

DEEP DIVE INTO ESG RATINGS AND SCORES – OPPORTUNITIES TO ENHANCE INVESTMENT DECISIONS

Presenters:

Laura Lutton, Risk Pillar Lead, Director of Product Management, Morningstar Sustainalytics

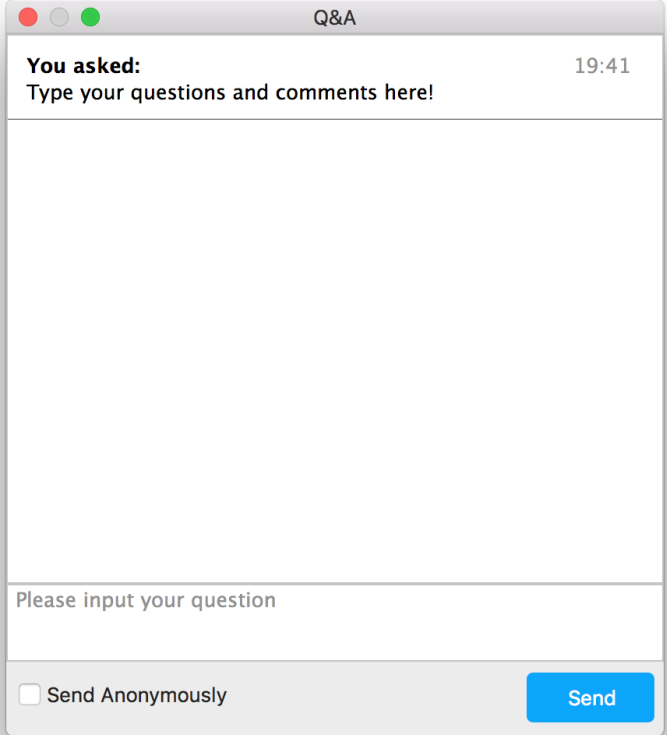
Gabriel Wilson-Otto, CFA, Head of Sustainable Investing Strategy, Fidelity International

David von Eiff, PhD, Director, Institutional Partnerships, Asia-Pacific, CFA Institute



HOUSEKEEPING

- Today's webinar is scheduled for 60 minutes including Q&A
- All participants are muted throughout the webinar
- We welcome comments via the Chat button and questions via the Q&A button on your screen
- We will be running a few polling questions – you will be prompted to submit your answers
- This webinar will be recorded and be made available to view soon after the presentation concludes today
- The main presentation will be uploaded onto [CFA Institute Asia-Pacific Research Exchange \(ARX, www.arx.cfa\)](http://www.arx.cfa)



The image shows a screenshot of a Q&A window. The window title is "Q&A". At the top right, the time is "19:41". Below the title bar, it says "You asked:" followed by "Type your questions and comments here!". There is a large empty text area for input. At the bottom, there is a prompt "Please input your question". Below the prompt, there is a checkbox labeled "Send Anonymously" and a blue "Send" button.

POLLING 1

Do you / your firm integrate ESG ratings and data into investment strategies?

▪ Yes, at a firm level	30%
▪ Yes, at the product level	14%
▪ Yes, at both firm and product level	31%
▪ No	25%

If yes, what are the drivers behind the integration of ESG ratings as part of investment strategies? (you can choose more than one option)

▪ Risk indication / mitigation	54%
▪ Alpha generation	32%
▪ Regulatory compliance	49%
▪ Fulfilment of investment mandates	43%
▪ Company / personal values	40%



POLLING 2

On a scale of 1 to 5, how do you rate your level of understanding towards ESG rating methodologies?

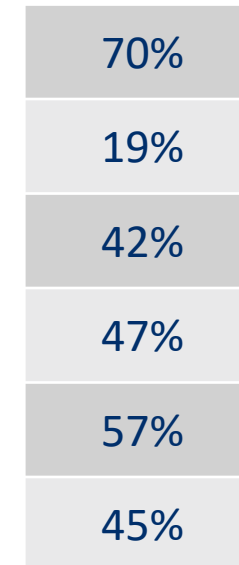
▪ 5 (Very much)	4%
▪ 4	14%
▪ 3	37%
▪ 2	24%
▪ 1 (Very low)	20%



