

**METHODOLOGY BOOK FOR:**

- **MSCI WORLD CUSTOM ESG LEADERS INDEX**
- **MSCI USA IMI CUSTOM ESG LEADERS INDEX**

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**CONTENTS**

- 1 Introduction ..... 3
- 2 MSCI ESG Research ..... 4
  - 2.1 MSCI ESG Ratings ..... 4
  - 2.2 MSCI ESG Controversies ..... 4
  - 2.3 MSCI ESG Business Involvement Screening Research..... 4
- 3 Constructing the MSCI Custom ESG Leaders Indexes ..... 5
  - 3.1 Applicable Universe..... 5
  - 3.2 Eligibility Criteria ..... 5
  - 3.3 Index Construction ..... 6
- 4 Maintaining the MSCI Custom ESG Leaders Indexes ..... 8
  - 4.1 Semi-Annual Index Review..... 8
  - 4.2 Quarterly Index Reviews ..... 9
  - 4.3 Ongoing Event-Related Maintenance ..... 9
- Appendix 1: Controversial Business Screening Criteria ..... 12

## **1 INTRODUCTION**

The MSCI World Custom ESG Leaders Index and the MSCI USA IMI Custom ESG Leaders Index are free float-adjusted market capitalization weighted indexes designed to represent the performance of companies that have high Environmental, Social and Governance (ESG) performance. The MSCI Custom ESG Leaders Indexes aim to target a minimum coverage of 50% of the underlying MSCI parent index (the “Parent Index”).

## 2 MSCI ESG RESEARCH

The MSCI ESG Leaders Indexes use company ratings and research provided by MSCI ESG Research. In particular, these indexes use the following MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Controversies and MSCI Business Involvement Screening Research.

For details on MSCI ESG Research’s full suite of ESG products, please refer to: [http://www.msci.com/products/esg/about\\_msci\\_esg\\_research.html](http://www.msci.com/products/esg/about_msci_esg_research.html)

### 2.1 MSCI ESG RATINGS

MSCI ESG Ratings provides research, 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.

For more details on MSCI ESG Ratings, please refer to [https://www.msci.com/documents/1296102/1636401/MSCI\\_ESG\\_Ratings.pdf](https://www.msci.com/documents/1296102/1636401/MSCI_ESG_Ratings.pdf)

### 2.2 MSCI ESG CONTROVERSIES

MSCI ESG Controversies (formerly known as MSCI Impact Monitor) 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 Score, please refer to <https://www.msci.com/documents/10199/acbe7c8a-a4e4-49de-9cf8-5e957245b86b>

### 2.3 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](http://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf)

### **3 CONSTRUCTING THE MSCI CUSTOM ESG LEADERS INDEXES**

#### **3.1 APPLICABLE UNIVERSE**

The applicable universe includes all existing constituents of the Parent Index.

#### **3.2 ELIGIBILITY CRITERIA**

##### **3.2.1 ESG RATINGS ELIGIBILITY**

The MSCI Custom ESG Leaders Indexes use MSCI ESG Ratings to identify companies that have demonstrated an ability to manage their ESG risks and opportunities. Companies are required to have a minimum ESG Rating of ‘BB’ to be considered eligible for inclusion.

Securities of companies not assessed by MSCI ESG Research for MSCI ESG Ratings are ineligible for inclusion.

##### **3.2.2 ESG CONTROVERSIES SCORE ELIGIBILITY**

The MSCI Custom ESG Leaders Indexes use MSCI ESG Controversies Scores to identify those companies that are involved in very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services. Companies are required to have a minimum ESG Controversy Score of 3 to be considered eligible for inclusion, with the exception as noted in Section 3.2.3.

Securities of companies not assessed by MSCI ESG Research for ESG Controversies are ineligible for inclusion.

