
Morningstar® Globe Rating for Companies

An Overview

Morningstar Research

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Introduction

In 2016 Morningstar and Sustainalytics partnered to provide the first-to-market Morningstar Sustainability Rating for funds, known to many as "the Globes," to provide a mechanism for fund investors to evaluate environmental, social, and governance, or ESG, factors across the global universe of managed products. Together as one company, Morningstar and Sustainalytics are introducing the Globe Rating for companies to offer a way for the whole market to speak a common language about ESG risk—across all audiences, workflows, and investment vehicles. By providing consistent Globes iconography to represent ESG Risk, Morningstar and Sustainalytics aim to strengthen the connection between the company and fund-level ESG ratings, which use the ESG risk rating as the primary input, and provide a simple way to convey ESG risk as a standard part of the investor toolkit.

The Globe Rating for companies is a visual representation of the Sustainalytics ESG Risk Classification that will allow investors to easily identify securities with low ESG risk. Sustainalytics' flagship ESG Risk Ratings measure the degree to which a company's economic value is at risk is driven by ESG factors. Morningstar will display this information broadly across the key places where investors look for our research intellectual property and independent assessments to evaluate securities, because we believe ESG factors are an important consideration for long-term investors.

Overview

Sustainalytics' ESG Risk Ratings

For almost three decades, Sustainalytics has been a leading global provider of ESG research, ratings, and data. Sustainalytics' ESG Risk Ratings are used worldwide by institutional asset owners and asset managers to understand security-level ESG risk and to inform their investment decision-making processes. These same ESG Risk Ratings provide the basis for the Morningstar Globe Rating for companies.

Company Exposure to and Management of Material ESG Issues

The central building blocks of Sustainalytics' ESG Risk Ratings are Material ESG Issues, or MEIs. For Sustainalytics, an ESG issue is material if it is likely to have a significant effect on the enterprise value of a typical company within a subindustry, and if the presence or absence of an MEI in financial reporting is likely to influence the decisions made by a reasonable investor. For example, the carbon emissions involved in a product's use, a company's management of human capital, or the waste management system of a factory can all be considered material. We first assess a company's exposure to each MEI identified to be relevant for the subindustry. We define exposure as a company's vulnerability to ESG-

related risk factors that may pose financial risks. As a starting point, relevant MEIs are selected for each subindustry. Based on this selection, a company's risk exposure to the material issues is assessed along with how well it manages this exposure to risk. Although the subindustry-level assessment is the starting point, each company is assessed individually to determine where it deviates from subindustry norms. Very low exposure to an ESG risk suggests that the issue is not material to a company, and vice versa.

Management scores are derived from a set of management indicators (that is, policies, programs and internal systems) and outcome-focused indicators (that is, carbon emissions, certifications, and controversial events), which measure how well a firm manages the ESG risks it is exposed to.

Sustainalytics' Approach to Calculating Exposure and Management

To calculate Exposure and Management scores, Sustainalytics examines up to 20 MEIs, supported by more than 300 ESG indicators, and analyzes information from over 1,300 data points, including a company's self-disclosed data, daily media, regulatory filings, and NGO reports. Our team of over 300 ESG analysts analyze and calculate the final ratings. Feedback mechanisms are also in place for companies to review ratings and provide additional data.

Controversy Assessments

Sustainalytics also considers a company's involvement in controversial or unexpected events when calculating an ESG Risk Rating score. Controversial events are those that have a negative impact on the environment or society, such as data breaches, allegations of accounting irregularities, and negative environmental supply chain incidents. The impact of controversial events on a firm's ESG score depends on the severity of the controversy. The more serious an event, the larger the negative impact on a company's overall ESG Risk Rating score. Events are assessed from Category 1 (low impact on environment and society, posing negligible risks to the company) to Category 5 (severe impact on the environment and society, posing serious risks to the company). During the 2020 global coronavirus pandemic, for instance, poorly managed COVID-19 outbreak incidents contributed to rating downgrades of several firms. Controversy assessments are important because involvement in such events may indicate a lapse in a company's management of ESG risk factors. Through our MEI assessments, we are judging a company's management based on its stated policies and programs. Our controversy research, on the other hand, allows us to assess how well a company is putting those stated policies into practice.

Overall ESG Risk Rating

The ESG Risk Rating score represents the overall material ESG risk which is unmanaged by a company. It covers two types of risk:

- ▶ Unmanageable risk is risk that is inherent in the subindustry which cannot be addressed by company initiatives (for example, airlines cannot reduce their carbon emissions to zero with current technology; therefore, MEIs related to emissions remain risks that cannot be managed to zero for airline companies).
- ▶ The management gap, which represents risks that could be managed by a company through suitable initiatives, but which are not yet managed.

The final score is the sum of the unmanaged risk scores for the company's MEIs. Scores range from 0 (no ESG risk) to an open-ended maximum, though for 95% of cases, the unmanaged ESG Risk score is below 50. Based on their quantitative scores, companies are grouped into one of five Risk Classifications (negligible, low, medium, high, and severe). These risk levels are absolute, meaning that a "high risk" assessment reflects a comparable degree of unmanaged ESG risk across all companies covered.

Final Globe Rating

The Globe Ratings are simply a visual representation of Sustainalytics ESG Risk Classifications on a 1 to 5 scale.

ESG Risk Score	Risk Category	Globes
0 - 9.99	Negligible	
10 - 19.99	Low	
20 - 29.99	Medium	
30 - 39.99	High	
>=40	Severe	

Use and Availability of the Globes

Our flagship approach to company ESG assessments covers large-cap companies across major global indexes. For some types of companies, which have fewer resources dedicated to ESG disclosures, we apply a Core Research framework to produce a comparable overall ESG Risk Rating based on a subset of indicators.

The Globes are represented visually in conjunction with the numeric overall ESG Risk Score and the ESG Risk Classification which directly correspond to it. Additionally, supplementary information about a company's top MEIs and its highest controversies also accompany the rating in most cases.

Environmental, social, and governance factors are important for long-term investors to consider when evaluating a company's future cash flows; its competitive position; and ultimately, the price they should pay for the underlying stock. Systematic consideration of ESG risks is now part of Morningstar's Economic Moat and Uncertainty Ratings, which leverage the inputs to Sustainalytics' ESG risk assessments in their analysis (link here:

https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/MasterEquityResearchMethodology_Oct2020.pdf). Some investors have ESG motivations beyond risk mitigation and performance, and therefore may consider ESG ratings of companies in more absolute terms—for example, only investing in those that meet a certain ratings threshold. The Morningstar Globe Rating for companies can help investors understand, at a high level, a company's exposure to ESG risk through

security screening, comparison to similar companies in an industry, or as a starting point for deeper fundamental analysis.

For more information, please visit <https://www.sustainalytics.com/esg-ratings/> 

About Morningstar Sustainability

Morningstar's Sustainability Solutions help financial professionals make sense of the sustainable investing landscape with differentiated data, research, and analytics for a growing number of applications.

For More Information

<https://www.morningstar.com/company/global-contacts>



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