



Extended ESG Focus and Choice ESG Screened Indexes

This product insight gives an overview of the **MSCI Extended ESG Focus** and **MSCI Choice ESG Screened Indexes**. These indexes illustrate two approaches to ESG index construction that offer investors choice when integrating ESG into their portfolios



Introduction

Sustainability is reshaping both the world we live in and the investment landscape. Companies are increasingly aware that their clients and their investors view sustainability as material to the bottom line. From tackling issues such as climate change to gender equality, and better corporate governance, a new era is emerging. Environmental, Social and Governance (ESG) considerations are galvanizing a complete rethink of all aspects of society.

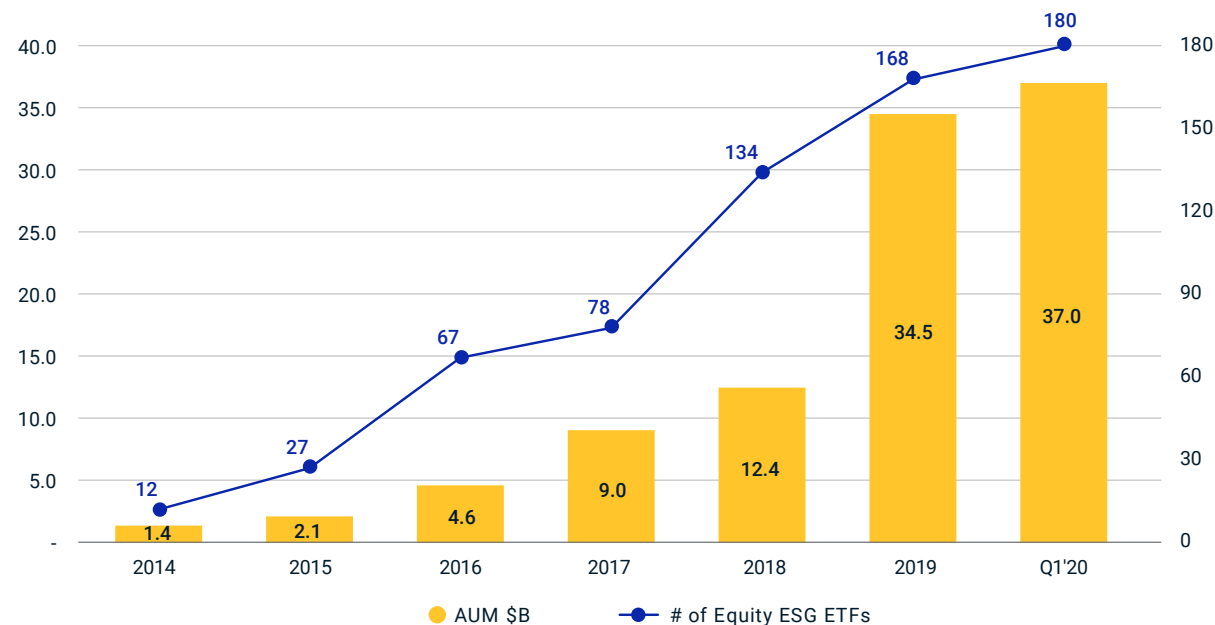
These significant changes may require new approaches to investing. The sustainable investing industry is growing as more investors integrate

ESG into their investment decision making process. Between 2016 and 2018, global assets managed using ESG investment strategies have risen by 34% from USD \$22.9 trillion to over \$30.7 trillion, globally.¹

In the U.S., flows into sustainable mutual funds and Exchange Traded Funds (ETFs) grew to \$20.6bn in 2019, almost four times the volume in 2018.²

As the figure shows, MSCI has seen a 120% growth year-on-year in ETF assets under management tracking MSCI ESG Indexes.³

Equity ETF assets linked to MSCI ESG Indexes



1. The Global Sustainable Investment Alliance 2018 – April, 2019 <http://www.gsi-alliance.org/>

2. Morningstar 2020 <https://www.morningstar.com/articles/961765/sustainable-fund-flows-in-2019-smash-previous-records>

3. As of Q1 2020; defined as each share class of an exchange traded fund, as identified by a separate ticker. Only primary listings, and not cross-listings, are counted. Equity ETF values for periods prior to April 26, 2019 were based on data from Bloomberg and MSCI, while the values for periods on or after April 26, 2019 were based on data from Refinitiv and MSCI.

ESG Growth Drivers

We attribute this growth to three main drivers.

