Morningstar Sustainable Attributes℠
Frequently Asked Questions

Morningstar Research
July 31, 2020

As the field of sustainable investing matures, Morningstar continues to evolve its data, research, and analytics to help investors assess the environmental, social, and governance, or ESG, risks and attributes in their portfolios. Most recently, this has included our enhancements to the Morningstar Sustainability Rating™ (globes) to focus on material ESG risk, our Low Carbon Designation™ for funds, and product involvement data.

In early 2019 Morningstar launched the first part of a multistage effort to assess the sustainable funds landscape and educate the investment community on manager intentionality: two new sets of intentionality indicators--one built around intentionally sustainable strategies, such as positive screens and specific impact goals--and another for exclusionary screens. Morningstar uses the information provided in regulatory filings to assign these attributes.

Over the course of the past year, we have assessed this global dataset and received input on its usability and relevance from Morningstar's own research teams, clients, and the market. As a result, in January 2020, we introduced a change to the collection criteria for the ESG Incorporation data point, which entailed restricting the definition to strategies that focus on sustainability. ESG Incorporation is one of the many Sustainable Attributes data points that make up the Morningstar Sustainable Attributes framework.

In July 2020, we enhanced the Morningstar Sustainable Attributes framework further by making the ESG Engagement attribute a stand-alone data point. This means that ESG Engagement is no longer part of the three-level hierarchy structure described in Exhibit 1 and no longer triggers the ESG fund (Level 2) and Sustainable Investment overall (Level 1) attributes tagging. This is consistent with our original intent to assign Sustainable Investment attributes only to strategies that focus on sustainability, especially in today's rapidly evolving environment in which integrating ESG tools, such as corporate engagement, into an investment strategy is becoming the norm.

This document provides a high-level overview of the framework and information relevant to the changes. A comprehensive description of the framework structure and definitions is available here.

Can you provide a brief overview of Morningstar's framework and process for identifying sustainable investments and exclusionary screens?

This framework applies to all managed investments that articulate an intentional sustainability mandate and/or exclusionary screening. The three-tiered structure provides deeper granularity for investors to identify investments intentionally focused on issue areas relevant to them without treating positive screening, exclusionary screening, faith-based, or Sharia-compliant focuses as mutually exclusive. Investors looking to avoid certain products or business practices have more insight into the universe of options that meet their criteria. Please note that ESG Engagement is being decoupled from the Attributes' multilevel hierarchy as of July 31, 2020, and becomes a stand-alone data point, even if its definition and collection process remain unchanged.

The system provides a meaningful comparison or complement to Morningstar's holdings-based ESG assessments and portfolio product-involvement metrics.

Exhibit 1 Morningstar Sustainable Investment Attributes

Level 1		Sustainable Investment	
Level 2	ESG Fund	Impact Fund	Environmental Sector Fund
Level 3	ESG Incorporation	Gender & Diversity Low Carbon/Fossil-Fuel Free Community Development Environmental Other Impact Themes	Renewable Energy Water-Focused General Environmental Sector

Exhibit 2 Morningstar Employs Exclusions Attributes

Level 1		Employs Exclusions	
Level 2	Norms-Based Screening Abortion/Stem Cells Adult Entertainment Alcohol Animal Testing Controversial Weapons	Fur & Specialty Leather Gambling GMOs Military Contracting Nuclear Palm Oil	Pesticides Small Arms Thermal Coal Tobacco Other

This data is reported at the investment level, and investment policies that apply to an asset-management company or series of funds will be reported at the investment level. Exclusions are identified separately because not all exclusions are deemed sufficient to make a strategy a sustainable investment. For example, many faith-based strategies exclude sin industries such as alcohol, gambling, and adult entertainment, but might not necessarily cite ESG criteria as the basis for security selection, in which case such a strategy would only receive exclusion tags.

Investments are marked as exclusionary or sustainable after a review of the prospectus or offering documents that are most relevant in the strategy's country of registration. Other filings, such as Statements of Additional Information, may be considered upon request, as well as marketing materials and websites in certain regions or external investment guidelines if they are cited in offering documents. Investments that are prohibited by national laws will also be marked in our exclusionary framework.

What is changing as of July 31, 2020?

Effective July 31, 2020, ESG Engagement becomes a stand-alone data point that is no longer part of the Sustainable Attributes framework. The field definition is not changing, and neither is the collection process around this attribute.

Why did we make this change?

Investors using the Morningstar Sustainable Attribute framework typically seek funds for which ESG or sustainability criteria are central to the overall strategy. As more portfolio managers incorporate ESG factors into their investment process, more funds have added ESG-related language to their regulatory filings. These include funds where ESG factors are just one of many inputs used to inform the investment process. At the same time, corporate engagement on ESG issues has become a common approach used to integrate sustainability in an investment process, but at varying degrees and following a wide variety of practices that are not easily described, let alone measurable from descriptions in legal filings. As a result, it has become difficult to define to what extent these practices are core to an investment process and if they are sufficient to consider a given fund sustainable. Hence the decision to make this data point a stand-alone attribute, separate from the Sustainable Attribute framework.

What is the impact on Level 2 and Level 1 Sustainable Attributes data?

ESG Fund (Level 2) will now consist only of funds that qualify for the ESG Incorporation tag. Sustainable Investments (Level 1) will now consist of ESG funds for which ESG Incorporation is central to their overall investment strategy, as well as Impact and Environmental Sector funds as previously defined.

What changed on Jan. 31, 2020?

Effective Jan. 31, 2020, the ESG Incorporation attribute was restricted to funds for which ESG or sustainability considerations are a central part of the fund's investment process. ESG Incorporation-tagged funds use ESG criteria as a key part of their security selection and portfolio construction. Though many funds may consider ESG factors as part of the investment process, it is common for these considerations to be nonrestrictive and nonbinding.

Strategies that use ESG criteria as a key part of the security selection and portfolio-construction process typically have explicit sustainable criteria that the portfolio securities must meet. These funds generally use some combination of positive screening, negative screening, and corporate engagement. Strategies with strict ESG policies or objectives often reflect this focus in the investment name.

Why does my fund that integrates ESG criteria not qualify for the ESG Incorporation attribute?
What is generally described as ESG integration or ESG consideration involves a set of measures, such as corporate engagement or the incorporation of ESG metrics into the investment process, which usually make sustainability a consideration--not its focus or binding factor--of the portfolio strategy. These may or may not be described in the legal filings. Our current ESG Incorporation definition, however, encompasses only funds whose core strategy is sustainability or investment policy includes binding ESG factors. This is in many cases reflected in the name of the investment and described in the following sections of the prospectus or other offering document: Investment Strategy, Investment Objective, or Investment Policy. At this stage, the Sustainable Attributes framework does not include any attribute for ESG integration or ESG consideration. Please refer to the following special cases for further information.

How are specific types of funds classified under this Sustainable Attributes framework?
Below are a few general rules for specific types of funds. There may be exceptions to these rules in our process based on prospectus language, but what prevails is that the Sustainable Attributes are not mutually exclusive. In this framework a fund may qualify for more than one attribute at any point in time.

Environmental Sector Funds—Funds that invest in specific sustainable sectors such as renewable energy and clean water. Sector funds that apply additional ESG criteria in selecting the companies within a sustainable sector, or utilize ESG criteria in selecting the rest of the investments other than the sector companies, may also be tagged as "Yes" for ESG Incorporation.

Fund of Funds—Funds that require underlying funds to be sustainability-focused are marked as ESG Incorporation. These funds typically require that invested funds meet predefined ESG criteria and reflect this commitment in the fund name.

Green Bond Funds—Funds that focus on investing in green bonds are tagged as Impact Fund—Environmental. Generally, these funds require a certain percentage of the fund's assets be in green bonds, but do not have any other ESG requirements or specific criteria applied. Some green bond funds apply additional ESG criteria in selecting the green bonds, or utilize ESG criteria in selecting the rest of the securities other than the green bonds, fully incorporating sustainability in the portfolio construction. These should be tagged as "Yes" for ESG Incorporation. This is often reflected in the name of the fund.

Index-Tracking Funds—Funds are marked "Yes" for ESG Incorporation if they track an ESG benchmark or if they seek to replicate the risk/return characteristics of a non-ESG benchmark while screening out securities on the basis of ESG criteria. ESG index-tracking funds often reflect this commitment in the fund name.

Low Carbon/Fossil Fuel Free—These funds typically exclude companies that derive a significant percentage of revenue from fossil fuel, that own fossil fuel reserves, or focus on companies that exhibit a low-carbon footprint and/or offer carbon-efficient solutions. Funds that fully incorporate ESG criteria into the investment process while also focusing on low-carbon/fossil fuel-free investing should be tagged as "Yes" for ESG Incorporation.

Microfinance Funds—Funds that aim to provide financial services for economically active poor social classes in developing markets and markets in transition are marked as Impact Fund—Community Development. These strategies may have additional impact areas such as Gender & Diversity. Strategies that fully incorporate ESG criteria throughout the investment process could also be tagged as ESG Incorporation.

How do these changes made so far this year affect the Socially Conscious, Ethical Issue strategy focus and Sharia-compliant data points?

The Socially Conscious and Ethical Issue strategy focus data points are two legacy data points that we plan to retire by the end of October, as they become redundant with the more granular and insightful Sustainable Attributes. However, the Sharia-compliant data point will remain available to investors who are looking for funds with related values and/or faith-based goals.

These types of changes occur with all Morningstar data as the industry evolves and our data-collection capabilities grow more robust.

We look forward to sharing more as we continue refining our collection and review processes for the Sustainable Attribute framework to reflect the rapidly changing landscape and regulatory environment, and to ensure it remains a comprehensive, reliable way to identify and compare sustainable funds.