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# INTRODUCING INSIGHT'S PRIME CLIMATE RISK RATINGS

MARCH 2023

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// Climate change is one of the most significant risks we face, with far-reaching implications across a wide range of industries. We developed our climate risk model to help us identify where climate risks matter most. //

ROB SAWBRIDGE, HEAD OF RESPONSIBLE INVESTMENT



# INTRODUCTION

Climate change is one of the greatest challenges of our time. Governments and businesses are grappling with the implications, and responsible investors seek to discern how climate change might affect investment risks and opportunities.

In 2017, Insight Investment introduced our climate risk ratings, which aim to be a comprehensive ranking of fixed income corporate credit issuers focusing on climate change-related risks. The ratings are aligned with the framework developed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), and we have enhanced our framework over time to incorporate more data and detail.

Today, the Prime climate risk ratings sit alongside Insight's Prime corporate and sovereign ESG ratings. Based on data from multiple inputs and adjusted using our in-house expertise, our Prime ESG ratings seek to more accurately and reliably reflect material risks, supporting Insight's focus on precision investment and risk management to help our clients achieve their goals.

In this brochure, we explain the Prime climate risk ratings, which aim to highlight the key climate risks companies face, including how corporate issuers are positioning themselves for a low carbon transition.



Powered by Insight Investment

## PRIME CLIMATE RISK RATINGS: KEY NUMBERS<sup>1</sup>

Universe of over  
**1,700**  
issuers

Material metrics selected  
from a database of over  
**200** data  
inputs

**15** key climate-related  
issues covered

<sup>1</sup> As of December 31, 2022. For more information on Insight's ESG ratings, please visit [www.insightprime.com](http://www.insightprime.com).

## HOW INSIGHT USES THE PRIME CLIMATE RISK RATINGS

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- The Prime climate risk ratings are integrated within Insight's investment process. They aim to help our analysts and portfolio managers consider material climate risks in their investment decisions and to identify potential issuers for engagement.
- Regular monitoring of ESG risks is a feature of our responsible investment process. We review changes on a quarterly basis to identify low or deteriorating performance and feed these results into investment team discussions.
- For clients seeking investment strategies that reflect their views on climate issues, Prime climate risk ratings enable dedicated solutions and portfolios with specific climate criteria.

## HOW THE PRIME CLIMATE RISK RATINGS HELP INVESTORS

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- The Prime climate risk model processes multiple data inputs, with our portfolio managers and analysts overlaying their expertise to ensure it reflects the climate risks that issuers face.
- We believe the Prime climate risk model generates high-quality ratings that are particularly relevant for fixed income investors, as it focuses on material risks regarding default and builds in our analysts' qualitative judgment.
- The model offers a transparent and powerful interface for Insight's portfolio managers and analysts to interrogate the information it provides, helping them to understand exactly why an issuer or sector receives a particular rating.

## APPLYING THE PRIME CLIMATE RISK RATINGS

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- The Prime climate risk ratings are a valuable input into our research process alongside other factors we consider when assessing risks and opportunities in investments to define an appropriate valuation.
- The use and impact of Prime climate risk ratings in specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- For specific details of how we use Prime climate risk ratings in our investment solutions, please contact your Insight relationship manager.

