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# Sustainability Style Guide

A resource for writers and editors.

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## Morningstar Research Services

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## About This Guide

Sustainable investing is a rapidly evolving phenomenon covering a range of investment approaches. The language of sustainable investing is also evolving, with investors using the same terms to mean different things or different terms to mean the same things. The purpose of this style guide is to standardize Morningstar's usage of sustainability-related terminology and to provide a central, comprehensive resource for writers and editors.

We want to avoid confusion among investors and be crystal clear in our use of language. For our guiding set of principles, we use the Morningstar Sustainable-Investing Framework developed by head of sustainability research for the Americas Jon Hale and others, published in November 2021.

Whenever possible, we default to the terminology defined in this style guide, which will continue to be updated.

## Defining Sustainable Investing

Let's begin with a definition: *Sustainable investing seeks to deliver competitive financial results while also driving positive environmental, social, and corporate governance outcomes.*

First and foremost, sustainable investing is investing. For most investors, in most instances, and across most approaches, sustainable investing seeks competitive returns. There is nothing concessionary about this intent when investing in public stocks and bonds. But it also recognizes that investment returns are part of a bigger picture that includes concerns about people and planet, as well as profits.

Sustainable investing differs from traditional investing in two important ways.

First, it aims to improve traditional investment analysis by incorporating ESG assessments to give investors a more complete understanding of an investment. ESG assessments can give investors an early warning of risks and opportunities before they have a financial impact. They can also provide insight into intangible assets, which make up a large portion of the value of many public companies today. ESG assessments can help identify companies that are more likely to thrive, or suffer, in a low-carbon economy as well as those that are more likely to prosper as sustainability becomes increasingly important to more stakeholders. ESG assessments may be incorporated into a wide range of strategies.

Second, in addition to assessing the financial materiality of ESG issues on an investment, sustainable investing considers the broader systemic impacts of the investments themselves. This is sometimes called *double materiality* and is useful to investors and other stakeholders who wish to drive positive ESG outcomes in addition to investment returns. The two ideas are linked inasmuch as improving a company's performance on material ESG issues may not only improve company financial performance but also lead to positive outcomes more broadly for people and planet.

Sustainability-focused investors can influence how public companies address climate change and direct capital to projects that are needed to finance the transition to a just, low-carbon economy. They can also encourage public companies to adopt a more stakeholder-oriented, long-term approach to expanding their business.

### **What's in a Name?**

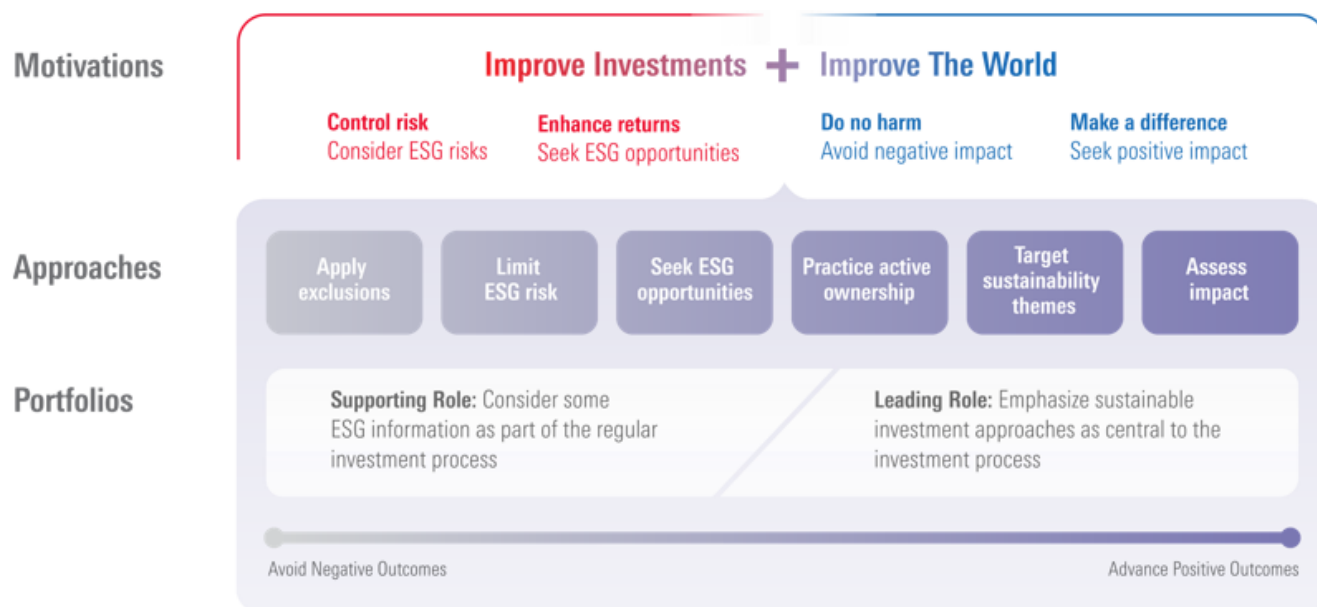
While *sustainable investing* is a common umbrella term, others are also used, such as *responsible investing*, *ESG investing*, and *impact investing*.

*Responsible investing* is an older term, shortened from *socially responsible investing*, which was used in the 1980s and 1990s to describe the forerunner to today's sustainable investing. SRI did not have the benefit of ESG data, which was in its infancy, and instead mostly relied on exclusions and limited shareholder engagement. Neither did it attract much investor interest, because sustainability issues did not have the urgency they have today. Still, SRI was a way for investors to align their portfolios with their values. References to *responsible investing* today typically refer to the same set of practices we call *sustainable investing*.

The other two terms—*ESG investing* and *impact investing*—are also often used interchangeably with *sustainable investing*. We think *ESG* is better suited to describe the issues that are of concern to these investors and the related metrics that have become so widely used, though *sustainable investing* is a more appropriate term for the overall strategy. Similarly, *impact* is best used to describe an approach to sustainable investing that emphasizes the broader effects of investments on people and planet.

### **Sustainable-Investment Approaches**

Sustainable investing is best understood not as a single, unified investment method, but rather as a range of possible approaches. To think otherwise can lead to investor confusion and a mismatch between expectations and outcomes. We have identified six sustainable-investment approaches and placed them along a continuum ranging from those that lean more toward avoiding negative outcomes, be they investment or real-world outcomes, to those that lean more toward advancing positive outcomes. Investors may use any of these approaches or a combination.

**Exhibit 1** Morningstar Sustainable-Investing Framework

Source: Morningstar.

**Apply Exclusions**

This approach refers to excluding sectors, companies, or practices that investors consider harmful or not in alignment with sustainability criteria. Exclusions may range from traditional “sin” stocks (alcohol, tobacco, gambling) to guns and controversial weapons to business ethics (violators of the United Nations Global Compact or companies engaged in major controversies). Many investors today exclude the fossil fuel industry from their portfolios, either entirely or by excluding practices with the worst climate and environmental impacts (such as thermal coal extraction and use, Arctic exploration, or tar sands drilling). Using company ESG metrics, investors can avoid companies that are poor sustainability performers, either overall or in certain areas of emphasis. Portfolio optimization techniques can be used to reduce the impact of exclusions on a portfolio’s tracking error to a market benchmark.

**Limit ESG Risk**

Investors can address sustainability concerns by taking steps to limit ESG risks. Sometimes referred to more generically as *ESG integration*, this approach uses ESG ratings and data in the risk-management process to assess material ESG risks. Investors may price ESG risk into valuation models or seek to avoid investments with a certain level of ESG risk regardless of valuation. This approach has become widespread among traditional investments as more investors have come to understand that material ESG issues may reflect hidden risks that traditional analysis may overlook. This is especially true of risks associated with climate change.

**Seek ESG Opportunities**

Investors may also use ESG information to identify companies that are sustainability leaders or those seeking to improve their ESG practices to build competitive advantages. This approach includes what is sometimes called *ESG best in class* or *positive screening* based on ESG ratings. An ESG best-in-class approach typically favors companies with better ESG ratings on a sector or industry basis. It is a subset of positive screening, which more generally builds portfolios around companies with better ESG ratings. Some investors look for companies with so-called ESG momentum that are improving their overall performance on ESG metrics in ways that will enhance their financial performance. Finally, investment approaches focused on quality growth may use ESG performance as a nonfinancial indicator of quality that contributes to a company's competitive advantage, or economic moat.

**Practice Active Ownership**

Investors may seek positive ESG outcomes via active ownership or stewardship activities, made possible primarily because asset managers are shareholders in public companies. These activities may include direct engagement with companies on ESG issues, proposing ESG-related shareholder resolutions, supporting ESG issues through proxy voting, participating in ESG-related investor coalitions, and advocating for public policy measures that address sustainability issues.

Through these activities, investors communicate not only their specific sustainability concerns but also encourage corporate leaders to focus more broadly on stakeholders and the long term. As corporate management teams come to understand that their investor base consists of a growing proportion of sustainability-minded investors, they become more likely to adjust corporate strategy in ways that support stakeholder capitalism.

**Target Sustainability Themes**

Thematic investing focuses on identifying long-term societal trends and the investments that stand to benefit from those trends. In targeting sustainability themes, investors seek to take advantage of opportunities created as the world moves toward greater sustainability and transitions to an economy driven by renewable energy. Sustainability-themed investments often use the 17 United Nations Sustainable Development Goals to identify a focus. Such themes may be related to climate action or other environmental concerns, like healthy ecosystems and natural resource security, or they may be related to social issues, like human development, including diversity, equity and inclusion, or basic needs.

**Assess Impact**

Investors may wish to integrate impact assessments into security selection and portfolio construction. Fixed-income investors, for example, may consider a bond's use of proceeds, focusing on bonds that finance projects that benefit people and planet. Equity investors may consider whether a company's products and services, as well as its policies and behaviors, support or detract from the U.N. goals, which many investors and companies use as an impact framework. At the portfolio level, investors may assess the overall impact of their portfolio holdings in relation to a goal or benchmark. Impact reporting

provides transparency for investors into the societal outcomes that an investment has created or encouraged and which social causes an investment is aligned with.

### **Sustainable-Investment Portfolios**

Most of the time, investors combine these approaches, as they are interrelated and largely complementary. It's not uncommon for an investment strategy in which sustainability plays a leading role to use several, or even all, of these approaches to varying degrees.

