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Update to the Consultation on a Proposed Enhanced MSCI Global Socially Responsible Indices Methodology

April 2012

MSCI Global SRI Index Consultation – Key Updates

- MSCI launched a consultation on proposed enhancements to the MSCI Global Socially Responsible Indices 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
- Methodology
 - MSCI proposes to use a combination of three MSCI ESG Research products for the purpose of index creation – IVA ratings for overall best-in-class ESG company performance and Impact Monitor scores for identifying highly controversial company practices and ESG Screener for excluding companies that fail the values based exclusion screens.
 - All existing constituents with an Impact Monitor controversy assessment of very severe (IM flag of RED & IM Score: 0&1) will be excluded from the MSCI Global SRI. All non-index constituents will be eligible only if they are not involved in any major controversies (IM Score \geq 4 versus IM Score \geq 5 earlier) .
- Transition Timeline
 - MSCI proposes to transition to the enhanced methodology in May 2012 Index Review.
 - Alternatively, MSCI could transition to the enhanced methodology in May 2013 along with the transition of the MSCI Global ESG Indices.

Executive Summary

- The MSCI Global Socially Responsible Indices(SRI) are currently based on the Global Socrates (GS) ESG ratings. MSCI intends to migrate these indices to an enhanced methodology based on a new suite of MSCI ESG Research products available on MSCI ESG Research’s new platform – ESG Manager- to increase the transparency and granularity of the ESG signals while keeping the philosophy underpinning the indices unchanged. Consequently, the impact of the enhancement is likely to be relatively marginal.
- MSCI proposes to use a combination of three MSCI ESG products for the purpose of index creation – IVA ratings for overall best-in-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. The document should be read in conjunction with the consultation document on MSCI Global ESG Indices*.
- In addition, MSCI also proposes the following changes to the existing MSCI Global SRI methodology, and is seeking feedback on these proposed additional enhancements.
 - Minimum Rating for a non index constituent in the MSCI Global SRI would be increased from “BBB” to “A”
 - An existing index constituent would be deleted if it falls to a ‘B’ or ‘CCC’.
- 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 Global SRI Methodology

- Currently, the MSCI Global Socially Responsible Indices are based on Global Socrates ESG ratings.
- The rebalancing results are announced five days before the effective date through Integrated Client File (ICF) and a Global Summary Document.
- An annual index review is done in May, coinciding with the May Semi-Annual Index Review of the MSCI equity indices (herein, “Parent Indices”). The indices are also reviewed on a quarterly basis to coincide with Semi-Annual Index Review in November and Quarterly Index Review in February and August.
- Companies that are inconsistent with certain values based criteria are excluded from the MSCI Global SRI.
- All constituents of the MSCI Global ESG indices having a company level rating of “BBB” or above are eligible for inclusion in the MSCI Global SRI.
- At each annual index review, the composition of the index is reassessed in order to target 50% free float-adjusted cumulative market capitalization of each sector of the underlying MSCI Parent Index. Buffer rules are applied in the following order to minimize turnover:
 - Companies in the top 35%
 - ‘AA’ rated companies in the top 50%
 - Current index constituents in the top 65%
 - Remaining companies in the eligible universe
- At the quarterly index reviews, any existing index constituent whose rating falls to “BB” or lower is deleted from the MSCI Global SRI. Additions to the indices are only considered in those sectors where the resulting free float adjusted market capitalization coverage does not meet the 50% target with 10% buffer.

Proposed enhancements

- MSCI ESG Research has introduced a new ESG research platform – ESG Manager. This platform provides products with two distinct ESG signals – overall ESG assessments (IVA ratings) and screening for controversial practices (Impact Monitor).
- Currently the MSCI Global SRI is based on the Global Socrates ratings which bundles both ESG management performance and penalties for controversial practices and business activity into one single rating.
- MSCI proposes to unbundle the above and use two different indicators to reflect the underlying philosophy of the MSCI Global SRI:
 - IVA Ratings : for overall, best-in-class company ESG ratings.
 - Select the “Best in Class” by sector.
 - Impact Monitor: assessment of company involvement in specific ESG controversies.
 - Avoid companies engaged in very severe and severe ESG controversies.
 - All existing constituents with an Impact Monitor controversy assessment of very severe (IM flag of RED & IM Score: 0&1) will be excluded from the MSCI Global SRI. All non-index constituents will be eligible only if they are not involved in any major controversies (IM Score ≥ 4) .
- Along with the above, the MSCI Global SRI will continue to exclude companies that are inconsistent with values based criteria such as Alcohol, Civilian Firearms, Gambling, Military Weapons, Nuclear Power, Tobacco, Adult Entertainment and Genetically Modified Organisms (GMO), as per the existing methodology.

