

# **MSCI USA IMI Stakeholders Sustainability Select Index Methodology**

**August 2024**

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## 1. Introduction

The MSCI USA IMI Stakeholders Sustainability Select Index ('the Index') is designed to represent the performance of a set of companies that exhibit a commitment towards business ethics, human capital management, gender diversity, racial diversity and community relations, while avoiding controversies related to employees, diversity, and community. The Index also incorporates the MSCI Quality Score<sup>1</sup> to select securities with stronger quality characteristics based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage<sup>2</sup>.

The Index excludes companies that are assessed as having involvement in controversies related to discrimination and workforce diversity, child labor, human rights and human capital. Meanwhile, the Index also upweights companies that outperform their peers in terms of fostering corporate ethics, human capital development and labor, community relations, as well as gender and racial diversity

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<sup>1</sup> For more details on the Quality score, please refer to MSCI Quality Indexes Methodology on <https://www.msci.com/index/methodology/latest/Quality>.

<sup>2</sup> The Index is governed by a set of methodology and policy documents ("Methodology Set"), including the present index methodology document. The Methodology Set for the Index can be accessed from MSCI's webpage <https://www.msci.com/indexmethodology> 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). See Appendix II for more information.

## 2. Index Construction Methodology

### 2.1 Applicable Universe

The Applicable Universe includes all the existing constituents of the MSCI USA IMI Index (herein, “the Parent Index”).

### 2.2 Eligible Universe<sup>3</sup>

The Eligible Universe is constructed from the Parent Index by excluding securities of companies based on the exclusions criteria below<sup>4</sup>:

1. **Controversy Related to Discrimination and Workforce Diversity**: This indicator measures the severity of controversies related to a firm’s workforce diversity. Companies with discrimination and workforce diversity controversy score of 0 or 1 are excluded.
2. **Controversy Related to Child Labor**: This indicator measures the severity of child labor controversies. Companies with child labor controversy score of 0 or 1 are excluded.
3. **Controversy Related to Human Rights**: This indicator is an assessment of controversies (if any) related to a firm’s impact on the communities in which it does business. Companies with human right controversy score of 0 or 1 are excluded.
4. **Controversy Related to Impact on Local Community**: This indicator measures the severity of controversies related to a firm’s interactions with communities in which it does business. Companies with impact on local community controversy score of 0 or 1 are excluded.
5. **Controversy Related to Labor Rights**: This indicator is an assessment of controversies (if any) related to a firm’s employee relations and supply chain. Companies with labor rights controversy score of 0 or 1 are excluded.
6. **Women Representation Score**:

- a. Calculation:

$$\begin{aligned}
 & \textit{Women Representation Score} \\
 &= 0.3 \times \% \textit{ Women On Board} \\
 &+ 0.3 \times \% \textit{ Women in Executive Management} \\
 &+ 0.3 \times \% \textit{ Women in Senior Management} \\
 &+ 0.1 \times \% \textit{ Women in Workforce}
 \end{aligned}$$

For companies with the number of female directors less than three, % *Women On Board* is discounted by 25%.

- b. The 25% of worst-scoring companies in the Applicable Universe are excluded.

<sup>3</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

<sup>4</sup> For exclusions based on scores (criterion 6 to 13), in case of a tie, securities are ranked by their weights in the Parent Index from high to low, and the exclusion would start from the bottom until the target number of securities are reached.

7. **Community Relations Score:** This indicator is a measurement of companies' management of local community relations, policies on conflict and human rights, and efforts to distribute benefits to local communities. The 25% of worst-scoring companies in the Applicable Universe are excluded.
8. **Controversial Sourcing Score:** This indicator is a measurement of the extent to which companies are at risk of incurring regulatory compliance costs, reputational damage, or supply chain disruptions resulting from reliance on raw materials that originate in areas associated with severe human rights and labor rights abuses. The 25% of worst-scoring companies in the Applicable Universe are excluded.
9. **Human Capital Development Score:** This indicator is a measurement of companies' ability to attract, retain and develop human capital based on their provision of benefits, training and development programs, and employee engagement. The 25% of worst-scoring companies in the Applicable Universe are excluded.
10. **Labor Management Score:** This indicator is a measurement of the extent to which companies are at risk of workflow disruptions due to labor unrest or reduced productivity due to poor job satisfaction. The 25% of worst-scoring companies in the Applicable Universe are excluded.
11. **Supply Chain Labor Standards Score:** This indicator is a measurement of the extent to which companies are exposed to risks of production disruptions and brand value damage due to sub-standard treatment of workers in the company's supply chain. The 25% of worst-scoring companies in the Applicable Universe are excluded.
12. **Corporate Ethics Score:** This indicator is a measurement of the extent to which a company may face business ethics issues such as fraud, executive misconduct, corruption scandals, money laundering, anti-trust violations or insider trading. The 25% of worst-scoring companies in the Applicable Universe are excluded.
13. **MSCI Quality Score:** After applying the exclusions defined above, the securities in the bottom 30% of the remaining securities by MSCI Quality score are also excluded.