An investment portfolio can be defined in terms of a particular strategy or fund, or an end investor's set of investments. Portfolios can be assessed in terms of whether and to what extent they use any of the six sustainable-investment approaches. In any given portfolio, sustainable-investment approaches may play no role, a supporting role, or a leading role. While sustainable-investment approaches play no role for many portfolios, they contribute in a supporting role to a growing number of portfolios, mainly through the use of ESG information to limit ESG risk, by practicing active ownership, or the use of limited exclusions. Portfolios in which sustainability plays a leading role often combine several, and sometimes all, of these approaches.

For end-investor portfolios that consist of multiple underlying investment strategies or funds, the Morningstar Sustainable-Investing Framework can be used to target exposure to the investor's preferred approaches and can be used to evaluate how much exposure an investor has to each approach.

### **The Framework in Action**

The framework can help individual investors, financial advisors, due-diligence teams, and asset managers develop a clear understanding of sustainable investing.

It can help individual investors determine whether sustainable investing is right for them. First, by providing an overall definition and a description of the range of investment approaches that are used to address sustainability concerns within investment portfolios, the framework can help individual investors develop a better, more decision-useful understanding of the field. Second, the framework can help people examine their own motivations for wanting to invest with a sustainability lens and to determine how far they want to take it in their portfolios. Third, the framework can be used to analyze investment products in terms of the specific sustainable-investment approaches they employ and of their overall commitment as a sustainable investment. This can help individual investors construct their portfolios in ways that align with their preferences.

The framework can be especially helpful to wealth managers and financial advisors. By adopting its overall definition of sustainable investing and using the descriptions of the sustainable-investment approaches, advisors can more easily convey to their clients the meaning and scope of sustainable investing. The framework's discussion of investor motivations can help advisors talk about sustainable investing with their clients and understand how suitable a sustainable-investment portfolio is for them. The framework's treatment of approaches and portfolios can help advisors match investments with investor preferences, helping ensure their clients' expectations are met.

The framework can also be helpful to intermediaries who conduct due diligence on investments. They can identify which, if any, sustainable-investment approaches are being employed by a given investment manager. They can use the language of the framework to more clearly determine the specific approaches being employed and to help determine whether sustainable-investment approaches play no role, a supporting role, or a leading role in an overall investment portfolio. These concepts can be used to compare investments.

Asset managers can use the framework to help clarify the purpose and scope of their sustainable-investing efforts. The framework can help them identify the role that sustainable-investment approaches play in every strategy they offer to investors. The framework can be used to distinguish among their strategies those in which sustainable-investment approaches play a leading role, a supporting role, or no role. Such clarity will go a long way toward enhancing investor understanding of their investments and reducing gaps between expectations and outcomes.

The framework neatly defines and summarizes sustainable investing, providing investors of all types a common reference point for understanding its scope and variety. It can be used to better understand investor motivations, identify the most appropriate sustainable investments for a given investor, and evaluate sustainable funds and portfolios.

## General Terms and Concepts

### **carbon footprint**

The amount of atmospheric greenhouse gas emissions generated by a particular industry, business, or household.

### **carbon risk (n.), carbon-risk (adj.)**

Also referred to as *transition risk*, carbon risk is a measure of how vulnerable a company is to the transition away from a fossil fuel economy to a low-carbon economy.

### **carbon tax**

A tax on carbon emissions, intended to discourage the use of fossil fuels and encourage investment in renewable energy sources.

### **climate change**

The terms *global warming* and *climate change* are often used interchangeably. But *climate change* is the more accurate scientific term to describe the various effects of increasing levels of greenhouse gases on the world because it includes extreme weather; storms; and changes in rainfall patterns, ocean acidification, and sea level. *Global warming*, the increase of average temperature around the world, is one aspect of climate change.

The terms *climate crisis* and *climate emergency* are used by some scientists, policymakers, and others and are acceptable.

### **CO<sub>2</sub>**

Spell out *carbon dioxide* on first reference. Capitalize the *O* (note that it's not a zero), and where possible, subscript the *2*.

### **COP meetings**

*COP* and its numerical designation is acceptable on first reference for the Conference of the Parties, the supreme decision-making body of the annual United Nations Framework Convention on Climate Change: *COP25*, *COP26*, and so on (note no space between letters and numbers). To avoid overuse, writers can also refer to the *U.N. climate conference* or *summit* or the *U.N. Climate Change Conference*.

**ESG**

Spell out *environmental, social, and governance* on first reference or very soon thereafter if first reference is exceptionally awkward.

**ESG exposure**

A measure of the extent to which a company is exposed to material ESG risks. Exposure can be considered as a sensitivity or vulnerability to ESG risks.

**ESG intentionality**

Refers to funds in which sustainable-investing approaches play a leading role. Avoid this jargony phrase in favor of *sustainable funds*.

**ESG investing**

Refers to a type of investing that prioritizes environmental, social, and corporate governance concerns. While *ESG investing* is often used interchangeably with *sustainable investing*, the latter term is more appropriate for the overall strategy, whereas the former is better suited to describe the issues that are of concern to sustainability-minded investors and related metrics.

**ESG risk**

Exposure to ESG issues, such as data privacy, climate change, or corporate controversies, and how companies manage their exposure to ESG issues. Poorly managed ESG risk could jeopardize a company's enterprise value.

**fossil fuel (n., adj.)****fossil-fuel-free****green**

Of, relating to, or advocating ecological awareness, the preservation of natural resources, and so on (*green energy technology*).

**green bond (n.), green-bond (adj.)**

A fixed-income instrument designed to support specific climate-related or environmental projects.

**greenhouse gas (n., adj.)**

Avoid *GHG*.

**greenwashing**

To mislead by falsely representing a person, company, product, or entity as being environmentally responsible; misleading publicity or propaganda disseminated by an organization so as to present an environmentally responsible public image; a public image of environmental responsibility promulgated by or for an organization regarded as being unfounded or intentionally misleading.

**impact investing (n.), impact-investing (adj.)**

An approach to sustainable investing that emphasizes the broader positive effects of investments on people and planet alongside financial returns.

**material ESG issues, MEIs**

Categories such as human rights, business ethics, product governance, and resource use that measure a company's exposure to ESG risk. *MEIs* acceptable on second reference. For MEIs used in Sustainalytics and Morningstar research, see [Appendix 1](#).

**net zero (n.), net-zero (adj.)**

Negating the amount of greenhouse gases produced by human activity by reducing emissions and implementing methods of removing carbon dioxide from the atmosphere. The meaning of *net zero* by itself might not be clear, so include a brief explanation or use in a phrase that makes its meaning understandable, such as *to achieve net-zero emissions over the next three decades*.

**Paris Agreement**

The pact, signed in 2015 at COP21, set two goals: to limit global warming to 2 degrees Celsius (3.6 degrees Fahrenheit) and, if possible, to limit it to no more than 1.5 C (2.7 F) compared with preindustrial temperatures.

For more information, visit <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>.

**Principles for Responsible Investment**

The United Nations-backed Principles for Responsible Investment were developed by an international group of institutional investors to address the increasing relevance of ESG issues to investment practices. Signatories commit to six aspirational principles in the pursuit of a more sustainable global financial system. See [Appendix 2](#) for the list of principles.

For more information, visit <https://www.unpri.org/pri/about-the-pri>.

**responsible investing (n.), responsible-investing (adj.)**

An older term, shortened from *socially responsible investing*, which was used in the 1980s and 1990s to describe the forerunner to today's sustainable investing. Socially responsible investing did not have the benefit of using ESG data, which was in its infancy, and instead relied mostly on exclusions and limited shareholder engagement.

**scope 1, 2, and 3 emissions**

Refers to the sources of carbon emissions. Scope 1 emissions are direct emissions from a company; scope 2 emissions are indirect emissions stemming from a company's operations; and scope 3 emissions are emissions from elsewhere in the value chain, including upstream and downstream operations. Lowercase and use numerals for these terms.

**Shariah-compliant**

Investing strategies that follow the requirements of Shariah law and the principles of Islam. Shariah-compliant investments exclude companies involved in certain activities, such as alcohol, gambling, tobacco, adult entertainment, and non-Islamic banking and finance. In addition, there are debt requirements and accounting restrictions involved in Shariah-compliant investing.

**stakeholder**

A group with an interest in a company that can affect or be affected by business performance. Historically referred to groups like investors, employees, and customers, but the definition has expanded to include local and global communities, governments, and more. Sustainable investing differs from traditional investing in that it considers the interests of stakeholders as opposed to only shareholders.

**sustainable/sustainability**

Designating, of, or characterized by a practice that sustains a given condition, such as economic growth, or a human population without destroying or depleting natural resources, polluting the environment, and so on (*sustainable agriculture*).

To avoid confusion, use the terms *sustainable* or *sustainability* only in reference to sustainable-investing strategies or environmentally or socially friendly business practices. Several synonyms can be used instead, depending on context: *durability*, *viability*, *staying power*, *to build*, *to maintain*, *to persist*.

The following sentences are problematic:

- ▶ We don't think this fund's management method is *sustainable*.
- ▶ To assess the *sustainability* of excess profits, analysts consider a company's moat trend.
- ▶ A moat allows a firm to *sustain* excess profits over a long period.
- ▶ The moat rating represents a company's *sustainable* competitive advantage.

Acceptable revisions:

- ▶ We don't think this fund's management method *can be maintained*.
- ▶ To assess the *durability/viability/persistence/staying power* of excess profits, analysts consider a company's moat trend.
- ▶ A moat allows a firm to *maintain* excess profits over a long period.
- ▶ The moat rating represents *the depth and breadth of* a company's competitive advantage *and how long it can be maintained*.
- ▶ The moat rating represents a company's *durable* competitive advantage.

**sustainable investing, sustainable-investing (adj.)**

An investing strategy that seeks to deliver competitive financial results while also driving positive ESG outcomes.

**socially responsible investing**

See [responsible investing](#).

**transition risk**

See [carbon risk](#).

**United Nations Framework Convention on Climate Change**

*UNFCCC* is OK on second reference.