1. ESG helps investors understand how the world is changing

Global challenges, such as water stress, privacy and data security and regulatory pressures, represent new or accelerating risks for investors. ESG investing can help investors identify the companies with the greatest exposure to these risks and how they are managing them.

2. A new generation of investors

Over the next few decades, the millennial generation is expected to direct between \$15 trillion and \$20 trillion into U.S.-domiciled ESG investments.⁴ A growing body of research suggests that millennials are asking more of their investments and are more interested in sustainable products.

3. Better data, coverage and technology

Advances in technology, including artificial intelligence and machine learning, combined with better ESG disclosure from companies, is facilitating better ESG data, research, indexes and analytics enabling more dynamic, quantitative, objective and financially relevant approaches to ESG investing.



4. US equity market in 2016. Reference: Bank of America Corporation 2016 Environmental, Social & Governance Report.

Greater solutions for more choice

As ESG Investing continues to evolve, MSCI is focused on bringing transparency and clarity to the market, serving investors' needs for ESG standards. MSCI has been at the forefront of providing data, research, indexes and other tools to help enable ESG integration across the entire investment process and is committed to further advancing solutions to facilitate and accelerate sustainable investing.⁵

We have invested extensively to expand and improve our ESG solutions keeping them in step with investors' evolving needs.

Since early 2017, MSCI ESG Research has expanded MSCI ESG Ratings coverage by roughly one-third to more than 8,500 companies and we continue to evolve our offering across asset classes.⁶

With over 30 years of ESG index experience⁷, MSCI calculates more than 1,500 equity and fixed income ESG Indexes designed to help investors more effectively benchmark ESG investment performance and manage, measure and report on ESG mandates.

We understand that there are many approaches to integrating ESG and that there is a greater desire for customization and choice to meet the growing range of ESG and investment objectives. Our aim is to deliver transparent, high quality and reliable ESG data, indexes and tools to power better investment decisions.

MSCI is pleased to offer ESG indexes that utilize a wide range of MSCI ESG Research's industry leading ESG ratings, climate metrics, controversies and screening data.



Index methodology review

Index applications

The MSCI Choice ESG Screened and MSCI Extended ESG Focus Indexes can be used as

- » the basis for index-based strategies, such as index-linked funds or ETFs
- » benchmarks for ESG portfolios and in order to assess the financial and ESG performance of managers
- » underlying index for structured products and derivatives

The MSCI **Extended ESG Focus** Indexes are designed to target companies with positive ESG profiles while exhibiting risk and return characteristics similar to those of the underlying market capitalization weighted index. The Indexes are constructed by selecting constituents of a parent index through an optimization process that aims to maximize exposure to high ESG scores for a target tracking error budget. The Indexes are sector-diversified and target companies with high ESG Ratings. Companies with exposure to Tobacco, Controversial Weapons, Civilian Firearms, Oil Sands and Thermal Coal are not eligible for inclusion in the Indexes.

The MSCI **Choice ESG Screened Indexes**

are designed to represent the performance of companies that have above average ESG ratings relative to their sector peers. Additionally, these indexes apply extensive exclusion criteria, which aim to exclude companies that are involved in a wide range of controversial business activities and Controversies. These business activities include values- and climate change-based screens, including controversial weapons, tobacco, and fossil fuels (see full list below).

Constructing these ESG Indexes involves the following steps:

1. Define the parent Index
2. Define the eligible universe of companies
3. Select companies
4. Weight scheme (market cap or optimized)
5. Cap issuer weights (where applicable)

Parent Indexes: The MSCI USA, EAFE, Emerging Markets and Canada IMI indexes are the parent (market cap) indexes for the MSCI Choice ESG Screened and MSCI Extended ESG Focus indexes.

5. MSCI ESG Ratings and data produced by MSCI ESG Research LLC. MSCI ESG Indexes and Analytics utilize information from, but are not provided by, MSCI ESG Research LLC. MSCI Indexes and Analytics are products of MSCI Inc. MSCI Indexes are administered by MSCI Limited (UK).

6. Source: MSCI ESG Research as of June 2020

7. The MSCI KLD 400 Social Index was launched on May 01, 1990

Ineligible Companies⁸

» MSCI Business Involvement Screens

The MSCI Extended ESG Focus and MSCI Choice ESG Screened Indexes use MSCI ESG Business Involvement Screening Research and MSCI Climate Change Metrics to identify companies that are involved in the business activities listed in the table below. These companies are not eligible for inclusion. Visit [msci.com/esg-investing](https://www.msci.com/esg-investing) to learn more.

