
Morningstar Sustainability Ratings



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The Morningstar Sustainability Rating is a measure of how well the portfolio **holdings** in a portfolio are managing their environmental, social, and governance, or ESG, risks and opportunities relative to the portfolio's **peer group**.

Morningstar Sustainability Rating

Company ESG Research Sustainalytics

Company ESG Scores (0–100)

Controversy Scores (1–5)



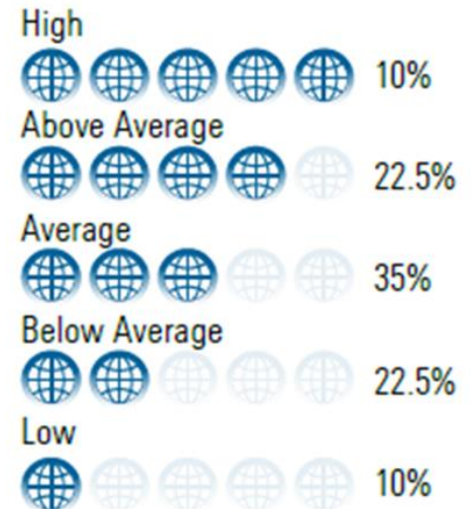
Portfolio Sustainability Score Morningstar

Asset-weighted roll-up of
company ESG scores with
deductions for controversies



Sustainability Rating Morningstar

Portfolio Sustainability Score
relative to peer group



Morningstar Sustainability Ratings Methodology Changes

- ▶ The Morningstar Sustainability Rating is a measure of how well the portfolio **holdings** in a portfolio are managing their environmental, social, and governance, or ESG, risks and opportunities relative to the portfolio's **peer group**
- ▶ Original Methodology
 - ▶ **Holdings** = most-recent portfolio
 - ▶ **Peer Group** = Morningstar Category
- ▶ Methodology after November 2018
 - ▶ **Holdings** = portfolios over the past year
 - ▶ **Peer Group** = Morningstar Global Category

Morningstar Sustainability Ratings Methodology Changes – Two More!

- ▶ **Holdings coverage threshold:** to 67% from 50%
 - ▷ % of portfolio assets covered by Sustainalytics company ESG ratings
- ▶ **Peer group size threshold:** to 30 from 10
 - ▷ # of portfolios within a peer group that meet the coverage threshold in order for any portfolios in a peer group to receive Sustainability Ratings

Rationale for Holdings and Peer Group Changes

▶ Holdings

- ▶ Ability to incorporate longer time period
- ▶ Allows assessment of manager consistency

▶ Peer Group

- ▶ Morningstar Global Category system buckets all like strategies in same category regardless of where a strategy is offered
- ▶ Results in larger, more-stable peer groups

Rationale for Threshold Changes

- ▶ **Coverage Threshold**

- ▶ Improvements in overall coverage
- ▶ Two-thirds threshold more representative of overall portfolio

- ▶ **Peer Group Threshold**

- ▶ Difficult to apply ratings distribution to small peer groups
- ▶ Most global categories have 30 rated funds

Holdings: Historical Sustainability Score Calculation

- ▶ Weighted average of the portfolios reported in the past 12 months
- ▶ More recent portfolio scores are weighted heavier than distant past portfolios

$$\text{Historical Portfolio Sustainability Score} = \frac{\sum_{i=1}^{12} (12 - i) \times \text{Portfolio_Sustainability}_i}{\sum_{i=1}^{12} i}$$

Where:

i = number of months from present

- ▶ Captures the manager's decision making process to see if ESG considerations are applied consistently