**United Nations Global Compact**

The United Nations Global Compact is a voluntary initiative based on CEO commitments to implement 10 universal sustainability principles based on human rights, labor, the environment, and anticorruption and to undertake partnerships in support of U.N. goals. See [Appendix 3](#) for more information about the 10 principles.

On second reference, use *U.N. Global Compact* or *Global Compact*. Avoid *UNGC*.

For more information, visit <https://www.unglobalcompact.org/>.

**United Nations Sustainable Development Goals**

A set of 17 interlinked goals designed to be “a call for action by all countries—poor, rich and middle-income—to promote prosperity while protecting the planet.” See [Appendix 4](#) for more about the Sustainable Development Goals.

On second reference, use *Sustainable Development Goals*. *SDGs* is acceptable.

For more information, visit <https://sdgs.un.org/>.

**values-based investing**

A general investing concept that can describe any instance of a portfolio built to align with any set of investor values. For example, investors wanting to avoid profiting from so-called sin stocks have avoided tobacco, alcohol, and gambling companies in their portfolios.

## Morningstar Terms and Ratings

### **ESG Consideration funds**

Otherwise conventional funds that claim to use ESG factors in their investment process, though these factors are not central to the funds' overall strategies.

### **ESG Focus funds**

Funds that make sustainability factors an intentional, featured component of their processes for both security selection and portfolio construction. Under the Morningstar Sustainable-Investing Framework, these funds can also be referred to as *sustainable funds*.

### **impact/thematic funds**

Funds that focus on broad sustainability themes and on delivering social or environmental impact alongside financial returns. Under the Morningstar Sustainable-Investing Framework, these funds can be referred to as *sustainable funds with an impact emphasis*, *impact funds*, or *thematic funds*.

### **Morningstar ESG Commitment Level for asset managers**

#### **Morningstar ESG Commitment Level for strategies**

An expression of Morningstar analysts' assessment of asset managers' and individual strategies' determination to incorporate ESG factors into their investment processes and organizations. It is assigned to both asset managers and strategies following a four-tier scale: Leader, Advanced, Basic, and Low.

*ESG Commitment Level* OK on second reference.

Asset Managers: Three pillars — Philosophy & Process Pillar, Resources Pillar, Active Ownership Pillar

Strategies (Active): Three pillars — Process Pillar, Resources Pillar, Asset Manager Pillar

Strategies (Passive): Two pillars — Process Pillar, Asset Manager Pillar

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/ESG\\_Commitment\\_Level\\_White\\_Paper\\_2020.pdf](https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/ESG_Commitment_Level_White_Paper_2020.pdf).

**Morningstar ESG Model Portfolios**

A series of model portfolios created by Morningstar director of personal finance Christine Benz that feature exposure to ESG funds geared toward people who are still accumulating assets for retirement, as well as “bucket” portfolios for people who are retired and actively drawing from their portfolios for living expenses.

For more information, visit <https://www.morningstar.com/articles/959365/model-esg-portfolios-for-savers-and-retirees>.

**Morningstar ESG Risk Rating Assessment**

A visual expression of Sustainalytics’ ESG Risk Ratings, which measure a company’s exposure to industry-specific material ESG risks and how well a company manages those risks. This approach combines the concepts of management and exposure to arrive at an absolute assessment of ESG risk.

This company-level assessment consists of a score and a classification, using the same easily recognizable and comparable globe iconography as the Morningstar Sustainability Rating:

- ▶ 5 globes corresponds to a score of 0-9.99 and a Negligible risk category;
- ▶ 4 globes = 10-19.99/Low risk;
- ▶ 3 globes = 20-29.99/Medium risk;
- ▶ 2 globes = 30-39.99/High risk; and
- ▶ 1 globe = 40 or higher/Severe risk.

Lowercase globes and capitalize Negligible, Low, Medium, High, and Severe in the context of category or assessment, but lowercase in general references to risk.

*General Electric has a Morningstar ESG Risk Rating Assessment of 1 globe. Its 1-globe ESG Risk Rating Assessment places it in the Severe category. GE faces severe risk in several factors.*

For more information, visit <https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/ESG-Risk-Rating-Assessment-for-Companies-Explainer.pdf>.

**Morningstar ESG Select List**

A list of mutual funds, exchange-traded funds, and separately managed accounts created by Morningstar Manager Selection Services for clients. Constituents of the list are evaluated on both their sustainability and investment merits.

**Morningstar Historical Corporate Sustainability Score**

A weighted average of the trailing 12 months of Morningstar Portfolio Corporate Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.

On second reference, use *Historical Corporate Sustainability Score*.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Historical Sovereign Sustainability Score**

A weighted average of the trailing 12 months of Morningstar Portfolio Sovereign Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.

On second reference, use *Historical Sovereign Sustainability Score*.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Low Carbon Designation**

A binary metric, represented by a green leaf icon, that can serve as a baseline check of a portfolio to determine whether a fund's holdings align with an investor's low-carbon objectives and with the transition to a low-carbon economy. Funds that receive the Low Carbon Designation are deemed to have aggregate portfolio holdings with low carbon risk and low exposure to fossil fuels, using underlying Sustainalytics metrics.

On second reference, *Low Carbon Designation* is acceptable.

For more information, visit [https://s21.q4cdn.com/198919461/files/doc\\_news/2018/Morningstar-Low-Carbon-Designation-Methodology-Final.pdf](https://s21.q4cdn.com/198919461/files/doc_news/2018/Morningstar-Low-Carbon-Designation-Methodology-Final.pdf).

### **Morningstar Portfolio Carbon Metrics**

A set of about 60 indicators based on Sustainalytics' company carbon metrics, including Carbon Intensity, Fossil Fuel Involvement, Stranded Assets Risk, and Green Solutions, that can help investors evaluate a portfolio's exposure to carbon risk. For a list of the indicators, see [Appendix 5](#).

On second reference, use *Carbon Metrics*.

For more information, visit [https://s21.q4cdn.com/198919461/files/doc\\_news/2018/Carbon-FAQ-Final-4\\_19\\_2018.pdf](https://s21.q4cdn.com/198919461/files/doc_news/2018/Carbon-FAQ-Final-4_19_2018.pdf).

### **Morningstar Portfolio Carbon Risk Score**

A measure that provides a direct assessment of the carbon risk embedded in a portfolio. The Portfolio Carbon Risk Score is the asset-weighted Sustainalytics Carbon Risk Rating of companies held in a

portfolio, which evaluates how much unmanaged carbon risk remains for a company after accounting for its management activities that might mitigate overall carbon-risk exposure.

The Portfolio Carbon Risk Score consists of a score and a category:

- ▶ 0 corresponds to the Negligible risk category;
- ▶ 0.10-9.99 = Low risk;
- ▶ 10-29.99 = Medium risk;
- ▶ 30-49.99 = High risk; and
- ▶ 50 or higher = Severe risk.

On second reference, use *Portfolio Carbon Risk Score*. Capitalize Negligible, Low, Medium, High, and Severe in the context of category, but lowercase in general references to risk.

*Vanguard Growth Index VIGIX has a Portfolio Carbon Risk Score of 3.19, which places it in the Low category. Overall, VIGIX has low carbon risk.*

For information, visit [https://www.morningstar.com/content/dam/marketing/shared/Company/LandingPages/CarbonRisk/Carbon\\_Risk\\_Paper.pdf?cid=EMO\\_](https://www.morningstar.com/content/dam/marketing/shared/Company/LandingPages/CarbonRisk/Carbon_Risk_Paper.pdf?cid=EMO_).

### **Morningstar Portfolio Corporate Sustainability Rating**

Morningstar assigns Portfolio Corporate Sustainability Ratings by ranking all scored funds within a Morningstar Global Category by their Historical Corporate Sustainability Score. The ranked funds are then divided into five groups based on a normal distribution, and each receives a rating from high to low. For each peer group, the median-scoring portfolio receives a 3 rating. Ratings are assigned to other portfolios in the peer group to achieve a normal distribution, with an exception for cases where the scores within the peer group are not meaningfully differentiated. In practice, this can mean that all portfolios within some peer groups may receive the same Corporate or Sovereign Rating. Please note that lower risk results in a higher rating. Higher ratings indicate that a fund is, on average, invested in fewer companies or sovereign debt with a high ESG risk under Sustainalytics' ESG Risk Rating and Country Risk Rating methodologies and therefore exposed to less risk driven by ESG factors.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Portfolio Corporate Sustainability Score**

Part of the Morningstar Sustainability Rating calculation, the Morningstar Portfolio Corporate Sustainability Score is an asset-weighted average of Sustainalytics' company-level ESG Risk Rating, which measures the degree to which a company's economic value may be at risk from ESG factors. Like the ESG Risk Ratings, the Portfolio Corporate Sustainability Score is rendered on a 0-100 scale, where lower scores are better, using an asset-weighted average of all covered securities. Morningstar determines whether each eligible portfolio holding can be classified under the corporate or sovereign framework. Each holding can only contribute an ESG Risk Rating or a Country Risk Rating, not both. To

receive a Portfolio Corporate Sustainability Score, at least 67% of a portfolio's corporate assets under management (long positions only) must have a company ESG Risk Rating.

On second reference, use *Portfolio Corporate Sustainability Score*.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Portfolio Fossil Fuel Involvement**

A metric representing the percentage of a fund's assets that are involved in fossil fuels. Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products and services are also included. Companies involved in Arctic oil and gas exploration and oil sands extraction will be included only if there is no involvement in oil and gas production.

On second reference, *Fossil Fuel Involvement* is acceptable.

For more information, visit [https://s21.q4cdn.com/198919461/files/doc\\_news/2018/Morningstar-Low-Carbon-Designation-Methodology-Final.pdf](https://s21.q4cdn.com/198919461/files/doc_news/2018/Morningstar-Low-Carbon-Designation-Methodology-Final.pdf).

### **Morningstar Portfolio Impact Metrics**

Using the Sustainalytics ESG Impact Framework at the company level as a basis, Morningstar uses its vast database of mutual fund holdings to map the company-level data to portfolio holdings and calculate impact metrics at the portfolio level. 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 United Nations Sustainable Development Goals, as well as with the Sustainalytics Impact Themes.

On second reference, use *Portfolio Impact Metrics* or *impact metrics*.

