

January 2021



INSIGHT ESG FIXED INCOME RATINGS CORPORATE METHODOLOGY SUMMARY

AT INSIGHT, WE BELIEVE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTORS CAN HAVE A MATERIAL IMPACT ON INVESTMENT RISK. IN DEVELOPING OUR PROPRIETARY CORPORATE INSIGHT ESG SCORE, WE HAVE CREATED A RISK-CENTRIC APPROACH USING ADVANCED QUANTITATIVE TOOLS AND AVOIDING SUBJECTIVE ETHICAL BIASES. OUR APPROACH LEADS TO HIGH COVERAGE OF GLOBAL BENCHMARKS: OVER 650,000 SUBSIDIARIES FOR 2,600 DIFFERENT PARENT ENTITIES HAVE AN INSIGHT FIXED INCOME ESG RATING.

Our new Insight ESG ratings aim to be more dynamic and complete, and to integrate our analysts' research more effectively. No single ESG data provider aligns with our house opinion on ESG credit risk, and so we have developed our new methodology using data from multiple third-party data providers.

We reclassify, reweight and organise the data according to our analysts' current views on material risks facing industries to generate an ESG rating and momentum signal for a wide range of entities.

Insight's methodology involves five key steps (see Figure 1).

Figure 1: Insight corporate ESG ratings methodology



DATA SOURCES

We incorporate ESG data from four sources. These comprise full ESG datasets from MSCI, Sustainalytics, VigeoEiris, and CDP climate change and water metrics.

We also use the Bloomberg legal entities for credit risk datasets to map the ESG records to all issuers within a credit risk tree.

We have created a robust data management infrastructure which underpins our quantitative analysis – this is highly scalable, and intended to support the evolution of our ESG ratings as we (i) add new datasets over time, (ii) perform historical analysis and back-testing of our ESG strategies, and (iii) implement enhanced reporting and visualisations for analysts to dig deep into the ESG profile of issuers, and portfolio managers to review aggregate levels in portfolios.

DATA MANAGEMENT

Raw data is collected from data providers at the start of month (or soon after it becomes available in the case of CDP). Preliminary checks on the datasets flag up any obvious problems with the datasets. Common problems include fields being added, removed,

or renamed, or the number of records changing drastically month-on-month.

Once we are satisfied with the high-level reliability of the data, we use bespoke software and a modified Bloomberg dataset to assign global company identifiers, and ultimate parent identifiers to the data provided. In particular, this modified dataset deals with cases where the ultimate parent of the issuer is sovereign (or a sovereign agency, central bank, etc), but the issuer's credit is not underwritten in any meaningful way by the sovereign entity. The 'mapped' raw data is added to our ESG database, giving us a consistent history of the raw data.

FRAMEWORK DEVELOPMENT

Each metric that contributes to an issuer's Insight ESG rating has two key elements:

1. A score (evaluating an issuer's performance in that metric)
2. A weight (evaluating the materiality of the metric to the issuer)

Both master datasets are then mapped onto one or more key issues in our framework (see Figure 2 overleaf).

To generate a weight and a score at key-issue level we combine inputs from our credit analysts together with third-party averages. The analysts' views on the materiality of key issues facing each industry group are merged with views of the data providers, and the values are averaged (with a 1:2 weighting).

To ensure our ESG ratings are based on good data coverage, we include only records which (i) have data under each (E, S and G) pillar, which are based on (ii) five distinct data points and (iii) more than five distinct data provider fields.

RATINGS PRODUCTION

Our methodology produces two separate ratings for every issuer: an **overall ESG rating** and an overall **momentum signal**.

Overall ESG rating

The overall ESG rating is designed to indicate an issuer's performance relative to its peers. We calculate each issuer's percentile based on the raw ESG ratings within each Global Industry Classification Standard (GICS) industry group, and assign an ESG rating between 1 and 5 (see table).

Insight ESG rating	Percentile range
1	90 - 100
2	70 - 89
3	30 - 69
4	10 - 29
5	0 - 10

By renormalising raw scores within each GICS industry group we ensure the same distribution of 1 to 5 ratings. This allows us to easily identify names which are best-in-class, even if they are in a risk-exposed industry group. These scores are rolled back down to each company within the credit risk hierarchy.

Momentum signal

The momentum signal considers the most recent five years of headline ESG scores, and determines an average year-on-year change, weighted towards the most recent data. Based on this data, a momentum score from -2 to 2 is assigned (see table).

Insight momentum signal	Percentile range
-2	>10% deterioration
-1	2% to 10% deterioration
0	< 2% change (positive or negative)
1	2% to 10% improvement
2	>10% improvement

QUALITY CONTROL

Insight credit analysts frequently engage with companies on ESG issues, and they have a degree of oversight when it comes to our headline ESG ratings. For this reason, they can recommend that the rating is manually raised or lowered. Recommendations are reviewed and authorised by an ESG panel, which ensures the analyst's recommendation aligns with our methodology.

Figure 2: Insight corporate ESG rating framework

ESG Overall Score								
Normalised industry-adjusted score 1-5								
Environment Pillar Absolute score 1-5			Social Pillar Absolute score 1-5			Governance Pillar Absolute score 1-5		
Climate change	Natural capital	Pollution	Customer	Product	Workforce	Corporate Governance	Behaviour	Macro
Environmental controversies			Social controversies			Governance controversies		
Carbon Emissions	Biodiversity and land use	Pollution and waste	Customer relations	Controversial sourcing	Health and demographic risk	Board	Anti-Competitive Practices	Conflict
Carbon financing and exposure	Raw material sourcing		Privacy and data security	Financial security	Health and safety	Pay	Business ethics	Financial system instability
Product Footprint	Water management			Quality and safety	Human capital	Ownership	Corruption and Instability	Policy and lobbying
				Responsible investment	Labour management	Accounting	Tax transparency	
					Supply chain			

IMPORTANT INFORMATION

RISK DISCLOSURES

Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.



FIND OUT MORE

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