Morningstar Portfolio Impact Metrics
Frequently Asked Questions

What are the Morningstar Portfolio Impact Metrics?
Businesses and governments provide the goods and services required by our global economy. These goods and services often bring real benefits to consumers, other businesses, and citizens at large. In addition to their economic contribution, business and government activities result in social and environmental externalities, which are referred to as impacts. These impacts can be positive or negative, and often they are positive in some areas while negative in others. With the introduction of the United Nations Sustainable Development Goals in 2015, businesses are increasingly being scrutinized on these externalities in the context of global issues including poverty, human well-being, consumption of natural resources, climate change, and environmental conservation.

Using Sustainalytics' company-level Impact Metrics as a basis, Morningstar leverages its vast database of mutual fund holdings to map the company-level data to portfolio holdings and calculate impact metrics at the portfolio level, following the standard aggregation methodology described here. This methodology has been created to help investors assess the alignment of their mutual fund portfolios, or other types of portfolios they may own, with the Sustainable Development Goals, as well as the impact themes outlined in Sustainalytics' ESG Impact Framework. The data set itself primarily consists of a variety of fields providing the percentage of involvement of a portfolio in any of the five defined impact themes and 12 of the 17 SDGs.

What is the Sustainalytics ESG Impact Framework?
The Sustainalytics ESG Impact Framework captures a company’s environmental and social impacts rather than the ESG risks that a company is exposed to. The latter is captured by Sustainalytics’ ESG Risk Ratings Framework.

A. The Sustainalytics ESG Impact Framework comprises 5+1 themes. They span two social areas and three environmental areas:

- Climate Action
- Healthy Ecosystems
- Resource Security
- Basic Needs
- Human Development

Additionally, there is a baseline theme, Leadership and Collaboration, which addresses the indirect impacts an entity can have by way of its leadership and contribution to collective efforts.

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The impact themes are considered exhaustive and are intended to encompass all potential environmental and social impacts that can be attributed to an entity's activities. Furthermore, they are meant to capture direct and indirect impacts across the value chain.

There are two types of impact metrics:
1. the revenue involvement metrics, which are quantitative measures of environmental or social outcomes (either positive or negative) attributable to the activities of an entity. Each of the topics outlined in the SDGs is represented within the Impact Framework. All impact themes and all impact metrics have been mapped to at least one SDG.
2. the operational metrics, which measure the impact of a company's own operations on the environment or society. These include measuring greenhouse gas emissions, water consumption and withdrawal, as well as percentage of women on board. Several of these operational metrics are already available at the portfolio level, such as the Carbon Intensity metric (aka Scope 1 and scope 2 Greenhouse Gas Emissions Intensity) that is a part of the Morningstar Portfolio Carbon metrics. Only one operational metric is newly introduced at the portfolio level, and it is the Water Withdrawal Intensity measure.

Further information on the themes and SDGs can be found in the methodology paper, which is available on https://www.morningstar.com/research/signature.

What is Sustainalytics' view on impacts?
The goods and services that businesses offer can bring fundamental benefits to consumers, governments, and other businesses, which can be regarded as economic contributions. However, business activities may also result in social and environmental externalities, which we refer to as impacts. These impacts can be positive, negative, or, often, positive in some areas while negative in others. Sustainalytics’ approach to impact aims to capture a company’s environment and social externalities. When we think, talk, and assess impact, it is informed by our ESG Impact Framework, which spans three environmental themes, two social themes, and one leadership and collaboration theme. We believe these themes are exhaustive, encompassing all potential environmental and social impacts that can be attributed to the activities of a corporate entity. They also capture direct and indirect impact across the value chain.

Why do we believe our clients care about considering impact? Why should they think about both risk and impact?
As our industry has grown, so have the use cases for our data. Many of our clients engage with ESG data to contribute to a more sustainable future. We believe that any client asking, "Are my investments aligned with a more sustainable future?" or "How do my investment decisions support or hinder that future?" cares about the impact of investments. So, what is driving impact-focused thinking?
Retail Investors: Several studies suggest that the investment values of the millennials generation look different from previous generations. They want to achieve positive social and environmental outcomes, alongside financial return, with their investments.