### **Morningstar Portfolio Sovereign Sustainability Rating**

As part of the Morningstar Sustainability Rating calculation, Morningstar assigns Portfolio Sovereign Sustainability Ratings by ranking all scored funds within a Morningstar Global Category by their Historical Sovereign Sustainability Scores. The ranked funds are then divided into five groups, based on a normal distribution, and each receives a rating from high to low. For each peer group, the median scoring portfolio receives a 3 rating. Ratings are assigned to other portfolios in the peer group to achieve a normal distribution, with an exception made for cases where the scores within the peer group are not meaningfully differentiated. In practice, this can mean that all portfolios within some peer groups may receive the same corporate or sovereign rating. Please note that lower risk results in a higher rating. Higher ratings indicate that a fund is, on average, invested in fewer companies or sovereign debt with a high ESG risk under Sustainalytics' ESG Risk Rating and Country Risk Rating methodologies and therefore exposed to less risk driven by ESG factors.

On second reference, use *Portfolio Sovereign Sustainability Rating*.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Portfolio Sovereign Sustainability Score**

Part of the Morningstar Sustainability Rating calculation, the Morningstar Portfolio Sovereign Sustainability Score is an asset-weighted average of Sustainalytics' Country Risk Rating, which measures the risk to a country's long-term prosperity and economic development by assessing its wealth and its ability to manage that wealth sustainably. Like the Country Risk Rating, the Portfolio Sovereign Sustainability Score is rendered on a 0-100 scale, where lower scores are better, using an asset-weighted average of all covered securities. Morningstar determines whether each eligible portfolio holding can be classified under the corporate or sovereign framework. Each holding can only contribute an ESG Risk Rating or a Country Risk Rating, not both. To receive a Portfolio Sovereign Sustainability Score, at least 67% of a portfolio's sovereign assets under management (long positions only) must have a Country Risk Rating.

On second reference, use *Portfolio Sovereign Sustainability Score*.

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Sustainability Rating**

A fund rating expressed as a range of one to five globes, designed to help investors evaluate portfolios on ESG factors. A higher number of globes indicates that the portfolio has lower ESG risk. Notably, the number of globes a fund receives is determined relative to other funds in the same Morningstar Global Category.

#### Percentage Rank Rating Depiction

- ▶ Top 10% = 5 globes/High
- ▶ Next 22.5% = 4 globes/Above Average
- ▶ Next 35% = 3 globes/Average
- ▶ Next 22.5% = 2 globes/Below Average
- ▶ Bottom 10% = 1 globe/Low

On second reference, *Sustainability Rating* is acceptable. Capitalize High, Above Average, Average, Below Average, and Low in the context of the rating, but lowercase in general references.

*It is a 5-globe company. The company earns 5 globes. Five-globe funds are rare in that category.* In list of data: *Morningstar Sustainability Rating: 5 Globes*

For more information, visit [https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology\\_2021.pdf](https://www.morningstar.com/content/dam/marketing/shared/research/methodology/SustainabilityRatingMethodology_2021.pdf).

### **Morningstar Sustainable-Attributes Framework**

A system that classifies the sustainable-funds landscape using their own stated objectives. Sustainable-investment funds are categorized into three distinct groupings: ESG funds, impact funds, and environmental sector funds. ESG funds prominently focus on incorporating ESG factors into the investment process. Impact funds, in addition to financial return, seek to deliver a measurable impact on specific issues or themes, like gender diversity, low carbon, or community development. Environmental sector funds are strategies that invest in environmentally oriented industries like renewable energy or water.

On second reference, *the framework* alone suffices if it's clear what we're referring to. Otherwise, use *Sustainable-Attributes Framework*.

For more information, visit <https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/992225.pdf>.

### **Morningstar Sustainable-Investing Framework**

Six distinct approaches to sustainable investing, placed along a continuum from those that lean more toward avoiding negative outcomes, be they investment or real-world outcomes, to those that lean more toward advancing positive outcomes:

- ▶ *Apply Exclusions* refers to excluding issuers based on certain products/services, an industry, or certain corporate behaviors, like controversies.
- ▶ *Limit ESG Risk* refers to using ESG information, usually in the form of ESG ratings of companies, to assess material ESG risks as part of the overall assessment of risk.
- ▶ *Seek ESG Opportunities* refers to using ESG information to identify companies that are sustainability leaders (often by industry or sector), improving, or using sustainability to establish or enhance a competitive advantage. This approach includes what is sometimes called *ESG best in class* or *positive screening* based on ESG ratings.
- ▶ *Practice Active Ownership* refers to seeking positive ESG outcomes via active ownership activities, primarily made possible because asset managers are shareholders in public companies. These activities may include:
  - ▶ Engaging directly with companies on ESG issues.
  - ▶ Proposing ESG-related shareholder resolutions.
  - ▶ Supporting ESG issues through proxy voting.
  - ▶ Participating in ESG-related investor coalitions.
  - ▶ Advocating for public policy measures that address sustainability concerns.
- ▶ *Target Sustainability Themes* refers to identifying investments that stand to benefit from the long-term trend toward greater sustainability in the way we live and work. Such themes may include

environmental themes like renewable energy, clean tech, and clean water, or socioeconomic themes such as gender equity, or health and well-being.

- *Assess Impact* refers to integrating impact assessments into security selection and portfolio construction. Fixed-income managers, for example, may consider a bond's use of proceeds, focusing on bonds that finance projects that benefit people and planet. Equity managers may consider whether a company's products, services, and behaviors support or detract from the United Nations Sustainable Development Goals, which many investors and companies are using as an impact framework. At the portfolio level, investors may assess the overall impact of their portfolio holdings in relation to a goal or benchmark.

On second reference, *the framework* alone suffices if it's clear what we're referring to. Otherwise, use *Sustainable-Investing Framework*.

For more information, visit <https://www.morningstar.com/articles/1058990/the-morningstar-sustainable-investing-framework>.

### **Morningstar Sustainable Investment tag**

A binary data point that indicates on a fund's quote page whether it's a sustainable investment or not.

### **Sustainable Sector funds**

Funds that focus on investment opportunities that contribute to, and aim to benefit from, the transition to a green economy in areas like renewable energy, energy efficiency, environmental services, water, and green real estate.

## Sustainalytics Terms and Ratings

### **Sustainalytics Style**

Sustainalytics writers and editors follow their own style guide for content on their own platforms that may differ from Morningstar style. Sustainalytics uses British English, for example, and follows some other spelling and punctuation conventions that Morningstar does not.

When publishing for Morningstar, we will honor Sustainalytics' proprietary terminology but adhere to Morningstar style guidelines otherwise.

### **Sustainalytics Carbon Risk Rating**

The Carbon Risk Rating quantifies a company's exposure and management of material carbon issues in its own operations as well as in its products and services. At each stage in its value chain, Sustainalytics assesses a company's vulnerability to carbon risks. This is followed by an assessment of how much of this risk is manageable as opposed to systemic, with a final step of evaluating the degree to which management policies are already in place.

Scores are on a 0-100 scale:

- ▶ 0 = Negligible;
- ▶ 0-9.99 = Low;
- ▶ 10-29.99 = Medium;
- ▶ 30-49.99 = High; and
- ▶ 50 or higher = Severe.

On second reference, use *Carbon Risk Rating*. Capitalize *Negligible*, *Low*, and so on, in the context of the rating, but lowercase in general references.

*The company's Carbon Risk Rating is High. The company's overall exposure is high.*

For more information, visit <https://globalaccess.sustainalytics.com/#/research/carbonriskrating>.

### **Sustainalytics ESG Impact Framework**

The philosophy and architecture that underlies Sustainalytics' approach to assessing an entity's impact on society and the environment. The framework rests on five topical themes plus an additional baseline theme, providing a foundational structure for research, and is the chosen organizing framework for

Sustainalytics' impact products. See [Appendix 6](#) for more information about the themes used in the ESG Impact Framework.

On second reference, *the framework* alone suffices if it's clear what we're referring to. Otherwise, use *Impact Framework*.

For more information, visit [https://morningstaronline.sharepoint.com/sites/sa/products/io/SitePages/Impact\\_Offering.aspx](https://morningstaronline.sharepoint.com/sites/sa/products/io/SitePages/Impact_Offering.aspx).

### **Sustainalytics ESG Risk Rating**

The degree to which a company's economic value (enterprise value) is at risk as a result of ESG factors, or, more technically speaking, the magnitude of a company's unmanaged ESG risks. A company's ESG Risk Rating consists of a quantitative score, which represents units of unmanaged ESG risk, and a risk category. Unmanaged risk is measured on an open-ended scale starting at zero (no risk) and, for 95% of cases, a maximum score below 50.

Based on their quantitative scores, companies are grouped into one of five risk categories (Negligible, Low, Medium, High, Severe):

- ▶ 0-9.99 = Negligible;
- ▶ 10-19.99 = Low;
- ▶ 20-29.99 = Medium;
- ▶ 30-39.99 = High; and
- ▶ 40 or higher = Severe.

These risk categories are absolute, meaning that a high assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered. This means that a bank, for example, can be directly compared with an oil company or any other type of company. With the ESG Risk Ratings' scores, we have introduced a single currency for ESG risk.

On second reference, use *ESG Risk Rating*. Capitalize *Negligible*, *Low*, and so on, in the context of the rating, but lowercase in general references.

*The company has a Medium ESG Risk Rating score. The company has medium risk.*

For more information, visit <https://globalaccess.sustainalytics.com/#/research/risk>.

### **Sustainalytics Country Risk Rating**

The Country Risk Rating measures the risks to a country's long-term socioeconomic prosperity and development by assessing the national wealth of a country and the ability to use and manage this wealth in an effective and sustainable manner.

The two main components of the Country Risk Rating are the Wealth Score and the ESG Factors Score. The Wealth Score measures the long-term health of a country's economy and its capacity to sustain economic growth. It consists of measures of the country's natural and produced capital, human capital, and institutional capital. The ESG Factors Score is the risk-management component of the Country Risk Rating framework. It aggregates a country's ESG Performance Score, ESG Trends, and Country Events.

The Country Risk Rating is determined by combining the country's Wealth Score and its ESG Factors Score and, after adjusting for other inputs, arriving at a score from 0 to 100:

- ▶ 0-9.99 = Negligible;
- ▶ 10-19.99 = Low;
- ▶ 20-29.99 = Medium;
- ▶ 30-39.99 = High; and
- ▶ 40-100 = Severe.

