

# **MSCI World ex Australia Custom ESG Leaders Index Methodology**

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**Contents**

- 1 Introduction..... 4
- 2 MSCI ESG Research..... 5
  - 2.1 MSCI ESG Ratings ..... 5
  - 2.2 MSCI ESG Controversies..... 5
  - 2.3 MSCI ESG Business Involvement Screening Research ..... 5
  - 2.4 MSCI Climate Change Metrics..... 6
- 3 Constructing the MSCI World ex Australia Custom ESG Leaders Index..... 7
  - 3.1 Underlying Universe..... 7
  - 3.2 Eligibility Criteria..... 7
    - 3.2.1 ESG Ratings Eligibility.....7
    - 3.2.2 ESG Controversies Score Eligibility .....7
    - 3.2.3 Controversial Business Involvement Criteria .....8
  - 3.3 Index Construction ..... 8
- 4 Maintaining the MSCI World ex Australia Custom ESG Leaders Index..... 10
  - 4.1 Annual Index Review ..... 10
    - 4.1.1 Updating the Eligible Universe .....10
    - 4.1.2 Ranking of Eligible Securities .....10
    - 4.1.3 Selection of Eligible Securities.....11
  - 4.2 Quarterly Index Reviews ..... 11
  - 4.3 Ongoing Event-Related Maintenance ..... 12
- Appendix 1: Guidelines on Achieving the Target Sector Coverage of 50% ..... 14

**Appendix 2: Controversial Business Involvement Criteria..... 16**

## 1 Introduction

The MSCI World ex Australia Custom ESG Leaders Index (the “Index”) aims to represent the performance of companies that are consistent with specific values- and climate change-based criteria. Additionally, the Index is designed to represent the performance of companies that have high Environmental, Social and Governance (“ESG”) ratings relative to their sector peers. The Index aims to target sector weights that reflect the relative sector weights of the underlying MSCI Global Investable Market Indexes to limit the systematic risk introduced by the ESG selection process. Overall, the Index targets coverage of 50% of the underlying MSCI parent index (the “Parent Index”).

## 2 MSCI ESG Research

The MSCI World ex Australia Custom ESG Leaders Index use company ratings and research provided by MSCI ESG Research. The indexes use the following MSCI ESG Research products: MSCI ESG Ratings, MSCI ESG Controversies, MSCI Business Involvement Screening Research and MSCI Climate Change Metrics.

For details on MSCI ESG Research’s full suite of ESG products, please refer to: <https://www.msci.com/esg-investing>

### 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/esg-ratings>

### 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, 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)

## **2.4 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 such as Low Carbon Transition scores and categories.

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

### 3 Constructing the MSCI World ex Australia Custom ESG Leaders Index

#### 3.1 UNDERLYING UNIVERSE

The selection universe for the MSCI World ex Australia Custom ESG Leaders Index is defined by the constituents of the MSCI Global Investable Market Indexes (“GIMI”) with the exception of securities classified under the following Global Industry Classification Standard (GICS®)<sup>1</sup> Sub-Industries.

- Oil & Gas Drilling (10101010)
- Oil & Gas Equipment & Services (10101020)
- Integrated Oil & Gas (10102010)
- Oil & Gas Exploration & Production (10102020)
- Coal & Consumable Fuels (10102050)

#### 3.2 ELIGIBILITY CRITERIA

The MSCI World ex Australia Custom ESG Leaders Index uses company ratings and research provided by MSCI ESG Research to determine eligibility for index inclusion.

##### 3.2.1 ESG RATINGS ELIGIBILITY

The MSCI World ex Australia Custom ESG Leaders Index uses MSCI ESG Ratings to identify companies that have demonstrated an ability to manage their ESG risks and opportunities. Companies are required to have an MSCI ESG Rating of ‘BB’ or above to be eligible for inclusion in the MSCI World ex Australia Custom ESG Leaders Index.

##### 3.2.2 ESG CONTROVERSIES SCORE ELIGIBILITY

The MSCI World ex Australia Custom ESG Leaders Index uses MSCI ESG Controversies Scores to identify 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 an MSCI ESG Controversies Score of 3 or above to be eligible for inclusion in the MSCI World ex Australia Custom ESG Leaders Index.

