FitchRatings | Sustainable Fitch

ESG ENCYCLOPEDIA VOL. 2

Related Research

- EU's Fit-for-55 to Spur Energy Transition in Multiple Sectors
- Investors Grapple with Stemming Biodiversity Loss
- Evolving Data Privacy Regulations Could Drive Long-Term Shift in Business Models
- ESG Litigation Risk
- SSA-50 Ratings Resilient to Pandemic Response; GSS Issuance Grows
- Political Risks and Climate Change: Where Are the Flashpoints?
- Insights from Fitch's Inaugural ESG Ratings
- What Investors Want to Know: Bank Climate Stress Tests and Credit
- China ESG Snapshot

CONTENTS

FitchRatings | Sustainable Fitch

Introduction

The second volume of Fitch's ESG Encyclopedia provides insights on the credit relevance and materiality of sector-focused social credit issues, specifically, issues related to:

- Labour
- Customer/consumer relations
- Social impact exposure
- Community relations

It explains how these issues can translate into relevant credit issues and materialise as credit risks. As such, it constitutes an absolute reference for investment professionals who need to integrate ESG in their credit investment or risk management processes.

For more information on Fitch's approach to integrating ESG, view our ESG Relevance Scores Data: https://www.fitchsolutions.com/products/fitch-ratings-esg-relevance-scores-data

LABOUR-RELATED ISSUES

HUMAN CAPITAL RANKS TOP OF INVESTORS' SOCIAL ESG CONCERNS

'Labour issues can be credit relevant through direct financial, operational, regulatory or reputational impacts. They are strongly linked to wider social and economic trends; workers are also community members, union members, voters, customers and investors.'

Nneka Chike-Obi, Director, Sustainable Fitch

Labour Issues Have Broad Social Linkages

Labour issues for entities are informed by a combination of internal and external factors. Macroeconomic, political and demographic trends interplay with the availability and cost of labour, and the satisfaction of a workforce. Labour is a key stakeholder in the operation of both private-sector activities and public services and infrastructure, such as healthcare, education and transportation. The wide-ranging impact of many labour issues, ranging from supply-chain disruptions to closure of schools, tend to give them a high public profile and can lead to reputational damage if prolonged.

Safety, Labour Relations and Diversity Are the Main Credit Issues

Within Fitch's rated universe, two topics feature most among issuers with elevated ESG.RS in labour-related issues: collective bargaining and labour negotiations; and health and safety incidents. Asset managers and owners consider human capital topics, such as health and safety, supply-chain management and diversity, as key parts of integrating ESG issues into the investment process. Investors are also increasing their engagement with portfolio companies on labour issues, particularly in diversity, equity and inclusion. There has also been a rise in sustainable bond issuances with workforce-focused proceeds or performance targets.

More Metrics-Based Reporting Needed

Despite there being several reporting frameworks for labour issues, many corporate disclosures lack numerical data and are more narrative than quantitative. Investors rank several labour topics as their ESG topics of greatest concern, but struggle to analyse them comprehensively due to the data gap. In response to investor demand, some financial regulators in major markets have human capital-focused reporting to provide more transparency.

Defining Labour-Related General Issues

Social general issues refer to the interactions between an issuer and its different stakeholder populations, both within the entity and in the market, community, and broader society. Compared with environmental risks, there is sometimes a perception that social issues are more difficult for relevant entities to identify or address as there no physical impacts.
In reality, there is a long history of social science and public policy that relies on measurable data to assess social risks. As awareness of the importance of sustainability in the private sector grows, the incorporation of these metrics into risk management and ESG disclosures is also expanding.

Labour as a constituency has both internal and external elements, and includes direct employees, contractors, and outsourced workers in the supply chain. Labour relations consist of a complex network of relationships between management, workers, unions, suppliers, governments and international organisations. Risks in this area can have significant financial, operational, regulatory, and reputational impacts. Where those impacts transmit into loss of profitability and restricted access to capital, they can potentially become material to an issuer's credit rating.

There are several international frameworks that attempt to categorize the key drivers related to labour and employment for different types of entities. The UN Sustainable Development Goals (SDGs) are the 17 priority policy outcomes for the 2030 Agenda for Sustainable Development.

ILO DECENT WORK INDICATORS

	Category	Selected Indicators
1	Employment opportunities	Employment-to-population ratio Unemployment rate Informal employment Youth not in education or employment
2	Adequate earnings and productive work	Working poverty rate Minimum wage as a percentage of median wage Average real wages
3	Decent working time	Excessive working time (more than 48 hours a week) Paid annual leave
4	Combining work, family and personal life	Maternity protection Parental leave
5	Work that should be abolished	Child labour Forced labour
6	Stability and security of work	Precarious employment rate Job tenure
7	Equal opportunity and treatment in employment	Occupational segregation by sex Female share of employment in senior & middle management Gender wage gap
8	Safe work environment	Occupational injury rate, fatal Occupational injury rate, non-fatal Time lost due to occupational injuries
9	Social security	Share of population 65+ benefitting from pension Public social security expenditure (% GDP)
10	Social dialogue, workers' and employers' representation	Union density rate Collective bargaining coverage rate Days not worked due to strikes and lockouts

Source: Fitch Ratings, ILO

FitchRatings | Sustainable Fitch

While initially designed for national governments and supranational agencies, the SDGs are increasingly being adopted as a benchmark for private sector firms, including tying them to borrowing through ESG-labelled and sustainability-linked debt. Goal 8 is "Decent work and economic growth" with targets related to improving economic productivity, creating safe working environments, reducing youth unemployment, protection of women and migrant workers, and eradication of modern slavery. The Global Reporting Initiative (GRI), a commonly used corporate sustainability reporting standard, provides indicators for reporting progress against Goal 8 and the other SDGs.

The International Labour Organization (ILO) Decent Work Indicators are measurable indicators against which entities can track progress towards a more productive, fair, and secure working environment. These mainly focus on government entities, but their outputs can be useful to the private sector and investors in evaluating the overall labour environment and conditions of a particular region and the potential for additional labour-related risk factors.