Regulatory Environment: The EU Action Plan and the EU Taxonomy largely rest on the idea that we need to understand whether and to what degree a company/entity/portfolio is sustainable. That view of sustainability is focused on an entity's real-world impact (positive or negative externalities) and establishing thresholds for what a "good" or "sustainable" impact looks like.

Justifying the Effort—Outcomes Focus: There is a renewed focus on understanding and showing how the efforts to use ESG information, craft new ESG insights, and integrate ESG into the investment value chain produce real-world outcomes and whether those outcomes align with a more sustainable future.

Impact is about shining a light on who or what is causing impacts, how much impact is created (positive or negative), and whether those impacts align with global, regional, national, or even individual views about a sustainable world. Theoretically, this means that any investors using any of our ESG products may be interested in understanding the impact outcomes of their investments.

What fields are being introduced at the portfolio level?
This new data set consists of the following field types:

- **Scope fields:** Percentage of Portfolio - Corporate/Sovereign/Other; Percentage of Portfolio Eligible
- **Coverage fields:** Percentage of Portfolio Covered/Not Covered; Percentage of Eligible Portfolio Covered/Not Covered
- **Involvement fields:** Percentage of Portfolio Involved/Not Involved (in any of the five themes or 12 SDGs); Percentage of Eligible Portfolio Involved/Not Involved (in any of the five themes or 12 SDGs); Percentage of Covered Portfolio Involved/Not Involved (in any of the five themes or 12 SDGs)
- **Average Revenue Percentage**
- **Percentage of Portfolio Involved Breakdown:** Less than 5%/5%-10%/10%-25%/25%-50%/Over 50% Involved

What is the scope of the calculation? What do we mean by "Eligible Portfolio"?
These calculations apply to all investments with portfolio holdings data within the Morningstar database, as well as Morningstar Indexes and client portfolios.

At the holdings level, only holdings defined as corporate—that is, primarily equities and corporate bonds—are eligible for this calculation.

What is the purpose of the coverage fields, and when should I use these?
Because these metrics currently apply only to the corporate portion of a portfolio (mostly equities and corporate bonds), it is important to understand that the percentages calculated may be derived from a partial portfolio only, especially in the case of allocation, balanced, or fixed-income portfolios. The coverage metrics should provide the relevant context for a user to easily understand what portion of the portfolio is included in the calculation.
The standard coverage fields are broken down as below:

Percentage of portfolio eligible/not eligible: This will provide you with the percentage that is considered eligible/not eligible for the calculation. These represent the proportion of holdings that could/could not have the relevant underlying data for the calculation and will include holdings for which no data is available.

Percentage of eligible portfolio covered/not covered: This will provide you with the percentage of the eligible portion of the portfolio that had/did not have the relevant underlying data for purposes of the calculation.

Percentage of portfolio covered/not covered: This will provide you with the percentage that had/did not have the relevant underlying data for purposes of the calculation.

Percentage of portfolio eligible not covered: This will provide you with the percentage of the portfolio made up of eligible holdings that did not have the relevant underlying data for purposes of the calculation.

If I create a sum of all the impact theme revenue percentages, do I get a reliable indicator of the overall impact of my portfolio?

No. The various metrics are calculated separately and do not add up to the size of the portfolio. Moreover, the underlying inputs to each of the metrics may in some cases overlap, which means that adding them would entail double-counting exposure to any of the underlying areas of impact that are mapped to a theme and/or an SDG.

How frequently is the data updated?

The calculation will be performed upon the collection of the portfolio, and so will be calculated on intramonth and month-end portfolios. Only data that is available to the market on the portfolio date will be used in the calculation of the aggregate values. We receive updated portfolio holdings on an ongoing basis, which means the metrics of individual funds get updated on an ongoing basis, too. In other words, these calculations will not be performed on a monthly or quarterly basis for all portfolios at the same time, but rather every time a fund receives a new portfolio.

Do these metrics capture how a portfolio’s impact is changing over time, or do they reflect a point in time only?

