

ESG Rating Methodology

Scope

This report describes the framework Sustainable Fitch applies to assign and monitor ESG Ratings on a global scale. We assign ESG Ratings to individual entities; to Green, Social, Sustainable (GSS) and Sustainability-Linked debt instruments, collectively referred to as “labelled instruments”; and to non-labelled instruments. These include secured and unsecured debt issued by entities, including corporates; financial institutions; infrastructure; public finance; and sovereigns, supranationals and agencies (SSAs); and structured finance transactions. The ESG Ratings that we assign are:

- ESG Entity Rating (ESG ER; to individual entities)
- ESG Framework Rating (ESG FR; to debt instruments)
- ESG Instrument Rating (ESG IR; derived by combining the ESG ER and ESG FR and applying filters; see page 12)

The ESG ER indicates an entity’s performance, commitment, and integration of environmental and social considerations into its business, strategy and management, and the effectiveness of governance. We measure the impact of business activities on the environment and on society. The ESG FR evaluates the use of proceeds (UoP) from green, social or sustainable instruments, or the key performance indicators (KPIs) and sustainability performance targets (SPTs) for sustainability-linked instruments, and the extent to which they contribute to environmental and social objectives.

ESG Ratings are derived from an analysis of actions, outcomes, impacts and activities, in addition to policies and broader commitments. When assessing environmental alignment and impact, we generally refer to science-based taxonomies such as the EU taxonomy and, for social issues, the social aspects of the UN Sustainable Development Goals (SDGs). ESG Ratings are independent of any effect that ESG factors may have on the credit profile of the entity or debt transaction itself.

Key ESG Rating Drivers

Key ESG ER Drivers (0–100)

| | |
|---------------------|--|
| Business activities | Determines whether an entity’s main business lines contribute positively to environmental and social goals. Each business activity is benchmarked against internationally recognised environmental taxonomies and internationally recognised documents setting out social goals. |
|---------------------|--|

Other ESG ER Drivers

| | |
|-----------------------|---|
| Entity overview | Description of the overall business and ESG strategy of an entity. |
| Environmental profile | Entity-wide environmental profile with a focus on policies, disclosure, targets, evolution, the supply chain and environmental incidents. |
| Social profile | Entity-wide social profile with a focus on human and labour rights; diversity; community and customers; targets and supply chain; and social incidents. |
| Governance profile | Entity-wide governance profile with a focus on financial reporting; management and control; remuneration; risk; and tax management. |

Key ESG FR Drivers (0–100)

| | |
|----------------------|---|
| UoP or KPIs and SPTs | Analysis of how the funds obtained from GSS instruments will be allocated, and the quality of the Sustainability-Linked instrument key performance indicators (KPI) and targets the entity has established. |
|----------------------|---|

Other ESG Framework Rating Drivers

| | |
|----------------------------------|--|
| Other data on UoP | Evaluation of whether the UoP from debt issuances and loans contribute to environmental and social goals. The analysis may include the pipeline of new projects, restrictions on projects and the transition pathway to achieve goals. |
| Project evaluation and selection | Assessment of an entity’s process for selecting projects; beginning with the establishment of eligibility criteria and extending to the governance of the selection process, including an assessment of whether oversight from a sustainable finance team (or similar group) and internal controls are in place. |
| Management of proceeds | Effectiveness of the tracking and monitoring of proceeds’ allocation. |
| Reporting and transparency | Availability and breadth of UOP or KPI information, report integrity, and timeliness. |

Source: Sustainable Fitch

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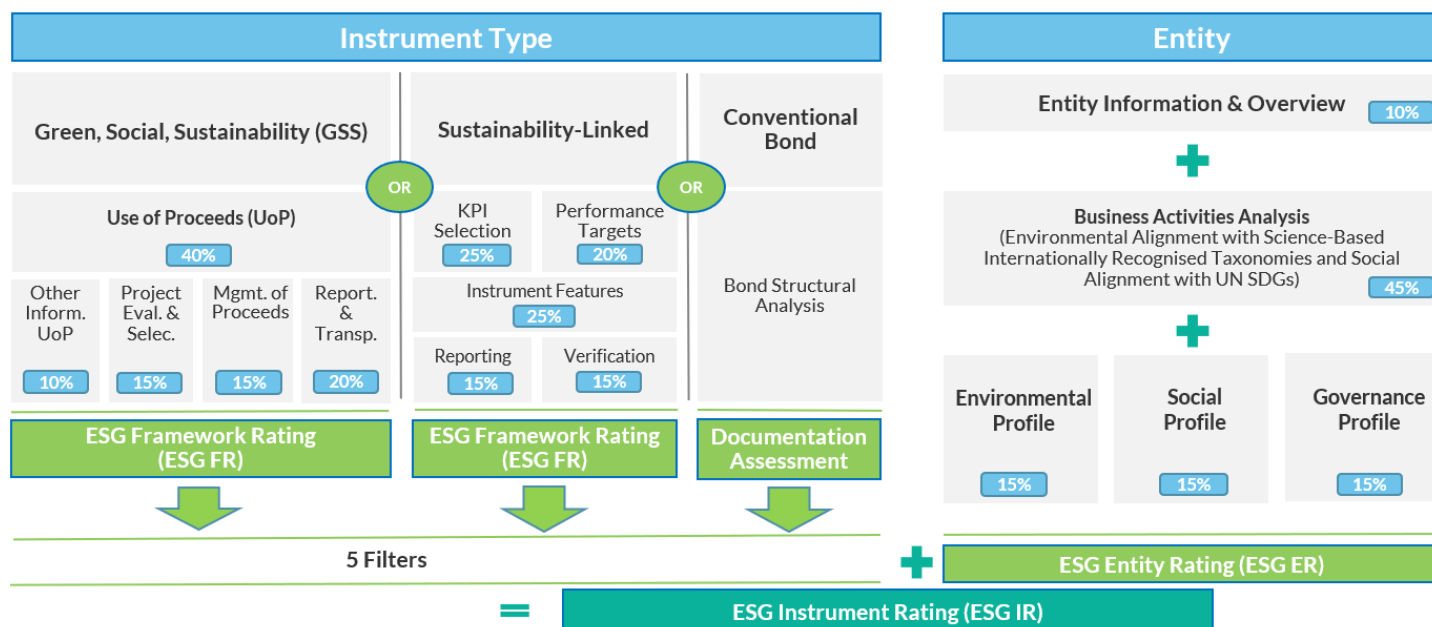
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Sustainable Fitch – ESG Ratings

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This report replaces the version originally published on 14 September 2022, to correct the formatting of the last chart on page 12 relating to Structured Finance. There have been no other changes to the methodology.

Methodology Overview



Source: Sustainable Fitch

Rating Scale and Data

Sustainable Fitch's ESG Rating Scale is expressed between one (highest) and five (lowest); it is derived from a more granular score between zero and 100, where 100 represents full alignment with ESG best practices and positive environmental, social and governance impact. The individual scores provide a transparent and quantitative analysis of each ESG factor influencing the entity or its instruments. Sustainable Fitch also comments on the alignment of the bond with indicators such as the ICMA principles and guidelines, the SDGs, and the EU Green Bond Standard.

