

# **MSCI KLD 400 SOCIAL INDEX METHODOLOGY**

May 2024

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## 1. Introduction

The MSCI KLD 400 Social Index (the 'Index')<sup>1</sup> is a free float-adjusted market capitalization index that aims to target U.S. companies that have positive Environmental, Social and Governance (ESG) characteristics while maintaining similar sector weights as MSCI USA. The Index consists of 400 companies selected from the MSCI USA Investable Market Index (IMI)<sup>2</sup>.

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<sup>1</sup> MSCI KLD 400 Social Index is also referred as the MSCI KLD 400 Index.

<sup>2</sup> The Index is governed by a set of methodology and policy documents ("Methodology Set"), including the present index methodology document. Please refer to Appendix 3 for more details.

## 2. Constructing the MSCI KLD 400 Social Index

### 2.1 Applicable Universe

The applicable universe for the Index is the MSCI USA IMI.

### 2.2 Eligibility Criteria

The Index uses company ratings and research provided by MSCI ESG Research<sup>3</sup> to determine eligibility for index inclusion.

#### 2.2.1 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 details on these criteria.

- Controversial Weapons
- Civilian Firearms
- Nuclear Weapons
- Tobacco
- Adult Entertainment
- Alcohol
- Conventional Weapons
- Gambling
- Genetically Modified Organisms
- Nuclear Power
- Fossil Fuel Reserves Ownership
- Fossil Fuel Extraction
- Thermal Coal Power

#### 2.2.2 ESG Ratings Eligibility

The Index uses MSCI ESG Ratings to identify companies that have demonstrated an ability to manage their ESG risks and opportunities. Existing constituents of the Index are required to have an MSCI ESG Rating of 'BB' or above to remain in the index, while companies that are currently not constituents of the Index are required to have an MSCI ESG rating of 'BBB' or above to be eligible for inclusion.

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<sup>3</sup> See section 4 for further information regarding 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 and MSCI Deutschland GmbH are the benchmark administrator for the MSCI indexes.

### 2.2.3 ESG Controversies Score Eligibility

The Index uses MSCI ESG Controversies Scores to identify companies that are involved in very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services. Existing constituents of the Index are required to have an MSCI ESG Controversies Score of 1 or above to remain in the index, while companies that are currently not constituents of the Index are required to have an MSCI ESG Controversies Score of 3 or above to be eligible for inclusion.

## 2.3 Sector Representation

The Index is designed to maintain sector weights approximately similar to the MSCI USA Index, by targeting relative sector weights of +/- 25% with respect to the MSCI USA Index.

Relative weight of a sector is computed as

$$\frac{\text{weight of the sector in MSCI KLD 400 Social Index} - \text{weight of sector in MSCI USA Index}}{\text{weight of sector in MSCI USA Index}}$$

Sectors having relative sector weight greater than upper threshold (+25%) with respect to the MSCI USA Index are considered to be overweight and sectors having relative sector weight less than lower threshold (-25%) with respect to the MSCI USA Index are considered to be underweight.

## 2.4 Size-Segment Representation

The Index targets a minimum count of 200 standard size-segment (Large Cap and Mid Cap) companies.

## 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 Ratings
- MSCI ESG Controversies
- MSCI Climate Change Metrics

## 3. Maintaining the MSCI KLD 400 Social Index

### 3.1 Quarterly Index Reviews

The composition of the Index is reviewed on a quarterly basis to coincide with the regular Index Reviews of the MSCI Global Investable Market Indexes. Changes are implemented at the end of February, May, August and November. The pro forma indexes are in general announced nine business days before the effective date.

At every Quarterly Index Review, deletions and additions are made to the Index described below.

In general, MSCI uses MSCI ESG Research data<sup>4</sup> (including MSCI ESG Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research 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.

