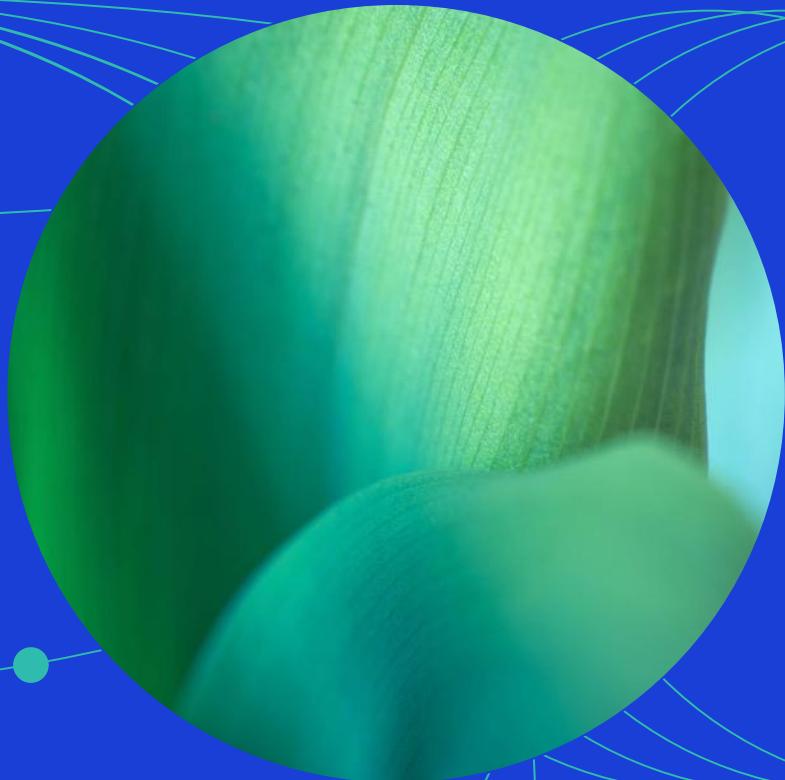


# MSCI Factor Advanced Series Indexes Methodology



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## 1 Introduction

The MSCI Factor Advanced Indexes (the “Indexes”)<sup>1</sup> are designed to represent the performance of a strategy that seeks systematic integration of environmental, social and governance (ESG) norms in factor investing, by seeking higher exposure to a style factor or combination of style factors along with the improvement in the ESG profile of the index.

MSCI categorizes the MSCI Factor Advanced Indexes as part of the family of MSCI Factor Indexes, which are designed to reflect the systematic elements of particular investment styles or strategies. While capitalization weighted indexes aim to represent the broad market beta, additional sources of systematic return associated with particular investment styles and strategies, such as value, quality, volatility, etc. or their combination could be represented through alternatively weighted indexes.

This index methodology aims to incorporate ESG-based constraints in a bottom-up factor index construction<sup>2</sup> approach.

The Indexes are constructed using individual stock exposures to the target factor/s along with specific ESG score criteria. The indexes aim to achieve relatively high exposure to the target single/multiple style factor/s while improving the index’s ESG profile relative to that of the underlying parent index by using risk-constrained optimization. The index construction selects the final index by maximizing the exposure to the target factor(s) less a penalty for the common factor and stock-specific risk characteristics of each potential constituent.

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<sup>1</sup> The Indexes are governed by a set of methodology and policy documents (“Methodology Set”), including the present index methodology document. Please refer to Appendix V for more details.

<sup>2</sup> For the methodology of MSCI Minimum Volatility Advanced Indexes please refer to MSCI Minimum Volatility Advanced Indexes methodology

## 2 Constructing the Indexes

The Indexes use company ratings and research provided by MSCI Solutions LLC ("MSCI Solutions")<sup>3</sup> to determine eligibility for index construction.

The applicable universe includes all the existing constituents of an underlying MSCI parent index (herein, the "Parent Index"). This approach aims to provide an opportunity set with sufficient liquidity and capacity.