Holdings: Historical Sustainability Score Sample Calculation

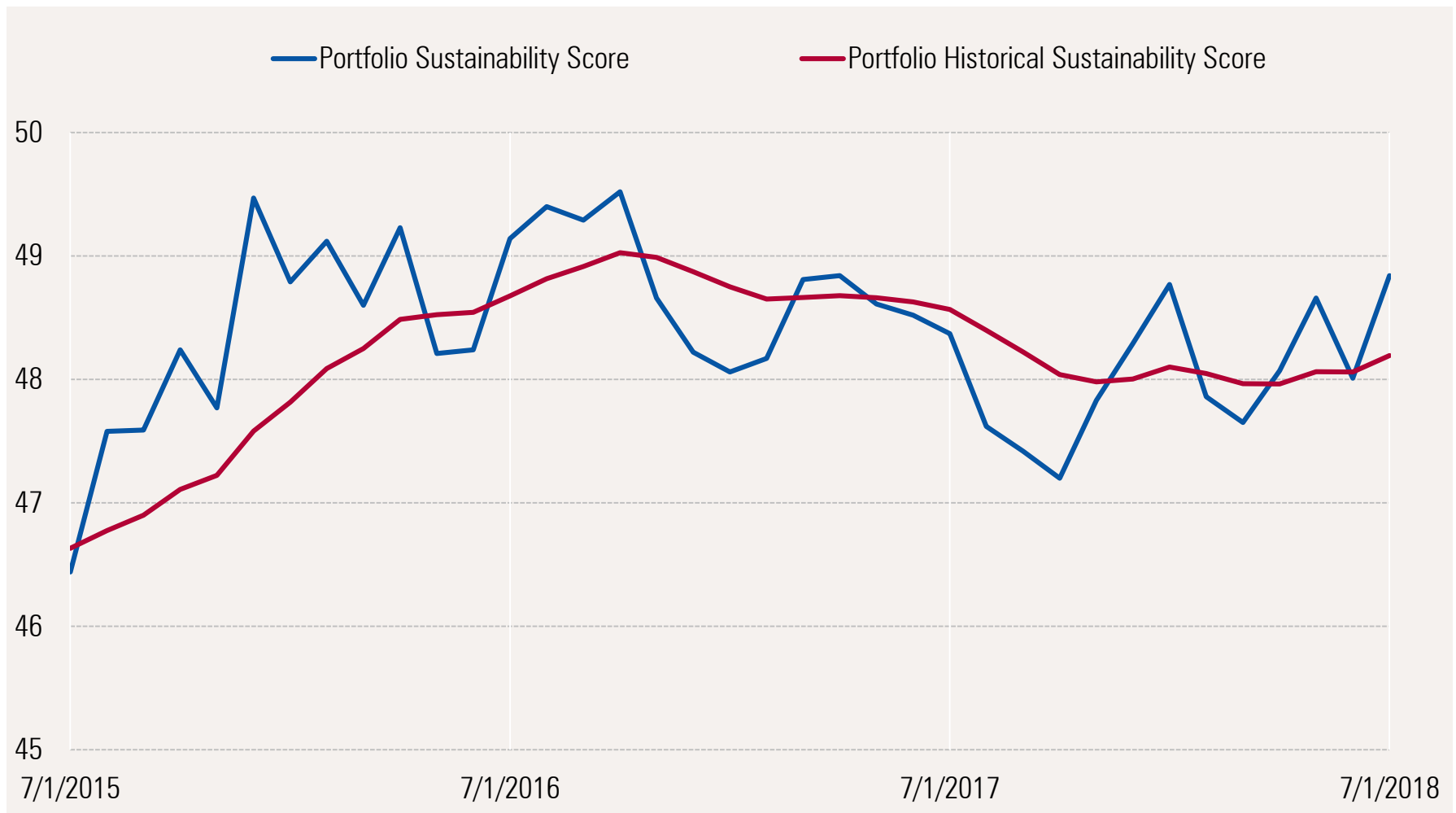
- ▶ Weighted average of the portfolios reported in the past 12 months
- ▶ More recent portfolio scores are weighted heavier than older portfolios

▶ Sample calculation:

Portfolio Date	Portfolio Sustainability Score	Weight	Weighted Sum
7/31/2018	48.84	12	586.08
6/30/2018	48.01	11	528.11
5/31/2018	48.66	10	486.60
4/30/2018	48.07	9	432.63
3/31/2018	47.65	8	381.20
2/28/2018	47.86	7	335.02
1/31/2018	48.77	6	292.62
12/31/2017	48.29	5	241.45
11/30/2017	47.83	4	191.32
10/31/2017	47.20	3	141.60
9/30/2017	47.42	2	94.84
8/31/2017	47.62	1	47.62
Total		78	3759.09

