

# **MSCI ACWI SUSTAINABLE IMPACT INDEX METHODOLOGY**

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## **1 INTRODUCTION**

The MSCI ACWI Sustainable Impact Index (“Index”) is designed to identify listed companies whose core business addresses at least one of the world’s social and environmental challenges, as defined by the United Nations Sustainable Development Goals (UN SDGs). The Index selects companies that contribute to the SDGs through the provision of products and services that can help address some of these challenges and meet minimum ESG standards for their operations.

## 2 MSCI ESG RESEARCH

The Index uses company ratings and research provided by MSCI ESG Research Inc.. In particular, the indexes use the following four MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Impact Monitor, ESG Business Involvement Screening Research and MSCI Sustainable Impact Metrics.

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 provide research, analysis and ratings of how well companies manage their environmental, social and governance risks and opportunities.

For more details on MSCI ESG Ratings, 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 assesses 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)

### 2.3 MSCI ESG BUSINESS INVOLVEMENT SCREENING RESEARCH

MSCI ESG Business Involvement Screening Research is designed to identify global publicly-traded companies involved in activities such as the production of controversial weapons, tobacco products, or those that violate religious screening mandates such as Catholic or Islamic Values. 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)

## 2.4 MSCI ESG SUSTAINABLE IMPACT METRICS

MSCI ESG Research’s Sustainable Impact Metrics is designed to identify companies that currently offer products or services that address at least one of the major social and environmental challenges as defined by the UN Sustainable Development Goals. Designed as a positive screen, it is designed to highlight companies that are deriving sales from products or services that may have a positive impact on society and the environment under the following categories:

**Figure 2 – MSCI Sustainable Impact Framework**

Pillar	Themes	Categories
Environmental*	Climate Change	<ol style="list-style-type: none"> <li>1. Alternative energy</li> <li>2. Energy efficiency</li> <li>3. Green building</li> </ol>
	Resource scarcity	<ol style="list-style-type: none"> <li>4. Sustainable water</li> <li>5. Pollution prevention</li> </ol>
Social	Basic needs	<ol style="list-style-type: none"> <li>6. Nutritious products</li> <li>7. Drugs for major diseases</li> <li>8. Sanitary products</li> <li>9. Affordable housing</li> </ol>
	Empowerment	<ol style="list-style-type: none"> <li>10. Loans to small &amp; medium size enterprises</li> <li>11. Education</li> </ol>

\* note that the environmental metrics are based on MSCI ESG Research CleantechMetrics

### 2.4.1 MSCI SUSTAINABLE IMPACT CATEGORIES

#### ALTERNATIVE ENERGY

This category includes products, services, or infrastructure projects supporting the development or delivery of renewable energy and alternative fuels, including:

- Generation, transmission, and distribution of electricity from renewable sources including wind, solar, geothermal, biomass, small scale hydro (25 MW), waste energy, and wave tidal.
- Fuels, technology, and infrastructure for the production and distribution of cleaner hybrid fuels, hydrogen, fuel cells, and alternative fuels, including biodiesel, biogas, and

cellulosic ethanol. Not eligible under this category: large scale hydroelectric plants (>25 MW installed capacity)

**ENERGY EFFICIENCY**

This category includes products, services, infrastructure, or technologies that proactively address the growing global demand for energy while minimizing effects on the environment, including:

- Technologies and systems that promote efficiency of industrial operations (e.g., turbines, motors, and engines), industrial automation and controls, and optimization systems (e.g., cloud computing, data optimization systems).
- Infrastructure, technology, and systems that increase the efficiency of power management, power distribution, power storage (e.g., batteries), demand-side management (e.g., wireless sensors, advanced meters, smart grid).
- Technologies and systems focused on reducing fuel consumption of transport vehicles and industrial operations (e.g., hybrid/electric vehicles)
- Sustainable transportation infrastructure including urban mass transit, efficiency improvements of public transportation fleets, electric vehicle charging, improved traffic systems.
- Architectural glass, efficient lighting, insulation, building automation and controls, and devices and systems designed to be utilized in the design and construction of environmentally sustainable buildings.

**MSCI ESG Research’s Energy Efficiency category does not include:**

- Corporate operational energy efficiency efforts, such as efficiency gains in manufacturing, transporting, or distributing standard products or services.
- Energy efficient components of finished goods.