The Indexes are constructed based on an optimization process from the underlying Parent Index using a Barra Equity Model to maximize the index-level exposure to the targeted style factors while controlling tracking error relative to the Parent Index. The optimization selects the final Index by maximizing the exposure to the target factor(s) less a penalty for the common factor and stock-specific risk characteristics of each potential constituent, as well as placing an upper bound on the predicted tracking error of the Index.

The steps for constructing the Indexes are described in the subsequent sections.

### 2.1 Eligible Universe

The Eligible Universe is constructed by excluding securities from the Parent Index based on the exclusion criteria described below.

- **Controversies:** All companies assessed as having involvement in Controversies that are classified as Red Flags (MSCI Controversy Score of 0). A Red Flag indicates an ongoing, Very Severe controversy implicating a company directly through its actions, products, or operations.
- **Controversial Weapons:** Companies involved in Controversial Weapons as defined by the methodology of the MSCI Ex-Controversial Weapons Indexes<sup>4</sup>.

### 2.2 Constituent Identification

The selection of constituents from the applicable universe is done using the optimization process. The optimization relies on the factor exposures for all the securities in the Parent Index and the factor covariance matrix of the relevant Barra Equity Model<sup>5</sup>. The optimization is performed using a base currency. The default currency is the US Dollar.

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<sup>3</sup> See Section 4 for further information regarding sustainability and climate data used in the Indexes that MSCI Limited and MSCI Deutschland GmbH source from MSCI Solutions LLC ("MSCI Solutions"), a separate subsidiary of MSCI Inc. MSCI Solutions is solely responsible for the creation, determination and management of such data as a provider to MSCI Limited and MSCI Deutschland GmbH. MSCI Limited and MSCI Deutschland GmbH are the benchmark administrators for the MSCI indexes

<sup>4</sup> The MSCI Global Ex Controversial Weapons Indexes Methodology is available at <https://www.msci.com/index/methodology/latest/XCW>

<sup>5</sup> Please refer to Appendix II for the detailed information on model usage.

## 2.3 Weighting Scheme

The optimization objective is to maximize the Alpha score (representative of the exposures to the set of target factors), while controlling the ex-ante tracking error relative to the Parent Index at the time of rebalancing.

### 2.3.1 Calculation of the Alpha Score

#### 2.3.1.1 Single Factor

$$\alpha_i = F_{j,i}$$

Where,

$F_{j,i}$  = Factor exposure of each security  $i$  for each of the target factors.

The factor exposures for the target factors are sourced as described in Appendix III

#### 2.3.1.2 Factor Combination

$$\alpha_i = W_1 F_{1,i} + W_2 F_{2,i} + \dots W_n F_{N,i}$$

Where,

$F_{j,i}$  = Factor exposure of each security  $i$  for each of the target factors.

$N$  = Number of factors.

$W_1 = W_2 = W_3 = \dots = W_n = 1/N$

The factor exposures for the target factors are sourced as described in Appendix III.

## 2.4 Optimization Constraints

At each Index Review, the following optimization constraints are employed, which aim to ensure investability while achieving improvement in ESG profile, subject to tracking error constraint relative to the Parent Index.

- The ex-ante tracking error of the Index, relative to the Parent Index will be capped at 3%
- The weighted-average industry-adjusted ESG score<sup>6</sup> of the Index portfolio will be at least 20% more than the weighted-average industry-adjusted ESG score of the Parent Index portfolio
- If the Parent Index is an MSCI Standard index or an MSCI Investable Market Index (IMI), then the maximum weight of index constituents that belong to the Large Cap size segment will be restricted to the lower of (the weight of the security in the Parent Index + 2%) and 10 times the weight of the security in the Parent Index. The minimum weight of an index constituent will be restricted to the higher of (weight of the security in the Parent Index - 2%) and 0. The maximum weight of index constituents that belong to the Mid Cap or Small Cap size segments will

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<sup>6</sup> Companies not assessed by MSCI Solutions on data for industry-adjusted ESG score are assigned an industry-adjusted ESG score of zero.

be restricted to the lower of (the weight of the security in the Parent Index + 1%) or 5 times the weight of the security in the Parent Index. The minimum weight of an index constituent will be restricted to the higher of the (weight of the security in the Parent Index - 1%) or 0

