

Construction Rules for the Morningstar[®] Minority Empowerment IndexSM



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Overview

The Morningstar® Minority Empowerment IndexSM is designed to provide exposure to U.S. companies that have strong racial and ethnic diversity policies embedded in their corporate culture and that ensure equal opportunities to employees irrespective of their race or nationality. The index pursues social objectives by selecting companies with high Minority Empowerment Scores, while companies with significant controversies are ineligible. Built with the data and risk ratings methodology from Sustainalytics, the individual indicators used in the determination of the Minority Empowerment Scores are selected in collaboration with the NAACP.

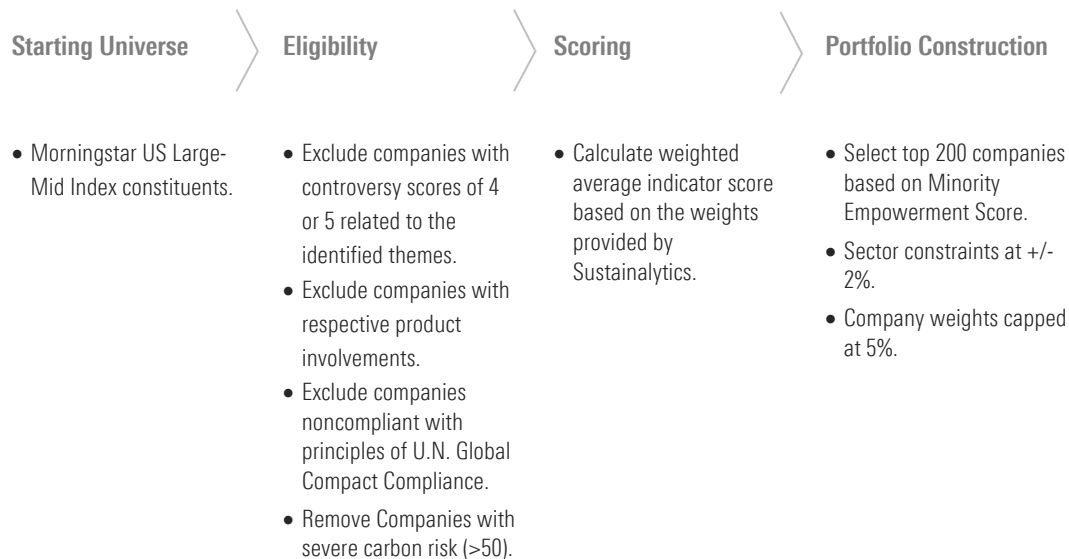
For more information on the computation of the Minority Empowerment Score, refer to Appendix 2.

Index Inception and Performance Start Date

The index inception date is May 29, 2018, and the performance start date, when the first back-tested index value was calculated, is December 15, 2017.

Index Construction

Exhibit 1: Construction Process



**Morningstar
Minority
Empowerment
Index**

Assigning Stocks to the Index

Starting Universe

At each reconstitution, securities for the Morningstar Minority Empowerment Index are derived from the Morningstar US Large-Mid Index (benchmark). For more details on benchmark construction, refer to the [Construction Rules for the Morningstar US Market Indexes](#).

Security Selection

To be eligible for the index, all constituents must meet the following criteria:

- Security must have at least five of the following indicator scores. For details regarding individual indicators, please refer to Appendix 2.
 - Board diversity
 - Discrimination policy
 - Scope of social supplier standards
 - Freedom of association policy
 - Diversity programs
 - Community development programs
 - Health and safety management system
 - Conflict minerals programs
 - Media ethics programs
 - Human rights programs
 - Editorial guidelines
 - Advertising ethics
 - Human capital development
 - Responsible product offering
 - Responsible marketing policy
 - Human rights policy
 - Gender pay equality programs
 - Gender pay disclosure
- Exclude securities noncompliant with the principles of the U.N. Global Compact.
- Security must have current Carbon Risk Rating.
- Exclude securities classified under the Sustainalytics subindustry Security Services and Correctional Facilities
- The security should not belong to the severe carbon risk category.
- Exclude securities that