**SUSTAINABLE WATER**

This category includes products, services, and projects that attempt to resolve water scarcity and water quality issues, including minimizing and monitoring current water use and demand increases, improving the quality of water supply, and improving the availability and reliability of water, including:

- Infrastructure and engineering projects developing new or repairing existing water and sanitation pipelines, including equipment and technology providers, resulting in improved quality and/or water use efficiency

- Technologies and products that reduce, reuse, or recycle water as a means of conservation (smart metering devices, low-flow equipment, and rainwater harvesting systems)
- Advanced materials, equipment, technologies, and services that filter or chemically treat wastewater for consumer or industrial use, including desalination

**MSCI ESG Research’s Sustainable Water category does not include:**

- Distribution of drinking water without measurable improvements to water quality
- Water efficiency

**GREEN BUILDING**

This category includes design, construction, redevelopment, retrofitting, or acquisition of ‘green’ certified properties – subject to local green building criteria, including:

- Properties that are certified as ‘green’ based on the local country’s environmental performance standard (eg, based on Energy Star, NABERS >3, or equivalent) or environmental design standards (eg, LEED Certified, BREEAM, or local equivalent).

**MSCI ESG Research’s Green Building category does not include:**

- Building materials, equipment, or supplies that are already included in the other themes. Examples include: Solar panels, energy efficient lighting, advanced materials used in construction, smart grids, etc.

**POLLUTION PREVENTION**

This category includes products, services, or projects that support pollution prevention, waste minimization, or recycling as a means of alleviating the burden of unsustainable waste generation, including:

- Technologies, systems, and projects aiming to reduce air pollution (environmental IT, conventional pollution control systems, CCS)
- Projects to salvage, use, reuse, and recycle post-consumer waste products
- Waste treatment and environmental remediation projects, including land treatment and brownfield cleanup, soil washing, chemical oxidation, and bioremediation
- Sustainable alternative materials including raw materials, paints, adhesives, etc. used primarily in the construction of environmentally sustainable buildings.



**MSCI ESG Research’s Pollution Prevention category does not include:**

- Landfill or incineration waste treatment projects without a specific waste-to-energy component.

**NUTRITIOUS PRODUCTS**

This category includes products and services classified under the “basic products” category, as defined by Choices International<sup>1</sup>. According to Choices International, basic products refer to those products that contribute to the daily intakes of essential nutrients while non basic are not needed to fulfill our daily requirements.

**Figure 3-Examples of “basic” and “non-basic” products**

Examples of Basic products	Examples of non-basic products
<ul style="list-style-type: none"> <li>• fruits and vegetables</li> <li>• beans and legumes</li> <li>• sources of carbohydrates</li> <li>• meat, fish, poultry, eggs, and meat substitutes</li> <li>• dairy products</li> <li>• oils, fats and fat-containing spreads</li> <li>• nuts</li> <li>• water</li> <li>• main meals</li> </ul>	<ul style="list-style-type: none"> <li>• soups</li> <li>• sauces</li> <li>• snacks (including pastry, ice cream, and sweet and savoury snacks)</li> <li>• beverages (excluding water) and fruit juices</li> <li>• bread toppings</li> </ul>

Source: Choices International, MSCI ESG Research

**DRUGS FOR MAJOR DISEASES**

This category includes drugs and healthcare equipment used to treat the world’s major diseases. Major diseases include those diseases with the highest DALY<sup>2</sup> as well as orphan diseases<sup>3</sup> and tropical neglected diseases<sup>4</sup>.

<sup>1</sup> For more information on Choices International refer to <http://www.choicesprogramme.org/public/criteria/international-product-criteria-2015-def.pdf>

<sup>2</sup> The WHO daily adjusted life year (DALY) represents the number of years of life lost due to poor health/disability and earlier death. The sum of these DALYs across the population represents the global burden of disease. More information on DALY can be found here: [http://www.who.int/healthinfo/global\\_burden\\_disease/metrics\\_daly/en](http://www.who.int/healthinfo/global_burden_disease/metrics_daly/en)

<sup>3</sup> Orphan drugs refer to treatments for orphan diseases which affect about 1 in 1500 people, as defined by the FDA. <http://www.fda.gov/ForIndustry/DevelopingProductsforRareDiseasesConditions/HowtoapplyforOrphanProductDesignation/default.htm>