The main sources of data used to assign ESG Ratings are publicly disclosed information (from the entity or an authoritative third-party source) and, to the extent available, financial and non-financial statements. These mainly include the entity's annual report, non-financial information, the entity and instrument frameworks, and the published allocation and impact reports. ESG analysts may review information published by credible media sources; they may also use private information, but this must be managed in an appropriate way.

For more information on the Rating scale and definitions please see Appendix 1; for Disclosure, Data and Datasets please see Appendix 2 and for a comparison between ESG Scores and ESG Rating, please refer to Appendix 3.

Reference Taxonomies

Environmental and social factors are key to analysing green bonds and social bonds, respectively, and both factors drive our sustainability bond assessments. Our environmental assessment of the business activities and use of proceeds is inspired by the 2021 version of the EU taxonomy, with science-based classifications of environmentally sustainable economic activities. For social alignment, we take inspiration from the social aspects of the SDGs.

The EU taxonomy only covers a limited number of activities; therefore, we refer to it (and in particular to its science-based technical screening criteria, and do no significant harm (DNSH) criteria), only when possible. We will refer to other taxonomies of choice for activities that are not covered by the EU taxonomy; for example, the Climate Bond Initiative's taxonomy. Sustainable Fitch may add other widely recognised and science-based taxonomies in the future. We will build on our experience and knowledge to identify major themes and drivers relevant to the analysis for activities not currently covered by any taxonomy of reference.

Methodology for ESG Entity Rating

This part of Sustainable Fitch's ESG Ratings focuses on a high-level strategic view of the entity, its approach to sustainability, and how it embeds sustainability in its business activities and strategy. We assess the environmental and social impacts of the entity's overall ESG policies, procedures and outcomes, as well as those at an individual business activities level, using the same references as those described in 'Reference Taxonomies' on Page 2.

We consider different levels of commitment and, when assessing the company's ESG strategy and policies, we look for tangible evidence that an ESG objective has been achieved (or that it is in the process of achieving it), and only give credit to it when this is the case.

Factors Analysed in ESG Entity Ratings

| Factor | Weight (%) | Scope of analysis |
|--|------------|--|
| Entity information (strategy overview) | 10 | The degree of sustainability embedded in the strategy, commitments and reporting of an entity. |
| Business activities | 45 | The extent to which an entity's activities contribute positively towards the environment, as well as the extent to which it makes a positive contribution to society. Each business activity is compared to science-based environmental taxonomies and the social aspects of the SDGs. |
| Environmental profile | 15 | Entity-wide environmental profile across various aspects (e.g. policies; disclosure; evolution; targets and supply chain; and environmental incidents treatments) |
| Social profile | 15 | Entity-wide social profile across various aspects (e.g. human rights; labour rights; diversity; community and customers; targets and supply chain; and social incidents treatments) |
| Governance profile | 15 | Entity-wide governance profile across various aspects (e.g. financial reporting; top management and control; remuneration; risk management; and tax management) |

Source: Sustainable Fitch

Entity Information (Strategy Overview)

The items evaluated are broken down as follows:

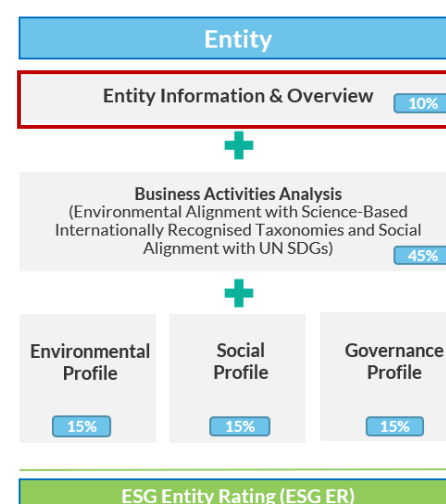
Sustainable Strategy: This section focuses on the high-level strategic view of the issuer, its sustainability-related commitments or policies and a verification by Sustainable Fitch of the progress towards strategic goals.

ESG Risk Management: We review how the company acknowledges and addresses ESG risks, including both environmental and social risks, and assess whether the entity is managing such risk through mitigation or adaptation.

Sustainability Reporting: We assess the alignment of sustainability reporting with international or established market standards such as the Task Force on Climate-Related Financial Disclosures and the Global Reporting Initiative.

Engagement on SDGs: We evaluate if the issuer strategy is aligned or committed to the SDGs. Sometimes this can be in addition to a sustainable strategy. We check for references to, and initiatives towards, the SDGs in the entity's financial and non-financial reporting.

ESG Considerations Incorporated Across Business Activities: This step is particularly relevant for financial institutions, as the scope of their activities can be very diverse and have different strategies and policies. Corporates, on the other hand, tend to have common strategies and policies across all their business lines. We check whether the ESG considerations are incorporated across all its business lines (e.g. asset management and commercial banking). There may also be exclusion policies for lending and investments (such as for coal mining and gambling), or the application of value discounts to portfolios that contain considerable physical risks.



Business Activities

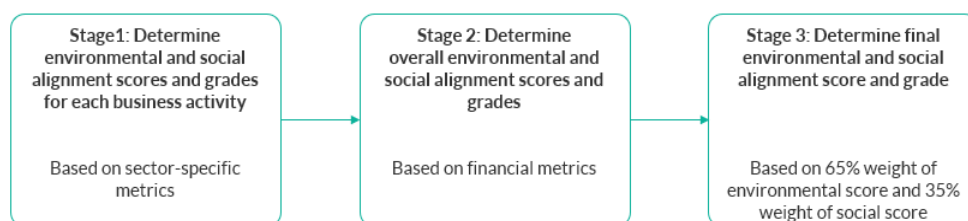
The assessment of the environmental and social impacts of an entity's business activities is at the core of the ESG ER. A grade from 1 to 5 (1 is best and 5 is worst) and a score from 0 to 100 (100 is best and 0 is worst) are assigned to each business activity based on the assessment of its environmental and social alignment to major science-based taxonomies and SDGs, respectively, or, in the absence of this alignment, based on Sustainable Fitch's assessment of beneficial or detrimental impact of such activity. Governance is assessed on an entity-wide level as it is applicable across the whole company. Each activity is weighted – based on its contribution to the entity's total revenue or other specific metrics – in order to assess the relative importance of each business activity to an entity's total activity. The scores and grades are described below:

| Score | | Environmental | Social |
|---------------------------------|------|---|--|
| 1 | Best | Activity fully aligned to major science-based taxonomies. | Activity directly contributing to social SDGs (assessed in terms of both activity and target population, e.g. vulnerable communities). |
| 2 | | Activity subject to technical science-based thresholds which are marginally not met, or may cause minimal damage. | Activity contributing to social SDGs (focusing on activity but not on a target population). |
| 3 | | Neutral (with no direct positive or negative impact). | Neutral (with no direct positive or negative impact). |
| "Negative" activity flag | 4 | Activity subject to technical science-based thresholds which are significantly not met, or may cause high damage. | Activity with marginal or limited negative impact on social SDGs; or high negative impact but partially mitigated. |
| | 5 | Worst | Activity with negative impact on social SDGs; or significant or high negative impact and not mitigated. |

There are three stages in the determination of the overall business activity grade. First, we identify the business activities of the entity being evaluated on a consolidated basis and which can be broken down by type of services or by targeted clients. For example, a bank's activities could include retail banking, corporate banking and asset management, among others; while for an energy company, it's activities could be broken down by solar energy production and electricity transmission and distribution. These are generally referred to as business segments in financial reporting.