- Derive more than 5% of revenue from predatory lending activities
 - Are involved in the manufacturing of riot control weapons
 - Derive more than 5% of revenue from tobacco products production
- Security controversy rating must be 3 (out of 5) or lower for the following incidents:
 - Employee incidents
 - Social supply chain incidents
 - Society and community incidents
- Securities with the highest Minority Empowerment Score are selected. The score calculation is explained in Appendix 2. The process is repeated until 200 stocks are selected from the parent index, subject to the following constraints:
- Sector active weight constraints: To minimize deviation from corresponding weights in the parent index, the sector weights in the index are maintained within a lower and upper bound calculated as:
 - Lower bound = $\text{Max}(\text{Weight in the benchmark} - 2\%, \text{Weight in the benchmark} / 2)$
 - Upper bound = $\text{Min}(\text{Weight in the benchmark} + 2\%, \text{Weight in the benchmark} * 2)$

The constraints are enforced by the locally optimal (greedy) selection algorithm explained in Appendix 2. Minimum controversy and empowerment scores eligibility criteria above take precedence over meeting the weight constraints if they are in conflict. If there are not enough eligible securities available to meet the minimum sector weight constraint, the constraint is relaxed.
- Buffer rules: A current constituent is given priority to remain in the portfolio over the new entrants, if its Minority Empowerment Score percentile rank is better than the portfolio's coverage of the benchmark in its peer group plus a buffer margin of 25%.

Number of Stocks

The indexes target 200 stocks based on a transparent ranking system subject to selection and eligibility criteria at reconstitution. However, if securities fall short of the selection and eligibility criteria, or if securities are added or deleted as a result of corporate actions after reconstitution, the indexes can have more or fewer than 200. During reconstitution, if the number of securities is less than the target, all eligible securities would be selected, and the weight of the constituents will be determined based on the index weighting scheme. The reconstitution schedule is available in the "Index Maintenance and Calculation" section.

Index Weighting

The index is float market capitalization weighted. For more details, refer to the [Morningstar Indexes Calculation Methodology rulebook](#).

Index Maintenance and Calculation

Scheduled Maintenance

The index is reconstituted, where the membership is reset, annually. Adjustments are made on the Monday following the third Friday of December. If the Monday is a holiday, reconstitution occurs on the Tuesday immediately following. The market data used for reconstitution is as of the last trading day of April and October.

The index is rebalanced quarterly and implemented after the close of business on the third Friday of March, June, September, and December and is effective the following Monday. If Monday is a holiday, rebalance is effective on the immediately following business day. The market data used for rebalancing is as of the last trading day of February, May, August, and November.

Because the reconstitution of the Morningstar Minority Empowerment Index is less frequent than the Morningstar US Market Index, the securities excluded from the Morningstar US Market Index at the reconstitution effective date are also deleted from the Morningstar Minority Empowerment Index.

During quarterly reviews, constituents with a controversy rating greater than 3 related to social issues are deleted from the index and weights are rebalanced to enforce 5% security capping.

Index files are published according to the U.S. calendar schedule. For more information, please refer to the [Morningstar Indexes Holiday Calendar](#).

Corporate Actions

The treatment of corporate actions will be as per the float market capitalization weighted indexes. For more details, please refer to the [Morningstar Indexes Corporate Actions Methodology rulebook](#)

Index Calculation and Price Data

Details about index calculations and price data can be found in their respective rulebooks: [Morningstar Indexes Calculation Methodology](#) and [Equity Closing Prices Used for Index Calculation](#).

Methodology Review and Index Cessation Policy

The index methodology is continually reviewed to ensure it achieves all stated objectives. These reviews consider corporate action treatment, selection, and maintenance procedures. Subscribers to the index will be notified before any methodology changes are made. For more details, refer to the [Morningstar Index Methodology Change Policy](#).