» MSCI ESG Controversies

Identify companies that are involved in very serious environmental, social, or governance controversies impacting their operations and/or products and services. Companies involved in controversies are excluded from both index series, however the Choice ESG Screened

indexes have a stricter controversy score threshold than the Extended ESG Focus Indexes. Visit [msci.com/esg-investing](https://www.msci.com/esg-investing) to learn more.

» MSCI ESG Ratings

Both indexes seek to provide exposure to companies that have demonstrated an ability to manage their ESG risks and opportunities as reflected in their ESG Rating. The MSCI Choice ESG Screened indexes require that companies have an MSCI ESG Rating of 'BBB' or above in order to be eligible for inclusion in the indexes, while the Extended ESG Focus indexes aim to maximize exposure to companies that have a high ESG Rating. Visit [msci.com/esg-ratings](https://www.msci.com/esg-ratings) to learn more.

	MSCI Extended ESG Focus Indexes	MSCI Choice ESG Screened Indexes
Description	The indexes aim to achieve a high ESG score and similar risk/return as parent index while avoiding most common controversial activities	The indexes are designed to target leading ESG performers combined with extensive climate change and values-based screens
Weighting	Optimized	Market Cap
Exclusions	Controversial Weapons, Tobacco, Civilian Firearms, Oil Sands, Thermal Coal <i>(Thermal Coal, Oil Sand not applicable for Canada IMI)</i>	Energy Sector, Adult Entertainment, Alcohol, Civilian Firearms, Conventional Weapons, Controversial Weapons, Gambling, Genetical Modified Organism, Nuclear Power, Nuclear Weapons, Predatory Lending, Palm Oil, For Profit Prisons, Tobacco <i>(Cannabis for Canada IMI)</i>
Minimum Controversy Score for Inclusion	1	3 <i>(1 for Canada IMI)</i>
Minimum ESG Rating	-	BBB

⁸ Data provided by MSCI ESG Research

Key Benefits & Differences

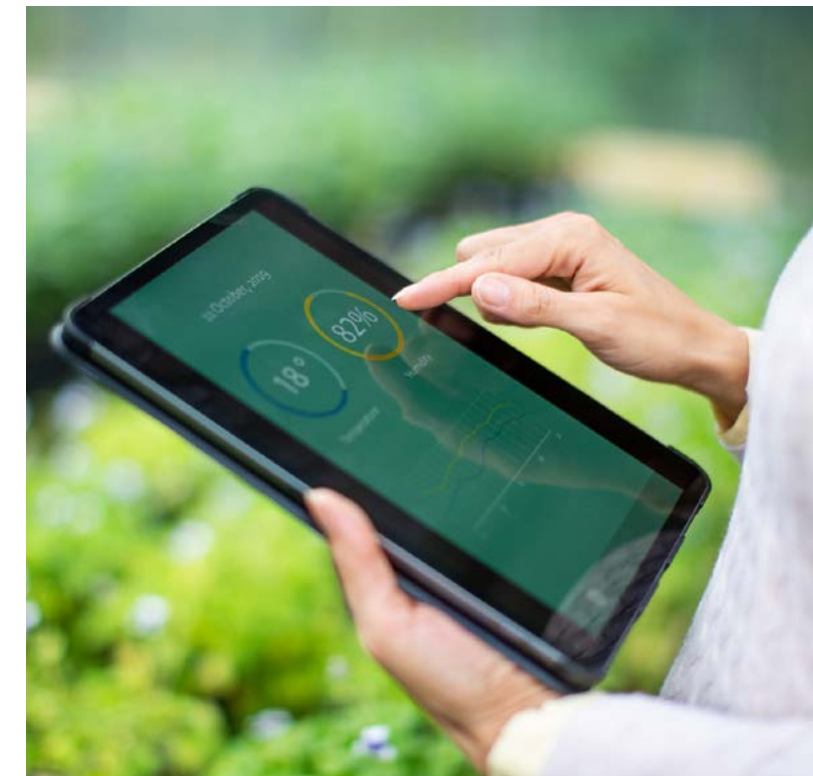
Both the MSCI Choice ESG Screened & MSCI Extended ESG Focus indexes offer the following characteristics

