

Firearms Divestment in the United States

MSCI ESG Research Issue Brief

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Overview

The Sandy Hook Elementary School shootings in Newtown, Connecticut, on December 14, 2012, have galvanized public attention on firearms manufacturers and retailers. Calls are mounting for institutional investors to sever their ties to the industry and urge corporate reforms through new initiatives such as the “Sandy Hook Principles.” Yet questions remain about defining the firearms industry and the segments that would be most affected by such actions; how to reconcile divestment options with fiduciary responsibility; and whether mutual funds and banks that support the industry financially might also distance themselves going forward.

One early decision came from private equity firm Cerberus Capital Management. Facing pressure from the California State Teachers’ Retirement System, Cerberus announced on December 18, 2012, that it would sell its shares of Freedom Group Inc., the manufacturer of the Bushmaster rifle used in the Newtown shootings. “It is apparent that the Sandy Hook tragedy was a watershed event that has raised the national debate on gun control to an unprecedented level,” Cerberus said in a statement.¹

Many Wall Street investors have had similar reactions to Newtown, the second-largest mass shooting in U.S. history. Share prices of some publicly traded firearms makers and retailers fell sharply in the days following the tragedy. Yet sales of military style assault weapons and high-volume ammunition clips have soared as gun owners anticipate possible new gun control legislation. For the most part, share prices in the affected companies have recovered in early 2013.

Meanwhile, a new national debate is forming over firearms regulations, with the Obama administration pledging to make gun policy reforms a top priority for its second term. Vice President Joe Biden has led a task force recommending, among other things, the adoption of universal background checks for gun purchasers, renewal of an assault weapons ban that lapsed in 2004, and more aggressive enforcement of existing gun control laws. While congressional action on an assault weapons ban remains uncertain, some task force proposals may be implemented through executive orders, including more research on gun ownership and public safety, and wider sharing of gun databases among federal and state agencies. At present, there is strong public support for universal background checks and closing a loophole that exempts background checks for some sales at gun shows.²

¹ <http://online.wsj.com/article/SB10001424127887324407504578186523224794006.html>

² <http://www.politifact.com/truth-o-meter/statements/2013/feb/13/barack-obama/president-barack-obama-says-overwhelming-majority-/>

Meanwhile, voluntary actions taken by the firearms industry in response to the Newtown tragedy have been modest, mainly limited to a few gun retailers. On December 18, 2012, Dick's Sporting Goods suspended the sale and display of guns and sporting rifles at stores closest to Newtown, Connecticut. Walmart Inc., the nation's largest gun retailer, removed information from its website on the Bushmaster .223, the rifle used in the Newtown shootings. Walmart issued a statement explaining that the company remained "dedicated to the safe and responsible sale of firearms in areas of the country where they are sold," and that it "had not made any changes to the assortment of guns [they] sell in select stores."³

Institutional Divestment Actions

By contrast, some institutional investors have taken more swift and decisive action to distance themselves from the firearms industry:

- The California State Teachers' Retirement System (CalSTRS) announced on January 9, 2013, that it would begin divesting from companies that manufacture firearms that are illegal for sale or possession in California. The process will involve engagement with identified firearms makers in which the fund is invested; analysis of the costs of divestment; and discussions with experts in the fields of firearms, public safety research and investments. The California Public Employees' Retirement System adopted a similar policy on February 19 in which it will sell \$5 million in holdings of two makers of assault weapons that are illegal for sale in California. The \$255-billion pension plan regards the holdings and related transaction costs as "de minimus" to fund value.
- New York State Comptroller Thomas DiNapoli announced on January 15, 2013, that the New York State Common Retirement Fund would freeze its investments in companies "whose primary business is manufacturing firearms for commercial sale." The freeze applies to both indexed and actively managed investments. The fund's main firearms holding is in an index fund that owns 45,325 shares of Sturm, Ruger, valued at more than \$2 million. The policy will remain in place indefinitely as the state plan evaluates further divestment options.
- Other state pension systems whose officials have said they will review firearms-related investments include the Connecticut Retirement Plans and Trust Funds, Illinois Teachers' Retirement System, Maryland Retirement and Pension System, Massachusetts Pension Reserves Investment Management Board, Rhode Island Employees' Retirement System, and Virginia Retirement System. Such reviews will not necessarily lead to changes in investment policy.
- At the municipal level, Chicago Mayor Rahm Emanuel on January 14, 2013, ordered a portfolio analysis from five city employee pension and retirement funds to identify debt or equity positions in companies that manufacture or sell assault weapons. He said this would be the first step toward removing these companies from the investment plans. Emanuel followed up with an address before the U.S. Conference of Mayors on January 19 calling on other city leaders to sever all investment ties with companies that manufacture or sell assault weapons.
- In Chicago, two pension funds have already taken action. On January 18, the Chicago Teachers Pension Fund, with \$9.5 billion in assets, voted to divest its holdings in companies that