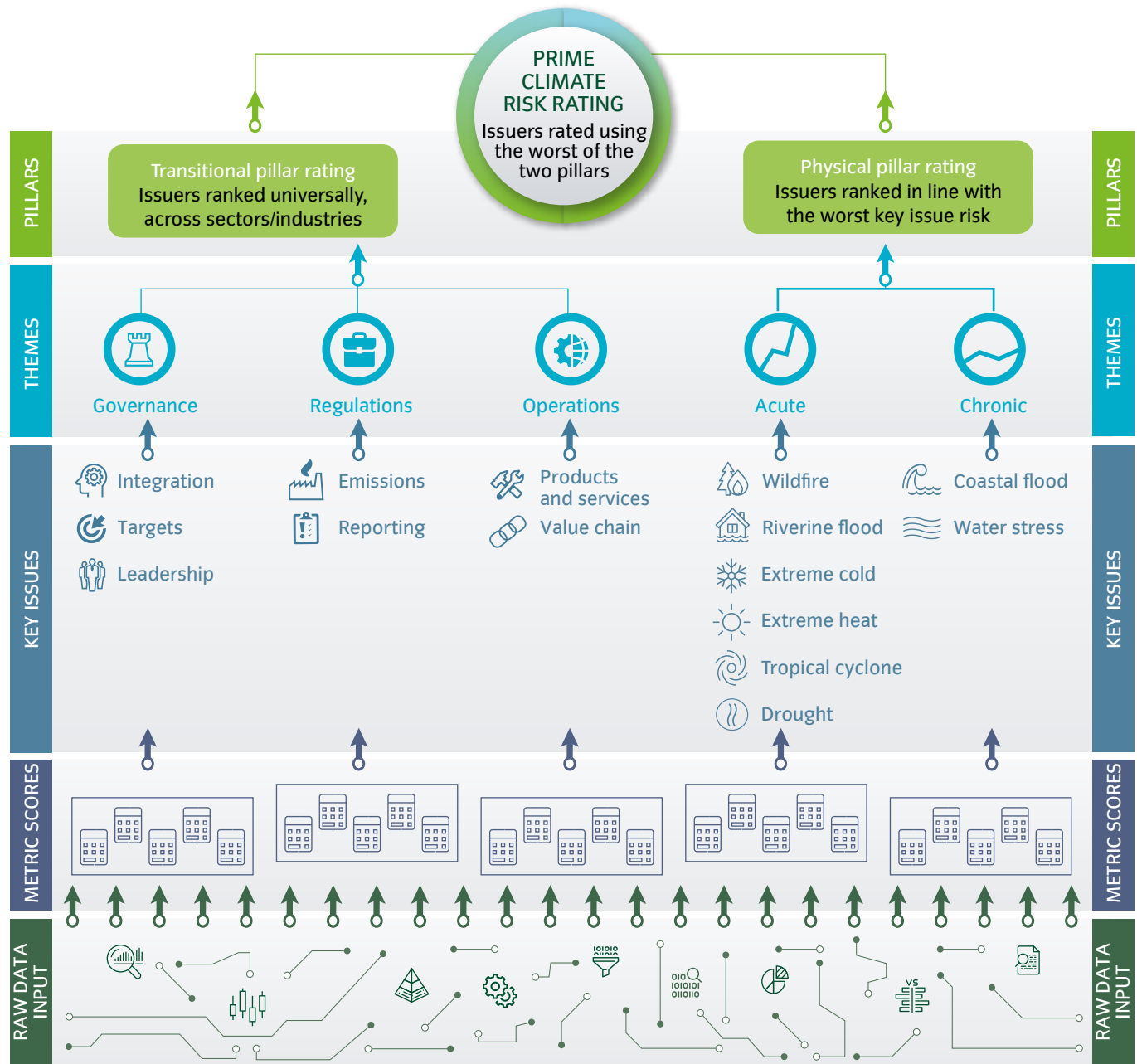
# PRIME CLIMATE RISK RATINGS

## AN OVERVIEW

THE PRIME CLIMATE RISK RATINGS EXPAND UPON THE PRINCIPLES OF THE TCFD. THE RATINGS INCLUDE FORWARD-LOOKING SCENARIO ANALYSIS, WHICH IN TURN REST ON KEY PERFORMANCE INDICATORS WE HAVE CURATED, WEIGHTED AND SCORED.

The ratings are generated using inputs from numerous climate data sources, adjusted for quality and relevance by Insight's credit, ESG and data experts, who also weight them according to their significance for different sectors. The Prime climate risk ratings were created with the TCFD framework at its core to generate ratings that we believe more accurately and reliably reflect the climate risks that corporates face. It aims to help our analysts and portfolio managers consider material climate risks, informing their decision-making and engagement, and to enable portfolios for clients requesting specific climate criteria.

Figure 1: The Prime climate risk model<sup>2</sup>



<sup>2</sup>For illustrative purposes only.