##### **3.2.3 ENHANCED CONTROVERSY SCORE SCREEN**

Securities with an ESG Controversy Score of 1 or 2 which satisfy any of the following criteria do not undergo Controversy Score exclusion screening (as per Section 3.2.2):

- Change in Industry Adjusted Score over the last three years is greater than or equal to 50%. Change in Industry Adjusted Score is calculated relative to the oldest available Industry Adjusted Score in 3 year long history. The change is calculated as  $(\text{current Industry Adjusted Score} - \text{oldest available Industry Adjusted Score}) / \text{current Industry Adjusted Score}$ .
  - The change is calculated relative to 2 year old Industry Adjusted Score, if 3 year old score is not available
  - The change is calculated relative to 1 year old Industry Adjusted Score, if neither 3 year old score nor 2 year old score is not available

- The change is not calculated if there is no available history within last 3 years
- MSCI ESG Rating is 'A' or better

**3.2.4 CONTROVERSIAL BUSINESS INVOLVEMENT CRITERIA**

Companies that are involved in specific businesses which have high potential for negative social and/or environmental impact are ineligible for inclusion in the index. Please refer to Appendix 1 for more details on these criteria.

- Alcohol
- Tobacco
- Gambling
- Nuclear Power
- Conventional and Controversial Weapons
- Civilian Firearms
- Thermal Coal

**3.3 INDEX CONSTRUCTION**

The MSCI Custom ESG Leaders Indexes target 50% of the free-float adjusted market capitalization within each Global Industry Classification Standard (GICS®) sector of the underlying MSCI parent index (“Parent Index”).

The following regional MSCI Custom ESG Leaders Indexes are aggregated to construct the MSCI World ex USA Custom ESG Leaders Index.

MSCI Regional Custom ESG Leaders Index	Region	Parent Index
MSCI Pacific Custom ESG Leaders Index	Developed Asia Pacific	MSCI Pacific Index
MSCI Europe & Middle East Custom ESG Leaders Index	Developed Europe & Middle East	MSCI Europe & Middle East Index
MSCI Canada Custom ESG Leaders Index	Canada	MSCI Canada Index

The following MSCI Custom ESG Leaders Indexes are aggregated to construct the MSCI USA IMI Custom ESG Leaders Index.

MSCI Custom ESG Leaders Index	Parent Index
MSCI USA Custom ESG Leaders Index	MSCI USA Index
MSCI USA Small Cap Custom ESG Leaders Index	MSCI USA Small Cap Index

## **4 MAINTAINING THE MSCI CUSTOM ESG LEADERS INDEXES**

### **4.1 SEMI-ANNUAL INDEX REVIEW**

The MSCI Custom ESG Leaders Indexes are reconstituted on a semi-annual basis in May and November to coincide with the regular Semi-Annual Index Review of the Parent Index, and the changes are implemented at the end of May. In general, the pro forma indexes are announced nine business days before the effective date.

In general, MSCI uses MSCI ESG Research data (including MSCI ESG Ratings, MSCI ESG Controversies Scores and MSCI Business Involvement Screening Research) as of the end of the month preceding the Index Reviews for the rebalancing of the MSCI Custom ESG Leaders Indexes. For some securities, such data may not be published by MSCI ESG Research by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the MSCI Custom ESG Leaders Indexes.

#### **4.1.1 SEMI-ANNUAL INDEX RECONSTITUTION: RANKING AND SELECTION**

At each semi-annual index review, the composition of the index is reassessed in order to target 50% free float-adjusted cumulative market capitalization of each sector of the Parent Index.

##### **4.1.1.1 RANKING**

For each sector, eligible companies of the regional Parent Index as described in Section 3.2 are ranked based on the following criteria:

- ESG rating
- Current index membership – Current index constituents with the same ESG Rating are ranked higher than non-index constituents to reduce turnover
- Industry adjusted ESG scores
- ESG Controversy scores
- Decreasing free float adjusted market capitalization

##### **4.1.1.2 SELECTION**

Constituents for the regional MSCI Custom ESG Leaders Index are then selected from the ranked universe in the following order until 50% coverage by cumulative free-float adjusted market capitalization target is reached:



- Securities in the top 35%
- ‘AAA’ and ‘AA’ rated securities in the top 50%
- Current index constituents in the top 65%
- Remaining securities in the eligible universe

In each sector, companies are selected as per the rules mentioned in section 4.1.1.2 until the cumulative sector coverage of the selected securities crosses 50% or there are no eligible securities left to be selected. The company that increases the cumulative sector coverage above 50% (‘marginal company’) is also included to ensure minimum 50% sector coverage in sectors where possible.

