

State Street Global Advisors' Approach to ESG Screening: Methodology

ESG screening involves excluding specific companies, industries, or countries from an investment portfolio based on ESG factors or risks. While this type of screening may sound relatively simple, the process involves a significant amount of judgment on the part of asset managers or the third-party data providers with whom they partner to conduct the screening.

The Complexities of ESG Screening

Investors who seek screened portfolios often express a desire for screening in a specific area — for example, seeking to screen tobacco from a portfolio. But there are a variety of ways that a company might be involved in tobacco: for example, as a manufacturer, licensor or retailer.

Additionally, there are multiple potential thresholds for what it means to be “involved” in tobacco. Should a business that derives 1 percent of its revenue from tobacco-related products count as “involved”? What about a business that owns a significant portion of a tobacco manufacturer but does not conduct its activities directly?

There are several ways in which a company can be considered to be involved in a particular product or service. Drivers of product involvement might be described in terms of:

- **Revenue thresholds** What percentage of a company’s total revenue is derived from this industry, product or topic?
- **Activities** What part of the value chain is the company involved in?
- **Significant ownership relationship with a company** Is the company an owner of, or owned by, another company with involvement in this issue?

To address this complexity, State Street Global Advisors has created an approach to evaluating commonly screened ESG issues. This approach represents the shared perspectives of our investment teams across active and index investment styles in equity, fixed income and alternatives. State Street Global Advisors’ approach is guided by the following principles:

- **Systematic and transparent approach** We follow a well-defined methodology that can be flexibly applied to different use cases.
- **Leverage best-in-class available data** We use inputs from multiple data providers where accessible to us. This broadens our overall coverage universe, and it reduces the potential biases of a single data provider.
- **Awareness of impact on risk and return objectives** Our point of view is attentive to the impact of excluded securities on a broader set of investment considerations.

- **Strive for consistency while accommodating for differences** Deviations from this approach are made where appropriate to adapt to investment styles, national legislation, and/or market-specific norms prevalent in certain regions. This allows us to offer our clients both a defined perspective and investment solutions most appropriate to their contexts.

Topics Screened and Data Used

To date, we have applied this approach to fourteen screening topics:

- 1 Arctic Drilling
- 2 Civilian Firearms
- 3 Controversial Weapons
- 4 Extreme ESG Controversies
- 5 Oil Sands
- 6 Tobacco
- 7 Thermal Coal
- 8 UN Global Compact Violators
- 9 Oil & Gas
- 10 Shale Energy
- 11 Alcohol
- 12 Gambling
- 13 Adult Entertainment
- 14 Cannabis

Below, we outline the data sets used for our approaches to each of these topics. We generate a restricted list from the relevant data provider(s) on a quarterly basis using the metrics and thresholds outlined below, using multiple data providers when that is accessible to us. We screen issuers that are flagged by either or both data provider, in order to improve overall coverage and decrease biases associated with a single provider.

1. Arctic Drilling

State Street Global Advisors screens companies that are involved in oil and gas exploration in Arctic regions.

Figure 1
Arctic Drilling
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Arctic Oil and Gas Exploration, Level of Involvement $\geq 10\%$	The company derives revenue from oil and gas exploration and extraction in the Arctic.

2. Civilian Firearms

State Street Global Advisors screens companies involved in the manufacturing and/or retailing of small arms and associated ammunition/components for civilian use.

Figure 2
Civilian Firearms
 Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	<ul style="list-style-type: none"> • Small Arms, Civilian Customers, Assault Weapons, Level of Involvement $\geq 10\%$ • Manufacture of key components, Level of Involvement $\geq 10\%$ • Small Arms, Retail and Distribution of Assault Weapons, Level of Involvement $\geq 10\%$ 	<ul style="list-style-type: none"> • The company derives revenue from manufacturing and selling small arms to civilian customers • The company derives revenue from manufacturing and selling key components of small arms • The company derives revenue from retailing and/or distribution of small arms
MSCI Business Intelligence Screening Research	<ul style="list-style-type: none"> • Firearms Production Maximum Revenue Percentage $\geq 10\%$ • Firearms Retailer Maximum Revenue Percentage $\geq 10\%$ 	<ul style="list-style-type: none"> • Recent-year percent of revenue, or maximum estimated percent, a company has derived from manufacturing firearms and small arms ammunition for civilian markets • Recent-year percent of revenue, or maximum estimated percent, a company has derived from the distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use

3. Controversial Weapons

The following types of weapons are covered by State Street Global Advisors' screen:

- Cluster munitions
- Antipersonnel mines and land mines
- Biological and chemical weapons
- Nuclear weapons
- Depleted uranium
- Incendiary weapons and white phosphorus