Following its environmental work, the European Union (EU) is developing a social taxonomy to identify and direct capital towards economic activities that generate positive social outcomes. In its July 2021 draft, it identifies employment-related activities as a priority. The first of three objectives in the horizontal dimension (i.e. process-related) is "ensuring decent work." Similar to the environmental taxonomy, the framework will also include "do no significant harm" alongside the primarily social objective. In the case of labour, this includes additional criteria addressing collective bargaining, no child/forced labour, decent employment conditions, health and safety, and impacts on workers in the entity's value chain.[1]

Within the debt market, there are several relevant frameworks for structuring socially oriented products, primarily the ICMA Social and Sustainability-Linked Bond Principles, and the LMA Social and Sustainability-Linked Loan Principles. Social bonds and loans raise capital for a specific use of proceeds (UOP) related to a positive social outcome that serves an identifiable target population. For example, a project that trains people from underserved communities to become employees provides benefits to the unemployed and those living below the poverty line. The ICMA identifies three eligible activities under the Social Bond Principles as aligned to SDG 8: Access to Essential Services, Employment Generation, and Socioeconomic Advancement and Empowerment.

FITCH'S ESG.RS FRAMEWORK AND SCORING TEMPLATES

Fitch's approach to sustainable finance and ESG integration is to provide transparency on ESG-related credit risks that influence credit ratings. In 2019, Fitch introduced ESG.RS, which have been fully integrated into Fitch's existing research process across asset classes.

ESG credit considerations are systematically evaluated by Fitch's analysts using the ESG.RS framework that extracts the issues from the relevant sector criteria. When assessing issuers and transactions, analysts refer to the asset-class and sector ESG scoring templates to allocate individual and overall E, S and G Relevance Scores (see table *Fitch's Airlines Scoring Template* for an example of an ESG scoring template).

ESG.RS articulate the level of influence an environmental, social or governance issue has had on a credit rating decision. Each entity or transaction receives 14 or 15 ESG.RS based on five environmental, five social and four or five governance issues. Scores range from '1' to '5' where an ESG.RS of '1' indicates no credit relevance at either a sector or entity level while an ESG.RS of '5' indicates a single identified environmental, social or governance risk that is unambiguously causing a change to the rating level.

1 "Draft Report by Subgroup 4: Social Taxonomy," European Commission Platform on Sustainable Finance, July 2021

For sustainability-linked products, Fitch uses key performance indicators (KPIs) to measure progress against sustainability outcomes. These metrics are largely aligned with the SDG targets and Decent Work Indicators, focused on labour issues that can be measured and assessed. Borrowers that meet or exceed these targets can benefit from a reduced interest rate or coupon. Within this market there have been a number of deals with labour-related targets, with employee health and safety and gender diversity featuring prominently across loans and bonds.

Fitch's ESG.RS framework includes two labour-related general issues: Labour Relations and Practices, which identifies how an issuer engages with employees with regard to pay, benefits, recruitment and retention; and Employee Wellbeing, which includes staff health and safety, engagement, and diversity and inclusion. These categories apply to issuers across a range of sectors and asset classes, including corporates, insurance, infrastructure and project finance, asset-backed securities and public finance.

In addition to the two explicitly labour-related areas, there are several other general issues that can have an impact on employment and labour matters (see box above).

FITCH'S AIRLINES SCORING TEMPLATE

General issue	Sector-specific issue
GHG emissions and air quality	Emissions and noise pollution
Energy management	Fuel use in operations
Water and wastewater management	n.a.
Waste and hazardous materials management; ecological impacts	n.a.
Exposure to environmental impact	The effect of extreme weather conditions or environmental events on operations
Human rights, community relations, access and affordability	Precarious employment rate Job tenure
Customer welfare – fair messaging, privacy and data security	Data security; safety regulations
Labour Relations and Practices	**Impact of labour negotiations and employee satisfaction; workforce diversity**
Employee Wellbeing	**Worker safety and accident prevention; prescriptive working conditions**
Exposure to social impacts	n.a.
Management strategy	Strategy development and implementation
Governance structure	Board independence and effectiveness; ownership concentration
Group structure	Complexity, transparency and related-party transactions
Financial transparency	Quality and timing of financial disclosure

Source: Fitch Ratings

Waste and Hazardous Materials Management; Ecological Impacts: Injury or illness resulting from employees working with poorly managed waste materials or in hazardous physical conditions created by an entity's operations can directly impact their health. This can expose employers to worker-related fines, criminal, or civil prosecution, and reduce their ability to recruit and retain staff due to reputational risk.

Human Rights, Community Relations, Access and Affordability: A company's operations can affect surrounding communities, such as negative impacts on local culture and livelihoods, or disputes over land rights.
In sectors providing key services, such as education and healthcare, cost may prohibit local populations from accessing them and entities may not be able to increase rates. This can cause dissatisfaction among employees from these communities.

Exposure to Social Impacts: Changes in consumer preferences could affect employment requirements, staffing levels, and working conditions, such as a shift from bricks-and-mortar retail to online shopping, or screen-based ordering in restaurants. Social resistance to large projects in such sectors as natural resource extraction or infrastructure can cause development delays or cost increases. In some cases, the resistance is related to the operator's employment practices, e.g. if jobs offered to the local community as a substitute for traditional economic activities do not meet expectations.

Employment and Income Equality: This issue only applies to sovereigns and is considered a citizen-related social risk. It addresses the impact of unemployment and income inequality on GDP growth, and political and social stability. The impact of this risk on the issuer is not related to its direct engagement with workers, and can be the result of other economic or social factors. An elevated score in this category could indicate that entities that rely on workers in that region face additional risks e.g. if high unemployment contributes to people accepting poorer working conditions or illegal work to earn an income.

Human Development, Health and Education: The relationship between a jurisdiction's human capital and its GDP is a social general issue for sovereign and local/regional government issuers. Poorer performance on delivering health and educational outcomes could point to a less-skilled or underemployed labour force.

The general issues are further broken down into sector-specific issues that place these risks into the context of the issuer's main economic activity.

The sector-specific issues represent the primary mode of transmission from the general issuer to a potential credit impact. In the airlines template, for example, "prescriptive working conditions" is a sector-specific issue under Employee Wellbeing. This refers to the strict health and safety rules for airline employees on the number of hours or shifts they work, to ensure fitness to fly and operate aircraft. For an issuer in a different sector, this factor is not relevant and would not be considered in the ratings process. Fitch has about 100 sector-specific templates, about half of which are for corporate issuers.

