MSCI USA Climate Paris Aligned Benchmark Extended Select Index Methodology

September 2023

Contents

1 Introduction

The MSCI USA Climate Paris Aligned Benchmark Extended Select Index ("the Index") [1] is designed to minimize its exposure to transition and physical climate risks while targeting an alignment with the Paris Agreement requirements. The Index is designed to exceed the minimum standards of the EU Paris-Aligned Benchmark. The Index is constructed from the MSCI USA Index ("Parent Index") following an optimization-process that aims to:

- Exceed the minimum technical requirements laid out in the EU Delegated Act[2]
- Reduce the Index's exposure to physical risk arising from extreme weather events by at least 50%
- Increase the weight of companies which are exposed to climate transition opportunities and reduce the weight of companies which are exposed to climate transition risks
- Increase the weight of companies with credible carbon reduction targets through the weighting scheme
- Achieve a modest tracking error compared to the Parent Index and low turnover

[1] The Indexes are governed by a set of methodology and policy documents ("Methodology Set"), including the present index methodology document. The Methodology Set for the Indexes can be accessed from MSCI's webpage https://www.msci.com/index-methodology in the section 'Search Methodology by Index Name or Index Code'.

The Methodology Set includes a document 'ESG Factors in Methodology' that contains the list of environmental, social, and governance factors considered, and how they are applied in the methodology (e.g., selection, weighting or exclusion).

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1816&from=EN)

2 Index Construction Methodology

The Index uses company ratings and research provided by MSCI ESG Research[3] for the Index construction.

2.1 APPLICABLE UNIVERSE

The Applicable Universe includes all the existing constituents of the parent index ("Parent Index"). This approach aims to provide an opportunity set with sufficient liquidity and investment capacity.

2.2 ELIGIBLE UNIVERSE

The Eligible Universe is constructed from the Applicable Universe by excluding securities of companies based on the exclusion criteria below:

1. **Controversial Weapons**: All companies involved in Controversial Weapons as defined by the methodology of the MSCI Ex-Controversial Weapons Indexes.
2. **ESG Controversies**: All companies assessed as having involvement in ESG controversies that are classified as Red Flags (MSCI ESG Controversy Score of 0). A Red Flag indicates an ongoing, Very Severe ESG controversy implicating a company directly through its actions, products, or operations.
3. **Tobacco**: All companies with involvement in Tobacco as defined by the methodology of the MSCI Global ex Tobacco Involvement Indexes. Additionally, companies classified as either "Ownership by a Tobacco Company" or "Ownership of a Tobacco Company" are excluded.
4. **Environmental Harm**: All companies assessed as having involvement in environmental controversies that are classified as Red (MSCI Environmental Controversy Score of 0) or Orange Flags (score of 1).
    - A Red Flag indicates an ongoing, Very Severe ESG controversy implicating a company directly through its actions, products, or operations.
    - An Orange Flag indicates an ongoing Severe ESG controversy implicating a company directly, or a Very Severe ESG controversy that is either partially resolved or indirectly attributed to the company's actions, products, or operations.
5. **Thermal Coal Mining**: as described in section 2.1 of the MSCI Climate Paris Aligned Indexes methodology.
6. **Oil & Gas**: as described in section 2.1 of the MSCI Climate Paris Aligned Indexes methodology.

[3] See section 4 for further information regarding ESG and climate data used in the Indexes that MSCI Limited sources from MSCI ESG Research LLC, a separate subsidiary of MSCI Inc. MSCI ESG Research is solely responsible for the creation, determination and management of such data. MSCI Limited is the benchmark administrator for the MSCI indexes.

7. **Power Generation**: as described in section 2.1 of the MSCI Climate Paris Aligned Indexes methodology

Further, companies based on the following exclusion criteria are also excluded from the Applicable Universe.

8. **Nuclear Weapons**: All Companies with activities classified under "Minimal Tolerance"
9. **Civilian Firearms**: All companies classified as "Producer" or deriving 5% or more revenue from the manufacture and retail of civilian firearms and ammunition.
10. **Oil Sands**: All companies deriving 5% or more revenue from oil sands extraction

Please refer to Appendix II for details on the criteria used for 8, 9 and 10. Finally, companies which do not have an ESG Rating are also excluded from the index.

