Morningstar® Sustainability Leaders Index Family℠

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For more information about all of Morningstar's indexes, please visit: http://indexes.morningstar.com

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Sustainalytics
A global leader in environmental, social, and governance ratings and research, Sustainalytics was acquired by Morningstar in 2020. Sustainalytics offers data on 40,000 companies worldwide and ratings on 20,000 companies. Since 2016, Sustainalytics and Morningstar have collaborated to supply investors around the world with new analytics, including the Morningstar Sustainability Rating for funds. Aggregating company-level ESG Risk Ratings assigned by Sustainalytics, the fund rating focuses on how effectively companies in a portfolio are managing their material ESG-related issues. Meanwhile, the Morningstar Low Carbon designation for funds leverages the Sustainalytics' Carbon Risk Rating, gauging the degree to which the companies in a portfolio are aligned with a low-carbon economy.

The concept of stakeholder capitalism is becoming mainstream. Expectations are rising that businesses should not only focus on profits, but also manage their impact on the environment, on society, and on their workforce. This is partly about sustainability—meeting current needs without compromising the livelihoods of future generations.

But environmental, social, and governance factors are increasingly recognized as material to financial results. Environmental stewardship is not just good for the planet, it can also help a company control costs, avoid damaging incidents, and position itself for tomorrow's economy. Treating workers well benefits society, but it also helps attract and retain talent—critical in the knowledge economy. Good governance leads to better corporate decision-making. Companies that carefully consider ESG are strategic in nature, focused less on beating next quarter's earnings and more on creating an enduring franchise.

The Morningstar Global Sustainability Leaders Index Family includes a select number of publicly traded equities across the globe, highlighting companies that set the standard on ESG issues and effectively manage their ESG-related risks.

Measuring ESG Risk

To highlight how well a company proactively measures the ESG issues that are most likely to affect financial results, Sustainalytics (see sidebar) developed the ESG Risk Rating. The ESG Risk Rating considers both subindustry-level and company-specific risk. It captures the fact that certain subindustries face more ESG risks than others and that those risks vary. For example, oil and gas companies are highly exposed to carbon emissions-related risks, while software companies are threatened by data privacy and security breaches. Oil and gas companies are inherently riskier. But a company's circumstances and risk-management efforts matter. Two oil companies can carry different risk ratings depending on several variables, including their ESG risk management.

Index Eligibility

The Morningstar Sustainability Leaders Indexes derive their constituents from the large-capitalization segment of their equivalent Morningstar region/country equity index (parent). The parent indexes represent the top 70% of equity market capitalization in the targeted market or grouping. Because of the indexes' sustainability focus, constituent businesses are excluded if they:

- derive any revenue from tobacco products
- have any involvement in nuclear production
- have any involvement in the production of controversial weapons (land mines, for example)
- have any involvement in the manufacture and sale of firearms to civilian customers
- have any involvement in the manufacture and sale of key components of small arms
- derive more than 50% of revenue from gambling operations and supporting services
- derive more than 50% of revenue from alcohol
- derive more than 50% of revenue from adult entertainment
- are not compliant with the United Nations Global Compact
- have average three-month daily traded value less than $1 million

Morningstar Sustainability Leaders Index Family
Membership and Constituent Counts

Broad Regional Markets		Developed Markets		Emerging Markets		Single Country	
Global Markets	100	Developed Markets	75	Emerging Markets	50	United States	50
Global Markets ex-US	75	Developed Markets ex-US	50			Japan	25
Asia ex-Japan	50	Developed Europe	50				
		Nordics	50				

Because securities are selected based on their ESG Risk Rating, companies must be under analytical coverage by Sustainalytics to be eligible and are excluded if they are assigned:

- an ESG Risk Rating of Severe (highest risk level)
- a Carbon Risk Rating of Severe
- a Controversy Score of 4 or 5 on 5-point scale (Controversy research focuses on incidents with negative stakeholder impact.)

Index Selection

Securities with the lowest ESG Risk Ratings are selected until a given number of constituents is reached, subject to constraints (See Index Weighting section).

Index Weighting

Index constituents are weighted according to their float-adjusted market capitalization. Individual constituent weight is limited to 10% at the time of reconstitution, while weight in constituents consuming more than 5% of index weight cannot collectively exceed 40% of the portfolio. The indexes maintain only loose constraints on their deviation from their parent indexes. Weights in regions and economic sectors may stray up to 15 percentage points from those of the parent index.

Rebalancing and Reconstitution

The indexes are reconstituted (membership reset) semiannually, in December and June. They are rebalanced quarterly, in March, June, September, and December. At rebalancing time, companies with a recent material controversy are removed from the portfolio.

Morningstar Sustainability Leaders Index Family Construction Process

Investable Universe	ESG Screens	Controversy Screen	Selection & Weighting	Morningstar Sustainability Leaders Index Family
▸ Global Large Cap Universe ▸ Companies must have ESG Risk Rating and Carbon Risk Rating	Screened Out: ▸ Tobacco ▸ Nuclear ▸ Controversial weapons ▸ Civilian firearms ▸ Gambling, alcohol, tobacco > 50%	▸ Eliminate all securities with Controversy Score of 4 or 5, Severe ESG Risk and Severe Carbon Risk	▸ Select on lowest ESG Risk Rating until fixed number reached ▸ Apply 5-10-40 Constraint ▸ Apply Regional/ Sector Constraint	▸ Reconstituted semi-annually ▸ Rebalanced quarterly