³ http://www.nytimes.com/2012/12/19/business/some-gun-retailers-make-changes-in-aftermath-of-newtown-shootings.html?_r=0

manufacture assault weapons. On January 23, the Chicago Municipal Employees Annuity and Benefit Fund Board followed suit, approving divestment of more than \$1 million in holdings of the Freedom Group, Smith & Wesson and Sturm, Ruger.

- Elsewhere, the Board of Trustees of the New York City Employees' Retirement System passed a unanimous resolution on January 22 requiring an analysis of any investments that the pension system may have in companies producing assault weapons and high-capacity ammunition clips. The resolution requests that the New York City Comptroller's Bureau of Asset Management conduct the analysis and find solutions on how the pension system might terminate such investments. In a related development, New York City Comptroller John Liu announced on Feb. 15 that the New York City Teachers' Retirement System had completed divestment of five publicly traded firearms and ammunition manufacturers from the \$46.6 billion fund.
- The Philadelphia Board of Pensions and Investments approved a policy on January 24 to divest holdings in selected gun manufacturers, ammunition suppliers and retailers. The policy applies a new set of investment principles modeled after the Sullivan Principles seeking reforms in South Africa during the apartheid era, and the MacBride Principles addressing employment discrimination in Northern Ireland. The so-called "Sandy Hook Principles," announced by Philadelphia Mayor Michael Nutter, is designed as a corporate code of conduct for civilian firearms manufacturers, ammunition suppliers, distributors and retailers. Affected companies will be notified by the Philadelphia pension system that they have 90 days to endorse the principles or face divestment action. (See Box on Sandy Hook Principles.)
- The Los Angeles City Council voted unanimously on February 6 for the city's three pension systems to begin a divestment process in companies that produce or profit from the sale of assault weapons and high-volume ammunition clips. The proposal includes gun retailers as well as manufacturers of these products. Most of the system investments are held in mutual funds.
- Beyond the firearms industry itself, the divestment campaign has spread to investments made by mutual fund companies in firearms makers and banks that provide other forms of financial support to the industry. As part of Mayor Emanuel's set of policy proposals, he has written six mutual fund companies urging them to divest and blacklist any gun manufacturers that oppose "commonsense" gun reforms. He has also asked commercial banks to stop providing financial services to gun companies that stand in the way of reform.
- Finally, in New York City, Public Advocate and mayoral candidate Bill de Blasio has produced a "Dirty Dozen" list of financial services firms that altogether have more than \$1.5 billion in direct investments in makers of assault weapons and high-ammunition clips, according to published estimates. In addition to calling on these firms to sell their holdings, de Blasio has asked all five New York City public pension funds to divest their holdings in publicly traded gun manufacturers. The funds hold a combined \$18 million in investments with assault weapon and ammunition manufacturers, according to recent estimates. "If we are investing in companies that put military-grade weapons on our streets, then we are part of the problem. It's time to stop business as usual and become part of the solution," de Blasio said in a statement.⁴

⁴ <http://pubadvocate.nyc.gov/dirtydozen>

These principles were endorsed by the U.S. Conference of Mayors on January 28, 2013. To view the principles in their entirety, including context and preamble, go to www.usmayors.org.