$$\text{Historical Score} = \frac{3759.08}{78} = 48.19$$

Holdings: Smoothing Effect of Historical Sustainability Score

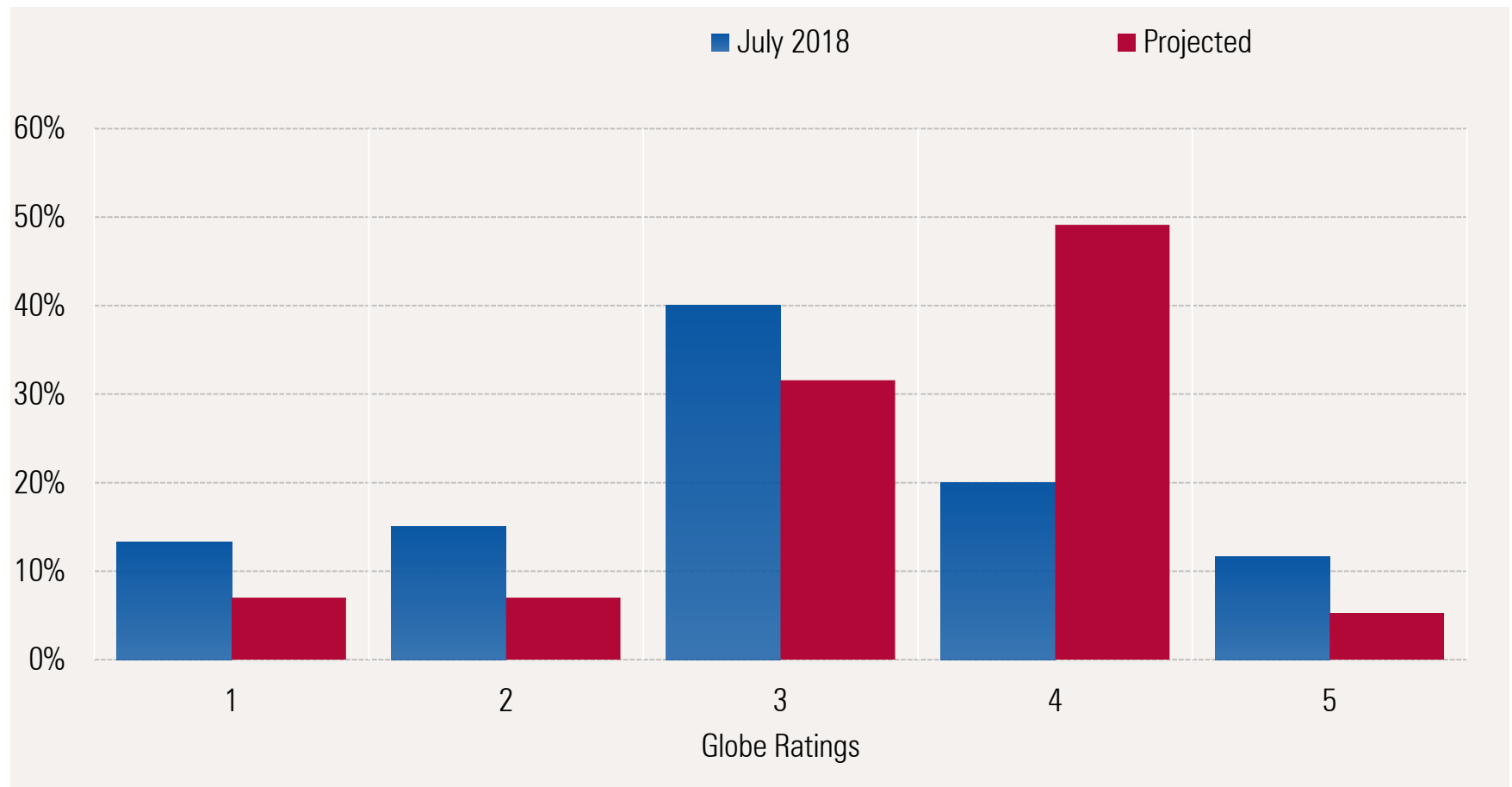


Peer Group: Morningstar Global Category System

- ▶ Morningstar Global Category is a system of peer groups for managed portfolios based on investment strategy without regard to where they are available for sale.
- ▶ For example, under the Morningstar Global Category system, diversified Emerging Markets funds are typically placed into the same peer group, regardless of where a fund is available for sale.
- ▶ Typical mapping for funds:

Morningstar Category	Morningstar Global Category
(US) Diversified Emerging Markets	Emerging Markets Equity
(EAA) Global Emerging Markets	Emerging Markets Equity
(AUS) Equity Emerging Markets	Emerging Markets Equity
(US) World Large Stock	Global Equity
(EAA) Global Flex-Cap Equity	Global Equity
(Japan) World Equity	Global Equity
(US) Large Cap Blend	US Equity Large Cap Blend
(EAA) US Large Cap Blend Equity	US Equity Large Cap Blend
(Can) US Equity	US Equity Large Cap Blend

