

# Construction Rules for the Morningstar® Global Corporate Bond Sustainability Indexes

**Morningstar Indexes**  
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**Overview**

Morningstar Corporate Bond Sustainability indexes achieve a high Morningstar Sustainability Rating by providing exposure to corporate bond securities of companies that have low environmental, social and governance (ESG) risk ratings in comparison to the securities of its parent index. To assess company ESG risk, Morningstar uses the Security ESG Risk Rating scores from Sustainalytics.

For more information on the Sustainalytics ESG Risk Rating, controversy scores, and Morningstar Portfolio Sustainability Score and Rating, please refer to the [Morningstar Sustainability Rating Methodology](#).

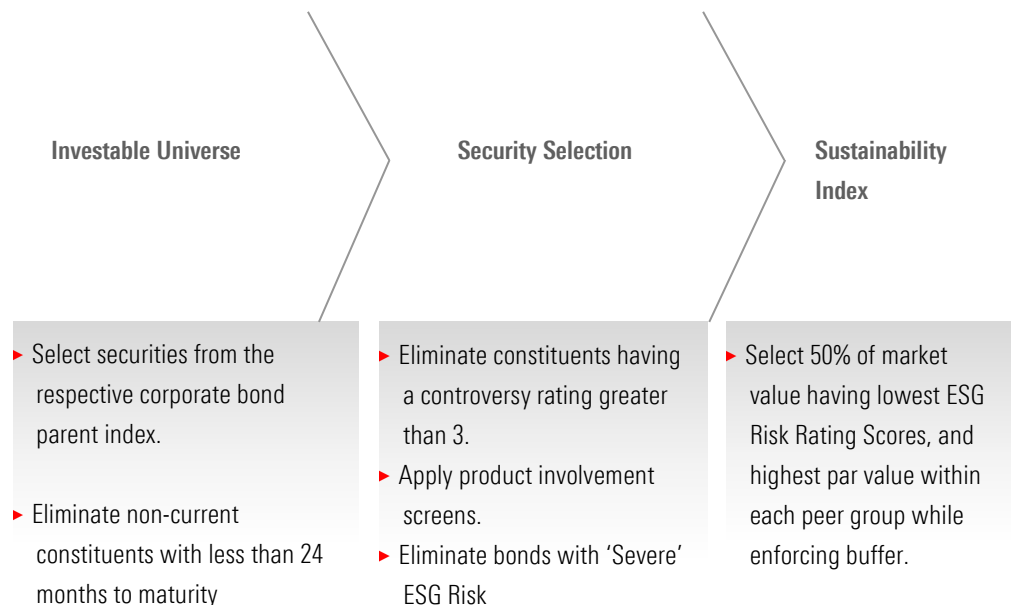
**Index Inception Date and Performance Inception Date**

The inception date of all indexes and the performance inception date, when the first back-tested index value was calculated are mentioned in Appendix 1.

**Corporate Bond Sustainability Index Construction Methodology**

Morningstar Global Corporate Bond Sustainability Indexes share a common construction methodology, differing only with respect to those rules that are specific to a region or currency.

**Exhibit 1** Morningstar® Corporate Bond Sustainability Indexes<sup>SM</sup> Construction Process



## Morningstar Global Corporate Bond Sustainability Indexes

- ▶ U.S.
- ▶ Canada
- ▶ U.K.
- ▶ European Union
- ▶ Japan
- ▶ Australia

## Assigning Securities to an Index

### Selection Universe

At each reconstitution, securities for each Morningstar Corporate Bond Sustainability Index are derived from its respective corporate bond parent index. The specific rules pertaining to the Morningstar Corporate Bond Indexes can be found in the methodology book noting "[Construction Rules for the Morningstar Bond Indexes](#)".

### Security Selection

- ▶ A constituent security must be a member of its corporate bond parent index.
- ▶ Securities entering the indexes must have a minimum of 24 months to final maturity at the time of inclusion to qualify for the index.
- ▶ Security must have current ESG Risk Rating and controversy scores.
- ▶ Security controversy score must be 3 (out of 5) or lower.
- ▶ Security must not belong to the 'Severe' ESG Risk Rating Category (e.g., risk rating  $\geq 40$ ).
- ▶ The bond issuer must
  - ▶ not have more than 50% tobacco products involvement by revenue
  - ▶ no involvement in "controversial weapons"
  - ▶ not have any involvement in the manufacturing and sale of firearms to civilian customers
  - ▶ not have any involvement in the manufacturing and sale of key components of small arms

### Portfolio Selection

Constituents are chosen from the universe of eligible securities in the following steps.

All securities in the parent corporate bond index are divided into twenty-seven (27) mutually exclusive cells (peer groups) based on common bond index characteristics:

- ▶ Sector: Industrial, Financial and Utility
- ▶ Tenor: Short 1-5 yrs, Intermediate 5-10 yrs and Long 10+ yrs.
- ▶ Credit Quality: AAA/AA, A and BBB

The peer groups are initially created without regard to the sustainability criteria described above. The security selection criteria will target 50% of the market value of each peer group before the exclusions are applied.