<sup>4</sup> More information on neglected diseases can be found here: [http://www.who.int/neglected\\_diseases/diseases/en/](http://www.who.int/neglected_diseases/diseases/en/)

**Figure 4-Examples of major diseases included in the category’s scope**

Major diseases	Neglected diseases	Orphan diseases
<ul style="list-style-type: none"> <li>• Ischaemic heart disease</li> <li>• Lower respiratory infections</li> <li>• Stroke</li> <li>• Diarrhoeal diseases</li> <li>• Chronic obstructive pulmonary disease</li> <li>• HIV/AIDS</li> <li>• Unipolar depressive disorders</li> <li>• Diabetes mellitus</li> <li>• Malaria</li> <li>• Tuberculosis</li> <li>• Trachea, bronchus, lung cancers</li> <li>• Cirrhosis of the liver</li> <li>• Meningitis</li> <li>• Kidney diseases</li> <li>• Anxiety disorders</li> <li>• Endocrine, blood, immune disorders</li> <li>• Asthma</li> <li>• Hypertensive heart disease</li> <li>• Liver cancer</li> <li>• Epilepsy</li> <li>• Hepatitis B and C</li> </ul>	<ul style="list-style-type: none"> <li>• Schistosomiasis</li> <li>• Leishmaniasis</li> <li>• Lymphatic filariasis</li> <li>• Rabies</li> <li>• Dengue</li> <li>• Trypanosomiasis</li> <li>• Onchocerciasis</li> <li>• Chagas disease</li> <li>• Trachoma</li> <li>• Leprosy</li> <li>• Buruli Ulcer</li> <li>• Yaws</li> </ul>	<ul style="list-style-type: none"> <li>• Cystic fibrosis</li> <li>• Wilson’s disease</li> <li>• Gaucher disease</li> <li>• Pompe disease</li> </ul>

Source: WHO, MSCI ESG Research

**SANITARY PRODUCTS**

This category includes products and services used for basic sanitation including:

**Figure 5:-Example of sanitary products**

Examples of basic sanitary products	Examples of non basic sanitary products
<ul style="list-style-type: none"> <li>• soaps</li> <li>• oral care (toothbrush, toothpaste)</li> <li>• detergents</li> </ul>	<ul style="list-style-type: none"> <li>• hair oil</li> <li>• deodorants</li> <li>• skin care</li> </ul>

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>• water purifier</li> <li>• sanitary napkins (feminine pad)</li> <li>• toilet paper</li> <li>• diapers (adult, child)</li> <li>• toilet basin</li> <li>• washbasins</li> </ul> | <ul style="list-style-type: none"> <li>• color cosmetics</li> <li>• perfumes</li> <li>• air care</li> <li>• fragrance</li> <li>• make up</li> <li>• After shave gel</li> <li>• Sunscreen cream</li> <li>• Fabric softener</li> </ul> |
|---|--|

Source: MSCI ESG Research

### AFFORDABLE HOUSING

This category includes low income residential and commercial properties. Residential properties take the form of homes for reconstruction efforts, affordable residences for the elderly and units devoted to be managed under social rent or purchased through shared equity or shared ownership. Low income commercial properties include commercial spaces for Small and Medium Enterprises (SMEs).

### LOANS TO SMALL AND MEDIUM SIZE ENTREPRISES

This category includes loans provided to small and medium enterprises.

## 2.4.2 RESEARCH PROCESS FOR MSCI ESG RESEARCH SUSTAINABLE IMPACT METRICS

MSCI ESG Research includes a team of analysts dedicated to covering the companies involved in sustainable impact themes and categories. On an annual basis, MSCI ESG Research analysts conduct a review of MSCI ACWI constituents to identify those companies that generate revenues from sustainable impact categories. In addition, MSCI ESG Research conducts data verification by engaging with subject companies in order to confirm public data concerning a company’s involvement and the nature of such involvement.

### ANNUAL UPDATES

On an annual basis, MSCI ESG Research analysts conduct a review of companies in the MSCI ACWI for involvement. The annual update involves:

1. **Identification of Sustainable Impact Universe:** the Sustainable Impact Universe is first defined by MSCI ESG Research. For more information regarding the Sustainable Impact Universe methodology, please refer to MSCI ESG Research Sustainable Impact Metrics methodology.
2. **The review of company’s literature:** for those companies included in the Sustainable Impact Universe analysts review the company regulatory filings, annual

reports, company websites, and third party sources to identify potential revenues from sustainable impact categories. For each category, analysts assess the company's product pipeline and only take into account revenues coming from products that match the sustainable impact categories definition outlined above.

