
Morningstar® Sustainability Pillar Scores™ Updates

Frequently Asked Questions

Morningstar Research

17 March 2021

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Executive Summary

The Morningstar Sustainability Rating is based on a portfolio's Sustainability Score, which represents the asset-weighted ESG risk of its holdings. The Sustainability Score can be further assessed using the Sustainability Pillar Scores, which break out the Sustainability Score into separate Environmental, Social, and Governance pillars. The pillar scores help investors understand the contribution of each to a portfolio's overall ESG risk.

In May 2021, Morningstar will introduce several data points that will make it easier for investors to use the pillar scores. First, an additional pillar score will be introduced, called 'Unallocated ESG Risk Score.' A portfolio's E, S, and G pillar scores do not always sum to its overall Sustainability Score because some issuers are part of Sustainalytics' Core coverage rather than Comprehensive coverage. Within the Core coverage universe, issuers receive an ESG Risk score that is not broken down into E/S/G components. As a result, when these issuers are held in a portfolio, their asset-weighted ESG Risk score cannot be further allocated to E/S/G pillars. With the addition of the Unallocated ESG Risk Score data point, the E/S/G and Unallocated pillars will sum to a portfolio's Sustainability Score. (An additional data point, Unallocated ESG Risk Global Category Average, will also be computed. A global category average data point already exists for the E/S/G pillars.)

Second, new datapoints will be added that represent the percentage contribution of each of the four pillars to a portfolio's overall Sustainability Score. Previously, users would have had to compute these percentages themselves.

Finally, several datapoints that rank E/S/G pillar scores relative to a portfolio's global category peers will be retired. Because, as explained above, not all holdings receive E/S/G pillar scores and portfolios therefore have different levels of Unallocated ESG Risk, a direct comparison of E/S/G pillar scores can be misleading. For example, one fund may have a lower Environmental Risk Pillar score than a peer fund, but a higher Unallocated ESG Risk Pillar score. Given this information, it is not clear that the fund truly has lower environmental risk than its peer because it may have unmeasured environmental risk that is part of its Unallocated ESG Risk Pillar score.

Frequently Asked Questions

What are the Morningstar Sustainability Pillar Scores?

Calculated as an asset-weighted average of the Sustainalytics Environmental, Social and Governance Risk cluster scores of a portfolio's holdings, the Sustainability Pillar Scores represent the components of a portfolio's ESG risk profile.

What is changing?

The enhanced Sustainability Pillar Score dataset will include six new data points:

- Portfolio Unallocated ESG Risk Score
- Unallocated ESG Risk Global Category Average
- Portfolio Sustainability Score Contribution % – Environmental Risk
- Portfolio Sustainability Score Contribution % – Social Risk
- Portfolio Sustainability Score Contribution % – Governance Risk
- Portfolio Sustainability Score Contribution % – Unallocated ESG Risk

Subsequently, the Sustainability Pillar Score dataset will retire 10 data points:

- Environmental Risk Absolute Rank in Global Category
- Social Risk Absolute Rank in Global Category
- Governance Risk Absolute Rank in Global Category
- Environmental Risk Percent Rank in Global Category
- Social Risk Percent Rank in Global Category
- Governance Risk Percent Rank in Global Category
- Environmental Risk Score vs. Global Category
- Social Risk Score vs. Global Category
- Governance Risk Score vs. Global Category
- Percent of AUM Covered - ESG Pillars

Why are we retiring peer group-relative metrics?

Though at the company level, the environmental, social, and governance risk scores will sum to its overall ESG Risk Rating, not all companies with ESG Risk Ratings have that ESG Risk decomposed into individual E, S, and G pillars. This disparity in coverage results in many portfolios with portfolio Pillar Scores which do not sum to the portfolio's Sustainability Score. Consequently, directly comparing individual pillar scores across portfolios may skew rankings and peer-based risk classification due to differences in coverage. In retiring relative ranking and classification analytics, we will move away from the notion of peer group-relative analysis and treatment of individual portfolio pillar scores as absolute metrics that can be compared directly across portfolios.