POLLING 3

Which of the following are important considerations to use a particular ESG rating? (you can choose more than one option)

- Provide better insights into the rationale behind the numbers
- Offer better customer experience (e.g. more responsive, lower cost etc.)
- Use better peer comparison
- Meet the needs of specific portfolio or industry sectors
- Generate ratings based on reliable data sources
- Drill down on components that are leveraged investment decisions





SUSTAINALYTICS

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Deep Dive into ESG Ratings & Scores

Laura Lutton

Risk Pillar Lead / Product Strategy & Development / Morningstar Sustainability

July 2023



Agenda

- 03 ESG Market Trends
- 06 ESG Risk Rating Framework
- 11 ESG Risk Smart Score
- 16 Low Carbon Transition Rating



ESG Market Trends

ESG Market Trends | Asia-Pacific Fund Flows

Europe dominates ESG flows and assets, but growth in Asia-Pacific region is encouraging

Global Sustainable Fund Flows

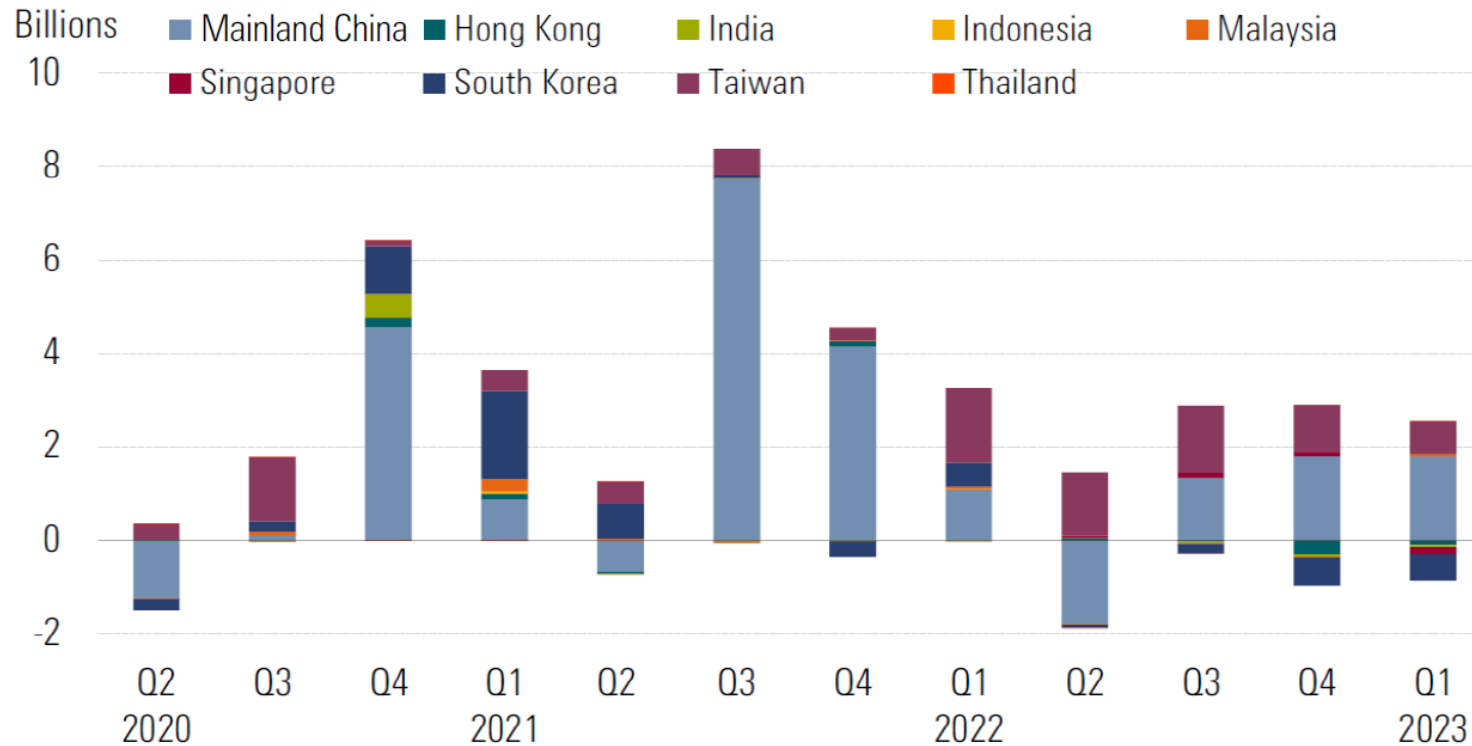
Q1 2023 Region	Flows	Assets		Funds	
	USD Billion	Billion	% Total	#	% Total
Europe	32.3	2,296	84	5,410	77
United States	-5.2	299	11	638	9
Asia ex-Japan	1.7	63	2	515	7
Australia/New Zealand	0.1	31	1	201	3
Japan	-1.0	26	1	60	1
Canada	1.0	30	1	206	3
Total	29.0	2,745		7,030	

