

MSCI



# Building Better Indexes: How Screening Shapes Sustainable and Climate Investing

# Creating Sustainable Investment Universes: The Role of Screening

Integrating sustainability and climate considerations into index design is a multi-dimensional process involving several connected layers, each playing an important role in helping investors achieve their objectives.

Screening forms the foundation of this process, serving an essential step toward creating a sustainable investment universe.

## Dimensions of Sustainable and Climate Investing



### **Thematic / Impact**

Target specific sustainability or climate outcomes

### **Integration**

Adjust weights and select securities for sustainability or climate performance

### **Screening**

Define investable universe by avoiding specific exposures

# A Brief History of Screening

Modern day investment screening dates back to the 1960s, when investors began excluding certain industries based on ethical or faith-based values.

By the 1990s, environmental, social, and governance (ESG) frameworks emerged, with indices such as KLD (now part of MSCI) formalizing data-driven exclusions around norms, policies, and international standards.

The 2020s brought climate into the screening conversation. Investors began using it not only to manage reputational and regulatory risks but also to achieve measurable pathways to reduce carbon exposure.

Fund/ Index Launches	1971	1990	2011	2013	2019	2021	2022
	Pax World Fund, the first socially responsible mutual fund, excluding defense and alcohol companies	MSCI KLD 400 Social Index	Socially Responsible Investing	MSCI ESG Leaders Indexes	MSCI Climate Change Indexes	MSCI Climate Paris Aligned Indexes	MSCI Climate Action Indexes
							
	1960s–1980s	1990s–2000s	2010s				2020s
Type	Ethical / Faith-based	Norms & policy alignment (data-driven exclusions)	ESG mainstreaming				Regulation & climate
Focus	Values & moral exclusions	UNGC, tobacco, weapons	ESG data-driven norms, fossil fuel exclusions				PAB/CTB fossil exclusions, SFDR
Examples	Church / Anti-apartheid divestments	Domini 400 (now MSCI KLD 400 Social)	ESG indexes				PAB & CTB Benchmarks

# Why Screening Still Matters

Despite the rise of more advanced sustainable integration and impact investing, screening remains the most widely used process for incorporating sustainability and climate considerations<sup>1</sup>.

It serves as the first step toward building responsible investment portfolios, allowing investors to:

Ensure investments reflect the institution's governing policies, ethical codes, and stakeholder expectations.

Comply with evolving sustainability disclosure rules and benchmark regulations.

Avoid exposure to companies that breach international norms or are involved in severe controversies.

Address climate transition challenges and potential for stranded assets. A topic that is growing in importance.

Provides a straightforward, transparent and cost-efficient way to reflect sustainability or climate objectives with limited impact on tracking error.

# How Screening fits into Index Construction

A typical workflow for building a sustainable or climate index with screening will look like this:

- 1 Starting universe:** Usually begins with a broad market-cap universe (the parent index).
- 2 Data coverage check:** Remove companies not assessed by MSCI Solutions.
- 3 Apply exclusions:** Use rules defined in the methodology to exclude issuers (norms-based, activity-based, controversy-based, climate filters, etc.).
- 4 Eligible universe:** The remaining companies form the eligible pool for selection and weighting.
- 5 Index construction:** Apply weighting schemes, sector/country constraints, and any further construction logic and parameters to produce the final index.

Some sustainability indices add additional constraints (sector or country caps, relative limits to the parent index) to help indexes representativeness.



# Types of Screening and associated MSCI Data Sets

## Norms-Based Screening

Excludes companies that breach international standards, such as the UN Global Compact or OECD guidelines, covering areas like human rights, labor, environmental responsibility, and anti-corruption.

MSCI Data Set: Controversies

## Activity-Based Screening (Business Involvement)

Assesses company revenues from specific activities — for example, tobacco, weapons, or fossil fuels. Using detailed data allows for precise thresholds (e.g., excluding producers with 5% or more of revenue from tobacco).

MSCI Data Set: Business Involvement Screening Research (BISR)

## Controversy Screening

Focuses on companies involved in significant ESG controversies, such as environmental incidents or labor violations. Each event is assessed for severity, the company's role, and resolution status. Cases are aggregated to determine whether an issuer receives a "red," "orange," or "yellow" flag. Red flags typically lead to exclusions in Sustainability and Climate indexes.

MSCI Data Set: Controversies

## Climate-Related Screening

Targets companies with high fossil fuel exposure, significant emissions intensity, or lack of science-based targets. These screens help investors reduce climate transition risks and align portfolios with decarbonization objectives.

MSCI Data Set: Climate Metrics

# Looking to the Future

Screening is a foundational and often underestimated process in sustainable and climate investing. Once viewed primarily as a simple exclusionary step, it now plays a more sophisticated role in shaping investment strategies — reflecting decades of evolution in investor priorities, regulatory expectations and data-driven insight.



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