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Update to the Consultation on MSCI KLD 400 Social Index Methodology

April 2012

MSCI KLD 400 Social Index Consultation – Key Updates

- MSCI launched a consultation on proposed enhancements to the MSCI KLD 400 Social Index on February 29, 2012.
- This updated consultation document incorporates the client feedback received so far as part of the consultation. The key updates to the earlier version are highlighted below, while the rest of the document describes the proposed enhancements in further detail
- Transition Timeline
 - Based on client feedback, MSCI proposes to transition to the enhanced methodology starting May 2012 Index Review over multiple phases
 - Phase 1 - Deletion of companies having ESG rating of B over four index reviews
 - Phase 2 - Deletion of non MSCI USA IMI ESG companies over four subsequent index reviews

Executive Summary

- MSCI started maintaining the MSCI KLD 400 Social Index along with the other MSCI ESG Indices post their transition in September 2010. It was then announced that MSCI would review the index methodology in the future.
- MSCI now proposes an objective and transparent methodology for the MSCI KLD 400 Social Index based on MSCI's new suite of ESG products on ESG Manager, while keeping the philosophy underpinning the index unchanged.
- MSCI proposes to use a combination of three MSCI ESG products for the purpose of index creation – IVA ratings for overall best-of-class ESG company performance, Impact Monitor scores for identifying highly controversial company practices and ESG Screener for excluding companies that fail the values based exclusion screens.
- These proposals are similar to the enhanced methodology proposal for the MSCI Global ESG Indices, on which MSCI is currently consulting with clients.*
- Please note this consultation may or may not lead to the adoption, in whole or in part, of the proposed enhancements described herein.

* The consultation document describing these proposed enhancements in detail is available on the MSCI web site at <http://www.msci.com/products/indices/consultations/>

Current MSCI KLD 400 Social Index Methodology

- MSCI KLD 400 Social Index is a free float-adjusted market capitalization index designed to provide exposure to U.S. companies that have positive Environmental, Social and Governance (ESG) characteristics.
- The Index excludes companies with involvement in alcohol, gambling, tobacco, firearms, weapons and nuclear power.
- The Index is composed of 400 securities with high ESG performance along with the considerations of size and sector representation.
- The index is reviewed on a quarterly basis to coincide with the Semi-Annual Index Reviews in May and November and Quarterly Index Reviews in February and August.
- At each Quarterly Index Review (QIR):
 - Current index constituents are reviewed to determine if any of them should be removed due to ESG performance
 - If a constituent is removed from the MSCI USA IMI as a result of the Index Review, it is simultaneously removed from the MSCI KLD 400 Social Index
 - The deleted securities are replaced with eligible securities taking into account size and sector representation
 - The MSCI KLD 400 Social Index is restored to 400 securities at each Index Review
- The rebalancing results are announced five days before the effective date through Integrated Client File (ICF) and a Global Summary Document.

Proposal for Enhanced Methodology

The proposed methodology for the MSCI KLD 400 Index is based on the following principles, in line with the current index philosophy:

- Parent Index
 - The selection universe for the MSCI KLD 400 Social Index will be MSCI USA IMI ESG Index. The MSCI USA IMI ESG Index is designed to provide exposure to companies that have high ESG performance by targeting the top 50% companies by ESG rating within each sector
- Positive exposure to superior ESG rated companies
 - Use IVA ratings to identify companies with superior ESG performance
 - Use values based exclusion screens as in the current methodology with further refinements (as detailed in the Appendix)
 - Exclude companies having involvement in specific ESG controversies as identified by Impact Monitor
- Sector representation
 - Target relative sector weights of +/- 25% with respect to MSCI USA to align sector weights
- Size representation
 - Target a minimum count of 200 standard segment companies

Proposal for Enhanced Methodology

The composition of the MSCI KLD 400 Social Index is reviewed on a quarterly basis. The proposed deletion and addition criteria at every QIR are as follows:

- Deletion criteria at QIRs
 - Companies that are deleted from the MSCI USA IMI ESG Index (at that QIR)
 - Companies that fail the values based exclusion screens
 - Companies whose IVA rating drops to B or below
 - Companies having Impact Monitor controversy assessment of very severe (Impact Monitor score of 0 or 1)
 - Companies from overweight sectors (starting with lowest IVA rated company) until the relative sector weights are within band

- Companies eligible for addition
 - Constituents of MSCI USA IMI ESG Index
 - Companies that pass the values based exclusion screens
 - Companies with IVA rating of BBB or above
 - Companies having Impact Monitor score of 3 or above

Proposal for Enhanced Methodology

At every index review, after reflecting all the deletions, additions will be made to the MSCI KLD 400 Social Index in order to restore the number of index constituents to 400. The additions to the index will be based on ESG performance, sector alignment and size representation.

Standard segment:

- Add all companies having IVA rating of AAA, irrespective of sector weight
- Add companies (in order of their IVA scores) to sectors where the relative sector weights are below the lower threshold (-25%). The sector weights will be recalculated after every addition
- Once relative sector weights of all sectors are above the lower threshold or no further companies are available for addition in these sectors, companies will be added sequentially based on their IVA scores. The sector weights will be recalculated after every addition
- No companies will be added to a sector if it reaches the upper threshold of +25%
- A minimum count of 200 securities will be maintained to ensure appropriate size representation
- While adding companies to the same sector, preference will be given to companies having higher IVA score. In case there are multiple companies with the same IVA score, one with higher free float-adjusted market capitalization will be added first

Small Cap segment:

- Add companies based on their IVA score. In case of a tie, add to the most underweight sector

Transition Proposal

- MSCI proposes to transition the MSCI KLD 400 Social Index to the enhanced methodology over multiple index reviews starting May 2012 Index Review
 - Phase 1 - All existing constituents currently rated “B” or below will be deleted from the index, starting with the most overweight sectors*, over four index reviews
 - This will result in a total of 35 deletions with a weight of 8.7% in the current index**
 - Phase 2 - All constituents that are not part of the pro forma MSCI USA IMI ESG Index will be deleted from the index, starting with the most overweight sectors, over four subsequent index reviews
 - This will result in a total of 22 deletions with a weight of 12.6% in the current index***
 - At each index review, other deletions and additions will be made to the index in line with the proposed methodology, to restore the number of securities to 400

* As long as the rating remains “B” or below at the time of the deletion

** Based on data as of close of November 30, 2011

*** These deletions are based on the pro forma MSCI USA IMI ESG Index constructed using the enhanced methodology

Proposed Top Deletions

Security Name	Sector	GS Rating	IVA Rating	Impact Monitor	Impact Monitor Score	Current weight
Microsoft Corp	Information Technology	BBB	A	Yellow	2	3.8%
Qualcomm	Information Technology	BBB	A	Yellow	3	1.8%
Disney (Walt)	Consumer Discretionary	BB	BB	Yellow	2	1.2%
Home Depot	Consumer Discretionary	BB	B	Yellow	2	1.1%
Amgen	Health Care	A	B	Yellow	3	1.0%
Cvs/caremark	Consumer Staples	BBB	BB	Yellow	2	1.0%
Costco Wholesale Corp	Consumer Staples	BBB	A	Yellow	2	0.7%
eBay	Information Technology	BBB	BBB	Yellow	2	0.7%
Baxter International	Health Care	A	B	Yellow	2	0.6%
Lowe's Cos	Consumer Discretionary	A	B	Green	5	0.6%
Walgreen Co	Consumer Staples	BB	B	Yellow	2	0.6%
Biogen Idec	Health Care	A	BB	Yellow	4	0.5%
Automatic Data Process	Information Technology	BBB	BBB	Green	10	0.5%
Corning	Information Technology	A	A	Green	5	0.5%
Johnson Controls	Consumer Discretionary	AA	B	Yellow	3	0.4%
Illinois Tool Works	Industrials	BB	B	Yellow	4	0.4%
McKesson Corp	Health Care	A	B	Yellow	2	0.4%
Thermo Fisher Scientific	Health Care	BBB	BB	Green	5	0.4%
Intuitive Surgical	Health Care	BBB	B	Green	10	0.3%
Netapp	Information Technology	BBB	B	Green	5	0.3%