For each business activity, we calculate the share of each segment to the overall business using a specific financial metric (e.g. pre-provision operating profit or revenue), thus determining their weight. Second, environmental and social alignment of each business activity are assigned grades. Third, as a next step, we blend the social and environmental scores and grades, applying a 65% weight for environmental alignment and 35% weight for social alignment. The greater weighting of environmental reflects the progression in environmental management best practices.

Three-Stages Process for Determining Business Activities Score and Grade



The specific cases for financial institutions and insurance businesses or companies are detailed in Appendix 4.

Environmental Profile

In this area, we assess a company’s entity-wide environmental objectives through five major themes:

Policies: We review companies’ environmental and natural resources policy regarding the use of natural resources; covering water, land use, biodiversity, waste, and pollution. Where relevant, we review the policy in depth to see if it covers all necessary aspects or if it is only partial. We also assess whether the entity discloses metrics and measurements across all the five mentioned natural resources, or only some.

Disclosures: We review the following disclosures from an entity:

- Emission disclosures (covering Scopes 1, 2 and 3 emissions)
- Natural resource usage disclosures
- Non-natural resource disclosures, such as energy and material usage

This is important for us to gain an understanding of the carbon and environmental footprint of the entity.

Evolution: We review the trend of the metrics disclosed, such as emissions and natural resource usage, over the last three years. We assess whether the company is following its targets and transitioning towards sustainability goals.

Targets and Supply Chain: We review the type, progress and remit of the issuer’s environmental targets. For example, if the targets are science-based targets or aligned with a net-zero strategy, as well as their time horizons. We also review environmental targets relating to supply and customer chains, as well as the commitment and their enforcement.

Risks and Incident Treatment: We review critical incidents from an environmental perspective; namely, those that an entity would usually classify in the highest category in terms of damage or severity. We consider the three years prior to the date of the analysis.

Social Profile

In this area, we assess a company’s entity-wide social objectives through six major themes:

Human Rights: We look into whether the issuer has a human rights policy and, if so, analyse its quality. We also look into whether the entity has signed up to the UN Global Compact or similar, or left it up to the local legislation. We also take into consideration whether those policies and commitments have actually been implemented.

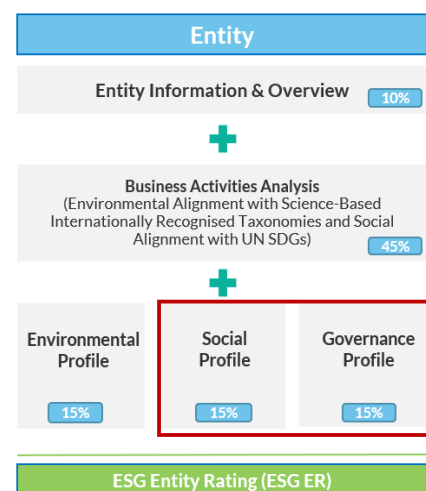
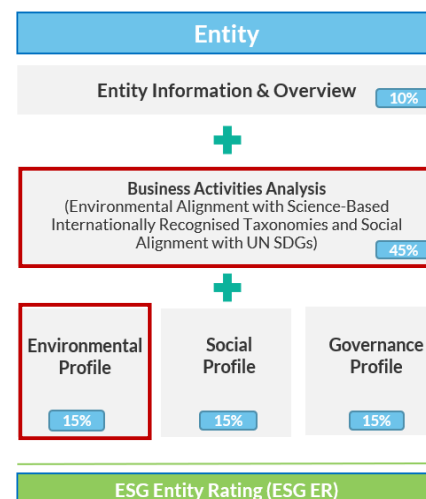
Labour Rights: We review the issuers’ labour rights policies and their extent; e.g. are they aligned with international standards such as those of the International Labour Organization. We also review the turnover rate, work conditions and incidents such as employee and contractor fatalities and permanent disabilities. We consider the three years prior to the date of the analysis.

Diversity: We assess several diversity factors, including employee diversity across the whole company, diversity at the senior management level, the overall gender pay gap, the gender pay gap at the senior management level and other types of diversity in addition to gender.

Community and Customers: We review the entity’s involvement in the communities it operates in, including its philanthropy programmes; and we review its customer relationship and satisfaction indicators based on multiple areas.

Targets and Supply Chain: We review the type, progress and remit of social targets. For example, if the targets are embedded in the issuer’s strategy and the management’s remuneration. We also assess whether the social targets are promoted in, or mandatory for, the supply and customer chain.

Risks and Incident Treatment: We review the critical incidents from a social perspective, namely those that an entity would usually classify in the highest category in terms of damage or severity. We focus on issuer accidents that have had an external effect (e.g. public fatalities), as incidents affecting employees and contractors are already considered in another sub-component. We look back to the prior three years of the date of the analysis.



Governance Profile

The governance profile assessment includes:

Financials and Reporting: We assess whether the issuer has been subject to any critical fines or investigations, or to significant external audit remarks related to fraud or financial reporting, during the past three years.

Top Management and Control: We review the board composition, independence and representation, including the diversity of its members; as well as the internal audit functions and their actions in the past three years. For example, we assess whether the board includes diversity in the minority or majority of its members, and whether the minority or majority are independent. We also consider employee representation.

Remuneration: We review the remuneration criteria and metrics. We also review pay gap ratios across employee levels (to the extent that such information is available), the CEO pay gap ratio, and the linkage of senior executive remuneration to environmental and social objectives. The information helps us assess whether an entity's remuneration policies are fair and how likely they are to drive positive environmental and social outcomes.

Risk Management: We assess whether the issuer has any form of risk management system in place and is able to identify and mitigate risks. We take into consideration cyber, legal, compliance and competition-related risks. This allows us to evaluate an issuer's overall risk profile. We look back to the prior three years of the date of the analysis.

Tax Management: We assess the entity's behaviour in relation to tax haven usage and transfer prices, together with its explanation of these. We look for any fines it may have received in the past three years related to tax management practices.

Methodology for ESG Framework Rating

The ESG FR aims to identify the ESG strength of the labelled bond framework on a standalone basis (i.e. not considering any of the broader activities of the issuer) regardless of any entity-assigned labels. The analysis focuses on the use of the proceeds or on the KPIs and SPTs associated with the labelled debt instrument. An important part of our analysis is determining the effectiveness of the framework it uses to contribute to the advancement in environmental and social goals. ESG FR can be assigned without assigning an ESG ER.

Conventional bonds or loans (i.e. instruments without a specific label) cannot receive an ESG FR grade, unless they have a sustainability framework (or specific information) that includes specific UoP or KPI linked targets.

Conventional bonds are only assessed at an overall instrument level (ESG IR), which combines an analysis of the entity (ESG ER) as well as instrument documentation; this leads to a more limited ESG insight than for labelled bonds. However, if the company issuing the conventional bonds is well-rated from an environmental and social basis due to the scope of its business, then the favourable rating will reflect positively on the instrument.