- ▶ Securities from the eligible universe are ordered within each peer group in the following sequence:
  - ▶ Ascending order of ESG risk scores
  - ▶ Descending order of par value outstanding
  
- ▶ Securities are selected in this order until the cumulative market value of each peer group approaches 45% of the market value of the parent index. The last security added should not breach 45%.
- ▶ To meet the target cumulative market value of each peer group, current constituents which lie between the top 45% and 55% of their respective peer groups will be selected in the order described above.
- ▶ If the cumulative market value of selected constituents in the peer group after selecting all current index constituents is less than 50% of the market value of the corresponding constituents of peer group in the parent index, we will start picking securities from the rest of the eligible securities in the order described above, till the target capitalization of that particular peer group is achieved.

### **Number of Constituents**

The number of constituents in the indexes is subject to the selection and eligibility criteria at the time of rebalance.

### **Index Weighting**

The indexes are market-capitalization-weighted unless stated otherwise.

## **Index Maintenance Rules**

### **Scheduled Maintenance**

The indexes are rebalanced monthly and are implemented after the last calendar day of each month, based on information available up to and including the "rebalancing lock-out date". The "rebalancing lock-out date" is the fifteenth calendar day of each month. The term "information available" includes information received and/or processed after the rebalancing lock-out date, but which was announced or publicly available prior to the rebalancing lock-out date.

Except as otherwise noted, no changes will be made to the index constituents after the rebalancing lock-out date unless Morningstar considers a change to be necessary to be consistent with changing market conditions. Changes that occur after the rebalancing lock-out date will be deferred until the following month-end rebalancing. This includes new issues, rating changes, balance changes and noncritical

corporate actions. New index-eligible bonds that have not yet been priced will be added to the index at the rebalancing which occurs immediately after pricing becomes available.

At each monthly rebalancing, all index selection rules are reapplied. The twenty-seven peer groups are recalculated based on all available information pertaining to eligible securities taking into account the changes in the underlying parent index. Changes to the portfolio reflect re-openings, buybacks, new issuance, exchanges, exercised options, or rating changes. The weightings are fixed, after the close, on the last calendar day of each month. Securities that have been deleted from a parent index will not be eligible for inclusion in a Corporate Bond Sustainability Index.

Sustainalytics risk scores and other sustainability data are refreshed monthly, coincident with the monthly rebalancing. This includes controversy scores and product involvement data.

A preliminary rebalancing report, or pro forma, indicating expected changes to the composition of the index will be available for review from the third business day before the last business day of each month (T-3), until the day before the last business day of the month. "T" refers to the last business day of the month. The pro forma reports and portfolios may differ from the actual rebalanced index. The portfolio as of the first business day of each month reflects all changes and is frozen for the month.

#### **File Delivery Schedule**

Index and constituent files are delivered daily on weekdays. However, if the month-end falls on a Saturday or a Sunday, then daily index and constituent files will be delivered on Saturday but not Sunday. All prices are carried forward (rolled) from the last business day and accrued interest is calculated for the new settlement date. One or two days of interest will be accrued depending on whether Saturday or Sunday is the last day of the month. The rebalanced portfolio for the forward month will also be delivered on Saturday if the last calendar day of the month falls on a weekend.

#### **Holiday Rules**

Weekdays on which WM Reuters does not publish closing foreign exchange rates are treated as "global holidays". Indexes are not published on Global Holidays unless they fall on the last calendar day of the month. In that case, prices are updated in all local markets that are open. In markets that are closed, prices will be carried forward (rolled) from the prior business day and accrued interest will be calculated for the new settlement date.

Index files will not be delivered on New Year's Day, Christmas Day, or Good Friday.

#### **Tenor**

For the application of the index inclusion and tenor rules, the term of a security is measured from the effective date of the rebalanced portfolio to maturity. The tenor is set on the lock-out date of the rebalanced portfolio.

**Corporate Actions**

Securities that are announced as fully called are removed from the indexes at the rebalancing following the effective date of the call. Partial calls, tenders and exchanges occur in the month-end rebalancing following the announcement provided that the announcement is made on or before the rebalancing lock-out date. Otherwise, the corporate action is deferred until the following month-end rebalancing.

**Defaulted Securities**

Corporate issues in legal default will be removed at the next rebalancing following the default event, provided this occurs on or before the rebalancing lock-out date. An issuer filing bankruptcy papers, or the local market equivalent, is in default. Defaulted securities that are restructured will be reinstated or included in an index as a new security when issued.

**Illiquid Securities**

Illiquid bonds are excluded or eliminated from the index. A bond is deemed illiquid when consistent pricing is unavailable or becomes unavailable. Bonds with limited liquidity may be removed at the discretion of the index committee. If a bond that is removed due to lack of pricing that bond will not qualify for any index thereafter, even if adequate pricing subsequently becomes available.

**Composite Rating**

Index constituent composite ratings are updated once a month as part of the rebalancing process. Composite rating changes take effect on the last calendar day of the month based on information available up to and including the rebalancing lock-out date.

