

# **MSCI Climate Action Indexes Methodology**

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## 1 Introduction

The MSCI Climate Action Indexes (the 'Indexes') are designed to represent the performance of companies that have been assessed to lead their sector peers in terms of their positioning and actions relative to a climate transition.

Companies from the underlying parent index (the "Parent Index") are assessed relative to their sector peers based on their emissions intensity, emissions reduction commitments, climate risk management and revenue from greener businesses. The Indexes uses this assessment to select 50% of the companies from each GICS®<sup>1</sup> sector in the Parent Index. Overall the Index targets a coverage of 50% of the companies per sector from the Parent Index.

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<sup>1</sup> GICS, the Global Industry Classification Standard jointly developed by MSCI and S&P Global.

## 2 MSCI ESG Research

The Index uses company ratings and research provided by MSCI ESG Research LLC. In particular, the Index uses the following three MSCI ESG Research products: MSCI Impact Solutions, MSCI ESG Ratings, and MSCI ESG Controversies.

For details on MSCI ESG Research’s full suite of ESG products, please refer to: <https://www.msci.com/esg-investing>

### 2.1 MSCI ESG RATINGS

MSCI ESG Ratings provides research, data, analysis and ratings of how well companies manage environmental, social and governance risks and opportunities. MSCI ESG Ratings provides an overall company ESG rating - a seven-point scale from ‘AAA’ to ‘CCC’. In addition, the product provides scores and percentiles indicating how well a company manages each key issue relative to industry peers, as well as underlying data and metrics used to compile the scores and ratings.

For more details on MSCI ESG Ratings, please refer to: <https://www.msci.com/esg-ratings>.

### 2.2 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 a 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>.

### 2.3 MSCI ESG CONTROVERSIES

MSCI ESG Controversies provides assessments of controversies concerning the 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.

For more details on MSCI ESG Controversies, please refer to: <https://www.msci.com/documents/10199/acbe7c8a-a4e4-49de-9cf8-5e957245b86b>.

### 2.4 MSCI CLIMATE CHANGE METRICS

MSCI Climate Change Metrics provides climate data & tools to support investors integrating climate risk & opportunities into their investment strategy and processes. It supports investors seeking to achieve a range of objectives, including measuring and reporting on climate risk exposure, implementing low carbon and fossil fuel-free strategies, align 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>.

## **3 Index Construction Methodology**

### **3.1 APPLICABLE UNIVERSE**

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

### **3.2 ELIGIBLE UNIVERSE**

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

#### **3.2.1. ESG CONTROVERSY SCORE ELIGIBILITY**

- **ESG Controversies:** All securities having faced very severe controversies pertaining to ESG issues – Defined as companies with an MSCI ESG Controversy Score of 0. Companies not assessed by MSCI ESG Research on ESG Controversies are also excluded.
- **Environmental Harm:** All companies having faced very severe and severe controversies pertaining to Environmental issues – Defined as companies with an MSCI Environment Controversy Score of 0 or 1. Companies not assessed by MSCI ESG Research on Environment Controversy Score are also excluded.

#### **3.2.2. ESG BUSINESS INVOLVEMENT ELIGIBILITY**

The MSCI Climate Action Indexes use MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics to identify companies that are involved in the following business activities. Companies that meet the business involvement criteria are excluded from the MSCI Climate Action Indexes. Please refer to Appendix I for details on these criteria.

- Controversial Weapons
- Tobacco
- Thermal Coal Mining
- Oil Sands
- Nuclear Weapons

### 3.2.3. EMISSION ELIGIBILITY

Securities which either have higher Emission Intensity<sup>2</sup> than the High Emission Threshold (defined below) or higher total potential emission<sup>3</sup> than the High Potential Emission Threshold (defined below) and do not yet have approved science-based targets<sup>4</sup> are excluded.

- High Emission Threshold – Emission Intensity of the constituent(s) of the MSCI ACWI Index at the 95<sup>th</sup> percentile based on Emission Intensity. This 95<sup>th</sup> percentile calculation excludes securities without emissions data.
- High Potential Emission Threshold – Total Potential Carbon Emissions excluding Metallurgical Coal of the constituent(s) of the MSCI ACWI Index at the 95<sup>th</sup> percentile based on Total Potential Carbon Emissions excluding Metallurgical Coal. This 95<sup>th</sup> percentile calculation only includes companies which are considered most likely to use their fossil fuel reserve for energy applications<sup>5</sup>. Securities without Total Potential Carbon Emissions data are not included in this calculation of 95th percentile.