TRANSMISSION MECHANISM FOR LABOUR-RELATED ISSUES

Labour-related issues

- Strikes
- Unionization
- Contract/third-party labor
- Health and safety
- Supply chain labor
- Staff turnover
- Aging workforce
- Senior executive pay/representation gap
- Discrimination
- Minimum wage and working conditions

→

Labour-related credit issues
ESG relevant Score = 2
(credit relevant to sector)

- Impact of labor negotiations and employee (dis)satisfaction
- Employee recruitment and retention
- Quality of contractors
- Worked health, safety and accident prevention
- Supply chain management
- Pension obligations and related litigation
- Workforce diversity
- Legal and regulatory compliance in operational georgraphies

→

Credit Risks
ESG relevant Score = 3, 4, or 5
(credit material)

- Business risk
- Demand risk
- Industry risk
- Macro risk
- Operational risk
- Supply and resource management risk
- Technical risk

Source: Fitch Ratings

While labour issues are interrelated with other general issues in our scoring temples, we only consider them to be credit relevant, and therefore a labour-related credit issue, when the issuer's relationship with its workers are the central risk factor. For example, a hazardous materials incident that affects workers does not necessarily lead to an elevated score in Employee Wellbeing. It only becomes a labour-related credit issue when there is a material impact on the company's operations or financials as a result, e.g. employee protests or walkouts over safety concerns.

Sector-Specific Credit Issues

Fitch analysts evaluate whether a labour-related general issue is credit relevant and material for issuers and transactions. Using the ESG scoring templates, analysts allocate a score between '1' and '5' for the general issues:

- **Labour Relations and Practices:** This category addresses an issuer's ability to uphold commonly accepted labour standards in the workplace, including compliance with labour laws and internationally accepted norms and standards. Specific issues include:

  Labour practices:
  - Human rights related to child, forced, bonded or exploitative labour
  - Minimum wage policies, fair wages, overtime pay, and other basic workers' rights
  -
  - Pension plans and provision of benefits
  - Issuer relationship with organised labour unions and other worker associations
  - Workforce recruitment and retention Supply-chain management (labour-related):
  - Human rights related to child, forced, bonded or exploitative labour
  - Labour practices, ethics and corruption

- **Employee Wellbeing**

  Employee health and safety:
  - Rate of injuries, illnesses, and fatalities in the workplace
  - Training provision for employees and contractors
  - Mental health and wellness
  - Employee engagement, diversity and inclusion
  - Corporate culture, hiring and promotion practices
  - Discriminatory practices on the basis of race, gender, ethnicity, religion, sexual orientation or any other characteristics

LABOUR RELATIONS AND PRACTICES

The sector-specific ESG credit issues for Labour Relations and Practices can be placed into four broad categories:

1. Labour negotiation and employee satisfaction: where an issuer's relationship with its workers involves dialogue about working conditions, wages, benefits, sometimes including third parties, such as unions, public agencies, and non-governmental organisations;
2. Workplace recruitment, retention, diversity and inclusion: where an issuer faces costs and reputational risk related to the ability to hire and maintain a productive and diverse workforce that represents the wider community, including board and senior management;
3. Labour practices in supply chain: where issuers source a significant amount of goods or services from Tier 1-3 suppliers, who are not under the employer's direct supervision and may be dependent on illegal sources of labour, or workers with few legal protections;
4. Labour practices with contractors: where issuers have large amounts of labour conducted by contract workers, who are not under the employer's direct supervision but may be subject to poorer working conditions or fewer legal protections.

EMPLOYEE WELLBEING

The sector-specific ESG credit issues for Employee Wellbeing can be placed into two broad categories:

1. Employee health and safety: where an issuer's management of risks including workplace accidents and injuries, exposure to dangerous materials, and provision of healthcare and medical services has a potential material financial impact;

FitchRatings | Sustainable Fitch

2. Employee engagement, diversity and inclusion: where an issuer faces costs or reputational risk associated with the working experience of staff in areas such as corporate culture, discrimination, harassment, and training.

Relevance and Materiality of Sector-Specific Labour-Related Issues

RELEVANCE OF CORE LABOUR-RELATED CREDIT ISSUES TO KEY SECTORS

Labour issues are relevant to a wide range of sectors and issuer types, as found in the table Labour-Related Credit Issues and their Associated Sectors in Appendix B. These can be grouped into six labour-related credit issues:

- Labour negotiation and employee (dis)satisfaction;
- Workplace recruitment, retention, diversity and inclusion;
- Labour practices with contractors;
- Labour practices in supply chain;
- Employee health and safety; and
- Employee engagement, diversity and inclusion

Sectors that are highly labour-intensive or rely on labour-intensive goods in their supply chains are more directly impacted by risks in these areas. These include service sectors, such as restaurants, healthcare, education, retailers with global suppliers, infrastructure and real estate that requires manual labour related to construction or operation of assets, and some forms of manufacturing.

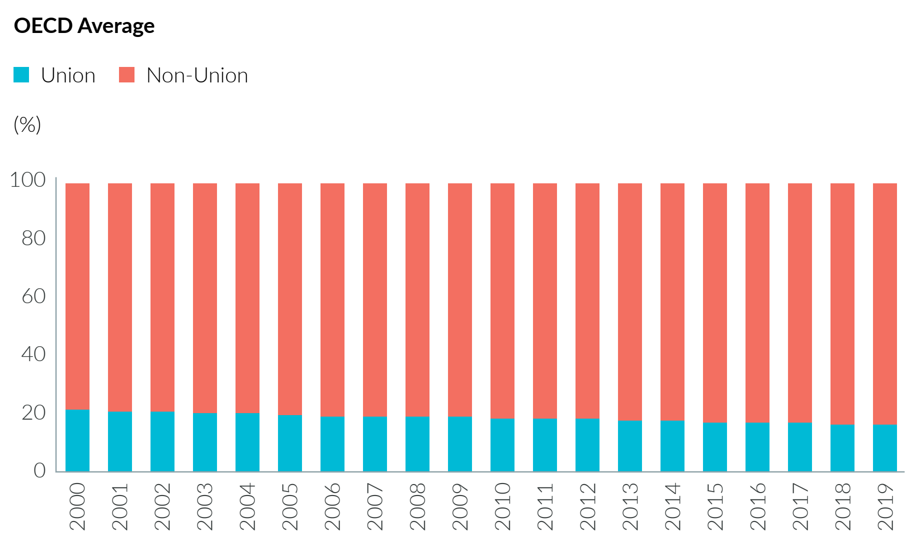
Some of these issues are primarily internal to an entity. Working conditions, corporate culture and discrimination are areas that employers have control over and can be used to differentiate peers in the same sector. Other labour-related issues are tied to external factors. Demographic shifts, particularly those that lead to political and regulatory changes, can contribute to recruitment or retention problems or expectations for increased board/management diversity.

