



## News Release

22 West Washington Street  
Chicago  
Illinois 60602

Telephone: +1 312 696-6000  
Facsimile: +1 312 696-6009

### Media Contact

Sarah Wirth, +1 312 244-7358 or [sarah.wirth@morningstar.com](mailto:sarah.wirth@morningstar.com)

### FOR IMMEDIATE RELEASE

#### **Morningstar Formally Integrates ESG into Its Analysis of Stocks, Funds, and Asset Managers**

*As assets and interest in sustainable investing continue to grow, Morningstar unpacks ESG risks to meet investor demand for in-depth qualitative and quantitative research to curate ESG investment choices*

CHICAGO, Nov. 17, 2020 -- [Morningstar, Inc.](https://www.morningstar.com) (Nasdaq: MORN), a leading provider of independent investment research, today announced it has begun formally integrating environmental, social, and governance (ESG) factors into its analysis of stocks, funds, and asset managers.

Morningstar equity research analysts will employ a globally consistent framework to capture ESG risk across over 1,500 stocks. Analysts will identify valuation-relevant risks for each company using Sustainalytics' [ESG Risk Ratings](#), which measure a company's exposure to material ESG risks, then evaluate the probability those risks materialize and the associated valuation impact. Results from this research will inform Morningstar's assessment of a stock's intrinsic value and the margin of safety required before assigning a Morningstar Rating™ for stocks between five- and one-star. Morningstar acquired Sustainalytics, a globally recognized leader in ESG ratings and research, in July 2020.

Morningstar manager research analysts will analyze the extent to which strategies and asset managers are incorporating ESG factors as part of its new Morningstar ESG Commitment Level evaluation. In conducting the strategy evaluation, the analysts will assess the analytics and personnel committed to each strategy and the extent to which the strategy incorporates those resources into the investment process. To perform the evaluation of asset managers, analysts will consider how clearly the firm has articulated its ESG philosophy and policies, and the degree to which it has driven those policies through its culture and investment processes. The ESG Commitment Level evaluation of strategies and asset managers will follow a four-point scale of Leader, Advanced, Basic, and Low.

"Investors are expressing their investment objectives in more-encompassing terms than ever before, and they're putting their money where their mouth is," said Haywood Kelly, Morningstar's head of research. "For companies, evaluating ESG risk is a business imperative to both meet diverse stakeholder needs and mitigate potential legal, operational, or reputational risks. Morningstar's equity and manager research teams aim to address these trends and empower investors through long-term, methodological research approaches, bolstered by qualitative analysis and independent thinking."

#### **Integrating Sustainalytics ESG Research into Morningstar's Equity Research Methodology**

Morningstar equity research analysts will utilize Sustainalytics research to capture ESG risk using a consistent process across industries, and in a manner that aligns with Morningstar's long-term oriented and fundamentals-focused

investment philosophy through two principal channels: the Morningstar® Economic Moat Rating™ and the Uncertainty Rating. These ratings inform Morningstar’s assessment of intrinsic value and required margin of safety, respectively, and ultimately, are rolled into the Morningstar Rating™ for stocks.

1. **Economic Moat Rating:** The framework to determine a company’s Economic Moat Rating, Morningstar’s measure of a firm’s sustainable competitive advantage, will be updated to capture the long-term threat ESG risks may pose to the value creation capabilities of an otherwise competitively advantaged business, thereby precluding or limiting an economic moat.
2. **Uncertainty Rating:** The framework for Morningstar’s Uncertainty Rating, which gauges the relative predictability of future cash flows, will be updated to formally capture long-term ESG risks alongside other factors, such as a firm’s sensitivity to the overall economy, product concentration, and pricing power.

Additionally, Morningstar will rename the Stewardship Rating to Morningstar Capital Allocation Rating and refine the framework to isolate and evaluate management performance across three key dimensions: balance sheet health, investment efficacy, and shareholder distributions. Analysts have identified these three factors as being important in measuring management’s impact on total shareholder returns.

“Integrating ESG directly into the marrow of our research methodology helps us to widen the aperture of the traditional financial analysis and more precisely capture ESG risks that can exert a profound influence on long-term competitive dynamics and the sustainability of a company’s earnings,” said Dan Rohr, head of equity research for Morningstar.