# IN DEPTH

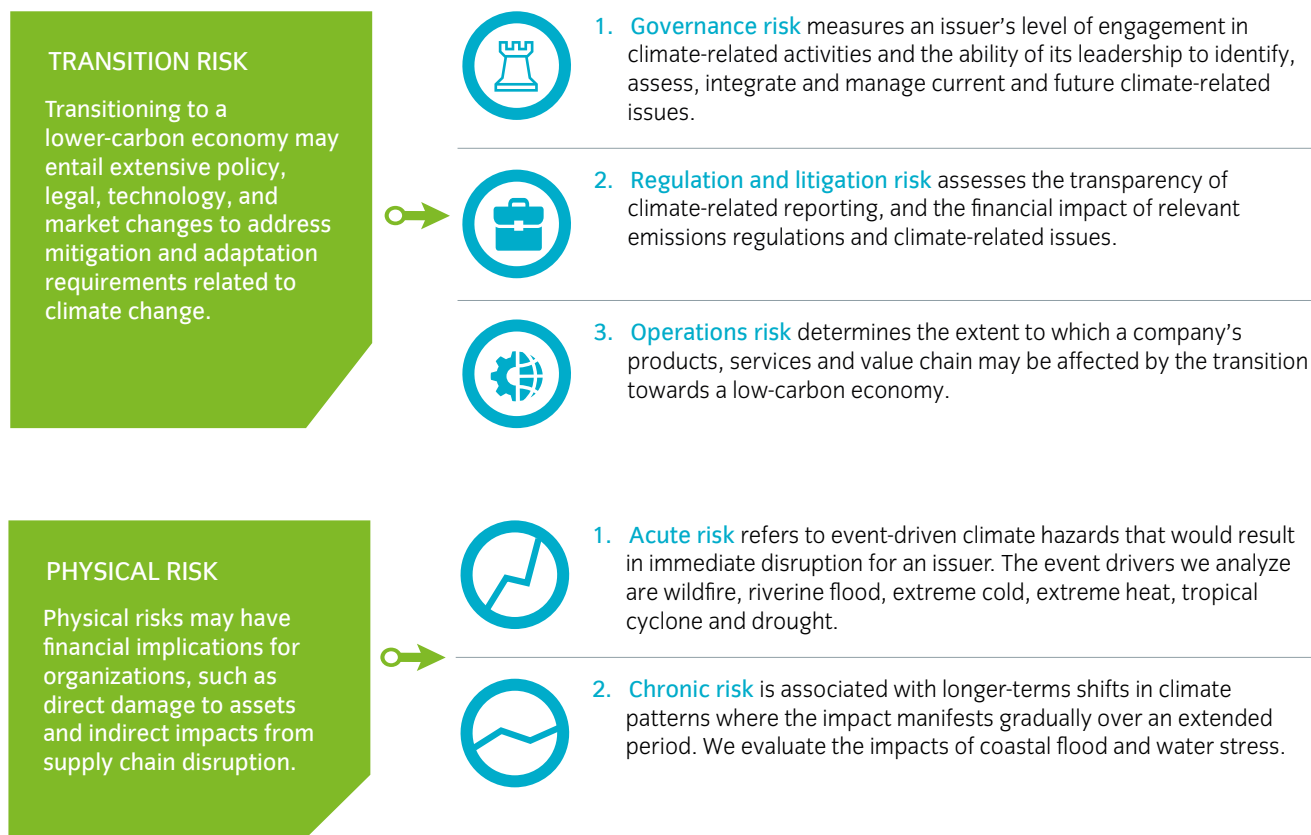
## HOW THE PRIME CLIMATE RISK RATINGS AIM TO REFLECT THE KEY CLIMATE ISSUES

THE PRIME CLIMATE RISK MODEL AIMS TO ANALYZE AND QUANTIFY THE RISK DUE TO CLIMATE CHANGE FOR MORE THAN 1,700 CREDIT ISSUERS<sup>3</sup>, DRAWING FROM OVER 200 INDIVIDUAL DATA INPUTS.

Our methodology harnesses information sourced from direct company responses and best-in-class third-party data providers, before overlaying sector- and location-adjusted weightings to give an overall climate risk measure.

The model is led by the principles of the TCFD, set up in 2015 by the Financial Stability Board to develop voluntary and consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. The model encompasses both transition and physical risk factors within its framework and is paired with a broad-based dataset designed to inform beyond the specific TCFD 'recommended disclosures'.

Figure 2: Digging down into transition and physical climate risks<sup>4</sup>



<sup>3</sup> As of December 31, 2022. <sup>4</sup> For illustrative purposes only.

Figure 3: How the Prime climate risk model considers transition risks<sup>5</sup>

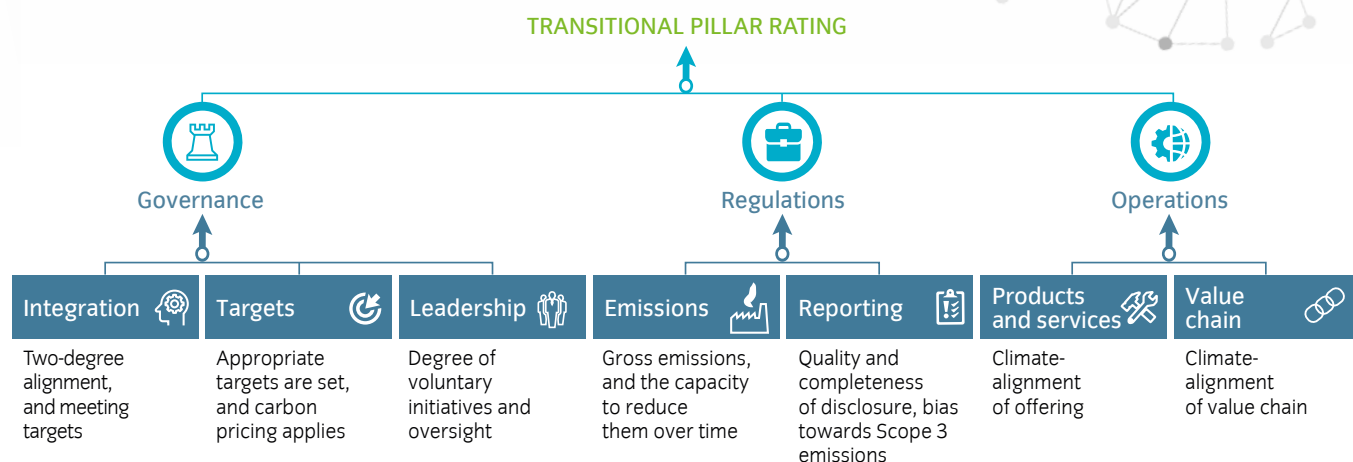
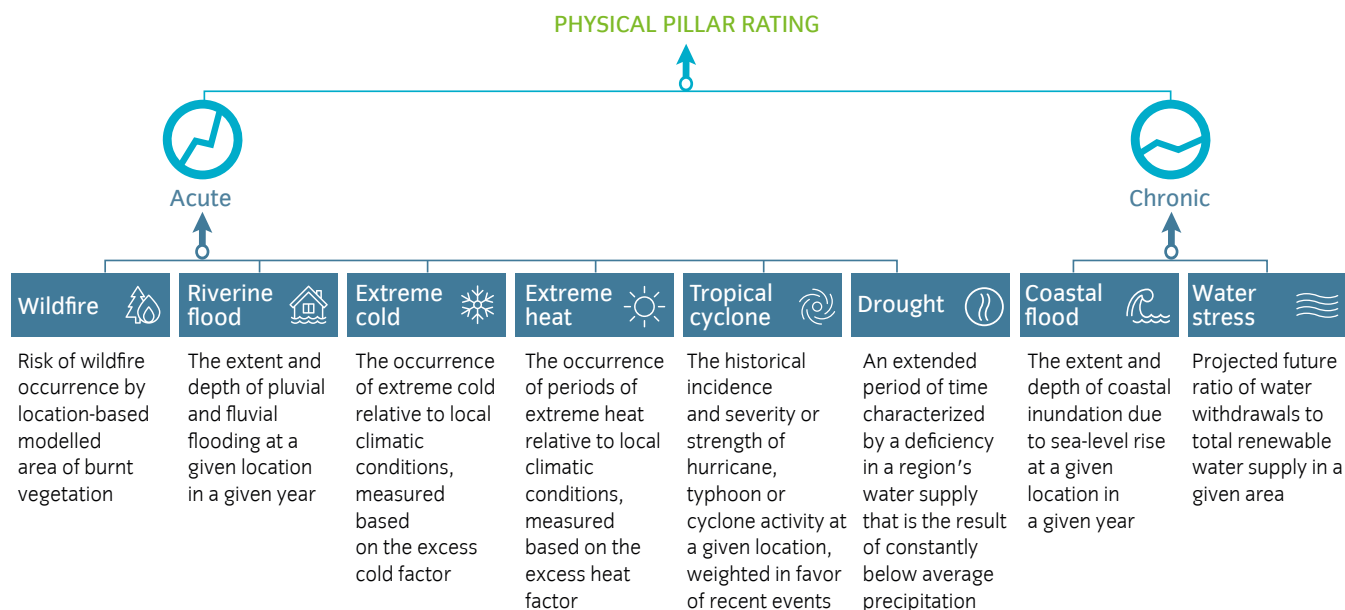


