

A GUIDE TO RESPONSIBLE INVESTMENT RATINGS AT COLUMBIA THREADNEEDLE INVESTMENTS

Our proprietary responsible investment (RI) ratings provide our global investment team with a robust responsible investment framework and enhanced analysis of over 5,500 companies around the world. As part of our fundamental research toolkit, the ratings help to identify and assess potentially material risks and opportunities, in addition to what may be captured by conventional analysis.

As an active manager, it's our duty to consider factors that can pose a risk to or enhance client assets. We believe that well governed and managed companies are better positioned to manage the risks and challenges inherent in business and to capture opportunities to create long-term, sustainable value.

Our responsible investment ratings reflect the combined outputs of two models that use proprietary mappings to analyse financial stewardship and Environmental, Social and Governance (ESG) factors in order to provide a single forward-looking investment signal. We believe analysis combining financial stewardship with an assessment of a company's leadership, culture and operational standards, focused on the specific issues that are material to that business, is key to both value creation and risk management.

How do the ratings work?

Our ratings give our analysts and fund managers an evidence-based and forward-looking numerical rating for a company, which provides insight into how sustainably it is managing its balance sheet and how effectively it is managing material ESG risks.

It does this by combining two models – one focused on **financial stewardship** (FS) and the other on performance on **ESG materiality** factors. The outputs of the models are combined to produce a **responsible investment rating** from 1 to 5.

The Financial Stewardship (FS) model: The FS model combines four separate academic models that measure prudent, long-term financial governance to identify well-managed businesses. These models represent a proxy for good corporate governance and importantly offer insight into whether corporate governance is working in practice. For example, it takes into account the level of R&D reinvestment, leverage, liquidity management and accounting standards.

The ESG Materiality model: Companies that manage ESG risks effectively are considered better positioned to address future challenges, avoid technical and social obsolescence, and capitalise on both unknown and known future business opportunities. As society, markets, and government regulations evolve, the companies that lead on the most financially material industry ESG metrics should be well positioned to mitigate risks, build competitive advantage and sustain their long-term future. To the same extent that quality companies command higher relative prices, so too will companies that perform well in terms of ESG risk management.

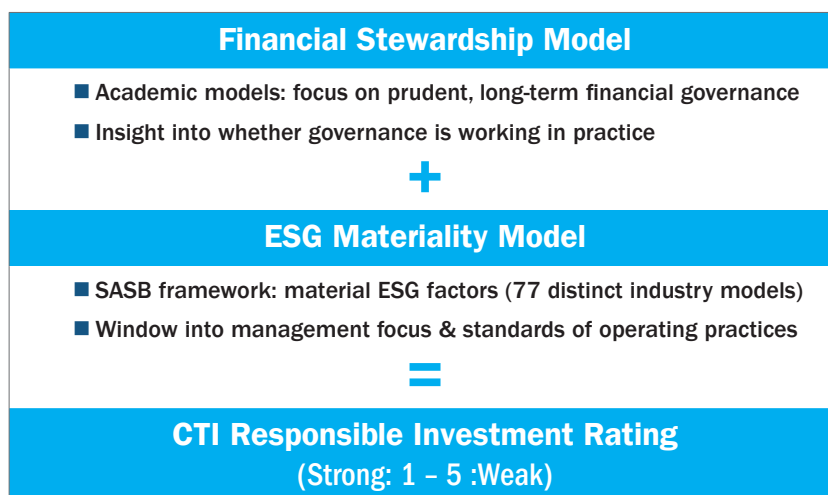
This model focuses on companies' performance in managing the ESG risks it faces. It does this by building on the Sustainability and Accounting Standards Board (SASB®) framework which identifies the most financially material ESG risk factors for 77 distinct industries and provides an insight into the management focus and operating practice standards of a company. For each company between two and 16 financially material ESG risk factors are identified for assessment.

The RI rating: The outputs of the Financial Stewardship model and the ESG Materiality model are generated by drawing on a large amount of published data for each constituent of our universe of 5,500 companies. Through the use of cloud-based analytics and data science, the outputs of the two models are combined to produce an overall responsible investment rating from 1 to 5.

Companies rated 1 are regarded as having the strongest prospects for delivering future outperformance, whilst companies rated 5 are regarded as displaying the weakest prospects.

In addition to the numeric rating, our responsible investment ratings tool helps our global investment team gain deeper insights into the specific issues facing each company, including questions to ask management in engagement, to enhance qualitative research and improve investment recommendations.

Responsible investment rating



Example

XYZ Co: a non-alcoholic beverage company based in the US.

RI rating: 4

ESG Materiality model: The ratings use the SASB® framework to identify the ESG risk factors which are most material to the financial performance of companies in the non-alcoholic beverage sector. For XYZ Co, these are:

- Energy efficiency (both manufacturing and logistics)
- Water use and management
- Health and nutrition
- Product labelling and marketing
- Packaging lifecycle management
- Environmental and social impacts of supply chains.

For each company in a given industry, the model draws on ESG data hosted in the cloud to generate an assessment of the risk management performance against each SASB® factor.

These assessment scores generate an overall score and the result calibrated with the rest of the universe to rank where the company would sit relative to other companies. This gives an output score of 1-5 (1 being best, 5 being worst).

For XYZ Co, the score is 4.

Financial Stewardship model: Using four financial models, XYZ Co is scored on various financial factors, such as accounting prudence, leverage, earnings stability and operating efficiency. As for the ESG Materiality model, this gives an output score of 1-5. For XYZ Co, the score is 5.

RI rating: The overall RI rating is produced by combining the outputs of the FS and ESG Materiality models. For XYZ Co, this rating is 4.

A rating of 4 allows the investor analysing the stock to quickly see that, based on an assessment of ESG and financial data that is independent of valuations, the company appears relatively poorly positioned to manage the ESG risks and challenges facing its business in the non-alcoholic drinks sector.

This analysis can be brought into the analyst's broader qualitative assessment of the company. The rating, along with information in an interface available to the analyst, could also be used to form the basis of future engagement, whether to gain improved insight into how the company is managing the risks it faces, or to seek improvement in risk management in practice.

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