Investing Thoughtfully With Allspring's ESG Risk Assessment Framework

+ We believe asset managers should have a view on ESG factors and their influence on sectors and businesses.
+ Allspring's scoring focuses on the risk and materiality of ESG factors while emphasizing governance.
+ Our ESG risk assessment process incorporates our level of conviction in the assessment of a company and the trend of its scores.

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At Allspring Global Investments, we strive to do the very best for our clients. For us, this means investing thoughtfully: putting ourselves in our clients' shoes, actively listening to understand their long-term objectives, and digging deeper in pursuit of better solutions and strategies.

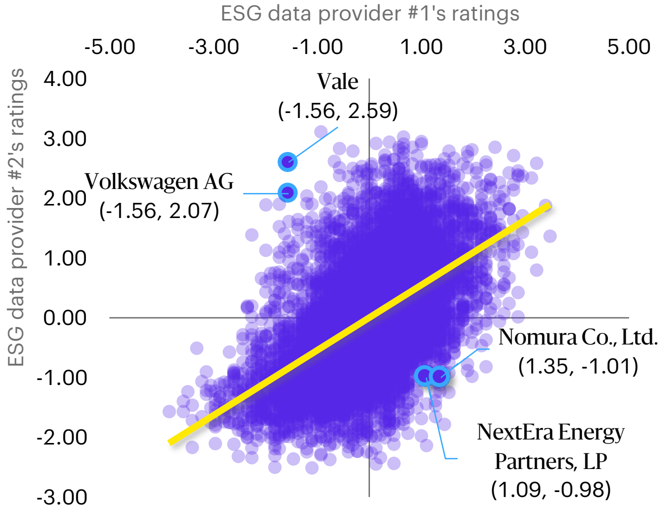
To that end, we believe that a deep, fundamental understanding of sectors, industries, and corporations—including their strategies—enables us to take advantage of market opportunities, inefficiencies, and dislocations, to drive investment performance and alpha generation. We also believe sharing ideas and opinions among team members enriches our understanding and enhances this pursuit.

Our philosophy and process incorporate a comprehensive analysis of quantitative and qualitative information, including, for many Allspring strategies, environmental, social, and governance (ESG) considerations. Integrating ESG elements into our assessment of fundamental creditworthiness and company valuation enhances our ability to identify opportunities and risks at the industry and issuer level.

But while ESG information is becoming more readily available, reliance solely on third-party data providers has three significant limitations:

01 **Unlike credit ratings, ESG ratings from third-party providers are constructed independently and aren't designed to analyze the same things.** These providers' ratings reflect their own views of materiality and their subjective assessments of ESG issues. As a result, ratings from different providers often exhibit weak-to-moderate positive correlations to each other. This is reflected in Figure 1, which plots ESG scores from two major ESG third-party data providers for various companies (with scores standardized to present them on the same scale). We highlight four of the companies rated, showing standardized scores they received from data provider 1 and data provider 2, to illustrate inconsistencies.

FIGURE 1: ESG RATINGS FROM TWO THIRD-PARTY VENDORS INDICATE BROAD COMMONALITY BUT INCONSISTENCY AT THE COMPANY LEVEL



Sources: Allspring and two ESG data providers; data points as of August 2023

While the yellow trend line shows a clear relationship between the two data sets, the dispersion of scores highlights the differences in methodologies and assessments among third-party providers. As the identified companies show, third-party data providers can have very differing opinions.

02 **The quality and uniformity of ESG data from companies is inconsistent.** Notably, ESG disclosure has improved in recent years, but not all companies report ESG data, and data that is disclosed isn't necessarily standardized. This leaves room for interpretation.

03 **ESG data provided by companies and used by third-party providers can often be stale and backward-looking.** Many companies issue sustainability reports annually, and the timing of these reports can significantly lag the release of financial data. Similarly, third-party data providers typically revise scores just once per year.

Given the constraints of ESG data available in the marketplace, we developed our own ESG scoring framework. It applies insights from our equity and credit analysts and embodies our values of clear communication, idea sharing, and collaboration across Allspring's global platform.