Additionally, Securities without Emission Intensity data (securities for which Emission Intensity cannot be calculated) are also excluded.

### 3.2.4. CLIMATE RISK MANAGEMENT ELIGIBILITY

All securities which are in the lowest quartile of their GICS sector based on their Climate Risk Management Score are excluded. The calculation of the Climate Risk Management Score is described in Appendix II.

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<sup>2</sup> The calculation of Emission Intensity is described in Appendix II.

<sup>3</sup> Total Potential Emission is calculated as the potential carbon emissions of the fossil fuel reserves, excluding metallurgical coal reserves, owned by a company. It is computed as the sum of the potential carbon emissions of the thermal coal, total oil and total gas reserves owned by the company.

<sup>4</sup> Company level emission reduction targets which have been approved by Science Based Targets initiative (SBTi). More details on SBT are available at <https://sciencebasedtargets.org/companies-taking-action>

<sup>5</sup> Companies with 'Fossil Fuel Reserves – Energy Application' set to True.



### 3.3 SELECTION OF ELIGIBLE SECURITIES

#### 3.3.1. SECURITY-LEVEL ASSESSMENT

- Intensity Score - Each security is assigned to a quartile based on its sector relative Scope 1+2+3 Greenhouse Gas (GHG) Intensity<sup>6</sup>.

This quartile is labelled as the 'Intensity Score' and is thus an integer between 1 and 4. For example, securities which constitute the lowest 25% of their sector based on emissions intensity would be assigned an 'Intensity Score' of 1.

- Each security is assigned a final Assessment by adjusting the initial Intensity Score according to the following sequence
  - The Intensity Score is lowered by two quartiles for all securities that either have an approved science-based targets (SBTi) or are assessed to have Credible Track Record.
  - For the remaining securities, the Intensity Score is lowered by one quartile for any securities in the fourth quartile based on sector-relative Climate Risk Management Weighted Average Score or Green Business Revenue.<sup>7</sup>
    - The Intensity Score of fourth quartile companies based on sector relative Green Business Revenue is lowered only if the Green Business Revenue  $\geq$  5%.
- The Security-Level Assessment is floored at 1.

The calculation steps for Intensity Score, Credible Track Record, Climate Risk Management Weighted Average Score, Green Business Score and Green Business Revenue are described in Appendix II.

#### 3.3.2. RANKED UNIVERSE

The Ranked Universe is constructed by sorting eligible securities of each GICS sector, in ascending order of Security-Level Assessment and descending order of float adjusted market capitalization.

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<sup>6</sup> Prior to the May 2020 Semi-Annual Index Review (SAIR) of the Indexes, the Green House Gas (GHG) Intensity has been calculated based on Scope 1+2 Emissions. The Scope 3 Emissions used in the May 2020 Semi-Annual Index Review of the Indexes is as of Jun 30, 2020.

<sup>7</sup> The fourth quartile here corresponds in broad terms to strong climate risk management or high sector relative green business revenues.

### 3.3.3. SECURITY SELECTION

For each GICS sector in the Ranked Universe, 50% of the number of securities in the Applicable Universe are selected in the following order -

- Securities are selected from the top until the number of selected stocks is less than or equal to 40%<sup>8</sup> of the number of securities in the Applicable Universe.
- Securities which are ranked between 40% and 60% of the number of securities in the Applicable Universe and are also current constituents of the Index are selected.
- Remaining securities which are ranked between 40% and 60% of the number of securities in the Applicable Universe are selected until the total number of selected securities is less than or equal to 50% of the number of securities in the Applicable Universe. Any security which takes the number of selected securities beyond 50% of the number of securities in the Applicable Universe is also selected.

## 3.4 WEIGHTING OF SELECTED SECURITIES

The Parent Index weights of selected securities are renormalized to 100%. Additionally, the max issuer weights are capped at 5%.

