

R-Factor™

Reinventing ESG Investing Through a Transparent Scoring System

- **The universe of ESG data coverage is expanding, but the lack of transparency into ESG materiality considerations, as well as opaque scoring systems, highlight the limitations of relying on any one ESG data provider.**
- **R-Factor™ is an ESG scoring system developed by State Street Global Advisors that leverages multiple data sources and aligns them to widely accepted, transparent materiality frameworks to generate a unique ESG score for listed companies.**
- **R-Factor™ measures the performance of a company's business operations and governance as it relates to financially material ESG challenges facing the company's industry. It is designed to provide companies a roadmap to improve ESG practices and disclosure, and to help create sustainable capital markets.**

Why We Built R-Factor™

The availability of high-quality, financially material, and consistently reported ESG data represents the biggest challenge facing asset managers as they work to meet the growing demand for sustainability-focused investing.

Investors face two key data challenges: the lack of a consistent and commonly accepted materiality framework, and opaque ESG scoring methodologies of existing data providers.

While firms providing valuable ESG data have proliferated in recent years, they provide limited transparency into how they consider materiality. (For a deeper exploration of this topic, please see [“The ESG Data Challenge.”](#))

Lack of transparency into how data providers determine which ESG issues are material to their scoring system poses a challenges for investors. It is difficult for users of this data to understand and explain which ESG factors have been considered in the investment process. This has led to a broader debate in the market among companies, investors, and regulators on whether there is a tension between ESG investing and fiduciary responsibility.

At State Street Global Advisors, we firmly believe that ESG investing and fiduciary responsibility are not contradictory, but rather that the consideration of material ESG factors in the investment process is an integral part of honoring our fiduciary duty. Consequently, we have made a commitment to fully integrate ESG into our investment processes over the long term.

We see this as our responsibility and so we have created an innovative solution to these data challenges. We call it the R-Factor™ score.

R-Factor™
A Transparent ESG
Scoring System

R-Factor™ is an ESG scoring system developed by State Street Global Advisors that leverages multiple data sources and aligns them to widely accepted, transparent materiality frameworks to generate a unique ESG score for listed companies. The score is powered by ESG data from four different providers (Sustainalytics, ISS-ESG (formerly Oekom Research), Vigeo-EIRIS, and ISS-Governance), in order to improve overall coverage and remove biases inherent in existing scoring methodologies.

These scores will power our investment and client reporting capabilities, and be fully integrated into our stewardship program.

**Defining
Characteristics
of R-Factor™**

We designed R-Factor™ around four core pillars. These pillars define our approach to ESG data and scoring:

1 Focus on materiality	2 Commonly Accepted, Transparent Frameworks	3 Multiple data sources	4 Strong Stewardship
<p>For investors to be able to fully trust and integrate ESG scoring into their investment process, they must have confidence that the ESG considerations are material and have a demonstrated link to sustainable long-term value creation.</p>	<p>We selected the SASB materiality map (See page 4 for more on SASB), as well as national and/or investor-developed corporate governance codes, because they are transparent frameworks supported by large numbers of investors. We support these frameworks as they send a unified message to companies about which ESG factors are material to a company's performance and are therefore important to disclose and address</p>	<p>R-Factor™ is powered by the raw metrics from four different data providers: three that inform the ESG component of the score and one that informs the CorpGov component of the score. This approach increases the overall coverage of our data set, filling in the gaps that exist with any one data provider. Using the inputs from multiple providers also reduces the potential biases that may be built into a provider's methodology.</p>	<p>R-Factor™ is fully integrated into our asset stewardship program. We screen companies for voting and engagement based on their scores. During engagements with portfolio companies, we disclose companies' R-Factor™ scores, as well as the underlying basis for those scores. This gives boards and management teams a roadmap for the specific dimensions that investors are evaluating to assess a company's sustainability efforts. It also helps companies identify which metrics to disclose and manage to improve future scores, creating a positive feedback loop in the market.</p>

