

THE MSCI ESG SCREENED INDEXES

An off-the-shelf approach to ESG screens

Guido Giese

October 2018

INTRODUCING THE MSCI ESG SCREENED INDEXES

Exclusionary screening remains the investment approach with the largest share of assets under management (AUM) in the environmental, social and governance (ESG) space.¹ In addition, many advanced ESG integration approaches start with an exclusionary screen.

Institutional investors' motivations for exclusionary screens include aligning portfolios with their social values, complying with global norms, such as the UN Global Compact and avoiding reputational risks that can be caused by exposures to investments that may be seen as controversial. Exclusions can also be motivated by the wish to mitigate financial risks, such as stranded assets (fossil fuels) or long-term business risks (tobacco production). Given the increasing utilization of values- and norms-based screens, investors may consider using market-cap benchmarks that leverage some of the most commonly used screens.

The MSCI ESG Screened Indexes are designed to serve this purpose: their index methodology applies the most common exclusions to the underlying market-cap benchmark, as shown on the following page.²

¹ Global Sustainable Investment Alliance. (2016). ["2016 Global Sustainable Investment Review."](#)

² We use the MSCI ACWI ESG Screened index for our analysis, which covers global developed and emerging markets. The MSCI ESG Screened Indexes also exist at a regional level, e.g. MSCI USA ESG Screened Index, etc.

MSCI ACWI ESG SCREENED INDEX

Detail of the exclusionary screen and number of companies removed by each screen

SCREEN	THRESHOLD	STOCKS EXCLUDED (MSCI ACWI)	WEIGHTS EXCLUDED (MSCI ACWI)
ENVIRONMENT			
NUCLEAR POWER	Any tie		
THERMAL COAL	5% revenue from mining of thermal coal or sale; 5% revenues from thermal coal based power generation	100	1.99%
OIL SANDS	5% revenue oil from sand extraction	6	0.33%
SOCIAL			
TOBACCO	All producers, 5% revenue from distribution, retail and supply of tobacco related products	23	1.26%
WEAPONS			
NUCLEAR WEAPONS		19	1.74%
CIVILIAN FIREARMS	All producers; 5% revenue from distribution for civilian use	3	0.21%
CONTROVERSIAL WEAPONS	Any tie	8	0.82%
GOVERNANCE			
UN GLOBAL COMPACT	Any violation	29	2.78%
TOTAL ¹		179	7.93%



¹ Some companies were excluded due to more than one screen and therefore the total is not exactly the sum of the individual exclusions.

Simulated data as of Aug. 31, 2018. Not indicative of future performance. Please see the Notices at the end of this paper regarding the use of backtested or simulated data.

The exclusion of controversial weapons and tobacco³ is part of the UN Global Compact. The divestment from thermal coal and oil sands is a global trend followed by a number of large investors, including some large global insurers. Divesting from nuclear weapons has been a focus of socially conscious investors since the early days of ESG investing.

MSCI ACWI ESG SCREENED INDEX PROFILE

In the period of analysis, May 31, 2012⁴ to Aug. 31, 2018, using simulated data, the MSCI ACWI ESG Screened Index covered over 90% of the market with a tracking error of 0.5%. Performance and risk figures (such as volatility and drawdown), as well as index liquidity (annualized traded value ratio (ATVR)) and index turnover closely tracked the parent index during this time.⁵

³ Since July 2017, see <https://www.unglobalcompact.org>.

⁴ The index was backtested starting on May 31, 2012.

⁵ This report may contain analysis of historical data, which may include hypothetical, backtested or simulated performance results. There are frequently material differences between backtested or simulated performance results and actual results subsequently achieved by any investment strategy.

The average ESG score for the MSCI ACWI ESG Screened Index was the same as in the benchmark, as it does not integrate MSCI ESG Ratings. At the same time, we observed a significant reduction in terms of both actual and potential carbon emissions due to the exclusions screen on thermal coal and oil sands.

Key Index metrics comparison

	MSCI ACWI Index	MSCI ACWI ESG Screened Index
Total Return (%)	12.2	12.6
Total Risk (%)	9.7	9.7
Sharpe Ratio	1.21	1.24
Tracking Error (%)	0	0.5
Information Ratio	-	0.80
Max Drawdown (%)	18.9	18.9
No of Stocks*	2476	2295
Parent Index Coverage* (%)	100	90.5
Large* (%)	82.7	81.9
Mid* (%)	17.3	18.1
Turnover** (%)	2.1	2.6
Weighted Average ATVR (%)	97.1	98.6
ESG score	5.7	5.7
Carbon Intensity (t CO₂e/\$M Sales)	230	158 (-31.3%)
Potential Carbon Emissions (t CO₂e/\$M Invested)	3072	1840 (-40.1%)

*From May 31, 2012 to Aug. 31, 2018 (*monthly averages; **annualized one-way index turnover over index reviews)*

In brief, the MSCI ACWI ESG Screened Index was very close to the standard MSCI ACWI benchmark in terms of its financial profile.

The analysis and observations in this report are limited solely to the period of the relevant historical data, backtest or simulation. Past performance — whether actual, backtested or simulated — is no indication or guarantee of future performance. None of the information or analysis herein is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision or asset allocation and should not be relied on as such.

POTENTIAL APPLICATIONS

Indexes are often used as benchmarks at both a strategic level as well as an implementation level. Investors may use policy benchmarks in their strategic asset allocation to define eligible markets and the universe of eligible securities for their portfolios. At the same time, they may use them to define active or passive allocations when implementing their asset allocation strategies.

Investors who have decided to implement certain norms- or values-based exclusions across their portfolios may want these exclusion screens reflected in their benchmarks for consistency and transparency. After all, exclusions are a form of investment constraint that an institutional investor may want to reflect in the strategic asset allocation framework – especially when defining the universe of eligible securities.