## 4.2 QUARTERLY INDEX REVIEWS

The MSCI Custom ESG Leaders Indexes are also reviewed on a quarterly basis to coincide with the regular Index Reviews of the Parent Indexes. The changes are implemented at the end of February and August. The pro forma indexes are in general announced nine business days before the effective date.

For the Quarterly Index Reviews, MSCI ESG Ratings, MSCI ESG Controversies Score assessments and MSCI BISR data are taken as of the end of the month preceding the Index Reviews, i.e., January and July. For some securities, this data may not be published by MSCI ESG Research by the end of the month preceding the Index Review. For such securities, MSCI will use ESG data published after the end of month, when available, for the rebalancing of the MSCI Custom ESG Leaders Indexes.

At the Quarterly Index Reviews, existing constituents are deleted from the MSCI ESG Leaders Indexes if they do not meet the eligibility criteria described in Section 3.2. Existing constituents that meet the eligibility criteria are retained in the index.

Additions, from the eligible securities as per section 3.2, are made only to those sectors where the current market capitalization coverage is less than 50%, until the cumulative sector coverage of the selected securities crosses 50% or there are no eligible securities left to be selected. The company that increases the cumulative sector coverage above 50% (‘marginal company’) is also included to ensure minimum 50% sector coverage in sectors where possible.

## 4.3 ONGOING EVENT-RELATED MAINTENANCE

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. 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. For cases where additions are noted below, securities will be added to the index only if added to the Parent Index.

Parent Index deletions will be reflected simultaneously.

EVENT TYPE	EVENT DETAILS
<b>New additions to the Parent Index</b>	A new security added to the parent index (such as IPO and other early inclusions) will be added to the index if it meets the eligibility criteria listed in Section 3.2 and the market capitalization coverage of the sector to which the security belongs is less than 50%.
<b>Spin-Offs</b>	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.
<b>Merger/Acquisition</b>	<p>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.</p> <p>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.</p>
<b>Changes in Security Characteristics</b>	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.

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

## APPENDIX 1: CONTROVERSIAL BUSINESS SCREENING CRITERIA

Companies that are involved in certain controversial business activities are ineligible to be included in the MSCI Custom ESG Leaders Indexes because of the high potential for negative social and/or environmental impacts of these activities. The details for the ineligibility criteria are as follows –

- Alcohol
  - All companies classified as a “Producer” that earn either 10% or more revenue or more than \$1 billion in revenue from alcohol-related products
- Gambling
  - All companies classified as involved in “Operations” and “Support” that earn 10% or more in revenue, or more than \$1 billion in revenue, from gambling-related products
- Tobacco
  - All companies classified as a “Producer” that earn either 10% or more revenue or more than \$1 billion in revenue from tobacco-related products
- Nuclear Power
  - All companies with 6000 MW or more of installed capacity attributed to nuclear sources or with 50% or more of installed capacity attributed to nuclear sources
  - All companies involved in nuclear fuel enrichment for nuclear power generation
  - All companies involved in uranium mining for nuclear power generation
  - All companies involved in nuclear reactor design or construction for nuclear power generation
- Conventional Weapons
  - All companies that manufacture conventional weapons components or conventional weapons and weapons systems and earn 10% or more in revenue, or \$3 billion or more in revenue from these activities
- Controversial Weapons
  - Cluster munitions manufacturers
  - Landmines manufacturers
  - Depleted Uranium Weapons manufacturers

- All companies involved in manufacturing of nuclear weapon components or nuclear weapon systems
- All companies involved in manufacturing of bio-chemical weapon components or bio-chemical weapon systems
- All companies involved in the production of weapons using Blinding Lasers, Non-Detectable Fragments and Incendiary weapons
- Civilian Firearms
  - All companies classified as a “Producer”
- Thermal Coal
  - Any company deriving 30% or more revenue from the mining of thermal coal and its sale to external parties.
  - Any company deriving 30% or more revenue from the thermal coal based power generation

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