- » Designed to maintain **diversification**: by selecting companies across various sectors
 - » **Target leading ESG companies**: the indexes are designed to represent the performance of companies that have above average MSCI ESG Ratings relative to their sector peers
 - » **Targeted ESG score improvement**: both indexes aim to improve the overall ESG score relative to the parent index
 - » **Designed to reduce headline risk**: utilize MSCI controversies data to exclude companies that are involved in controversies or in controversial business activities
 - » **Designed to mitigate climate risk**: through the exclusion of fossil fuel companies
 - » **Alignment with values**: exclusion of companies involved in business activities reflecting most common Values based concerns across the spectrum of ESG investors
- Major differences between the MSCI Choice ESG Screened & MSCI Extended ESG Focus indexes include
- » **Screens**: The MSCI Choice ESG Screened indexes have more extensive values-based screens compared to the Extended ESG Focus indexes

» **ESG eligibility thresholds**: companies must meet more stringent ESG Ratings and Controversies thresholds to be included in the MSCI Choice ESG Screened indexes

» **Weighting of constituents**: The MSCI Extended ESG Focus indexes are built using an optimizer that selects and re-weights companies in order to maximize the ESG score for the indexes, with a tracking error target; while the Choice ESG Screened indexes constituents are market cap weighted

The MSCI Extended ESG Focus Indexes are constructed by selecting through an optimization process that aims to maximize exposure to ESG factors subject to maintaining risk and return characteristics similar to the parent Index. The index also seeks to remove the most common and controversial companies and activities.



Index Characteristics

We analyzed the historical performance of the indexes, from November 2014 through May 2020.

We compared the risk and return characteristics as well as the ESG profile of the MSCI Choice ESG Screened Indexes relative to the MSCI Extended ESG Focus Indexes and the respective regional parent market cap indexes. Exhibit 1 highlights the key financial and ESG characteristics.

Exhibit 1 - Key Financial and ESG Metrics – MSCI Extended ESG Focus and MSCI Choice ESG Screened Indexes

	MSCI USA	MSCI USA Extended ESG Focus Indexes	MSCI USA Choice ESG Screened Indexes
Financial Metrics			
Total Return (%)	9.6	9.9	13.5
Total Risk (%)	14.6	14.6	14.8
Return/Risk	0.66	0.68	0.92
Tracking Error (%)	0.0	0.6	2.8
Turnover (%)	1.7	13.9	14.2
Number of constituents	630	308	252
Market Capitalization (M US\$)	26,685,347	20,774,793	12,331,281
ESG Metrics			
ESG Score	5.9	6.9	7.2
Index ESG Rating	A	AA	AA
ESG leaders (AAA-AA) %	25.6	42.6	45.7
ESG laggards (B-CCC) (%)	6.6	1.9	0.1
Red flag controversies (%)	1.4	0.0	0.0
Fossil Fuel Reserves (%)	3.6	2.5	0.0
Weighted Avg Carbon Intensity	157	101	61

Source MSCI Inc. November 2014 - May 2020

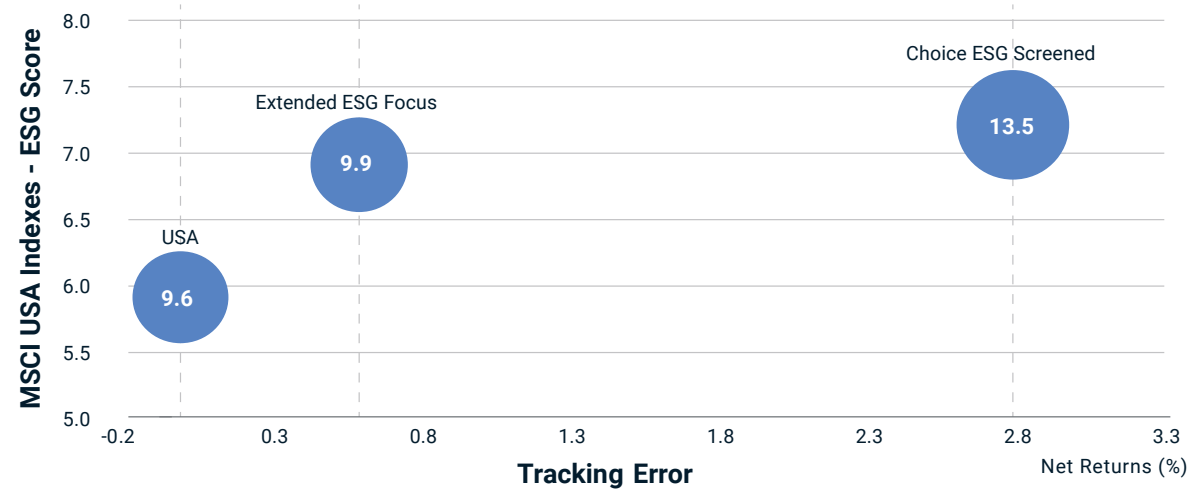
	MSCI EAFE	MSCI EAFE Extended ESG Focus Indexes	MSCI EAFE Choice ESG Screened Indexes
Financial Metrics			
Total Return (%)	1.6	2.1	3.9
Total Risk (%)	14.2	14.2	14.2
Return/Risk	0.11	0.15	0.27
Tracking Error (%)	0.0	0.6	1.9
Turnover (%)	1.7	15.9	8.1
Number of constituents	922	445	517
Market Capitalization (M US\$)	12,609,999	9,373,911	6,234,191
ESG Metrics			
ESG Score	6.8	7.9	7.4
Index ESG Rating	AA	AA	AA
ESG leaders (AAA-AA) %	42.2	64.7	53.5
ESG laggards (B-CCC) (%)	2.9	0.1	0.0
Red flag controversies (%)	4.3	0.0	0.0
Fossil Fuel Reserves (%)	7.6	5.8	0.0
Weighted Avg Carbon Intensity	142	105	80