LABOUR NEGOTIATION AND EMPLOYEE SATISFACTION

This is the most common labour-related issue in Fitch's ESG.RS framework, applying to more than 60 issuer sub-sectors. It refers to organised dialogue between an entity and its employees on working conditions, pay, benefits, or other elements of their contractual relationship. General staff satisfaction matters, on the other hand, fall under Employee Wellbeing.

Union membership has fallen as a percentage of the total workforce across OECD countries to 15.8% in 2019 from 20.9% in 2000. While there has been an overall downward trend, circumstances differ from country to country. US union participation has fallen to about 10% of workers, while in Italy it has been broadly steady at just over 30% for the past 20 years. Union membership also varies between the private and public sector, and is typically higher in the latter. In the US, about 35% of public-sector workers are members of a union, compared with about 6% in the private sector.

TRADE UNION MEMBERSHIP – SHARE OF WORKFORCE



Source: Fitch Ratings, OECD

FitchRatings | Sustainable Fitch

Industries dependent on skilled or unionised workers, such as manufacturing and logistics, often have larger financial obligations related to pensions, benefits and training. In many countries, public-sector workers have higher rates of unionisation than those in the private sector and have powerful collective bargaining tools. Public-sector strikes in key services, such as education, public safety and healthcare, can have significant knock-on effects. Workers in sectors with a mix of private- and public-sector employers like transportation and utilities also tend to have higher union participation rates, with a high potential for disruption in the case of work stoppages.

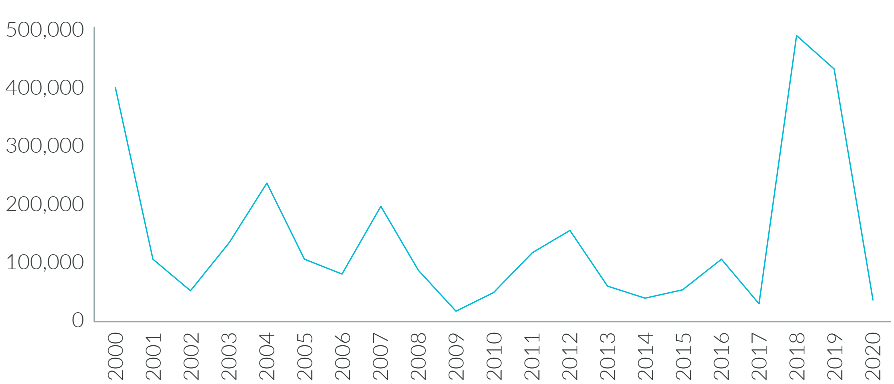
Data from the US Bureau of Labor Statistics (BLS) show a substantial increase in the number of workers involved in stoppages in 2018 and 2019 – the highest numbers since 1991. In 2019, seven of the 10 largest work stoppages in the US were in the public sector – six school systems and one state-funded university and medical school. This dropped sharply in 2020 due to the pandemic, but there were more worker stoppages in the first eight months of 2021 than in the whole of the previous year.

Impact on Credit Ratings

Stoppages in themselves only become credit relevant when they materially affect an issuer's financial profile. One of the largest strikes in 2019 was at General Motors Company (BBB-/Stable), with more than 46,000 workers involved in a six week walk out. At the time Fitch determined that GM's financial position was strong enough to withstand a strike due to the amount of liquid cash, securities, and short-term debt available. The eventual impact was substantial – falls of USD11 billion in net revenue and USD5.4 billion in automotive free cash flow – but not enough for a rating downgrade. As a result, we kept GM's score for Labour Relations and Practices at '3'.

Similarly, the French rail worker strike that spanned two months in 2019-2020 affected operations for national operator SNCF Reseau and urban rail operator Regie Autonome des Transports Parisiens (RATP) (both AA/Negative). The strike over pension reforms was the longest in France since the 1990s. Fitch considered that the action would not contribute to a change in rating or Outlook due to government financial support as public entities and because the strike straddled the Christmas period, thereby spreading the impact over two financial years.

NUMBER OF US WORKERS INVOLVED IN WORK STOPPAGES



Source: Fitch Ratings, BLS

FitchRatings | Sustainable Fitch

CONTRACT NEGOTIATIONS RELEVANT FOR SEAPORT ISSUERS

There have been years-long disagreements between private port tenants and the International Longshore and Warehouse Union representing dock workers in southern California. The most recent conflict centres on automation plans. Fitch has assigned ESG.RS of '4' for Labour Relations and Practices to Los Angeles Harbor Department, Long Beach CA Port Facilities, and Alameda Corridor Transportation Authority as a result of the impact of these tensions during contract negotiations, which have included work stoppages.

FA MGT Limited Partnership, a terminal operator at the Port of Montreal, has a score of '4' for Labour Relations and Practices due to negotiations with the Canadian Union of Public Employees. There have been several strikes since a collective bargaining agreement expired in 2018, most recently a five-day stoppage in May 2021.