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<sup>1</sup> GICS, the global industry classification standard jointly developed by MSCI Inc. and S&P Global.

### 3.2.3 CONTROVERSIAL BUSINESS INVOLVEMENT CRITERIA

The MSCI World ex Australia Custom ESG Leaders Index uses MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics to identify companies that are involved in the following business activities. Companies that meet the business involvement criteria are excluded from the MSCI World ex Australia Custom ESG Leaders Index. Please refer to Appendix 2 for details on these criteria.

- Adult Entertainment
- Alcohol
- Civilian Firearms
- Controversial Weapons
- Conventional Weapons
- Fossil Fuel Extraction and Reserves
- Gambling
- Nuclear Power
- Nuclear Weapons
- Oil Sands
- Thermal Coal Power
- Tobacco

In addition to the above, companies that fail to comply with the United Nations Global Compact Principles are also excluded from the MSCI World ex Australia Custom ESG Leaders Index.

### 3.3 INDEX CONSTRUCTION

The MSCI World ex Australia Custom ESG Leaders Index constructed by aggregating the following regional Indexes. Each regional index targets 50% of the free float-adjusted market capitalization within each GICS sector of the underlying Parent Index.

Regional Index	Region	Parent Index
MSCI Pacific ex Australia Custom ESG Leaders Index	Developed Asia Pacific	MSCI Pacific ex Australia 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
MSCI USA Custom ESG Leaders Index	USA	MSCI USA Index

## 4 Maintaining the MSCI World ex Australia Custom ESG Leaders Index

### 4.1 ANNUAL INDEX REVIEW

The MSCI Index is reviewed on an annual basis in May to coincide with the May Semi-Annual Index Review of the Parent Indexes, 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 Index. 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 Index.

At each Annual Index Review, the eligible universe is updated, and 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 UPDATING THE ELIGIBLE UNIVERSE

The eligible universe is updated during each Annual Index Review.

Companies that are currently not constituents of the Index are evaluated using the same eligibility criteria described in Section 3.2.

Existing constituents of the Index are maintained in the eligible universe if they meet all the following conditions:

- MSCI ESG Rating of 'BB' or above
- MSCI ESG Controversies Score of 1 or above
- Not screened by the business involvement criteria described in Section 3.2.3

#### 4.1.2 RANKING OF ELIGIBLE SECURITIES

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

- ESG Rating

- ESG Trend<sup>2</sup> (positive ESG Trend preferred to neutral ESG Trend and neutral ESG Trend preferred to negative ESG Trend)
- Current index constituency (existing constituents above non-constituents)
- Industry-adjusted ESG scores
- Decreasing free float-adjusted market capitalization

#### 4.1.3 SELECTION OF ELIGIBLE SECURITIES

For each sector, eligible securities of the regional Parent Index are then selected from the ranked universe in the following order until the target 50% coverage by cumulative free float-adjusted market capitalization is reached:

- Securities in the top 35% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 35%
- 'AAA' and 'AA' rated securities in the top 50% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 50%
- Current index constituents in the top 65% cumulative free float-adjusted market capitalization coverage of the ranked universe, including the first security that increases the cumulative coverage above 65% if that security is a current index constituent
- Remaining eligible securities in the ranked universe

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

#### 4.2 QUARTERLY INDEX REVIEWS

The Index is 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.

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, July and October. For some securities, this data may not

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<sup>2</sup> ESG Trend is defined as the latest change in ESG Rating over the previous 12 months. A security without any change in ESG Rating over the previous 12 months will have a neutral ESG Trend. Also, companies that receive a re-initiated ESG Rating due to a change in the ESG Ratings Industry are considered to have a neutral ESG Trend.

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 ESG Leaders Indexes.

At the Quarterly Index Reviews, existing constituents are deleted from the Index if they do not meet the eligibility criteria described in Section 4.1.1. 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 45%, until the 50% target is reached.