Source MSCI Inc. November 2014 - May 2020

	MSCI EM	MSCI EM Extended ESG Focus Indexes	MSCI EM Choice ESG Screened Indexes
Financial Metrics			
Total Return (%)	0.9	2.0	0.5
Total Risk (%)	17.4	17.4	17.1
Return/Risk	0.05	0.12	0.03
Tracking Error (%)	0.0	1.1	3.9
Turnover (%)	6.0	20.5	13.0
Number of constituents	980	296	289
Market Capitalization (M US\$)	5,243,171	3,030,208	2,397,181
ESG Metrics			
ESG Score	4.7	6.3	6.1
Index ESG Rating	BB	A	A
ESG leaders (AAA-AA) %	9.8	26.4	17.8
ESG laggards (B-CCC) (%)	19.9	0.8	0.0
Red flag controversies (%)	2.1	0.0	0.0
Fossil Fuel Reserves (%)	8.4	5.9	0.0
Weighted Avg Carbon Intensity	300	165	104

Source MSCI Inc. November 2014 - May 2020

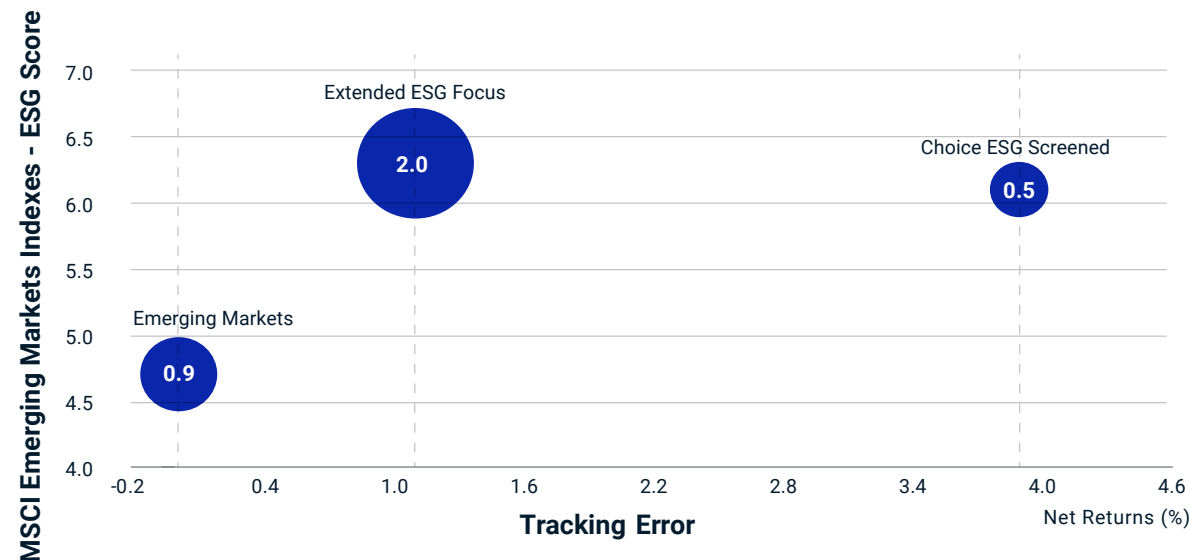
Exhibit 2 - ESG Integration versus tracking error and net returns – Choice ESG Screened & Extended ESG Focus Indexes



Period from Nov 28, 2014, to May 29, 2020. ESG Score as of May 29, 2020. Bubble sizes represent the annualizes net return of indexes.