DISTRIBUTION OF ESG RELEVANCE SCORES – LABOUR RELATIONS & PRACTICES

Score	1	2	3	4	5
Corporates	1	228	1444	3	0
USPF/IPF	0	0	2259	8	0
Infrastructure	0	62	274	4	0
Structured finance	3023	1288	42	0	0

As of 30 September 2021
Source: Fitch Ratings

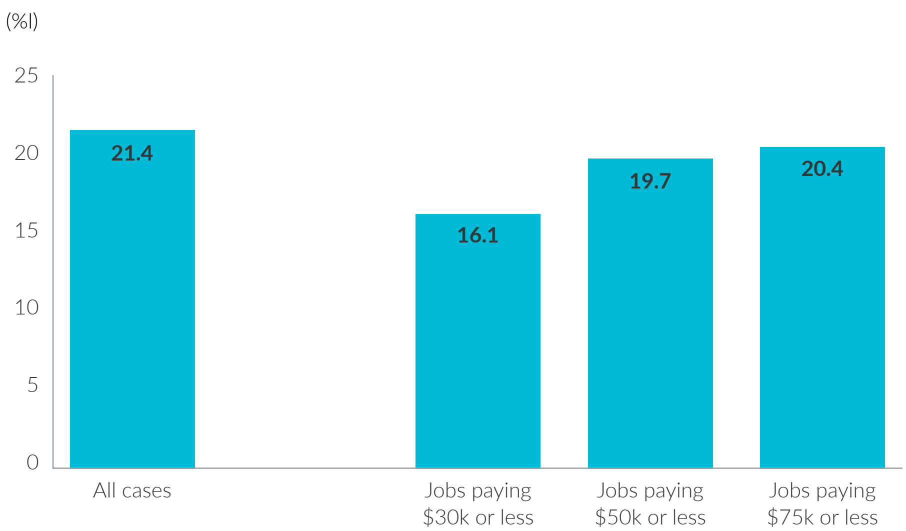
WORKPLACE RECRUITMENT, RETENTION, DIVERSITY AND INCLUSION

Recruitment and retention are key issues for issuers reliant on workers with specialist skills. This includes several public finance entities like higher education, hospitals, health care, life plan communities, and government-related entities. Among corporate issuers, this issue is potentially credit-relevant for airlines, business services, healthcare, pharmaceuticals, and technology. An analysis by the Center for American Progress found that the median cost of replacing employees across a range of sectors (retail, healthcare, lodging, restaurants, education and manufacturing) was 21.4% of the job's salary, and that this cost increases for staff with higher seniority and salaries. In one study, the turnover cost for a physician was nearly three-times higher than that for a registered nurse.

FitchRatings | Sustainable Fitch

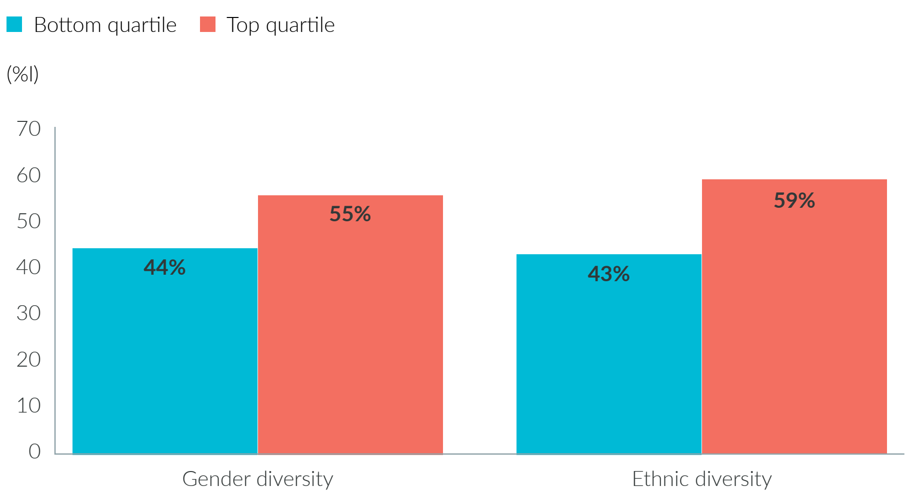
MEDIAN COST OF REPLACING AN EMPLOYEE AS % OF SALARY

US Case Studies, 1992-2007



Source: Fitch Ratings, CRU

LIKELIHOOD OF FINANCIAL OUTPERFORMANCE BASED ON EXECUTIVE TEAM DIVERSITY



Source: Fitch Ratings, "Diversity Wins," McKinsey, 2019
Companies: 1,039; Countries: 15

Diversity and inclusion is a growing area of focus for companies as workers, customers, and increasingly regulators are expecting corporate boards and senior management to more closely reflect societal demographics. By end-2022, corporates listed on major exchanges, including Nasdaq, Tokyo Stock Exchange, Euronext and the Stock Exchange of Hong Kong, will have to disclose their policies on diversity. In the case of Nasdaq, this includes a minimum level of diversity at board level. There is a growing body of research indicating there may be a financial advantage to increasing diversity among senior management. A 2019 McKinsey report found that among more than 1,000 large companies in North America, South America, Europe, sub-Saharan Africa and Asia-Pacific, those with more diverse executive teams ("top quartile") had a higher rate of financial outperformance than those with less diversity ("bottom quartile").

There is an emerging trend of unionisation among private-sector white-collar workers – a population that has not traditionally participated in organised labour. This is concentrated in the media and technology sectors, and may indicate a shift in the type of companies that can be affected by employee collective bargaining. Demands from unions could raise the already high costs in recruiting and replacing staff in professional and skilled roles. In the past 18 months, workers at Google parent Alphabet Inc., Swedish streaming company Spotify SA and technology staff at The New York Times Company have established unions.

FitchRatings | Sustainable Fitch

Motivating factors for this extends beyond pay and working condition to diversity, inclusion, and concerns about the societal impact of corporate activity, such as social media and digital content.

Impact on Credit Ratings

Recurrent strikes at French public hospitals over the past two years led Fitch to assign ESG.RS of '4' for Labour Relations and Practices to two bonds issued by a consortium of hospitals – French Public Hospitals 3 and French Public Hospitals Joint Bond Issue CHU France Finance. A group called the Inter-Hôpitaux Collective led protests for months in 2019 and 2020 demanding improved pay and working conditions. As a result of the strikes and the pandemic, hospitals have increased salaries for medical and paramedical staff relative to the private sector, which had been able to attract staff from public hospitals. This has limited the flexibility for individual hospitals in managing costs and affected their Standalone Credit Profiles.

Fitch commented in August 2021 on a service sector labour shortage in the US following the reopening of in-person leisure businesses after extended lockdowns. The shortage increased the costs of hiring and retaining staff and many restaurants have been able to pass this on to customers through higher prices. To reduce costs during the downturn for dining out, many companies improved operational efficiency and increased the use of self-service technology. As a result, the sector's recruitment and retention problem has not yet led to any negative rating actions for US restaurant issuers.