#### Deletion Criteria

At Quarterly Index Reviews, companies are deleted from the Index for one or more of the following reasons:

- If a company is deleted from the MSCI USA IMI as a result of the Index Review, it is simultaneously removed from the Index
- Any company that fails the eligibility criteria outlined in Section 2 is deleted from the Index

#### Eligibility for Addition

At every Quarterly Index Review, after reflecting all the deletions, additions are made to the Index in order to restore the number of index constituents to 400 companies. All eligible securities of each issuer are included in the index, so the index may have more than 400 securities.

All companies of the pro forma Parent Index that pass the eligibility criteria outlined in Section 2 are eligible for inclusion in the index.

#### Index Additions

Additions are made to the Index from the list of eligible additions based on considerations of ESG performance, sector alignment and size representation. Additions will be made to the standard size segment as per below until the number of companies in MSCI KLD 400 Social Index is restored to 400. If the count of 400 cannot be reached, additions will be made from the small cap segment.

Standard segment:

- All companies having an MSCI ESG Rating of AAA are added

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<sup>4</sup> See section 4 for details of data sourced from MSCI ESG Research used in the Index.

- Companies are added (in order of their industry adjusted ESG Scores) to sectors where the relative sector weights are below the lower threshold (-25%)
- Once the relative weights of all sectors are above the lower threshold or no further companies are available for addition in these sectors, companies are added sequentially based on their ESG Scores
- Companies are not added to sectors where the relative sector weight reaches the upper threshold of +25%
- A minimum of 200 standard segment companies are maintained to ensure appropriate size representation
- While adding companies to the same sector, preference is given to companies having the higher ESG Score. In case there are multiple companies with the same ESG score, the security with the highest free float-adjusted market capitalization will be added first

Small Cap segment:

- Companies are added purely based on their ESG Scores. In case of a tie, companies are added to the most underweight sector

### 3.2 Ongoing Event-Related Changes

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.

There are no deletions from the Index between Index Reviews on account of a security becoming ineligible because of MSCI ESG Rating downgrade and/or decrease in MSCI ESG Controversies Score and/or change in business involvement.

#### EVENT TYPE

#### EVENT DETAILS

#### New additions to the Parent Index

New securities added to the Parent Index (such as IPOs, other early inclusions and migrations from a different size-segment) will not be added to the Index at the time of event implementation. Such securities will be considered for addition in the Index at the subsequent Index Review.

#### Spin-Offs

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 Indexes will occur at the subsequent Index Review.

#### Merger/Acquisition

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.

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 Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics. MSCI Indexes are administered by MSCI Limited and MSCI Deutschland GmbH.

### 4.1 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/legal/disclosures/esg-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>.

### 4.4 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-change-solutions>.

## Appendix I: Controversial Business Involvement Criteria

MSCI ESG Research has developed a framework designed to define significant involvement in controversial activities. According to this framework, there are four levels of restrictiveness: Most Restrictive, Highly Restrictive, Moderately Restrictive, Least Restrictive.

Each controversial activity screened by the MSCI KLD 400 Social Index (except Fossil Fuel Reserves Ownership, Fossil Fuel Extraction and Thermal Coal Power) is assigned to one of these restrictiveness levels.

### "Most Restrictive" screen applied

- 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/latest/XCW>
- Civilian Firearms
  - All companies with any tie to Civilian Firearms, covering the production and distribution (wholesale or retail) of firearms or small arms ammunitions intended for civilian use, as well as ownership of or by another company with involvement. It does not include companies that cater to the military, government, and law enforcement markets

### "Highly Restrictive" screen applied

- Nuclear Weapons
  - All companies that manufacture nuclear warheads and/or whole nuclear missiles
  - All companies that manufacture components that were developed or are significantly modified for exclusive use in nuclear weapons (warheads and missiles)
  - All companies that manufacture or assemble delivery platforms that were developed or significantly modified for the exclusive delivery of nuclear weapons
  - All companies that provide auxiliary services related to nuclear weapons
  - All companies that manufacture components that were not developed or not significantly modified for exclusive use in nuclear weapons (warheads and missiles) but can be used in nuclear weapons
  - All companies that manufacture or assemble delivery platforms that were not developed or not significantly modified for the exclusive delivery of nuclear weapons but have the capability to deliver nuclear weapons
  - All companies that manufacture components for nuclear-exclusive delivery platforms
- Tobacco

