

# **MSCI High Dividend Yield Advanced Select Indexes Methodology**

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## Contents

<b>1</b>	<b>Introduction</b>	<b>4</b>
<b>2</b>	<b>Constructing the Indexes</b>	<b>5</b>
2.1	Defining the Parent Index	5
2.2	Eligible Universe	5
2.3	Defining the Exclusion Criteria	5
2.3.1	Controversy-Based Exclusion Criteria	5
2.3.2	Business Exclusion Criteria	5
2.4	Dividend Yield-Related Screens	6
2.4.1	Dividend Sustainability Screening	6
2.4.2	Dividend Persistence Screening	6
2.4.3	Quality Screening	6
2.4.4	Price Performance Screening	6
2.5	Defining the Security Level Carbon Exposure	6
2.5.1	Greenhouse Gas Emissions	7
2.5.2	Potential Carbon Emissions from Fossil Fuels	7
2.6	Defining the Optimization Setup	7
2.6.1	Calculation of the Sector Relative Grossed-Up Dividend Yield Z-Score	7
2.6.2	Optimization Constraints	8
2.7	Determining the Optimized Index	9
2.8	Treatment of Unrated Companies	9
<b>3</b>	<b>Maintaining the Index</b>	<b>10</b>
3.1	Semi-Annual Index Review	10
3.2	Monthly Review of Controversies	10
3.3	Ongoing Event Related Changes	11
<b>4</b>	<b>MSCI ESG Research</b>	<b>13</b>
4.1	MSCI ESG Ratings	13
4.2	MSCI ESG Controversies	13
4.3	MSCI ESG Business Involvement Screening Research	13

4.4	MSCI Climate Change Metrics .....	13
4.4.1	Fossil Fuels and Power Generation Metrics .....	14
4.4.2	Greenhouse Gas (GHG) Emissions .....	14
4.5	MSCI Impact Solutions: Sustainable Impact Metrics .....	14
<b>Appendix I: The Parent Index and the Base Currency for Optimization .....</b>		<b>16</b>
<b>Appendix II: Business Exclusion Criteria .....</b>		<b>17</b>
<b>Appendix III: Calculation of the grossed-up sectorrelative Dividend Yield z-Score .....</b>		<b>19</b>
<b>Appendix IV: Handling Infeasible Optimizations .....</b>		<b>20</b>
<b>Appendix V: New release of Barra® Equity Model or Barra® Optimizer .....</b>		<b>21</b>
<b>Appendix VI: Company-Level Sustainable Exposure and Calculation of Index SE% .....</b>		<b>22</b>
<b>Appendix VII: Minimum Index SE% Constraints .....</b>		<b>23</b>
<b>Appendix VIII: Calculation of Carbon Exposure Metrics .....</b>		<b>24</b>
<b>Appendix IX: Methodology Set .....</b>		<b>25</b>
<b>Appendix X: Changes to this Document .....</b>		<b>26</b>

## 1 Introduction

The MSCI High Dividend Yield Advanced Select Indexes (herein, 'the Indexes') are designed to represent the performance of a strategy that seeks systematic integration of environmental, social and governance (ESG) norms and maximizes its exposure to the Yield factor.

The Indexes are constructed by selecting constituents of a market capitalization weighted index (the 'Parent Index') and applying an optimization process that aims to maximize the exposure to the Yield factor, minimize Tracking Error, meet minimum index-level sustainable exposure percentage ("Index SE%") thresholds, reduce the carbon-equivalent exposure to CO<sub>2</sub> and other GHG, as well as reduce its exposure to potential emissions risk of fossil fuel reserves by thirty percent (30%) and improve the weighted-average industry-adjusted ESG score of each index by with respect to their respective underlying Parent Indexes using certain constraints described below.<sup>1</sup>

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<sup>1</sup> The Indexes are governed by a set of methodology and policy documents ("Methodology Set"), including the present index methodology document. Please refer to Appendix IX for more details.

