

# 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 potential limitations of relying on any one ESG data provider.**
- **R-Factor™ is an ESG score developed by State Street Global Advisors that leverages multiple data sources and aligns them to the widely accepted, transparent Sustainability Accounting Standards Board Materiality Framework for over 12,000 publicly listed companies. SSGA uses R-Factor™ as a quantitative input to a variety of investment solutions and as a metric in relevant reports and factsheets. Additionally, a company may request its R-Factor™ score (instructions are posted on [ssga.com](https://www.ssga.com)) and may also request a related engagement with the SSGA Asset Stewardship team. Finally, R-Factor™ scores are among the many inputs the SSGA Asset Stewardship team may review when performing analysis on portfolio companies before engagements.**

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### Why We Built R-Factor™

We believe availability of high-quality, financially material, and consistently reported ESG data represents one of the biggest challenges facing asset managers as they work to meet the growing demand for sustainability-focused investing from their clients.

Investors commonly 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, in our view, they provide limited transparency into how they consider materiality.

Lack of transparency into how data providers determine which ESG issues are material to their scoring system poses a challenge 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.

## R-Factor™ A Transparent ESG Scoring System

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These scores will power our investment and client reporting capabilities.

## 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  |
|---|---|--|---|
| 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. | 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. | R-Factor™ is powered by the raw metrics from five different datasets: four 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. | During engagements with portfolio companies, we disclose companies' R-Factor™ scores, as well as the underlying basis for those scores. |

## Materiality Frameworks and the R-Factor™ Methodology

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 (the latter is interpreted as governance and oversight of sustainability issues such as regulatory compliance, risk management, and anti-competitive behavior) (ESG) issues, which are market-agnostic but industry specific, and Corporate Governance CorpGov issues (defined as issues linked to board independence, shareholder rights, and executive compensation), 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.

## Materiality Framework and Methodology for ESG Component

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 four 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: roughly 200 metrics provided by a data provider
- Of these, 143 metrics are considered material according to the SASB framework
- Of the 143 material metrics:
  - 45 metrics power the ESG component of the R-Factor™ score for companies in the Asset Management and Custody industry
  - 39 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 roughly 200 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 a 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 \$52T.

In 2020, SASB merged with the IIRC (International Integrated Reporting Council) to create the VRF (Value Reporting Foundation). A year later, the new organization became part of the IFRS (International Financial Reporting Standards). The IFRS established the ISSB (International Sustainability Standards Board) immediately thereafter, and the ISSB is currently working on collecting information and evidence to update the SASB Standards. The updated framework should be released in the coming two years, and the SASB standards are currently still relevant and up to date.

To learn more about SASB's materiality framework, visit [materiality.sasb.org](https://materiality.sasb.org).

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## Materiality Framework and Methodology for Corporate Governance Component

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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 16<sup>1</sup> 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 Code<sup>2</sup> 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.

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## Conclusion

The composite R-Factor™ score is comprised of a company's ESG and CorpGov scores.

For **companies**, R-Factor™ offers clear guidance on which ESG topics to focus on and disclose to investors, while utilizing the SASB Materiality Framework as a prism to identify industry-specific, relevant ESG issues.

By investing in ESG solutions powered by R-Factor™, **investors** have the opportunity to help ensure their capital is being allocated to companies that are focusing on managing and mitigating financially material ESG risks as defined by the SASB Materiality Framework.

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

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## Endnotes

1 State Street Global Advisors is a founding member of the Investor Stewardship Group and currently chairs the group's Steering Committee.

2 See <https://isgframework.org/corporate-governance-principles>.

## About State Street Global Advisors

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of index and active strategies to create cost-effective solutions. As pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager\* with US \$4.13 trillion<sup>+</sup> under our care.

\* Pensions & Investments Research Center, as of December 31, 2022.

<sup>+</sup> This figure is presented as of December 31, 2023 and includes approximately \$64.44 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.

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Investing involves risk including the risk of loss of principal.

Responsible-Factor (R Factor) scoring is designed by State Street to reflect certain ESG characteristics and does not represent investment performance. Results generated out of the scoring model is based on sustainability and corporate governance dimensions of a scored entity.

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