Source: Morningstar Direct, Manager Research. Data as of March 2023.

ESG Investing | ESG Preferences Vary by Jurisdiction

Mainland China and Taiwan have largest influence on regional sustainable fund-flow trends

Asia Ex-Japan Sustainable Fund Flows by Quarter (USD Bil)



Source: Morningstar Direct, Manager Research. Data as of March 2023



ESG Risk Rating Framework

Introducing the ESG Risk Rating

Sustainalytics' ESG Risk Ratings measure the degree to which a company's enterprise value is at risk driven by ESG factors.

Introducing Sustainalytics' ESG Risk Ratings

Two-dimensional Materiality Framework:



The Three Building Blocks of the Comprehensive ESG Risk Ratings

Material ESG issues (MEIs) are central to the ESG Risk Ratings

Material ESG Issues

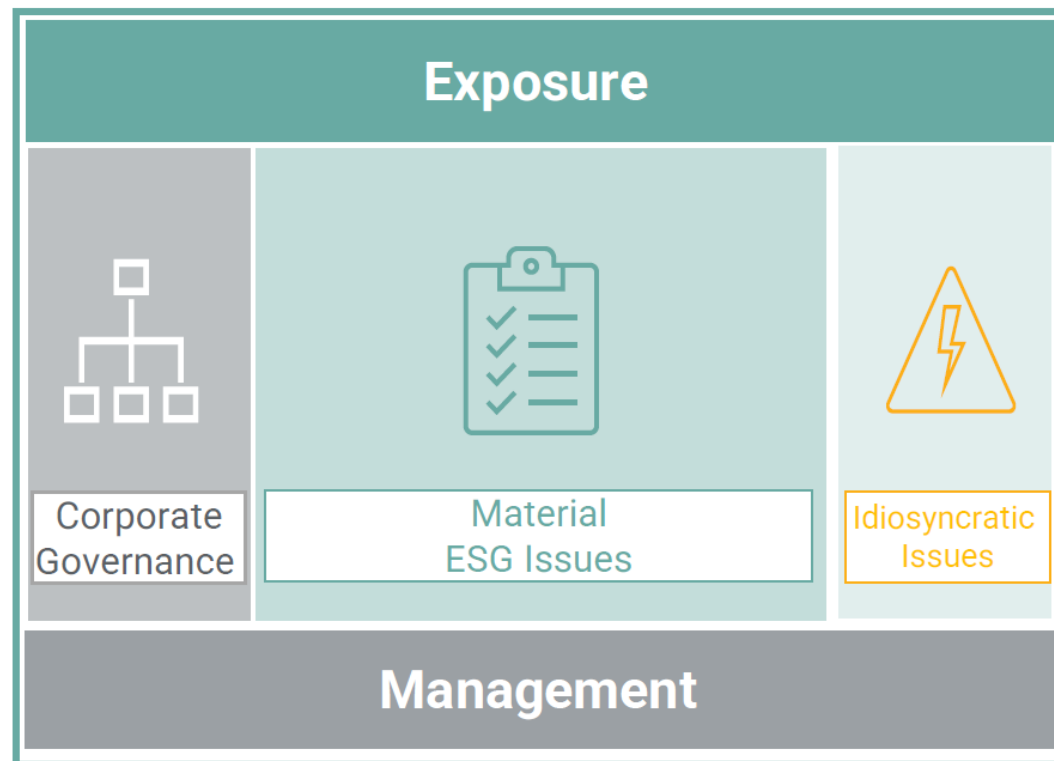
- » Are selected at the subindustry-level
- » Provide an assessment of Exposure on a subindustry-level, through identifying which issues are material, thus the name: Material ESG Issues
- » Subsequently, Exposure will be adjusted at the company level through the Beta components