Materiality Frameworks and the R-Factor™ Methodology

Materiality Framework and Methodology for ESG Component

In building R-Factor™, we sought frameworks that could transparently address material environmental, social, and governance issues. In doing so, we differentiate between Environmental, Social, and Governance (ESG) issues, which are market-agnostic but industry specific, and Corporate Governance ("CorpGov") issues, which are industry-agnostic but market specific. For example, the impacts of climate change do not stop at geographical borders, but they impact industries differently. In contrast, the business practices, governance structures, and market expectations of firms vary widely when it comes to different geographic regions, and we believe it important to hold companies to the standards appropriate to their market. R-Factor™ takes these nuances into account.

We selected the SASB materiality framework as the ESG framework for R-Factor™. Unlike SASB, other sustainability reporting frameworks that pre-date SASB provide disclosure guidance on a broad set of ESG topics and do not provide guidance as to which topics are financially material by sector. This leaves the difficult decision of defining materiality by sector to companies. This has caused the current inconsistencies in company reporting related to ESG. With its laser focus on financial materiality defined by industry, SASB gives specific and standardized guidance to companies, removing guesswork for all users of the framework.

Given the recent codification of the SASB standards as well as the voluntary nature of the framework, companies have yet to fully align their disclosure practices to it. To access appropriate data, we leverage raw metrics from three different ESG data providers, and identify which metrics are material to an industry according to the SASB framework.

Here, we provide two examples of how we leverage that data with precision. We illustrate applications in two industries: Asset Management and Custody, and Household and Personal Products.

- Starting point: 180 metrics provided by a data provider
- Of these, 91 metrics are considered material according to the SASB framework
- Of the 91 material metrics:
 - 22 metrics power the ESG component of the R-Factor™ score for companies in the Asset Management and Custody industry
 - 26 metrics power the ESG component of the R-Factor™ score for companies in the Household and Personal Products industry

This mapping approach helps ensure that the R-Factor™ score is only informed by material ESG metrics and not all of the 180 metrics provided by the data provider.

Since materiality of the metrics differs by industry, companies in the Household and Personal Products industry are asked to report on only four general issues: water and waste management, product quality and safety, product design and lifecycle management, and supply chain management.

In contrast, there are five general issue items that apply to companies in the Asset Management industry. These include selling practices and product labeling, employee engagement/diversity and inclusion, product design and lifecycle management, business ethics, and systemic risk management. Within each general topic, SASB's accounting standards provide guidance to companies by industry on specific metrics to be disclosed. While many of these metrics are not currently reported in financial statements, they obviously contain investor-relevant information.

Who is SASB? The Sustainability Accounting Standards Board (SASB) is non-profit organization with a mission to help businesses around the world identify, manage, and report on the sustainability topics that matter most to investors.

Established in 2011, SASB has developed two key pieces of market infrastructure: a commonly accepted materiality map identifying financially material ESG issues for 11 sectors and 77 industries, as well as a set of sustainability accounting standards that companies can use as a guide to report on material topics and related metrics.

SASB's standards were developed over six years, with consultation and public comment from investors, companies and other stakeholders. SASB's standards are supported by investors representing \$33T.

The value of SASB's materiality framework is validated by academic research showing that companies that score higher on material ESG metrics for their industries according to the SASB framework generate stronger long-term sustainable returns.²

To learn more about SASB's materiality framework, visit materiality.sasb.org.

Materiality Framework and Methodology for Corporate Governance Component

The SASB materiality framework does not incorporate traditional corporate governance factors, which tend to be more market specific and are well defined by the myriad of the corporate governance codes globally.

To construct the CorpGov component of the R-Factor™ score, we draw on country-level corporate governance codes, developed by either regulators or investors. Like the SASB materiality map, these codes are transparent and supported by a large number of investors. In all, we draw on 16³ market-specific codes, with the remaining markets aligned to the International Corporate Governance Network (ICGN) code.

