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# Morningstar Sustainable Attributes<sup>SM</sup>

## Framework and Definitions for "Sustainable Investment" and "Employs Exclusions" Attributes

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### Morningstar Data Content

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

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

Over the course of the last year, we have assessed this global data set and received input on its usability and relevance from Morningstar's own research teams, clients, and the market. As a result, we are introducing a change to the collection criteria for the ESG Incorporation data point. This data point is one of many Sustainability Attributes data points offered by Morningstar and is part of our Morningstar Sustainability Attributes framework.

The Attributes framework offers investors a system that classifies the sustainable funds landscape using funds' own stated objectives. This document provides a detailed explanation of the Attributes framework and a definition of each individual attribute.

## Sustainable Investment

Morningstar defines a strategy as a "Sustainable Investment" if it is described as focusing on sustainability; impact; or environmental, social, and governance, or ESG; factors in its prospectus or other regulatory filings. At the next level of granularity, "Sustainable Investment" funds are categorized into three distinct groupings. "ESG Funds" primarily incorporate ESG factors into the investment process or engagement activities. "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.

### Exhibit 1 Sustainable Investment Framework

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

Source: Morningstar.

### ESG Fund

These are sustainable strategies that incorporate ESG criteria throughout the investment process or through engagement activities.

### ESG Incorporation

These are strategies that use ESG criteria as a central part of their security-selection and portfolio-construction process.

Strategies that use ESG Incorporation typically have explicit sustainable criteria that invested companies must meet. These strategies generally use some combination of positive screening, negative screening, and active engagement with investee. While some may include a specific thematic or impact focus, these strategies endeavor to promote sustainability and minimize negative impact. (See Appendix A for special cases.)

### **ESG Engagement**

These are strategies that use investment stewardship (also called active ownership), including voting and direct company engagement, as a central part of their investment process to pursue ESG goals with invested companies.

Engagement is currently only marked based on regulatory filings. However, due to the firmwide nature of engagement methods and their frequent absence from regulatory filings, we are currently exploring additional ways of confirming this data.

### **Impact Fund**

These are strategies that seek to make a measurable impact alongside financial return on specific issue areas through their investments. Impact funds are often focused on specific themes or use the 17 U.N. Sustainable Development Goals as a framework for evaluating the overall impact of the portfolio.

### **Gender and Diversity**

These are strategies that seek to make a measurable impact on gender and diversity disparities or limit their investments to companies that meet certain diversity guidelines. These may include, for example, having a certain number of women on a company board and in management, and/or a positive record on racial and LGBTQ issues.

### **Low Carbon/Fossil-Fuel Free**

These are strategies that seek to make a measurable impact through their investments in or tilts toward companies with small or decreasing carbon footprints or low carbon risk, and/or through avoidance of or reduced exposure to fossil fuels.

### **Community Development**

These are strategies that seek to make a measurable impact through their investments in issuers of securities that support community development and engagement. These strategies may accomplish this through seeking to positively affect economic development, local institutions, or the availability of resources in target communities.

### **Environmental**

These are strategies that intend to invest in companies with a positive environmental record or are specifically involved in industries that positively impact the environment. This also includes strategies that invest in securities whose use of proceeds contribute to positive environmental impact.

### **Other Impact Themes**

These are strategies that seek to make a measurable impact alongside financial return through their investments in companies with other specifically stated or general impact themes that do not fall within the other impact categories.

### **Environmental Sector Fund**

These are strategies that invest in environmentally oriented industries, such as renewable energy or water.

#### **Renewable Energy**

These are strategies that intend to invest in companies involved in the renewable energy sector.

#### **Water-Focused**

These are strategies that intend to invest in companies with clean water practices.

#### **General Environmental Sector**

These are strategies that invest in other environmental industries without a primary focus on renewable energy or water.

### **Employs Exclusions**

"Employs Exclusions" strategies exclude certain sectors, companies, or practices. This indicator is marked if any exclusions are employed by the strategy, even if it is not a "Sustainable Investment" strategy based on the criteria outlined above.

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#### **Exhibit 2** Employs-Exclusions Framework

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

Source: Morningstar.

#### **Uses Norms-Based Screening**

These are strategies that cite international agreements, such as the UN Global Compact or Universal Declaration of Human Rights, as a guideline for investing responsibly. These frequently involve human rights violations, child labor issues, or investments in companies in conflict zones like Syria or Afghanistan.

**Excludes Abortion/Stem Cells**

These are strategies that intend to avoid investments in companies that derive revenue from abortion services, abortifacients, and/or the use of embryonic stem cells. Strategies that exclude human cloning are also included in this data point because of the use of embryonic stem cells and the issue's relationship to life ethics questions. While many strategies employing these exclusions also exclude contraceptives, the exclusion of the latter is reflected in "Excludes Other."

**Excludes Adult Entertainment**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from adult entertainment. Strategies that identify specific exclusions of a subindustry, such as pornography, also receive this tag.

**Excludes Alcohol**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of alcohol.

**Excludes Animal Testing**

These are strategies that intend to avoid investments in companies that engage in animal testing practices.

**Excludes Controversial Weapons**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from controversial military weapons, such as weapons of mass destruction, nuclear weapons, land mines, and cluster munitions. These do not necessarily preclude investments in companies with revenue from conventional military weapons but may include companies that produce materials used in controversial weapons.

**Excludes Fur and Specialty Leather**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of fur and/or specialty leather.

**Excludes Gambling**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from gambling or casinos.

**Excludes GMOs**

These are strategies that intend to avoid investments in companies that are significantly involved in the use of genetically modified organisms.

**Excludes Military Contracting**

These are strategies that intend to avoid investments in military contractors or companies that derive a significant percentage of their revenue from nonconsumer military contracting or operations. Some strategies cite companies that derive a significant amount of revenue from working with military organizations, or defense more generally. This category does not necessarily exclude nonmilitary companies that are involved in materials or components used in controversial weapons.

**Excludes Nuclear**

These are strategies that intend to avoid investments in companies that are significantly involved in the research or production of nuclear energy. This does not reflect exclusions of nuclear weapons, which are instead reflected in "Excludes Controversial Weapons."

**Excludes Palm Oil**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of unsustainable palm oil and its products. This may not require the exclusion of companies that produce, distribute, or sell palm oil that has been shown to be sustainably sourced, including cosmetics and lotions.

**Excludes Pesticides**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of pesticides for environmental or biological concerns.

**Excludes Small Arms**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of personal weapons and small arms. These strategies most frequently exclude firearms but may exclude other personal weapons as well.

**Excludes Thermal Coal**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the extraction, distribution, sale, or use of thermal coal. Investments in companies exposed to metallurgical coal are typically not included in this category.

**Excludes Tobacco**

These are strategies that intend to avoid investments in companies that derive a significant percentage of their revenue from the production, distribution, or sale of tobacco and/or tobacco-related products.

**Excludes Other**

These are strategies that intend to avoid investments in companies that are significantly involved in other products or practices deemed to be contradictory to the strategy's values. Examples include

companies with business operations in countries whose governments pose human rights concerns, or more general language about companies whose products or services are "anti-family" or have a "severely negative" impact on customers. 

## Appendix: ESG Incorporation Special Cases

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

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

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

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

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

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