Proposed Top Additions

Security Name	Sector	IVA Rating	Impact Monitor	Impact Monitor Score	Proforma weight
Viacom B (New)	Consumer Discretionary	BBB	Yellow	4	0.52%
Centurylink	Telecommunication Services	BBB	Green	5	0.51%
Cognizant Tech Solutions	Information Technology	BBB	Green	5	0.46%
Time Warner Cable	Consumer Discretionary	A	Yellow	4	0.43%
Equity Residential	Financials	BBB	Green	5	0.37%
Marsh & McLennan Cos	Financials	BBB	Yellow	4	0.36%
Hcp	Financials	BBB	Green	10	0.34%
Intuit	Information Technology	A	Green	8	0.34%
Motorola Solutions	Information Technology	AA	Yellow	3	0.31%
Paccar	Industrials	BBB	Green	5	0.29%
Macy's	Consumer Discretionary	BBB	Yellow	3	0.29%
Kroger Co	Consumer Staples	A	Yellow	3	0.28%
Avalonbay Communities	Financials	BBB	Green	5	0.26%
Int'l Paper Co	Materials	BBB	Yellow	3	0.26%
O'reilly Automotive	Consumer Discretionary	BBB	Green	5	0.23%
Cliffs Natural Resources	Materials	BBB	Green	5	0.23%
Dover Corp	Industrials	A	Green	8	0.23%
Conagra Foods	Consumer Staples	A	Yellow	4	0.23%
Fluor Corp	Industrials	AA	Yellow	3	0.21%
Bunge	Consumer Staples	A	Yellow	3	0.20%

Discussion Points

- Is the selection of MSCI USA IMI ESG as the selection universe appropriate?
- Are the IVA rating thresholds for the deletions (B or below) and additions (BBB or above) appropriate?
- Is the application of a higher Impact Monitor controversy assessment of very severe or severe for non index constituents appropriate?
- Are the thresholds for relative sector weights (+/- 25%) appropriate?
- Is the floor on the number of standard segment companies (200) adequate?
- What would be the appropriate timeline for the transition?
- Is the deletion of existing constituents that are “B” rated, or are not part of the MSCI USA IMI ESG Index appropriate?

Appendix

Proposed Enhanced Values based exclusion screens

	Current	Proposed
<u>Adult Entertainment</u>		<ul style="list-style-type: none"> All companies classified as “Producer” that earn 5% or more of revenue from adult entertainment activities
		<ul style="list-style-type: none"> All “Producers” that earn USD \$500 million in revenue from adult entertainment activities
<u>Alcohol</u>	<ul style="list-style-type: none"> Producers: any involvement 	<ul style="list-style-type: none"> All companies classified as “Producers” that earn 5% or more of total revenues from alcohol-related activities
		<ul style="list-style-type: none"> All “Producers” that earn USD \$500 million in revenue from alcohol
<u>Burma</u>		<ul style="list-style-type: none"> All companies classified as “Involvement in Natural Gas/Petroleum”, “Involvement in Mineral Extraction”, “Involvement in Power Production”, “Business tie to the Burmese Military”, or “Payments to Government for Mineral/Energy Rights”
		<ul style="list-style-type: none"> Burma Exceptions: Companies involved in minor power production. All companies only involved through their parent company’s activities.
<u>Civilian Firearms</u>	<ul style="list-style-type: none"> Producers: any involvement 	<ul style="list-style-type: none"> All companies classified as “Producers” that earn 5% or more of total revenue from firearms
		<ul style="list-style-type: none"> All “Producers” that earn USD \$500 million in revenue from firearms
		<ul style="list-style-type: none"> All companies classified as “Retailers” that earn 15% or more of revenues from civilian firearms
<u>Gambling</u>	<ul style="list-style-type: none"> Owner/operators of gambling facilities 	<ul style="list-style-type: none"> All companies classified as “Operations” or “Support” that earn 5% or more of revenues from gambling-related activities
	<ul style="list-style-type: none"> Suppliers of key products: >50% or major player 	<ul style="list-style-type: none"> All “Operations” and “Support” companies that earn USD \$500 million in revenue from gambling
<u>Nuclear Power</u>	<ul style="list-style-type: none"> Owner/operator: any level 	<ul style="list-style-type: none"> All companies classified as “Utility”, “Uranium Mining”, “Nuclear Reactor Construction/Design” or “Fuel Enrichment”
	<ul style="list-style-type: none"> Design nuclear reactors 	<ul style="list-style-type: none"> All companies classified as “Essential Supplier” that earn 15% or more of revenues from nuclear-related activities
	<ul style="list-style-type: none"> Uranium Mining 	