## 2 Constructing the Indexes

The Indexes use company ratings and research provided by MSCI ESG Research<sup>2</sup> for the Index construction.

- Defining the Parent Index
- Defining the exclusion criteria
- Defining dividend yield-related screens
- Defining the security level carbon exposure
- Defining the optimization setup
- Determining the optimized index

The steps mentioned above are defined in detail in the subsequent sections.

### 2.1 Defining the Parent Index

Construction of the Indexes begins with identifying the Parent Index and the Eligible Universe for optimization. The Parent Index serves as the universe of eligible securities for optimization.

### 2.2 Eligible Universe

The Eligible Universe is constructed by excluding securities from the Parent Index based on the exclusion criteria described below.

### 2.3 Defining the Exclusion Criteria

#### 2.3.1 Controversy-Based Exclusion Criteria

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.

#### 2.3.2 Business Exclusion Criteria

Companies that are involved in specific businesses which have high potential for negative social and/or environmental impact are ineligible for inclusion in the Indexes.

- Controversial Weapons
- Conventional Weapons
- Nuclear Weapons
- Civilian Firearms

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<sup>2</sup> 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

- Tobacco
- Thermal Coal
- Oil Sands

In addition to the above, companies that fail to comply with the United Nations Global Compact Principles (UN Global Compact Alignment value of “Fail”) are also excluded from the Indexes. Please refer to Appendix II for more details on these criteria.

## 2.4 Dividend Yield-Related Screens

### 2.4.1 Dividend Sustainability Screening

Securities with zero or negative payout ratios<sup>3</sup> are not considered for inclusion in the MSCI High Dividend Yield Advanced Select Indexes. Additionally, within each sector, securities in top 5% ranked in descending order of payout ratio within the universe of securities with positive payout, are not considered eligible for inclusion in the Index.

### 2.4.2 Dividend Persistence Screening

Securities with a negative 5-year dividend per share (5Y DPS) growth rate<sup>4</sup> are also excluded from the index. Securities which have insufficient data to calculate a 5Y DPS growth rate are not excluded from the Index.

### 2.4.3 Quality Screening

Securities with negative sector-relative Quality z-score are not considered for inclusion in the Indexes.

The sector-relative Quality z-scores are calculated using fundamental variables such as Return on Equity, Earnings Variability and Debt to Equity. For the details on computation of the Quality z-scores, please refer to the Section 2.2 of the MSCI Quality Indexes Methodology (for details about the methodology, please refer to: <https://www.msci.com/index-methodology>).

### 2.4.4 Price Performance Screening

Within each sector, securities in the bottom 5% of the universe of securities ranked by negative 1-year price performance are excluded from the Index.

## 2.5 Defining the Security Level Carbon Exposure

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 Indexes use MSCI Climate Change Metrics data from MSCI ESG Research.

<sup>3</sup> Please refer to Appendix of MSCI High Dividend Yield Indexes Methodology for definition of Payout Ratio and 5Y DPS growth and their calculation. Methodology can be accessed from MSCI’s webpage <https://www.msci.com/index-methodology>

<sup>4</sup> Please refer to Appendix of MSCI High Dividend Yield Indexes Methodology for definition of 5Y DPS growth and its calculation. Methodology can be accessed from MSCI’s webpage <https://www.msci.com/index-methodology>

### 2.5.1 Greenhouse Gas Emissions

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

For newly added companies to the Index which do not report emission data and where MSCI ESG Research has not yet estimated the greenhouse gas emissions, 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 emission for the company.

### 2.5.2 Potential Carbon 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 (e.g. coking coal used for steel production). Only fossil fuel reserves used for energy are taken into account. The data is updated on an annual basis and 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. The size of reserves of a company typically influences its market valuation, and hence MSCI normalizes for size by dividing the potential carbon emissions of the company by its market capitalization.

