i + (0.67) * \text{EarningsYield}_i$$

Quality:

The quality score for each security is calculated by combining in equal proportion the security-level exposures to five factors - Profitability, Investment Quality, Earnings Quality, Leverage and Earnings Variability - from the relevant Barra Equity Model. A sector-relative score is derived from the combined score by standardizing the latter within each sector and winsorizing at +/- 3.

$$\text{Quality}_i = (0.2) * \text{Profitability}_i + (0.2) * \text{Investment Quality}_i + (0.2) * \text{Earnings Quality}_i + (-1) * (0.2) * \text{Earnings Variability}_i + (-1) * (0.2) * \text{Leverage}_i$$

Volatility:

The volatility score for each security is currently based on the Beta and Residual Volatility factors from the relevant Barra Equity Model.

$$\text{Volatility}_i = (-1) * (0.5) * \text{Beta}_i + (-1) * (0.5) * \text{Residual Volatility}_i$$

Size:

The size score for each security is the negative of the Size factor score taken from the relevant Barra Equity Model.

Momentum:

The momentum score for each security is same as the Momentum factor score taken from the relevant Barra Equity Model

Appendix V: Calculation of Carbon Exposure Metrics

Carbon emissions of a company are normalized for size by dividing annual carbon emissions by Enterprise Value including Cash (EVIC). The Carbon Emissions Intensity is calculated using the latest Scope 1+2 carbon emissions, Scope 3 carbon emissions and EVIC of a company.

Security Level GHG Intensity (Scope 1+2+3) =

$$(\text{Unadjusted Security Level GHG Intensity (Scope 1+2)} + \text{Unadjusted Security Level GHG Intensity (Scope 3)}) * (1 + \text{EVI AF})$$

Unadjusted Security Level GHG Intensity (Scope 1+2) =

$$\frac{(\text{Scope 1} + 2 \text{ Carbon Emissions})}{\text{EVIC (in M\$)}}$$

If Scope 1+2 carbon emissions and/or EVIC are not available, the average Scope 1+2 intensity of all the constituents of the MSCI ACWI in the same GICS Industry Group in which the security belongs is used.

Unadjusted Security Level GHG Intensity (Scope 3) =

$$\frac{(\text{Scope 3 Carbon Emissions})}{\text{EVIC (in M\$)}}$$

If Scope 3 carbon emissions and/or EVIC are not available, the average Scope 3 intensity of all the constituents of the MSCI ACWI in the same GICS Industry Group in which the security belongs is used.

Enterprise Value Inflation Adjustment Factor (EVI AF) =

$$\left(\frac{\text{Average (EVIC)}}{\text{Previous (Average (EVIC))}} \right) - 1$$

Weighted Average GHG Intensity of Parent Index =

$$\sum (\text{Weight in Parent Index} * \text{Security Level GHG Intensity})$$

Weighted Average GHG Intensity of Derived Index =

$$\sum (\text{Index Weight} * \text{Security Level GHG Intensity})$$

Calculation of Potential Carbon Emissions Intensity

Security Level Potential Carbon Emissions (PCE) Intensity =

$$\frac{\text{Absolute Potential Emissions}}{\text{EVIC (in M\$)}}$$

If Absolute Potential Emissions data is not available, MSCI uses zero fossil fuel reserves.

Weighted Average Potential Emissions Intensity of Parent Index =

$$\sum (Weight\ in\ Parent\ Index * Security\ Level\ PCE\ Intensity)$$

Weighted Average Potential Emissions Intensity of Derived Index =

$$\sum (Index\ Weight * Security\ Level\ PCE\ Intensity)$$

Appendix VI: Methodology Set

The Index is governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document as mentioned below:

- Description of methodology set – <https://www.msci.com/index/methodology/latest/ReadMe>
- MSCI Corporate Events Methodology – <https://www.msci.com/index/methodology/latest/CE>
- MSCI Fundamental Data Methodology – <https://www.msci.com/index/methodology/latest/FundData>
- MSCI Index Calculation Methodology – <https://www.msci.com/index/methodology/latest/IndexCalc>
- MSCI Index Glossary of Terms – <https://www.msci.com/index/methodology/latest/IndexGlossary>
- MSCI Index Policies – <https://www.msci.com/index/methodology/latest/IndexPolicy>
- MSCI Global Industry Classification Standard (GICS) Methodology – <https://www.msci.com/index/methodology/latest/GICS>
- MSCI Global Investable Market Indexes Methodology – <https://www.msci.com/index/methodology/latest/GIMI>
- MSCI Global ex Controversial Weapons Indexes Methodology – <https://www.msci.com/index/methodology/latest/XCW>
- ESG Factors In Methodology*

The Methodology Set for the Index can also be accessed from MSCI’s webpage <https://www.msci.com/index-methodology> in the section ‘Search Methodology by Index Name or Index Code’.

* ‘ESG Factors in Methodology’ contains the list of environmental, social, and governance factors considered, and how they are applied in the methodology (e.g., selection, weighting or exclusion). It can be accessed in the Methodology Set as described above.

Appendix VII: Changes to this Document

The following sections have been modified effective December 2022:

- Section 3.3: Optimization Constrains: Update to reference Appendix V
- Appendix V: Added to reference formulae used for Carbon Emission Intensity and the Potential Emissions per dollar of market capitalization calculation.

The following sections have been modified effective December 2023:

- The Eligible Universe was defined and additional ESG screens were added, including updated language for the ESG Controversy screen in Section 2.
- The carbon emissions intensity definition was modified to include Scope 3 emissions in Section 2.
- The methodology book was updated to reflect the transition of the MSCI Global Investable Market Indexes (GIMI) to Quarterly Comprehensive Index Reviews in Section 3.
- All references to “Semi-Annual Index Reviews” and “Quarterly Index Reviews” of the MSCI GIMI were replaced with “Index Reviews” in Section 3.
- The ESG Product descriptions were moved to section 4 from section 2.
- The language for the ESG Product descriptions were updated following a review by MSCI ESG Research
- The calculation of carbon exposure metrics was updated to reflect the change to weighted average carbon emissions intensity.

The following sections have been modified as of February 2025

- The methodology and index name was updated. Effective February 3, 2025, the MSCI World Select 5-Factor ESG Low Carbon Target Index have been renamed to the MSCI World 5-Factor Select Advanced Target Index

Section 2.5: Treatment of Unrated Companies

- New section detailing the treatment of companies with ratings and research is not available from MSCI ESG Research

Section 4.1: Climate Change Metrics

- Added a sub-section under Climate Change Metrics to provide additional details on Fossil Fuels related activities and Greenhouse Gas Emissions.

Appendix VI: Methodology Set

- Added details on the Methodology Set for the Indexes

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To learn more, please visit www.msci.com.

The process for submitting a formal index complaint can be found on the index regulation page of MSCI's website at: <https://www.msci.com/index-regulation>.

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