Proposed Enhanced Values based exclusion screens (contd.)

	Current	Proposed
<u>Sudan</u>		<ul style="list-style-type: none"> • Sudan focus list without excluding substantial action companies
<u>Tobacco</u>	<ul style="list-style-type: none"> • Producers: any involvement 	<ul style="list-style-type: none"> • All companies classified as “Producer” • All companies classified as “Distributor”, “Retailer”, or “Supplier” that earn 15% or more of revenues from tobacco products
<u>Weapons</u>	<ul style="list-style-type: none"> • Controversial Weapons (NBC): any involvement • Conventional Weapons and key component parts: 2% or \$50 million 	<ul style="list-style-type: none"> • All companies classified as “Nuclear Weapons Systems”, “Nuclear Weapons Components”, “Chemical/Biological Weapons Systems”, “Chemical/Biological Weapons Components”, “Depleted Uranium Manufacturer”, “Cluster Bomb Manufacturer”, or “Landmine Manufacturer” • All companies that earn 5% or more of revenue from weapons-related products or services • All companies that earn USD \$500 million in revenue from weapons-related products or services

MSCI KLD 400 Social Index – Historical Turnover

MSCI KLD 400 Social Index

Index Review	# Additions	# Deletions	Turnover
Nov 2011	6	3	1.4%
Aug 2011	9	4	1.2%
May 2011	14	8	3.6%
Feb 2011	1	0	0.5%
Nov 2010	8	7	3.7%
Aug 2010	2	2	2.1%

MSCI USA ESG Index – Eligible Universe

Break up of MSCI USA ESG Index constituents (327)			
not in MSCI KLD 400 Social Index		in MSCI KLD 400 Social Index	
Total	130	Total	197
Ineligible	74	Exclusions	17
Values based exclusions	12	Values based exclusions	0
IVA rating of BB or below	41	IVA rating of B or below	17
Rating not available	7		
Impact Monitor score (0,1,2)	14	Impact Monitor score (0,1)	0
Remaining (eligible)	56	Remaining	180
Total remaining = 56+180 = 236			

- There are 236 standard segment constituents that are eligible for inclusion in the MSCI KLD 400 Social Index

Size / Sector / Rating Distribution

	Standard	Small Cap	Total
#Current	237	162	399
#Proforma	228	172	400

	IVA Rating	weight in current index	weight in proforma index
Standard segment	AAA	12.0%	13.8%
	AA	6.3%	8.3%
	A	31.2%	31.0%
	BBB	19.0%	25.3%
	BB	16.3%	14.5%
	B	8.2%	0.0%
	CCC	0.5%	0.0%
	NA	1.3%	1.3%
	Total	94.8%	94.2%
Small Cap	NA	5.2%	5.8%
	Grand Total	100.0%	100.0%

Sector	MSCI USA	Relative sector weights	
		Current	Proforma
Consumer Discretionary	11.2%	5.4%	2.9%
Consumer Staples	11.1%	19.9%	22.2%
Energy	12.5%	-53.8%	-47.5%
Financials	13.0%	-14.4%	10.4%
Health Care	11.6%	39.1%	22.5%
Industrials	10.4%	-7.9%	-0.5%
Information Technology	19.7%	34.4%	11.2%
Materials	3.7%	-26.3%	-1.0%
Telecommunication Services	3.1%	-64.7%	-40.6%
Utilities	3.7%	-46.8%	-45.1%

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