3. **Company verification:** all companies in the Sustainable Impact Universe are contacted to verify the level of involvement in the sustainable impact categories.

### 3 INDEX CONSTRUCTION METHODOLOGY

The MSCI ACWI Sustainable Impact Index (“Index”) is constructed using the following steps:

- Defining the Parent Index
- Security Selection
- Weighting Scheme

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

#### 3.1 DEFINING THE PARENT INDEX

The Parent Index serves as the universe of eligible securities for the Index. The MSCI ACWI Sustainable Impact Indexes is constructed on the MSCI ACWI Index (“Parent Index”).

#### 3.2 SECURITY SELECTION

To be eligible for inclusion in the Index, companies must meet all of the below criteria:

##### 3.2.1 SUSTAINABLE IMPACT SALES PERCENTAGE

Companies must generate cumulatively at least 50% sales from one or more of the eleven sustainable impact categories as defined by MSCI ESG Research Sustainable Impact Metrics..

1. Alternative energy
2. Energy efficiency
3. Green building
4. Sustainable water
5. Pollution prevention
6. Nutritious products
7. Drugs for major diseases
8. Sanitary products
9. Affordable housing
10. Loans to small & medium size enterprises
11. Education

##### 3.2.2 MINIMUM ESG STANDARDS

Companies must maintain all of the following minimum ESG standards:

1. Companies must not have faced ESG controversies as defined by IM score of 0, 1 and 2 respectively (see appendix for more details on the definition of controversies)

2. Companies must not generate more than 10% sales from tobacco production
3. Companies must not generate more than 10% sales from alcohol production
4. Companies must not be involved in predatory lending practices. MSCI ESG Research defines involvement in lending practices as those companies that provide products and services associated with certain controversial lending activities and those companies that have been subject of alleged lending controversies (see appendix for more details on the definition of predatory lending)
5. Companies must have an ESG Rating greater or equal to BB

### 3.2.3 MINIMUM NUMBER OF ISSUERS

The Index is constructed with a minimum of 30 issuers. All securities from the issuer whose Sustainable Impact Sales Percentage is greater than 50% and meet minimum ESG standards as per 3.2.2 are included in the Index.

If the number of issuers selected is less than 30, remaining issuers are selected from those issuers that meet the minimum ESG Standards in decreasing order of Sustainable Impact Sales Percentage. If multiple eligible issuers have the same Sustainable Impact Sales Percentage, then the issuer having a higher weight in the Parent Index is given a higher rank.

### 3.3 WEIGHTING SCHEME

Securities are weighted on basis of sustainable impact dollar sales in proportion of the ratio of free-float adjusted market capitalization of security to total market capitalization of issuer. Sustainable impact dollar sales are computed using product of the trailing 12-month sales and the cumulative percentage of sales from the sustainable impact categories.

$$Security\ Weight = \left( Sustainable\ impact\ sales\ \% \times Trailing\ 12\ -\ month\ sales \right) \times \frac{Free\ -\ float\ adjusted\ market\ capitalization\ of\ security}{Total\ market\ capitalization\ of\ issuer}$$

For Financial companies, where trailing 12-month sales is not available, net interest income would be used to calculate security weight. For companies where net interest income is unavailable, earnings (net income from the continuing operations) would be used.

For more details on the MSCI definition of sales and earnings, please refer to

[https://www.msci.com/eqb/methodology/meth\\_docs/MSCI\\_Nov13\\_Fundamental\\_Data.pdf](https://www.msci.com/eqb/methodology/meth_docs/MSCI_Nov13_Fundamental_Data.pdf)

The above weights are then normalized to 100%.

Additionally, sector weights are capped at 20% and issuer weights are capped at 4%.

## **4 MAINTAINING THE MSCI ACWI SUSTAINABLE IMPACT INDEX**

### **4.1 ANNUAL INDEX REVIEW**

The MSCI ACWI Sustainable Impact Index is rebalanced annually based on the methodology described above, coinciding with the November Semi-Annual Index Review of the Parent Index.