On second reference, use *Country Risk Rating*. Capitalize Negligible, Low, and so on, in the context of the rating, but lowercase in general references.

*The Country Risk Rating is Severe. Overall, the risk is severe.*

For more information, visit [https://morningstaronline.sharepoint.com/sites/sa/products/crr/SitePages/Country-Risk-Rating\(1\).aspx](https://morningstaronline.sharepoint.com/sites/sa/products/crr/SitePages/Country-Risk-Rating(1).aspx).

### **Sustainalytics Controversy Rating**

Reflects a company's level of involvement in incidents that have negative impacts on stakeholders and how well it manages the resulting or related ESG risks. See [Appendix 7](#) for full list of controversy indicators.

For more information, visit <https://morningstaronline.sharepoint.com/sites/sa/products/cr/SitePages/Controversies-Research.aspx>.

### **Sustainalytics Corporate Governance Score**

We assess a company's corporate governance structures, practices, and behaviors along six pillars that are deemed crucial for good governance: board integrity and quality, board structure, remuneration, shareholder rights, financial reporting, and stakeholder governance. See [Appendix 8](#) for more information about governance indicators.

For more information, visit <https://morningstaronline.sharepoint.com/sites/sa/products/cg>.

## Compliance Procedures

To ensure that all writers and editors within Morningstar Research Services are using a consistent set of terms and usage guidelines, we will require training for all analysts, copy editors, and applicable compliance team members. We will continue this training on a rolling basis to ensure that all new analysts know the rules, as well as to remind existing analysts. As we roll out additional sustainability-related metrics and offerings, we will update our policies and guidelines accordingly.

To ensure ongoing compliance, our copy editors will review all content before publishing to make sure the terminology adheres to the guidelines laid out in this document.

Analysts are required to adhere to the Advertising Policy, which is part of the [Compliance Policy Manual](#) for Morningstar Research Services LLC. Our compliance team will review all marketing materials (including external presentations) associated with Morningstar Research Services. Specifically, analysts are expected to submit their review requests to compliance generally three business days in advance via the Jira system to track the review records. ■■■

# Appendix

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## Appendix 1: Material ESG Issues

Lowercase in body copy.

### Corporate Governance

Corporate governance comprises six pillars: Board/management quality and integrity; board structure; ownership and shareholder rights; remuneration; audit and financial reporting; and stakeholder governance. These six pillars represent foundational structures for the management of ESG risks.

### Access to Basic Services

Access to basic services focuses on the management of access to essential products or services, such as healthcare services and products to disadvantaged communities or groups.

### Bribery and Corruption

Bribery and corruption focuses on the management of risks related to alleged or actual illicit payments, such as kickbacks, bribes, and facilitation payments to government officers, suppliers, or other business partners, as well as the receipt of those payments from suppliers or business partners. If these are not material in their own right for a subindustry, these issues are handled within business ethics.

### Business Ethics

Business ethics focuses on the management of general professional ethics, such as taxation and accounting, anticompetitive practices, and intellectual property issues. Business ethics may include bribery and corruption for subindustries that do not have bribery and corruption as a separate material ESG issue. Additional subindustry-specific topics—such as medical ethics and ethics regarding the provision of financial services—may also be included in this issue. In addition, ethical considerations related to customer selection may be included here for some subindustries if products or services may be used to violate human rights, for example.

### Community Relations

Community relations focuses on how companies engage with local communities (including indigenous peoples) through community involvement, community development

and/or measures to reduce negative impacts on local communities.

### Data Privacy and Security

Data privacy and security focuses on data governance practices, including how companies collect, use, manage, and protect data. The emphasis is on measures taken to ensure safe and secure use and/or maintenance of customers' personally identifiable data.

### Emissions, Effluents, and Waste

Emissions, effluents, and waste focuses on the management of emissions and releases from a company's own operations to air, water, and land, excluding greenhouse gas emissions. Depending on the subindustry, emphasis is put on one or several of these waste streams.

### Carbon–Own Operations

Carbon–own operations refers to a company's management of risks related to its own operational energy use and greenhouse gas emissions (scopes 1 and 2). It also includes parts of scope 3 emissions, such as transport and logistics. It does not include emissions in the supply chain or during the use phase/end-of-life cycle of a product.

### Carbon–Products and Services

Carbon–products and services refers to a company's management of the energy efficiency or greenhouse gas emissions of its services and products during the use phase. This does not include carbon risks related to financial services, which are considered within ESG integration–financials.

### Environmental and Social Impact of Products and Services

Refers to the management of environmental or social impacts of products or services, including inherent characteristics of input materials, both positive and negative, and impacts during use, disposal, and recycling. This category may include carbon impacts if carbon–products and services is not regarded as a material ESG issue for the subindustry.

**Human Rights**

Human rights focuses on how companies manage and respect fundamental human rights within their own operations. Emphasis is on measures taken to protect civil and political rights as well economic, social, and cultural rights, including child and forced labor.

**Human Rights–Supply Chain**

Human rights–supply chain focuses on a company's management of fundamental human rights issues occurring in its supply chain. For subindustries that rely on conflict minerals, this also includes a company's handling of conflict minerals in its supply chain.

**Human Capital**

Human capital focuses on the management of human resources. It includes the management of risks related to scarcity of skilled labor through retention and recruitment programs and includes career development measures such as training programs. Additionally, it includes labor relations issues, such as the management of freedom of association and nondiscrimination, as well as working hours and minimum wages.

**Land Use and Biodiversity**

Land use and biodiversity focuses on how companies manage the impact of their operations on land, ecosystems, and wildlife. Topics covered include land conversion, land rehabilitation, and forest management, as well as the protection of biodiversity and ecosystems.

**Land Use and Biodiversity–Supply Chain**

Land use and biodiversity–supply chain focuses on how companies manage the impact of their suppliers' operations on land, ecosystems, and wildlife.

**Occupational Health and Safety**

Occupational health and safety focuses on the management of workplace hazards affecting a company's own employees and on-site contractors. Where relevant, the issue may also include HIV/AIDS programs.

**ESG Integration–Financials**

ESG integration–financials includes all ESG integration activities by financial institutions that are either driven by

financial downside risk considerations or by business opportunity considerations. This issue includes an institution's own current assets, including direct investments, corporate credits, or stakes in project financing, as well as assets managed for clients. Product offerings can span a wide spectrum of product types, starting with ESG investment funds, microfinance products, and so on. The issue also includes the consideration of ESG criteria in real estate investments, such as green building initiatives.

**Product Governance**

Product governance focuses on how companies manage their responsibilities vis-à-vis clients (quality and/or safety of their products and services). Emphasis is put on quality management systems, marketing practices, fair billing, and postsales responsibility. For media companies, this issue also includes the management of content-related standards, such as journalistic standards and the protection of sources (media ethics).

**Resilience**

Resilience focuses on the financial stability and the management of related risks in the financial-services industry, with emphasis on compliance with capital requirements. This issue applies to financial institutions that pose systemic risks and therefore potential external costs to society in the case of bailouts by taxpayers.

**Resource Use**

Resource use focuses on how efficiently and effectively a company uses its raw material inputs (excluding energy and petroleum-based products) in production and how it manages related risks. Though water use is a main focus, the issue can also include the management of critical raw materials that are either scarce or difficult to access, through recycling programs, the substitution of less scarce materials and/or ecodesign.

**Resource Use–Supply Chain**

Resource use–supply chain focuses on how efficiently and effectively a company manages risks related to water scarcity and raw material inputs (excluding energy and petroleum-based products) within its supply chain.

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**Appendix 2: Six Principles for Responsible Investment**

- ▶ Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- ▶ Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- ▶ Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- ▶ Principle 4: We will promote acceptance and implementation of the principles within the investment industry.
- ▶ Principle 5: We will work together to enhance our effectiveness in implementing the principles.
- ▶ Principle 6: We will each report on our activities and progress toward implementing the principles.

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### Appendix 3: 10 Principles of the United Nations Global Compact

#### Human Rights

- ▶ Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- ▶ Principle 2: make sure that they are not complicit in human rights abuses.

#### Labor

- ▶ Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- ▶ Principle 4: the elimination of all forms of forced and compulsory labor;
- ▶ Principle 5: the effective abolition of child labor; and
- ▶ Principle 6: the elimination of discrimination in respect of employment and occupation.

#### Environment

- ▶ Principle 7: Businesses should support a precautionary approach to environmental challenges;
- ▶ Principle 8: undertake initiatives to promote greater environmental responsibility; and
- ▶ Principle 9: encourage the development and diffusion of environmentally friendly technologies.

#### Anticorruption

- ▶ Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

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### Appendix 4: United Nations Sustainable Development Goals

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>▶ Goal 1: End poverty in all its forms everywhere.</li> <li>▶ Goal 2: End hunger, achieve food security and improved nutrition, and promote sustainable agriculture.</li> <li>▶ Goal 3: Ensure healthy lives and promote well-being for all at all ages.</li> <li>▶ Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.</li> <li>▶ Goal 5: Achieve gender equality and empower all women and girls.</li> <li>▶ Goal 6: Ensure availability and sustainable management of water and sanitation for all.</li> <li>▶ Goal 7: Ensure access to affordable, reliable, sustainable, and modern energy for all.</li> <li>▶ Goal 8: Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all.</li> <li>▶ Goal 9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation.</li> <li>▶ Goal 10: Reduce inequality within and among countries.</li> </ul> | <ul style="list-style-type: none"> <li>▶ Goal 11: Make cities and human settlements inclusive, safe, resilient, and sustainable.</li> <li>▶ Goal 12: Ensure sustainable consumption and production patterns.</li> <li>▶ Goal 13: Take urgent action to combat climate change and its impacts.</li> <li>▶ Goal 14: Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.</li> <li>▶ Goal 15: Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss.</li> <li>▶ Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive institutions at all levels.</li> <li>▶ Goal 17: Strengthen the means of implementation and revitalize the global partnership for sustainable development.</li> </ul> |
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### Appendix 5: Carbon Metrics Indicators

Issues used in Morningstar and Sustainalytics research that can help investors evaluate a portfolio's exposure to carbon risk.

#### Percent AUM Covered—Carbon

The percentage of a fund's assets under management that have carbon risk scores from Sustainalytics. The calculation includes long portfolio positions only.