2.3 OPTIMIZATION CONSTRAINTS

At each Semi-Annual Index Review, the Index is constructed using an optimization process that aims to achieve replicability and investability as well as minimize ex-ante tracking error relative to the Parent Index subject to the following constraints:

1. Transition and physical risk objectives – constraints detailed in Table 1
2. Transition opportunities objectives – constraints detailed in Table 2
3. Diversification objectives – constraints detailed in Table 3

Table 1: Constraints imposed to meet transition and physical risk objectives

No.	Transition and Physical Risk Objective	Target Value
1.	Minimum reduction in Greenhouse Gas (GHG) Intensity (Scope 1+2+3)[4] relative to Parent Index	As described in Section 2.2 - Table 1, of the MSCI Climate Paris Aligned Indexes methodology for the corresponding 'Transition and
2.	Minimum average reduction (per annum) in GHG Intensity relative to GHG Intensity at the Base Date[5]	
3.	Minimum active weight in High Climate Impact sector relative to the Parent Index	
4.	Minimum reduction in Weighted Average Potential Emissions Intensity relative to Parent Index	
5.	Minimum increase in weighted average Low Carbon Transition (LCT) Score relative to Parent Index	

[4] Prior to the May 2020 Semi-Annual Index Review (SAIR), the Weighted Average Carbon Emissions Intensity was calculated based on Scope 1+2 Emissions.

[5] Prior to the May 2020 Semi-Annual Index Review (SAIR) of the Indexes, the average reduction in WACI was calculated using Scope 1+2 Emissions since Inception.

No.	Transition and Physical Risk Objective	Target Value
	Please see more detail on LCT Score in Appendix III	Physical Risk Objective.
6.	Minimum reduction in Weighted Average Extreme Weather Climate Value-At-Risk (Aggressive Scenario) relative to Parent Index	
7.	Minimum Increase in aggregate weight in companies setting targets relative to the aggregate weight of such companies in the Parent Index. Companies Setting Targets are defined in Appendix III	20%

Table 2: Constraints imposed in order to meet transition opportunity objectives

No.	Transition Opportunity Objective	Target Value
8.	Minimum increase in weighted average LCT Score relative to Parent Index[6]	As described in Section 2.2 - Table 2, of the MSCI Climate Paris Aligned Indexes methodology for the corresponding 'Transition Opportunity Objective'.
9.	Minimum ratio of Weighted Average Green Revenue/ Weighted Average Brown Revenue relative to Parent Index	
10.	Minimum increase in Weighted Average Green Revenue relative to the Parent Index	

Table 3: Constraints imposed to meet diversification objectives

No.	Diversification Objective	MSCI USA Climate Paris Aligned Benchmark Extended Select Indexes
11.	Constituent Active Weight	As described in Section 2.2 - Table
12.	Minimum constituent weight	

[6] The constraint on increase in LCT Score is designed to underweight companies with a low LCT Score (assessed as companies facing risks from a low carbon transition) and overweight companies with a high LCT Score (assessed as companies which may have opportunities from a low carbon transition). Thus, the constraint has been repeated in Table 2 to illustrate how the constraint meets both the objectives.

No.	Diversification Objective	MSCI USA Climate Paris Aligned Benchmark Extended Select Indexes
13.	Security Weight as a multiple of its weight in the Parent Index	3, of the MSCI Climate Paris Aligned Indexes methodology for the corresponding 'Diversification Objective'.
14.	Active Sector Weights (the Energy Global Industry Classification Standard (GICS®)[7] Sector is not constrained)	
15.	Active Country Weights[8]	
16.	One Way Turnover	
17.	Common Factor Risk Aversion	
18.	Specific Risk Aversion	

The definitions of the target metrics for the optimization are detailed in Appendix III of the MSCI Climate Paris Aligned Indexes methodology.

The Weighted Average GHG Intensity on the base Date and the base dates for the respective indexes are described in Appendix I.

During the Semi-Annual Index Review, in the event that there is no optimal solution that satisfies all the optimization constraints, the following constraints will be relaxed, until an optimal solution is found:

- Relax the one-way index turnover constraint in steps of 1% up to 20%
- Relax the active sector weight constraint in steps of 1% up to +/-20%
- The one-way index turnover constraint and the active sector weight constraint are alternately relaxed until a feasible solution is achieved.

In the event that no optimal solution is found after the above constraint relaxations are exhausted, the relevant Index will not be rebalanced for that Semi-Annual Index Review.