To convert reserves data to potential carbon emissions, MSCI ESG Research applies a formula from the Potsdam Institute for Climate Impact Research<sup>5</sup>.

## 2.6 Defining the Optimization Setup

The optimization objective is to maximize the sector-relative gross dividend yield zscore of the index<sup>6</sup>, while controlling the ex-ante Tracking Error relative to the Parent Index at the time of rebalancing.

The optimization is performed from a base currency perspective and does not allow short selling of securities. The default currency is the US Dollar.

Please refer to Appendix I for more details.

### 2.6.1 Calculation of the Sector Relative Grossed-Up Dividend Yield Z-Score

The sector-relative grossed-up dividend yield z-score for each security is calculated using the formulae defined in Appendix III.

<sup>5</sup> 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.

<sup>6</sup> Weighted-average sector-relative gross dividend yield z- score of the Index

## 2.6.2 Optimization Constraints

At each semi-annual Index Review ('Index Review'), the following optimization constraints are employed, which aim to ensure replicability and investability:

- The weighted-average dividend yield of the Index will be targeted to be 50% more (soft constraint) and constrained to be at least 30% more (hard constraint) than the weighted-average dividend yield of the Parent Index at the time of rebalancing
- The ex-ante Tracking Error of the Index, relative to the Parent Index will be constrained to be equal to or less than 5%
- The maximum weight of an index constituent will be restricted to the lower of (the weight of the security in the Parent Index + 2%) and 10 times the weight of the security in the Parent Index. The minimum weight of an index constituent will be restricted to be the higher of the (weight of the security in the Parent Index - 2%) and 0
- For countries with weight greater than 2.5% in a composite Parent Index, the weight in the Index will not deviate more than +/-20% from the country weight in the Parent Index
- For countries with weight less than 2.5% in a composite Parent Index, the weight in the Index will be capped at 3 times their weight in the Parent Index
- The above country weight constraint will also apply on China A Stock Connect listings as a group separately in addition to the usual country weight constraint on China
- The sector weights of Index will not deviate more than +/-5% from the sector weights of the Parent Index
- The minimum weighted-average industry-adjusted ESG score of the Index at the time of rebalancing will be higher of the following:
  - 120% of the weighted-average industry-adjusted ESG score of the Parent Index and
  - The ESG Score of the Index by removing at least bottom 20% of the Parent Index by lowest ESG score
- The minimum reduction in the Weighted Average Carbon Emission Intensity<sup>7</sup> relative to the Parent Index will be 30%
- The minimum reduction in the Potential Emissions per dollar of market capitalization relative to the Parent Index will be 30%
- The constraint on minimum Index SE% (which reflects a particular interpretation of the company-level sustainable investment assessment as per Article 2(17) of the Sustainable Finance Disclosure Regulation (SFDR)<sup>8</sup> along with an associated aggregation method) for the Index is defined in Appendix VII.

<sup>7</sup> Carbon Intensity = Scope 1 & 2 Emission / Sales. For Parent Index constituents where the Emissions Intensity is not available, the average Emissions Intensity of all the constituents of the MSCI ACWI Index in the same GICS Industry Group in which the constituent belongs is used.

<sup>8</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>



- The one-way turnover of the Index is constrained to a maximum of 20% at each index review

Please refer to Appendix VI for the criteria used to determine the company-level sustainable exposure qualification and the calculation of Index SE%.

The Potential Emissions per dollar of market capitalization of the Indexes is calculated using the formulae defined in Appendix VIII.

The Weighted Average Carbon Intensity is calculated using the formulae defined in section 1.2 of MSCI Carbon Footprint Index Ratios Methodology<sup>9</sup>.

## 2.7 Determining the Optimized Index

The MSCI High Dividend Yield Advanced Select Indexes are constructed using the Barra Open Optimizer in combination with the relevant Barra Equity Model<sup>10</sup>. The optimization uses the Eligible Universe as the universe of eligible securities and the specified optimization objective and constraints to determine the Index. Infeasible optimizations are handled as explained in Appendix IV.