Period from Nov 28, 2014, to May 29, 2020. ESG Score as of May 29, 2020. Bubble sizes represent the annualizes net return of indexes.



Period from Nov 28, 2014, to May 29, 2020. ESG Score as of May 29, 2020. Bubble sizes represent the annualizes net return of indexes.

MSCI ESG leadership

1. MSCI ESG Research is a pioneer in measuring forward looking ESG risk and use of alternative data and AI technology, with deep history and 40+ years of experience⁹ in objectively measuring and modelling ESG performance
2. MSCI ESG Research was the first ESG provider to assess companies based on industry financial materiality, dating back to 1999.¹⁰ We have over 13 years of live ESG Ratings history demonstrating economic relevance. Learn more [msci.com/esg/deconstructing-esg-performance](https://www.msci.com/esg/deconstructing-esg-performance)
3. The MSCI KLD 400 Index is the longest running ESG index with 30 years of live history¹¹ and above-benchmark returns since 1994¹²
4. Today we have over 1,500+ equity and fixed income indexes leveraging MSCI ESG Research data designed to support ESG integration, screening and impact approaches

Conclusion

The MSCI Extended ESG Focus and MSCI Choice ESG Screened indexes are both designed to target higher ESG rated companies compared to traditional market cap indexes. At the same time, they aim to minimize their climate-related risks and reduce exposure to controversial companies and business activities. We understand that when it comes to sustainable investing, one size does not fit all. That's why these indexes take different approaches to construction and exclusions to provide investors with more choice to better align with their beliefs and objectives.

Institutional investors may wish to take into account their ESG objectives and constraints when evaluating ESG indexes. What are the desired ESG improvements or climate mitigation outcomes? Is there tolerance for tracking error and deviation from market performance in exchange for higher ESG quality, lower exposure to stranded asset risk, reduced exposure to controversial companies or business activities? These considerations can help each investor adopt and tailor an ESG approach that best meets their needs.

9. Through MSCI's legacy companies KLD, Innovest, IRR, and GMI Ratings
 10. Origins of MSCI ESG Ratings established in 1999. Produced time series data since 2007.
 11. According to KLD 2008. The MSCI KLD 400 Social Index was launched on May 01, 1990
 12. MSCI KLD 400 Social Index factsheet <https://www.msci.com/documents/10199/904492e6-527e-4d64-9904-c710bf1533c6>



About MSCI ESG Research Products and Services

MSCI ESG Research products and services are provided by MSCI ESG Research LLC, and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research LLC. are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc.

About MSCI Inc.

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 45 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

To learn more, please visit www.msci.com/esg-investing.

The information contained herein (the "Information") may not be reproduced or disseminated in whole or in part without prior written permission from MSCI. The Information may not be used to verify or correct other data, to create indexes, risk models, or analytics, or in connection with issuing, offering, sponsoring, managing or marketing any securities, portfolios, financial products or other investment vehicles. Historical data and analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. None of the Information or MSCI index or other product or service constitutes an offer to buy or sell, or a promotion or recommendation of, any security, financial instrument or product or trading strategy. Further, none of the Information or any MSCI index is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. The Information is provided "as is" and the user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF MSCI INC. OR ANY OF ITS SUBSIDIARIES OR ITS OR THEIR DIRECT OR INDIRECT SUPPLIERS OR ANY THIRD PARTY INVOLVED IN THE MAKING OR COMPILING OF THE INFORMATION (EACH, AN "MSCI PARTY") MAKES ANY WARRANTIES OR REPRESENTATIONS AND, TO THE MAXIMUM EXTENT PERMITTED BY LAW, EACH MSCI PARTY HEREBY EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES, INCLUDING WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE. WITHOUT LIMITING ANY OF THE FOREGOING AND TO THE MAXIMUM EXTENT PERMITTED BY LAW, IN NO EVENT SHALL ANY OF THE MSCI PARTIES HAVE ANY LIABILITY REGARDING ANY OF THE INFORMATION FOR ANY DIRECT, INDIRECT, SPECIAL, PUNITIVE, CONSEQUENTIAL (INCLUDING LOST PROFITS) OR ANY OTHER DAMAGES EVEN IF NOTIFIED OF THE POSSIBILITY OF SUCH DAMAGES. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited.