ESG Rating Methodology

Fedafin's methodology for ESG rating assignments

August 2023

1. General Remarks

Fedafin considers a corporate's ability and effort to cope with an economy in transition and its relative position in the transformation process a key driver contributing to a comprehensive risk assessment. The need for economic transition is not only being claimed by stakeholders from outside the corporate world but rather emerges from a fundamental shift taking place in the perception of economic sustainability importance for long-term business success among major corporate and capital market participants.

Fedafin's ESG rating methodology provides the general framework for guidelines, principles and criteria we apply when assigning an ESG rating to corporates and its debt instruments.[1] Corporate ESG ratings are usually assigned both to issuers and its outstanding general debt instruments. Deviations from ESG rating assignments to an issuer can occur, for example, for debt raised to fund specifically defined operations, projects or purposes.

The ESG rating is a short to medium term rating reflecting our opinion about a corporate's relative position on its way to cope with ESG related business transformation requirements. The rating does not represent an exact measure, a probability or a risk metric, but rather gives a thorough indication of a corporate's ability and effort to fully implement the necessary policies and measures as a prerequisite for sustainable business activities.

The ESG rating covers a standard period of one year, which is in line with our monitoring policy effective for annual credit rating updates. As a matter of fact, our rating opinion may change substantially with material new information or data available prior to the standard annual update. ESG rating updates, therefore, may take place more frequently than credit rating updates.

The ESG rating methodology describes a range of possible criteria and indicators potentially affecting rating assignments. Acknowledging the nature of transformation processes, we expect business transformation requirements to vary substantially subject to a corporate's business model, product line and business size. As a consequence, the rating team may judge certain criteria and indicators non-relevant or, alternatively, include other business specific criteria and indicators not described in this methodology.

The rating team can deviate from standard assessment by actively tailoring the set of criteria case by case if considered appropriate. We therefore acknowledge that in certain cases a very pronounced transformation requirement can more than compensate other existing transformation requirements and vice versa.

[1] For the sake of simplicity this document refers to corporates as issuers of debt instruments. All statements in this document also apply to all other entities issuing debt instruments, accordingly.

2. ESG Policy

Economic research provides a range of explanations for market failure phenomena adversely affecting the business activity of market participants and thus contributing to inefficient and unsustainable resource allocations. Rating agencies have long ago recognized the potentially negative impacts of market failure phenomena as a key driver for credit risk. Appropriate criteria were incorporated in their credit rating methodologies, accordingly. Nevertheless, the issue of market participants not suffering from but rather causing market failure phenomena has been a major blind spot in traditional credit risk assessment until recently. Our ESG policy intends to close this gap.

The ESG rating methodology details main criteria and indicators for the areas **Environment**, **Social** and **Governance**. The term "ESG" and the three areas of corporate responsibility covered have become a well-established market standard over the past decades. We follow market standards but prefer to further separate the environmental area into the sections **Greenhouse Gas** emission and **Biodiversity** preservation. It is our view that biodiversity preservation poses a transformation requirement just as important for corporates as the reduction of greenhouse gas emissions. The ESG rating methodology builds on a thorough assessment of these four sections by assigning an ESG rating to each section on its own, complemented with an overall ESG rating for all sections together.[2]

Material standardization has been achieved in dealing with ESG since the millennium. Public perception, investor demand and the regulatory environment are key drivers in pushing ahead the evolvement of common definitions, criteria and reporting. Nevertheless, ESG assessments and ratings provided by third parties still differ significantly for one and the same issuer. This finding is not very surprising. While quantitative metrics are becoming more abundant, they are still hard to reliably generate and often difficult to interpret. ESG philosophies and methodologies based on alternative soft criteria, in return are strongly diverse by nature.

Fedafin understands the importance of quantitative metrics provided by management software tools as a prerequisite to implement and maneuver a company's transition strategy. Beyond considering the reporting and disclosure of quantitative metrics, our ESG policy strongly builds on a thorough analysis of soft criteria applied on a company's business activity in terms of sustainable development and fair competition. In our view, a qualitative criteria based corporate impact approach provides a more reliable ranking of corporate issuers.

From an economic perspective, the nature of transition goals differs according to the specific market characteristics of a corporate's business activity. We distinguish strategic transition goals of the economy as a whole for issuers broadly divided into three sectors:

- Public sector: (1) administration of public services and (2) provision of regulatory framework aiming at promoting and ensuring sustainable third-party investment, production and consumption

- Industry and commerce sector: (1) management of production and (2) launch of products and services aiming at promoting and ensuring sustainable third-party production and consumption

- Finance and insurance sector: allocation of investments in financial assets (1) on balance sheet through lending and (2) off balance sheet through wealth management aiming at promoting and ensuring sustainable third-party investment and production

While we acknowledge the importance of standardized ESG criteria promoted by leading authorities and institutions, we consider it necessary to deviate from the rather extensive range of criteria discussed in some cases.[3] Our policy in

[2] For an ESG rating report of a municipality, for example, see annex 1.

[3] See, for example, the UN Sustainable Development Goals (2015).

selecting robust criteria does not only cope with common statistical characteristics such as comparability, consistency and causality. We also put emphasis on challenging some minimum standards for a criteria's academic foundation and empirical evidence.[4]

3. ESG Rating Methodology

The ESG rating methodology provides an outline of the general corporate criteria evaluated in the four ESG sections. A standard set of indicators details the assessment process for all criteria.[5] The standard methodology deploys five criteria with another five indicators each to evaluate one section, summing up to a total of 20 criteria with 100 indicators for an overall corporate ESG assessment. Transformation requirements considered material and a corporate's efforts to cope with these requirements are systematically addressed by the rating team.

Deviations from the standard procedure are considered necessary especially when dealing with non-corporate legal entities such as trusts, funds, foundations or SPV. In these cases, the ESG rating assessment incorporates criteria stemming predominantly from the legal and organizational frameworks, statutory provisions and investment guidelines.

3.1. ESG criteria

The evaluation of ESG criteria generates an ESG rating for every ESG section. We refer to the terminology "profile" to facilitate reporting standards and benchmarking requirements while assigning the rating to each of the four ESG sections.

3.1.1. Environmental profile

The assessment of a corporate's environmental impact builds on two pillars; the assessment of an issuer's (1) greenhouse gas emission profile and (2) biodiversity preservation profile. The rating team makes a judgement on criteria to assess material impacts of a corporate's business activity causing damages to both climate and biodiversity. The costs of these damages are not reflected in the prices of the products or services of a corporate and, hence, burdened by the community. Economic literature describes the lack of internalization of such costs into product prices as negative external effects. Negative (and positive) external effects cause misallocations of capital and resources which eventually leads to an increasingly growing gap relative to a sustainable economic path. The climate crisis and biodiversity crises are non-ignorable examples for the exacerbating damages caused by an economy unable or unwilling to fully internalize external costs in product prices or, alternatively, to restrain unsustainable business activities through regulatory measures.

The main criteria to evaluate the climate profile include:

- GHG reduction strategy
- GHG reduction measures
- Clean energy usage and production
- Clean logistic and mobility
- Clean waste disposal

The main criteria to evaluate the biodiversity profile include:

- Biodiversity preservation strategy
- Biodiversity preservation measures
- Natural resources usage
- Biodiversity contamination
- Biodiversity regeneration

3.1.2. Social profile

The rating team makes a judgement on criteria to assess material impacts of a corporate's business activity causing damages to different community stakeholders in terms of economic welfare loss and economic development

[4] Some gender diversity related topics, for example, get excluded from our governance assessment due to the lack of sufficient foundation and evidence to qualify for a solid governance success factor.

[5] For an outline of standard ESG indicators, see annex 2.

deficiencies. Free and fair competition between market participants is a prerequisite to efficiently allocate capital and resources. Academic literature describes various characteristics of market structures and business practices that prevent free and fair competition to take place. Along with external effects, phenomena like market concentration, various forms of business manipulation practices and regulatory arbitrage practices are among major causes of market failures that we attribute to social responsibility flaws.

The main criteria to evaluate the social profile include:

- Employee and labour practices
- Client and contractor practices
- Public health and safety
- Public welfare and participation
- Public finance and development

3.1.3. Governance profile

The rating team makes a judgement on criteria to assess material impacts of governance flaws to a corporate's business activity. Deficiencies in disclosure and reporting, in corporate and board structures and judgement capabilities of management members can hamper good governance and, therefore, facilitate business failure. Academic literature describes a wide range of cognitive biases that can encourage or amplify poor judgment and decision-making. Together with cognitive bias issues we consider asymmetric information phenomena such as adverse selection and moral hazard as major causes of market failures we attribute to governance flaws.

The main criteria to evaluate the governance profile include:

- Judgement and diversity
- Disclosure and reporting
- Compliance and reputation
- Structures affecting independence
- Structures affecting effectiveness

[6] The selected weightings break down in a contribution of the different ESG sections and criteria that roughly align to ESG market standards.

3.2. ESG assessment design

The following remarks aim at better understanding and specifying the implementation of weighting, evaluation and materiality aspects in Fedafin's ESG policy.

3.2.1. Rating assessment

The general procedure in corporate ESG assessment entails the preliminary assignment of an ESG rating to every section. Subsequently, a standard weighting approach is applied to determine the corporate overall ESG rating.[6]

Profile / criteria	Sub-weight	Weight
Climate profile		32.5%
(1) GHG reduction strategy (2) GHG reduction measures	50%	
(3) Clean energy usage and production (4) Clean logistic and mobility (5) Clean waste disposal	50%	
Biodiversity profile		32.5%
(1) Biodiversity preservation strategy (2) Biodiversity preservation measures	50%	
(3) Natural resources usage (4) Biodiversity contamination (5) Biodiversity regeneration	50%	
Social profile		25%
(1) Employee and labour practices (2) Client and contractor practices	40%	
(3) Public health and safety (4) Public welfare and participation (5) Public finance and development	60%	
Governance profile		10%
(1) Judgement and diversity (2) Disclosure and reporting (3) Compliance and reputation	40%	
(4) Structures affecting independence (5) Structures affecting effectiveness	60%	

The equal weighting approach for the climate and biodiversity profiles highlights the importance we attribute to both environmental sections of ESG.

3.2.2. Criteria assessment

The ESG methodology allows for variable weighting, depending on the selection of criteria aligned to a corporate's specific business environment. Once a set of business specific ESG criteria is tailored, the general evaluation procedure provides a score for all criteria that can be attributed to an ESG rating category.

rating category	rating opinion	criteria score	indicator valuation
ESG 1	excellent	0.0 - 1.8	0/1
ESG 2	strong	1.8 - 2.6	2
ESG 3	moderate	2.6 - 3.4	3
ESG 4	weak	3.4 - 4.2	4
ESG 5	vulnerable	4.2 - 5.0	5

The rating team's judgment of ESG indicators provides a valuation from 0 to 5. While indicators within a set get equally weighted as the standard procedure, some predefined indicators can override other indicators. One such indicator is the red flag indicator which entails either the rating team's judgement or third-party opinions on general credibility flaws. The content of such flaws and deficiencies could be, for example, grossly unfair deception practices.[7] In our view, the monitoring efforts of third parties such as media or NGO's we consider reliable contribute to a more objective and reliable assessment.

Fedafin also relies on carefully selected global indices provided by well-established NGO's such as, for example, the Transparency International Corruption Perception Country Index. Global indicators are mainly deployed in the social responsibility and governance section of ESG assessment. From a global perspective, the deployment of appropriate indices contributes to a substantial improvement of objectivity and comparability in ESG assessment. Indices can influence the assessment by either aligning the evaluation of other indicators within a set of indicators or by shaping the set of indicators itself.

Another group of indicators worth mentioning includes third-party labels, partnerships and awards. This kind of commitments is a way of dealing with corporate sustainability that can frequently be observed in connection with a corporate code of conduct. Binding commitments can be useful and reasonable in replacing a sophisticated ESG strategy especially, but not exclusively, for small corporates. As a consequence, we consider credible third-party labels, partnerships and awards as an important contributor to a consistent ESG assessment. Fedafin's ESG policy applies strict requirements to the selection and deployment of binding ESG relevant commitments as an indicator since plentiful of labels and alike have literally flooded the marketplace for sustainability issues, recently.[8]

3.2.3. Materiality assessment

Many ESG rating providers apply some kind of materiality matrix to attribute a predetermined ESG exposure to different corporate business sectors. While we acknowledge the benefit of this approach, considerable problems attached to it remain. The attribution of exposures to single sectors can cause systematically biased results and consistency flaws mainly due to the broad range in exposure specifications and business sector definitions. In our opinion, even if two corporates are indisputably attributed to the same business sector, substantial deviations in business models and product lines can raise questions to the treatment of the two as equally exposed to ESG relevant transformation requirements.

On the other hand, considerations about how to deal with business size is essential when dealing with ESG assessment. Small and locally based corporates obviously cannot be attributed the same responsibility for market failure

[7] Relevant deception practices at the expense of corporate stakeholders are also labeled as, for example, "greenwashing", "socialwashing" or "diversity-washing".

[8] Labels we consider credible include, for example, energy town labels in the public sector or cradle to grave labels in the consumer goods and manufacturing sector.

impacts than big corporates with business activities on a global scale. This presumption holds with observations of market characteristics, especially in terms of supply chains. Bigger corporates frequently establish many-fold requirements for its small corporate suppliers and contractors, including ESG relevant topics. In our view it is justified, therefore, to systematically apply a size specific adjustment factor in the process of ESG rating assignment.

The adjustment factor's purpose is to benefit corporates with decreasing size in terms of revenues.[9] The benefit builds analytically on the non-linear log of the corporate size in relation to a corporate threshold. The benchmark is chosen according to generally accepted statistical definitions in terms of corporate size. While big corporates do not get any benefit at all, the adjustment factor's benefit starts to slowly kick in for medium-sized enterprises with substantial benefits resulting for small enterprises only.

4. ESG rating assignment

The ESG rating scale reflects our opinion about a corporate's relative position on its way to cope with ESG related business transformation requirements.[10]

Deviations from the standard procedure in assigning ESG ratings may occur if structural, legal or institutional circumstances are considered to justify a simplified approach. In our view, it can be appropriate to align the rating assignment procedure in cases like:

- tight linkage: the same ESG rating can be assigned to different corporates in case of tight linkage and control between entities. This holds true, for example, for subsidiary and affiliated corporates in a group structure or for tightly linked public sector corporates to the government entity.

- tight governance: an anchor approach for the corporate ESG assignment can be applied, alternatively, in case of strategic governance between entities. This holds true, for example, for public sector corporate business activities in a regulatory and institutional framework. In such circumstances, the public sector entity's ESG rating can serve as a starting point to assign a corporate ESG rating based on a reduced set of criteria and indicators.

- special purpose funding: for some debt instruments, it can be appropriate to include neither governance nor social ESG criteria in the rating assignment process. The main focus of a thorough ESG assessment for covered debt instruments or structured debt instruments often lies on the environmental impact of the projects being funded, alone. This holds true, for example, for a mortgage designed to fund an apartment building or a structured private placement note designed to fund an offshore windfarm park.

Fedafin does not expect transformation processes to be simple and steady task but a rather challenging management responsibility, instead. The transformation to sustainability can be a ride on a bumpy road with tailwind and occasional setbacks along the way. Changes in trends, assumptions or expectations that were key for the assignment of ESG ratings may occur more frequently than for the assignment of credit ratings. We acknowledge the assumption of a higher migration rate for ESG ratings compared to credit ratings. As a consequence, our ESG policy refrains from assigning a rating outlook to ESG ratings. ■

[9] ESG rating assignments to public and financial sector entities build on thresholds based on population size and asset volume, accordingly.

[10] For more details on Fedafin's ESG rating scale, see annex 3.

Annex 1: ESG rating report

Public Sector Entities. ESG Rating Rationale Cantons & Municipalities.

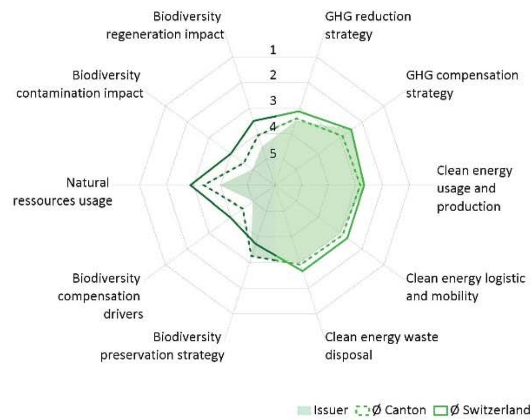
Issuer:		**ESG rating:**	**ESG 3**
Segment:	Political municipality (excl. school)	**Release date:**	**08.09.2022**
Order status:	Investor Solicited / Non-Public Rating		
Rating status:	Current Rating / Under Monitoring		
Listing:	Non SIX bond listed		
Accounting standard:	Harmonised Accounting Model		

08.09.2022

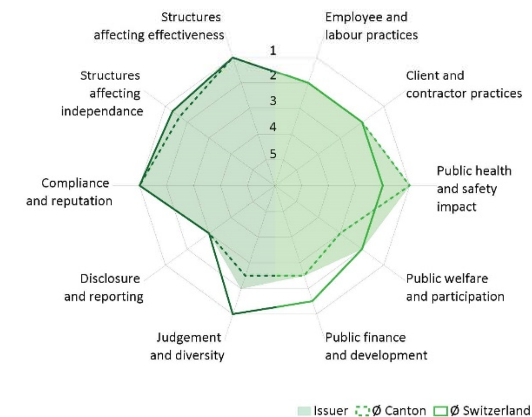
Rating overview

Environment		**ESG 3**
Greenhouse gas emissions		ESG 3
GHG reduction strategy	limited	
GHG compensation strategy	strong	
Clean energy usage and production	moderate	
Clean energy logistic and mobility	moderate	
Clean energy waste disposal	moderate	
Biodiversity		ESG 4
Biodiversity preservation strategy	moderate	
Biodiversity compensation drivers	weak	
Natural ressources usage	limited	
Biodiversity contamination impact	weak	
Biodiversity regeneration impact	weak	
Social		**ESG 2**
Employee and labour practices	strong	
Client and contractor practices	strong	
Public health and safety impact	excellent	
Public welfare and participation	strong	
Public finance and development	strong	
Governance		**ESG 1**
Judgement and diversity	strong	
Disclosure and reporting	moderate	
Compliance and reputation	excellent	
Structures affecting independance	excellent	
Structures affecting effectiveness	excellent	

Greenhouse gas emissions & Biodiversity preservation



Social responsibility & Governance standards



Labels impacting ESG rating

- Energy town

ESG assessment

excellent	strong	moderate	limited	weak
1	2	3	4	5

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Annex 2: ESG criteria and general indicators

GHG emission profile ESG criteria	Public sector ESG indicators	Industry and commerce sector ESG indicators	Finance and insurance sector ESG indicators
(1) GHG reduction strategy	- strategy (constitution vs legislation, GHG targets, loopholes, responsibilities) - pricing regulation (certificate or tax pricing approach, area of application, price level) - labels and projects considered relevant	- strategy (GHG targets, KPI metrics, KPI performance track, responsibilities) - remuneration policy (incentives) - pricing regulation (certificate or tax pricing approach, area of application, price level) - labels, awards and projects considered relevant	- strategy (GHG targets, KPI metrics, KPI performance track, responsibilities) - remuneration policy (incentives) - labels, awards and projects considered relevant
(2) GHG reduction measures	- public service innovation and technology transformation - compensation measures (scope, quality and protection of forests) - policy measures (executive and legislative declarations, subsidy and grant policy)	- business model transformation - product line transformation - innovation and technology transformation - facility management transformation - compensation measures (donations and sponsoring, nature of projects, third-party execution and supervision)	- financial product line transformation - investment transformation (alignment, integration or impact approach, area of application) - pricing transformation (pricing approach, area of application) - facility management transformation - compensation measures (donations and sponsoring, nature of projects, third-party execution and supervision)
(3) clean production & products	- energy sector (fossil vs renewable production mix, energy import balance, energy sources) - housing and industry sector (legislation, fossil energy usage, renewable energy production) - farming sector (legislation, structure and intensity, cattle farming)	- fossil energy usage in production (energy dependant business models, business conditions) - fossil energy usage in products (critical product lines, technologies) - renewable energy production	- fossil energy usage in business activity (fossil vs renewable energy mix) - fossil energy usage in financial product lines and investments (critical product lines, technologies) - renewable energy production
(4) clean logistic & mobility	- public sector transportation (legislation, fossil energy usage, innovation and technology transformation, population size) - private sector transportation (fossil energy usage)	- geographic scope of production (regional, national, transnational, international, global) - critical non-corporate activity (fossil energy dependant means of transport, sector technology and innovations, sector regulation and supervision)	- geographic scope of business activity (regional, national, transnational, international, global) - critical non-corporate activity (fossil energy dependant means of transport, sector technology and innovations, sector regulation and supervision)
(5) clean waste disposal	- waste disposal sector (legislation, waste structure and volume) - waste disposal technology and efficiency - waste disposal renewable energy production	- waste generating production (waste dependant business model, business conditions) - waste generating product lines (critical product lines, disposable and complementary products, product-lifecycle technology) - plastic recycling and packaging management (recycling approach, recycling pricing, geographic scope of markets)	- waste generation in business activity (business conditions) - waste generation in financial product lines and investments (critical product lines, disposable and complementary products, product-lifecycle technology)