Figure 3
Controversial Weapons
 Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Controversial Weapons Radar	Controversial weapons noted above for which: <ul style="list-style-type: none"> • There is evidence of activity • The weapon is a core weapon system or a core weapon activity • The product has a dedicated scope • The scope is key to the production of the weapon 	The company is involved in the core weapon system, or components/services of the core weapon system that are considered tailor-made and essential for the lethal use of the weapon.
	Any controversial weapon for a subsidiary that the company has >=50% ownership of	The company is involved, through corporate ownership, in the core weapon system, or components/services of the core weapon system that are considered tailor-made and essential for the lethal use of the weapon.
MSCI Business Involvement Screening Research	Cluster Munitions Manufacturer = True	Companies that manufacture cluster munitions whole weapons systems, components or delivery platforms.
	Land mines Manufacturer = True	Companies that manufacture land mines whole systems or components.
	Nuclear Weapons Manufacturer Maximum Revenue Percentage >= 10%	The recent-year percentage of revenue, or maximum estimated percentage, a company has derived from the production of nuclear weapons.
	Depleted Uranium Manufacturer = True	Companies involved in the production of depleted uranium (DU) weapons, ammunition and armor, including companies that manufacture armor-piercing, fin-stabilized, discarding sabot tracing rounds (APFSDS-T); kinetic energy missiles made with DU penetrators; and DU-enhanced armor, including composite tank armor.
	Incendiary Weapons (White Phosphorous) = True	Companies that manufacture incendiary weapons using white phosphorus.
	Biological/Chemical Weapons Maximum Revenue Percentage >= 10%	The recent-year percentage of revenue, or maximum estimated percentage, a company has derived from the manufacture of chemical or biological weapons and related systems or components.

4. Extreme ESG
 Controversies

State Street Global Advisors screens companies involved in incidents/events that may pose business or reputational risk due to the potential impacts on stakeholders, the environment, or the company's operations.

Figure 4
**Extreme ESG
 Controversies**
 Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Category 5 — Severe Controversies	The event has a severe impact on the environment and society, posing serious business risks to the company. This category represents exceptionally egregious corporate behavior, high frequency of recurrence of incidents, very poor management of ESG risks, and a demonstrated lack of willingness by the company to address such risks.

5. Oil Sands

State Street Global Advisors screens companies for whom a meaningful portion of their average daily production comes from oil sands.

Figure 5
Oil Sands
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Oil Sands Extraction, Level of Involvement $\geq 10\%$	The company derives revenue from the extraction of oil sands.

6. Tobacco

State Street Global Advisors screens companies that are involved in the production and manufacturing of tobacco and tobacco-related products (including vaping, pipes and other related products).

Figure 6
Tobacco
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Tobacco Production, Level of Involvement $\geq 10\%$	The company derives revenue from the production of tobacco and tobacco-related products.
MSCI Business Involvement Screening Research	Tobacco Production Maximum Revenue Percentage $\geq 10\%$	The recent-year percentage of revenue, or maximum estimated percentage, a company has derived from the manufacture of tobacco products (such as cigars, blunts, cigarettes, e-cigarettes, inhalers, beedis, kreteks, smokeless tobacco, snuff, snus and dissolvable and chewing tobacco). This also includes companies that grow or process raw tobacco leaves.

7. Thermal Coal

State Street Global Advisors screens companies involved in the extraction or power generation of thermal coal.

Figure 7
Thermal Coal
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	<ul style="list-style-type: none">Thermal Coal Extraction, Level of Involvement $\geq 10\%$Thermal Coal Power Generation, Level of Involvement $\geq 10\%$	<ul style="list-style-type: none">The company derives revenue from thermal coal extraction.The company derives revenue from generating electricity from thermal coal.

8. United Nations Global Compact Violations

The UN Global Compact (UNGC) is the world's largest corporate sustainability initiative. It sets forth 10 responsible business principles for companies to follow¹. State Street Global Advisors screens companies who are in violation of the UNGC principles.

United Nations Global Compact Responsible Business Principles

Human Rights	<ol style="list-style-type: none"> 1 Businesses should support and respect the protection of internationally proclaimed human rights. 2 They should make sure that they are not complicit in human rights abuses.
Labor	<ol style="list-style-type: none"> 3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining. 4 They should promote the elimination of all forms of forced and compulsory labor. 5 They should endorse the effective abolition of child labor. 6 They should support the elimination of discrimination in respect of employment and occupation.
Environment	<ol style="list-style-type: none"> 7 Businesses should support a precautionary approach to environmental challenges. 8 They should undertake initiatives to promote greater environmental responsibility. 9 They should encourage the development and diffusion of environmentally friendly technologies.
Anti-Corruption	<ol style="list-style-type: none"> 10 Businesses should work against corruption in all its forms, including extortion and bribery.