Our solution: ESGiQ

Allspring's ESGiQ (ESG Information Quotient) is a proprietary rating framework created to assess ESG risk factors. Our methodology enhances data from third-party providers with our analysts' in-depth sector knowledge and expertise. The rating framework leverages high-quality ESG data and analyses from leading external data providers, enabling broader coverage than what's available from a single provider. Also, assessment by our fundamental investment analysts complements the vended data to ensure timeliness and capture trends. We use a simple 1-through-5 scoring system—with 5 being best—to articulate our assessment.

There are two main components of our ESGiQ score:

1. A proprietary quantitative score that's distilled from multiple independent ESG datasets
2. An in-house qualitative score based on our analysts' assessments of risk exposure, risk management, and trend/outlook

ESGiQ's quantitative score

The quantitative score leverages proprietary processes that use statistical analysis and specialized sampling methodologies to distill insights from multiple ESG data sources. It's a robust system capable of dealing with the inconsistent methodologies, incomplete information, and nonuniform coverage found in many ESG datasets. By using custom-crafted algorithms, we're able to create a score that scales well across these diverse data sources, providing us with improved breadth of coverage.

The quantitative score offers three main benefits:

- **Reduced vendor bias.** Figure 1 shows potential vendor bias toward a given company, industry, or sector. Our ESGiQ quantitative framework uses a non-biased systematic approach to capture and distill information from ESG data providers.
- **Broader coverage.** By drawing on several ESG data providers with differing sets of coverage, our ESGiQ quantitative score is able to efficiently combine and make use of the total coverage potential.
- **More frequent updates.** Although data providers may report each month, some ESG data providers only guarantee an updated rating for an issuer annually. Our ESGiQ quantitative score is able to draw on multiple sources and provide a more timely assessment.

These attributes enhance the value of the ESGiQ quantitative score, enabling us to use it as an active, applied tool as well as an indicator for research. The quantitative scoring presents a unique benefit, as it can discern meaningful insights from multiple ESG data sources to benefit our investment teams and clients.

ESGiQ's qualitative score

Our fundamental analysts drive the qualitative score through their assessments of ESG risk factors. These experienced specialists have deep familiarity with their sectors, the companies within those sectors, and the management teams of those companies.

The qualitative score has several key features:

- **It's multifaceted.** Our ESG framework uses qualitative assessments on industry-wide topics to form an overall view of ESG risk and risk management for the issuer. Beneath the overall ESGiQ qualitative score for an issuer lies detailed information on risks the issuer faces and how they're managing each risk.
- **The assessment is sector-relative and risk-oriented.** The qualitative assessment is sector-specific, as material ESG risks vary based on factors such as a company's operations, industry, geography, regulatory environment, and markets, among others. Building on the framework of the Sustainability Accounting Standards Board, now maintained by the International Sustainability Standards Board, we've tailored each sector so that the qualitative score reflects material ESG risks. This differs significantly from a "kitchen sink" approach, which can mischaracterize actual risk by including a broad array of less relevant ESG topics.

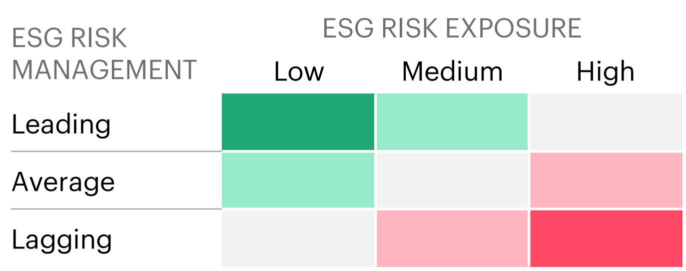
  Also, issuers in the same sector may face varying levels of risk for a particular issue; our qualitative score accounts for this using a relative-risk approach. For example, in the automotive industry, traditional automakers are more at risk from emissions standards than pure-play electric vehicle manufacturers.
- **It focuses on materiality.** Fundamental analysts focus their assessment of each issuer on key ESG issues. Thus, issuers are judged only on ESG factors likely to affect their financial performance or carry significant business risk. The qualitative ESG score doesn't judge the virtues of an issuer, nor does it assess the issuer's net contribution to positive environmental or social outcomes. Rather, it considers the material ESG factors faced by the company and how it's managing that risk. Isolating material ESG risks allows us to focus on risk and return.
- **Management and oversight are emphasized.** We believe management quality is a primary determinant of how well material issues will be managed. Therefore, a significant portion of our qualitative assessment is based on analysts' assessment of management quality and board oversight. The rest of the score's weighting is distributed across other material ESG risk factors the company faces.

