

# MSCI WORLD SELECT CLIMATE TARGET INDEX\*

\* A custom index calculated by MSCI based on the stock exclusions defined by Länsförsäkringar

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## **1 Introduction**

The MSCI World Select Climate Target Index aims to represent the performance of a strategy that is designed to maximize the MSCI Low Carbon Transition (LCT) Score while exhibiting risk and return characteristics similar to those of the underlying market capitalization weighted index.

The index is constructed by selecting constituents of the MSCI World Index through an optimization process that aims to maximize exposure to the LCT Score for a target tracking error budget and increase the allocations to companies with high ESG Scores under certain constraints.

The Index aims to be sector-diversified and targets companies with high LCT Scores in each sector.

The index also, via an exclusion list from Länsförsäkringar, aims to exclude companies involved in serious violations of international norms and conventions, controversial weapons, fossil fuels and tobacco. Additionally, the Index excludes all stocks in the Energy Sector, stocks of companies involved in uncertified production of palm oil and top emitters of Scope 1+2 Emissions with respect to their sector peers.

## **2 ESG Research Framework**

MSCI ESG Research LLC provides in-depth research, ratings and analysis of the environmental, social and governance-related business practices of thousands of companies worldwide. It consists of an integrated suite of tools and products to efficiently manage research, analysis and compliance tasks across the spectrum of ESG factors.

The MSCI World Select Climate Target Index uses research provided by MSCI ESG Research. In particular, this index uses the following three MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics Data.

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 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)

## 2.3 MSCI CLIMATE CHANGE METRICS

MSCI Climate Change Metrics is designed to support investors seeking to achieve a range of objectives, including measuring and reporting on climate risk exposure, implementing low carbon and fossil fuel-free strategies, and factoring climate change research into their risk management processes. It provides Carbon Emissions, Fossil Fuel exposure, environmental impact (i.e., clean technology) data and screens, as well as climate-related risk exposure and management assessment on companies.

For more details on MSCI Climate Change Metrics, please refer to <https://www.msci.com/climate-change-solutions>

### 3 Constructing the MSCI World Select Climate Target Index

Constructing the MSCI World Select Climate Target index involves the following steps:

- Defining the underlying Parent Index
- Defining the exclusion criteria
- Defining the optimization constraints
- Determining the optimized portfolio

#### 3.1 PARENT INDEX

Index construction starts with the MSCI World Index (the “Parent Index”). The Index then excludes some stocks from the Parent Index based on exclusion criteria as listed in Section 3.2.

#### 3.2 SECURITY EXCLUSION CRITERIA

Securities from the Parent Index which meet any of the below criteria are not considered for inclusion in the Index:

- **Specific Stock Exclusions:** The MSCI World Select Climate Target Index, excludes all securities listed for exclusion by Länsförsäkringar AB's (LFAB) Asset Management and Mutual Fund Company.

The exclusion list is determined and signed off by LFAB in accordance with LFAB’s Sustainability policy<sup>1</sup> and the referenced methodology document<sup>2</sup>.

The exclusion list<sup>3</sup> is sent by LFAB to MSCI via e-mail at least 14 business days prior to the effective date of the index review and is also publicly available.

The exclusions are reviewed and updated quarterly and made effective to coincide with the MSCI Quarterly Index Reviews as of the close of the last business day of February, May, August and November.

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<sup>1</sup> <https://www.lansforsakringar.se/globalassets/aa-global/dokument/ovrigt/aa-om-oss/lf-fondforvaltning/criteria-and-list-of-excluded-companies.pdf>

<sup>2</sup> <https://www.lansforsakringar.se/globalassets/aa-global/dokument/ovrigt/aa-om-oss/lf-fondforvaltning/mifid/lf-process-of-exclusion.pdf>

<sup>3</sup> <https://www.lansforsakringar.se/globalassets/aa-global/dokument/ovrigt/aa-om-oss/lf-fondforvaltning/kopia-av-excluded-companies-from-index-excel.xlsx>

- **Energy Sector:** The MSCI World Select Climate Target Index, excludes all securities of companies that belong to the Energy Sector as per the Global Industry Classification Standard (GICS®).
- **Palm Oil:** The MSCI World Select Climate Target Index, excludes all securities of companies that meet the below criteria

$$\%Revenue\ from\ Palm\ Oil\ Production * \frac{(100 - \%RSPO\ Certified)}{100} \geq 5$$

where

**% Revenue from Palm Oil Production** - The recent-year percent of revenue, or maximum estimated percent, a company has derived from the production of Palm Oil.