Figure 8
United Nations Global Compact Violations Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Global Standard Screening (GSS)	Global compact principles breached = Noncompliant	A company is assessed as Noncompliant when it is found to be responsible for egregious and severe violations of commonly accepted international norms related to human rights, labor rights, the environment and business ethics. In other words, a company is assessed as Noncompliant when it does not act in accordance with the UN Global Compact Principles and its associated standards, conventions and treaties. GSS also assesses companies that facilitate third parties in human rights violations due to their involvement in weapons with disproportional and/or nondiscriminatory impact on citizens and society as Noncompliant (with Principle 2 of the UN Global Compact). However, this assessment is limited to companies involved in the production and development of antipersonnel mines, cluster munitions, and chemical and biological weapons, or producers of nuclear weapons who support their proliferation outside of the five designated nuclear states or who violate UN sanctions/ International Atomic Energy Agency rules.

9. Oil & Gas

State Street screens companies involved in the extraction or power generation of oil & gas.

Figure 9
Oil & Gas Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	<ul style="list-style-type: none"> • Oil & Gas Extraction, Level of Involvement >=10% • Oil & Gas Power Generation, Level of Involvement >=10% 	<ul style="list-style-type: none"> • The company derives revenue from oil & gas extraction • The company derives revenue from generating electricity from oil & gas

10. Shale Energy

State Street screens companies involved in the extraction and/or production of oil and/or gas shale energy.

Figure 10
Shale Energy
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	<ul style="list-style-type: none">Shale Energy Extraction, Level of Involvement $\geq 10\%$	<ul style="list-style-type: none">The company is involved in shale energy exploration and/or production

11. Alcohol

State Street screens companies involved in the production of alcoholic beverages.

Figure 11
Alcohol
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Alcoholic Beverages Production, Level of Involvement $\geq 10\%$	The company is involved in the manufacturing of alcoholic beverages
MSCI Business Involvement Screening Research	Alcohol Production Maximum Revenue $\geq 10\%$	Recent-year percent of revenue, or maximum estimated percent, a company has derived from the manufacture of alcoholic products

12. Gambling

State Street screens companies deriving revenue by owning and/or operating gambling establishments.

Figure 12
Gambling
Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Gambling Operations, Level of Involvement $\geq 10\%$	The company owns and/or operates a gambling establishment, and/or offers gambling services (operation of casinos, lotteries, bookmarking, online gambling, etc.)
MSCI Business Involvement Screening Research	Gambling Operations Maximum Revenue $\geq 10\%$	Recent-year percent of revenue, or maximum estimated percent, a company has derived from ownership or operation gambling facilities such as casinos, racetracks, bingo parlors, or other betting establishments

13. Adult Entertainment

State Street screens companies involved in the production of adult entertainment.

Figure 13
Adult Entertainment
 Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	Adult Entertainment Production, Level of Involvement >=10%	The company is involved in the production of adult entertainment and/or owns/operates adult entertainment establishments. Those include sex shops, producers of adult movies and television programs, magazines, and adult websites, and ownership of strip clubs and topless bars
MSCI Business Involvement Screening Research	Adult Entertainment Production Maximum Revenue >=10%	Recent-year percent of revenue, or maximum estimated percent, a company has derived from producing, directing, or publishing adult entertainment materials that fall into the following categories: Producer of X-rated films, Producer of Pay-per-view programming or channels, Producer of sexually explicit video games, Producer of books or magazines with adult content, Live entertainment of an adult nature, Producer of adults-only material on the internet

14. Cannabis

State Street screens companies involved in the production of cannabis products.

Figure 14
Cannabis
 Metrics and Thresholds

Data Source	Indicator	Definition
Sustainalytics Product Involvement	<ul style="list-style-type: none"> Production of Medical Cannabis, Level of Involvement >=10% Production of Recreational Cannabis, Level of Involvement >=10% 	<ul style="list-style-type: none"> The company is involved in the development and/or cultivation of medical cannabis The company is involved in the development and/or cultivation of recreational cannabis

Updating the ESG Screens

The restricted lists are updated quarterly using the input data available in the first two weeks of the month. (Example: Screens are updated for October 15, 2021, using input data that is updated between October 1st and 15th, 2021) Corporate actions that occur intra-quarter may not always be reflected in the restricted lists until the following quarter.

We continue to explore screening topics that are relevant to a significant set of our clients globally, and we expect to apply our approach to a broader set of screening topics over time.

As we continue to expand our ESG capabilities and offerings, we look forward to partnering with clients to implement this approach to screening in portfolios. For more information, please contact your State Street Global Advisors relationship manager.

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Endnote

1 <https://unglobalcompact.org/what-is-gc/mission/principles>.

About State Street Global Advisors

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* Pensions & Investments Research Center, as of December 31, 2021.

[†] This figure is presented as of September 30, 2022 and includes approximately \$55.12 billion USD 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. Please note all AUM is unaudited.

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