

MSCI GLOBAL LOW CARBON LEADERS INDEXES METHODOLOGY

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1 INTRODUCTION

The MSCI Global Low Carbon Leaders Indexes are designed to address two dimensions of carbon exposure – carbon emissions and fossil fuel reserves. By selecting companies with low carbon emissions relative to sales and those with low potential carbon emissions per dollar of market capitalization, the indexes aim to reflect a lower carbon exposure than that of the broad market. They also aim to minimize the tracking error relative to the market capitalization weighted Parent index through an optimization process.

This methodology may be applied to create MSCI Low Carbon Leaders Indexes from any of the existing MSCI equity indexes (herein, “Parent Indexes”). Some of the parameters applied to determine the MSCI Low Carbon Leaders Index may vary based on the Parent Index on which the Low Carbon Leaders Index is constructed.

2 CHARACTERISTICS OF MSCI GLOBAL LOW CARBON LEADERS INDEXES

The MSCI Global Low Carbon Leaders Indexes aim to demonstrate the following characteristics across markets:

- Lower carbon exposure – in terms of carbon emissions and fossil fuel reserves¹
- Low tracking error relative to the Parent Index
- Low active sector, country and regional biases relative to the Parent Index

¹ Defined in Appendix I

3 CONSTRUCTING THE MSCI GLOBAL LOW CARBON LEADERS INDEXES

The MSCI Global Low Carbon Leaders Indexes are constructed using the following steps:

- Defining the Parent Index
- Defining the Carbon Exposure of each Parent Index constituent
- Defining the rules for selection of companies with the lowest carbon exposure
- Defining the optimization parameters
- Determining the optimized portfolio

The steps mentioned above are defined in detail in the subsequent sections .

3.1 DEFINING THE PARENT INDEX

The Parent Indexes serve as the universe of eligible securities for the Index. The MSCI Global Low Carbon Leaders Indexes can be constructed on any market capitalization weighted MSCI Index.

3.2 DEFINING THE CARBON EXPOSURE OF EACH PARENT INDEX CONSTITUENT

The Carbon exposure of a security is measured in terms of its greenhouse gas emissions and its potential carbon emissions from fossil fuel reserves. The MSCI Global Low Carbon Leaders Indexes use MSCI ESG CarbonMetrics data from MSCI ESG Research.

3.2.1 GREENHOUSE GAS EMISSIONS

MSCI ESG Research collects company-specific direct (Scope 1) and indirect (Scope 2) greenhouse gas (GHG) emissions data from company public documents and/or the Carbon Disclosure Project. If a company does not report GHG emissions, then MSCI ESG Research uses a proprietary methodology to estimate Scope 1 and Scope 2 GHG emissions. The data is updated on an annual basis. Since the current carbon emissions of a company are directly influenced by its current business activity, MSCI normalizes for size by dividing the annual carbon emissions of the company by the annual sales of the company.

For newly added companies to the index which do not report emission data and where MSCI ESG Research has not estimated the greenhouse gas emissions yet, MSCI uses the average emissions per dollar of issuer market capitalization for the companies in the same industry group, multiplied by the market capitalization of the company as the estimated emission for the company.

3.2.2 POTENTIAL CARBON EMISSIONS FROM FOSSIL FUELS

MSCI ESG Research collects fossil fuel reserves data where relevant for companies which have reserves, typically in the Oil & Gas, Coal Mining and Electric Utilities industries². Fossil fuel reserves can be used for several applications including energy or industrial (e.g. coking coal used for steel production). For the development of the MSCI Global Low Carbon Leaders Indexes, only fossil fuel reserves used for energy are taken into account. The data is updated on an annual basis and based on information disclosed by companies. Sources include company publications, other public records and third party data providers. For newly added companies to the index where data is not available yet, MSCI uses zero fossil fuel reserves. The size of reserves of a company typically influences its market valuation, and hence MSCI normalizes for size by dividing the potential carbon emissions of the company by its market capitalization.

To convert reserves data to potential carbon emissions, MSCI ESG Research applies a formula from the Potsdam Institute for Climate Impact Research.³

3.3 DEFINING THE RULES FOR SELECTION OF COMPANIES WITH THE LOWEST CARBON EXPOSURE

The MSCI Global Low Carbon Leaders Indexes select companies with low exposure to carbon risk, identified as companies with low carbon emission intensity and low potential emissions per dollar of market capitalization.

3.3.1 CARBON EMISSION SELECTION RULES

To select companies with low exposure to carbon emissions, the Parent Index constituents are ranked by the carbon emission intensity, and the top 20% of securities, by number, are excluded from the Index. The cumulative weight of securities excluded from any sector is less than 30% of the weight of the sector in the Parent Index. In case this limit is reached for any sector, no further securities from that sector are excluded.

² For more information on MSCI ESG CarbonMetrics, please refer to <https://www.msci.com/index-carbon-footprint-metrics>

³ Malte Meinshausen, Nicolai Meinshausen, William Hare, Sarah C. B. Raper, Katja Frieler, Reto Knutti, David J. Frame & Myles R. Allen. *Greenhouse-gas emission targets for limiting global warming to 2 °C*. *Nature* 458, 1158-1162 (30 April 2009) | doi:10.1038/nature08017; Received 25 September 2008; Accepted 25 March 2009. Supplementary Information, p. 7.