## 2.3 Constituent Weighting

At each rebalancing, the followings steps are followed to arrive at the final weights:

1. All the securities eligible for inclusion in the Index are weighted by their market capitalization weight.
2. The above weights are then normalized to 100%.
3. For each of the following scores, securities within the top 10% by count, are upweighted by a factor of 1.25.
  - a. Women representation score
  - b. Racial minority representation score<sup>5</sup>
  - c. Community relations score

<sup>5</sup> See Appendix I for the calculation of the Racial minority representation score

- d. Controversial sourcing score
  - e. Human capital development score
  - f. Labor management score
  - g. Supply chain labor standards score
  - h. Corporate ethics score
  - i. MSCI Quality Score
4. The aggregate upweighting factor<sup>6</sup> is capped at 2.
  5. The above weights are then normalized to 100%.

## 2.4 Diversification Considerations

The Index is designed to take into account certain diversification rules. After the application of the rules described in section 2.3, the following steps are performed<sup>7</sup>.

- The maximum weight of all group entities will be constrained at 15%.
- A buffer of 10% of the value is applied on the maximum weight constraint. More specifically, as part of a rebalancing, the maximum weight of all group entities cannot exceed 13.5% of the Index weight.
- The sum of the weights of all group entities representing more than 5% weight will be constrained at 50%.
- A buffer of 10% of the value is applied on the aggregation factor of 5% and the aggregation constraint of 50%. More specifically, as part of a rebalancing, the aggregated weight of all group entities with weight above 4.5%, cannot exceed 45% of the Index weight.
- The Index will not be rebalanced between the two successive index reviews as per the schedule mentioned in Section 3
- The above reweighting resulting from group entity capping would take priority over any other methodological requirement.

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<sup>6</sup> A security may be upweighted based on multiple scores, where it is given 1.25 for score 1 and 1.25 for score 2, resulting in an aggregated upweighting factor of 1.56.

<sup>7</sup> Please refer to the MSCI 25/50 Indexes methodology available at: <https://www.msci.com/index/methodology>

### 3. Maintenance of the Index

#### 3.1 Annual Index Reviews

The Index is rebalanced on an annual basis, as of the close of the last business day of May, coinciding with the May Index Review of the MSCI Global Investable Market Indexes. The pro forma Index is in general announced nine business days before the effective date.

In general, MSCI uses MSCI ESG Research data (including MSCI ESG Controversies and MSCI ESG Ratings) as of the end of the month preceding the Index Review for the rebalancing of the Index.

#### 3.2 Quarterly Index Reviews

Security weighting and diversification considerations as defined in the section 2.4 are applicable only during Quarterly Index Reviews to coincide with the February, May, August, and November Index Reviews of the MSCI Global Investable Market Indexes.

The pro forma Index in general is announced nine business days before the effective date.

#### 3.3 Ongoing Event Related Changes

The general treatment of corporate events in the Index aims to minimize turnover outside of Index Reviews. The methodology aims to appropriately represent an investor’s participation in an event based on relevant deal terms and pre-event weighting of the index constituents that are involved.

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

No new securities will be added (except where noted below) to the Index between Index Reviews. Parent Index deletions will be reflected simultaneously in this derived 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 inclusions), will not be added to the Index.

**Spin-Offs**

All securities created as a result of the spin-off, including detached securities, of an existing index constituent will not 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 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.) Re-evaluation 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 Non-Market Capitalization Weighted indexes.

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



## 4. MSCI ESG Research

The Index is a product of MSCI Inc. that utilizes information such as company ratings and research produced and provided by MSCI ESG Research LLC (MSCI ESG Research), a subsidiary of MSCI Inc. In particular, the Index uses the following MSCI ESG Research products: MSCI ESG Ratings and MSCI ESG Controversies. MSCI Indexes are administered by MSCI Limited and MSCI Deutschland GmbH.