Corporate Governance baseline

- » Fully integrates Sustainalytics' Corporate Governance ratings
- » Independent of subindustry, however it integrates CG market angle

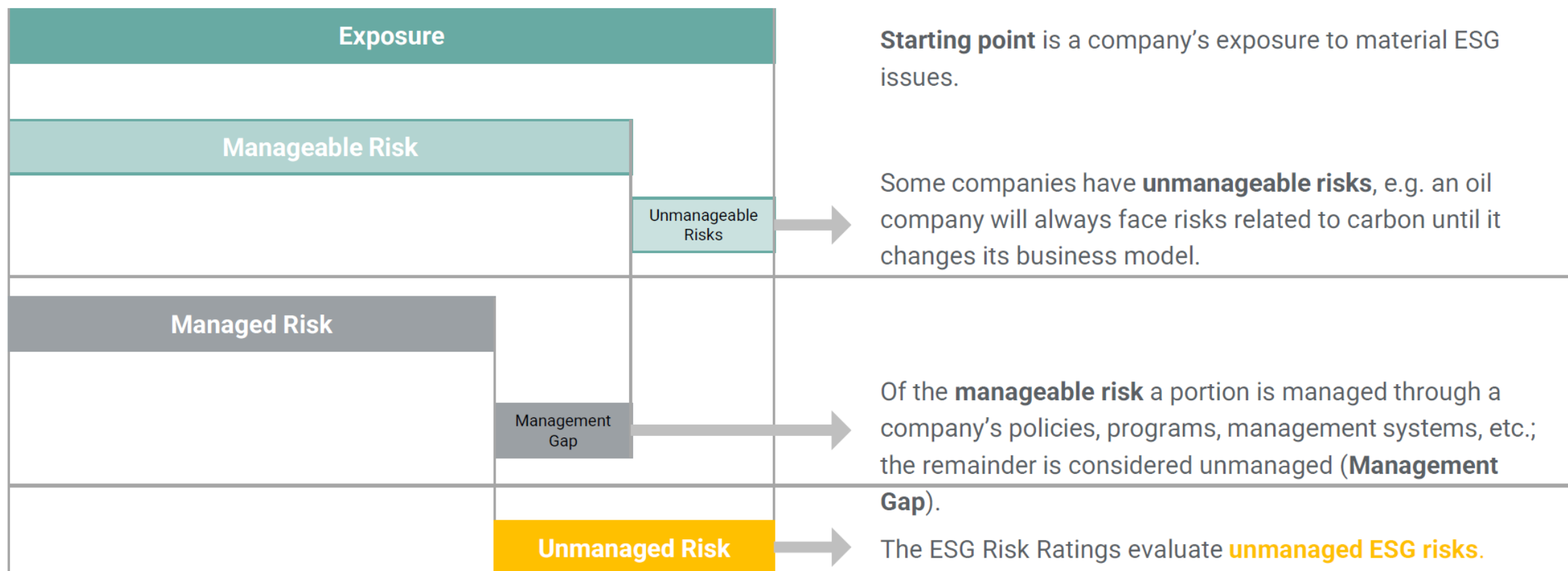
Idiosyncratic ESG issues

- » Triggered by most significant controversies (category 4 and 5 events)
- » Are very rare, reflecting “black swan” events, defined as highly significant, but inherently unpredictable



How Do the ESG Risk Ratings Work?