Factors Considered for GSS Instruments

The table below shows the five key factors considered for the ESG FR, as well as their respective weightings and analytical scope.

| Factors | Weight (%) | Scope of analysis |
|----------------------------------|------------|---|
| UoP | 40 | Degree and strength of the contribution of each UoP to environmental and social improvement, with reference to generally accepted international standards and taxonomies. |
| Other data on UoP | 10 | Strength of the framework in relation to the UoPs. |
| Project evaluation and selection | 15 | Strength of the framework in relation to the evaluation and selection process of various projects financed. |
| Management of proceeds | 15 | Strength of the framework in relation to how the proceeds are managed. |
| Reporting and transparency | 20 | Strength of the framework in relation to the allocation and impact reporting. |

Source: Sustainable Fitch

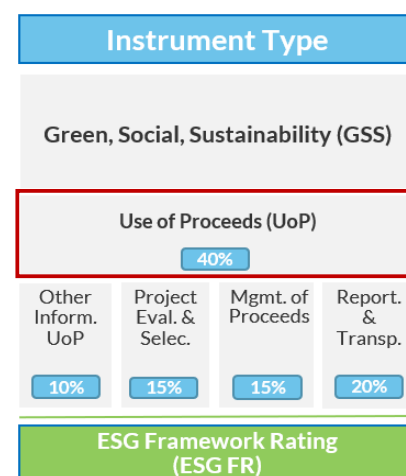
Use of Proceeds (UoP)

The UoP of a particular instrument is the most significant part of Sustainable Fitch's analysis to arrive at the ESG FR. The instrument's legal documentation, offering memorandum or framework are checked to determine if the bond has predefined UoPs. The main documents used to determine the UoPs for labelled instruments include:

- bond prospectus and final terms;
- GSS framework;
- investor presentations;
- allocation report (if available); and
- impact report (if available).

Once each UoP is identified, they are indexed to the NACE classification, where relevant; and the percentage share of each UoP is calculated. If the percentage share is not available (for example, because the instrument was issued less than a year before the analysis date), or no guidelines on allocation are available, then Sustainable Fitch may assume that the UoPs are equally apportioned to the portfolio of eligible projects.

Sustainable Fitch does not categorise bonds as GSS based on the label chosen by the entity; instead we select the most appropriate categorisation and form a view based on the main areas covered by the UoP, and assess the instrument on that basis. For example, if the entity labelled



the bond as a sustainability bond, but there are no social aspects to be assessed in the bond UoPs, we will assess it as a green bond.

Each UoP is graded from 1 to 5 (1 is best and 5 is worst) from an environmental and/or social perspective. The assessment of environmental alignment and impact takes inspiration from major science-based taxonomies, while the evaluation of social aspects is largely based on contributions to the social part of the SDGs. (See Reference Taxonomies on Page 2).

The different scoring levels broken down by Environmental and Social activities are:

| Score | | Environmental | Social |
|---------------------------------|------|--|---|
| 1 | Best | Activity is aligned to the EU taxonomy under any circumstance i.e. no additional thresholds, meets screening criteria or meets DNSH criteria | Activity directly contributing to the social SDGs (for both activity and target population, e.g. vulnerable communities). |
| 2 | | Activity subject to threshold, screening criteria marginally not met and/or potential minimum damage albeit mitigated | Activity contributing to the social SDGs (focusing on activity but not on a target population). |
| 3 | | Neutral | Neutral to the social SDGs (with no direct positive or negative impact) |
| "Negative" activity flag | 4 | Activity subject to threshold, screening criteria significantly not met, and/or potential for high damage | Activity with marginal or limited negative impact on the Social SDGs; or activity with high negative impact on social SDGs that is partially mitigated. |
| | 5 | Worst | Always negative impact with potential for high damage |
| | | | Activity with significant or high negative impact on social SDGs that is unmitigated |

Other Information on UoP

In this section, we analyse five key areas:

Financing Versus Refinancing: An understanding of the bond's contribution to achieving sustainability goals is key in this section of our assessment. We calculate the split of funding allocated to new and existing projects. This is important as the higher the share of new projects funded, the better the expected impact from the instrument's proceeds, in terms of additionality towards environmental and social objectives.

Look-Back Period: We assess the age of the projects and activities financed by the labelled bond issued. This allows us to evaluate the incremental future impact of the debt instrument. We consider proceeds used entirely for new projects to have a better ESG impact, and that a reasonable look-back period for projects is no more than three years.

Transition Pathway: We review the associated transition pathway for labelled instruments with transition-related UoPs, which covers the targets for projects and investments that are helping the issuers successfully transition to a low-carbon environment.

UoP Definition: We review UoP definitions, and whether there are any restrictions or covenants that will ensure enforceability in case of potential breaches from a sustainability point of view.

Controversial Projects: Based on the UoP selected, we check if there are explicit bans on controversial projects, either from an environmental or social perspective, to ensure that funds are not allocated to projects with a potentially harmful ESG impact.

Project Evaluation and Selection

In this section, we analyse four key areas:

Pre-defined Selection Process: We identify whether a pre-defined and clear process is in place to identify and select eligible projects and activities that the bond proceeds would be allocated to.

Internal Checks and Balances Among Relevant Teams: We evaluate whether there are multiple teams or an ad-hoc multi-skills committee involved in the UoP decision-making process, or whether decisions are made by a single department or team. We believe decisions



taken by committees made up of representatives from a range of business units can help to avoid the risk of greenwashing and social washing.

Internal Control Structure: We evaluate and review an entity’s project selection process to understand whether there is a division of duties between the group of people who propose eligible projects and those making the decision to approve or reject them. This reinforces internal debate on project eligibility so that proceeds are assigned in a manner that promotes positive environmental and/or social contribution.

Sustainability Team Involvement: We review whether a sustainable finance team (or a group with similar skills or attributes) are represented in the project selection process as their presence would help to ascertain that the selection criteria are correctly applied.

Management of Proceeds

The process of tracking and monitoring the bond proceeds focus on four key topics:

Proceeds Tracking Method: We assess whether the issuer is using a suitable tracking method to guarantee that the proceeds raised by the instrument will be used appropriately. Setting up an SPV to segregate the proceeds, or using a dedicated bank account, can help ensure that the proceeds are used for specific eligible assets and that commingling of funds with those for non-eligible projects can be avoided.

Unallocated Proceeds: We assess how the entity is going to use, or is using, the unallocated proceeds, and whether they are applied to environmental or social projects or are invested in the same manner as the entity’s other treasury investments.

Allocation Monitoring: We assess if, and how, the issuer is performing eligibility monitoring on the allocated UoPs. If an allocated project loses its eligibility, there should be a procedure in place to remove such a project from the allocation.

External Verification of Tracking: We assess if, and how, the tracking method and allocation is verified by an external entity. This could be through a financial auditor or other specialised companies. We expect proceeds to be used as stated by the entity in its framework.

Reporting and Transparency

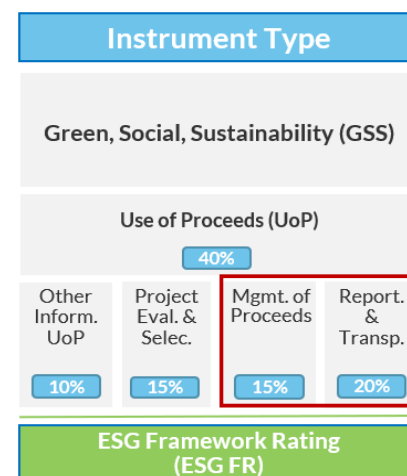
We review the company’s allocation and impact reporting with a specific focus on:

Allocation Reporting: This is a key transparency metric to allow us to understand the effective allocation breakdown and allocated projects, the frequency and duration of reporting, and informative details (e.g. the split of capex to opex). We review whether the commitment in the allocation reporting is a mandatory obligation or is a less binding, intention-based commitment.

Qualified Verification: We assess the frequency and type of verification provided. We view it as positive when asset allocations are verified by a qualified, independent body or individual, and reviewed on greenness and socialness, ideally on an annual basis.

Impact Reporting: The environmental and social impact from labelled bonds or loans are important to our assessment. We assess the impact report, as well as its frequency, quality, relevance and data details. We view it as positive when the issuer has used a recognised standard for impact reporting. The report can include data provided at asset or project level, aggregated by a group of similar projects or at portfolio level. The more detailed the disclosure and transparency provided is, the better it is for the market.

Reporting on Transition: Should the bond have transition-related UoPs with dedicated transition pathways, we assess the reporting on those targets and their degree of achievement. An example would be the entity issuing a bond to reposition business activities that have Ratings of 4 or 5 under our methodology, with it identifying some targets for improvement.



Factors Considered for Sustainability-Linked Instruments

The five key factors when assessing the ESG ratings for Sustainability-Linked frameworks are:

| Factor | Weight (%) | Scope of analysis |
|---------------------|------------|---|
| KPI selection | 25 | Strength of the KPI selection. |
| Performance targets | 20 | The quality and ambition of the performance targets. |
| Bond features | 25 | Strength of the ESG-related instrument features in the framework. |
| Reporting | 15 | Strength of the reporting and disclosure. |
| Verification | 15 | Strength of the verification process. |

Source: Sustainable Fitch

We also assess the soundness of the defined KPIs and associated targets. The indicators should be relevant, ambitious, credible and measurable. Performance should be tracked over a time period against a pre-defined benchmark.

KPI Selection

In this section we review the selection of KPIs focusing on three key topics:

Measurement: We assess the KPIs considered in the instruments, reviewing the relevance for the entity from an ESG perspective; the proportion of the entity covered (i.e. the whole entity or partial); and the metric's transparency. For example, if the KPI is related to an external ESG rating, then the transparency of this underlying metric, as well as its dynamics, should be disclosed.

Historical Disclosure: We gain an understanding of the company's record and ambition, and assess whether the KPI has been determined and disclosed in previous years, giving more value to KPIs which have been used over a time period as well as to the company's record and ambition.

Qualified Verification: We assess whether a qualified independent specialist or an auditor was involved in the verification of the KPI at issue date and historically, enabling us to understand the importance of the target to the entity.

Performance Targets

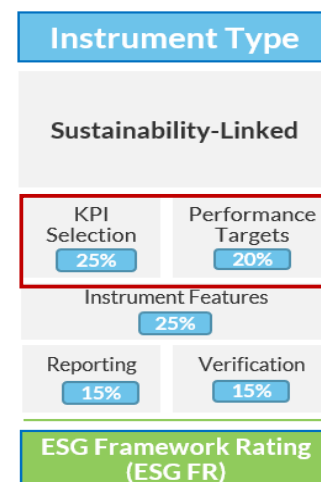
In this section, we assess certain parameters related to the performance targets:

Transition Pathway: Targets can be established using a scientific approach and, if they are not, we review the extent to which measurable and quantifiable targets are available, and assess the quality of the targets and whether they are aligned with the company's strategy.

Time of Target Observation: Observation dates for targets are important as their positioning could result in opportunistic behaviour and misleading readings. For example, testing too early in the life of the bond may reduce the relevance of the targeted ambition. Similarly, testing too late during the life of the bond may limit the impact of achieving or missing the target.

Peer Comparison: We assess the key ESG targets of each entity and address relevant comments about the target where necessary. In order to carry out our assessments, we need to gain an understanding as to whether the identified target is absolute and based on company-only performance, and how it compares with the performance of other parties.

Target Scope: We review the target and assess whether it is multidimensional, i.e. covering multiple ESG aspects, as this may magnify the target's impact.



Instrument features

The two key factors evaluated are:

Impact of Instrument: We assess the impact of meeting (or not meeting) the target by considering different types of impact, including financial and structural. For the financial impacts, we differentiate between investment grade and sub-investment grade. The bigger the impact on the company's funding costs or instrument structure, the bigger the incentive to meet the target, which increases the value of the KPI in our assessment.

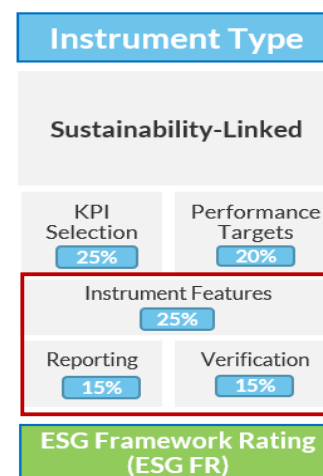
Dynamic or Static Target: We analyse the potential future transformations that the entity could be subject to when defining the KPI or target (e.g. M&A, disposals, and other changes to the entity perimeter). Ideally, a company should identify ways to incorporate such a parameter change in the calculation of its KPIs and targets.

Reporting and Verification

Our review of reporting and verification for KPI-linked bonds is similar to that for GSS bonds:

Reporting: We assess the availability of publicly available reporting on KPIs and targets, reporting frequency and informative details.

Qualified Verification: We assess the frequency and type of verification provided and the publication of verification results. In particular, we assess the strength of the verification or technical analysis sought by the issuer. The verification is stronger if an external technical specialised body or individual conducts the verification. It can weigh negatively on the entity's ESG Score if verifications are performed by consultants with limited visibility of the overall picture of the issuer's ESG profile.



Methodology for Conventional Bonds; Sovereigns, and Local and Regional Governments; and Structured Finance and Other Secured Funding

Conventional Bonds

The ESG FR is also applicable to non-labelled bonds, although our focus is on relevant data included in either sustainable financing frameworks or in alternative documents. Conventional bonds generally lack a framework or similar documents, but our analysis strives to gain an understanding as to whether there are some bond specificities that could lead us to consider some credit toward environmental or social goals.

We perform a documentation assessment, where we check prospectuses, final terms and other instrument documents to determine whether the proceeds are for general corporate purposes or if there are specific indications, restrictions, targets or other features.

Sovereigns, and Local and Regional Governments

Methodologies for rating sovereigns and local and regional governments are currently under development.

Structured Finance and Other Secured Funding

In addition to the ESG FR (or documentation assessment for some conventional bonds), we factor in an assessment of the collateral or assets for secured funding. Specifically, we address:

Environmental or Social Nature of the Assets: We assess the environmental and social features of the assets that serve as collateral for a particular bond, and try to gain an understanding of whether they contribute to the general environmental or social good, respectively.

