

# MSCI Sustainable Water Transition Index Methodology

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# 1 MSCI Sustainable Water Transition Index

The MSCI Sustainable Water Transition Index (the ‘Index’) aims to represent the performance of a set of companies that are associated with key aspects of addressing water scarcity through their products or services, and/or through their management of related issues, all assessed within the context of potential contribution towards a circular economy (see Appendix I).<sup>1</sup>

In particular, the Index incorporates companies that provide technologies (“circular technologies”) and/or those that help enable the transition to a circular economy (“circular transition”), as defined using the following measures:

- Water Supply
- Water Utilities
- Water Treatment
- Water-related Equipment
- Water Stress

The Index also applies exclusions criteria to screen companies with business activities that are not considered aligned with the overall objective of addressing water scarcity or promoting circularity. Additionally, the Index utilizes a combination of weighting strategies at both security and component levels, as well as applies issuer capping.

<sup>1</sup> 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 Indexes 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 MSCI Sustainable Water Transition Index

### 2.1 Selection Universe

The underlying universe for the Index is defined by the constituents of the MSCI ACWI Investable Market Indexes (IMI, the 'Parent Index'<sup>2</sup>), from which three separate universes of stocks are constructed (as described in Sections 2.2 to 2.4).<sup>3</sup>

### 2.2 ESG Filtered Universe

The Index applies two sets of exclusions criteria to determine eligibility in the ESG Filtered Universe.

#### 2.2.1 Sustainable Water Transition-specific Exclusions

The Index uses MSCI Impact Solutions' SDG Alignment to identify companies that have been assessed as negatively impacting the index objective. The exclusions criteria are as follows:

- SDG 6 and 14 Net Alignment: All companies that are assessed as Strongly Misaligned and Misaligned on their Net Alignment to SDG 6 (Clean Water and Sanitation) and SDG 14 (Life Below Water)

#### 2.2.2 Circular Economy-related Screens

The Index uses MSCI ESG Controversies, MSCI ESG Ratings, MSCI ESG Business Involvement Screening Research, MSCI Climate Change Metrics, and MSCI Impact Solutions' SDG Alignment to apply a set of exclusions standards which either address headline risks and/or contribute negatively to a circular economy. The exclusions filters are as follows:

1. **ESG Controversies Score:** All companies that are 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.

<sup>2</sup> Other parent indexes, as a subset of MSCI ACWI IMI, may also be used. However, use of some indexes as parent indexes may result in a low number of constituents, which may affect replicability.

<sup>3</sup> Where ESG data is applied, 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. **Environmental Controversies:** All companies that are assessed as having involvement in environmental controversies that are classified as Red (MSCI Environmental Controversy Score of 0), Orange<sup>4</sup> (score of 1), or Yellow<sup>5</sup> Flags (scores 2 to 4).
3. **Environmental Pillar Quartile:** All companies that are assessed as belonging to the bottom quartile relative to their relevant ESG Ratings Industry.
4. **Key Issue Management Score/s:** All companies belonging to the bottom 25% of the applicable key issue management score/s. For each key issue, the following steps are applied:
  - Step 1: Using MSCI ACWI IMI Index as the universe, only key issue management scores of companies with more than 5% weight assigned to the corresponding key issue are considered.
  - Step 2: Companies are ranked based on their key issue management scores relative to all the companies considered in Step 1. When two companies have the same key issue management score, the company with higher weight in the Parent Index is ranked higher.
  - Step 3: The lowest 25% based on the ranking of Step 2 are excluded.
5. **SDG 12 Net Alignment:** All companies that are assessed as Strongly Misaligned and Misaligned on their Net Alignment to SDG 12 (Responsible Consumption and Production).
6. **Controversial Weapons:** All companies with any tie to Controversial Weapons (cluster munitions, landmines, depleted uranium weapons, biological/chemical weapons, blinding lasers, non-detectable 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>.
7. **Thermal Coal Mining:** All companies deriving 5% 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 does not cover revenue from metallurgical coal, coal mined for internal power

<sup>4</sup> An Orange Flag indicates an ongoing Severe ESG controversy implicating a company directly, or a Very Severe ESG controversy that is either partially resolved or indirectly attributed to the company's actions, products, or operations.

<sup>5</sup> A Yellow Flag indicates noteworthy ESG controversies. This includes a Very Severe or Severe ESG controversy that has been concluded, a Very Severe controversy that is partially resolved and is indirectly attributed to the company, a Severe controversy that is either partially resolved or indirectly attributed to the company, or an ongoing Moderate controversy implicating a company directly.

generation (e.g., in the case of vertically integrated power producers), intracompany sales of mined thermal coal, and revenue from coal trading.