Biodiversity profile ESG criteria	Public sector ESG indicators	Industry and commerce sector ESG indicators	Finance and insurance sector ESG indicators
(1) biodiversity preservation strategy	- strategy (constitution vs legislation, GHG targets, loopholes, responsibilities) - pricing regulation (polluter-pays pricing approach, area of application, price level) - labels and projects considered relevant	- strategy (biodiversity preservation targets, KPI metrics, KPI performance track, responsibilities) - remuneration policy (incentives) - labels, awards and projects considered relevant	- strategy (biodiversity preservation targets, KPI metrics, KPI performance track, responsibilities) - remuneration policy (incentives) - labels, awards and projects considered relevant
(2) biodiversity preservation measures	- public service innovation and technology transformation - topography and vegetation structure (scope and quality of flora and fauna) - compensation measures (scope and quality of protected areas) - policy measures (executive and legislative declarations)	- business model transformation - product line transformation - innovation and technology transformation - property management transformation - flora and fauna compensation measures (donations and sponsoring, nature of projects, third-party execution and supervision)	- financial product line transformation - investment transformation (alignment, integration or impact approach, area of application) - pricing transformation (pricing approach, area of application) - property management transformation - compensation measures (donations and sponsoring, nature of projects, third-party execution and supervision)
(3) natural resources usage	- housing and industry sector (legislation, water usage, land usage) - industry sector (legislation, business sectors, production conditions)	- natural resources usage in production (land, water, woods, flora and fauna) - natural resources usage in products (metals, rare earth, recycling mix) - energy usage in production (intensity, sources, fossil vs renewable mix)	- natural resources usage in financial product line and investments (land, water, woods, flora and fauna) - energy usage in production (intensity, sources, fossil vs renewable mix)
(4) biodiversity contamination	- agriculture sector (legislation, structure and intensity, biodiversity sensitive areas, flora and fauna impact) - land and water pollution (non-degradable pesticides, fungicides and fertilizers usage)	- critical use of substances in production and products (hazardous, toxic, non-degradable chemicals, hormones) - natural resources pollution (land, water, woods, air) - biodiversity sensitive areas pollution (seas, precious woods, flora and fauna)	- critical substances in financial product line and investments (hazardous, toxic, non-degradable chemicals, hormones) - natural resources pollution in financial product line and investments (land, water, woods, air) - biodiversity sensitive areas pollution in financial product line and investments (seas, precious woods, flora and fauna)
(5) biodiversity regeneration	- housing and industry sector (waste disposal volume, waste recycling volume) - agriculture and farming sector (structure and intensity, industrial vs biological production)	- waste generating production (waste dependant business models, business conditions) - waste generating product lines (critical product lines, disposable and complementary products, product-lifecycle technology, repair and maintenance policy) - recycling management (recycling approach, recycling volume, recycling pricing, geographic scope of markets)	- waste generation in business activity (business conditions) - waste generation in financial product lines and investments (critical product lines, disposable and complementary products, product-lifecycle technology, repair and maintenance policy)

Social profile ESG criteria	Public sector ESG indicators	Industry and commerce sector ESG indicators	Finance and insurance sector ESG indicators
(1) employee and labour practices	- ITUC Global Labour Rights Country Index - unfair labour contracting practices (subcontracting, temporary contracting) - unfair employee practices (age structure bias, salary structure bias, whistleblowing) - labels and projects considered relevant	- ITUC Global Labour Rights Country Index - unfair regulatory arbitrage (production sites) - unfair labour contracting practices (subcontracting, temporary contracting) - unfair employee practices (age structure bias, salary structure bias, whistleblowing) - code of conduct, labels, awards and projects considered relevant	- ITUC Global Labour Rights Country Index - unfair regulatory arbitrage (business sites) - unfair labour contracting practices (subcontracting, temporary contracting) - unfair employee practices (age structure bias, salary structure bias) - code of conduct, labels, awards and projects considered relevant
(2) client and contractor practices	- TI Corruption Perception Country Index - unfair client and contractor practices (public service and fees manipulation, data requirements & safety flaws) - unfair contract practices (public responsibility and liability) - labels and projects considered relevant	- TI Corruption Perception Country Index - unfair regulatory arbitrage (production sites) - unfair client and contractor practices (marketing and PR manipulation, service and price manipulation, data requirement & safety flaws) - unfair contract practices (market power, gagging contracts, responsibility and liability) - code of conduct, labels, awards and projects considered relevant	- TI Corruption Perception Country Index - unfair regulatory arbitrage (business sites) - unfair client and contractor practices (marketing and PR manipulation, service manipulation, data requirement & safety flaws) - unfair contract practices (market power, gagging contracts, responsibility and liability) - code of conduct, labels, awards and projects considered relevant
(3) public health and safety	- unfair business activity (GHG emissions and biodiversity preservation unsustainable) - security sector (regulation, criminal offense intensity, public security facility provision) - health care sector (regulation, public health care provision, hospital facility provision) - labels and projects considered relevant	- unfair business activity (GHG emissions and biodiversity preservation unsustainable) - unfair product line (critical community health and safety impact) - code of conduct, labels, awards and projects considered relevant	- unfair business activity (GHG emissions and biodiversity preservation unsustainable) - unfair financial product line and investments (critical community health and safety impact) - code of conduct, labels, awards and projects considered relevant
(4) public welfare and participation	- ILO Social Protection Country Index - social welfare sector (regulation, public expenditure level and structure) - housing sector (regulation, public housing provision, housing cooperatives, tax-related local migration) - labels and projects considered relevant	- ILO Social Protection Country Index - unfair regulatory arbitrage (production sites) - unfair welfare system pressure (early retirement, price regulation, market power, local migration) - code of conduct, labels, awards and projects considered relevant	- ILO Social Protection Country Index - unfair regulatory arbitrage (business sites) - unfair welfare system pressure (early retirement, price regulation, market power, local migration) - code of conduct, labels, awards and projects considered relevant
(5) public finance and development	- TI Corruption Perception Country Index - tax regime (tax raising power, fiscal equivalence and fiscal transfer system) - tax policy (individual and corporate income tax level, inheritance and gift tax level) - off balance sheet risk (local economy structure, systemic risk & implicit support)	- TI Corruption Perception Country Index - unfair business activity (GHG emissions and biodiversity preservation unsustainable) - unfair regulatory arbitrage (tax shifting, tax domiciles, tax burden) - unfair public finance pressure (price & cost regulation, systemic risk & implicit support) - code of conduct, labels, awards and projects considered relevant	- TI Corruption Perception Country Index - unfair regulatory arbitrage (tax shifting, tax domiciles, tax burden) - unfair public finance pressure (price & cost regulation, systemic risk & implicit support) - code of conduct, labels, awards and projects considered relevant

Governance profile ESG criteria	Public sector ESG indicators	Industry and commerce sector ESG indicators	Finance and insurance sector ESG indicators
(1) judgement and diversity	- TI Corruption Perception Country Index - public elections and participation (electorate behaviour and patterns, political party preferences)	- TI Corruption Perception Country Index - management background (curriculum, education, career and experience) - board diversity mix (insider, university, nationality, age, board experience) - board entry barriers (quota and restrictions)	- TI Corruption Perception Country Index - management background (curriculum, education, career and experience) - board diversity mix (insider, university, nationality, age, board experience) - board entry barriers (quota and restrictions)
(2) disclosure and reporting	- reporting and disclosure standards (HRM 1, HRM 2, IPSAS) - accounting standards (investment, valuation & consolidation regulation)	- reporting and disclosure standards (IFRS/USGAAP, Swiss GAAP FER, OR) - reporting and disclosure frequency	- reporting and disclosure standards (IFRS/USGAAP, Swiss GAAP FER, OR) - reporting and disclosure frequency
(3) compliance and reputation	- TI Corruption Perception Country Index - reputation history (topography and population size, local economy and housing structure, local corruption history) - legal history (investigations, measures, penalties, supervisory actions)	- TI Corruption Perception Country Index - reputation history (business model, sector reputation, production sites) - legal history (investigations, measures, penalties, supervisory actions)	- TI Corruption Perception Country Index - reputation history (business model, sector reputation, production sites) - legal history (investigations, measures, penalties, supervisory actions)
(4) structures affecting independence	- public sector independence (topography and population size, local economy and housing structure) - public sector conflict of interest (fiscal equivalence structure, private sector engagements)	- board member independence (board size, management, other board mandates) - board member conflict of interest with stakeholders (labour union, main supplier or client, politics, short-term activist shareholder, single person or smoky mirror ownership)	- board member independence (board size, management, other board mandates) - board member conflict of interest with stakeholders (labour union, main supplier or client, politics, short-term activist shareholder, single person or smoky mirror ownership)
(5) structures affecting effectiveness	- simplicity focus (population size, scope and organization of administration, nature and legal status of government-linked corporates)	- integration focus (synergies, remuneration cultures, complex risk control and risk oversight) - simplicity focus (complexity of group structures, group levels, subsidiary companies, cross-participations, domiciles) - control focus (free float, share transfer restriction)	- integration focus (synergies, remuneration cultures, complex risk control and risk oversight) - simplicity focus (complexity of group structures, group levels, subsidiary companies, cross-participations, domiciles) - control focus (free float, share transfer restrictions)

Annex 3: ESG rating scale

ESG 1	excellent Business activity highly sustainable with ESG related business transformation requirements either non-existent or neglectable. Business activity not sustainable but excellent relative position on the way to cope with ESG related business transformation requirements. Policies in place and measures implemented to ensure sustainable business activities are considered to be highly appropriate and credible.
ESG 2	strong Business activity predominantly sustainable with ESG related business transformation requirements existent but not substantial. Business activity unsustainable but strong relative position on the way to cope with ESG related business transformation requirements. Policies in place and measures implemented to ensure sustainable business activities are considered to be largely appropriate and credible. Minor flaws or deficiencies in specific ESG relevant areas are present and expected to remain.
ESG 3	moderate Business activity partially sustainable with ESG related business transformation requirements existent and substantial to some extent. Business activity unsustainable with moderate relative position on the way to cope with ESG related business transformation requirements. Policies in place and measures implemented to ensure sustainable business activities are considered to be basically appropriate and credible. Major flaws or deficiencies in specific ESG relevant areas are present and expected to remain.
ESG 4	weak Business activity poorly sustainable with substantial ESG related business transformation requirements. Weak relative position on the way to cope with ESG related business transformation requirements. Policies in place and measures implemented to ensure sustainable business activities are considered to be not sufficiently appropriate and/or credible. Major flaws and deficiencies across several ESG relevant areas are present and expected to remain.
ESG 5	vulnerable Business activity very poorly sustainable with very substantial ESG related business transformation requirements. Very weak relative position on the way to cope with ESG related business transformation requirements. Policies in place and measures implemented to ensure sustainable business activities are considered to be not sufficient, inappropriate and/or lack credibility. Major flaws and deficiencies across most ESG relevant areas are present and expected to remain.

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