**% RSPO Certified** - The percentage of the company's palm oil holdings / estates that are certified by the Roundtable on Sustainable Palm Oil.

- **Carbon Exclusions:** The constituents of the Parent Index are ranked in descending order of Scope 1 + Scope 2 emissions intensity. If two stocks have the same emissions intensity, the stock with the lower parent weight will be assigned a higher rank.

Top ranked stocks from each GICS Sector are excluded till the total number of stocks excluded from the GICS Sector is not more than 20% of the number of stocks in the GICS Sector in the Parent Index.

### 3.3 DEFINING THE OPTIMIZATION CONSTRAINTS

Constituents are selected to maximize exposure to higher LCT scores, subject to maintaining risk and return characteristics similar to the Parent Index. LCT scores are normalized and used in the optimization process. Optimization maximizes the Index's exposure to LCT scores for a given predicted tracking error of 1%.

Optimization is a quantitative process that considers the market capitalization weights from the Parent Index, LCT scores and additional constraints to select and weight the constituents of the Index. Normalization of the LCT scores allows the optimization process to assess each score in the context of the overall distribution of the LCT scores. Please refer to Appendix 1 for the Optimization constraints.

### **3.4 DETERMINING THE OPTIMIZED PORTFOLIO**

The Indexes are constructed using the Barra Open Optimizer in combination with the relevant Barra Equity Model. The optimization uses universe of eligible securities and the specified optimization objective and constraints to determine the constituents of the MSCI Select Climate Target Indexes.



## **4 Maintaining the MSCI World Select Climate Target Index**

### **4.1 QUARTERLY INDEX REVIEWS**

The Index is rebalanced on a quarterly basis to coincide with the regular Index Reviews (Semi-Annual Index Reviews in May and November and Quarterly Index Reviews in February and August) of the MSCI Global Investable Market Indexes. Changes are implemented at the end of February, May, August and November. The pro forma indexes are in general announced nine business days before the effective date.

LCT scores used for the Quarterly Index Reviews will be taken as of the end of the month preceding the Index Review, i.e., January, April, July and October.

At each Index Review, the optimization process outlined in Section 3 is implemented.

In general, MSCI uses MSCI ESG Research data (including MSCI ESG Ratings, MSCI Business Involvement Screening Research, and MSCI Climate Change Metrics) 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 MAINTENANCE**

The general treatment of corporate events in the MSCI World Select Climate Target Index 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.

The following section briefly describes the treatment of common corporate events within the MSCI World Select Climate Target 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 1: Optimization Constraints

At each Quarterly Index Review, the following optimization constraints are used to ensure replicability and investability:

### Optimization Constraints

No.	Parameter	Values
1	Ex-Ante Tracking Error	1.0%
2	Minimum Constituent Weight	0.05%
3	Constituent Active Weight	+/-2%
4	Maximum Security Weight as a Multiple of its weight in the Parent Index	20
5	Active Sector Weights	+/-5%
6	Active Country Weights*	+/-5%
7	Minimum aggregate weight in companies with an ESG Rating of AAA and AA	1.2x
8	One Way Turnover during May and November Index Review	10%
9	One Way Turnover during Feb and Aug Index Review	5%
10	Specific Risk Aversion	0.075
11	Common Factor Risk Aversion	0.0075

\* Active Country Weights – In case there are countries in the MSCI World Index which weigh less than 2.5% in the MSCI World Index, then for such countries the active country upper bound of +5% is not applicable. When a country weighs less than 2.5% in MSCI World Index then the upper bound of country weight in the MSCI World Select Climate Target Index is set at three times of the country's weight in MSCI World Index.

**Infeasible Solution** - During the Quarterly and Semi-Annual Index Reviews, in the event that there is no optimal solution that satisfies all the optimization constraints, first the turnover constraint will be relaxed up to a maximum turnover of 30% in steps of 1% until an optimal solution is found. If a feasible solution is not found at turnover of 30%, the ex-ante tracking error is relaxed up to a maximum of 5 times of the original ex-ante tracking error in steps on 0.1%. In the event that feasible solution is not found for maximum ex-ante tracking error, the Index will not be rebalanced for that index review.

## 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 *
Tokyo	+ 81 3 5290 1555

\* = toll free

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