Morningstar also notifies all subscribers and stakeholders of the index that circumstances might arise that require a material change to the index or a possible cessation of the index. Circumstances that could lead to an index cessation include, but are not limited to, market structure change, product definition change, inadequate supply of data, insufficient revenue associated with the index, insufficient number of clients using the index, and/or other external factors beyond the control of the Morningstar Index Methodology Committee.

Because the cessation of the index or benchmark index could disrupt subscriber products that reference this index, all subscribers are encouraged to have robust fallback procedures if an index is terminated. For more details, refer to the [Morningstar Index Cessation Process](#).

Data Correction and Precision

Intraday Index Data Corrections

Commercially reasonable efforts are made to ensure the accuracy of data used in real-time index calculations. If incorrect price or corporate action data affects index daily highs or lows, it is corrected retroactively as soon as is feasible.

Index-Related Data and Divisor Corrections

Incorrect pricing and corporate action data for individual issues in the database will generally be corrected upon detection. In addition, an incorrect divisor of an index, if discovered within five days of its occurrence, will be fixed retroactively on the day it is discovered to prevent an error from being carried forward. Commercially reasonable efforts are made to correct an older error subject to its significance and feasibility.

For more details, refer to the [Recalculation Guidelines](#).

Computational and Reporting Precision

For reporting purposes, index values are rounded to two decimal places and divisors are rounded to appropriate decimal places.

Exceptions

While Morningstar will seek to apply the method described above, the market environment, supervisory, legal, financial, or tax reasons may require an alternative approach to be adopted. A decision to take an alternative approach will be made by the relevant Morningstar Indexes Methodology Committee, and in all instances, the application of a nonstandard process will be reported to the Morningstar Indexes Oversight Committee.

Appendixes

Appendix 1: Modifications to the Rulebook

Section	Description of Change	Update Date
Index Weighting	Treatment of individual company weights exceed 5%	June 2021
Entire Rulebook	Moved rulebook to new template	June 2023

Appendix 2: Minority Empowerment Score Calculation

The Minority Empowerment Score is calculated as a weighted average of the following indicator scores. The indicator weights are determined by Sustainalytics based on the indicator's importance to determine a company's performance

$$\text{Minority Empowerment Score} = \frac{\sum_i^n w_i * S_i}{\sum_i^n w_i}$$

Where:

Wi = Weight of Indicator i for a given company

Si = Score of Indicator i for a given company

- Board diversity: This indicator assesses the level of gender and/or national diversity on the board.
- Discrimination policy: This indicator assesses the quality of a company's policies to eliminate discrimination and ensure equal opportunity.
- Scope of social supplier standards: This indicator provides a general assessment of whether a company has supply chain/contractor policies and the scope of social standards, including items such as nondiscrimination.
- Freedom of association policy: This indicator provides an assessment of the quality of a company's freedom of association and collective bargaining policy.
- Diversity programs: This indicator assesses the strength of a company's initiatives to increase the diversity of its workforce.
- Community development programs: This indicator gauges the strength of a company's local community development programs. It does not focus on cash donations, but formal programs that promote long-term economic development among communities directly affected by the company's operations.
- Health and safety management system: This indicator assesses the strength of a company's initiatives to manage employee health and safety and prevent accidents and occupational illnesses.
- Conflict minerals programs: This indicator measures the strength of a company's initiatives to eliminate conflict minerals from its products and its supply chain. The term conflict minerals refers to tantalum (coltan), tin (cassiterite), tungsten (wolframite), and gold (together, they are commonly referred to as the 3TG), which have originated in conflict-affected or high-risk regions and may be used to financially support the conflict or human rights abuses. The most prominent example is the Democratic Republic of Congo, where conflict minerals have been linked to the illegal trafficking of these mineral ores and to egregious human rights violations in the eastern conflict regions of the country.