Analysts will use Sustainalytics’ ESG Risk Ratings as the basis for identifying valuation-relevant risks. The ESG Risk Ratings measure a company’s exposure to industry-specific material ESG risks and how well a company is managing those risks. This approach to measuring ESG risk combines the concepts of management and exposure to arrive at an assessment of ESG risk – the ESG Risk Rating – which is comparable across all industries.

“Investors need to understand what the long-term risks to a company are, how much of that risk is well managed by a company, and how much unmanaged risk remains,” said Wilco van Heteren, Sustainalytics’ executive director of ESG research. “By affording material ESG issues a central role in a risk-based approach to valuation, Morningstar is reinforcing its long-term investment philosophy. We are excited that Morningstar is incorporating our ESG Risk Ratings into its equity research environment.”

Morningstar will begin to roll out the equity research rating enhancements on Dec. 9, 2020 and apply to Morningstar’s global equity research coverage universe of more than 1,500 companies. The incorporation of ESG factors will update on a rolling basis through 2021.

The new methodology for Morningstar’s equity research is available [here](#). Further detail on how ESG will be integrated into each component is available [here](#) and more specifically for the Capital Allocation Rating [here](#).

### **The Morningstar ESG Commitment Level**

Morningstar manager research analysts will analyze the extent to which strategies (The Morningstar ESG Commitment Level for Strategies) and asset managers (The Morningstar ESG Commitment Level for Asset Managers) are incorporating ESG factors. The ESG Commitment Level assessment is qualitative in nature, with analysts assigning a Commitment Level to strategies and asset managers on a four-point scale of Leader, Advanced, Basic, and Low.

Analysts determine the ESG Commitment Level for Strategies by evaluating each strategy's process, resources, and the asset manager behind the strategy. The analysts will assign an ESG Commitment level of "Leader" to strategies that have top-flight resources, including dedicated ESG investment professionals as well as comprehensive ESG data and analytics. Moreover, these strategies fully incorporate those resources and analysis into the investment process, spanning initial screening, issue selection, portfolio construction, and risk management, and have transparent and well-implemented programs to actively engage with portfolio holdings on ESG issues and vote proxies.

Analysts assign the ESG Commitment Level for Asset Managers by assessing each firm's philosophy and process, resources, and active ownership activities. The analysts will assign an ESG Commitment Level of "Leader" to firms that incorporate ESG principles into their investment programs to the greatest extent relative to peers. This includes a clearly articulated ESG philosophy and associated policies, top-of-line ESG resources and data, and incorporation procedures that span all asset classes and extend to the majority of assets under management. These firms also follow best-in-class engagement and proxy voting practices.

Morningstar's manager research team today published ESG Commitment Level assignments to a global set of funds and asset managers in a new research paper, "The Morningstar ESG Commitment Level: Our first assessment of 100-plus strategies and 40 asset managers."

"In an increasingly confusing area of investing with different approaches, standards, disclosures, and more, the ESG Commitment Level will help investors discern funds and asset managers that truly focus on sustainable investing from those that incorporate ESG factors but in a limited way," said Hortense Bioy, director of sustainability research for Morningstar in EMEA and APAC.

The analysts will continue to extend the ESG Commitment Level to additional strategies and asset managers under analyst coverage and receive the Morningstar Analyst Rating™ for funds in the regular course of their work. As of November 2020, analyst coverage includes more than 5,400 vehicles, including open-end funds, closed-end funds, exchange-traded funds, and other vehicle types globally. In 2021, the ESG Commitment Level will be made available on Morningstar platforms, including Morningstar's flagship investment research platform Morningstar Direct<sup>SM</sup>, and individual investor website, Morningstar.com.

The full research paper and first set of ESG Commitment Level designations is available [here](#). The methodology for the ESG Commitment Level is available [here](#).

### **About Morningstar, Inc.**

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. The Company offers an extensive line of products and services for individual investors, financial advisors, asset managers, retirement plan providers and sponsors, and institutional investors in the debt and private capital markets. Morningstar provides data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, debt securities, and real-time global market data. Morningstar also offers investment management services through its investment advisory subsidiaries, with approximately \$215 billion in assets under advisement and management as of Sept. 30, 2020. The Company has operations in 29 countries. For more information, visit [www.morningstar.com/company](http://www.morningstar.com/company). Follow Morningstar on Twitter @MorningstarInc.

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