3.3.2 POTENTIAL CARBON EMISSION SELECTION RULES

To select companies with low exposure to fossil fuel reserves, the Parent Index constituents are ranked by the potential carbon emissions per dollar of the market capitalization of the company. Securities are excluded until the cumulative potential carbon emission of the excluded securities reaches 50% of the sum of the potential carbon emission of the constituents of the Parent Index.

The two screens mentioned above are applied independently.

3.4 DEFINING THE OPTIMIZATION PARAMETERS

At each semi-annual index review, the following optimization constraints are employed, which aim to ensure replicability and investability while achieving the lowest tracking error:

- The maximum weight of an index constituent will be restricted to 20 times its weight in the Parent Index
- The country weights in the MSCI Global Low Carbon Leaders Index will not deviate more than +/-2% from the country weights in the Parent Index
- The sector weights in the MSCI Global Low Carbon Leaders Index will not deviate more than +/-2% from the sector weights in the Parent Index
- The reduction in the Carbon Emission Intensity and in the potential emissions per dollar of market capitalization of the MSCI Global Low Carbon Leaders Index relative to the Parent Index will be at least 50%
- The one-way turnover of the MSCI Low Carbon Leaders Index is constrained to a maximum of 10% at each index review.

3.5 DETERMINING THE OPTIMIZED INDEX

The MSCI Global Low Carbon Leaders Index is constructed using the Barra Open Optimizer in combination with the relevant Barra Equity Model. The optimization uses the Parent Index, after the selection as defined in section 3.3, as the universe of eligible securities and the specified optimization objective and constraints to determine the optimized MSCI Global Low Carbon Leaders Index.

4 MAINTAINING THE MSCI GLOBAL LOW CARBON LEADERS INDEXES

4.1 SEMI-ANNUAL INDEX REVIEWS

The changes resulting from the semi-annual index reviews of the MSCI Global Low Carbon Leaders Indexes will be made as of the close of the last business day of May and November, coinciding with the May and November Semi-Annual Index Reviews of the Parent Indexes. The pro forma indexes are announced nine business days before the effective date.

For the May and the November Semi-Annual Index Reviews, the Barra model data as of the end of April and the end of October is used respectively.

At each rebalancing, a constraint factor is calculated for each constituent in the MSCI Global Low Carbon Leaders Index. The constraint factor is defined as the weight in the MSCI Global Low Carbon Leaders Index at the time of the rebalancing divided by the weight in the Parent Index. The constraint factors as well as the constituents in the index remain constant between index reviews except in case of corporate events as described below.

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 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.

4.2 ONGOING EVENT RELATED CHANGES

The general treatment of corporate events in the MSCI Global Low Carbon Leaders 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 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 MSCI Global Low Carbon Leaders Index, the changes made to the Parent Index during intermediate Index Reviews will be neutralized in the MSCI Global Low Carbon Leaders Index.

The following section briefly describes the treatment of common corporate events within the MSCI Global Low Carbon Leaders Indexes.

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	<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>
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: CALCULATION OF CARBON EXPOSURE METRICS

INDEX CARBON EMISSIONS

- Parent Index Carbon Emissions –

$$\sum_i \left(\frac{(\text{Float Market Capitalization} * \text{Absolute Emissions})}{\text{Issuer Market Capitalization}} \right)$$

- Derived Index Carbon Emissions –

$$\sum_i \left(\frac{(\text{Derived Index Market Capitalization} * \text{Absolute Emissions})}{\text{Issuer Market Capitalization}} \right)$$

- Parent Index Carbon Emission Intensity is defined as Parent Index Carbon Emissions, as defined above, divided by Parent Index Sales –

$$\sum_i \left(\frac{(\text{Float Market Capitalization} * \text{Absolute Emissions})}{\text{Issuer Market Capitalization}} \right) / \sum_i \left(\frac{(\text{Float Market Capitalization} * \text{Sales})}{\text{Issuer Market Capitalization}} \right)$$

- Derived Index Carbon Emissions Intensity is defined as Derived Index Carbon Emissions, as defined above, divided by Derived Index Sales –

$$\sum_i \left(\frac{(\text{Derived Index Market Capitalization} * \text{Absolute Emissions})}{\text{Issuer Market Capitalization}} \right) / \sum_i \left(\frac{(\text{Derived Index Market Capitalization} * \text{Sales})}{\text{Issuer Market Capitalization}} \right)$$

INDEX POTENTIAL CARBON EMISSIONS FROM FOSSIL FUELS

- Parent Index Potential Carbon Emissions from Fossil Fuels–

$$\sum_i \left(\frac{(\text{Float Market Capitalization} * \text{Absolute Potential Emissions})}{\text{Issuer Market Capitalization}} \right)$$

- Derived Index Potential Carbon Emissions from Fossil Fuels–

$$\sum_i \left(\frac{(\text{Derived Index Market Capitalization} * \text{Absolute Potential Emissions})}{\text{Issuer Market Capitalization}} \right)$$

The following sections have been modified since September 2014:

- The details on the Corporate Events treatment are now included in Section 4.2.

The following sections have been modified since June 2017:

Section 3.2

- Updated link to the description of MSCI ESG CarbonMetrics

Section 4.1

- Clarification on use of ESG data for securities whose data would be available after the end of the month preceding Index Review.

The following sections have been modified since September 2017:

Section 3.4

- Clarification on the turnover constraint applied at each index review.

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