- **Media ethics programs:** This indicator assesses the strength of a company's initiatives to ensure good governance, ethics, and integrity throughout its content creation or dissemination activities, that is, to ensure impartiality, transparency, objectivity, fairness, age-appropriateness, independence, plurality, and inclusiveness (diversity of content, topics, and viewpoints).
- **Human rights programs:** This indicator assesses the strength of the company's initiatives to comply with its obligation to respect human rights.
- **Editorial guidelines:** This indicator provides an assessment of the company's commitment to address media ethics issues during content creation and dissemination.
- **Advertising ethics:** This indicator provides an assessment of the presence and strengths of a company policy on advertising ethics.
- **Human capital development:** This indicator assesses the strength of a company's initiatives to recruit, retain, and develop human capital to avoid a shortage of skilled labor.
- **Responsible product offering:** This indicator assesses the strength of a financial institution's initiatives to market products and services responsibly, so as to avoid predatory lending and minimize risks to clients.
- **Responsible marketing policy:** This indicator provides an assessment of the quality of a company's responsible marketing policy.
- **Human rights policy:** This indicator provides an assessment of the strength of the company's commitment to respect human rights in within its sphere of influence.
- **Gender pay equality programs:** This indicator assesses the strength of programs a company has implemented to ensure gender pay equality. This includes initiatives to identify, measure, and close the gender pay gap.
- **Gender pay disclosure:** This indicator assesses the strength of a company's disclosure related to the gender pay gap.

Appendix 3: Construction Algorithm

MS – lowest stock score in cap-only portfolio (upper bound lowest score for collar constraint).

NC – number of grouping constraints (for sector and region constraints, NC = 2).

TGT – target coverage of the benchmark index by modified market cap (weighting scheme).

Initialize TGT to target number of stocks, N, divided by number of stocks in the benchmark index.

Build portfolio achieving TGT coverage of benchmark:

- **Phase 1: Achieving Minimum Weights Per Each Peer Group**
For n in NC...1:
 - If any group minimum weights not met, and best qualifying stock score > MS, and target market cap not reached; then add best-scoring stock from the opportunity set that doesn't violate any group maximum and at least n of the groups it belongs to are under minimum

- Phase 2: Filling the Remaining Portfolio
While target market cap not reached, add best-scoring stock from the opportunity set that doesn't violate any group maximum
- While number of stocks in the constructed portfolio is not equal to N and binary search step size is above threshold, perform binary search of TGT space, repeating construction algorithm above for the new value of TGT at each step.

About Morningstar Indexes

Morningstar Indexes was built to keep up with the evolving needs of investors — and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers, and advisors in navigating investment opportunities across major asset classes, styles, and strategies. From traditional benchmarks and unique IP-driven indexes to index design, calculation, and distribution services, our solutions span an investment landscape as diverse as investors themselves.

Morningstar Indexes Methodology Committee

The Morningstar Indexes Methodology Committee oversees all new index development, index methodology changes, and cessation of indexes for any indexes where Morningstar owns the intellectual property. This committee is also charged with ensuring that indexes align with Morningstar Research principles and values. The group comprises members of the index team with index research, product development, product management, client service, index implementation, and operation expertise who provide the first layer of governance over index design and methodology.

Morningstar Indexes Operations Committee

The Morningstar Indexes Operations Committee governs the processes, systems, and exception handling of the day-to-day management of all live indexes, including index rebalancing and reconstitution, restatements, market classification, and contingency management. The committee oversees the annual review of index methodology (as required by U.K. and EU benchmark regulations, or BMR), ensuring that methodologies remain fit for purpose and continue to achieve their stated investment objectives. The group comprises members of the index team with data, operations, corporate actions, product development, index launch, client service, and index management experience who provide the first layer of governance over index operations.

Morningstar Indexes Oversight Committee

The Morningstar Indexes Oversight Committee is responsible for the index oversight function as per the requirements of the U.K. and European BMR, providing independent oversight of all aspects of the governance of benchmark administration as required by the relevant BMR. Its remit extends to all calculation and administration-related business activities of Morningstar Indexes, including administration of Morningstar-owned benchmarks as well as client-owned benchmarks and index calculation. The oversight function is part of the organizational structure of Morningstar but is separate and independent from the index business, index management, and the other index committees.

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