#### Notes on Unrated Securities or Securities with Missing Coverage:

- Companies that are not assessed on MSCI ESG Research's ESG Controversies (exclusion filters 1 and 2) are excluded from the ESG Filtered Universe.
- Companies that are not assessed on MSCI ESG Research's ESG Ratings and SDG Alignment (exclusion filters 3 to 5) are not excluded from the ESG Filtered Universe.

## 2.3 “Circular Technologies” Universe

The Circular Technologies Universe is constructed by selecting companies in the ESG Filtered Universe that are assessed to have high exposure, as defined in Section 2.3.1, to the water theme. The theme consists of the following business activities:

- Water Supply
- Water Utilities
- Water Treatment
- Water-related Equipment

MSCI may seek input from outside market experts on the ongoing evolution of the themes underlying the water theme. However, such input is only advisory in nature. The use of any such input is at MSCI's discretion and may or may not lead to a change to the Index or index methodology.

### 2.3.1 Thematic selection criteria

The selection rules are in accordance with Sections 3.1 to 3.3 of the MSCI ACWI IMI Water Index methodology<sup>6</sup> but applies the following variations:

- **Selection on ESG Revenue**  
Companies with 25% or more revenue from the Sustainable Water category instead of using a threshold of 15% as per Section 3.2.4 of the MSCI ACWI IMI Water Index
- **Additional ESG Filter**  
Companies that do not have any revenue from products, services, and projects that attempt to resolve water scarcity and quality issues are

<sup>6</sup> Please refer to the MSCI ACWI IMI Water Index methodology at <https://www.msci.com/index-methodology>

excluded from the eligible universe, in addition to the GICS®<sup>7</sup> sector and sub-industry filtering in Section 3.3.1 of the MSCI ACWI IMI Water Index.

## 2.4 “Circular Transition” Universe

The Index uses MSCI ESG Ratings’ key issue management scores to identify companies that have better management strategies to address water scarcity relative to their sector peers.

The Circular Transition Universe is constructed by selecting stocks in the top 10% of the Intermediate Universe (as described in Section 2.4.1) based on their Sector-Relative Management Score (SRMS), which is computed using the following key issue management score/s:

- Water Stress

Please refer to Appendix II detailing the computation steps.

### 2.4.1 Intermediate Universe

The Intermediate Universe is constructed by selecting stocks in the ESG Filtered Universe (Section 2.2) that are not part of the Circular Technologies Universe (Section 2.3).

## 2.5 Weighting Scheme

The Index constituents that are determined to be part of the Circular Technologies and Circular Transition universes are weighted as follows:

### 2.5.1 Security Weighting

- Circular Technologies Universe  
Securities that meet the selection criteria outlined in Section 2.3 are weighted in proportion of their weight in the Parent Index. The weights are then normalized to sum to 100%.
- Circular Transition Universe  
Securities that meet the selection criteria outlined in Section 2.4 are weighted in proportion of their weight in the Parent Index. The weights are then normalized to sum to 100%.

<sup>7</sup> GICS, the global industry classification standard, jointly developed by MSCI Inc. and S&P Global.

## 2.5.2 Component Weighting

Each component is scaled down to the following proportion:

Component	Component Weight
Circular Technologies	60%
Circular Transition	40%

## 2.5.3 Issuer Capping

The maximum weight of any issuer in the Index is then capped at 5% in accordance with the MSCI Capped Indexes methodology<sup>8</sup>. The excess weight of the capped issuers is distributed among the remaining constituents in proportion of their existing weights in the Index<sup>9</sup>.

<sup>8</sup> Please refer to the MSCI Capped Indexes methodology at [www.msci.com/index-methodology](https://www.msci.com/index-methodology)

<sup>9</sup> Issuer capping may result in a drift in the component weights.



## 3 Maintaining the MSCI Sustainable Water Transition Index

### 3.1 Semi-Annual Index Review

The Index is reviewed on a semi-annual basis, as of the close of the last business day of May and November, coinciding with the May and November Index Reviews of the Parent Index. The pro forma index is generally announced nine business days before the effective date.

As a rule, MSCI uses MSCI ESG Research data (including MSCI Impact Solutions, MSCI ESG Ratings, MSCI ESG Controversies, and MSCI Climate Change Metrics) 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.