NEW TECH WORKER UNIONS (SELECTED)

Company	Date	Union name	Sector
Kickstarter PBC	Feb 20	Kickstarter United	Technology
Glitch Inc.	Mar 20	Glitch Union	Technology
Wired (Conde Nast)	Apr 20	The Wired Union	Media
Alphabet Inc.	Jan 21	Alphabet Workers Union	Technology
National Public Radio Inc.	Apr 21	Digital Media United (tech workers)	Media/Technology
Spotify SA	Apr 21	Gimlet Union/ Parcast Union/ Ringer Union	Media
Insider Inc.	Apr 21	Insider Union	Media
Change.org PBC	Jun 21	Solidarity@Change	Technology
The Atlantic	Jun 21	The Atlantic Union	Media
The New York Times Company	Jul 21	New York Times Tech Guild (tech workers)	Media/Technology

Source: Fitch Ratings

PILOT STRIKES AFFECT AIRLINE CREDIT RATING

Colombian airline Avianca Holdings S.A. (D) has an ESG.RS of '4' for Labour Relations and Practices, reflecting significant pilot strikes. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors. Although the most recent widespread action was in 2017, when 1,300 pilots held a seven-week strike, Avianca and the pilots' union did not come to an agreement until 2020 – the first in 11 years. The current deal is for four years.

FitchRatings | Sustainable Fitch

LABOUR PRACTICES WITH CONTRACTORS

Contract labour is becoming increasingly widespread due to the flexibility it offers employers. Independent contractors can be engaged on a short-term basis and are not eligible for paid leave and employee benefits. There can also be savings in training and development by hiring experienced contractors for their existing skill set.

Regulatory risk is becoming a factor for companies that rely on a large proportion of contractors. The gig economy has grown in recent years with the development of internet- or app-based services, such as ride sharing, food and product delivery, and lodging. Workers are engaged as independent contractors and therefore receive limited financial support or benefits. The company acts as a middleman between the gig worker and the customer. As this type of work has become more prevalent, so has concern that there is an increasing pool of workers who lack the protections typically reserved for direct employees.

Governments are starting to notice. California's legislature introduced a law in 2020 that would have designated most gig workers as employees, although this was overturned by a judge a year later for being unconstitutional. In 2021, courts in the Netherlands and the UK ruled that drivers for Uber Technologies, Inc. (not rated) should be considered employees rather than contractors. The European Parliament adopted a resolution in September 2021 noting that "EU legal instruments are often not applied to many platform workers [...] and do not sufficiently address the new realities of the world of work [...] resulting in those workers enjoying fewer or more limited rights than should be guaranteed to all workers."[2]

Impact on Credit Ratings

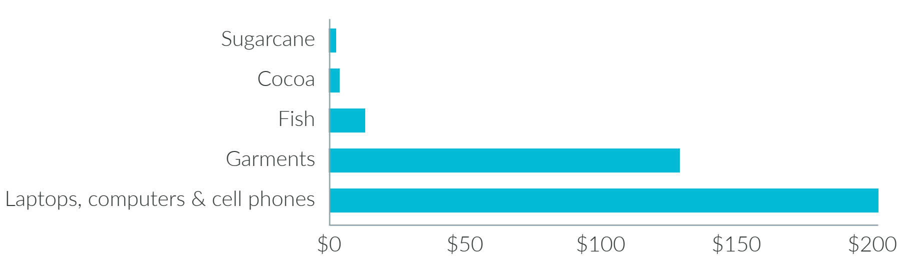
In September 2021, Fitch downgraded Chinese e-commerce platform Meituan to 'BBB-' from 'BBB' as government regulations aimed at improving conditions for delivery drivers came into effect. The guidelines address minimum wage, safety and the provision of a decent working environment. Companies will have to change any performance algorithms that unduly pressure drivers to make too many deliveries within a short period of time. Meituan has been assigned a '4' for Employee Wellbeing as a result of its exposure to the new regulations from its large food delivery business segment.

REGULATORY RISK DUE TO CONTRACT WORKER STATUS

Rede D'Or Sao Luiz S.A. (BB/Negative), the largest private hospital operator in Brazil, has an ESG.RS of '4' for Labour Relations and Practices due to labour/tax litigation. The company registers its employees, mostly physicians, as service providers, not as Rede D'Or employees. This could expose the company to a sizable tax obligation of BRL1.1 billion (USD204 million) if tax authorities determine these should be considered employees, not contractors. This has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

TOP PRODUCTS IMPORTED INTO THE G20 AT RISK OF MODERN SLAVERY BY VALUE

(USDbn)



Source: Fitch Ratings, Global Slavery Index 2018

2 European Parliament resolution of 16 September 2021 on fair working conditions, rights and social protection for platform workers – new forms of employment linked to digital development. 2019/2186 (INI)

LABOUR PRACTICES IN SUPPLY CHAIN

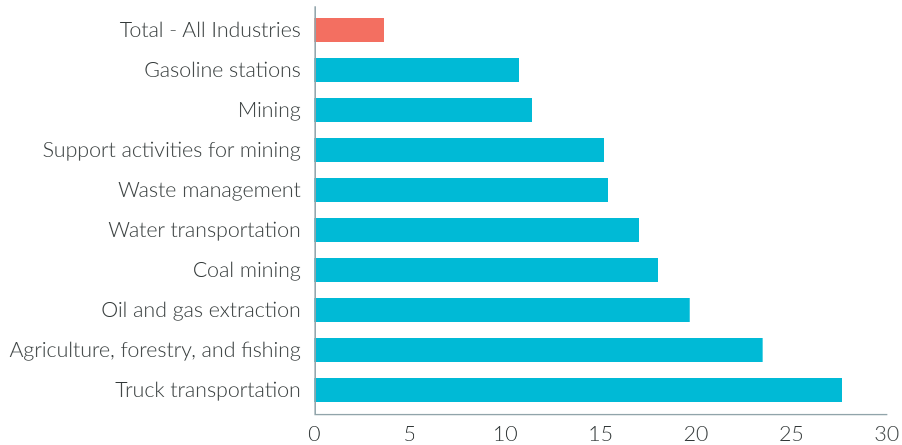
Manufacturers use outsourced labour to benefit from cost and economy of scale when producing certain components. When this takes place in some of the lowest-cost emerging markets, the difference in labour standards between where the inputs are made and where they will be sold can be sizeable. Many less developed countries lack the resources to enforce labour laws and manufacturers often have limited visibility into the practices of their suppliers.