Figure 4: How the Prime climate risk model considers physical risks<sup>6</sup>



## EXPLAINING CARBON EMISSIONS

Carbon emissions are a key metric that helps to measure how an entity contributes to climate change. The TCFD recommends the disclosure of Scope 1 and Scope 2, and if relevant Scope 3, greenhouse gas emissions, and the related risks.

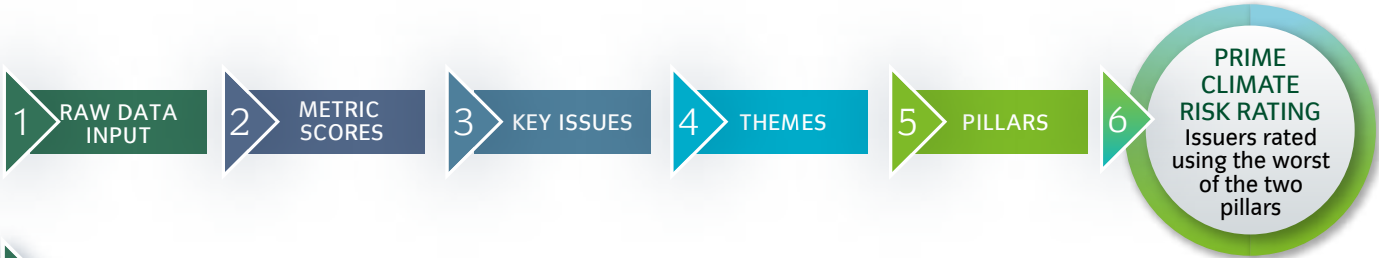
- **Scope 1 emissions:** These are direct emissions from sources owned or controlled by the entity.
- **Scope 2 emissions:** These are indirect emissions, resulting from the generation of electricity, heating and/or cooling, and steam, from a utility provider.
- **Scope 3 emissions:** These are indirect emissions that impact an entity's value chain.<sup>7</sup>

<sup>5,6</sup>For illustrative purposes only. <sup>7</sup> For more information on how Scope 3 emissions might be calculated and measured, the Greenhouse Gas Protocol organization (<https://ghgprotocol.org/>) has developed the Corporate Value Chain (Scope 3) Accounting and Reporting Standard. More information is available here: <https://ghgprotocol.org/standards/scope-3-standard>

# HOW THE PRIME CLIMATE RISK MODEL GENERATES CLIMATE RISK RATINGS

THE PRIME CLIMATE RISK MODEL FOLLOWS A TRANSPARENT AND ROBUST PROCESS TO GENERATE CLIMATE RISK RATINGS, GUIDED BY INSIGHT'S QUANTITATIVE RESEARCHERS, CREDIT ANALYSTS AND EXPERTS IN SEEKING TO ENSURE THE RATINGS REFLECT THE MATERIAL CLIMATE RISKS THAT CORPORATES FACE.