At each Semi-Annual Index Review, the ESG Filtered, Circular Technologies, and Circular Transition universes are updated based on the criteria outlined in Sections 2.2 to 2.4.

### 3.1 Quarterly Index Reviews

The Index is also reviewed on a quarterly basis to coincide with the Index Reviews of the Parent Indexes. The changes are implemented at the end of February and August. The pro forma indexes are generally announced nine business days before the effective date.

For the Quarterly Index Reviews, MSCI ESG Ratings, MSCI ESG Controversies, MSCI BISR, MSCI Climate Change Metrics, and MSCI SDG Alignment data are taken as of the end of the month preceding the Index Reviews, i.e., January and July. For some securities, this 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.

At the Quarterly Index Reviews, existing constituents in the ESG Filtered Universe are deleted from the Index if they do not meet the exclusions criteria described in Section 2.2. Existing constituents that meet the criteria are retained in the Index.

## 3.2 Annual Index Review

The business segment selection criteria (in accordance with Section 3.2.2.1 of the MSCI ACWI IMI Water Index) are reviewed annually by MSCI during the May Semi-Annual Index Review. In general, MSCI completes this review nine business days before the effective date of the May Semi-Annual Index Review.

## 3.3 Ongoing Event-Related Maintenance

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.

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. Parent Index deletions will be reflected simultaneously.

There are no deletions from the Index between Index Reviews on account of a security becoming ineligible because of lower SRMS resulting in a drop in ranking, decrease in MSCI ESG Controversies Score, and/or change in SDG Alignment assessment.

EVENT TYPE	EVENT DETAILS
<b>New additions to the Parent Index</b>	A new security added to the Parent Index (such as IPO and other early inclusions) will not be added to the index.
<b>Spin-Offs</b>	All securities created as a result of the spin-off of an existing Index constituent will not be added to the Index at the time of event implementation. Reevaluation for addition in the Index will occur at the subsequent Index Review.
<b>Merger/Acquisition</b>	<p>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.</p> <p>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.</p>
<b>Changes in Security Characteristics</b>	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.

The MSCI Corporate Events methodology book is available at:  
<https://www.msci.com/index-methodology>.

## 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 Impact Solutions, MSCI ESG Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research, and MSCI Climate Change Metrics. MSCI Indexes are administered by MSCI Limited.

### 4.1 MSCI Impact Solutions: Sustainable Impact Metrics

MSCI Impact Solutions' Sustainable Impact Metrics is designed to identify companies that derive revenue from products or services with positive impact on society and the environment. The Sustainable Impact Metrics are comprised of six Environmental Impact categories and seven Social Impact categories arranged by theme.

#### MSCI Sustainable Impact Taxonomy

Pillar	Themes	Categories
Environmental Impact	Climate Change	1. Alternative energy 2. Energy efficiency 3. Green building
	Natural capital	4. Sustainable water 5. Pollution prevention 6. Sustainable agriculture
Social Impact	Basic needs	7. Nutrition 8. Major Disease Treatment 9. Sanitation 10. Affordable Real Estate
	Empowerment	11. SME Finance 12. Education 13. Connectivity – Digital divide

Under each of the actionable environmental and social impact themes, MSCI ESG Research has identified specific categories of products and services that it has determined companies can offer as potential solutions to environmental and social challenges.

More detailed taxonomy for each category can be found in Section 2.4 of the MSCI ACWI Sustainable Impact Index Methodology available at <https://www.msci.com/index-methodology>.

## 4.2 MSCI Impact Solutions: SDG Alignment

MSCI Impact Solutions' SDG Alignment is designed to provide a holistic view of companies' net contribution – both positive and negative – towards addressing each of the 17 UN Sustainable Development Goals (SDGs). SDG Alignment assessments and scores include analysis of companies' operations, products and services, policies, and practices and their net contribution – positive and adverse – to addressing key global challenges.

The MSCI SDG Alignment framework provides 17 SDG Net Alignment scores and 17 SDG Net Alignment assessments (including Strongly Aligned, Aligned, Neutral, Misaligned and Strongly Misaligned) for each of the 17 global goals. In addition, the model offers assessments and scores for two dimensions, product alignment and operation alignment, for each company and for each of the 17 goals.

For more details on MSCI Impact Solutions including MSCI SDG Alignment, please refer to <https://www.msci.com/our-solutions/esg-investing/impact-solutions>.