- If the Parent Index is an MSCI Mid Cap index or an MSCI Small Cap index, the maximum weight of an index constituent will be restricted to the lower of (the weight of the security in the Parent Index + 1%) and 5 times the weight of the security in the Parent Index. The minimum weight of an index constituent will be restricted to the higher of (the weight of the security in the Parent Index - 1%) and 0.
- Active exposure of the MSCI Factor Advanced Index to the target Barra style factors (factors included in the calculation of Alpha score) will be constrained to be greater than 0.1 and less than 0.6. Factors, namely, Earnings Variability, Leverage, Size, Beta and Residual Volatility if included in the calculation of Alpha score, will be constrained to be greater than -0.6 and less than -0.1 relative to the Parent Index.
- The exposure of the MSCI Factor Advanced Index to the non-target Barra style factors will be restricted to +/-0.1 standard deviations relative to the Parent Index.
- The sector weights of the MSCI Factor Advanced Index will not deviate more than +/- 5% from the sector weights of the Parent Index.
- For countries with weight greater than 2.5% in the Parent Index, the weight in the MSCI Factor Advanced Index will not deviate more than +/-5% from the country weight in the Parent Index.
- For countries with weight less than 2.5% in the Parent Index, the weight in the MSCI Factor Advanced Index will be capped at 3 times their weight in the Parent Index.
- The above country weight constraint will also apply on China A Stock Connect listings as a group separately in addition to the usual country weight constraint on China.
- The one-way turnover of the MSCI Factor Advanced Index is constrained to a maximum of 10% at each QIR.
- The common factor risk aversion parameter used in the optimization of the risk-adjusted target factor exposure is 0.0015 and the specific risk aversion parameter is 0.015.

## 2.5 Defining the Optimized Index

The Indexes are constructed using the Barra Open Optimizer in combination with the relevant Barra Equity Model. The optimization uses the Parent Index as the universe of eligible securities and the specified optimization objective and constraints to determine the MSCI Factor Advanced Index. Infeasible optimizations are handled as explained in Appendix I.

## 2.6 Treatment of Unrated Companies

Companies not assessed by MSCI Solutions on data for any of the following MSCI sustainability and climate products are not eligible for inclusion in the Indexes.

- MSCI Controversies

## 3 Maintaining the Index

### 3.1 Index Reviews

The Indexes are rebalanced on a quarterly basis, usually as of the close of the last business day of February, May, August and November, coinciding with the regular Index Reviews of the MSCI Global Investable Market Indexes. The Barra Equity Model data as of the day before the rebalancing day is used. This approach aims to capture timely updates to the risk characteristics of the companies and coincide with the rebalancing frequency of the relevant Parent Index.

In general, MSCI uses MSCI Solutions data<sup>7</sup> (including MSCI ESG Ratings, MSCI Controversies Scores and MSCI Business Involvement Screening Research) as of the end of the month preceding the Index Review for the rebalancing of the Index. For some securities, such data may not be published by MSCI Solutions by the end of the month preceding the Index Review. For such securities, MSCI will use data published after the end of month, when available, for the rebalancing of the Index.

The pro forma Indexes are in general announced nine business days before the effective date.

### 3.2 Ongoing Event Related Changes

The general treatment of corporate events in the MSCI Factor Advanced 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 Factor Advanced Index, the changes made to the Parent Index during intermediate Index Reviews will be neutralized in the MSCI Factor Advanced Index.

The following section briefly describes the treatment of common corporate events within the MSCI Factor Advanced 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
<b>New additions to the Parent Index</b>	A new security added to the Parent Index (such as IPO and other early inclusions) will not be added to the Index.

<sup>8</sup> See section 4 for details of data sourced from MSCI Solutions used in the Indexes

**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/latest/CE>.

## 4 MSCI Solutions

The Indexes are products of MSCI Inc. that utilize information such as company ratings and research produced and provided by MSCI Solutions LLC ("MSCI Solutions"), a subsidiary of MSCI Inc. In particular, the Indexes use the following MSCI sustainability and climate products: MSCI ESG Ratings, MSCI Controversies and MSCI Business Involvement Screening Research. MSCI Indexes are administered by MSCI Limited and MSCI Deutschland GmbH.