**Methodology Review and Index Cessation Policy**

The index methodology is continually reviewed to ensure it achieves all stated objectives. These reviews consider corporate action treatment, security selection, and maintenance procedures. Subscribers to the index will be notified before any methodology changes are made. For more details, refer to the [Morningstar Index Methodology Change Process](#).

Morningstar also notifies all subscribers and stakeholders of the index that circumstances might arise that require a material change to the index, or a possible cessation of the index. Circumstances that could lead to an index cessation include, but are not limited to, market structure change, product definition change, inadequate supply of data, insufficient revenue associated with the index, insufficient number of clients using the index, and/or other external factors beyond the control of the Morningstar Index Committee.

Because the cessation of the index or benchmark index could disrupt subscriber products that reference this index, all subscribers are encouraged to have robust fallback procedures if an index is terminated. For more details, refer to the [Morningstar Index Cessation Process](#).

## **Data Correction and Precision**

### **Index Data Corrections**

Incorrect pricing and corporate action data for individual issues in the database will be corrected upon detection. Commercially reasonable efforts are made to correct an older error subject to its significance and feasibility. For more details, refer to the [Recalculation Guidelines](#).

### **Index Errors**

When errors are noted on the current index level, the calculation agent will make a best effort to address and correct the levels within one index calculation day of its publication. When historical errors are detected, the necessary change will be classified as immaterial or material according to criteria established by Morningstar.

### **Computational and Reporting Precision**

All calculated and adjusted data are stored as real numbers. For reporting purposes, index values are rounded to two decimal places.

### **Market Events**

In the case of a significant market event (default, delayed payment, debt restructuring), any affected securities will not be removed until the next rebalancing date. Market prices and the index team's best estimate of how to treat the securities in question will be used to compute index returns.

Since all bond indexes are calculated using month-to-date returns, errors in return calculations that occur only intramonth are self-correcting over time; that is, the impact on compounded total, excess, and price return levels are isolated to the affected dates and do not affect current index levels or index levels going forward. In this case, in which the error in returns calculations is limited in scope to intramonth dates, the change will generally be considered immaterial.

## **Calculation Agent**

Morningstar partners with a third-party calculation agent to calculate the Morningstar Bond Indexes. The calculation agent calculates the actual change in all measured characteristics of the respective indexes daily including the individual bonds that make up the indexes.

The calculation agent for Morningstar Indexes is ICE Data Indices, LLC or its affiliates ("ICE Data"). Information pertaining to the sections labeled General Methodology for Morningstar Indexes, Index Maintenance Rules and Index Calculation Methodology can be found in the ICE Data Services Bond Index Methodologies document. The latest version of this document may be found on the ICE Index Platform, under Publications/General Methodology located here:

<https://indices.theice.com/publications/showPublications#>.

Additional information pertaining to the definition of data fields, taxonomy or analytical computations used in the Morningstar Bond Indexes may also be found in that document.

ICE Data and its third party suppliers make no express or implied warranties, and hereby expressly disclaims all warranties of merchantability or fitness for a particular purpose with respect to the index, index values or any data included therein as well as with respect to the calculation and dissemination of such index. In no event shall ICE Data and its third-party suppliers have any liability for any special, punitive, direct, indirect, or consequential damages (including lost profits), even if notified of the possibility of such damages.

## Appendixes

### Appendix 1: Index Inception Date and Performance Inception Date

Index Name	Performance Inception Date	Inception Date
Morningstar US Corporate Bond Sustainability Index	12/31/2015	01/07/2020

#### About Morningstar, Inc.

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. Morningstar offers an extensive line of products and services for individual investors, financial advisors, asset managers, and retirement plan providers and sponsors. Morningstar provides data on approximately 510,000 investment offerings, including stocks, mutual funds, and similar vehicles, along with real-time global market data on more than 17 million equities, indexes, futures, options, commodities, and precious metals, in addition to foreign exchange and Treasury markets. Morningstar also offers investment management services through its investment advisory subsidiaries.

#### About Morningstar Indexes

Morningstar® Indexes combine the science and art of indexing to give investors a clearer view into the world's financial markets. Our indexes are based on transparent, rules-based methodologies that are thoroughly back-tested and supported by original research. Covering all major asset classes, our indexes originate from the Morningstar Investment Research Ecosystem—our network of accomplished analysts and researchers working to interpret and improve the investment landscape. Clients such as exchange-traded fund providers and other asset management firms work with our team of experts to create distinct, investor-focused products based on our indexes. Morningstar Indexes also serve as a precise benchmarking resource.

#### Morningstar Index Committee

The [Morningstar Index Committee](#) is currently comprised of senior officials who possess the appropriate levels of knowledge in relation to Indexes. A wide array of business groups are represented to allow for a

broad voice to be heard and for a wider view to be expressed in evaluating all subjects brought up during Committee meetings. The Committee seeks to create indexes of the highest quality that meet the recognized qualities of a good benchmark.

**For More Information**

For any queries, reach out to us via our [communication page](#).



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