- All companies classified as a “Producer”
- All companies deriving 5% or more aggregate revenue from the production, distribution, retail, supply and licensing of tobacco-related products

“Moderately Restrictive” screen applied

- Adult Entertainment
  - All companies deriving 5% or more revenue from the production of adult entertainment materials
  - All companies deriving 15% or more aggregate revenue from the production, distribution and retail of adult entertainment materials
- Alcohol
  - All companies deriving 5% or more revenue from the production of alcohol-related products
  - All companies deriving 15% or more aggregate revenue from the production, distribution, retail and supply of alcohol-related products
- Conventional Weapons
  - All companies deriving 5% or more revenue from the production of conventional weapons and components
  - All companies deriving 15% or more aggregate revenue from weapons systems, components, and support systems and services
- Gambling
  - All companies deriving 5% or more revenue from ownership of operation of gambling-related business activities
  - All companies deriving 15% or more aggregate revenue from gambling-related business activities
- Genetically Modified Organisms (GMO)
  - All companies deriving 5% or more revenue from activities like genetically modifying plants, such as seeds and crops, and other organisms intended for agricultural use or human consumption
- Nuclear Power
  - All companies generating 5% or more of their total electricity from nuclear power in a given year
  - All companies that have 5% or more of installed capacity attributed to nuclear sources in a given fiscal year
  - All companies deriving 15% or more aggregate revenue from nuclear power activities

No specific restrictiveness level applied

- Fossil Fuel Reserves Ownership
  - All companies with evidence of owning proven & probable coal reserves and/or proven oil and natural gas reserves used for energy purposes, as defined by the methodology of the MSCI Global Ex Fossil Fuels Indexes available at <https://www.msci.com/index-methodology>
- Fossil Fuel Extraction
  - All companies deriving any revenue (either reported or estimated) from thermal coal mining or unconventional oil and gas extraction.
    - *Thermal Coal Mining:* Revenue 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 generation (e.g. in the case of vertically integrated power producers); intra-company sales of mined thermal coal; and revenue from coal trading
    - *Unconventional Oil & Gas Extraction:* Revenue from oil sands, oil shale (kerogen-rich deposits), shale gas, shale oil, coal seam gas, and coal bed methane. It does not cover all types of conventional oil and gas production including Arctic onshore/offshore, deep water, shallow water and other onshore/offshore.
- Thermal Coal Power
  - All companies deriving 5% or more revenue (either reported or estimated) from thermal coal-based power generation.

## Appendix II: Methodology Transition

June 2016

Effective at the May 2016 Index Review, the MSCI KLD 400 Social Index reflected enhancements to the MSCI ESG Controversies (formerly known as MSCI Impact Monitor). The details of the changes are as given below.

The changes to MSCI ESG Controversies included adjusting the scoring model to align the scores with individual controversy case levels, including the introduction of an Orange flag, and the removal of specific controversial business involvement (CBI) criteria from the model to refocus the ESG Controversies scores on event-driven controversies.

MSCI implemented the following changes to the MSCI KLD 400 Social Index methodology effective June 1, 2016 to maintain consistency with the existing index construction objectives:

1. As per the old MSCI ESG Impact Monitor methodology, securities which had an Impact Monitor score of 0 and 1 had a Red controversy flag. Under the new methodology, only securities with an ESG controversies score of 0 have a Red controversy flag. For indexes where constituents were ineligible to be included in the index if their Impact Monitor score was 0 or 1 (current Red controversy flag), the exclusion criteria was changed to ESG Controversies score = 0 in order to continue to only exclude securities with Red controversy flag in the MSCI KLD 400 Social Index.
2. MSCI Impact Monitor earlier incorporated exclusion rules based on controversial business involvement criteria related to alcohol, tobacco, gambling, nuclear power, conventional weapons and controversial weapons. The values-based exclusion criteria that were already a part of the MSCI KLD 400 Social Index were more stringent than most of these rules. As a result, only the 'Nuclear Power' screen was updated to reflect the additional rules that were earlier incorporated in the MSCI Impact Monitor. The details of the exclusion rules are mentioned in Appendix 1.