### 4.1 MSCI ESG Ratings

MSCI ESG Ratings aim to measure entities' management of environmental, social and governance risks and opportunities. MSCI ESG Ratings use a weighted average key issue calculation that is normalized by industry to arrive at an industry-adjusted ESG score (0-10), which is then translated to a seven-point scale from 'AAA' to 'CCC', indicating how an entity manages relevant key issues relative to industry peers.

The MSCI ESG Ratings methodology can be found at: <https://www.msci.com/legal/sustainability-and-climate-resources-and-disclosures>.

### 4.2 MSCI Controversies

MSCI Controversies provide assessments of controversies concerning the potential negative environmental, social, and/or governance impact of company operations, products and services. The evaluation framework used in MSCI 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 Controversies Score falls on a 0-10 scale, with "0" being the most severe controversy.

The MSCI Controversies methodology can be found at: <https://www.msci.com/legal/sustainability-and-climate-resources-and-disclosures>.

### 4.3 MSCI Business Involvement Screening Research

MSCI Business Involvement Screening Research (BISR) aims to enable institutional investors to manage environmental, social and governance (ESG) standards and restrictions reliably and efficiently.

The MSCI Business Involvement Screening Research methodology can be found at: <https://www.msci.com/legal/sustainability-and-climate-resources-and-disclosures>.

## Appendix I: Handling Infeasible Optimizations

During the Index Review, in the event that there is no optimal solution that satisfies all the optimization constraints defined in Section 2.4, the following constraints will be relaxed, until an optimal solution is found:

- Maximum asset weight multiple
- Maximum turnover
- Weighted-average industry-adjusted ESG score improvement

### Relaxation Steps:

- Step I: Relax the maximum asset weight multiple in steps of 2 for the Large Cap size segment and in steps of 1 for the Mid Cap and Small Cap size segments, up to a maximum of 5 iterations based upon the following formula

$$wm_{i+1} = step + wm_i \text{ for } i = 0 - 4$$

Where  $wm_{i+1}$  = Maximum Active weight multiple

$wm_0$  and  $step = 2$  for the Large Cap size segment

$wm_0 = 5$  and  $step = 1$  for the Mid Cap and Small Cap size segment

- Step II: Relax the maximum turnover constraint in steps of 2%, up to a maximum of 20%
- Step III: The maximum asset weight multiple constraint and the maximum turnover constraint are alternately relaxed until a feasible solution is achieved For example, constraints relaxation is executed in the sequence as illustrated below:

Order of Relaxation	Maximum Asset Weight Multiple	Turnover Limit
1	12 times (for Large Cap)/ 6 times (for Mid Cap and Small Cap) the weight of the security in the Parent Index	10%
2	12 times (for Large Cap)/ 6 times (for Mid Cap and Small Cap) the weight of the security in the Parent Index	12%
3	14 times (for Large Cap)/ 7 times (for Mid Cap and Small Cap) the weight of the security in the Parent Index	12%
4	14 times (for Large Cap)/ 7 times (for Mid Cap and Small Cap) the weight of the security in the Parent Index	14%

### ESG Score Improvement Target Relaxation

If no optimal solution is found after the maximum asset weight multiple constraint and the maximum turnover constraint are fully relaxed, the minimum required weighted-average industry-adjusted ESG

Score Improvement of the Index relative to the Parent Index will be relaxed from 20% to 1% in steps of 1%, defined as below:

- The ESG Score Improvement Target of the Index is relaxed by 1% and the maximum asset weight multiple constraint and the maximum turnover constraint are reset to their initial thresholds.
- Steps I, II and III are repeated and the maximum asset weight multiple and maximum turnover constraints are relaxed again from their initial thresholds.
- This process of relaxing the ESG Score Improvement Target and subsequently relaxing the maximum asset weight multiple and maximum turnover constraints from their initial threshold to maximum threshold is repeated in the same manner until a feasible solution is achieved.

In the event that no optimal solution is found even after all the above constraints are fully relaxed, including the ESG Score Improvement Target relaxation to 1%, the relevant MSCI Factor Advanced Index will not be rebalanced for that Index Review.

