

# **MSCI GLOBAL SUSTAINABILITY INDEXES METHODOLOGY**

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## **1 INTRODUCTION**

The MSCI Global Sustainability Indexes are free float-adjusted market capitalization weighted indexes designed to provide exposure to companies that have high Environmental, Social and Governance (ESG) performance. The MSCI Global Sustainability Indexes aim to target sector weights that reflect the relative sector weights of the underlying indexes to limit the systematic risk introduced by the ESG selection process. Overall the MSCI Global Sustainability Indexes target coverage of 50% of the underlying MSCI parent index (“Parent Index”).

Currently MSCI constructs MSCI Global Sustainability Indexes for the Standard size-segment in all Developed Markets and the Small Cap size-segment in the USA.

## 2 MSCI ESG RESEARCH

The MSCI Global Sustainability Indexes use company ratings and research provided by MSCI ESG Research. In particular, these indexes use the following MSCI ESG Research products: MSCI ESG Intangible Value Assessment and MSCI ESG Impact Monitor.

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 INTANGIBLE VALUE ASSESSMENT

MSCI ESG Intangible Value Assessment (IVA) company reports provide research, analysis and ratings of how well companies manage their most material environmental, social and governance risks and opportunities.

MSCI ESG IVA 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 IVA, please refer to [http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_IVA.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_IVA.pdf)

### 2.2 MSCI ESG IMPACT MONITOR

MSCI ESG Impact Monitor company reports include 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 Impact Monitor 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.

For more details on MSCI ESG Impact Monitor, please refer to [http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_Impact\\_Monitor.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_Impact_Monitor.pdf)

### **3 CONSTRUCTING THE MSCI GLOBAL SUSTAINABILITY INDEXES**

#### **3.1 UNDERLYING UNIVERSE**

The selection universe for the MSCI Global Sustainability Indexes is defined by the constituents of the MSCI Global Investable Market Indexes (GIMI).

#### **3.2 ELIGIBILITY CRITERIA**

The MSCI Global Sustainability Indexes use company ratings and research provided by MSCI ESG Research to determine eligibility.

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

The MSCI Global Sustainability Indexes use MSCI ESG Intangible Value Assessment research to identify companies that demonstrated an ability to manage their ESG risks and opportunities. Existing constituents of the MSCI Global Sustainability Indexes are required to have an IVA rating above CCC to remain in the index, while companies that are currently not constituents of the MSCI Global Sustainability Indexes are required to have an IVA rating above B to be considered eligible for addition.

##### **3.2.2 ESG CONTROVERSY SCORE ELIGIBILITY**

MSCI Global Sustainability Indexes use MSCI ESG Impact Monitor research 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. Impact Monitor overall company scores fall on a 0-10 scale, with “0” being the most severe controversy. Existing constituents of the MSCI Global Sustainability Indexes are required to have an Impact Monitor score above 1 to remain in the index, while companies that are currently not constituents of the MSCI Global Sustainability Indexes are required to have an Impact Monitor score above 2 to be considered eligible for addition.

#### **3.3 INDEX CONSTRUCTION**

Currently MSCI constructs MSCI Global Sustainability Indexes for:

- Standard size-segment in all Developed Markets; and
- Small Cap size-segment in the USA.

The MSCI Global Sustainability Indexes for the Standard size segment are constructed at a regional level, with the exception of North America which is built separately from Canada and the USA. Each regional sustainability index targets 50% of the free float adjusted market

capitalization of each Global Industry Classification Standard (GICS®) sector of the underlying MSCI parent index (“Parent Index”).

The following regional ESG Indexes are aggregated to construct the MSCI World ESG Index.

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

The Large Cap and Mid Cap size segments of the MSCI Global Sustainability Indexes are derived from the Standard size-segment.

The following regional ESG Indexes are aggregated to construct the MSCI EM ESG Index.

MSCI Regional ESG Index	Region	Parent Index
MSCI Emerging Markets Asia ESG Index	Emerging Asia	MSCI Emerging Markets Asia Index
MSCI Emerging Markets Europe, Middle East & Africa ESG Index	Emerging Europe, Middle East & Africa	MSCI Emerging Markets Europe, Middle East & Africa Index
MSCI Emerging Markets Latin America ESG Index	Emerging Latin America	MSCI Emerging Markets Latin America Index

The MSCI USA Small Cap ESG Index is constructed by targeting 50% of the free float adjusted market capitalization of each sector of the MSCI USA Small Cap Index. The MSCI USA IMI ESG Index is created by aggregating the MSCI USA ESG Index and the MSCI USA Small Cap ESG Index.

## 4 MAINTAINING THE MSCI GLOBAL SUSTAINABILITY INDEXES

### 4.1 ANNUAL INDEX REVIEW

The MSCI Global Sustainability Indexes are reconstituted on an annual basis in May to coincide with the May Semi-Annual Index Review of the Parent Index, and the changes are implemented at the end of May. The pro forma indexes are in general announced nine business days before the effective date. Ratings and scores provided by MSCI ESG Research (IVA and Impact Monitor) for the Annual Index Review are taken as of the end of April.