Other Proposed enhancements

- IVA ratings are based on a 7 point scale, 'AAA'- 'CCC' while the Global Socrates ratings are based on a 9 point scale, 'AAA' – 'C'. Since the IVA ratings system has a different ratings' scale compared to Global Socrates ratings, a higher minimum entry rule would be applied along with a higher buffer threshold for rebalancing.
- A higher minimum entry rule would also avoid excessive movement in index constituents due to minor changes in the rating of a company. A non index constituent must achieve a 'A' rating to become eligible for inclusion in the index.
- An existing index constituent would remain in the index until it is rated 'BB' or above.

Transition Proposal

- The transition analysis using the enhanced methodology based on the data as of the close of November 30 2011 shows :
 - Turnover for the proposed MSCI Global SRI would be 17.79%

Index	# Current	# Proforma	# Additions	# Deletions	One Way Index Turnover
MSCI Global SRI	416	441	110	85	17.79%

Break up of One Way Index Turnover

	Weight	# of securities
Change In weight	2.40%	
Additions	8.32%	110
Deletions	7.06%	85
Not in MSCI World ESG	2.38%	28
Current IVA rating : B	0.76%	8
Sector Ranking	3.93%	49
One Way Index Turnover	17.79%	

Historical Turnover

Index Review	Turnover
February 2011	Initial Construction
May 2011	13.1%
August 2011	0.70%
November 2011	3.06%

Top Additions to MSCI Global SRI

Name	Country	Region	Sector	GS rating*	IVA rating	IM rating	IM Score	Weight
Kraft Foods A	USA	US	Consumer Staples	AA	A	Yellow	4	1.0%
Unilever NV Cert	NETHERLANDS	EU	Consumer Staples	A	BBB	Yellow	4	0.9%
Allianz	GERMANY	EU	Financials	BBB	AAA	Yellow	4	0.8%
Unilever Plc	UNITED KINGDOM	EU	Consumer Staples	A	AA	Yellow	4	0.7%
Gilead Sciences	USA	US	Health Care	A	A	Green	5	0.5%
Norfolk Southern Corp	USA	US	Industrials	BBB	A	Yellow	4	0.4%
General Mills	USA	US	Consumer Staples	AA	A	Green	5	0.4%
Centrica	UNITED KINGDOM	EU	Utilities	BBB	AA	Green	5	0.4%
Travelers Cos	USA	US	Financials	A	AAA	Green	7	0.4%
Teck Resources B	CANADA	CA	Materials	BBB	A	Yellow	4	0.4%
Chubb Corp	USA	US	Financials	A	AA	Yellow	4	0.3%
Hong Kong Exch.&Clearing	HONG KONG	HK	Financials	BB	AA	Green	8	0.3%
QBE Insurance Group	AUSTRALIA	AU	Financials	BBB	AA	Green	5	0.3%
Blackrock A	USA	US	Financials	BB	A	Green	5	0.3%
Fresenius Med. Care St	GERMANY	EU	Health Care	A	AA	Green	5	0.3%
Adidas	GERMANY	EU	Consumer Discretionary	A	AAA	Yellow	4	0.2%
Holcim	SWITZERLAND	EU	Materials	BBB	AAA	Yellow	4	0.2%
Mitsui Fudosan Co	JAPAN	JP	Financials	BBB	AA	Green	8	0.2%
Deutsche Post	GERMANY	EU	Industrials	BBB	AAA	Yellow	4	0.2%
Vornado Realty Trust	USA	US	Financials	BBB	AA	Green	8	0.2%
Santos	AUSTRALIA	AU	Energy	A	AAA	Yellow	4	0.2%
Kellogg Co	USA	US	Consumer Staples	A	AAA	Yellow	4	0.2%
Silver Wheaton	CANADA	CA	Materials	BBB	A	Green	10	0.2%
Alexion Pharmaceuticals	USA	US	Health Care	BBB	A	Green	8	0.2%
Progressive Corp	USA	US	Financials	A	A	Green	5	0.2%
Toray Industries	JAPAN	JP	Materials	A	A	Yellow	4	0.2%
Murata Manufacturing Co	JAPAN	JP	Information Technology	A	AAA	Green	10	0.2%
Dover Corp	USA	US	Industrials	BBB	A	Green	8	0.2%
Conagra Foods	USA	US	Consumer Staples	A	A	Yellow	4	0.2%