## HOW THE PRIME CLIMATE RATINGS ARE GENERATED

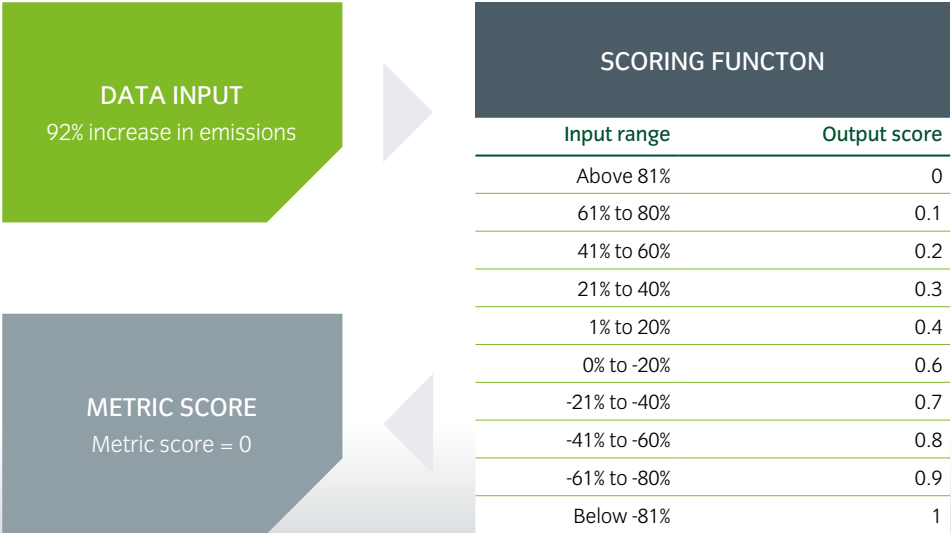


**1 RAW DATA INPUT**  
 Significant measures have been developed to refine the data by adjusting for unexplained outliers, incomplete entries and responses not applicable to particular companies for a given scoring metric. Attention is given to the transparency of responses provided, which is incorporated into the overall risk rating. Over 200 raw data inputs are considered for Prime climate risk model.

**2 METRIC SCORES**  
 The raw data inputs are assigned to one or more of 15 relevant key issues. These inputs are curated by Insight's Responsible Investment Team to ensure they are weighted for materiality, with c.60 metrics currently considered material for the key issues within the model.<sup>8</sup>

The process of producing a transition raw metric score, prior to weighting adjustments, is illustrated below (see Figure 6). The scoring of each metric produces an output score between 0 (worst) and 1 (best).

Figure 5: Illustrative scoring metric



<sup>8</sup>As of December 31, 2022.



### 3

#### KEY ISSUE SCORE

The metric weights are adjusted to reflect the quality of the data available, the extent to which the data has been transformed into a meaningful metric and how appropriate the metric is to the underlying key issues to which it pertains.

Physical risk key issues are measured by assigning each company a sensitivity to each weather/climate event, and the likelihood of such an event occurring is determined by location. The model applies low, medium and severe climate change scenarios, considered between various points in the 21st century. The likelihood and sensitivity scores are combined to give a key issue measure.

For transition risk key issues, scores are weighted averages of the relevant metric values. For physical risk key issues, where we have data on numerous related entities, we take the worst quartile scores for each metric, wherever the corresponding company has assets/operations.

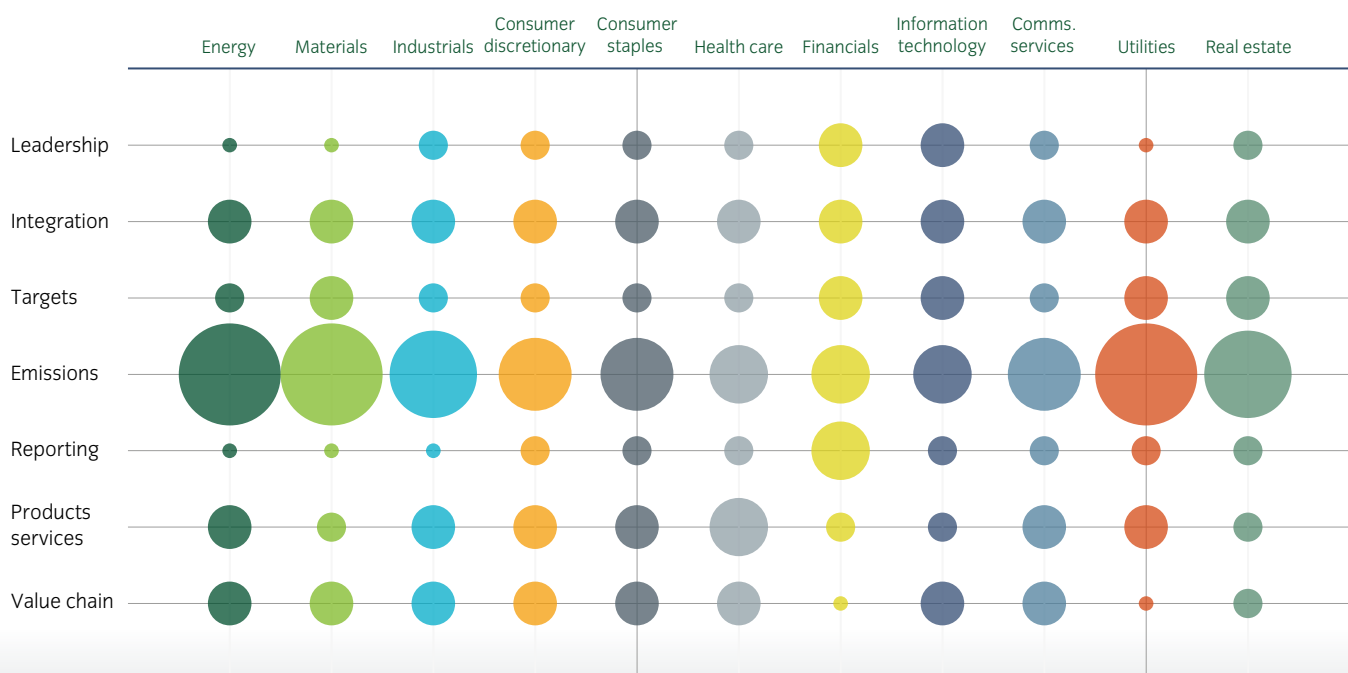
### 4

#### THEME SCORE

To produce theme scores, the key issue scores are weighted in accordance with the materiality of their risk, classified by industry and location. To do this, we derive the weighting based on two matrices. A fixed weighting is assigned to each, and the values are multiplied to derive a final weighting:

- The Global Industry Classification Standard (GICS) Sector Matrix considers the importance of the key issues in relation to the Industry of a company (see Table 1).
- The Location Matrix reflects the prominence of the key issues in relation to the country of the responding company, capturing anomalous events or unusual policy. Since the scoring is reactive, a neutral score is standard.

Figure 6: Sector weightings and materiality of transition climate risks<sup>9</sup>



<sup>9</sup> Source: Insight. For illustrative purposes only. As of December 31, 2022. These are based on Insight analysts' qualitative assessments and are subject to change.

## 5

**PILLAR RATING**

We calculate the transition risk by taking the weighted average of the relevant transition key issue scores, and the physical risk by taking the weakest physical key issue score for each company. These pillar scores allow for improved transparency of the source of risk for each company when making investment decisions.

For the **transitional pillar**, we generate a raw score using the weighted average of the key issue scores under that pillar. These raw scores are ranked over the model's entire coverage universe to generate a rating of 1 (best) to 5 (worst). These are generated according to the model's percentile ranges in Figure 7.

For the **physical pillar**, we set absolute boundaries for generating ratings 1 (best) to 5 (worst) based on the raw scores. These levels are calibrated using issuers who have previously suffered defaults due to physical risk events.

Figure 7: Transitional pillar rating is renormalized relative to the Prime climate risk model's entire coverage universe

Transitional pillar rating	Percentile range
1 (best)	90 – 100
2	70 – 89
3	30 – 69
4	10 – 29
5 (worst)	0 – 10

## 6

**CLIMATE RISK RATING**

The final Prime climate risk rating is the worse of the two pillar scores, to ensure the rating reflects the most significant risk.

- If there is no transitional pillar rating, no overall climate risk rating is assigned.
- If there is no physical pillar rating, the transitional pillar rating is assigned as the overall climate risk rating.

For issuers without a Prime climate risk rating that operate in a sector particularly exposed to climate risks, we seek assurances from the company, both via direct engagement and credit research, either of their appropriate management of these risks or that the investor is compensated for these risks.

As part of our stewardship program, we encourage issuers to disclose pertinent climate-related information to CDP<sup>10</sup>, and to set aggressive and verifiable decarbonization targets with the Science Based Targets initiative<sup>11</sup>. For some issuers with no coverage, we may choose to exclude them from the investible universe. The precise approach depends on the strategy.

<sup>10</sup> [www.cdp.net](http://www.cdp.net) <sup>11</sup> <https://sciencebasedtargets.org>

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Climate change can be a material risk, due to changes in the environment as well as the broad long-term shift towards a low-carbon economy. The Prime climate risk ratings aim to highlight the specific risks different companies face.

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LUCY SPEAKE,  
CO-HEAD OF FIXED INCOME



# HOW INSIGHT'S PORTFOLIO MANAGERS AND ANALYSTS USE THE PRIME CLIMATE RISK RATINGS

INSIGHT IS DEDICATED TO PRECISION INVESTING THAT HELPS CLIENTS ACHIEVE THEIR GOALS, AND WE BELIEVE ANALYSIS OF CLIMATE ISSUES CAN PLAY A CENTRAL ROLE.

The Prime climate risk ratings help our portfolio managers and analysts to:

- **consider material climate risks**, supporting their investment decisions and identifying potential for constructive engagement with debt issuers
- **build dedicated strategies for clients** seeking portfolios that reflect specific climate criteria

## INTEGRATING CLIMATE RISKS WITHIN THE INVESTMENT PROCESS

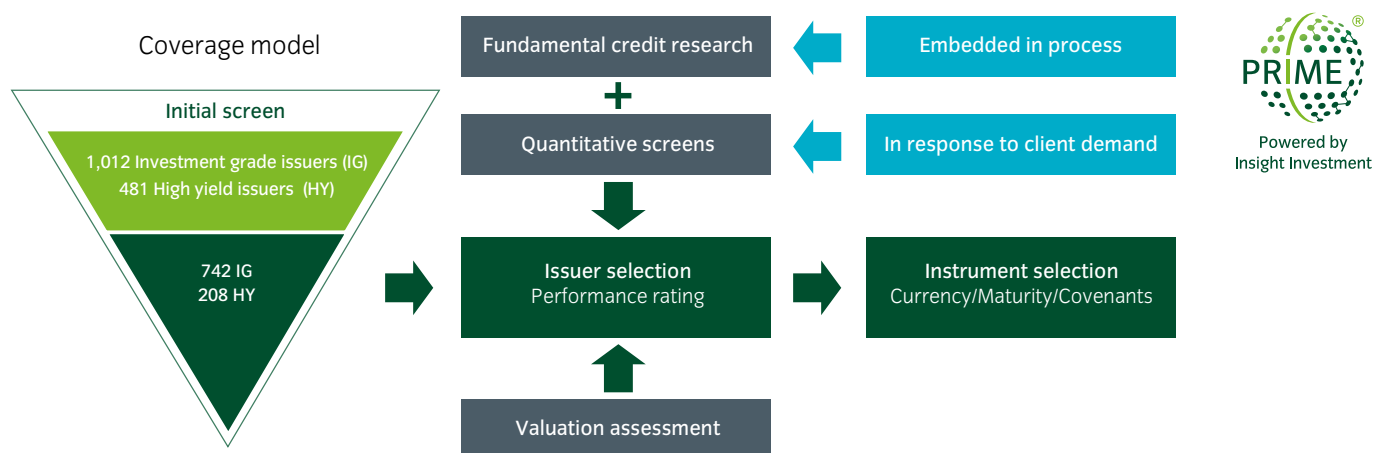
Within fixed income, default risk is the prism through which our analysts consider every bond issue analyzed. A full investment analysis is required to inform an investment decision and climate risks are a necessary element in assigning a credit rating that indicates the relative risk of default loss.

Through the combination of climate risk screening and financial analysis, Insight's extended credit risk appraisal process brings together an assessment of the financial risks associated with a company's performance with a clearly defined set of key business risks, including climate considerations, as a part of the mainstream investment process (see Figure 8).

Generally speaking, for active fixed income portfolios without explicit investment criteria linked to climate change, climate risk is a material but not a central risk factor in most sectors. For such portfolios, our analysts are required to check and record the materiality of climate risk as part of their research.

For portfolios with a longer-term time horizon, such as our strategic credit portfolios, and for portfolios with explicit sustainability and climate change investment criteria, our assessment of climate risk is a key factor which can drive portfolio allocations. We will typically seek to engage with entities with meaningful climate risks, to understand those risks and how they are managed.

Figure 8: ESG risks, including climate risks, are integrated within Insight's credit analysis<sup>12</sup>



<sup>12</sup>As of November 30, 2022.

Identifying topics and targets for engagement is informed by our clients' interests and our engagement with them. Engagements are identified and prioritized through a financial materiality lens, which looks at the following criteria:

1. Potential ESG risks identified through our Prime ESG and climate ratings, and controversy flags
2. Potential ESG impacts which are aligned with client desired outcomes
3. Size of holding

Both our Responsible Investment Team and investment professionals identify and implement engagements. Their responsibilities are outlined below:

- **Responsible Investment Team:** The Responsible Investment Team monitors and reviews wider ESG initiatives and considers appropriate collaborative initiatives. Where specific sustainability concerns arise, the Responsible Investment Team organize calls or meetings with an issuer, where they will set objectives in advance which will be discussed with the issuer. The Responsible Investment Team share their perspective directly with investment teams and complete an engagement log (see below). Issuer progress against engagement targets is tracked over time to understand the success of the engagements. The Responsible Investment Team will also be responsible for running our thematic engagement program in 2022, which focuses on climate change, water and diversity and inclusion.
- **Investment professionals:** Based on qualitative analysis and research, including proprietary questionnaires developed for specific markets, our investment teams identify the engagement issues relevant for specific issuers within their coverage universe. Engagement themes are identified, and relevant targets are set in order to encourage change with each issuer. The ESG-specific performance objectives, which account for 10-20% of their annual performance evaluation require our team of credit analysts to:
  - Evidence they have reviewed critically ESG risks faced by issuers.
  - Ensure ESG ratings are noted and commented on as follows:
    - All '5' ratings (the worst possible in the Prime corporate ESG ratings framework) are commented on and explained.
    - All new issuers/new positions commented on regardless of ESG scores being strong/weak.
- Undertake a minimum of 2 company specific ESG deep dive engagements as agreed with the Head of Credit Analysis. These have been identified based on analyst industry or sector focus, and cover laggards in ESG issues, such as carbon disclosure, labor rights and governance shortcomings. We were pleased that, on average, the credit analysts significantly exceeded the target of 2 ESG deep dive engagements in 2022.

## BUILDING PORTFOLIOS WITH CLIMATE-SPECIFIC CRITERIA

The Prime climate risk ratings can be used to help build portfolios for investors seeking to invest in line with specific climate criteria. These may also involve sector exclusions or a bias in favor of specific metrics (see Figure 9), as well as requirements for proactive engagement on climate issues.

Figure 9: Investors may seek to build portfolios with a wide range of climate-specific criteria

<b>Exclusion screens</b>	Screen out holdings using criteria to prevent investments in certain business activities.
<b>Norms screens</b>	Managing exposure to companies with past high-profile events that suggest they don't meet globally respected standards such as the UN Global Compact and those set out by the International Labor Organization.
<b>Best in class</b>	Using the Prime climate risk ratings to tilt portfolios away from companies with the worst climate performance or the highest climate risks, and towards companies with the best climate performance or the lowest climate risks.
<b>Low carbon</b>	Identifying companies with poor carbon emissions performance or those demonstrating greater environmental risk, using this information to reduce the carbon footprint of portfolios.
<b>Positive impact</b>	Tilting portfolios in favor of either individual bonds or corporate issuers that have an environmental element, such as green bonds.

# FREQUENTLY ASKED QUESTIONS

- **How often are the Prime climate risk ratings updated?**

The Prime climate risk ratings are updated quarterly. Inputs from data providers are checked for high-level fidelity and consistency, then incorporated into the Prime climate risk model. These regular updates help our analysts to understand how both short and long-term risks are having an impact on the industries and companies they cover. Some data providers release information annually, so while our data will be up-to-date with the underlying data providers, they themselves might be out of date with the issuers – e.g. CDP releases new data annually.