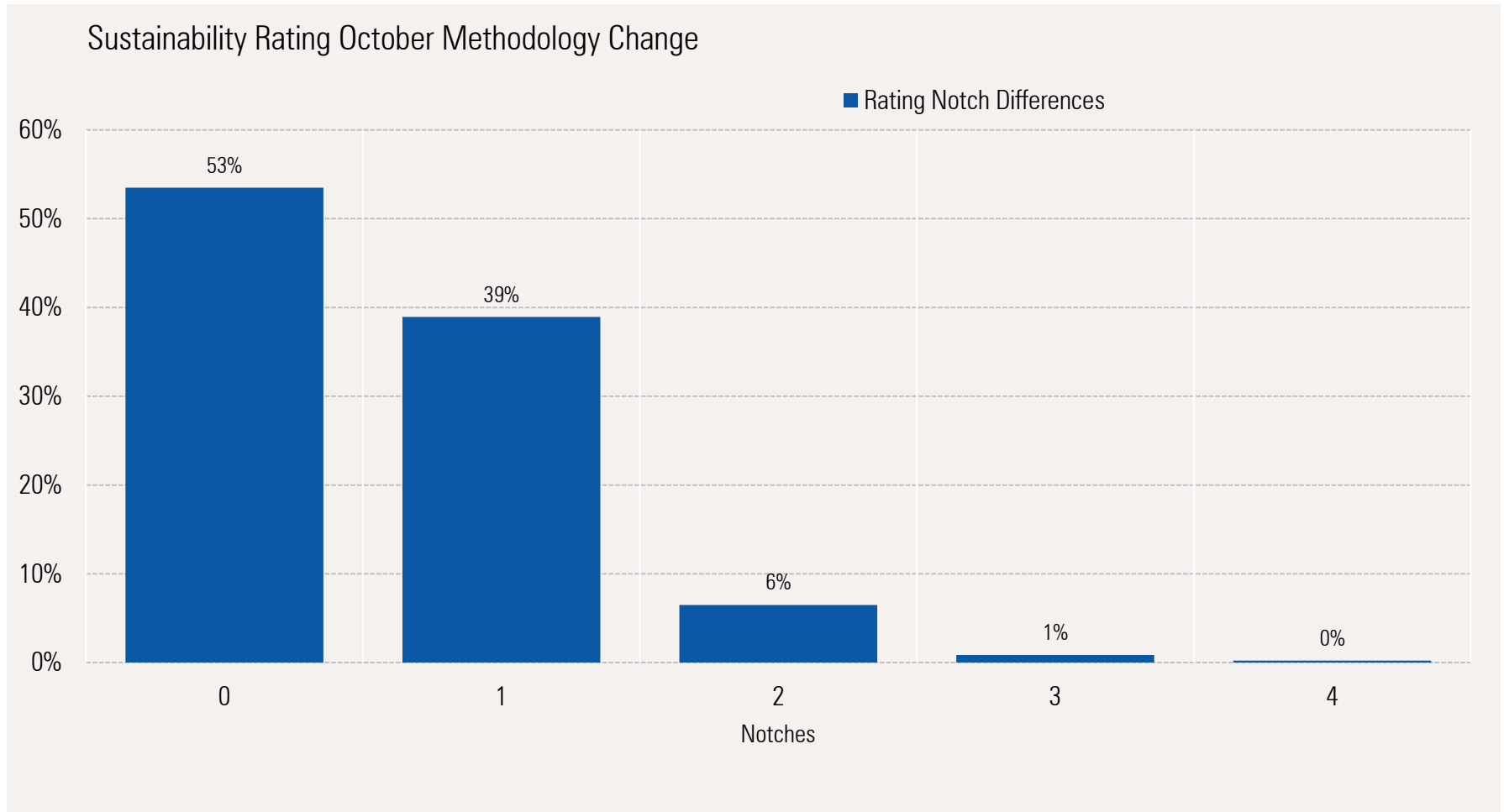
Peer Group: Impact of Moving to Larger Global Category (Denmark Equity to Europe Equity Other)