In this initial release, these metrics do not capture how a portfolio’s impact is changing over time. They only provide snapshots of the portfolio’s aggregate involvement in any of the themes or SDGs each time there is a new portfolio. There is no current way to capture the evolution of a portfolio’s performance on these metrics over time.
Time-series data will be available, though, and it will be possible to see how the portfolio changes over time by observing the evolution of the portfolio metrics and underlying data. However, more analysis of the holdings would be required to define which holdings most contribute to the involvement over time.

**What sources is the data based on?**
The Sustainalytics impact metrics research process is driven by Sustainalytics’ Product Research team, which employs a methodology for capturing reported and generating estimated product and service-related metrics—that is, percentage of revenues. The research analysts rely on company disclosure (websites, annual reports, sustainability reports, and so on). There is currently no engagement with companies to obtain feedback or verify captured data. In some cases, third-party data is used to derive a metric. Given significant gaps in company reporting and reporting consistency, estimations are a valuable way for creating a usable data set for impact-reporting purposes. As a result, when a company does not report a metric and estimation modeling is available, Sustainalytics estimates the company’s impact metric. If the same company reports the impact metric during the next reporting cycle and it is consistent with our methodologies, Sustainalytics captures the data point as reported.

**What fiscal year-end is the reported data based on?**
Sustainalytics aims to deliver the most complete and up-to-date impact metrics based on a company’s reported data. Because of company reporting cycles, this typically means that, in any given year, we are delivering a data set that contains metrics associated with a fiscal year of two years previous. For example, in 2021, we delivered, for most metrics, a fiscal-year 2019 data set at the company level, while in early 2022, we released a fiscal-year 2020 data set for the same metrics. For every metric, we ensure that the deliverable contains a consistent fiscal year’s worth of data. For example, in 2021, our deliverable contains fiscal-year 2019 data only for all companies in the product universe for water consumption or water withdrawal. The underlying company research is updated annually, on a rolling basis, based on companies’ reporting cycles. We aim to release the next fiscal year of data in the first quarter of each new calendar year.

**Why does Sustainalytics not provide metrics on SDGs 1, 8, 16, and 17?**
Sustainalytics does not currently have metrics for SDGs 1, 8, 16, and 17. In some cases, the SDG contribution is difficult to quantify and there isn’t a single metric that reflects a company’s or portfolio’s contribution. For example, SDG 17, which is focused on building Partnerships for the Goals, is not easily quantifiable, as most company activities that would contribute here involve participation in multistakeholder and collaborative programs. As well, Sustainalytics relies heavily on company-reported data, and in some cases, reporting is not strong enough to warrant the collection of a metric. As impact and SDG data sets evolve, we expect to expand our impact metrics and will aim to cover additional metrics where and when it is feasible. SDG 5 is covered by our gender diversity metrics methodology paper.
Which of the Sustainalytics themes or U.N. Sustainable Development Goals should I use to measure my portfolio’s alignment with impact measures?

The Sustainalytics impact themes and the U.N. SDGs overlap and have been mapped by Sustainalytics. There are benefits to using either of these or a combination, depending on your goals, your audience, and what you are trying to communicate. The Sustainalytics impact themes are comprehensive and well-defined, so they encompass most if not all the environmental and social areas covered by the SDGs. The SDGs are a global standard; it is important to understand to what extent your portfolio may align with them. Moreover, if your portfolio targets a specific theme that may directly align with one of the SDGs, then it would be worth prioritizing the particular theme or SDG that will help you best measure and represent this alignment.

How are category averages calculated?

For a selection of portfolio impact metrics, category averages are computed in order to enable comparison of funds against their peer groups. The peer groups used are the standard Morningstar Categories. Funds need to have a Percentage of Eligible Portfolio Covered of at least 67% to be included in the category average calculation. A category average is computed for a given Morningstar Category only when at least five funds meet the coverage requirement within this category. The number of funds included in the calculation is also provided.

Category averages are calculated for each of the five themes and 12 SDGs and available for the following fields: Percentage of Portfolio Involved (Percentage Revenue Involved — Category Average) and Average Revenue Percentage (Revenue Percentage — Category Average).