## Appendix II: New Release of Barra® Equity Model or Barra® Optimizer

The methodology presently uses MSCI Barra Global Equity Model for Long-Term Investors ("GEMLTL") for the optimization. A new release of the relevant Barra Equity Model or Barra Optimizer may replace the former version within a suitable timeframe.

## Appendix III: Target Factor Definition Summary

The style factors targeted in the MSCI Factor Advanced Index are the six style factor families and their combinations: Value, Quality, Momentum, Low Size, Yield and Low Volatility. These factor families are described using individual factor scores from the current release of the MSCI Barra Equity Model. The choice of factors used within each factor family is governed by the current model used for the optimization, which may change with a new release of the Barra Equity Model (as specified in Appendix II). The model data will be used from a day prior to the rebalancing date. All factor exposures are re-normalized at the Parent Index level prior to the calculation of the Alpha score. Following are the definitions of factor families currently used in the Index. For more detailed information on individual factors in GEMTL, please refer to <https://www.msci.com/portfolio-management>.

### **Value:**

The Value score for each security is calculated by combining the security-level exposures to two factors, Book-to-Price and Earnings Yield, from the GEMTL model. A sector-relative score is derived from the combined score by standardizing (z-score) the latter within each sector and winsorizing at +/- 3

$$Value_i = (0.33) * BtoP_i + (0.67) * EarningsYield_i$$

### **Quality:**

The Quality score for each security is calculated by combining in equal proportion the security-level exposures to five factors - Profitability, Investment Quality, Earnings Quality, Leverage and Earnings Variability - from GEMTL model. A sector-relative score is derived from the combined score by standardizing (z-score) the latter within each sector and winsorizing at +/- 3

$$Quality_i = (0.2) * Profitability_i + (0.2) * Investment\ Quality_i + (0.2) * Earnings\ Quality_i + (-1) * (0.2) * Earnings\ Variability_i + (-1) * (0.2) * Leverage_i$$

### **Low Volatility:**

The Low Volatility score for each security is calculated by combining in equal proportion the security-level exposures to two factors - Beta and Residual Volatility - scores. The Beta and Residual Volatility score for each security is the winsorized (at +/- 3) z-score of Beta and Residual Volatility factor scores, respectively taken from the relevant Barra Equity Model (currently GEMTL).

$$Low\ Volatility_i = -(1) * (-0.5)Beta_i + -(1) * (0.5)Residual\ Volatility_i$$

### **Momentum:**

The Momentum score for each security is the winsorized (at +/- 3) z-score of the Momentum factor score taken from the relevant Barra Equity Model (currently GEMTL).

**Low Size:**

The Low Size score for each security is the winsorized (at +/- 3) z-score of the Size factor score in the GEMTL Barra Equity Model with sign reversed.

$$\text{Low Size}_i = -(1)\text{Size}_i$$

**Yield:**

The Yield factor score for each security is the winsorized (at +/- 3) z-score of the Dividend Yield factor score in the GEMTL Barra Equity Model.

## Appendix IV: Transition Parameters during May 2022 Index Review

At the transition, during May 2022 Index Review, the one-way turnover cap will be maintained at 20%<sup>8</sup> for the May 2022 Index Review and the maximum weight of an index constituents in the Mid Cap and Small Cap segments will be restricted to the lower of (the weight of the security in the Parent Index + 1%) and 7 times<sup>9</sup> the weight of the security in the Parent Index.

Starting from August 2022 Index Review, the one-way turnover cap will be set to 10% at each index review and the maximum weight of an index constituent in the Mid Cap and Small Cap segments will be restricted to the lower of (the weight of the security in the Parent Index + 1%) and 5 times the weight of the security in the Parent Index.