The introduction of modern slavery laws in the UK (2015) and Australia (2018) aims to address this, placing requirements on companies to audit their suppliers' practices. It has also increased the number of large corporates that have to report and disclose their labour-related supply-chain risks as both laws apply to companies of a certain size operating in their countries, regardless of their home jurisdiction. The European Commission has also proposed introducing a supply chain due diligence law focused on human and labour rights.

California-based e.l.f Cosmetics Inc. (not rated) received a USD40 million fine in 2019 for violating the US government's sanctions against North Korea. Some of its products were found to have been manufactured in North Korea and all products made there are identified as "forced-labour goods" under US sanction law. The penalty was reduced to USD1 million after the company offered additional disclosures and made operational changes. The Office of Foreign Assets Control, which enforces the sanctions, noted that the company's supply-chain compliance programme was "non-existent or inadequate."

FATAL INJURY RATE PER 100,000 EMPLOYEES

United States, Selected Sectors, 2019



Source: Fitch Ratings, US Bureau of Labor Statistics

Since 2020, the US has imposed import bans on several key agricultural exports from Malaysia over suspicions of forced labour. This includes palm oil from Sime Darby Plantation Berhad (BBB/Stable) and FGV Holdings Berhad, and rubber products from Top Glove Corporation Berhad and Supermax Corporation Berhad (all not rated). Top Glove's 14-month ban, which was lifted in September 2021, has had financial consequences for the company. It had to delay plans to list on the Hong Kong stock exchange and experienced a fall of nearly 50% in earnings in 2Q21.

EMPLOYEE HEALTH AND SAFETY

Health and safety is the most common general issue under Employee Wellbeing and is potentially material for issuers in such sectors as transportation, natural resources, healthcare and agriculture. Poor management of health and safety can have several financial impacts, including fines, revenue loss through reduced output, increased costs to remedy safety failings, and increased costs for staff healthcare and insurance. In sectors where the health and safety risk to workers exposes customers to the same risk, reputational damage to the issuer can lead to a loss of market share.

One example of operational safety risks having wider impacts to issuers is the aftermath of the Fukushima Daichi nuclear disaster in Japan, which caused Fitch to revise Japan's sovereign Outlook to Negative. The German government announced a gradual phase-out of nuclear power in the same year in response to public pressure over the safety of nuclear power plants, affecting several companies with contracts to deliver nuclear power. In 2021, the German government paid out EUR2.4 billion in compensation to plant operators affected by this policy change – Vattenfall AB (not rated), RWE AG, Energie Baden Wuerttemberg AG (EnBW) and E.ON SE (all BBB+/Stable). Fitch considers this credit positive for these utilities and could limit their short-term external financing needs. However, we but did not revise any of their ratings pending additional information on how the proceeds are invested into new activities, such as renewable energy.

In several jurisdictions, including parts of Australia, Canada, Hong Kong and the UK, "corporate manslaughter" is a recognised criminal offense that allows a corporation and its senior management to be held liable for causing a person's death. This exposes companies in industries with higher rates of workplace fatalities and injuries to both financial and key-person risks. In 2017, a UK-based construction company was fined GBP1.2 million and its director imprisoned for 14 months for the deaths of two workers deemed to be as a result of poor training and supervision.

Impact on Credit Ratings

In 2013, a large group of former players filed a lawsuit against the National Football League (NFL) over its treatment of concussions and head injuries sustained during a game. Several high-profile cases of players who had developed a serious condition called chronic traumatic encephalopathy garnered media attention. Current players negotiated an increase in healthcare and benefits for retirees, and donations to head injury-related medical research and charities. Fitch did not change the issuer's rating but noted that there was potential for a risk to the credit quality if any pay-out sizeably exceeded the league's USD675 million injury compensation fund. In 2014, the case was settled for USD765 million and the rating was maintained.

During the pandemic, working conditions for employees in warehouses, transportation and logistics were affected both by the coronavirus itself and by increased demand as customers ordered products for delivery during lockdowns. This caused productivity declines for companies whose staff work closely together in indoor environments, such as meatpacking. Fitch viewed this to be a credit risk for the US protein sector in 2020 due to the reduction in capacity utilisation as a result of plant closures and employee absenteeism, was a key driver for the change in Outlook for Tyson Foods, Inc.'s Issuer Default Rating of 'BBB' to Negative in May 2020. The Outlook has since been returned to Stable.

DAM COLLAPSE LEAD TO HUMAN TOLL, REGULATORY COSTS

Within days of the January 2019 dam collapse at an iron ore mine in Brumadinho, Brazil that killed 270 people, Fitch downgraded its owner Vale S.A. (BBB/Stable). Vale's ESG.RS for Employee Wellbeing was raised to '5' because the majority of those killed were mine staff. Following efforts to address risks that led to the dam failure and to compensate the surrounding communities, including a USD7 billion settlement, Fitch upgraded Vale in September 2020 and lowered the Employee Wellbeing score to '4,' meaning that this issue has a negative impact on the credit profile in conjunction with other factors.

FitchRatings | Sustainable Fitch

EMPLOYEE ENGAGEMENT, DIVERSITY AND INCLUSION

This issue addresses the work environment that an employer cultivates and its impact on staff. In a 2019 report, Gallup defined engaged employees as being "highly involved in and enthusiastic about work and workplace. They are psychological 'owners,' drive performance and innovation, and move the organisation forward." Conversely, low employee engagement can reduce labour productivity. In its global survey, engagement is the lowest in roles where the work consists of rote or repetitive tasks, or the employee has less control over their working schedule.

Remote working, which saw a sharp increase during Covid-19, has become an area where employers can attract workers. A 2021 survey of 16,000 workers countries by EY found more than half said they would consider leaving a job if flexibility was not available.[3] While this can support employee engagement, there are potential knock-on effects in the commercial real estate sector. In a series of commentaries in 2021, Fitch evaluated the potential financial impacts of "longer-term, secular headwinds related to flexible work and demographics" on US CMBS and Office REIT issuers and considers them to be a source of downward pressure on ratings should employers offer three or more days of remote working a week.