Sandy Hook Principles

As a company which endorses the Sandy Hook Principles we will respect the law, and as a responsible corporate member of society we will apply these Principles with integrity consistent with the legitimate role of business. We will develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to these Principles throughout our organization. We believe the application of these Principles will improve the health, safety and well-being of communities across America.

Accordingly, we will:

- Support and promote restrictions on firearm and ammunition sales, transfers and possession to keep guns out of the hands of children (unless authorized), persons with mental illness or mental health challenges (unless authorized), criminals, domestic or international terrorists, or anyone else prohibited from possessing them under federal law.
- Conduct background checks on all gun and ammunition sales or transfers and support of a federal universal background check system for every such transaction.
- Reevaluate policies regarding the sale, production, design or conversion of military style assault weapons for use by civilians, including the distribution of any materials/information or that may be used to assist such conversion.
- Ensure that all business clients, including gun show operators or gun dealers, conduct background checks for every sale or transfer of guns or ammunition.
- Make a commitment to develop, share and implement technology-enabled safety measures for guns and ammunition.
- Support and promote the creation of a federal gun trafficking statute to ensure strict punishment for individuals engaging in the trade of selling firearms to anyone prohibited possessing them under federal law.
- Support and promote sharing of background check and gun sale data for law enforcement purposes.
- Support and promote gun safety education at the point of sale and in the communities in which we conduct business operations.

We will be transparent in our implementation of these principles and provide information which demonstrates publicly our commitment to them.

U.S. Firearms Market: Facts and Figures

- The United States is the largest firearms market in the world. Between 40 and 45 percent of U.S. households own at least one firearm. The total number of guns in civilian circulation is between 270 million and 300 million, nearly equal in size to the American population.⁵
- Eighty percent of deaths from firearms among the world's 23 wealthiest nations are in the U.S.
- Annual U.S. gun and ammunition sales increased at an annual rate of 5.7 percent from 2007 through 2011, reaching approximately \$4 billion in sales in 2011, a 20-year high.⁶
- Companies in the United States that manufacture, distribute and sell firearms, ammunition and hunting equipment employed nearly 100,000 people and contributed \$13.6 billion in direct economic impact in 2011, up from \$6.8 billion in 2008, according to the National Shooting Sports Foundation, a firearms industry trade association. Firearms suppliers employed another 40,000 people and contributed another \$7.9 billion in direct economic impact.⁷
- According to the U.S. Bureau of Alcohol, Tobacco, Firearms, and Explosives, U.S. manufacturers produced nearly 6.4 million firearms in 2011. In 2010, the top three firearms makers were Sturm, Ruger & Co. Inc., which manufactured 903,968 handguns and rifles; Smith & Wesson Holding Corp. (681,834 firearms); and Remington Arms, part of the privately held Freedom Group (555,794 firearms).⁸
- The U.S. Federal Bureau of Investigation has received 158 million background checks for firearms purchases since Congress mandated this requirement in 1993. Nearly 16.8 million background check requests took place in 2012, nearly double the figure for 2002.⁹
- An estimated 40 percent of U.S. gun purchases each year are through private sales that do not undergo background checks, according to the Law Center to Prevent Gun Violence. This includes a gun show "loophole" that allows private purchases to occur at gun shows. Any purchase by a federally licensed dealer – whether at a store or at a show – must have a background check.¹⁰
- Recent polling suggests that more than 90 percent of Americans support universal background checks on firearms sales, and a majority support bans on sales of military style assault weapons and high-volume ammunition clips.¹¹ The National Rifle Association opposes these measures on grounds that it infringes on Second Amendment rights to permit private sales of firearms, and that criminals will not participate in universal background checks.

⁵ http://www.huffingtonpost.com/2012/12/14/statistics-firearms-industry_n_2303336.html. Deaths from firearms referenced.