* GS (Global Socrates) rating is a bundling of ESG performance and highly controversial business activities represented by Impact Monitor Ratings

Top Deletions from MSCI Global SRI

Name	Country	Region	Sector	GS Rating*	IVA rating	IM Rating	IM score	In Proforma MSCI World	
								ESG? **	Weight
MITSUBISHI UFJ FIN GRP	JAPAN	PA	Financials	AA	BB	Green	7	0	0.99%
COLGATE-PALMOLIVE	USA	US	Consumer Staples	AA	BB	Yellow	2	1	0.74%
LOWE'S COS	USA	US	Consumer Discretionary	A	B	Green	5	1	0.57%
RECKITT BENCKISER GROUP	UNITED KINGDOM	EU	Consumer Staples	AA	A	Green	5	1	0.56%
BAXTER INTERNATIONAL	USA	US	Health Care	A	B	Yellow	2	0	0.51%
DANAHER CORP	USA	US	Industrials	BBB	BB	Green	5	1	0.51%
FRANCE TELECOM	FRANCE	EU	Telecommunication Services	A	AA	Yellow	2	1	0.47%
BMW STAMM	GERMANY	EU	Consumer Discretionary	A	A	Green	5	1	0.46%
MEDCO HEALTH SOLUTIONS	USA	US	Health Care	A	B	Yellow	4	0	0.41%
VINCI	FRANCE	EU	Industrials	A	BBB	Green	10	1	0.37%
JOHNSON CONTROLS	USA	US	Consumer Discretionary	AA	B	Yellow	3	1	0.36%
STATE STREET CORP	USA	US	Financials	BBB	BB	Yellow	2	1	0.36%
BB&T CORP	USA	US	Financials	A	BB	Yellow	2	1	0.33%
COMPASS GROUP	UNITED KINGDOM	EU	Consumer Discretionary	A	BBB	Yellow	3	0	0.31%
UNICREDIT ORD	ITALY	EU	Financials	AA	BB	Yellow	3	0	0.30%
ASTELLAS PHARMA	JAPAN	PA	Health Care	AA	A	Green	5	1	0.30%
ROGERS COMMUNICATIONS B	CANADA	CA	Telecommunication Services	BBB	A	Yellow	4	0	0.27%
AHOLD (KON.)	NETHERLANDS	EU	Consumer Staples	AA	BB	Green	5	1	0.26%
INPEX CORP	JAPAN	PA	Energy	BBB	A	Yellow	4	1	0.25%
SCHWAB (CHARLES) CORP	USA	US	Financials	A	BB	Green	5	1	0.24%
NOMURA HOLDINGS	JAPAN	PA	Financials	AA	BB	Yellow	3	0	0.23%
FIFTH THIRD BANCORP	USA	US	Financials	A	B	Green	7	0	0.21%
TELENOR	NORWAY	EU	Telecommunication Services	A	AA	Yellow	4	1	0.19%
CHIPOTLE MEXICAN GRILL	USA	US	Consumer Discretionary	A	B	Green	8	1	0.19%
DNB	NORWAY	EU	Financials	AA	BBB	Green	8	1	0.18%
MORRISON WM SUPERMARKETS	UNITED KINGDOM	EU	Consumer Staples	AA	BBB	Green	5	1	0.17%
ORICA	AUSTRALIA	PA	Materials	A	BBB	Yellow	2	1	0.17%
DANSKE BANK	DENMARK	EU	Financials	A	B	Green	8	0	0.16%
ANTOFAGASTA	UNITED KINGDOM	EU	Materials	BBB	BBB	Green	5	0	0.14%
AVON PRODUCTS	USA	US	Consumer Staples	AA	B	Yellow	4	1	0.14%