Coverage Threshold: Average Portfolio AUM ESG Coverage Through Time

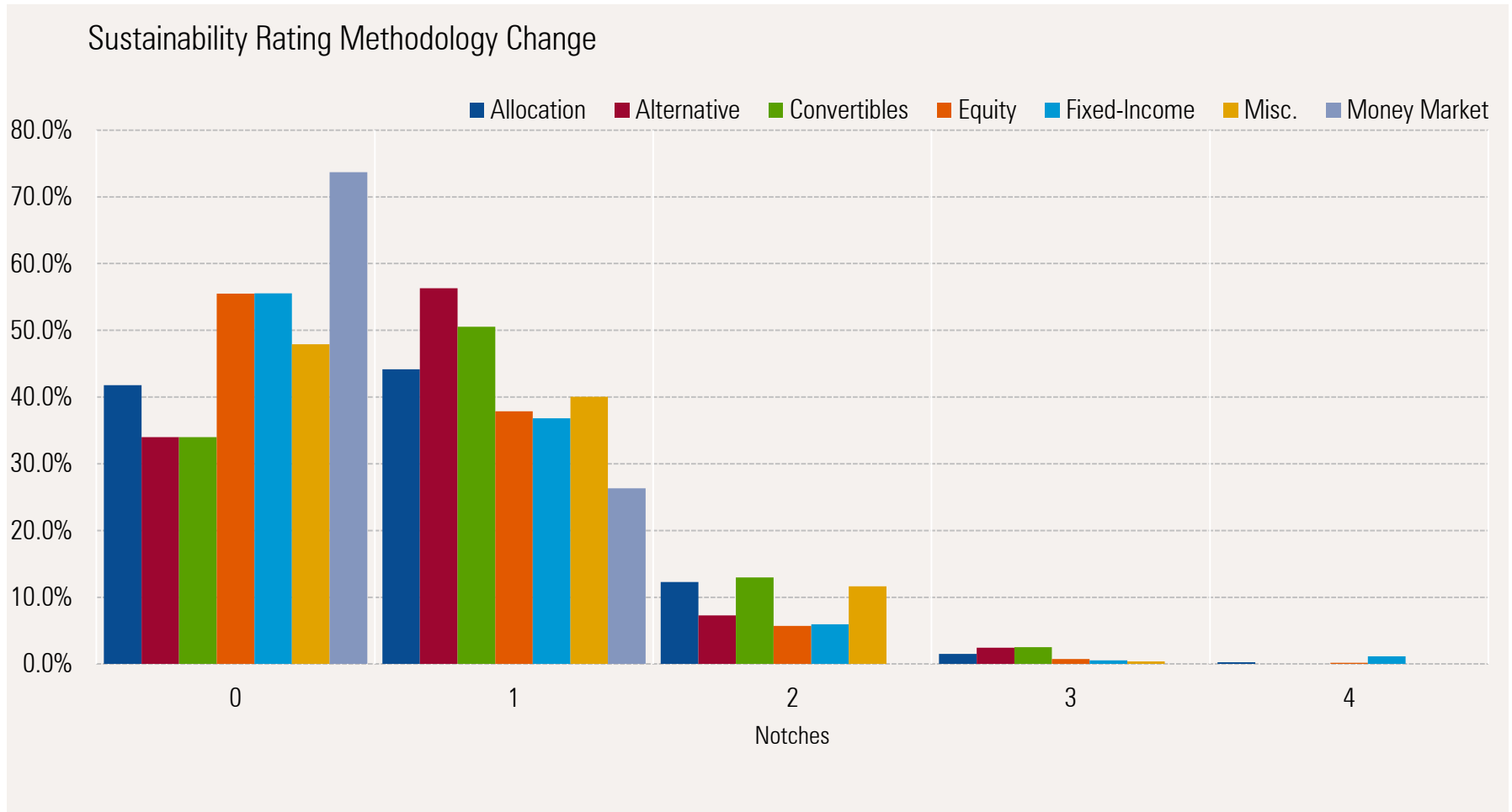


Impact Assessment: Expected Rating Changes



Data as of 7/31/2018

Impact Assessment: Expected Rating Changes by Asset Class



Data as of 7/31/2018

Timing Details for Methodology Changes

- ▶ When will the changes take place?
 - ▶ Methodology in effect as of October 31, 2018
 - ▶ Morningstar Sustainability Ratings for September 2018 will be run on November 8, 2018

- ▶ When will the new data point 'Historical Sustainability Score' be added to Morningstar Products?
 - ▶ Licensed Data - 10/25
 - ▶ Direct Desktop - 10/31
 - ▶ Direct and Office Cloud - 11/1
 - ▶ Morningstar Essentials - 11/7
 - ▶ Advisor Workstation - 12/7

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