After the optimization process, any securities with weights below 0.05% are eliminated, and their weight is proportionately distributed over the remaining securities in order to determine the final Index.

## 2.8 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

<sup>9</sup> For details about the methodology, please refer to: <https://www.msci.com/index-carbon-footprint-metrics>.

<sup>10</sup> Please refer to Appendix V for the detailed information on model usage.

## 3 Maintaining the Index

### 3.1 Semi-Annual Index Review

The Indexes are rebalanced on a semi-annual basis, usually as of the close of the last business day of May and November, coinciding with the May and November Index Reviews of the MSCI Global Investable Market Indexes. Fundamental variables and Barra Equity Model data as of the end of April and October are used respectively.

In general, MSCI uses MSCI ESG Research data<sup>11</sup> (including MSCI ESG Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research, MSCI Climate Change Metrics and MSCI Impact Solutions) as of the end of the month preceding the Index Reviews for the rebalancing of the Index. For some securities, such data may not be published by MSCI ESG Research by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the Index.

The pro forma Indexes are in general announced nine business days before the effective date.

During each semi-annual Index Review, the constituents of the underlying Parent Index are screened for potential inclusion in the Index according to the screening process described in Section 2.

Existing constituents of the current Index will also be evaluated for continued inclusion using the following screening process:

- If a security is already an Index constituent, it will still be allowed to remain in Eligible Universe until it reaches the top 2% (within each sector), by decreasing order of Dividend Payout. If it is within the top 2% limit, it will be excluded from the Index
- If a security is already an Index constituent but its 5Y DPS growth rate turns negative, it will still be allowed to remain in the eligible universe, provided that the 1-year dividend per share (1Y DPS) growth rate<sup>12</sup> of that security is nonnegative. Securities which do not have sufficient data to calculate a 5Y DPS growth rate or 1Y DPS growth rate would still be eligible to remain in the Index.
- If a security is already an Index constituent, it will still be allowed to remain in the Eligible Universe as long as its sector-relative Quality Z-score is higher than or equal to -0.5.

### 3.2 Monthly Review of Controversies

Index constituents are reviewed on a monthly basis for the involvement in ESG controversies and for compliance with the United Nations Global Compact Principles. Existing constituents will be deleted if they face controversies as defined by MSCI ESG Controversies Score of 0 ('Red Flag' companies), or if they fail to comply with the United Nations Global Compact Principles.

MSCI uses MSCI ESG Controversies data as of the end of the month preceding the review (e.g., end of June data for the end of July monthly review). For some securities, such data may not be published by MSCI ESG Research by the end of the month preceding the review. For such securities,

<sup>11</sup> See section 4 for details of data sourced from MSCI ESG Research used in the Indexes.

<sup>12</sup> Please refer to Appendix of MSCI High Dividend Yield Indexes Methodology for definition of 1Y DPS growth and its calculation.

MSCI will use ESG data published after the end of month, when available, for the monthly review of the Index.

The pro forma indexes are generally announced nine business days before the first business day of the month.

### 3.3 Ongoing Event Related Changes

The general treatment of corporate events in the Indexes 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.

The following section briefly describes the treatment of common corporate events within the Indexes.

No new securities will be added (except where noted below) to the Index between Index Reviews. Parent Index deletions will be reflected simultaneously in the Index.

#### **EVENT TYPE**

#### **EVENT DETAILS**

##### **New additions to the Parent Index**

A new security added to the Parent Index (such as IPO and other early inclusion) 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 nonconstituent 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 NonMarket 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 Indexes are products of MSCI Inc. that utilize 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 Indexes use the following MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Controversies, MSCI ESG Business Involvement Screening Research, MSCI Climate Change Metrics and MSCI Impact Solutions. 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 in: <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 in: <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 provide climate data & tools to support institutional investors seeking to integrate climate risk & opportunities into their investment strategy and processes. This includes investors seeking to achieve a range of objectives, including measuring and reporting on climate risk exposure, implementing low carbon and fossil fuel-free strategies, alignment with temperature pathways and factoring climate change research into their risk management processes, in particular through climate scenario analysis for both transition and physical risks.

