



Lonsec Sustainability Report and Sustainability Score

Process Methodology

About the Sustainability Report and Score

Lonsec has identified an increased demand by clients and investors to understand the extent to which their portfolios are contributing to, or detracting from the key environmental and social challenges facing society and the environment. Lonsec's Sustainability Report and Score have been designed to help investors to assess portfolios in this way.

The Lonsec Sustainability Score assesses funds against the [UN's Sustainable Development Goal](#) (SDG) framework. The SDGs are 17 individual goals which are a "universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity" (UN, 2016).

Traditionally, ESG measures, scores and analysis focus on how ESG risks might impact the economic value of a company or stock. Whilst Lonsec believes that this type of ESG analysis is an important element in the overall investment process, it generally fails to capture the broader ramifications of portfolios and companies on addressing the sustainability related risks facing our society and the environment. Lonsec's Sustainability Report and Score aim to address the opportunities and risks not captured in traditional environmental social and governance (ESG) assessments.

The Sustainability Report and Score, updated quarterly and available on the Lonsec iRate adviser research platform, is not an investment rating and readers should use this report in conjunction with a Product Review Report.

The Reports are available for those funds which have an investment rating from Lonsec Research. Initially, the Reports and Score will be available for funds in the Australian equities asset class and will be progressively rolled out to other asset classes. Lonsec has several pre-requisites for the research process to commence. These are detailed in our [Research Process Document](#).



The Lonsec Sustainability Score

Lonsec's Sustainability Score ("Score") is a quantitative estimate of the net 'goodness' in a portfolio. The Score nets the positive contributions to the 17 SDGs against the negative impact of exposures to controversial industries from the activities of the companies held in a fund's portfolio. The 10 controversial industries are: fossil fuels, gambling, alcohol, tobacco, deforestation, defence, nuclear, opioids, genetically modified organisms (GMO) and adult industries.

The Score is a peer relative assessment of a fund at a point in time. It is not an ESG negative screen, however for comparison, in the report we have included the most common industry exclusions as provided by the manager. These exclusions do not contribute to the calculation of the Score.

Lonsec recognises that today there is no global standard measure of sustainability or controversy. Given the technologies available today and the structure of our current world, there is a reliance on certain industries, such as mining and fossil fuels, and it is expected that most portfolios would have some exposure to them.

Measuring contribution to SDG and Controversial Industries

Lonsec has partnered with Perth-based data provider [Sustainable Platform](#) to obtain environmental and social information on over 17,000 global listed companies.

Sustainable Platform uses artificial intelligence and proprietary algorithms and fundamental sustainability methods to assist its research team to obtain and process data from publicly available documents, such as government departments, company reports and news sources.

Sustainable Platform applies its proprietary Sustainability Classification Standard (SCS[®]) to process the information. SCS[®] is a probabilistic classification taxonomy that categorises a company's contribution to sustainable development by what it makes, how it operates and how its products and services are utilised by the end user. SCS[®] looks through the standard industry classifications for companies, capturing its entire range of products and services. For example, the fossil fuel exposure of a company considers any emissions and emission offsets and provides a single, quantitative method to compare any other company (or portfolio) on carbon pollution, regardless of the reported industry that the company is in.

The SDGs provide a framework for government action and intergovernmental and supranational cooperation and are not a direct blueprint for corporate activity. Corporations do, however, provide the essential goods and services necessary for these goals to be implemented and it is through the provision of these various products that the mapping has been created.



How is the Sustainability Score determined?

01. Inputs

- Peer universes are determined from Lonsec Research's asset class/sector classifications for funds with an investment rating of highly recommended, recommended or investment grade for:
 - Australian equities
 - Global equities
 - Australian listed property and infrastructure
 - Global listed property and infrastructure
- Data inputs include fund security holdings and weights provided quarterly by each fund manager, and company SDG contributions and controversial industry exposures (percentage of sales) provided by Sustainable Platform.

02. Process

- Fund holdings are mapped to the Sustainable Platform company data using market identifiers (ISIN, SEDOL, or ticker).
- To ensure a valid peer comparison, data quality and coverage are assessed, and data is normalised:
 - Funds are excluded from the peer universe if in aggregate the investments held do not meet data quality and coverage hurdles;
 - Cash, cash equivalents, and foreign exchange are removed i.e. funds are unlevered; and
 - Security weights are normalised (reweighted to 100%).
- Controversial industry exposures for each investment held are scaled by a factor greater than 1, i.e. \$1 contribution to SDGs is not commensurate with a \$1 exposure to a controversial activity.
- For each fund, the Sustainable value (%) is calculated; the value is the weighted average contribution (%) to SDG less scaled CI exposure (%) of investments held. Peer universe sustainability values are approximately normally distributed.
- Sustainable value is calculated for the market benchmark, e.g. ASX200 for Australian equities.
- Peer fund values are ranked, highest to lowest. Higher values correspond to greater relative net 'goodness' in the fund.