Management gaps and unmanageable risks are added up across all material ESG issues





ESG Risk Smart Score

Successful Integration of ESG Risks Requires Broad Coverage

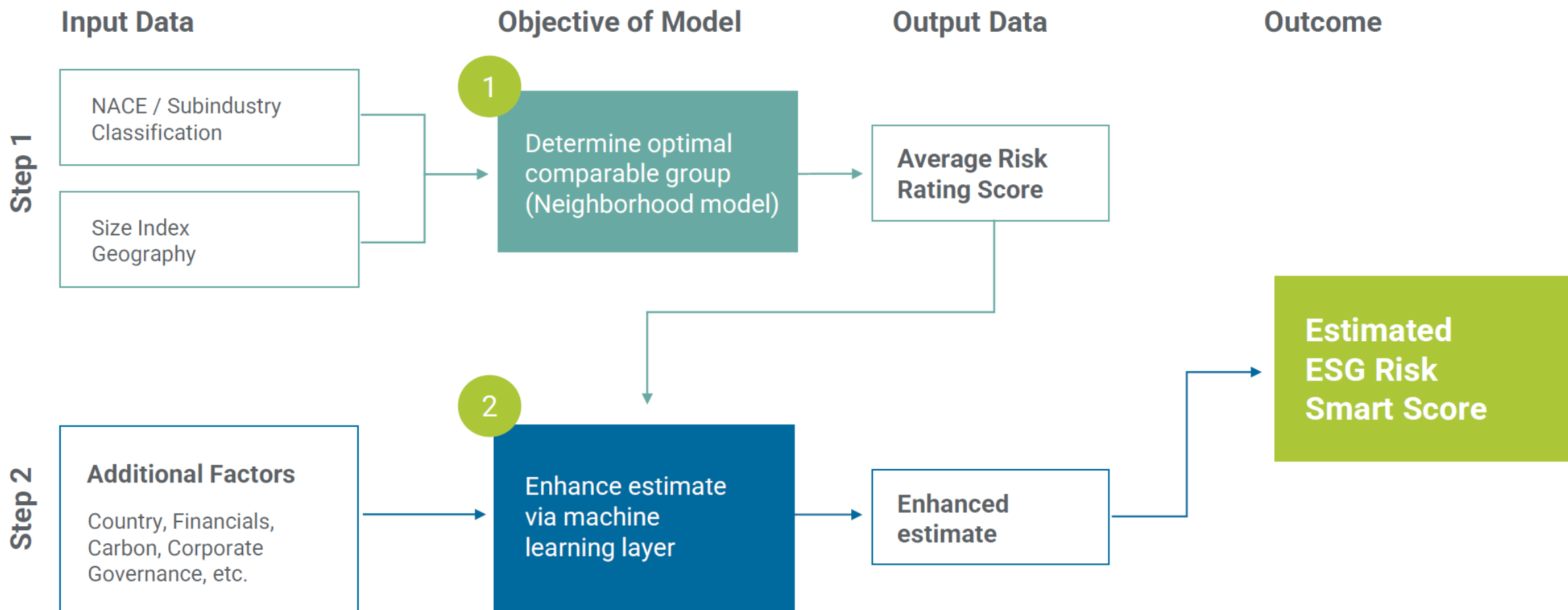
SOLUTION

ESG RISK SMART SCORE

- Provides an estimated score of a company's top level ESG risk for over **34,000 companies**
- Leverages an in-house, quantitative **AI-driven framework**, with an average risk category accuracy > 80%
- Extends ESG risk signals **regardless of the company size or jurisdiction**

How is the ESG Risk Smart Score Calculated?

The ESG Risk Smart Score has an average risk category accuracy of above 80%



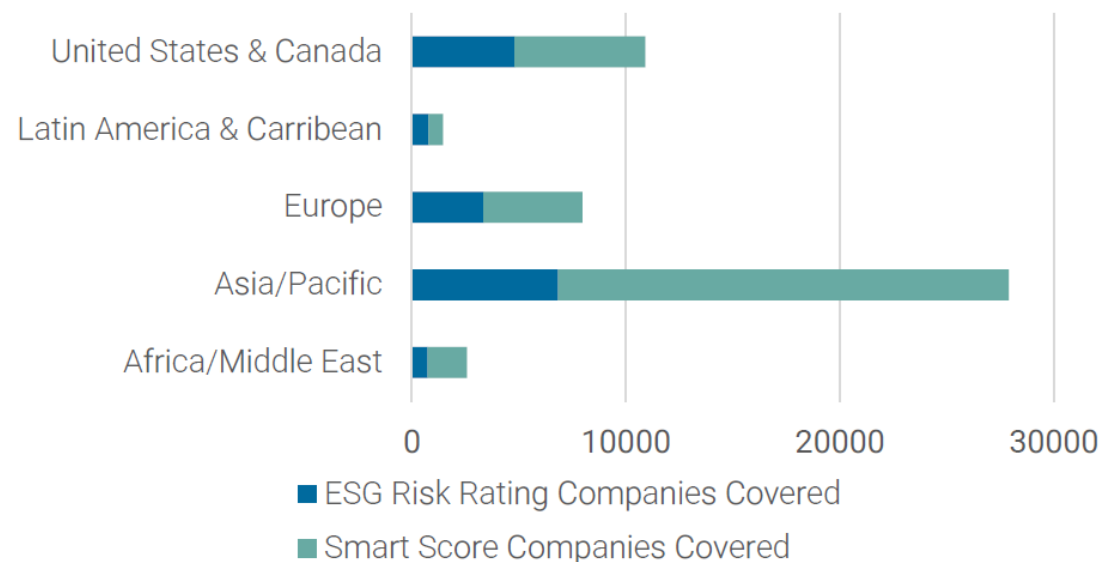
[as of May 30, 2023]