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

#### 4.4.1 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).

#### 4.4.2 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>

### 4.5 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.

For more details on MSCI Sustainable Impact Metrics, please refer to <https://www.msci.com/legal/disclosures/esg-disclosures>.

## Appendix I: The Parent Index and the Base Currency for Optimization

MSCI High Dividend Yield Advanced Select Index	Parent Index	Base Currency for Optimization
MSCI USA High Dividend Yield Advanced Select Index	MSCI USA Index	USD
MSCI World High Dividend Yield Advanced Select Index	MSCI World Index	USD
MSCI Europe High Dividend Yield Advanced Select Index	MSCI Europe Index	USD
MSCI Japan High Dividend Yield Advanced Select Index	MSCI Japan Index	USD
MSCI Emerging Markets High Dividend Yield Advanced Select Index	MSCI EM (Emerging Markets) Index	USD



## Appendix II: Business Exclusion Criteria

MSCI ESG Research has developed a framework designed to define significant involvement in controversial activities. According to this framework, there are three tolerance levels: Zero Tolerance, Minimal Tolerance and Low Tolerance.

Each controversial activity screened by the MSCI High Dividend Yield Advanced Select Indexes (except Thermal Coal, Oil Sands and Global Norms) is assigned to one of these tolerance levels:

### Activities classified under “Zero Tolerance”

- **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 Ex-Controversial Weapons Indexes available at <https://www.msci.com/index/methodology/latest/XCW>.

### Activities classified under “Minimal Tolerance”

- **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).
- All companies that manufacture or assemble delivery platforms that were not developed or not significantly modified for the exclusive delivery of nuclear weapons.
- All companies that manufacture components for nuclear-exclusive delivery platforms.

- **Civilian Firearms**

- All companies classified as “Producer” of firearms and small arms ammunitions for civilian markets. It does not include companies that cater to the military, government, and law enforcement markets.
- All companies deriving 5% or more revenue from the distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use.

- **Tobacco**

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

- **Conventional Weapons**

- All companies deriving 5% or more revenue from the production of conventional weapons and components
- All companies deriving 10% or more aggregate revenue from weapons systems, components, and support systems and services

**Activities not classified under any specific tolerance level**

- **Thermal Coal**

- 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 generation (e.g. in the case of vertically integrated power producers); intra-company sales of mined thermal coal; and revenue from coal trading.
- All companies deriving 5% or more revenue (either reported or estimated) from the thermal coal based power generation.

- **Oil Sands**

- All companies deriving 5% or more revenue from oil sands extraction, which own oil 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 that own oil sands reserves with no associated revenue are also not excluded.

- **Global Norms – United Nations Global Compact Compliance**

- All companies that fail to comply with the United Nations Global Compact principles.

## Appendix III: Calculation of the grossed-up sectorrelative Dividend Yield z-Score

Within each sector, the grossed-up dividend yield z-score for each security within the sector is first computed as described:

$$z = \frac{(x - \mu)}{\sigma}$$

Where:

- $z$  is the sector-relative grossed-up Dividend Yield z-score of security
- $x$  is the grossed-up Dividend Yield for a given security
- $\mu$  is the equal weighted mean of the grossed-up Dividend Yield within the sector
- $\sigma$  is the equal weighted standard deviation of the grossed-up Dividend Yield within the sector

## Appendix IV: Handling Infeasible Optimizations

During the semi-annual Index Review, in the event that there is no optimal solution that satisfies all the optimization constraints defined in Section 3.6, the following constraints are relaxed, until an optimal solution is found:

- Relax the maximum weight multiple in steps of 2 up to a maximum of 5 iterations (up to a maximum of 20 times the weight of the security in the Parent Index)
- Relax the turnover constraint in steps of 4%, up to a maximum of 40%
- The maximum active weight multiple constraint and the maximum turnover constraint are alternately relaxed until a feasible solution is achieved. For example, constraints relaxation is executed in the sequence as illustrated below:

Order of Relaxation	Maximum Asset Weight Multiple	Turnover Limit
1	12 times the weight of the security in the Parent Index	20%
2	12 times the weight of the security in the Parent Index	24%
3	14 times the weight of the security in the Parent Index	24%
4	14 times the weight of the security in the Parent Index	28%

In the event that no optimal solution is found after the above constraints have been relaxed and if the ESG Score constraint is set at 120% of the Parent Index ESG Score, the ESG score<sup>13</sup> is relaxed from 120% of the weighted-average industry-adjusted ESG score of the Parent Index down to a minimum value equivalent to the ESG score of the Index by removing at least bottom 20% of the Parent Index by lowest ESG score in 5 equal steps.

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

<sup>13</sup> Weighted-average industry-adjusted ESG score of the Index.

## **Appendix V: New release of Barra® Equity Model or Barra® Optimizer**

The methodology presently uses MSCI Barra Global Equity Model for Long-Term Investors (“GEMLTL”) 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 VI: Company-Level Sustainable Exposure and Calculation of Index SE%

A company qualifies as having company-level sustainable exposure if it meets all the following conditions.

1. MSCI ESG Rating of “BB” or above<sup>14</sup>
2. MSCI ESG Controversies Score of 2 or above<sup>15</sup>
3. At least one of the following conditions is met:
  - a. Derives 20% or more aggregate revenue from any of the thirteen social and environmental impact categories of Sustainable Impact Metrics (including nutrition, sanitation, major diseases treatment, SME finance, education, connectivity, affordable real estate, alternative energy, energy efficiency, green building, pollution prevention, sustainable agriculture and sustainable water).
  - b. Has one or more active carbon emissions reduction target(s) approved by the Science Based Targets initiative (SBTi).
4. Not flagged by the following business involvement criteria:
  - a. Has any tie to Controversial Weapons (cluster munitions, landmines, depleted uranium weapons, biological/chemical weapons, blinding lasers, non-detectable fragments and incendiary weapons), in line with the methodology of the MSCI Ex-Controversial Weapons Indexes available at <https://www.msci.com/index-methodology>.
  - b. Derives 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.
  - c. Manufactures tobacco products, such as cigars, blunts, cigarettes, ecigarettes, inhalers, beedis, kreteks, smokeless tobacco, snuff, snus, dissolvable and chewing tobacco.
  - d. Derives 5% or more aggregate revenue from the production, distribution, retail, supply and licensing of tobacco-related products.

The index-level sustainable exposure is calculated as the sum of the weight of companies in the Index that qualify as having company-level sustainable exposure.

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<sup>14</sup> The condition is not met if the MSCI ESG Rating is missing for the company.

<sup>15</sup> The condition is not met if the MSCI ESG Controversies Score is missing for the company.

## Appendix VII: Minimum Index SE% Constraints

The following optimization constraints on minimum Index SE% are used for each Index.

No.	Index	Index SE% Threshold
1	MSCI USA High Dividend Yield Advanced Select Index	15%
2	MSCI World High Dividend Yield Advanced Select Index	25%
3	MSCI Europe High Dividend Yield Advanced Select Index	25%
4	MSCI Japan High Dividend Yield Advanced Select Index	20%
5	MSCI Emerging Markets High Dividend Yield Advanced Select Index	5%

## Appendix VIII: Calculation of Carbon Exposure Metrics

### Index Carbon Emissions –

For Parent Index constituents where the Scope 1+2 Emissions Intensity is not available, the average Scope 1+2 Emissions Intensity relative to Sales of all the constituents of the MSCI ACWI in the same GICS Industry Group in which the constituent belongs to is used.