## 4.3 MSCI ESG Ratings

MSCI ESG Ratings aim to measure entities' management of environmental, social and governance risks and opportunities. MSCI ESG Ratings use a weighted average key issue calculation that is normalized by industry to arrive at an industry-adjusted ESG score (0-10), which is then translated to a seven-point scale from 'AAA' to 'CCC', indicating how an entity manages relevant key issues relative to industry peers.

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

## 4.4 MSCI ESG Controversies

MSCI ESG Controversies provides 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>

## 4.5 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 [http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_BISR.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf)

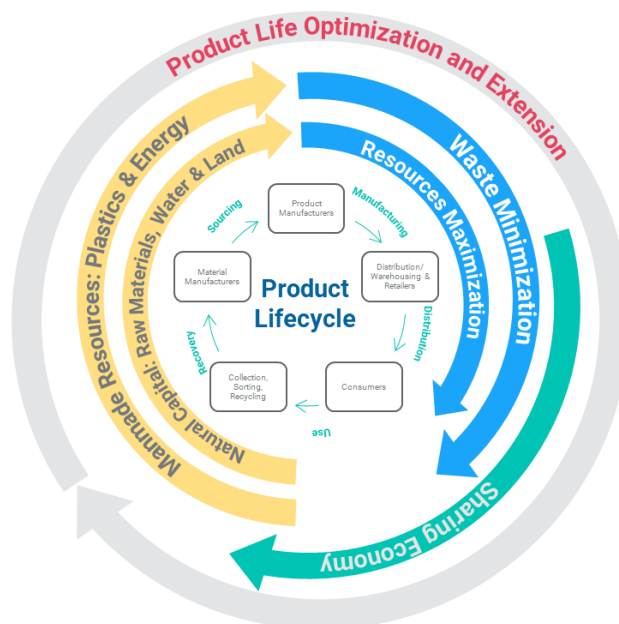
## 4.6 MSCI Climate Change Metrics

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.

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

## Appendix I: What is a Circular Economy?



A circular economy is an economic system wherein resources are kept as long as possible within the system, whether by rethinking resource-intensive products and processes, maximizing the use of materials, extending the life of products, and/or recycling of waste materials. This is a structural shift from the current linear economy, where materials are taken, converted via a manufacturing process, used, and then disposed. Underlying to the concept of a circular economy are the 9R strategies,<sup>10</sup> which provide a holistic view to improving circularity at each stage of a product's lifecycle.

For more information, please see the Circular Economy Theme Insight written by Rachel A. Meidl:

<https://www.msci.com/documents/1296102/28401354/ThematicIndex-CircularEconomy-cbr-en.pdf>

<sup>10</sup> Circular Economy: Measuring Innovation in the Product Chain, *Policy Report by PBLK Netherlands Environmental Assessment Agency*, (Potting, J., Hekkert, M., Worrell, E., Hanemaaijer, A.), <https://www.pbl.nl/sites/default/files/downloads/pbl-2016-circular-economy-measuring-innovation-in-product-chains-2544.pdf>

## Appendix II: Sector-Relative Management Score (SRMS) Calculation

Companies are selected based on their SRMS. The calculation steps are as follows:

1. An average management score (AMS) is calculated for companies in MSCI ACWI IMI using management scores based on the identified key issue/s, granted that they meet the following conditions:
  - Companies are assessed on any of the identified key issue/s listed in Section 2.4.
  - Companies have corresponding key issue weight/s greater than 5%.

The calculation of AMS will consider the applicable number of key issues, meaning a company with two relevant scores are divided by two, for example.

2. The SRMS is calculated for companies that are identified in Step 1 by dividing the AMS by the corresponding highest (maximum) AMS based on their GICS Sector.

*Exception clause: A GICS Sector with a maximum AMS below 5 is excluded from scope, which in turn, results in the exclusion of all companies belonging to the excluded sector, from the calculation of SRMS.*



## Appendix III: Changes to this Document

### The following sections have been updated as of May 2022:

#### Section 3.2.2: Circular Economy-related Screens

- Clarified the calculation logic for the 'Key Issue Management Score/s' exclusions criterion.

### The following sections have been modified as of November 2023:

The Methodology book was updated to re-organize the sections and clarify key components.

#### Section 2.2.2: Circular Economy-related Screens

- The MSCI ESG Controversies-related criteria were updated to reflect the enhancement to the underlying MSCI ESG Controversies framework.
- The Key Issue Management Score/s criterion was clarified by outlining the calculation steps.

#### Section 3.1: Semi- Annual Index Review

- 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 4: MSCI ESG Research

- Moved the information regarding MSCI ESG Research from Section 2 to Section 4.

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