



# Morningstar Sustainability Indexes

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Sustainable investing, which Morningstar defines as an approach that considers environmental, social, and governance factors and their impact, is gaining traction across the globe. Growing numbers of investors are sensitive to issues such as climate change, diversity, and business ethics—not just in their personal lives but also in their portfolios. While sustainable investing is partially about aligning capital with values or organizational mission, the field has broadened. Environment, social, and governance (ESG) issues are increasingly recognized as material financial risks.

The Morningstar Sustainability Indexes are designed to provide diversified, broad market exposure with significantly lower ESG risk. The index methodology selects stocks representing the top 50% of the parent universe by market cap of securities with the lowest ESG Risk Ratings while limiting sector and regional tilts relative to the broad market.

- Significantly lower ESG Risk: Best-in-class stock selection reduces exposure to companies with high ESG risk relative to their sector peers.
- Market-like exposure and performance: Performance and risk characteristics closely match the parent broad market index, making them suitable core benchmark replacements.
- A consistent approach to ESG across asset classes: Powered by Sustainalytics ESG data, flagship equity and fixed income indexes can be seamlessly combined to develop a holistic multi-asset ESG strategy.

## Measuring ESG risk

Sustainalytics ESG Risk Ratings measure the degree to which a company's economic value is at risk driven by the magnitude of its unmanaged ESG risks. The ESG Risk ratings are composed of three building blocks that contribute to a company's overall rating. These building blocks include Corporate Governance, material ESG issues (MEIs), and idiosyncratic ESG issues. To be considered relevant in the ESG Risk Ratings, an issue must have a

potentially substantial impact on the economic value of a company and, hence, its financial risk- and return profile from an investment perspective. The ESG Risk Rating is forward looking in the sense that it identifies these issues based on the typical business model and business environment a company is operating in. The final ESG Risk Ratings score is calculated as the sum of the individual material ESG issues' unmanaged risk scores

## Sustainalytics

A global leader in environmental, social, and governance ratings and research, Sustainalytics was acquired by Morningstar in 2020. 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.

## Index eligibility

The Morningstar Sustainability Indexes derive constituents from their equivalent Morningstar global/regional/country large-mid index (parent). Because of the indexes' sustainability focus, a company is ineligible for the index if it:

- derives more than 50% of revenue from tobacco products;
- is involved in activities related to controversial weapons (land mines, for example);
- is involved in activities related to small arms

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); or
- a Controversy Score of 4 or 5 on a 5-point scale. (Controversy research focuses on incidents with negative stakeholder impact.)

### Index selection

Securities with the lowest ESG Risk Ratings are selected until 50% coverage of the parent index's market capitalization is reached, subject to constraints illustrated below. The constituent count for each index is variable.

### Index weighting

Index constituents are weighted according to float-adjusted market capitalization. To preserve market-like exposure, Individual constituent weight is limited to 10% at the each reconstitution, and the weight of constituents representing more than 5% of the index cannot collectively

exceed 40% of the portfolio. Regional and economic sector weights may not exceed parent index representation by more than 2 percentage point.

### Rebalancing

The indexes are reconstituted semiannually in June and December and rebalanced quarterly in March, June, September, and December. At each quarterly rebalance, companies with a recent material controversy are removed from the index.

## Construction process



## About Morningstar Indexes

Morningstar Indexes was built to keep up with the evolving needs of investors—and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers and advisors in navigating investment opportunities across major asset classes, styles and strategies. From traditional benchmarks and unique IP-driven indexes, to index design, calculation and distribution services, our solutions span an investment landscape as diverse as investors themselves.

Please visit [indexes.morningstar.com](https://indexes.morningstar.com) for more information.