Why are we retiring Percent of AUM Covered - ESG Pillars?

This data point was introduced in early 2019 as an interim solution for the disparity in coverage between company ESG Risk Ratings and company E/S/G risk scores. Calculated as a percent of portfolio holdings with a company ESG Risk Rating that also have an E/S/G risk score, a 67% threshold was implemented when this data point was released, such that 67% of all holdings with an ESG Risk Rating must also have E/S/G risk score in order for a portfolio's pillar score data points to populate. Intended as a way to

mitigate the impact of differences in coverage skewing relative rankings and risk classification, this coverage data point is not meaningful in the enhanced Sustainability Pillar Score dataset.

What is the Portfolio Unallocated ESG Risk Score and why are we adding it?

The Portfolio Unallocated ESG Risk Score represents the unmanaged ESG risk exposure to companies assigned an ESG Risk Rating, but whose risk is not decomposed into environmental, social and governance components. Calculated as the asset-weighted average of the company ESG Risk scores for the covered holdings in a portfolio that do not have E/S/G risk scores, unallocated ESG risk is displayed as a number between 0 and 100, where lower is better. Together, the four portfolio pillar score data points- Environmental Risk Score, Social Risk Score, Governance Risk Score, and Unallocated ESG Risk Score- will add up to a portfolio's Sustainability Score.

What is the Unallocated ESG Risk Global Category Average and why are we adding it?

This data point represents the average Unallocated ESG Risk Score for portfolios within a Global Category that have Portfolio Unallocated ESG Risk Scores. This data point is added for parity, as Morningstar currently calculates the global category average for the existing environmental, social and governance pillar scores. When viewed as a complete risk profile, comparison of a portfolio's pillar scores against the average pillar scores of the peer group may provide insights such as risk trends within a peer group, or deviations from it.

What are the Sustainability Score Contribution data points?

Calculated as the percent of each pillar score relative to the portfolio's Sustainability Score, the Portfolio Sustainability Score Contribution % data points reflect the amount of risk in the Portfolio Sustainability Score attributable to each of the four portfolio Pillar Scores. The contribution data points supplement the pillar score risk profile by providing measures of how each thematic pillar directly impacts a portfolio's Sustainability Score.

How should I use the Pillar Scores?

The portfolio Pillar Scores provide a reliable, objective way to assess and understand the components of a portfolio's ESG risk through the traditional environmental, social and governance thematic framework. Cross-portfolio analysis of ESG risk and contribution profiles allows for comparison of the thematic risk drivers of different portfolios, as well as a deeper understanding of the ESG risk composition of individual funds.

How does the Sustainability Pillar Score methodology enhancement impact my portfolio Sustainability Score?

There is no impact to either the calculation, or the inputs, of the portfolio Sustainability Score. Rather, the enhancements to the Sustainability Pillar Scores data set allow for a more meaningful and comprehensive way to assess and understand the components driving a portfolio's Sustainability Score through the traditional environmental, social and governance thematic framework.

In addition to data points being added or retired, will there be any update or impact to existing pillar score data points?

There will be no change to either the calculation, or the inputs, of existing portfolio Pillar Score data points. Currently, the same holdings contribute to both the portfolio Sustainability Score, and portfolio Pillar Score. This allows the portfolio pillars scores to reflect the actual risk they are known to contribute to the portfolio Sustainability Score. However, for portfolios with low pillar score coverage, this causes the environmental, social and governance portfolio risk scores to add up to a lower risk value than the portfolio Sustainability Score, as there are holdings with ESG Risk whose allocation to E/S/G thematic areas are unknown. The new Unallocated ESG Risk Score does not change the way the existing E/S/G pillar scores are calculated, but rather captures the remaining risk of holdings contributing to the Sustainability Score whose E/S/G allocations are unknown.

About Morningstar Sustainability Research

Morningstar Sustainability Research is dedicated to helping investors evaluate the values and impact of their investments.

For More Information

<https://www.morningstar.com/company/global-contacts>



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