### 4.1 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>.

### 4.2 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>.

## Appendix I - Calculation of the Racial Minority Representation Score

The racial minority representation score is calculated as follows:

*Racial Minority Representation Score*

$$= 0.4 \times \% \text{ Racial Minority on Board} + 0.4 \times \% \text{ Racial Minority in Leadership} \\ + 0.2 \times \% \text{ Racial Minority in Workforce}$$

where

*% Racial Minority on Board*

$$= \% \text{ Asian on Board} + \% \text{ Black or African American on Board} \\ + \% \text{ Hispanic or Latino on Board} \\ + \% \text{ Native Hawaiian or Pacific Islander on Board}$$

*% Racial Minority in Leadership*

$$= \% \text{ Asian in Leadership} + \% \text{ Black or African American in Leadership} \\ + \% \text{ Hispanic or Latino in Leadership} \\ + \% \text{ Native Hawaiian or Pacific Islander in Leadership} \\ + \% \text{ Native American or Alaska Native in Leadership} \\ + \% \text{ Two or More Races or Ethnicities in Leadership}$$

*% Racial Minority in Workforce*

$$= \% \text{ Asian in Workforce} + \% \text{ Black or African American in Workforce} \\ + \% \text{ Hispanic or Latino in Workforce} \\ + \% \text{ Native Hawaiian or Pacific Islander in Workforce} \\ + \% \text{ Native American or Alaska Native in Workforce} \\ + \% \text{ Two or More Races or Ethnicities in Workforce}$$

The identified races or ethnicities are based on MSCI ESG Research's US Racial and Ethnic Diversity dataset pertaining to the percentage by race or ethnicity of the board<sup>8</sup>, leaders<sup>9</sup>, and employees<sup>10</sup>. The percentages may be of all members within the specified job category (board, leadership, or workforce) or only those that have opted to self-identify within the category. The races or ethnicities are defined as follows:

- Asian: Percentage [of board members, leaders, or employees] who self-identify as Asian, Asian American or having origins in any of the original peoples of the East Asia, Southeast Asia, or the Indian subcontinent as disclosed by the company.

<sup>8</sup> Does not include Native American or Alaska Native and Two or More Races or Ethnicities

<sup>9</sup> e.g., senior vice presidents or senior leadership. May include caveats such as the exclusion of leaders based on a specific location or from a specific business division. Where companies did not specify the location of the leaders to which the data refers it was assumed that the data pertained to the U.S. workforce only. When data concerning two or more leadership groups is disclosed, only the data regarding the most senior one will be mapped to the leadership diversity workforce group. May include executives' racial or ethnic data if such information has been grouped with information concerning other leaders.

<sup>10</sup> May include caveats such as the exclusion of employees based on a specific location or from a specific business division. Where companies did not specify the location of the employees to which the data refers it was assumed that the data pertained to the U.S. workforce only.

- Black or African American: Percentage [of board members, leaders, or employees] who self-identify as Black, African American or have origins in any of the Black racial groups of Africa, as disclosed by the company.
- Hispanic or Latino: Percentage [of board members, leaders, or employees] who self-identify as Hispanic, Latino, or having Cuban, Mexican, Puerto Rican, South or Central American, or cultures or origins related to Spain regardless of race, as disclosed by the company.
- Native Hawaiian or Pacific Islander: Percentage [of board members, leaders, or employees] who self-identify as Native Hawaiian, Pacific Islander or having origins in any of the original peoples of Hawaii, Guam, Samoa or other Pacific Islands as disclosed by the company.
- Native American or Alaska Native: Percentage [of leaders or employees] who self-identify as American Indian, Alaska Native, Native American or having origins in any of the original peoples of North and South America (including Central America) and who maintain tribal affiliation or community attachment, as disclosed by the company.
- Two or more races or ethnicities: Percentage [of leaders or employees] who self-identify as belonging to two or more races or ethnic groups, as disclosed by the company.

## Appendix II - 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 Investable Market Indexes Methodology – <https://www.msci.com/index/methodology/latest/GIMI>
- [ESG Factor 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 III – Changes to this Document

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

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

#### Section 2.3

- Added reference to the Racial minority representation score

#### Section 3

- The 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

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

#### Appendix I

- Added the calculation logic of the Racial minority representation score, as well as the underlying definitions

### The following sections have been updated effective August 2024:

#### Section 2

- Effective August 2024 Index Review, diversification considerations will be applied.

#### Section 3

- Quarterly Index Review has been included.

#### Appendix II

- Methodology Set Section added to the document

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