ESG Risk Smart Score Extends Risk Flags across Market Cap and Geography

Market Cap Coverage of the ESG Risk Rating & ESG Risk Smart Score



Geographic Coverage of the ESG Risk Rating & ESG Risk Smart Score

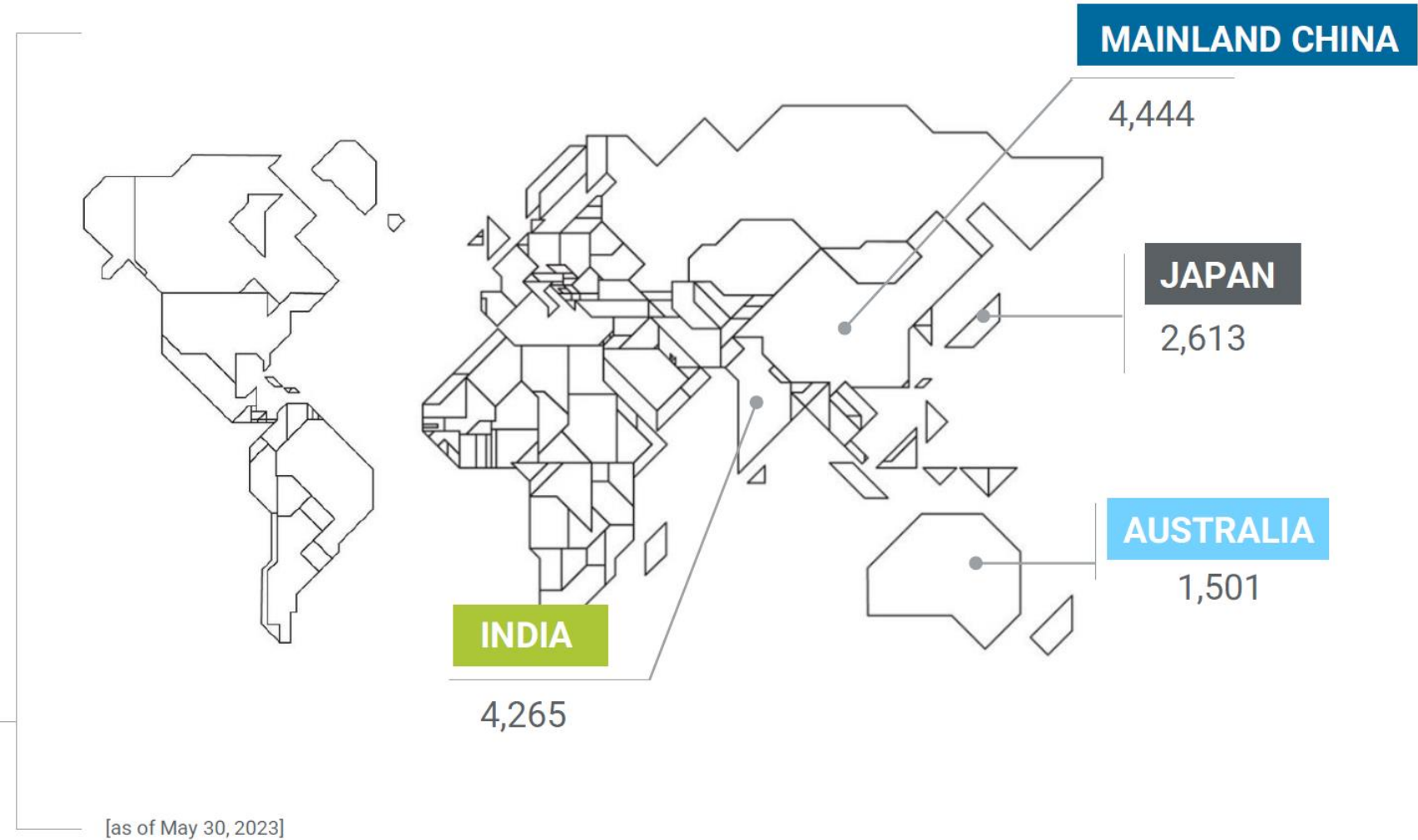


[as of May 30, 2023]

ESG Risk Smart Score Coverage of APAC Domiciled Companies

> **20**^K

Entities covered in the APAC region



Low Carbon Transition Ratings | Introduction

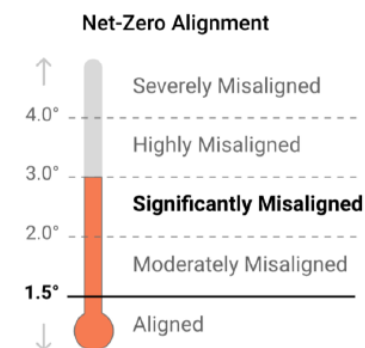
What is it?

Morningstar Sustainalytics' new flagship ratings product provides investors with a science-based forward-looking assessment of public issuers' alignment to a net zero pathway by 2050.

Low Carbon Transition Rating

2.4°C

Significantly Misaligned



What does the product do?