December 2021

Effective from the November 2021 Index Review, the controversial business involvement criteria have been enhanced to reflect the framework designed by MSCI ESG Research to define significant involvement in controversial activities. According to this framework, there are four restrictiveness levels: Most Restrictive, Highly Restrictive, Moderately Restrictive, Least Restrictive. Also, screens for Fossil Fuel Reserves, Fossil Fuel Extraction and Thermal Coal Power were added.

## Appendix III: Methodology Set

The Indexes are 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>
- ESG Factors In Methodology\*

The Methodology Set for the Indexes 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 IV: Changes to this Document

**The following sections have been modified as of November 2014:**

2 ESG Research Framework

- Updated

3.1 Underlying Universe

- Updated the selection universe

3.2 Eligibility Criteria

- Replaced old section 3.2 titled 'Values Based Exclusion Criteria'

4.1 Quarterly Index Reviews

- Updated sub-sections titled 'Index Additions' and 'Deletion Criteria'

Appendix 1: Value Based Exclusion Criteria

- Updated values based exclusion criteria for 'Military Weapons' and 'Civilian Firearms' categories

Appendix 2: Transition to the enhanced MSCI KLD 400 Social Index Methodology

- Section Deleted

**The following sections have been modified as of May 2016:**

Section 3.2.3: ESG Controversies Score Eligibility

- Updated the MSCI ESG Controversies Score eligibility requirements

Appendix 1: Values Based Exclusion Criteria

- Updated the screening criteria for companies involved in 'Nuclear Power'

Appendix 2: Methodology Transition

**The following sections have been modified as of September 2017:**

Section 1: Introduction

- Updates to the description

Section 4.1: Quarterly Index Reviews

- Clarification on use of ESG data for securities whose data would be available after the end of the month preceding Index Review

**The following sections have been modified as of May 2018:**

Appendix 1: Values Based Exclusion Criteria

- Updated the controversial business screening criteria pertaining to Controversial Weapons

**The following sections have been updated as of November 2021:**

Section 2.4: MSCI Climate Change Metrics



- New section

#### Section 3.2.1: Controversial Business Involvement Criteria

- Added screens for 'Fossil Fuel Reserves Ownership', 'Fossil Fuel Extraction' and 'Thermal Coal Power'

#### Section 4.2: Ongoing Event-Related Maintenance

- Clarified the maintenance rules

#### Appendix 1: Controversial Business Involvement Criteria

- Updated the controversial business involvement criteria for each activity according to the framework designed by ESG Research
- Added screens for 'Fossil Fuel Reserves Ownership', 'Fossil Fuel Extraction' and 'Thermal Coal Power'

#### Appendix 2: Methodology Transition

- Added details which highlight the changes to the MSCI KLD 400 Social Index effective December 2021

#### **The following sections have been modified as of June 2023:**

##### Section 3: Maintaining the MSCI KLD 400 Social Index

- 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 that section after the Section 3 (Maintaining the MSCI KLD 400 Social Index)
- Updated the descriptions of MSCI ESG Research products.

#### **The following section have been modified as of January 2024:**

##### Section 2.5: Treatment of Unrated Companies

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

#### Appendix 3: Methodology Set

- Added details on the Methodology Set for the Indexes.

#### **The following section has been modified as of May 2024**

##### Section 1: Introduction

- Added footnote to disclose the new abbreviation for the MSCI KLD 400 Social Index

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