* GS (Global Socrates) rating is a bundling of ESG performance and highly controversial business activities represented by Impact Monitor Ratings

** Pro forma MSCI World ESG Index is based on the enhanced methodology for the MSCI Global ESG indices

Discussion Points

- Is the application of the following enhancements to the existing MSCI Global Socially Responsible Indices appropriate
 - Only 'A' and above rated non index constituents eligible for inclusion
 - Only 'BB' and above rated current index constituents eligible for inclusion
- Is the application of a higher Impact Monitor controversy assessment for non index constituents appropriate?
- Would it be appropriate to create the MSCI Global SRI by targeting 25% free float market capitalization of each GICS sector of the underlying MSCI regional Index (Parent : MSCI World) ?
 - Current : Target 50% of free float market capitalization of each GICS sector of the underlying MSCI regional ESG Index (Parent Index : MSCI World ESG)

Appendix

MSCI Global SRI: Construction from MSCI World

- Parent : MSCI World
- Coverage : Target 25% free float adjusted market capitalization of each GICS sector of the underlying MSCI regional Index.

Index	# Current	# Proforma	# Additions	# Deletions	One Way Index Turnover
MSCI Global SRI	416	430	111	97	19.73%

MSCI Global SRI: Coverage Comparison

Region	Sector	Construction from MSCI World	Construction from MSCI World ESG
Canada	Consumer Discretionary	44.24%	44.24%
	Consumer Staples	29.31%	29.31%
	Energy	28.91%	28.91%
	Financials	31.97%	31.97%
	Health Care	0.00%	0.00%
	Industrials	27.16%	84.86%
	Information Technology	26.19%	26.19%
	Materials	38.98%	38.98%
	Telecommunication Services	26.71%	26.71%
	Utilities	28.12%	28.12%
Europe & Middle East	Consumer Discretionary	25.23%	25.23%
	Consumer Staples	26.33%	21.99%
	Energy	17.52%	17.52%
	Financials	25.91%	29.47%
	Health Care	25.07%	43.27%
	Industrials	25.37%	26.02%
	Information Technology	28.24%	28.24%
	Materials	28.70%	28.70%
	Telecommunication Services	34.03%	34.03%
	Utilities	36.01%	36.01%

Region	Sector	Construction from MSCI World	Construction from MSCI World ESG
Pacific	Consumer Discretionary	25.08%	25.41%
	Consumer Staples	25.90%	25.90%
	Energy	40.04%	40.04%
	Financials	24.52%	24.99%
	Health Care	26.56%	27.68%
	Industrials	25.60%	24.36%
	Information Technology	29.39%	29.39%
	Materials	26.87%	26.87%
	Telecommunication Services	33.81%	33.81%
	Utilities	30.98%	30.98%
USA	Consumer Discretionary	24.80%	24.80%
	Consumer Staples	28.52%	28.52%
	Energy	12.55%	12.55%
	Financials	25.13%	26.95%
	Health Care	25.80%	25.80%
	Industrials	25.07%	25.58%
	Information Technology	25.32%	24.59%
	Materials	22.75%	22.75%
	Telecommunication Services	12.96%	12.96%
	Utilities	16.62%	16.62%

IVA Rating System

- IVA ratings represent an assessment of how well companies manage their exposure to environmental, social and governance risks and opportunities.
- The IVA ratings model assigns the majority of the scoring weight to the key ESG issues of an industry.
- IVA ratings are based on a 7 point scale, AAA-CCC. The ratings are based on the scores of the top and the lowest scoring companies in any given industry.
- IVA ratings are designed to complement conventional analysis of company financial performance. IVA ratings highlight how certain key ESG issues might have a material impact on a firm's business model.

ESG Impact Monitor Overview

- Allows investors to analyze a company's significant social and environmental impacts and its ability to manage those impacts
- Captures ESG controversies and violations involving publicly traded companies
- Based on five categories of ESG Research
 - Environment, Customers, Human Rights & Community, Labor Rights & Supply Chain, Governance
- Three categories: Red (0-1), Yellow (2-4) and Green (5-10).
- Current constituents with an Impact monitor controversy assessment of very severe (IM flag of RED & IM Score: 0&1) will be excluded from the MSCI Global SRI. All non-index constituents will be eligible only if a company is not involved in any major controversies (IM Score \geq 4).