⁶ <http://www.thefiscaltimes.com/Articles/2012/12/18/Gun-Industry-Has-Boomed-During-Obama-Years.aspx#page1>

⁷ <http://nssf.org/impact/>

⁸ <http://www.atf.gov/statistics/afmer/>

⁹ <http://www.usatoday.com/story/news/nation/2012/12/12/gun-background-checks-surge-across-usa/1765513/>

¹⁰ <http://smartgunlaws.org/>

¹¹ <http://www.politifact.com/truth-o-meter/statements/2013/feb/13/barack-obama/president-barack-obama-says-overwhelming-majority-/>

U.S. Firearms Manufacturers

MSCI ESG Research tracks nearly two-dozen publicly traded companies worldwide that manufacture firearms or supply ammunition. Many other firearms companies are privately held. Fewer than half of the publicly held companies are included in commonly traded indexes, such as the MSCI All Country World Index. Total portfolio exposure of firearms companies in such broad indexes is typically less than 0.50 percent on a market-capitalization weighted basis. The table below lists the top U.S. firearms manufacturers in 2010, based on total firearms sold. This table does not correspond to the complete list of firearms manufacturers and ammunition suppliers tracked by MSCI ESG Research. It is meant to give a recent representation of the public and private U.S. companies involved in firearms manufacturing.

Top U.S Firearms Manufacturers¹²	Status	Ticker	Market Capitalization (February 2013)	2010 Total Firearms Sold (units)
Sturm, Ruger & Co.	Public	RGR	\$937,502,322	903,968
Smith & Wesson Holding Corp.	Public	SWHC	\$580,395,981	681,834
Remington Arms (Freedom Group)	Private			555,794
O.F. Mossberg & Sons (Mossberg/Maverick Arms)	Private			460,222
SIG Sauer GmbH (Germany)	Private			296,080
Marlin Firearms (Freedom Group)	Private			254,013
Savage Arms Co.	Private			171,472
Beretta U.S.A.	Private			142,798
Taurus International Manufacturing Inc. (Brazil)	Public	FJTA3	\$66,603,457	128,160
Henry RAC Holding Corp.	Private			124,701
Kel-Tec CNC Industries Inc.	Private			118,795
Hi-Point Firearms (Beemiller)	Private			115,200
H&R 1871 (Freedom Group)	Private			107,731
Burbak Machine	Private			93,841
Kimber Manufacturing	Private			90,376
Saeilo Inc.	Private			54,491
Thompson/Center Arms Co. (Subsidiary of Smith & Wesson Holding)	Public		See Smith & Wesson above	54,254
Heritage Mfg. Inc.	Private			53,805
ATW Companies	Private			49,882

¹² <http://www.shootingindustry.com/u-s-firearms-industry-today-2012/> accessed January 10, 2013

U.S. Firearms Retailers

Firearms enter the civilian market through many avenues, including licensed gun stores, sporting goods outlets, pawnshops, and even licensed home businesses. Gun shows that include licensed and unlicensed dealers account for 40 to 45 percent of estimated U.S. firearms sales. Family owned and privately held gun stores that sell hunting, shooting and outdoor equipment are a primary source of other firearms sales. However, some large publicly traded retail firms that sell firearms are major distributors, by virtue of their size.

Walmart Inc. is the nation’s largest seller of civilian firearms. In 2011, Walmart expanded its gun sales to half of its 3,985 stores nationwide, including new urban areas such as Albuquerque, NM. None of the publicly traded retailers tracked by MSCI ESG Research report that more than 15 percent of annual revenues come from firearms sales. MSCI ESG Research tracks reported sales figures from these retail outlets as well as other mass merchandisers that are Federal Firearms Licensees who specialize in the sale of sporting goods.