#### Low Carbon Designation

An indication the fund has a Low Carbon Designation. This is based on two metrics: the Morningstar Portfolio Carbon Risk Score and Morningstar Portfolio Fossil Fuel Involvement. Funds may receive the Low Carbon Designation, which allows investors to easily identify low-carbon funds within the global

universe. To receive the designation, a fund must have a 12-month average Portfolio Carbon Risk Score below 10 and a 12-month average Fossil Fuel Involvement of less than 7% of assets.

#### **Carbon-Risk Score**

The asset-weighted carbon-risk score of the equity or corporate-bond holdings in a fund (long positions only). To calculate the Portfolio Carbon Risk Scores, Morningstar uses Sustainalytics' company Carbon Risk Ratings, which indicate the risk that companies face from the transition to a low-carbon economy. At least 67% of portfolio assets must have a Carbon Risk Rating from Sustainalytics for a score to be calculated. The percentage of assets covered is rescaled to 100% before calculating the score.

#### **Carbon-Risk Score Percent Rank in Category**

The fund's percentile rank, within its Morningstar Category, for the most recent quarter's Portfolio Carbon Risk Score. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **Carbon-Risk Score Category Average**

The average carbon-risk score for funds within the Morningstar Category that have carbon-risk scores for the most recent quarter. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **Benchmark Carbon-Risk Score**

The carbon-risk score aggregated for a fund's primary category benchmark, calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **12-Month Average Carbon-Risk Score**

The asset-weighted carbon-risk score of the equity or corporate-bond holdings in a fund (long positions only), averaged over the trailing 12 months. To calculate this score, Morningstar uses Sustainalytics' company Carbon Risk Ratings. At least 67% of portfolio assets must have a Carbon Risk Rating from Sustainalytics. The percentage of assets covered is rescaled to 100% before calculating the score.

#### **12-Month Average Carbon-Risk Category Average**

The average, for the Morningstar Category, of the constituent fund's 12-month average carbon-risk score. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **12-Month Average Carbon-Risk Percent Rank in Category Carbon-Exposure Score**

The asset-weighted average of the carbon-exposure score for the fund's portfolio holdings based on Sustainalytics carbon research. A lower score is better. The carbon-exposure score is one of the key components of the carbon-risk score. At a company level, it quantifies the undertakings exposure to material carbon issues in its subindustry and own operations as well as its products and services.

#### **Carbon-Exposure Score Category Average**

The average carbon-exposure score for funds within a Morningstar Category that have carbon-exposure scores. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **Carbon-Management Score**

The asset-weighted average of the carbon-management score for the fund's portfolio holdings with Sustainalytics carbon research. The carbon-management score is one of the key components of the carbon-risk score. It evaluates a company's preparedness and record of managing carbon operations and products and services risks that are considered manageable.

#### **Carbon-Management Score Category Average**

The average carbon-management score for funds within a Morningstar Category that have carbon-management scores. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

#### **Carbon-Operations Risk**

The asset-weighted average of the carbon-operations risk score for the holdings with Sustainalytics carbon research in a portfolio. A lower score is better. The carbon-operations risk score is part of the company value chain evaluation and determines carbon-related operations risks.

#### **Carbon-Operations Risk Category Average**

The average carbon-operations score for funds within a Morningstar Category that have carbon-operations risk calculated based on holdings with Sustainalytics carbon research.

#### **Carbon Products and Services Risk**

The asset-weighted average of the carbon products and services risk score for holdings with Sustainalytics carbon research in a fund. A lower score is better. Products and services risk is part of the value chain evaluation and determines carbon-related risks stemming from the products and services a company provides.

#### **Carbon Products and Services Risk Category Average**

The average carbon products and services risk for funds within a Morningstar Category that have carbon products and services risk calculated based on holdings with Sustainalytics carbon research.

#### **Stranded Assets Risk**

The asset-weighted average of the carbon stranded assets risk for holdings with Sustainalytics carbon research in a portfolio. This score measures exposure to stranded asset risk based on carbon intensity of fuel mix and involvement in high-cost production. A lower score is better. The stranded assets risk assesses the carbon-assets risk of both oil and gas producers and the top 1,000 U.S. companies. Exposure

includes lifecycle carbon intensity of production and proven reserves as well as involvement in high-cost projects.

#### **Stranded Assets Risk Category Average**

The average stranded assets risk for funds within a Morningstar Category that have stranded assets risk scores calculated based on holdings with Sustainalytics carbon research.

#### **Carbon Intensity**

The asset-weighted average of holdings with actual emissions data from the Carbon Disclosure Project or estimated values from Sustainalytics in a portfolio. A lower score is better. Carbon intensity is computed for each holding as follows: Total emissions (metric tons of CO<sub>2</sub>)/revenue (\$m) and aggregated at the fund level. Sustainalytics looks at the latest reported scope 1 (direct emissions from owned or controlled sources) and scope 2 (indirect emissions from the generation of purchased energy) greenhouse gas intensity and emissions for over 10,000 companies. More than 100 different estimation models are used for nonreporting companies.

#### **Carbon Intensity Category Average**

The average carbon intensity for funds within a Morningstar Category that have carbon intensity calculated based on holdings with Sustainalytics carbon research.

#### **Fossil Fuel Involvement**

The percentage of a fund's assets that are involved in fossil fuels. Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products and services are also included. Companies involved in Arctic oil and gas exploration and oil sands extraction will be included only if there is no involvement in oil and gas production.

#### **12-Month Average Fossil Fuel Exposure**

The percentage of a fund's assets that are involved in fossil fuels averaged over the trailing 12 months. Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products and services are also included. Companies involved in Arctic oil and gas exploration and oil sands extraction will be included only if there is no involvement in oil and gas production.

#### **Fossil Fuel Category Average**

The average fossil fuel exposure for funds within a Morningstar Category that have fossil fuel involvement

calculated based on holdings with Sustainalytics carbon research.

#### **Thermal Coal Power Generation Involvement**

The percentage of a portfolio's assets involved in power generation based on thermal coal, including companies that own/operate coal-fired power plants. A lower percentage is optimal. Holdings are considered involved in thermal coal power generation if they derive at least a 5% share of total revenue from involvement.

#### **Thermal Coal Power Generation Category Average**

The average thermal coal power generation involvement percentage for funds within a Morningstar Category that have thermal coal power generation revenue exposure using Sustainalytics research on holdings.

#### **Thermal Coal Extraction Involvement**

The percentage of a fund's assets involved in extraction of thermal coal for coal mining and exploration. A lower percentage is optimal. Holdings are considered involved in thermal coal extraction if they derive at least a 5% share of total revenue from involvement.

#### **Thermal Coal Extraction Category Average**

The average thermal coal extraction involvement percentage for funds within a Morningstar Category that have thermal coal extraction revenue exposure using Sustainalytics research on holdings.

#### **Oil Sands Extraction Involvement**

Oil sands involvement is a portfolio's asset-weighted percentage exposure to extraction of tar sands. Oil/tar sands are a mixture of clay, sand, water, and bitumen that is mined and refined into oil. A lower percentage is optimal. Holdings are considered involved with oil sands extraction if they have at least 0.1% exposure.

#### **Oil Sands Extraction Category Average**

The average oil sands extraction involvement percentage for funds within a Morningstar Category that have oil sands extraction revenue exposure.

#### **Arctic Oil and Gas Exploration Involvement**

The percentage of a fund's assets that are involved in Arctic oil and gas exploration. A lower percentage is optimal. Holdings are considered involved if they derive at least 0.1% share of total revenue from involvement. Revenue exposure in Arctic oil and gas exploration is typically included in oil and gas production revenue exposure. Due to differences in revenue indicators analyzed, there may be instances where a company has a share of total revenue derived from Arctic oil and gas exploration, while oil and gas production has no revenue exposure indicated.

**Arctic Oil and Gas Exploration Category Average**

The average Arctic oil and gas exploration involvement percentage for funds within a Morningstar Category that have Arctic oil and gas exploration exposure.

**Carbon-Solutions Involvement**

Carbon-solutions involvement is the percentage of the portfolio's assets involved in carbon solutions, including renewable energy generation, renewable energy supporting products/services, energy efficiency distribution and management, energy efficiency material, energy efficiency industrial systems and processes, energy efficiency consumer products, green buildings development, green buildings management, green buildings technologies and materials, green transportation vehicles, green transportation technologies, green transportation services, green transportation infrastructure involvement. A higher percentage is optimal.

**Carbon-Solutions Category Average**

The average carbon-solutions percentage fund within a Morningstar Category that has carbon-solutions exposure.

**Oil and Gas Generation Involvement**

Oil and gas generation involvement is the portfolio's asset-weighted percentage revenue from utilities that generate electricity by burning oil, natural gas, diesel, or heavy oil. A lower percentage is optimal. Holdings are considered involved with oil and gas generation if they have at least a 5% share of total generating capacity.

**Oil and Gas Generation Category Average**

The average oil and gas generation involvement percentage for funds within a Morningstar Category that have oil and gas generation revenue exposure.

**Oil and Gas Production Involvement**

The percentage of a fund's assets that are involved in oil and gas production. There are three components of oil and gas production:

- ▶ Owning exploration and production oil and gas assets, which consists of working with service companies that license, survey, or conduct other appraisal activities before a field or reservoir is exploited.
- ▶ Transportation of crude oil, natural gas, diesel, or heavy oil from production sites to refining facilities by pipelines, tankers, trucks, or rail cars, as well as storage of crude oil, natural gas, or derivatives in terminals, depots, and facilities before transportation to refineries or retailers.
- ▶ Refining, or the process by which oil and natural gas are converted into petroleum products such as LPG, gasoline, jet fuel/kerosene, diesel, fuel oil, and asphalt.

Petrochemical products derived from petroleum products such as ethylene, benzene, polyesters, and fertilizers are also included. A lower percentage is optimal. Holdings are

considered involved with oil and gas production if they derive at least a 5% share of total revenue from involvement.

**Oil and Gas Production Category Average**

The average oil and gas production involvement percentage for funds within a Morningstar Category that have oil and gas production revenue exposure.