Corporate governance codes are written as sets of principles. To incorporate them into the CorpGov component of R-Factor™, we systematically map the appropriate metrics from our fourth data provider, ISS-Governance, to the principles articulated in each code.

Here, too, we draw only on the corporate governance metrics that are material to a given geography. We have leveraged the expertise of our Asset Stewardship team to build out a consistent framework that identifies and aligns material corporate governance metrics with the different corporate governance codes. For example, of the 230 metrics provided by ISS-Governance, only 86 are relevant to the United States to align with the Investor Stewardship Group Code⁴ while 95 are relevant to companies governed by the United Kingdom's code.

Adapting our model to different geographies allows for this market specificity, and honors differences in governance structures and business practices, without placing judgment on those differences. This allows us to identify, within a given market, companies who are relatively stronger and those who are underperforming, within the context of investors' governance expectations for companies in that market.

Conclusion

The composite R-Factor™ score is comprised of a company's ESG and CorpGov scores, and allows for a global comparison of companies' ESG performance within a sector or industry. Companies can improve their scores through better practice of and disclosure on industry-specific SASB topics, as well as better adherence to their applicable corporate governance code.

For **companies**, R-Factor™ offers clear guidance on which ESG topics to focus on and disclose to investors. In doing so, this is the first ESG scoring system to put companies in the driver's seat, allowing them to take the action needed to improve practices and enhance their scores. R-Factor™ increases ESG integration into company strategy, offering clear guidance to boards and management teams on which financially material ESG topics to focus on. Finally, R-Factor™ takes the guesswork out of ESG reporting, with scores based on a focused set of specific financially material ESG metrics. This is particularly beneficial for small and mid-cap companies, who may not have the resources to hire dedicated sustainability teams and improve investors' view of their ESG performance.

By investing in ESG solutions powered by R-Factor™, **investors** have the opportunity to ensure their capital is being allocated to companies that are focusing on managing and mitigating financially material ESG risks. Investing in an ESG scoring methodology that provides clear guidance to companies on what to disclose will ultimately lead to better available data and will allow for ESG to be more accurately priced into financial markets.

At State Street Global Advisors, we believe that R-Factor™ is the change needed for ESG to become an integral part of the financial system. We look forward to further exploring this innovation with you.

For more information about R-Factor™ and our ESG investment capabilities, please contact your State Street Relationship Manager.

Endnotes

- 1 Khan, Serafeim, et al. "Corporate Sustainability: First Evidence of Materiality." Harvard Business Review, 2016.
- 2 Australia, Denmark, Finland, France, Germany, Hong Kong, Italy, Japan, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK, US.
- 3 State Street Global Advisors is a founding member of the Investor Stewardship Group and currently chairs the group's Steering Committee.
- 4 See <https://isgframework.org/corporate-governance-principles>.

About State Street Global Advisors

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 31 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's third-largest asset manager with US \$3.47 trillion* under our care.

* This figure is presented as of December 31, 2020 and includes approximately \$75.17 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

ssga.com

State Street Global Advisors Worldwide Entities

Abu Dhabi: State Street Global Advisors Limited, ADGM Branch, Al Khatem Tower, Suite 42801, Level 28, ADGM Square, Al Maryah Island, P.O. Box 76404, Abu Dhabi, United Arab Emirates. Regulated by the ADGM Financial Services Regulatory Authority. T: +971 2 245 9000. **Australia:** State Street Global Advisors, Australia, Limited (ABN 42 003 914 225) is the holder of an Australian Financial Services License (AFSL Number 238276). Registered office: Level 14, 420 George Street, Sydney, NSW 2000, Australia. T: +612 9240-7600. F: +612 9240-7611. **Belgium:** State Street Global Advisors Belgium, Chaussée de La Hulpe 120, 1000 Brussels, Belgium. T: 32 2 663 2036. F: 32 2 672 2077. SSGA Belgium is a branch office of State Street Global Advisors Ireland Limited. State Street Global Advisors Ireland Limited, registered in Ireland with company number 145221, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. **Canada:** State Street Global Advisors, Ltd., 1981 McGill College Avenue, Suite 500, Montreal, Qc, H3A 3A8, T: +514 282 2400 and 30 Adelaide Street East Suite 800, Toronto, Ontario M5C 3G6. T: +647 775 5900. **France:** State Street Global Advisors Ireland Limited, Paris branch is a branch of State Street Global Advisors Ireland Limited, registered in Ireland with company