[7] GICS, the global industry classification standard jointly developed by MSCI Inc. and S&P Dow Jones Indices.

[8] In case there are countries in the parent index which weigh less than 2.5% in the parent index then for such countries the active country upper bound of +5% is not applicable. When a country weighs less than 2.5% in parent index then the upper bound of country weight in the Index is set at three times of the country's weight in parent index.

2.4 DETERMINING THE OPTIMIZED PORTFOLIO

The Index is constructed using the Barra Open Optimizer[9] in combination with the relevant Barra Equity Model. The optimization uses universe of eligible securities and the specified optimization objectives and constraints to determine the constituents of the Indexes.

[9] Please refer to Appendix V and VI of the MSCI Climate Paris Aligned Indexes methodology document for more details.

3 Index Maintenance

3.1 SEMI-ANNUAL INDEX REVIEWS

The Indexes are rebalanced on a semi-annual basis, as of the close of the last business day of May and November, coinciding with the May and November Index Reviews of the MSCI Global Investable Market Indexes. The pro forma Indexes are in general announced nine business days before the effective date.

In general, MSCI uses MSCI ESG Research data[10] (including MSCI Climate Change Metrics, MSCI Climate Value-at-Risk, MSCI ESG Sustainable Impact Metrics, MSCI ESG Controversies and MSCI ESG Business Involvement Screening Research) as of the end of the month preceding the Index Reviews for the rebalancing of the Indexes.

3.2 MONTHLY REVIEW OF CONTROVERSIES

Index constituents are reviewed on a monthly basis for the involvement in ESG controversies. Existing constituents will be deleted if they are assessed as having involvement in ESG controversies that are classified as Red Flags (MSCI ESG Controversies Score of 0). A Red Flag indicates an ongoing, Very Severe ESG controversy implicating a company directly through its actions, products, or operations.

MSCI uses MSCI ESG Controversies data as of the end of the month preceding the review (e.g., end of June data for the 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, 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 effective date.

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.

Additionally, if the frequency of Index Reviews in the Parent Index is greater than the frequency of Index Reviews in the Index, the changes made to the Parent Index during intermediate Index Reviews will be neutralized in the Index.

The treatment of the common corporate events in the indexes follow the corporate events treatments as described in section 3.2 of the MSCI Climate Paris Aligned Indexes methodology.

[10] See section 4 for details of data sourced from MSCI ESG Research used in the Indexes.

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 Climate Change Metrics, MSCI Climate Value-at-Risk, MSCI ESG Sustainable Impact Metrics, MSCI ESG Controversies and MSCI ESG Business Involvement Screening Research. MSCI Indexes are administered by MSCI Limited.

4.1 MSCI CLIMATE CHANGE METRICS

MSCI Climate Change Metrics provides climate data & tools to support institutional investors seeking to integrate climate risk & opportunities into their investment strategy and processes. This includes investors seeking to achieve a range of objectives, including measuring and reporting on climate risk exposure, implementing low carbon and fossil fuel-free strategies, alignment with temperature pathways and factoring climate change research into their risk management processes, in particular through climate scenario analysis for both transition and physical risks.

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

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

4.2 MSCI CLIMATE VALUE-AT-RISK

Climate Value-at-Risk (Climate VaR) is designed to provide a forward-looking and return-based valuation assessment to measure climate related risks and opportunities in an investment portfolio. The fully quantitative model offers deep insights into how climate change could affect company valuations.

For more details on MSCI Climate Value-At-Risk, please refer to https://www.msci.com/climate-data-and-metrics

4.3 MSCI ESG SUSTAINABLE IMPACT METRICS

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

MSCI Sustainable Impact Taxonomy

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

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

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

4.4 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/esg-and-climate-methodologies.

4.5 MSCI ESG BUSINESS INVOLVEMENT SCREENING RESEARCH

MSCI ESG Business Involvement Screening Research (BISR) aims to enable institutional investors to manage environmental, social and governance (ESG) standards and restrictions reliably and efficiently.