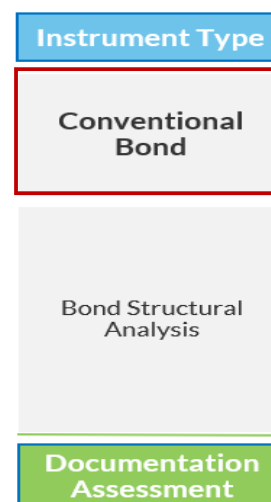
GSS Asset Tracking Method: We assess the recourse of the sustainable investor to the assets with environmental or social characteristics in priority to other creditors, and how these assets are segregated from the rest of the collateral.

Quantity of the GSS Assets: We verify the amount of GSS assets available in the structure in relation to the analysed instrument volume and the overall collateral amount available.

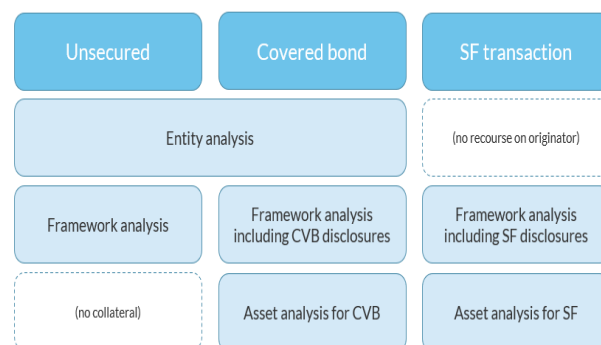
GSS Asset Substitution: Should the asset no longer be eligible (or lose their GSS nature), we measure the extent of the willingness and ability to substitute assets. An example would be any external obligation to maintain a certain level of GSS assets similar to the requirement by the European Banking Authority to calculate the green asset ratio.

Cash Balances: Cash balances that are invested in assets which have similar characteristics to the UoP of the bond are given credit in our assessment.

The methodology for Structured Finance (SF) can be applied to covered bonds, synthetic asset-backed securities (ABS), and structured finance instruments both with and without recourse to the originator.



Comparison of Unsecured and Secured Debt - ESG Analytical Process



| | ESG Asset Assessment | ESG Framework Rating | ESG Entity Rating | ESG Instrument Rating |
|---|----------------------|----------------------|-------------------|-----------------------|
| Covered bonds | ✓ | based on the UoP | ✓ | ✓ |
| Synthetic ABS | ✓ | based on the UoP | ✓ | ✓ |
| SF with recourse to the originator/sponsor | ✓ | based on the UoP | ✓ | ✓ |
| SF without recourse to the originator/sponsor | ✓ | based on the UoP | X | ✓ |

Source: Sustainable Fitch

Methodology for ESG Instrument Ratings

The ESG IR places the ESG FR in the context of the entity's ESG ER. This allows for an absolute ESG credential assessment whereby each instrument can be compared globally with other similar types of instruments issued by different issuers, as well as different types of instruments issued by a single issuer.

Once the ESG FR is produced for the GSS or sustainability-linked instrument (or the documentation assessment is completed for conventional bonds), the resulting output goes through a series of filters (with potential upward and downward adjustments) which are aggregated with the ESG ER and include:

- The framework quality and strength from the ESG FR
- The documentation features from the documentation assessment
- The entity's business activities quality and performance

Filters Used in Sustainable Fitch's ESG Rating Methodology to Determine the Instrument Rating

Sustainable Fitch derives the ESG instrument rating by combining the ESG ER and the ESG FR and applying five different filters, where relevant. Positive or negative adjustments will increase or decrease the assigned instrument rating. These filters are:

| Filter | Item Evaluated | Rationale |
|--------|---|--|
| 1 | Business activities of the entity | When a Rating of 1, 2 or 3 (see page 13 for the definition) is assigned to a particular business activity, we deem it to contribute positively (or at least neutrally) to society both from an environmental and a social perspective. This filter will affect the extent of the positive or negative impact for KPI-linked or conventional instruments issued by the entity. |
| 2 | Debt instrument: restrictions on UoP | We evaluate whether the terms and conditions of the issuance of the analysed instrument include restrictions on financing controversial activities (i.e. coal or oil extraction or activities violating human rights). The restriction should be environmental-related in the case of green bonds and social-related in the case of social bonds. KPI-linked instruments will be evaluated in the same manner. |
| 3 | Framework quality: GSS instruments | The higher the score of the GSS instrument framework, the higher will be the impact of the positive adjustment. |
| 4 | Framework quality: KPI-linked instruments | The higher the score of the KPI-linked framework, the higher the impact of the positive adjustment. |
| 5 | Documentation quality: conventional instruments | We assess the use of proceeds, restrictions, targets, and other green and socially relevant features included in the issuance documentation. |



Appendix 1: ESG Rating Scale

The ESG Rating Scale is applicable to each of the pillars of Sustainable Fitch's ESG Ratings (ESG FR, ESG ER and ESG IR). Each debt security is assessed together with its related issuing entity. These assessments are monitored, at least, annually.

For each type of assessment, we assign the following:

- A grade, from one (the highest) to five (the lowest).
- A score (from zero to 100), for greater granularity, that forms the basis for the grade.
- Commentary on issuer information for the assessment and our view of each item.

Mapping the Grade to a More Granular Score

| Grade | Description | Band (range) | Mid-point |
|-------|----------------------|--------------|-----------|
| 1 | Fully ESG aligned | 100-87.5 | 93.75 |
| 2 | Mostly ESG aligned | 87.5-62.5 | 75 |
| 3 | Neutral | 62.5-37.5 | 50 |
| 4 | Mostly ESG unaligned | 37.5-12.5 | 25 |
| 5 | ESG unaligned | 12.5-0.0 | 6.25 |

Note: In this context "aligned" means level of alignment with best practises and taxonomies of reference.

Source: Sustainable Fitch

Sustainable Fitch ESG Rating Definitions

| Rating | ESG ER Definition | Band (range) | Mid-Point |
|--------|---|--------------|-----------|
| 1 | Indicates that the entity analysed evidences an excellent ESG profile and impact. Entity is excellent in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. | 100-87.5 | 93.75 |
| 2 | Indicates that the entity analysed evidences a good ESG profile and impact. Entity is good in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. | 87.5-62.5 | 75 |
| 3 | Indicates that the entity analysed evidences an average ESG profile and impact. Entity is average in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. | 62.5-37.5 | 50 |
| 4 | Indicates that the entity analysed evidences a sub-average ESG profile and impact. Entity is sub-average in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. | 37.5-12.5 | 25 |
| 5 | Indicates that the entity analysed evidences a poor ESG profile and impact. Entity is poor in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. | 12.5-0.0 | 6.25 |

Source: Sustainable Fitch

| Rating | ESG FR Definition | Band (range) | Mid-Point |
|--------|---|--------------|-----------|
| 1 | Indicates that the debt instrument and its framework evidence an excellent ESG profile. Framework structure is excellent in terms of alignment with ambitious best practices, and proceeds are dedicated to excellent environmental and/or social activities or projects according to taxonomies of reference. | 100-87.5 | 93.75 |
| 2 | Indicates that the debt instrument and its framework evidence a good ESG profile. Framework structure is good in terms of alignment with ambitious best practices, and proceeds are dedicated to good environmental and/or social activities or projects according to taxonomies of reference. | 87.5-62.5 | 75 |
| 3 | Indicates that the debt instrument and its framework evidence an average ESG profile. Framework structure is average in terms of alignment with ambitious best practices, and proceeds are dedicated to average environmental and/or social activities or projects according to taxonomies of reference. | 62.5-37.5 | 50 |
| 4 | Indicates that the debt instrument and its framework evidence a sub-average ESG profile. Framework structure is sub-average in terms of alignment with ambitious best practices, and proceeds are dedicated to sub-average environmental and/or social activities or projects according to taxonomies of reference. | 37.5-12.5 | 25 |
| 5 | Indicates that the debt instrument and its framework evidence a poor ESG profile. Framework structure is poor in terms of alignment with ambitious best practices, and proceeds are dedicated to poor environmental and/or social activities or projects according to taxonomies of reference. | 12.5-0.0 | 6.25 |