**Oil and Gas Products and Service Involvement**

A fund's asset-weighted percentage exposure to oil and gas products and services. Company involvement in oil and gas products and services is defined as having tailor-made products and/or services that support oil and gas exploration, production, and refining processes. Companies in this category do not own oil and gas assets. Examples of services include rental of tailor-made equipment, drilling services, and geophysical engineering, while product examples are chemicals that support drilling, pumps, rigs, and pressure pipelines. A lower percentage is optimal. Holdings are included in the portfolio oil and gas products and services involvement calculation if they have at least 50% exposure.

**Oil and Gas Products and Services Category Average**

The average oil and gas products and services involvement percentage for funds within a Morningstar Category with oil and gas products and services revenue exposure.

**Carbon-Risk Score All Funds Rank**

A fund's percentage rank based on all funds globally that receive a carbon-risk score for the most recent quarter.

**Carbon-Risk Classification**

An indication of the severity of the carbon risk of a fund. It is based on the asset-weighted average carbon-risk score by grouping into the following categories: negligible: 0.00, low: 0.01-9.99, medium: 10-29.99, high: 30-49.99, severe: >= 50

**Percent of AUM With Negligible Carbon Risk**

The proportion of a fund's portfolio that is invested in securities designated as having negligible carbon risk by Sustainalytics.

**Percent of AUM With Low Carbon Risk**

The proportion of a fund's portfolio that is invested in securities designated as having low carbon risk by Sustainalytics.

**Percent of AUM With Medium Carbon Risk**

The proportion of a fund's portfolio that is invested in securities designated as having medium carbon risk by Sustainalytics.

**Percent of AUM with High Carbon Risk**

The proportion of a fund's portfolio that is invested in securities designated as having high carbon risk by Sustainalytics.

**Percent of AUM with Severe Carbon Risk**

The proportion of a fund's portfolio that is invested in securities designated as having severe carbon risk by Sustainalytics.

**Carbon Exposure Score Percent Rank in Category**

A fund's percentage rank within its Morningstar Category, based on the carbon-exposure scores.

**Carbon-Management Score Percent Rank in Category**

A fund's percentile rank within its Morningstar Category, for funds that have carbon-management scores. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

**Carbon-Operations Risk Percent Rank in Category**

A fund's percentile rank within its Morningstar Category, for funds that have carbon-operations risk calculated based on holdings with Sustainalytics carbon research.

**Carbon Products and Services Risk Percent Rank in Category**

A fund's percentage rank within its Morningstar Category, based on the carbon products and services risk

**Stranded Assets Risk Percent Rank in Category**

The average stranded assets risk for funds within a Morningstar Category that have stranded assets risk scores.

**Carbon Intensity Percent Rank in Category**

A fund's percentage rank within its Morningstar Category, based on carbon intensity for funds that have carbon intensity calculated based on holdings with Sustainalytics carbon research.

**Highest Carbon Risk Score Category**

The highest carbon risk score within a Morningstar category, for the most recent quarter's carbon risk scores. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

**Lowest Carbon-Risk Score Category**

The lowest carbon-risk score within a Morningstar category, for the most recent quarter's carbon-risk scores. The scores are calculated based on portfolio holdings with Sustainalytics carbon research.

**Highest Fossil Fuel Category**

The highest fossil fuel involvement within a Morningstar category, based on the most recent quarter's Fossil Fuel Involvement.

**Lowest Fossil Fuel Category**

The lowest Fossil Fuel Involvement within a Morningstar category, based on the most recent quarter's Fossil Fuel Involvement.

**12-Month Average Fossil Fuel Category Average**

The 12-month average fossil fuel exposure for funds within a Morningstar Category, based on the 12-month average of Fossil Fuel Involvement.

**12-Month Average Highest Carbon-Risk Score Category**

The highest carbon-risk score in a Morningstar Category, based on the 12-month average carbon-risk scores.

**12-Month Average Lowest Carbon-Risk Score Category**

The lowest carbon-risk score in a Morningstar Category, for the 12-month average carbon-risk scores. The scores are calculated based on the portfolio holdings with Sustainalytics carbon research.

**12-Month Average Highest Fossil Fuel Involvement Category**

The highest Fossil Fuel Involvement percentage in a Morningstar Category, based on the 12-month average Fossil Fuel Involvement.

**12-Month Average Lowest Fossil Fuel Involvement Category**

The average, for a Morningstar Category, of a fund's lowest fossil fuel exposure over the previous 12 months, using Sustainalytics carbon research on holdings.

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**Appendix 6: ESG Impact Framework Themes**

Sustainalytics' impact framework comprises five topical themes plus an additional baseline theme.

At the macro level, Sustainalytics' ESG Impact Framework comprises 5+1 themes. They span two social areas and three environmental areas. Additionally, there is a baseline theme that addresses the indirect impacts an entity can have by way of its leadership and contribution to collective efforts. These themes are considered exhaustive and intended to encompass all potential environmental and social impacts that can be attributed to the activities of an entity. Furthermore, they are meant to capture direct and indirect impacts across the value chain.

The five social and environmental themes are defined as follows:

- Climate action: This theme is concerned with the global effort to curb the Earth's temperature rise and cope with unavoidable consequences. It includes measures to promote clean energy, limitations on greenhouse gas emissions and climate change adaptation measures.

- ▶ **Healthy ecosystems:** This theme is concerned with the safeguarding of ecologically sound environments on land, air, and water. It does not include greenhouse gas emissions and water consumption as these are covered under other themes.
- ▶ **Resource security:** This theme is concerned with the contribution to resource security through efficient use and circular economies. Resources of concern include water, timber, metals, minerals, gases, and all types of manufactured materials.
- ▶ **Basic needs:** This theme is concerned with addressing the basic needs of humans and focuses particularly on lower-income individuals. Basic needs include providing access to food, housing, essential healthcare concerning major and neglected diseases, clean water, and energy for underserved populations. It also addresses human safety, including safe workplaces and communities.
- ▶ **Human development:** This theme is concerned with enhancing human capabilities and promoting human progress. It includes measures that support education, improve equality, employment opportunities, and advanced healthcare.

The baseline theme is defined as follows:

- ▶ **Leadership and collaboration:** This theme is concerned with the standards, structures and interconnections that underly our societies and economies. It addresses the benefits that can be achieved through our collective efforts. The theme includes measures that support public accountability, fair business practices, international cooperation, and government effectiveness; support innovation of sustainable technologies and infrastructure; and help secure a resilient financial system.

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## Appendix 7: Event Indicators for Sustainability Controversy Ratings

### Access to Basic Services

This event indicator assesses incidents related to a company's failure to ensure access to essential products or services, such as food, water, and healthcare.

### Accounting and Taxation

This event indicator assesses incidents related to accounting irregularities as well as efforts to reduce the amount of taxes paid through tax evasion (use of illegal means to evade taxes) or tax avoidance (the use of legal means to reduce tax liabilities).

### Animal Welfare

This event indicator assesses incidents related to a company's failure to ensure the well-being of animals kept for human consumption, animal testing, or other purposes.

### Anticompetitive Practices

This event assesses incidents related to attempts to prevent, reduce, or restrict competition in a market, primarily through alleged violations of antitrust regulation.

### Bribery and Corruption

This event indicator assesses incidents related to bribes that are paid or accepted by a company to or from government officials or other private entities to secure an unfair advantage over other companies.

### Business Ethics

This event indicator assesses incidents related to ethical violations committed by a company or its employees. This includes fraud or enabling fraud, money laundering,

manipulation, misuse of power or of corporate assets, and conflicts of interest, among others.

### Community Relations

This event assesses incidents related to company activities that negatively impact local communities, including indigenous communities, and how companies respond to and manage conflicts with affected groups.

### Land Use and Biodiversity

This event assesses incidents related to a company's failure to adhere to sustainable land use practices, resulting in negative impacts on land or ecosystems, such as biodiversity.

### Corporate Governance

This event assesses incidents related to the quality and integrity of a company's corporate governance structures, including the structure and oversight of its board of directors and shareholder rights and remuneration.

### Emissions, Effluents, and Waste

This event indicator assesses incidents related to the release or improper disposal of waste, effluents, or emissions (excluding carbon dioxide) into the environment.

### Energy Use and Greenhouse Gas Emissions

This event indicator assesses incidents related to the poor management or excess release of greenhouse gas emissions from a company's business activities.

### Environmental Impact of Products

This event indicator assesses incidents related to a product's negative impact on the environment, as well as those related

to products from a company's suppliers. Incidents may emerge because of lawsuits, product bans, recalls, or stakeholder scrutiny due to the negative impact of a company's product.

#### **Occupational Health and Safety**

This event indicator assesses incidents related to a company's activities that have a negative impact on workers' health and safety. These include workplace accidents, chemical contamination, diseases, and labor activities that endanger employee safety.

#### **Intellectual Property**

This event indicator assesses incidents related to breaches of intellectual property rights, such as patents, copyright, industrial design rights, trademark, or trade secrets.

#### **Labor Relations**

This event indicator assesses incidents related to poor compensation or unfair working conditions that are raised by a company's own employees or their representatives, such as labor unions. It also includes incidents related to discrimination and harassment in the workplace.

#### **Lobbying and Public Policy**

This event assesses incidents related to lobbying or public spending that is perceived to violate ethical or legal standards.

#### **Marketing Practices**

This event indicator assesses incidents related to false or deceptive marketing practices, such as using misleading or incorrect statements in promotional materials or targeting vulnerable consumers.

#### **Media Ethics**

This event indicator assesses incidents related to breaches in editorial standards, content, or general ethical principles for the media, including broadcast, print, digital, and other types of media outlets.

#### **Data Privacy and Security**

This event indicator assesses incidents related to breaches of customer data privacy, unauthorized disclosure, collection or use of personal data, or failure to protect customer data.

#### **Quality and Safety**

This event indicator assesses incidents related to alleged quality or safety issues associated with a company's products or services, which may result in negative impacts on the safety or well-being of consumers, or society.

#### **Resilience**

This event assesses incidents related to the ability of financial institutions to withstand negative shocks arising from changes in economic conditions, and therefore avoid negative impacts on taxpayers and other stakeholders.

#### **Sanctions**

This event indicator assesses incidents related to corporate activities that result in a breach of international sanctions, issued by supranational organizations or individual countries.