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<sup>8</sup> For the methodology transition in May 2022 Index Review, the turnover constraint is relaxed from 20% in steps of 4%, up to a maximum of 40% along with other constraints as defined in Appendix I

<sup>9</sup> For the methodology transition in May 2022 Index Review, the maximum weight multiple of the Mid Cap and Small Cap size segments is relaxed from 7 times in steps of 1.4 up to a maximum of 5 iterations (14 times) along with other constraints as defined in Appendix I

## Appendix V: Methodology Set

The Indexes are governed by a set of methodology and policy documents ("Methodology Set"), including the present index methodology document as mentioned below:

- Description of methodology set –  
[www.msci.com/index/methodology/latest/ReadMe](http://www.msci.com/index/methodology/latest/ReadMe)
- MSCI Corporate Events Methodology –  
[www.msci.com/index/methodology/latest/CE](http://www.msci.com/index/methodology/latest/CE)
- MSCI Fundamental Data Methodology –  
<https://www.msci.com/index/methodology/latest/FundData>
- MSCI Index Calculation Methodology –  
[www.msci.com/index/methodology/latest/IndexCalc](http://www.msci.com/index/methodology/latest/IndexCalc)
- MSCI Index Glossary of Terms –  
[www.msci.com/index/methodology/latest/IndexGlossary](http://www.msci.com/index/methodology/latest/IndexGlossary)
- MSCI Index Policies –  
[www.msci.com/index/methodology/latest/IndexPolicy](http://www.msci.com/index/methodology/latest/IndexPolicy)
- MSCI Global Industry Classification Standard (GICS) Methodology –  
<https://www.msci.com/index/methodology/latest/GICS>
- MSCI Global Investable Market Indexes Methodology –  
[www.msci.com/index/methodology/latest/GIMI](http://www.msci.com/index/methodology/latest/GIMI)
- MSCI Global ex Controversial Weapons Indexes Methodology –  
[www.msci.com/index/methodology/latest/XCW](http://www.msci.com/index/methodology/latest/XCW)
- ESG Factors In Methodology\*

The Methodology Set for the Indexes can also be accessed from MSCI's webpage <https://www.msci.com/index-methodology> in the section 'Search Methodology by Index Name or Index Code'.

\* 'ESG Factors in Methodology' contains the list of environmental, social, and governance factors considered, and how they are applied in the methodology (e.g., selection, weighting or exclusion). It can be accessed in the Methodology Set as described above.

## Appendix VI: Changes to this Document

### **The following sections have been modified since September 2017**

- Clarified the mean-variance optimization problem solved in the index construction in the Introduction (Section 1) and section 3.
- Added a description of the values used for the common factor risk aversion and the specific aversion parameters used in the optimization in Section 3.4.
- Updated Appendix III to explain the dependence of the precise factor definitions used within each target factor on the Barra model currently used for optimization.

### **The following sections have been modified since November 2017**

- Section 3.4 has been updated to reflect the additional constraint on China A Stock Connect listings.

### **The following sections have been modified effective May 2022**

- Section 3.4 has been updated to reflect the change in optimization constraints.
- Section 4.1 has been updated to reflect the change in rebalance frequency.
- Appendix I has been updated to reflect the change in handling of optimization infeasibility.
- Appendix III has been updated to reflect the parent-level normalization of target factors.
- Appendix V has been added to describe transition parameters during May 2022 Index Review.

### **The following sections have been modified effective July 2023**

- Updated to reflect the transition of the MSCI Global Investable Market Indexes (GIMI) to Quarterly Comprehensive Index Reviews (all references to "Semi-Annual Index Reviews" and "Quarterly Index Reviews" of the MSCI GIMI were replaced with "Index Reviews".)
- Section 2.1 & Appendix IV: Clarified the exclusion criteria for companies involved in ESG Controversies.
- MSCI ESG Research. Moved that section after the Section 3. Updated the descriptions of MSCI ESG Research products

### **The following section has been modified as of February 2025**

- The Methodology Name and Index Name were updated, effective February 3rd; MSCI Factor ESG Target Indexes have been renamed as MSCI Factor Advanced Indexes

### Appendix VI: Methodology Set

- Added details on the Methodology Set for the Indexes

**The following section has been modified as of February 2026**

- Moved Controversy Score and Controversial Weapons Exclusion from Appendix IV to Section 2.1
- Added footnote in Section 2.4 clarifying the treatment of missing industry-adjusted ESG score data.
- Added Section 2.6: Treatment of Unrated Companies.
- Updated the language in Section 3.1 and 3.2 describing the MSCI Solutions data used at the time of the Index Reviews
- Updated Appendix I: Handling Infeasible Optimizations to incorporate the relaxation related to ESG Score Improvement Target.

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