Source: Sustainable Fitch

| Rating | ESG IR Definition | Band (range) | Mid-point |
|--------|---|--------------|-----------|
| 1 | Indicates that the debt instrument, in the context of the ultimate issuing entity, has an overall excellent ESG profile and impact. Entity is excellent both in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. Instrument is excellent in terms of framework structure and proceeds destination. | 100–87.5 | 93.75 |
| 2 | Indicates that the debt instrument, in the context of the ultimate issuing entity, has an overall good ESG profile and impact. Entity is good both in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. Instrument is good in terms of framework structure and proceeds destination. | 87.5–62.5 | 75 |
| 3 | Indicates that the debt instrument, in the context of the ultimate issuing entity, has an overall average ESG profile and impact. Entity is average both in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. Instrument is average in terms of framework structure and proceeds destination. | 62.5–37.5 | 50 |
| 4 | Indicates that the debt instrument, in the context of the ultimate issuing entity, has an overall sub-average ESG profile and impact. Entity is sub-average both in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. Instrument is sub-average in terms of framework structure and proceeds destination. | 37.5–12.5 | 25 |
| 5 | Indicates that the debt instrument, in the context of the ultimate issuing entity, has an overall poor ESG profile and impact. Entity is poor both in terms of alignment of the activities with taxonomies of reference and integration of ESG considerations into the business, strategy and management. Instrument is poor in terms of framework structure and proceeds destination. | 12.5–0.0 | 6.25 |

Source: Sustainable Fitch

Appendix 2: Disclosure, Data and Datasets

Individual datasets with grades and commentary will be available through various channels (e.g. CSV and feeds). Access to the score and sub-score database will allow the market to perform direct comparisons among entities and instruments on a broader ESG perspective using one of the ESG Ratings offered, or on specific fields or sub-components.

Example of Entity Peer Comparison in Oil and Gas Sector

| | Entity 1 | Band score | Entity 2 | Band score |
|-------------------------------------|----------|------------|----------|------------|
| Issuer ESG strategy | 2 | 80 | 2 | 68 |
| Business activities | 4 | 18 | 5 | 10 |
| Upstream (%) | 38 | - | 83 | - |
| Downstream (%) | 62 | - | 13 | - |
| Chemicals (%) | 0 | - | 3 | - |
| Environmental view | 3 | 58 | 4 | 22 |
| Policies | 3 | 50 | 3 | 43 |
| Disclosure | 2 | 88 | 4 | 25 |
| Evolution | 3 | 44 | 5 | 0 |
| Targets and supply chain | 1 | 91 | 3 | 45 |
| Risk and incident treatment | 5 | 0 | 5 | 0 |
| Social view | 2 | 65 | 4 | 30 |
| Human rights policies | 1 | 100 | 1 | 100 |
| Labour rights and employee policies | 3 | 60 | 4 | 26 |
| Diversity | 3 | 40 | 5 | 11 |
| Customer and community | 2 | 67 | 2 | 67 |
| Targets and supply chain | 1 | 93 | 4 | 30 |
| Risk and incident treatment | 1 | 100 | 3 | 40 |
| Governance view | 2 | 65 | 3 | 50 |
| Financials and reporting | 1 | 100 | 3 | 40 |
| Top management and control | 3 | 58 | 3 | 58 |
| Remuneration | 2 | 81 | 5 | 13 |
| Risk management | 3 | 50 | 3 | 50 |
| Tax management | 1 | 100 | 1 | 100 |

Source: Sustainable Fitch

Dataset Content

In addition to the three main ESG Ratings, users will be able to have full visibility on the five sub-components for each rating and on many other sub-factors that are part of the overall analysis.

In the next sections, we identify the most relevant data and grades that will be made available. Initially, we will focus on making numerical fields available, with access to the qualitative data and commentary being available in a second stage.

Framework analysis for GSS instruments

- UoP Analysis (Grade, NACE, allocation share for each UoP)
- UoP/Other Info Analysis (Grade, targets, refinancing share, review back period)
- Project Evaluation & Selection Analysis (Grade)
- Management of Proceeds (Grade, tracking method)
- Reporting & Transparency (Grade, verifier, frequency, capex/opex mix)
- Transition Label (if applicable; Fitch-defined)
- ICMA alignment (with full external review form)
- Contribution to SDGs
- EU Green Bond Standards alignment (with reference to Environmental Objectives, Technical Screening Criteria, DNSH and Social Safeguards for each UoP)
- Instrument relevance & Instrument/Business Activities integration

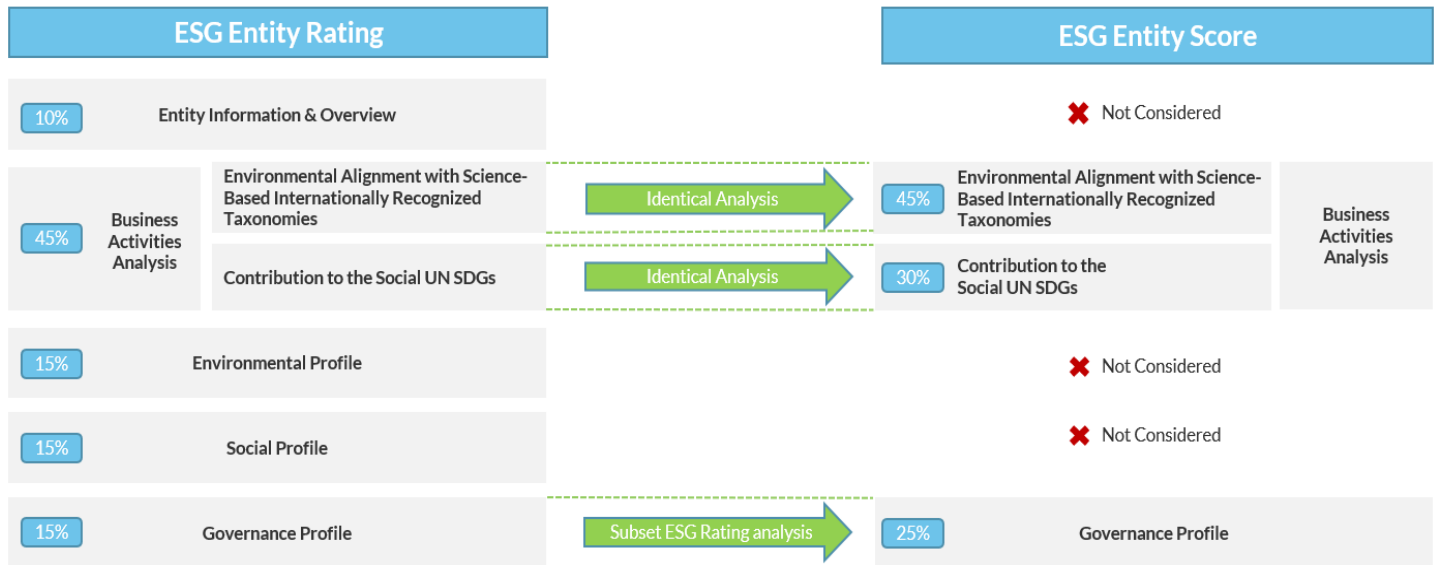
Framework analysis for sustainability-linked instruments