The Ratings measure the under/overshoot of each issuer's **projected (forward-looking) emissions relative to a Net-Zero emissions budget** – Referred to as their alignment to a Net-Zero pathway.

The alignment is communicated by both the amount of misaligned emissions, as well as the **Implied Temperature Rise** if the global economy had the same trajectory.

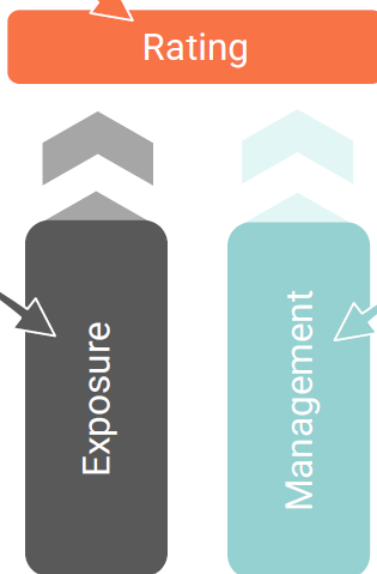
Low Carbon Transition Ratings | How are they built?

Using the same risk framework as Morningstar Sustainalytics' ESG Risk Ratings

Rating – Evaluates the Implied Temperature Rise based on expected overall under/overshoot of emissions after combining both Exposure and Management.

Exposure – Estimates the alignment before taking mitigation & management into consideration

How? By projecting under/overshoot of the issuers' emissions based on the historical emissions trend of the issuer