### 3.4.1. ACTIVE GICS SECTOR WEIGHT CAP AND FLOOR

The Active sector weights of selected securities are restricted between +/-5%. The active sector weights are capped in the following steps –

- Active sector weights are calculated by aggregating the active weight of securities in the Parent Index. The active weight is calculated as the difference between the weight of securities calculated as per section 3.4 and their respective weight in the Parent Index.
- Active sector weights which are greater than +5% are capped at +5% and active sector weights which are smaller than -5% are floored at -5%.
- Sector weights of remaining sectors are renormalized so that aggregate weight of all sectors sum to 100%.

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<sup>8</sup> During the May 2022 Semi Annual Index review, securities are selected from the top until the number of selected stocks is less than or equal to the 50% of the number of securities in the Applicable Universe.

- For each GICS sector, the sector weight as calculated above is distributed to the selected securities within the GICS sector in proportion of their weight calculated under section 3.4.

## **4 Maintaining the Climate Action Indexes**

### **4.1 SEMI-ANNUAL INDEX REVIEWS**

The Indexes are rebalanced on a semi-annual basis<sup>9</sup>, as of the close of the last business day of May and November, coinciding with the May and November Semi-Annual Index Review 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 (including MSCI Climate Change Metrics, MSCI ESG Sustainable Impact Metrics, MSCI ESG Controversies and MSCI Business Involvement Screening Research) as of the end of the month preceding the Index Reviews for the rebalancing of the Indexes.

### **4.2 MONTHLY INDEX REVIEWS**

The Indexes are rebalanced on a monthly basis, as of the close of the last business day of the month. The pro forma Indexes are in general announced nine business days before the effective date.

During Monthly reviews, the ‘ESG Controversy Score Eligibility’ and ‘ESG Business Involvement Eligibility’ of existing constituents are reviewed. Existing constituents that meet the exclusion criteria are deleted from the index and the weight of remaining constituents are renormalized to 100%.

In general, MSCI uses MSCI ESG Controversies data and MSCI Business Involvement Screening Research data as of the end of the month preceding the Index Reviews for the rebalancing of the Indexes.

### **4.3 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

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<sup>9</sup> Certain ESG datapoints required for historical index rebalancing are unavailable. In those cases, the Index used the values of those datapoints as of the date described below. For example, each periodic rebalancing of the Index prior to October 31, 2019, would have applied the “Reporting Emission Reduction Targets” value as of October 31, 2019 and “Approved Science Based Targets” from November 30, 2021.

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.

**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 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 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.) 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 Non-Market Capitalization Weighted indexes.

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

## Appendix I: ESG Business Involvement Eligibility

- **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 Global Ex-Controversial Weapons Indexes available at <https://www.msci.com/indexmethodology>.
- **Tobacco**
  - All companies classified as a “Producer.”
  - All companies deriving 5% or more aggregate revenue from the production, distribution, retail, supply, and licensing of tobacco-related products.
- **Thermal Coal Mining**
  - All companies deriving 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. It excludes 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 (either reported or estimated).
- **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.
- **Nuclear Weapons**
  - All companies that manufacture nuclear warheads and/or whole nuclear missiles. It includes assembly and integration of warhead and missile body, as well as companies with contracts to

operate/manage government-owned facilities that manufacture nuclear warheads and missiles.

- All companies that manufacture components that were developed or are significantly modified for exclusive use in nuclear weapons (warheads and missiles). It includes companies with contracts to operate/manage government-owned facilities that manufacture components for nuclear 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, such as repairing and maintaining nuclear weapons, providing overhaul and upgrade services, stockpiling and stewardship, R&D work, testing and simulations, etc. It also includes companies with contracts to operate/manage government-owned facilities that conduct R&D, testing, simulations, and other essential sciences on nuclear weapons.
- All companies that manufacture components that were not developed or not significantly modified for exclusive use in nuclear weapons (warheads and missiles) but can be used in nuclear weapons.
- All companies that manufacture or assemble delivery platforms that were not developed or not significantly modified for the exclusive delivery of nuclear weapons but have the capability to deliver nuclear weapons.
- All companies that manufacture components for nuclear-exclusive delivery platforms.