Selected Firearms Retailers	Ticker	Market Capitalization (February 2013)
Big 5 Sporting Goods Corp.	BGFV	\$284,864,157
Cabela's Incorporated	CAB	\$3,082,122,007
Dick's Sporting Goods, Inc.	DKS	\$5,692,325,590
Sears Holdings Corporation	SHLD	\$4,338,973,261
The Kroger Co.	KR	\$13,245,984,893
Wal-Mart Stores, Inc.	WMT	\$229,382,959,031
Xtek Ltd. (Australia)	XTE	\$ 4,362,813

Fiduciary Considerations in Firearms Divestment

Institutional investors do not entertain divestment decisions lightly. Most plan sponsors are guided by longstanding policies and federal law to maximize investments commensurate with risk. With limited exceptions, ethical considerations cannot override this prime directive of prudence and loyalty to plan beneficiaries. An “all things being equal” test leaves room for some fiduciaries to apply investment screens if they can demonstrate that it would be prudent to reduce exposure to the affected assets and that portfolio performance would not be harmed.¹³

As a practical matter, some plan sponsors have adopted investment screens that have not found to be a breach of fiduciary duty. Historical examples include divestment from companies with ties to terrorist groups or governments supporting human rights violations; and companies whose products harm public health, safety or the environment. Beyond objections based on social responsibility, these funds may argue that companies exposed to these issues are subject to added reputational, regulatory and statutory risks and may lose favor with investors as these concerns are priced into the market. Pension funds and endowments that are building and preserving multi-generational assets are especially inclined to these long-term considerations.

Yet the short-term transaction costs of divesting selected securities and any potential resulting imbalances in matching selected investment benchmarks present other practical and serious considerations for institutional investors. Even if future performance considerations are set aside, the transaction costs and possible tracking error are tangible effects that also must be evaluated and justified.

In the case of firearms manufacturers, the fiduciary hurdles are not as high as with some prior divestment campaigns, simply because of the size of the companies involved. The largest publicly traded U.S. firearms makers have a market value of less than a billion dollars and are classified as “small cap” companies on an index basis. As a result, they have a very small representation in broadly held indices. Even when larger companies are considered, they do not tend to have much impact. For example, four firearms manufacturers represented in the float-adjusted MSCI World Index constitute only 0.33 percent (one-third of 1 percent) of its recent market capitalization. Thus, the change in index performance would be expected to be de minimus, unless the excluded companies produced returns (positive or negative) that were far outside of the range of overall index performance. Even then, it might be possible to rebalance affected portfolios to reduce the risk of such tracking errors.

In short, each fund considering a firearms investment restriction should be guided by its own fiduciary principles and the advice of legal counsel, investment consultants and investment professionals. Logically, funds will want to review their current holdings in firearms manufacturers and affiliated industries to gauge their degree of exposure. That assessment, in turn, may inform judgments about the effects of restricting or excluding these holdings from the portfolio and how narrowly or broadly the screen might be applied. This includes not only the types of companies selected for the policy mandate, but also which asset classes are affected, and whether the policy also applies to commingled and indexed investments. Transaction costs, tracking error and projected changes in risk-adjusted returns should also be considered in arriving at the final policy.

Plan sponsors that implement a firearm investment restriction will want to review the policy periodically to gauge the measurable effects on portfolio performance and see if judgments made with respect to

¹³ See for example: <http://www.groom.com/practices-38.html>

fiduciary prudence continue to apply over time. They will also want to monitor actions taken by their portfolio managers to ensure compliance with the policy as long as it remains in effect. Portfolio managers may be given some discretion in implementing the policy or the timing of divestment actions. The terms and bounds of such discretionary decisions should also be made clear by the plan sponsor.