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

### 4.3 ONGOING EVENT-RELATED MAINTENANCE

The following section briefly describes the treatment of common corporate events within the MSCI World ex Australia Custom ESG Leaders 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.

There are no deletions from the MSCI World ex Australia Custom ESG Leaders Index between Index Reviews on account of a security becoming ineligible because of MSCI ESG Rating downgrade and/or decrease in MSCI ESG Controversies Score and/or change in business involvement.

#### EVENT TYPE

#### EVENT DETAILS

##### **New additions to the Parent Index**

New securities added to the Parent Index (such as IPOs, other early inclusions and migrations from a different size-segment) will be added to the MSCI World ex Australia Custom ESG Leaders Index on the date of security inclusion only if they meet the eligibility criteria described in Section 3.2 and the market capitalization coverage of the sector

to which the security belongs is less than 45%.

**Spin-Offs**

All securities created as a result of the spin-off of an existing Index constituent will not be added to the MSCI World ex Australia Custom ESG Leaders Index at the time of event implementation. Reevaluation for addition in the Indexes will occur at the subsequent Index Review.

**Merger/Acquisition**

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.

The MSCI Corporate Events methodology book is available at:

<https://www.msci.com/index-methodology>

## Appendix 1: Guidelines on Achieving the Target Sector Coverage of 50%

The MSCI World ex Australia Custom ESG Leaders Index targets 50% coverage of the free float-adjusted market capitalization of each GICS sector of the regional Parent Index. The underlying principle in the construction of the Index is to achieve cumulative sector coverage closest to 50%, while aiming to maintain index stability.

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

- For each sector, the eligible companies of the regional Parent Index are first ranked based on the company level ESG Rating.
- If two companies have the same ESG Rating, the company with better ESG Trend is given priority (positive ESG Trend preferred to neutral ESG Trend and neutral ESG Trend preferred to negative ESG Trend).
- In case of two companies with the same ESG Rating and the same ESG Trend, the existing index constituent is given priority to maintain index stability. Between two existing constituents with the same ESG Rating and the same ESG Trend, the company with the higher industry-adjusted ESG Score is given priority. For two existing index constituents with the same industry-adjusted ESG score, the security with the largest free float-adjusted market capitalization is given priority.
- The cumulative sector coverage at each rank is calculated.
- In each sector, companies are selected as per the rules mentioned in Section 4.1.3 until the cumulative sector coverage crosses 50% or there are no eligible securities left to be selected.
- MSCI defines the company that increases the cumulative sector coverage above 50% as the “marginal company”.
  - If the marginal company is a current index constituent, then it is always selected.
  - If the marginal company is not a current index constituent, then it is selected only if the cumulative sector coverage with the marginal company is closer to 50% compared to the cumulative sector coverage without the marginal company.
- The minimum cumulative sector coverage is set to 45%.



- The marginal company is always selected if this is required to achieve cumulative sector coverage of 45%.
- Securities which are ineligible as per Section 4.1.1 will not be selected even if the cumulative sector coverage after selection of all eligible securities is below 50%.

## Appendix 2: Controversial Business Involvement Criteria

Companies, whose activities meet the following criteria, as determined by MSCI ESG Research, are excluded from the MSCI World ex Australia Custom ESG Leaders Index:

- **Adult Entertainment**
  - All companies classified as a “Producer”
  - All companies deriving 5% or more aggregate revenue from the production, distribution and retail of adult entertainment materials
- **Alcohol**
  - All companies deriving 5% or more revenue from the production of alcohol-related products
  - All companies deriving 15% or more aggregate revenue from the production, distribution, retail and supply of alcohol-related products
- **Civilian Firearms**
  - All companies classified as “Producer” of firearms and small arms ammunitions for civilian markets. It does not cover companies that cater to the military, government, and law enforcement markets
  - All companies deriving 5% or more aggregate revenue from the production and distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use
- **Controversial Weapons**
  - All companies with any tie to Controversial Weapons (cluster munitions, landmines, depleted uranium weapons, biological/chemical weapons, blinding lasers, non-detectable fragments and incendiary weapons), as defined by the methodology of the MSCI Global Ex-Controversial Weapons Indexes available at <https://www.msci.com/index-methodology>
- **Conventional Weapons**
  - All companies deriving 10% or more revenue from the production of conventional weapons and components