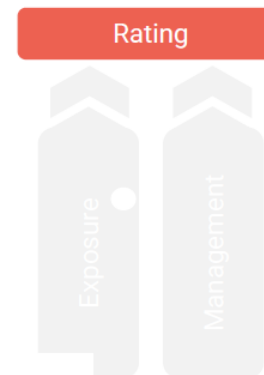
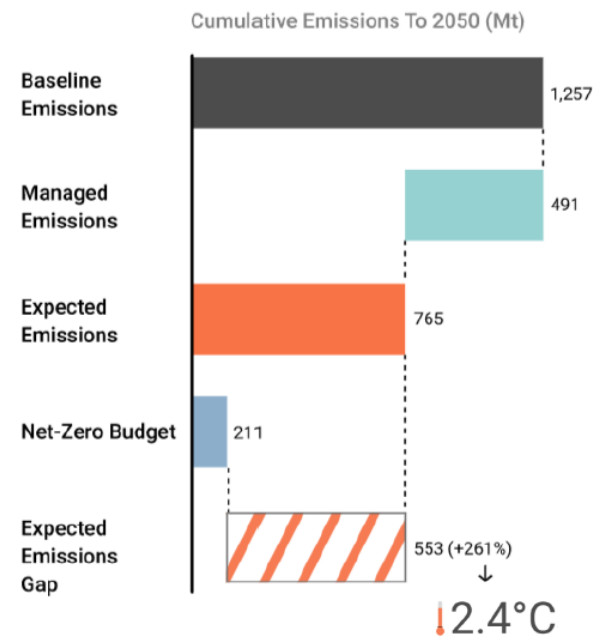
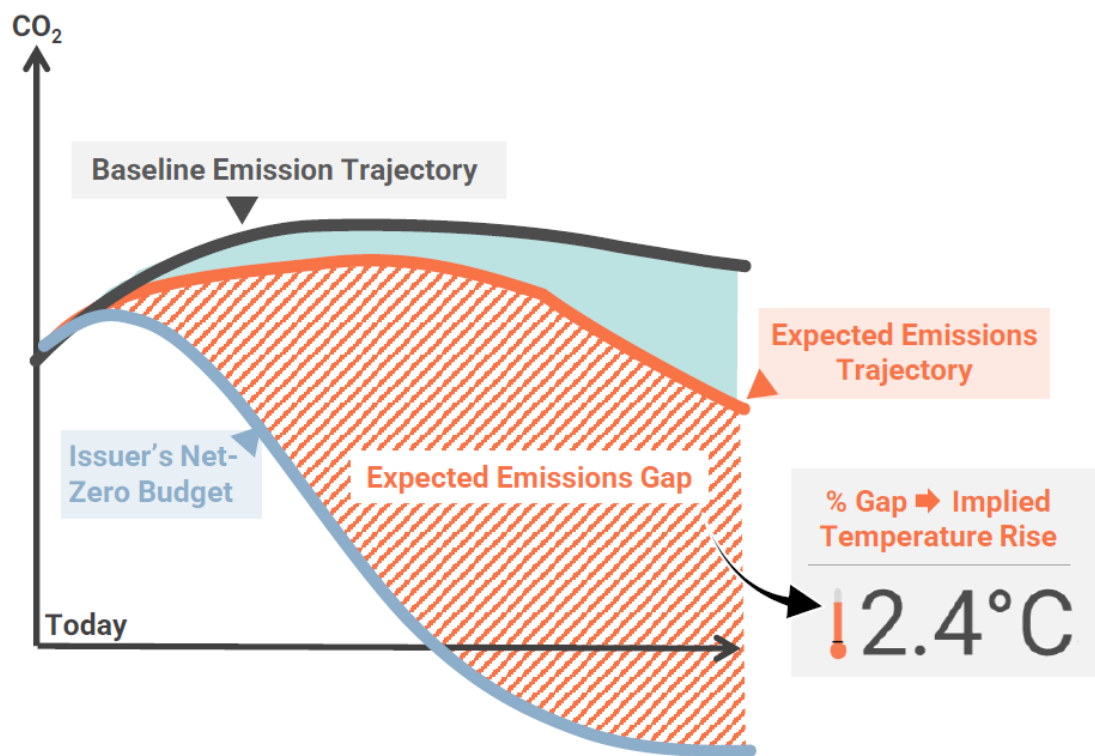


Management – Assesses how much of the company's Exposure will be managed

How? Through its current investment plans, and our confidence in the company's transition preparedness.

Low Carbon Transition Ratings | How is the overall rating expressed?

The Rating is the revised/residual cumulative emission overshoot/undershoot from now until 2050. It's expressed in terms of the Implied Temperature Rise (ITR): What would global temperatures rise to if the whole economy had the same % of misaligned emissions out to the year 2050.



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Asia-Pacific,
CFA Institute

POLLING 4

On a scale of 1 to 5, how do you rate your level of understanding towards applying ESG rating to your investment strategy?

▪ 5 (Very much)	7%
▪ 4	36%
▪ 3	43%
▪ 2	12%
▪ 1 (Very low)	2%

thank you