## Appendix II: Calculation of Security Level Scores

### Sector Relative Quartiles

For each security in the Applicable Universe, the following security level sector relative quartiles are calculated –

**Table 1**

	Score	Ranking Metric
<b>1</b>	Intensity Score	Emission Intensity
<b>2</b>	Green Business Score	Green Business Revenue
<b>3</b>	Climate Risk Management Score	Climate Risk Management Weighted Average Score
<b>4</b>	Track Record Score	Emission Track Record

- Emission Intensity
  - Security level Emission Intensity = Global Green House Gas (GHG) Emission / (Enterprise Value + Cash (\$))
  - GHG Emission = Emissions from Scope 1+2+3<sup>10</sup>
- Green Business Revenue - Security level cumulative % of revenue from a set of 'Clean Tech' themes described in Appendix IV.
- Climate Risk Management Raw Score - Security level weighted average of a set of climate change related key issues management score which are described in Appendix III.
- Emission Track Record – Security level track record is calculated as follows
  - Security level yearly (YoY) change in emission is calculated for last 4 years (3 yearly changes).
  - Average Yearly Emission Change – security level 'average yearly emission change' is calculated as a geometric average of last 3

<sup>10</sup> Prior to June 1, 2020, security level GHG Emission = Emissions from Scope 1+2

yearly changes. Average Yearly Emission Change is not calculated for securities with less than 4 years of emission data.

- Emission Track Record – For securities with Average Yearly Emission Change  $\leq -2\%$ .

Emission Track Record = Average Yearly Emission Change.

- Emission Track Record is not assigned to securities with Average Yearly Emission Change  $> -2\%$ .

### Calculation of Sector Relative Quartiles

- For each GICS sector, securities are ranked in descending order of their ranking metric and descending order of float adjusted market capitalization.
- Ranked securities are divided in four equal groups.
- Securities in the top group receive a score of 4 and securities in the bottom group receive a score of 1.

### Assessment of Credible Track Record

Security is assessed to have Credible Track Record if it meets following conditions

- Reports Scope 1 and 2 emissions
- Has published an emission reduction target
- Track Record Score = 1

## **Appendix III: Climate Risk Management Weighted Average Score**

Climate Risk Management Weighted Average Score is calculated for securities in the Applicable Universe using following key issue management scores from MSCI ESG Ratings methodology related to management of Climate Change Risk and Environmental Opportunities.

- Carbon Emissions Management Score
- Product Carbon Footprint Management Score
- Climate Change Vulnerability Management Score
- Biodiversity and Land use Management Score
- Opportunities in Clean Tech Management Score
- Opportunities in Green Building Management Score
- Opportunities in Renewable Energy Management Score

Security's Climate Risk Management Weighted Average Score by considering security's key issue management score and key issue weight.

If a security is only assigned a Management Score for the key issue 'Carbon Emissions Management Score' then the 'Climate Risk Management Weighted Average Score' is set to be equal to the 'Carbon Emissions Management Score'.

## Appendix IV: Calculation of Green Business Revenue

For each constituent in the Parent Index, the Green Revenue% is calculated as the cumulative revenue (%) from the six Clean Tech themes which are as follows:

- Alternative Energy – products and services that support the transmission, distribution and generation of renewable energy and alternative fuels to reduce carbon and pollutant emissions in supporting affordable and clean energy to combat climate change.
- Energy Efficiency – products, and services that support the maximization of productivity in labor, transportation, power, and domestic applications with minimal energy consumption to ensure universal access to affordable, reliable, and modern energy services.
- Sustainable Water – products, services, infrastructure projects and technologies that resolve water scarcity and water quality issues, through minimizing and monitoring current water demand, improving the quality and availability of water supply to improve resource management in both domestic and industrial use.
- Green Building – design, construction, redevelopment, retrofitting, or acquisition of green-certified properties to promote mechanisms for raising capacity for effective climate change mitigation and adaptation.
- Pollution Prevention – products, services, infrastructure projects and technologies that reduces volume of waste materials through recycling, minimizes introduction of toxic substances, and offers remediation of existing contaminants such as heavy metals and organic pollutants in various environmental media to significantly address pollution in all levels and its negative effects.
- Sustainable Agriculture - revenues from forest and agricultural products that meet environmental and organic certification requirements to significantly address biodiversity loss, pollution, land disturbance, and water overuse.

## 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
São 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 *
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