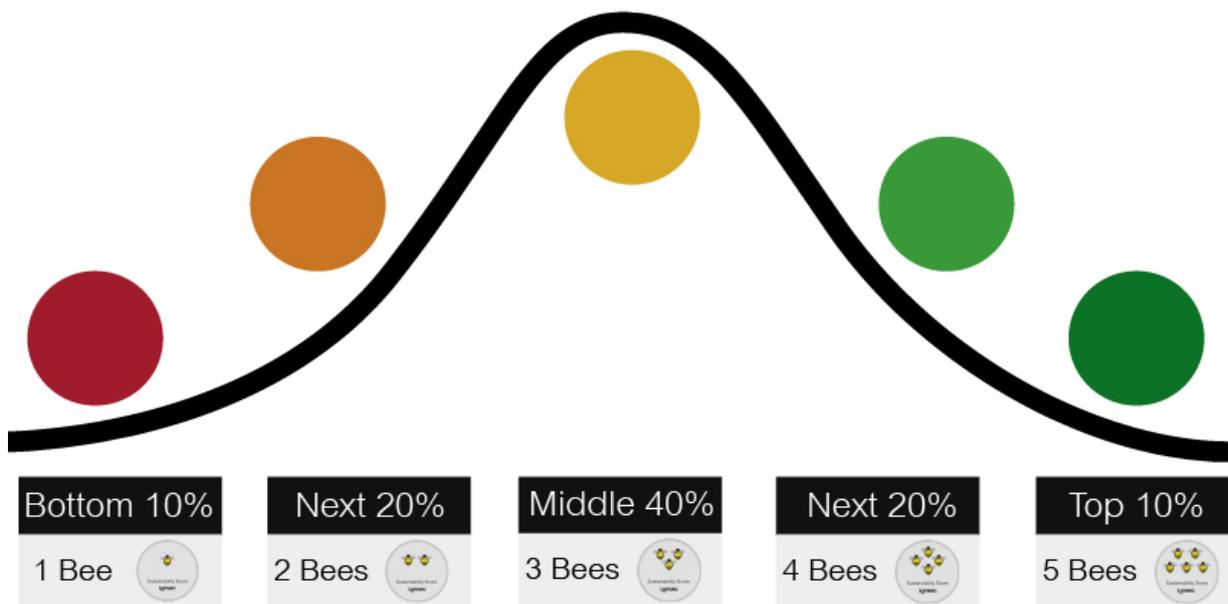
03. Output

Funds are first ranked by their Sustainability Value from highest to lowest. The funds are then sorted to formulate buckets of 10/20/40/20/10 to approximate a normal distribution.

For example, if there are 200 funds, the top 10% of funds, i.e. 20 funds, will receive the highest Sustainability Score of five.

A Sustainability Score of five bees is the highest a fund can achieve. This signifies that the fund's holdings are ranked within the top 10% of peer universe, on a net 'goodness' basis. The following table breaks down the Sustainability Score and the position of the fund relative to all Lonsec-rated funds.

Sustainability Score	Rank in peer universe
5 Bees	Top 10%
4 Bees	Top 10% to 30%
3 Bees	Middle 40%
2 Bees	Bottom 10% to 30%
1 Bee	Bottom 10%



Where a significant change occurs with the financial product which has a material impact on the assessment outcome, or where a product issuer decides to remove the product from the rating process, a report and score may be updated or removed, as detailed in the [Research Process Document](#).

Research Approach

Lonsec has extensive experience in assessing the implementation of ESG by investment managers. For over 10 years Lonsec has been reviewing managers with Ethical, ESG or Sustainable tilts to their portfolios. Further, in 2017 Lonsec launched its ESG BIometric to improve disclosure and information to clients. A revised ESG assessment process was launched in early 2020 to reflect the changing ESG landscape and variety of approaches being used by managers.

With the mainstreaming of ESG and increased demand for sustainability reporting on portfolio's Lonsec has employed Tony Adams as head of Sustainable Investment Research. With over 30 years of hands-on investment experience in Australian fixed interest markets and over 10 years incorporating ESG assessment into portfolio's Tony brings a new focus for ESG within Lonsec. Having completed his Diploma in Sustainability to complement his B.Comm and MBA, Tony has refreshed Lonsec's overall ESG assessment framework with a focus on ensuring that investing clients are provided with clear useful reporting on their portfolios.

How does Lonsec Manage and Disclose Conflicts of Interest?

Lonsec is aware of the inherent potential conflicts of interest associated with the provision of ratings and how we are remunerated for our services. Lonsec has in place a comprehensive set of policies, procedures and information barriers (both permanent and temporary) consistent with our regulatory obligations under Regulatory Guide 79, to manage either perceived or actual conflicts of interest.

These policies and procedures are designed to manage and control our conflicts including commercial, contractual, and commissioning party relationships, fee structures, cross subsidisation and transparency in the ratings process. For more information on how Lonsec identifies, manages and discloses conflicts of interest see the [Research Process Document](#).

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Want to find out more?

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