- **Fossil Fuel Extraction and Reserves**
  - All companies deriving 5% or more aggregate revenue (either reported or estimated) from thermal coal mining and unconventional oil and gas extraction
    - *Thermal Coal Mining:* Revenue from the mining of thermal coal (including lignite, bituminous, anthracite and steam coal) and its sale to external parties. It does not cover revenue from metallurgical coal; coal mined for internal power generation (e.g. in the case of vertically integrated power producers); intra-company sales of mined thermal coal; and revenue from coal trading
    - *Unconventional Oil & Gas Extraction:* Revenue from oil sands, oil shale (kerogen-rich deposits), shale gas, shale oil, coal seam gas, and coal bed methane. It does not cover all types of conventional oil and gas production including Arctic onshore/offshore, deep water, shallow water and other onshore/offshore
  - All companies with evidence of owning oil and/or natural gas reserves, and deriving at least 15% revenue (either reported or estimated) from the extraction and production of oil and gas
  - All companies with evidence of owning thermal coal reserves, and deriving at least 15% revenue (either reported or estimated) from the mining of thermal coal and its sale to external parties
- **Gambling**
  - All companies those own or operate gambling facilities such as casinos, racetracks, bingo parlors, or other betting establishments, including: horse, dog, or other racing events that permit wagering; lottery operations; online gambling; pari-mutuel wagering facilities; bingo; pachislot and pachinko parlors; slot machines; Jai-alai; mobile gambling; and sporting events that permit wagering
  - All companies deriving 5% or more aggregate revenue from gambling-related business activities
- **Nuclear Power**
  - All companies generating 5% or more of their total electricity from nuclear power in a given year
  - All companies that have 5% or more of installed capacity attributed to nuclear sources in a given fiscal year

- All companies deriving 15% or more aggregate revenue from nuclear power activities
- **Nuclear Weapons**
  - All companies that manufacture nuclear warheads and/or whole nuclear missiles
  - All companies that manufacture components that were developed or are significantly modified for exclusive use in nuclear weapons (warheads and missiles)
  - All companies that manufacture or assemble delivery platforms that were developed or significantly modified for the exclusive delivery of nuclear weapons
  - All companies that provide auxiliary services related to nuclear weapons
  - All companies that manufacture components that were not developed or not significantly modified for exclusive use in nuclear weapons (warheads and missiles) but can be used in nuclear weapons
  - All companies that manufacture or assemble delivery platforms that were not developed or not significantly modified for the exclusive delivery of nuclear weapons but have the capability to deliver nuclear weapons
  - All companies that manufacture components for nuclear-exclusive delivery platforms
  - All companies that manufacture nuclear weapons, including nuclear warheads, intercontinental ballistic missiles, and ballistic missile submarines, which are capable of the delivery of nuclear warhead
  - All companies that manufacture key nuclear weapons components
  - All companies that are 50 percent or more owned by a company with nuclear weapons involvement
  - All companies that own 20 to 49.99 percent of a company with nuclear weapons involvement
- **Oil Sands**
  - All companies deriving 5% or more revenue from oil sands extraction, which own oil sands reserves and disclose evidence of deriving revenue from oil sands extraction. Companies that derive revenue from non-extraction activities (e.g. exploration, surveying, processing, refining) or intra-company

sales are not excluded. Additionally, companies that own oil sands reserves with no associated revenue are also not excluded

- **Thermal Coal Power**
  - All companies deriving 5% or more revenue (either reported or estimated) from thermal coal-based power generation
- **Tobacco**
  - All companies classified as a “Producer”
  - All companies deriving 5% or more aggregate revenue from the production, distribution, retail, supply and licensing of tobacco-related products
- **Global Norms – United Nations Global Compact Compliance**
  - All companies that fail to comply with the United Nations Global Compact principles

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