Security Level GHG Intensity relative to Sales =

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

Weighted Average GHG Intensity relative to Sales of the Parent Index -

$$\sum_i (\text{Weight in Parent Index} * \text{Security Level GHG Intensity relative to Sales})$$

Weighted Average GHG Intensity relative to Sales of the Derived Index –

$$\sum_i (\text{Weight in Derived Index} * \text{Security Level GHG Intensity relative to Sales})$$

### Index Potential Carbon Emissions from Fossil Fuels–

Parent Index Potential Carbon Emissions from Fossil Fuels–

$$\sum_i \left( \frac{(\text{Float Market Capitalization} * \text{Absolute Potential Emissions})}{\text{Issuer Market Capitalization}} \right)$$

Derived Index Potential Carbon Emissions from Fossil Fuels–

$$\sum_i \left( \frac{(\text{Derived Index Market Capitalization} * \text{Absolute Potential Emissions})}{\text{Issuer Market Capitalization}} \right)$$



## Appendix IX: 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 – <http://www.msci.com/index/methodology/latest/XCW>
- MSCI High Dividend Yield Indexes Methodology – <http://www.msci.com/index/methodology/latest/HDY>
- MSCI ACWI Sustainable Development Indexes Methodology – <http://www.msci.com/index/methodology/latest/StustainableDev>
- 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 X: Changes to this Document

### The following sections have been modified since May 2022:

#### Section 2.6.2: Optimization Constraints

- Update to reflect the change in the weighted-average industry-adjusted ESG score constraint
- Appendix IV: Handling Infeasible Optimizations

Update to reflect the change in weighted-average industry-adjusted ESG score constraint relaxation

### The following sections have been modified since November 2022:

- Introduction: Updated to reflect the new requirement on index-level sustainable exposure
- Section 2.6.2: Optimization Constraints
- Update to reflect the addition of minimum index-level sustainable exposure (Index SE%) constraint
- Section 3.2: Monthly Review of Controversies
- Added to reflect the monthly exclusions of ‘Red Flag Companies’
- Appendix VI: Additional details of the calculation of index-level sustainable exposure
- Appendix VII: Added to reflect the optimization constraints on index-level sustainable exposure

### The following sections have been modified since December 2022:

- Section 2.6.2 Optimization Constrains: Update to reference Appendix VIII
- Appendix VIII: Added to reference formulae used for Potential Emissions per dollar of market capitalization calculation

### The following sections have been modified since July 2023:

- Methodology book was updated to reflect the transition of the MSCI Global Investable Market Indexes (GIMI) to Quarterly Comprehensive Index Reviews.
- All references to “Semi-Annual Index Reviews” and “Quarterly Index Reviews” of the MSCI GIMI were replaced with “Index Reviews.”
- Section 2.3.1 Companies Involved in Red Flag ESG Controversies. Clarified the exclusion criteria for companies involved in ESG Controversies.
- Section 4: ESG Research
  - Moved that after Section 3.
  - Updated the descriptions of MSCI ESG Research Products.

### The following sections have been modified since March 2024:

- Appendix I: Updated to reflect addition of new Indexes on Japan and EM region.
- Appendix VII: Updated to reflect optimization constraints on index-level sustainable exposure in Japan and EM region.



- Appendix IX: The details of the Methodology Set for the Indexes were added.

**The following sections have been modified as of February 2025**

- The Methodology Name and Index Name were updated, effective February 3rd; MSCI High Dividend Yield ESG Reduced Carbon Target Select Indexes will be renamed as MSCI High Dividend Yield Advanced Select Indexes
- Section 2.8: Treatment of Unrated Companies. Moved treatment of companies when ratings and research is not available from MSCI ESG Research to a new section
- Section 4.4: MSCI Climate Change Metrics. Added a sub-section under Climate Change Metrics to provide additional details on Fossil Fuels related activities and Greenhouse Gas Emissions.

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