For more details on MSCI ESG Business Involvement Screening Research, please refer to
http://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf

Appendix I: Decarbonization Trajectory of Indexes

The Weighted Average GHG Intensity on the Base Date (W_1) is used to compute the target Weighted Average GHG Intensity at any given Semi-Annual Index Review (W_t) as per the below formula.

$$W_t = W_1 * \ 0.90^{\frac{(t-1)}{2}}$$

Where 't' is the number of Semi-Annual Index Reviews since the Base Date. The table below shows the Weighted Average GHG Intensity on the Base Date(W_1) for each of the regions where the Indexes are constructed:

Index	Parent Index	Base Date	W_1 (tCO2/M$ Enterprise Value + Cash)
MSCI USA Climate Paris Aligned Benchmark Extended Select Index	MSCI USA Index	June 01, 2020	197.67

Appendix II: Additional ESG Exclusions Criteria

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 manufacture and retail of civilian firearms and ammunition.
- All companies deriving $20 million in revenue from civilian firearms-related products

ACTIVITIES NOT CLASSIFIED UNDER ANY SPECIFIC TOLERANCE LEVEL

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.

Appendix III: MSCI Low Carbon Transition Risk Assessment

MSCI ESG Research's Low Carbon Transition Risk assessment[11] is designed to identify potential leaders and laggards by holistically measuring companies' exposure to and management of risks and opportunities related to the low carbon transition.

The final output of this assessment is two company-level factors as described below:

(1) **Low Carbon Transition Category**: This factor groups companies in five categories that highlight the predominant risks and opportunities they are most likely to face in the transition (Exhibit 1).

(2) **Low Carbon Transition Score:** This score is based on a multi-dimensional risks and opportunities assessment and considers both predominant and secondary risks a company faces. It is industry agnostic and represents an absolute assessment of a company's position vis-à-vis the transition.

LOW CARBON TRANSITION SCORE	LOW CARBON TRANSITION CATEGORY		LOW CARBON TRANSITION RISK / OPPORTUNITY	
Score = 0	ASSET STRANDING		Potential to experience "stranding" of physical / natural assets due to regulatory, market, or technological forces arising from low carbon transition.	Coal mining & coal based power generation; Oil sands exploration/production
	TRANSITION	PRODUCT	Reduced demand for carbon-intensive products and services. Leaders and laggards are defined by the ability to shift product portfolio to low-carbon products.	Oil & gas exploration & production; Petrol/diesel based automobile manufacturers, thermal power plant turbine manufacturers etc.
	TRANSITION	OPERATIONAL	Increased operational and/or capital cost due to carbon taxes and/or investment in carbon emission mitigation measures leading to lower profitability of the companies.	Fossil fuel based power generation, cement, steel etc.
	NEUTRAL		Limited exposure to low carbon transition carbon risk. Though companies in this category could have exposure to physical risk and/or indirect exposure to low carbon transition risk via lending, investment etc.	Consumer staples, healthcare, etc.
Score = 10	SOLUTIONS		Potential to benefit through the growth of low-carbon products and services.	Renewable electricity, electric vehicles, solar cell manufacturers etc.

Exhibit 1: Low Carbon Transition Categories and Scores

[11] For more details on MSCI Climate Change Metrics, please refer to https://www.msci.com/climate-changesolutions

Appendix III: Companies Setting Targets

The Index requires a minimum 20% increase in the aggregate weight of companies setting emissions reduction targets compared to the weight of such companies in the Parent Index. Companies setting targets are defined as companies that:

- Publish emissions reduction targets and
- Publish their annual emissions and
- Have reduced their GHG intensity by 7% over each of the last 3 years

Appendix IV: Changes to this Document

The following sections have been modified as of May 2023:

Section 1: Introduction

- The methodology book was updated to add a footnote on the Methodology Set

Section 2: Index Construction

- The reference to the Climate Paris Aligned Indexes methodology for the companies setting target constraint was removed.
- The language for ESG Controversies and Environmental Controversies were modified using the latest product descriptions from MSCI ESG Research.

Section 3: Maintaining the Index

- The reference to the MSCI Global Investable Market Indexes (GIMI) Indexes was updated due the change towards the Quarterly Comprehensive Index Reviews.

Section 4: MSCI ESG Research

- Moved the ESG Research section after Section 3 (Maintaining the Indexes)
- Updated the descriptions of MSCI ESG Research products.

Appendix

- Added further details for the companies setting target constraint

The following sections have been modified as of September 2023:

Section 3: Index Maintenance

- The monthly review of ESG controversies is applied within the index effective October 2, 2023 and is not applicable historically prior to that date.

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