- Full details on KPI(s), Performance Target(s), Bond Features, Reporting Frequency, Verification
- Transition Label (if applicable)
- ICMA alignment (with full external review form)
- Contribution to SDGs
- Instrument relevance and Instrument/Business Activities integration

Entity

- Sector Trajectory / Company Direction (commentary)
- Issuer Business Activities (E/S Grade, NACE, impact on revenue or another relevant/available financial metric for each business activity)
- ESG Issuer Strategy (Grade)
- Environmental (Grade, targets list/details, Disclosure Grade, Evolution Grade, Risk & Incident Treatment Grade, Target and Supply Chain Grade)
- Social (Grade, Community and Customers Grade, Diversity Grade, Human Rights Grade, Labour Rights Grade, Risk & Incident Treatment Grade, Target and Supply Chain Grade)
- Governance (Grade, Financial and Reporting Grade, Remuneration Grade, Risk Management Grade, Tax Management Grade, Top Management and Control Grade)
- Contribution to SDGs
- Issuer Environmental/Social Impact metrics (selected principle adverse indicators)
- Pure Player label (Fitch-defined)

Appendix 3: Comparison Between ESG Ratings and ESG Scores



Source: Sustainable Fitch

Appendix 4: Financial Institution- and Insurance-Specific Business Activities Rationales

Financial Institutions

The assessment of environmental and social impact for a financial institution’s business activities (retail banking, corporate banking, etc.) is focused on an analysis of its loan book and investment portfolio in line with the breakdown provided in the financial reporting and will include loans, which positively contribute to the environment or society or, at another extreme, to sectors with medium or adverse environmental impacts (such as high carbon-emitting sectors). We turn to lending criteria and considerations such as sector exclusions or transition policies, where actual and stratification information of sector exposures does not have sufficient details of the environmental or social impact.

We generally use pre-impairment operating profit for the entity’s full financial year to calculate the share of each banking business activity. If pre-impairment operating profit by segment is not available, we can use the sum of net interest income and net fees and commissions or net revenue.

We assign grades and scores for environmental and social alignment of the credit exposure (gross loans for corporate or retail banking, etc.). From a baseline score, we adjust for internal policies on environmental and socially sensitive sectors, as well as for transition policies, commitments and other factors which have the potential to limit negative environmental and social impact. We also consider whether there could be a positive transformation of the current credit exposure.

The list of environmentally and socially sensitive sectors include, but are not limited to, thermal coal, fossil fuels, mining, cement, steel, transportation, real estate, weapons, tobacco, and nuclear production. We apply the adjustments to the corresponding subsegment where different policies are applicable to a business activity (e.g. when SME lending is included in retail banking business activity).

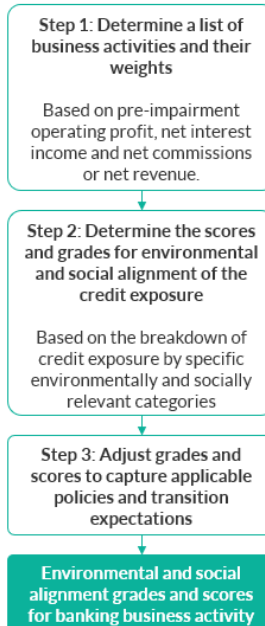
Insurance Business / Companies

Our assessment of environmental and social alignment of the insurance business activities is based on the analysis of the investment portfolios of the institutions and their underwriting business. We use the disclosed breakdown of actual investments and gross written premiums. We analyse the investment criteria and considerations such as sector exclusions or transition policies where actual and stratification information does not provide sufficient details of the environmental or social impact.

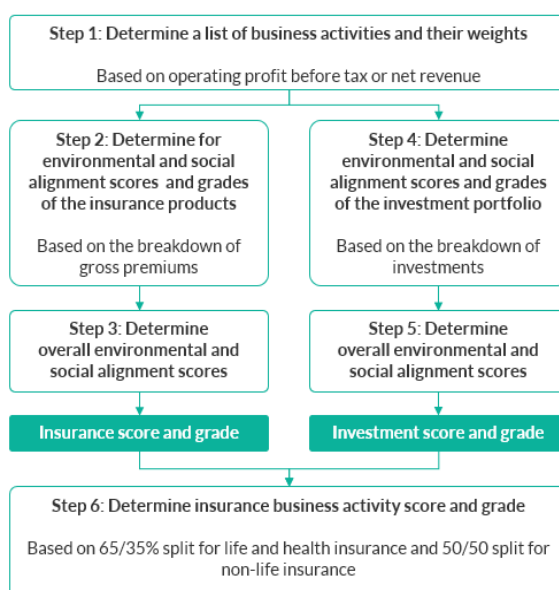
We calculate the weight of each business activity using operating profit before tax per business segment for the last full financial year. If this information is not available we also can use net revenue.

We then determine the scores for environmental and social alignment of the underwriting business (insurance products) with a focus on the impact from issuing insurance, while considering their environmental and social alignment to major science-based taxonomies and SDGs, respectively. If the information on insurance products is not sufficient, we analyse insurance policies and commitments which have the potential to limit negative environmental and social impact from insurance.

Banking Business Activities Assessment



Insurance Business Activities Assessment



For the analysis of the investment exposure, we look at whether funds are allocated to sustainable and traditional investments. Where this information is insufficient to assess the environmental and social alignment of the investment activities, we analyse internal investment policies, the company's approach towards environmentally and socially sensitive sectors and the potential to limit negative environmental and social impact. We also consider whether there could be a positive transformation of the current investment portfolio.

As a final step, we determine overall insurance business activities score and grade. For non-life insurance, we weight the scores and grades for insurance products and investment activities 50%/50% and, for life and health insurance, we apply a weight of 35%/65% respectively. The difference in weights allows for the additional capacity of non-life insurance businesses to manage their environmental and social impact through sectoral products and policies versus life and health insurance.

A Sustainable Fitch ESG Score, Rating or Second Party Opinion (either such output being an “ESG Product”) is an assessment of the Environmental, Social and Governance (“E”, “S” and “G”) qualities of financial instruments, Green, Social and Sustainability (GSS) frameworks and/or entities. An ESG Product is not a credit rating. ESG Products are provided by Sustainable Fitch, a separate division of Fitch Ratings. Sustainable Fitch has established certain policies and procedures intended to avoid creating conflicts of interest and compromising the independence or integrity of Fitch Ratings’ credit rating activities, as well as its ESG Product generation activities. For a description of the methodology, limitations and disclaimers of Sustainable Fitch’s ESG Products, please use this link: www.sustainablefitch.com.

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