#### 4.1.1 ANNUAL INDEX RECONSTITUTION: RANKING AND SELECTION

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 ELIGIBILITY

All securities that are part of the pro forma Parent Index and satisfy the criteria described in Section 3 are eligible for inclusion in the index.

##### 4.1.1.2 RANKING

For each sector, eligible companies of the regional Parent Index are ranked based on the following criteria:

- IVA Rating
- Current index membership
- IVA industry-adjusted scores
- Decreasing free float adjusted market capitalization.

##### 4.1.1.3 SELECTION

Constituents for the regional MSCI Sustainability 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

Please see Appendix 1 for additional details on the ranking and selection rules.

## 4.2 QUARTERLY INDEX REVIEWS

The MSCI Global Sustainability 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, August and November. The pro forma indexes are in general announced nine business days before the effective date.

ESG IVA ratings and ESG Impact Monitor assessments used for the Quarterly Index Reviews are taken as of the end of the month preceding the Index Reviews, i.e., January, July and October.

At the Quarterly Index Reviews, existing constituents are deleted from the MSCI Global Sustainability Indexes if they do not meet the eligibility criteria described in Section 3. Existing constituents that meet the eligibility criteria are retained in the index.

At the Quarterly Index Reviews, all companies that are currently not constituents, and meet the criteria mentioned in Section 3 are eligible for addition to the index. Additions are made only to those sectors where the current market capitalization coverage is less than 45%, until the 50% target is reached.

Market price movements may cause small deviations in the sector coverage between two Index Reviews and so a buffer of 10% is used on the target coverage of 50% to define under-representation, in order to minimize turnover.

## 4.3 ONGOING EVENT-RELATED MAINTENANCE

The MSCI Corporate Events Methodology is applied for the maintenance of the MSCI Global Sustainability Indexes between Index Reviews.

### IPOS AND OTHER EARLY INCLUSIONS

IPOs and other newly listed securities, which have been added to the Parent Index, are considered for inclusion to the MSCI Global Sustainability Indexes at the time of their inclusion in the Parent Index. These securities are added to the MSCI Global Sustainability Indexes only if they meet the eligibility criteria described in Section 3 and the market capitalization coverage of the sector to which the security belongs is less than 45%.

### ADDITIONS AND DELETIONS DUE TO CORPORATE EVENTS

Deletions from the Parent Index following a corporate event will be simultaneously deleted from the MSCI Global Sustainability Indexes. Additions to the Parent Index following corporate events related to existing constituents (such as spin-offs) will not be automatically



added to the MSCI Global Sustainability Indexes. These Parent Index additions will be considered for addition at the next index review according to the rules outlined in Sections 4.1 or 4.2.

## APPENDIX 1: GUIDELINES ON ACHIEVING THE TARGET SECTOR COVERAGE OF 50%

The MSCI Global Sustainability Indexes target 50% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS®) sector of the Parent Index. The underlying principle in the construction of the index is to achieve sector coverage closest to 50%, while aiming to maintain index stability.

The following guidelines are used in achieving the target sector coverage of 50%:

- For each sector, the constituents of the Parent Index are first ranked based on the company level ESG Rating and then by decreasing free float adjusted market capitalization.
- In case of two companies with the same ESG Rating, an existing index constituent is given preference to maintain index stability. Between two existing constituents with the same ESG Rating, the company with the higher ESG Score is given preference. For two existing index constituents with the same ESG score, the larger company by free-float adjusted market capitalization is given preference.
- The cumulative sector coverage at each rank is calculated.
- All companies classified in a sector for which the cumulative coverage is less than 50% will be considered for inclusion in the ESG Index in order of decreasing ESG scores.
- MSCI defines the company that increases the cumulative sector coverage above 50% as the ‘marginal company’.
- If the marginal company is a current ESG Index constituent, then it is retained in the ESG Index even though it may result in a cumulative sector coverage significantly higher compared to the 50% target. This is aimed at ensuring better index stability and lower turnover.
- If the marginal company is a non index constituent, then the marginal company will be included in the ESG Index only if the absolute difference between the resulting coverage of including the marginal company and the 50% target is lower than the absolute difference between the resulting coverage of not including the marginal company and the 50% target.
- The minimum cumulative sector coverage is set to 45%.
- The marginal company will be added to the ESG Index if its non-inclusion would result in cumulative sector coverage of less than 45%.

## **APPENDIX 2: METHODOLOGY TRANSITION**

The MSCI Global Sustainability Indexes transitioned to the methodology described in this book at the May 2013 Index Review. The MSCI Global Sustainability Indexes were previously constructed using the Global Socrates ESG ratings. Any company that had an ESG rating of 'CCC' or lower was not eligible for inclusion in the MSCI Global Sustainability Indexes. The MSCI Global Sustainability Indexes were constructed by targeting 50% of the free float adjusted market capitalization of each Global Industry Classification Standard (GICS) sector of the underlying MSCI regional ESG Index.

**THE FOLLOWING SECTIONS HAVE BEEN MODIFIED SINCE JUNE 2013:**

Section 2: MSCI ESG Research and Section 3: Constructing the MSCI Global Sustainability Indexes

- Clarification of MSCI Global Sustainability Index construction rules

Section 4: Maintaining the MSCI Global Sustainability Indexes

- Enhancement of treatment of corporate events

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