#### **Social Impact of Products**

This event indicator assesses incidents related to a product's negative impact on society. Incidents may emerge as a result of lawsuits, product bans, recalls, or stakeholder scrutiny due to the negative impact of a company's product.

#### **Water Use**

This event indicator assesses incidents of excessive water use associated with a company's operations, or activities in water-scarce areas.

#### **Weapons**

This event indicator assesses incidents related to the production or sale of weapons that are subject to arms export regulations, or otherwise controversial weapons, as well as the sale of weapons to countries that are especially prone to armed conflict and human rights violations.

#### **Animal Welfare—Supply Chain**

This event indicator assesses incidents related to the failure of a company's suppliers to ensure the wellbeing of animals kept for human consumption, animal testing, or other purposes.

#### **Bribery and Corruption—Supply Chain**

This event indicator assesses incidents related to bribes or kickbacks that are paid or accepted by a company's suppliers to government officials or other private entities to secure an unfair advantage over other companies.

#### **Business Ethics—Supply Chain**

This event indicator assesses incidents related to ethical violations committed by a company's suppliers. This includes fraud or enabling fraud, money laundering, manipulation, misuse of power or of corporate assets, and conflicts of interest, among others.

#### **Community Relations—Supply Chain**

This event assesses incidents related to activities by a company's suppliers that negatively influence local communities, including Indigenous communities, and how a company responds to and manages conflicts with affected groups.

#### **Emissions, Effluents, and Waste—Supply Chain**

This event assesses incidents in the supply chain related to the release or improper disposal of waste, effluents, or emissions (excluding carbon dioxide) into the environment.

**Energy Use and Greenhouse Gas Emissions–Supply Chain**

This event assesses incidents related to the poor management or excess release of greenhouse gas emissions from business activities in a company's supply chain.

**Labor Relations–Supply Chain**

This event indicator assesses incidents relating to poor compensation or unfair working conditions in a company's supply chain.

**Land Use and Biodiversity–Supply Chain**

This event indicator assesses incidents related to the failure of a company's supplier to adhere to sustainable land use practices, resulting in negative impacts on land or ecosystems, such as biodiversity.

**Occupational Health and Safety–Supply Chain**

This event indicator assesses incidents related to activities by a company's suppliers that have a negative impact on worker health and safety. Such incidents include occupational hazards such as workplace accidents, chemical contamination, diseases, and labor activities that endanger employees' safety.

**Water Use–Supply Chain**

This event indicator assesses incidents of excessive water use associated with a company's suppliers, or activities by suppliers in water-scarce areas.

**Carbon Impact of Products**

This event indicator assesses incidents related to the harmful environmental impacts of carbon dioxide emissions associated with the use of a company's products. For financial institutions, this may include the financing of

projects or companies whose products result in significant carbon dioxide emissions.

**Employees–Human Rights**

This event indicator assesses incidents related to violations of the human rights of employees within a company's own operations. This includes incidents involving the use of forced labor, slavery, and child labor, discrimination, or sexual exploitation.

**Society–Human Rights**

This event indicator assesses incidents related to a company's direct or indirect involvement with corrupt governments, dictatorial regimes or parties that have a record of human rights violations or are engaged in human rights abuses. This indicator also analyzes incidents regarding a company's direct or indirect activities in occupied territories and non-self-governing territories.

**Employees, Human Rights–Supply Chain**

This event indicator assesses incidents related to violations of the human rights of workers within a company's supply chain. This includes incidents involving the use of forced labor, slavery, and child labor, discrimination, or sexual exploitation.

**Society, Human Rights–Supply Chain**

This event indicator assesses incidents related to a company's suppliers' direct or indirect involvement with corrupt governments, dictatorial regimes or parties that have a record of human rights violations or are engaged in human rights abuses. This indicator also analyzes incidents regarding a company's suppliers' direct or indirect activity in occupied territories and non-self-governing territories.

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**Appendix 8: Corporate Governance Pillars**
**Board and Management Quality and Integrity**

Do the board's experience, record, and behavior demonstrate its ability to provide strategic leadership and oversight?

- ▶ Board experience: Industry experience of nonexecutive directors and chair; linkage of experience to company strategy.
- ▶ Director record: Association of directors with governance and performance failures; excessive board service.
- ▶ Board capture: Linkages among directors; connections of outside directors to CEO/chair.
- ▶ Related party transactions: RPT approval and evaluation process; existence of material RPTs with board/insiders.
- ▶ Director stock ownership: Proportion of directors with stock ownership; comparison against relevant market practice.
- ▶ Executive/board misconduct: Controversies reflecting on integrity of executives or board members.
- ▶ Business practices controversies: Controversies reflecting on business ethics.
- ▶ Governance controversies: Controversies reflecting on compliance and governance culture.
- ▶ Stakeholder engagement and responsiveness: Response to votes opposing directors or board proposals, or management proposals more broadly; engagement policy; absence of shareholder engagement.

### Board Structure

Do the organization and structure of the board provide sufficient oversight, representation, and accountability to shareholders?

- ▶ Board leadership: Independence/separation of chair and CEO roles; chair's status as founder/family member or affiliate/former executive; succession planning.
- ▶ Board tenure: Proportion of board with long tenure and representation on main board committees; retirement, term limits, and other refreshment policies.
- ▶ Board independence: Level of board independence, computed ratio, and comparison to market practice; affiliations of outside directors with CEO/insiders.
- ▶ Nominating committee effectiveness: Nominating committee independence; role of insiders/chair on committee; disclosure of nomination process.
- ▶ Director disclosure: Level of disclosure of board biographies and directors' remuneration (individual/aggregate).
- ▶ Voting structures: Majority/plurality voting standards; resignation policies; proxy access; cumulative voting.
- ▶ Directors not elected by shareholders: Presence and affiliations of designated directors; presence of directors not elected by shareholders.
- ▶ Risk oversight: Presence of board-level risk oversight function; disclosure of industry-specific risks under their responsibility; level of disclosure of the work of risk oversight function.
- ▶ Board diversity: Gender diversity on board; quality of diversity policy.

### Ownership and Shareholder Rights

Do the constitution of the company and its ownership structures respect the right of outside shareholders relative to the board, management, and major holders?

- ▶ Director appointment and removal: Board classification and elections; ability of shareholders to remove directors; ability of board to change its size.
- ▶ Proportionality — one share/one vote: Dual-class shares; voting limitations/caps based on duration and size; golden shares; other proportionality violations.
- ▶ Ownership structure: Presence of controlling/significant blockholders; is control achieved through disproportionate voting rights?
- ▶ Capital issuance risks: Excessive issuance authorities; excessive buyback authorities; abusive or potentially abusive capital issuances.
- ▶ Shareholder action: Rights to call special meeting/act by written consent.
- ▶ Poison pill and takeover defenses: Shareholder rights plans, including evaluation of shareholder-friendly provisions; quality of the market's takeover regime.
- ▶ Supermajority provisions: Supermajority provisions for charter/bylaw amendment and/or M&A transactions; in context of presence of controlling shareholder.

### Remuneration

Do the company's remuneration policies and practices provide appropriate incentives for management to build value?

- ▶ Remuneration disclosure: Quality and granularity of disclosure of CEO and other executive pay.
- ▶ Remuneration committee effectiveness: Independence of remuneration committee; presence of executives/ insiders on committee.
- ▶ Say on pay: Ability of shareholders to approve or advise on remuneration policy, report, and equity compensation.
- ▶ Pay controversies: Controversies related to pay, including negative votes.
- ▶ STI performance metrics: Quality of performance metrics for the annual bonus; degree of discretion.
- ▶ LTI performance metrics: Quality of performance metrics for the long-term/equity incentives.
- ▶ Pay magnitude: CEO pay relative to regional and sector norms; dilution concerns related to equity awards.
- ▶ Pay for performance: Alignment of pay with long-term financial performance; qualitative assessment of remuneration program features.
- ▶ Pay for failure: Excessive golden parachutes, and sign-on awards without performance conditions that presage excessive payouts.
- ▶ CEO termination scenarios: Vesting provisions for equity pay under various CEO termination scenarios.
- ▶ Internal pay equity: CEO pay relative to other employees.
- ▶ Clawback policy: Presence of recoupment policy; requirements for malfeasance.

### Audit and Financial Reporting

Are the company's financial reports reliable and subject to appropriate oversight?

- ▶ Audit committee structure: Audit committee independence relative to market standards; presence of insiders on committee.
- ▶ Audit committee effectiveness: Audit committee meetings; financial and industry expertise of committee members.
- ▶ Audit fees: Level of nonaudit fees relative to audit fees.
- ▶ Audit rotation policy: Presence of rotation and retendering policies; relative to market practice.
- ▶ Auditor change: Change in auditor; reasons for change.
- ▶ Reporting irregularities: Material restatements, adverse auditor opinions, going concern issues.

### Stakeholder Governance

Does the company's management of extra financial risks and broader stakeholder relationships raise concerns regarding its governance of long-term value creation?

- ▶ ESG governance: Level of oversight of ESG-specific issues by the board, management, or other bodies.
- ▶ ESG reporting standards: Adoption of ESG reporting standards.
- ▶ Verification of ESG reporting: External validation of the depth of ESG reporting and monitoring.
- ▶ Global compact signatory: Public commitment to principles of corporate responsibility as through the U.N. Global Compact.
- ▶ ESG performance targets: Incentives for ESG performance; board attention to ESG considerations.
- ▶ Political involvement policy: Policy regarding political involvement and contributions.
- ▶ Lobbying and political expenses: Level of lobbying and political expenses.
- ▶ Bribery and corruption policy: Policy on bribery and corruption.
- ▶ Environmental policy: Environmental policy as a framework for oversight of material risks.
- ▶ Whistleblower programs: Companywide whistleblower program; structures to oversee and process reports; risk oversight and mitigation initiatives.
- ▶ Tax disclosure: Transparency regarding taxes paid; possible use of tax shelters.
- ▶ Discrimination policy: Policy on discrimination; commitment to ensure equal opportunity.
- ▶ Scope of social supplier standards: Policies or codes of conduct for expectations of working conditions at contractors and suppliers.
- ▶ Greenhouse gas reduction program: Initiatives to manage and reduce greenhouse gas emissions.
- ▶ Green procurement policy: Degree of incorporating environmental aspects in procurement decisions.