As illustrated in the previous exhibit, as well as the one below, active size and sector weights for the MSCI ACWI ESG Screened Index were fairly small.

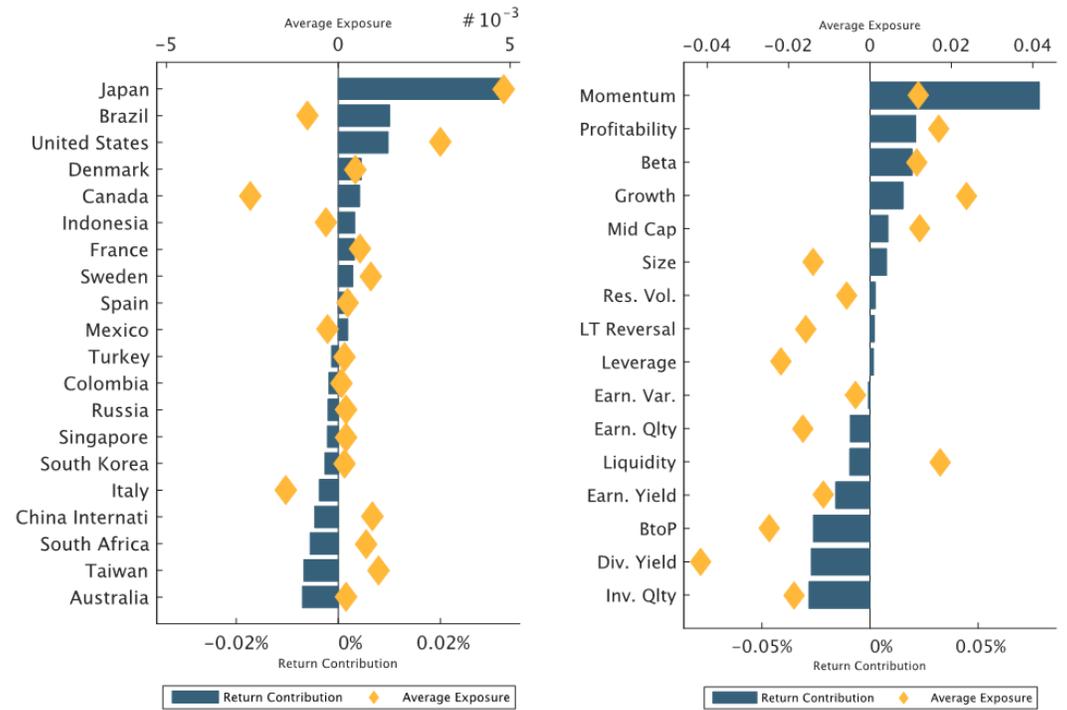
Active sector weights in the MSCI ACWI ESG Screened Index

Sector	Active weight %
Energy	-1.2
Materials	-0.5
Industrials	-1.1
Consumer Discretionary	0.8
Consumer Staples	-0.9
Health Care	0.6
Financials	1.5
Information Technology	1.7
Telecommunication Services	0.2
Utilities	-1.3
Real Estate	0.3
Standard Deviation	1.08

Simulated data as of Aug. 31, 2018. Not indicative of future performance.

In addition, the active exposures and returns due to country and equity style factor shifts caused by exclusions were fairly small during the study period. It is important to mention that these active factor exposures and their performance impact are simulated, unintended exposures and may vary over time.

Active country (left) and style exposures (right) in the MSCI ACWI ESG Screened Index



Simulated data from May 31, 2012 to Aug. 31, 2018

Exclusionary screening is often an important element of ESG investing for many asset owners and asset managers, and is also a key component of some advanced ESG integration methodologies for active and passive portfolios. Building commonly used exclusion screens into a market-cap index may help institutional investors align their strategic asset management framework with their values or their wish to divest from certain business activities to mitigate long-term financial risks.

CONTACT US

clientservice@msci.com

AMERICAS

Americas	1 888 588 4567 *
Atlanta	+ 1 404 551 3212
Boston	+ 1 617 532 0920
Chicago	+ 1 312 675 0545
Monterrey	+ 52 81 1253 4020
New York	+ 1 212 804 3901
San Francisco	+ 1 415 836 8800
Sao Paulo	+ 55 11 3706 1360
Toronto	+ 1 416 628 1007

EUROPE, MIDDLE EAST & AFRICA

Cape Town	+ 27 21 673 0100
Frankfurt	+ 49 69 133 859 00
Geneva	+ 41 22 817 9777
London	+ 44 20 7618 2222
Milan	+ 39 02 5849 0415
Paris	0800 91 59 17 *

ASIA PACIFIC

China North	10800 852 1032 *
China South	10800 152 1032 *
Hong Kong	+ 852 2844 9333
Mumbai	+ 91 22 6784 9160
Seoul	00798 8521 3392 *
Singapore	800 852 3749 *
Sydney	+ 61 2 9033 9333
Taipei	008 0112 7513 *
Thailand	0018 0015 6207 7181 *
Tokyo	+ 81 3 5290 1555

*toll free

ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

MSCI serves 99 of the top 100 largest money managers, according to the most recent P&I ranking.

For more information, visit us at www.msci.com.

NOTICE AND DISCLAIMER

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the “Information”) is the property of MSCI Inc. or its subsidiaries (collectively, “MSCI”), or MSCI’s licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the “Information Providers”) and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, “Index Linked Investments”). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investable assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.’s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.’s company filings on the Investor Relations section of www.msci.com.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI’s products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, IPD, and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor’s. “Global Industry Classification Standard (GICS)” is a service mark of MSCI and Standard & Poor’s.