number 145221, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. State Street Global Advisors Ireland Limited, Paris Branch, is registered in France with company number RCS Nanterre 832 734 602 and whose office is at Immeuble Défense Plaza, 23-25 rue Delarivière-Lefoullon, 92064 Paris La Défense Cedex, France. T: (+33) 1 44 45 40 00. F: (+33) 1 44 45 41 92. **Germany:** State Street Global Advisors GmbH, Brienner Strasse 59, D-80333 Munich. Authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). Registered with the Register of Commerce Munich HRB 121381. T: +49 (0)89-55878-400. F: +49 (0)89-55878-440. **Hong Kong:** State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. T: +852 2103-0288. F: +852 2103-0200. **Ireland:** State Street Global Advisors Ireland Limited is regulated by the Central Bank of Ireland. Registered office address 78 Sir John Rogerson's Quay, Dublin 2. Registered Number: 145221. T: +353 (0)1 776 3000. F: +353 (0)1 776 3300. **Italy:** State Street Global Advisors Ireland Limited, Milan Branch (Sede Secondaria di Milano) is a branch of State Street Global Advisors Ireland Limited, registered in Ireland with company number 145221, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. State Street Global Advisors Ireland Limited, Milan Branch (Sede Secondaria di Milano), is registered in Italy with company number

10495250960 - R.E.A. 2535585 and VAT number 10495250960 and whose office is at Via Ferrante Aporti, 10 - 20125 Milano, Italy. T: +39 02 32066 100. F: +39 02 32066 155. **Japan:** State Street Global Advisors (Japan) Co., Ltd., Toranomon Hills Mori Tower 25F 1-23-1 Toranomon, Minato-ku, Tokyo 105-6325 Japan. T: +81-3-4530-7380. Financial Instruments Business Operator, Kanto Local Financial Bureau (Kinsho #345), Membership: Japan Investment Advisers Association, The Investment Trust Association, Japan, Japan Securities Dealers' Association. **Netherlands:** State Street Global Advisors Netherlands, Apollo Building, 7th floor Herikerbergweg 29 1101 CN Amsterdam, Netherlands. T: 31 20 7181701. SSGA Netherlands is a branch office of State Street Global Advisors Ireland Limited, registered in Ireland with company number 145221, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. **Singapore:** State Street Global Advisors Singapore Limited, 168, Robinson Road, #33-01 Capital Tower, Singapore 068912 (Company Reg. No: 200002719D, regulated by the Monetary Authority of Singapore). T: +65 6826-7555. F: +65 6826-7501. **Switzerland:** State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Registered with the Register of Commerce Zurich CHE-105.078.458. T: +41 (0)44 245 70 00. F: +41 (0)44 245 70 16. **United Kingdom:** State Street Global Advisors Limited. Authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 2509928. VAT No.

5776591 81. Registered office: 20 Churchill Place, Canary Wharf, London, E14 5HJ. T: 020 3395 6000. F: 020 3395 6350. **United States:** State Street Global Advisors, 1 Iron Street, Boston, MA 02210-1641. T: +1 617 786 3000.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without State Street Global Advisors' express written consent.

© 2021 State Street Corporation.
All Rights Reserved.
ID403913-2518396.61.GBL.RTL 0221
Exp. Date: 02/28/2022