

# Advisory Blog

Timely insights on the issues that matter most to advisors and their clients

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## Calvert's approach to ESG data and the creation of Custom Composite Indicators

By: Calvert Research and Management | March 17, 2021

**Washington** - Calvert's ESG research is differentiated by its focus on financially material ESG issues, or ESG issues that present risks and opportunities that may significantly impact a company's profitability, valuation or access to capital.

These concepts have long been incorporated into Calvert's ESG investment research process, in which key performance indicators (KPIs) are used to measure companies' performance on material environmental, social, and governance (ESG) themes. These analyses are performed at the subindustry (e.g., "peer group") level to facilitate a relative comparison between companies that face similar ESG risks and opportunities. However, there are a host of challenges investor's may encounter when utilizing ESG data from a variety of sources that have been outlined in recent work from the Calvert Institute ("[Exploring ESG Data: A Deeper Understanding](#)"). Chief among these challenges are identifying KPIs with a focus on financially material ESG issues and maximizing KPI coverage for a diverse set of global issuers.

To address these challenges, Calvert has undertaken a project, in partnership with financial data science firm Sociovestix Labs, to develop a set of proprietary composite ESG KPIs, known as the Calvert Custom Composite Indicators (CCIs) across a selection of key ESG themes. These CCIs aggregate ESG data from a variety of third-party data vendors and weight toward constituents most highly associated with equity upside to arrive at a proprietary ESG score for a given issuer and ESG theme. With this methodology, Calvert's research system has been streamlined to zero in on information most relevant to ESG investors.

### **Custom Composite Indicator creation**

The Calvert CCIs have been developed to measure issuer performance on the key ESG themes already identified as material by our research analysts across various subindustries, and will replace or complement individual KPIs currently used in the Calvert research process.

To construct the CCIs, Calvert identified over 700 KPIs from five data vendors that met quality standards and were available with sufficient data history. Each KPI was assigned to one of 16 ESG themes used within the Calvert research process based on indicators' underlying definitions and vendor classifications. These KPIs were assessed to determine their relationship to company financial performance. Using a proprietary econometric model that controls for multiple geographic, sector, and market factors, equity returns for single-factor portfolios were modeled for each KPI across a range of score values and compared against returns of a global benchmark portfolio. Using these results, Calvert assigned a 'materiality factor' to each KPI tested, indicative of the strength of each indicator's association with equity upside.


CCIs were then constructed for each issuer by weighting all available constituent KPI values based on their corresponding

materiality factors, with a materiality factor threshold applied to ensure inclusion of only KPIs that meet a desired level of materiality. Calvert's research process allows for the adjustment of the threshold for KPI inclusion, allowing analysts to balance the goals of achieving high materiality and broad coverage across global issuers.

**Bottom line:** The CCIs enhance Calvert's research by providing a comprehensive and systematic way to measure the quality of incoming vendor data, specifically its relationship to equity price movements. By incorporating the CCIs in our modeling, Calvert employs financial data science to focus our investment decisions and engagement work on companies that we believe are well positioned to drive long-term value for shareholders and stakeholders alike.

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To read the full white paper from which this post was excerpted, [click here](#)

Picture of Calvert Research and Management  Calvert Research and Management

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