The pro forma MSCI ACWI Sustainable Impact Index is generally announced nine business days before the effective date.

### **4.2 QUARTERLY INDEX REVIEWS**

The MSCI ACWI Sustainability Impact Index is reviewed on a quarterly basis to coincide with the Quarterly Index Reviews of the Parent Index.

Since sustainable impact sales percentage is reviewed on an annual basis, the existing constituents are reviewed only on ESG standards to check for index eligibility.

Companies added to MSCI ACWI after the previous index review are evaluated for index eligibility as per security section rules defined in section 3.2, while existing constituents of the MSCI ACWI constituents that would have been ineligible for inclusion earlier due to low ESG scores would be reviewed for index eligibility as well.

Sector weights would be capped at 20% and issuer weights would be capped at 4% at each Quarterly Index Review.

Deletions from the respective Parent Index at the time of the Quarterly Index Reviews are simultaneously reflected in the Index.

### **4.3 MINIMUM NUMBER OF ISSUERS**

At each index review, the Index is constructed with a minimum of 30 issuers. All securities from the issuer whose Sustainable Impact Sales Percentage is greater than 50% and meet minimum ESG standards as per 3.2.2 are included in the Index.

If the number of issuers selected is less than 30, remaining issuers are selected from those issuers that meet the minimum ESG Standards in decreasing order of Sustainable Impact Sales Percentage. If multiple eligible issuers have the same Sustainable Impact Sales Percentage, then the issuer having a higher weight in the Parent Index is given a higher rank



**4.4 MONTHLY UPDATES ON BASIS OF CONTROVERSIES**

Index constituents would be reviewed on a monthly basis for the involvement in ESG controversies. Existing constituents would be deleted if they face controversies as defined by IM score of 0, 1 and 2. The pro forma index is generally announced nine business days before the first business day of the month.

**4.5 ONGOING EVENT RELATED CHANGES**

The Index follows the event maintenance of the Parent Index subject to the exceptions noted below.

**4.5.1 IPOS AND OTHER EARLY INCLUSIONS**

IPOs and other newly listed securities will only be considered for inclusion at the next Index Review, even if they qualify for early inclusion in the Parent Indexes.

**4.5.2 ADDITIONS AND DELETIONS DUE TO CORPORATE EVENTS**

There will be no early inclusion of new securities to the Index. A constituent deleted from the Parent Index following a corporate event or during the Index Review of the Parent Index will be simultaneously deleted from the Index.

Please refer to the MSCI Corporate Events Methodology book available at <http://www.msci.com/products/indexes/size/standard/methodology.html> for more details.

## APPENDIX

### DEFINITION OF CONTROVERSY SEVERITY

Each controversy case is assessed for the severity of its impact on society or the environment and consequently rated **Very Severe** (reserved for ‘worst of the worst’ cases), **Severe**, **Moderate**, or **Minor**. To reach these assessments, each case is analyzed along two dimensions: nature of impact and scale of impact. 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)

Figure 6- Assessment of controversy severity: the severity matrix

		Nature of Impact			
		Very Serious (Death, disability, torture, enslavement, destruction of livelihood or traditional way of life)	Serious (Livelihood seriously impaired, interference with basic needs, child labor, displacement)	Medium (Minor impairment to livelihood, denial of opportunity, most labor disputes and violations)	Minimal (Potential denial of opportunity, potential violation of rights, procedural failings)
Scale of Impact	Extremely Widespread (1000+ people)	Very Severe	Very Severe	Severe	Moderate
	Extensive (25-999 people)	Very Severe	Severe	Moderate	Moderate
	Limited (10-24 people)	Severe	Moderate	Minor	Minor
	Low (<10 people)	Moderate	Moderate	Minor	Minor

### DEFINITION OF PREDATORY LENDING

Predatory lending is defined as the “imposition of unfair and abusive loan terms on borrowers” by engaging in deception, fraud, or manipulation through aggressive sales tactics, and taking unfair advantage of a borrower’s lack of understanding about complicated transactions.

Examples of products and services associated with predatory lending include payday loans, installment loans, pawn loans, title loans, tax refund anticipation loans, doorstep loans, and check cashing.

For more details on predatory lending, please refer to the MSCI ESG Research’s Business Involvement Screening Research

[http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_BISR.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_BISR.pdf)

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