Interpreting the qualitative score

By design, the qualitative score espouses **Allspring's value judgment** of risk exposure and management (Figure 2).

- **Low qualitative scores indicate "lagging ESG companies."** These are companies we feel have higher, material ESG risks and issues that are not well managed relative to peers.
- **High qualitative scores reflect the reverse: "leading ESG companies."** We believe these companies have lower, less material risks and are leaders in how they manage risks.

FIGURE 2: OUR QUALITATIVE SCORING FRAMEWORK



Source: Allspring

Timeliness and outlook of ESGiQ scoring

Our proprietary framework can capture new information (for example, ESG controversies) in a timely manner, and it allows for a forward-looking outlook. Quantitative scores are generated monthly to account for these changes. Additionally, analysts can quickly update their assessment of a company based on material events, and changes are immediately reflected in our scores. Our overall outlook is captured in the ESGiQ score. We incorporate a trend sign that reflects analysts' outlook: positive (+), stable, or negative (-).

The influence of analyst conviction

Our ESGiQ scores combine our quantitative and qualitative assessments based on our fundamental analysts' level of conviction in their ESG assessments. While our fundamental analysts know and understand the companies they cover, their ability to assess ESG factors may be limited or less certain for a variety of reasons, including lack of data, insufficient data, a new strategy, or a new company under evaluation.

As a result, an ESGiQ score reflects our qualitative score when an analyst has a high degree of confidence in the assessment. However, when an analyst is not completely confident in the ESG assessment, the ESGiQ score incorporates the quantitative and the qualitative scores. Should an analyst have minimal conviction in the ESG assessment, our ESGiQ score reflects the quantitative rating only. We expect that as company disclosures improve, and our analysts' knowledge evolves, our ESGiQ scores will rely less on quantitative scores and increasingly on our analyst-supported qualitative scores.

Figure 3 illustrates the output of our ESGiQ scoring methodology for three companies.

FIGURE 3: ESGiQ SCORING RESULTS

ISSUER	ALLSPRING QUANTITATIVE SCORE	ALLSPRING QUALITATIVE SCORE	ALLSPRING ESGiQ SCORE	ANALYST'S ESG CONVICTION	ANALYST'S COMMENTS
Global agribusiness and food company	4	3+	3+	Medium	Analyst outlook reflects average management of most ESG risks and a positive outlook due to its decarbonization strategy and science-based carbon goals.
Multinational oil and gas company	4	5-	5-	High	Good management of risk compared with peers, including ambitious net-zero target for Scope 1, 2, and 3 emissions by 2050, led to favorable view by analyst. Worker safety is an area of concern, leading to a slightly negative outlook.
U.S.-based property and casualty insurance company	3	2	2	Medium	Limited evidence of integrating ESG into the investment process, partly offset by reasonable efforts to mitigate risk of climate change in underwriting.

Source: Allspring, as of September 2023

The ultimate goal: A holistic and thoughtful process

Our proprietary ESG scoring framework speaks to the thoughtfulness of how we integrate ESG in many of Allspring's strategies. The sector-specific orientation of our risk assessment focuses on material issues influencing companies; the trend assessment provides additional valuable information.

The transparency and granularity of Allspring's ESGiQ framework allow us to dig deeply into topics and issuers in ways that address our clients' needs, enabling us to provide a more holistic assessment of risk across our research and investment processes.

For more information

We want to help clients build for successful outcomes, defend portfolios against uncertainty, and create long-term financial well-being. To learn more, investment professionals can contact us.

allspringglobal.com

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Investing in environmental, social, and governance (ESG) carries the risk that, under certain market conditions, the investments may underperform products that invest in a broader array of investments. In addition, some ESG investments may be dependent on government tax incentives and subsidies and on political support for certain environmental technologies and companies. The ESG sector also may have challenges such as a limited number of issuers and liquidity in the market, including a robust secondary market. Investing primarily in responsible investments carries the risk that, under certain market conditions, an investment may underperform funds that do not use a responsible investment strategy.

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