FAQ: MSCI ESG Research Firearms Screen

- What does MSCI ESG Research include under the *Civilian Firearms – Producer* category?
 - Companies that manufacture firearms and ammunition for the civilian market, including hunting and other recreational rifles, as well as semi-automatic and automatic rifles are included in the standard screen. *For full definitions please see below.*
 - Note: During the 2013 Annual Update of the Firearms Screen, the following new screening options will be made available as sub-categories of the Firearms Producers category: Ammunition, Semi-Automatic, and Automatic.
- What does MSCI ESG Research include under the *Civilian Firearms – Retailers and Distributors* category?
 - Companies that derive 15 percent or more of total annual company revenues from the retail sale or wholesale of civilian firearms and/or ammunition are included in the standard screen. *At this time, there are no global publicly traded companies that meet this threshold.* However, MSCI ESG Research maintains an internal watchlist of retailers with sales below the 15 percent level that is reviewed and updated annually.
 - Note: During the 2013 Annual Update of the Firearms Screen, the revenue threshold for the Firearms Retailer category will be removed so that retailers and distributors will be routinely listed in the Firearms Screen and clients can choose their own revenue threshold for screening purposes.
- What is an assault weapon?
 - According to the Federal Assault Weapons Ban (1994-2004), which prohibited 19 guns considered to be assault weapons, these are **semi-automatic firearms with a detachable magazine** and any two of the following five items:
 - a folding or telescoping stock;
 - a pistol grip that protrudes conspicuously beneath the action of the weapon;
 - a bayonet mount;
 - a flash suppressor or threaded barrel designed to accommodate a flash suppressor; and/or
 - a grenade launcher.
 - The AR-15 Bushmaster rifle use in the Sandy Hook shootings (manufactured by Freedom Group) is a semiautomatic military-style assault weapon.
 - For a further breakdown of MSCI ESG Research's *Civilian Firearms – Producer* category into ammunition, semi-automatic, and automatic weapons producers, please contact your account manager, or email esgclientservice@msci.com.

MSCI ESG Research Firearms Screening Definitions

MSCI ESG Research’s firearms research identifies publicly traded companies that manufacture handguns, pistols, shotguns, rifles, revolvers, and ammunition for civilian (non-military) use. The research describes both the type of involvement and the revenue from that involvement.

Definition: *Firearms are devices capable of firing a projectile and using an explosive charge as a propellant.* MSCI ESG Research categorizes involvement in the industry as follows:

Factor Name	Column Header	Description
Producer of Civilian Firearms	PROD_CIV_ARMS	Companies that manufacture firearms and small arms ammunitions for civilian markets. The research does not cover companies that cater to the military, government, and law enforcement markets. <i>NOTE: Firearms manufactured for military use are captured under the Global Weapons – Conventional Weapons category.</i>
Firearms Retailer and Distributor	FIREARM_RETAILER	Companies that derive 15 percent or more of total annual revenues from the distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use.
Ownership Of a Firearms Company	FIREARM_OWN_OF	Companies that own 20 to 49.99 percent of another company with involvement. When a company owns 50 percent or more of a subsidiary with involvement, MSCI ESG Research treats it as a wholly owned subsidiary.
Ownership By a Firearms Company	FIREARM_OWN_BY	Companies that are 50 percent or more owned by a company with involvement.
Any Tie	FIREARM_TIE	Companies with an industry tie to firearms through any of the above categories.

MSCI ESG Research’s firearms research does not include:

- Firearms or ammunition components;
- Air rifles, air pistols, or airsoft guns;
- Toy guns, replica weapons, paintball guns, or blank ammunition;
- Gun safety equipment such as trigger locks and safe storage boxes; or
- Firearm accessories, such as scope, shooting gloves, ammo carriers, mounts, gun care products, slings, belts, and gun cases.

For more information, please visit MSCI ESG Research’s firearms methodology on the ESGManager Help site: http://help.riskmetrics.com/Screener/Content/Methodology/Business_Involv_Meth.pdf

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MSCI Inc. is a leading provider of investment decision support tools to investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indices, portfolio risk and performance analytics, and governance tools.

The company's flagship product offerings are: the MSCI indices with close to USD 7 trillion estimated to be benchmarked to them on a worldwide basis¹; Barra multi-asset class factor models, portfolio risk and performance analytics; RiskMetrics multi-asset class market and credit risk analytics; IPD real estate information, indices and analytics; MSCI ESG (environmental, social and governance) Research screening, analysis and ratings; ISS governance research and outsourced proxy voting and reporting services; FEA valuation models and risk management software for the energy and commodities markets; and CFRA forensic accounting risk research, legal/regulatory risk assessment, and due-diligence. MSCI is headquartered in New York, with research and commercial offices around the world.

¹As of March 31, 2012, as published by eVestment, Lipper and Bloomberg in September 2012.