

ESG

Overview of ESG handling

October 2019

Introduction

Fedafin has been a signatory of the "[Statement on ESG in credit risk and ratings](#)" by [PRI](#) since August 2018.

PRI is an investor initiative in partnership with the Finance Initiative of the United Nations Environment Programme (UNEP FI) and the United Nations Global Compact, a worldwide pact between companies and the UN to make globalization socially and environmentally more responsible. Together with its international network of signatories, PRI is dedicated to the practical implementation of the six principles for responsible investing. The goal is to better understand the impact of investment activities on environmental, social, and governance (ESG) issues and to help signatories integrate these issues into their investment decisions.

After the focus for sustainable investing had for a long time been on equity investments, PRI has also turned its attention to the debt market. Credit rating agencies and their analyses of creditworthiness play a crucial role in this ecosystem. By signing the "Statement on ESG in credit risk and ratings", we share the common vision of improving the systematic and transparent consideration of ESG factors in credit ratings.

Credit Rating Agency vs. ESG Agency

It should be noted that, as an independent credit rating agency, fedafin continues to give its opinion exclusively on the probability of default and related parameters such as "loss given default" or "expected loss" in the form of credit ratings. This is the key distinction from ESG agencies, which assess companies exclusively or mainly on the basis of ESG criteria, while the question of the probability of default plays no or only a minor role.

ESG Concept

Specifically, fedafin reports ESG factors separately, which have a material influence on the credit rating. In this context, it is not ideological considerations that play the central role, but purely economic ones. The main question is therefore whether and to what extent a certain factor, which is or can be subsumed under ESG, has a material influence on the credit rating.

This approach leads to the following two crucial questions:

Which factors are being subsumed under ESG?

ESG is and remains a dynamic field without a conclusive list of factors. The definition is determined and further developed by the socio-political discourse. What was ESG ten years ago is different from today and will continue to develop over the next ten years.

At fedafin, the following major topics are currently covered:

- E: Resource consumption, emissions, innovations, biodiversity, CO₂, waste, water
- S: Personnel, human rights, society, product responsibility, customers, human capital, security, social cohesion
- G: Shareholders, management, corporate social responsibility, reporting, corporate structure, transparency, values

Do such factors have a material influence on the credit rating?

A material influence is exerted by factors that affect the income or expense side and ultimately the cash flow of a company in a way that is relevant to the credit rating.

On the revenue side, factors are generally conceivable that could have a positive or negative impact on demand or that could influence pricing (e.g. higher demand for solar vs. nuclear power, possibly accompanied by a change in prices - or a decline in revenue due to damage to the company's reputation).

On the expense side, higher procurement costs due to the above factors play a role. In addition, regulatory changes can also influence the cost side (e.g., punitive tariffs on imports of cars with excessive CO₂ emissions). In the future, a fundamental internalization of external costs, which have so far been borne by the general public, can also be expected.

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