- **Is there a mechanism to review or adjust the Prime climate risk ratings?**

If an analyst believes that a rating is incorrect owing to missing, out-of-date, or verifiably incorrect data, a manual adjustment to correct a rating which is too high or too low may be considered. There is a formal process under which they may apply for a rating change to an independent Responsible Investment Ratings Review Group. The Group members exclude portfolio managers or analysts with potential conflicts of interest. Any change to ratings made as a result of this process is documented and reviewed annually.

- **How does the Prime climate risk model deal with gaps in climate data?**

The transparency within the Prime climate risk model, which shows in detail how ratings are generated, enables analysts and portfolio managers to identify gaps in underlying data at a glance, raising the potential for further qualitative research and engagement with company management. We also encourage issuers to be transparent with the data providers. This activity will serve to further inform our teams of material climate risks, and may be used to adjust the Prime climate risk rating if material risks are identified.

- **How does the non-assignment of a Prime climate risk rating affect how we treat an issuer?**

For issuers without a Prime climate risk rating that operate in a sector particularly exposed to climate risks, we seek assurances from the company, both via direct engagement and credit research, either of their appropriate management of these risks or that the investor is compensated for these risks. For some issuers with no coverage, we may choose to exclude them from the investible universe, depending on the specific investment strategy. See page 12 for more information.

## INSIGHT'S RESPONSIBLE INVESTMENT AND FIXED INCOME CREDENTIALS

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- Insight was a founding signatory to the PRI in 2006, the world's leading proponent of responsible investment.
- We have been supporters of the Institutional Investors Group on Climate Change (IIGCC) and CDP initiatives since our founding in 2002.
- Insight manages ESG strategies including those with best-in-class, climate, positive impact and exclusion objectives and criteria. Alongside the Prime climate risk ratings, Insight uses proprietary corporate and sovereign ESG ratings.
- Our Credit Analysis Team has an average industry experience of 15 years across 43 analysts and draws on the expertise of Insight's wider Fixed Income Group, which comprises 119 investment professionals in total.

## ASSOCIATED INVESTMENT RISKS

### ESG

- **Investment type:** The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.
- **Integration:** The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that what we believe to be relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.
- **Ratings:** The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
- **Engagement activity:** The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- **Reporting:** The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.  
Performance/quality: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.
- **Costs:** The costs described will have an impact on the amount of the investment and expected returns.
- **Forward looking commitments and related targets:** Where we are required to provide details of forward-looking targets in line with commitments to external organizations, e.g. Net Zero Asset Managers Initiative, these goals are aspirational and defined to the extent that we are able and in accordance with the third party guidance provided. As such we do not guarantee that we will meet them in whole or in part or that the guidance will not evolve over time. Assumptions will vary, but include whether the investable universe evolves to make suitable investments available to us over time and the approval of our clients to allow us to align their assets with goals in the context of the implications for their investments and issues such as their fiduciary duty to beneficiaries.

Insight applies a wide range of customized ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at [www.insightinvestment.com](http://www.insightinvestment.com) and where applicable information in the following link for mandates in scope of certain EU sustainability regulations <https://www.insightinvestment.com/regulatory-home/sustainability-regulations/>; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

## CONTRIBUTORS



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Assets under management (AUM) represented by the value of the client's assets or liabilities Insight is asked to manage. These will primarily be the mark-to-market value of securities managed on behalf of clients, including collateral if applicable. Where a client mandate requires Insight to manage some or all of a client's liabilities (e.g. LDI strategies), AUM will be equal to the value of the client specific liability benchmark and/or the notional value of other risk exposure through the use of derivatives. Regulatory assets under management without exposures can be provided upon request. Unless otherwise specified, the performance shown herein is that of Insight Investment (for Global Investment Performance Standards (GIPS), the 'firm') and not specifically of Insight North America. A copy of the GIPS composite disclosure page is available upon request.

Past performance is not a guide to future performance, which will vary. The value of investments and any income from them will fluctuate and is not guaranteed (this may partly be due to exchange rate changes). Future returns are not guaranteed and a loss of principal may occur.

Targeted returns intend to demonstrate that the strategy is managed in such a manner as to seek to achieve the target return over a normal market cycle based on what Insight has observed in the market, generally, over the course of an investment cycle. In no circumstances should the targeted returns be regarded as a representation, warranty or prediction that the specific deal will reflect any particular performance or that it will achieve or is likely to achieve any particular result or that investors will be able to avoid losses, including total losses of their investment.

The information shown is derived from a representative account deemed to appropriately represent the management styles herein. Each investor's portfolio is individually managed and may vary from the information shown. The mention of a specific security is not a recommendation to buy or sell such security. The specific securities identified are not representative of all the securities purchased, sold or recommended for advisory clients. It should not be assumed that an investment in the securities identified will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed.

The quoted benchmarks within this document do not reflect deductions for fees, expenses or taxes. These benchmarks are unmanaged and cannot be purchased directly by investors. Benchmark performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. There may be material factors relevant to any such comparison such as differences in volatility, and regulatory and legal restrictions between the indices shown and the strategy.

Transactions in foreign securities may be executed and settled in local markets. Performance comparisons will be affected by changes in interest rates. Investment returns fluctuate due to changes in market conditions. Investment involves risk, including the possible loss of principal. No assurance can be given that the performance objectives of a given strategy will be achieved.

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