* As of close of November 30 2011

ESG Impact Monitor

List of companies with IM Rating as RED

Name	Country Name	Sector	IVA rating	In Current ESG Index	IM Rating
EXXON MOBIL CORP	USA	Energy	BB	0	Red
CHEVRON CORP	USA	Energy	BB	0	Red
NESTLE	SWITZERLAND	Consumer Staples	A	0	Red
PFIZER	USA	Health Care	B	0	Red
BP	UNITED KINGDOM	Energy	BB	0	Red
TOTAL	FRANCE	Energy	BBB	0	Red
WAL-MART STORES	USA	Consumer Staples	BBB	0	Red
RIO TINTO PLC	UNITED KINGDOM	Materials	A	0	Red
BAYER	GERMANY	Health Care	BBB	0	Red
ANGLO AMERICAN (GB)	UNITED KINGDOM	Materials	AA	0	Red
BARRICK GOLD CORP	CANADA	Materials	BBB	0	Red
GOLDMAN SACHS GROUP	USA	Financials	A	0	Red
ABB LTD	SWITZERLAND	Industrials	AA	0	Red
DAIMLER	GERMANY	Consumer Discretionary	CCC	0	Red
MONSANTO CO	USA	Materials	CCC	0	Red
FREEPORT MCMORAN C & G B	USA	Materials	BB	0	Red
HALLIBURTON CO	USA	Energy	CCC	0	Red
NEWS CORP A	USA	Consumer Discretionary	CCC	0	Red
RIO TINTO LTD	AUSTRALIA	Materials	0	0	Red
BAE SYSTEMS	UNITED KINGDOM	Industrials	CCC	0	Red
NEWS CORP B	USA	Consumer Discretionary	CCC	0	Red
TYSON FOODS A	USA	Consumer Staples	CCC	0	Red
ALPHA NAT RESOURCES	USA	Energy	B	0	Red
TOKYO ELECTRIC POWER CO	JAPAN	Utilities	CCC	0	Red
ALCATEL LUCENT	FRANCE	Information Technology	AAA	0	Red
KBR	USA	Industrials	CCC	0	Red
OLYMPUS CORP	JAPAN	Health Care	CCC	0	Red
VEDANTA RESOURCES	UNITED KINGDOM	Materials	CCC	0	Red
FOXCONN INTERNATIONAL	HONG KONG	Information Technology	BB	0	Red

* As of close of November 30 2011

ESG Screener - Controversial Business Involvement

- Identifies all global publicly traded companies involved in activities such as production of alcohol or tobacco products, or those that violates religious screening mandates such as Catholic values and Islamic values.
- Allows investors to divest from companies that violate legislative mandates that prohibit investment in companies that manufacture controversial weapons or operate in companies such as Sudan and Iran.
- Companies with involvement in certain controversial business activities above a certain thresholds will be excluded from the MSCI Global SRI

Values based Exclusion Criteria for MSCI Global Socially Responsible Index

Screens	Values based Exclusion Criteria for MSCI Global Socially Responsible Index
Alcohol	<ul style="list-style-type: none"> •Producers that earn 5% or more revenue
Gambling	<ul style="list-style-type: none"> •Operations & Support that earn 5% or more revenue
Tobacco	<ul style="list-style-type: none"> •All companies classified as producers •Distributors, retailers and suppliers with more than 15% revenue
Adult Entertainment	<ul style="list-style-type: none"> • Producers that derive 5% or more revenue
Nuclear Power	<ul style="list-style-type: none"> •All companies classified as nuclear “Utility” or involved in Uranium mining or designing nuclear reactors •Essential Supplier : companies that earn 5% or more revenue from nuclear related activities
Military Weapons	<ul style="list-style-type: none"> • All companies classified as “Nuclear Weapons System”, “Nuclear Weapons Components”, “Chemical & Biological Weapons System”, Chemical and Biological Weapons components”, “Cluster Bomb Manufacturer” or “Landmine manufacturer” • 5% or more revenue from Military Weapons
Civilian Firearms	<ul style="list-style-type: none"> • All companies classified as Producers • Retailers that earn 15% or more
Genetically Modified Organisms	<ul style="list-style-type: none"> • Companies that derive any revenue from activities such as genetically modified plants

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