DISTRIBUTION OF ESG RELEVANCE SCORES – EMPLOYEE WELLBEING

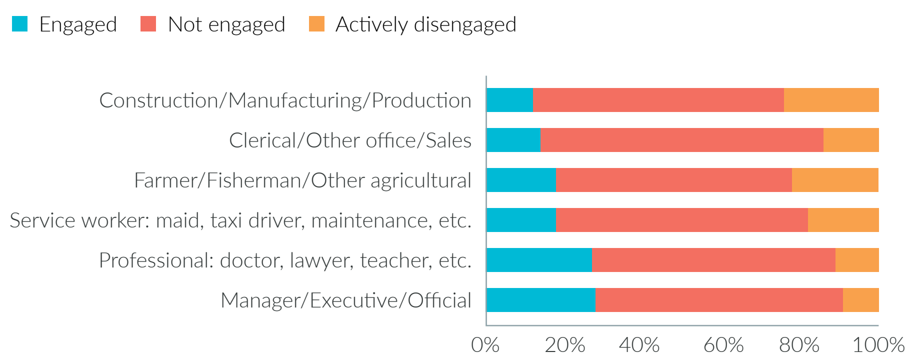
Score	1	2	3	4	5
Corporates	667	687	310	2	0
USPF/IPF	0	865	264	0	0
Infrastructure	1	331	8	0	0
Structured finance	4350	1288	3	0	0

As of 30 September 2021

Notes: Detailed descriptions of the scores can be found on the first heatmap, *Distribution of ESG Relevance Scores – Manufacturing Process*, on page 8. Asector can appear under more than one core issue due to the categorisation of the water-related credit issues in the ESG scoring template

Source: Fitch Ratings

ENGAGEMENT AMONG EMPLOYED, WORLDWIDE



Source: Fitch Ratings, Gallup

3 EY Work Reimagined Employee Survey 2021

Corporate culture is an important element of both employee engagement and approaches to diversity and inclusion. This includes such issues as a clear framework for career progression, structured channels for employees to express feedback or complaints, frequency of discrimination or harassment claims, and workplace demographics that reflect the surrounding community. As well as affecting employee engagement, a non-inclusive working environment can expose an issuer to lawsuits or legal penalties.

LAWSUIT, REPUTATIONAL RISK OVER DISCRIMINATORY PRACTICES

Signet Jewelers Ltd. (BB/Stable), the largest jewellery retailer in the US, faced widespread press coverage of accusations of gender pay discrimination and harassment of female employees. Fitch made several downgrades of Signet from 'BB' in January 2019 to 'B' in April 2020 "partly due to allegations of poor treatment of female employees, which has a negative impact on the credit profile." Signet paid a USD240 million settlement in 2020 to resolve a shareholder lawsuit claiming investors had been misled about the scope of the harassment claims. In 2021, Fitch upgraded Signet and lowered all ESG. RS to '3' or below.

CUSTOMER-RELATED ISSUES

REGULATIONS DRIVE STANDARDISATION AND DISCLOSURES ON CUSTOMER-RELATED SOCIAL ISSUES

Customers as Key Stakeholders

Customer-related issues are captured in Fitch's ESG.RS for issuers from the corporate, financial institutions, structured and public finance sectors.

Changes in macroeconomic conditions and business operations, as well as increasing regulatory pressure and litigation risks highlight the importance of consumer issues. Credit risks could arise from related issues as investors increase the integration of ESG factors in investment practices and divert capital flows towards issuers with more favourable credentials in this regard.

Regulations Raise Exposure to Credit Risk

Evolving regulations could accelerate the materiality of major customer-related issues, including customer welfare, product safety, marketing and lending practices, as well as customer data privacy. There has been increasing legislation for consumer protection in several jurisdictions to prevent fraud, violations of consumer rights and enhance data safety and privacy.

Rising regulatory pressure could heighten the risk exposure of customer-focused issuers, or incentivise investments in capex and opex to adapt to changing consumer behaviour. This can pose medium- to long-term credit risks to most customer-focused issuers, such as issuers in food and beverages, healthcare and pharmaceuticals, and consumer lenders.

Investors Demand Standardised Disclosures of Social Issues

Some investors rely on a stewardship and engagement approach to address customer-related social issues through investments. There are challenges around developing technical criteria to measure social aspects of project performance to avoid "social washing."

The draft EU Social Taxonomy represents one response to rising focus on social risks and the need for transparency of this issue. Standardised disclosure systems for social issues are in demand for better transparency and clarity in analysing their impact on issuers' financial performance.

FitchRatings | Sustainable Fitch

Defining Customer-Related General Issues

As with other social issues in the ESG space, definitions are not standardised across different bodies and stakeholders on the plethora of issues that can affect consumers. However, there are some key parameters that emerge as we review the different definitions.

Customer issues in general relate to product safety, ethical marketing, fair lending and data privacy. The focus on customer issues in recent years reflects the shift from a shareholder-centric perspective towards one that considers all stakeholders and an issuer's interaction with broader society. As sustainability awareness continues to grow, there is increasing incorporation of customer-related social issues into ESG risk management.

Fitch views customer-related issues mainly through four categories, which include:

1. an issuer's ability to provide consumers with products that align with social expectations,
2. fair selling and labelling practices that are in the best interest of customers,
3. fair lending practices with transparency that protect borrowers' interests, and
4. management of data privacy and security.

The application of these considerations will vary by business sector. It can refer to the wellbeing of customers in the food and beverage sector, ethical marketing and product safety for the healthcare sector, fair lending practices for non-bank financial institutions, and data privacy and security for financial institutions and other consumer-focused sectors.

SOCIAL GENERAL ISSUES FOR CORPORATE, FINANCIAL INSTITUTION, PUBLIC FINANCE, INFRASTRUCTURE AND STRUCTURED FINANCE SECTORS

The international sustainability standard setter, Sustainability Accounting Standards Board (SASB), identifies customer-relevant issues across several sectors, including health and nutrition, food and beverage. Specific issues may include antibiotic use in animal production, management of controlled substances, and shifting consumer preferences towards healthy options. This category addresses the quality of products and services, and a company's ability to prevent counterfeit products.[1]

Another area highlighted by SASB is fair selling practices and product labelling, which captures the social issues that may arise from a failure to manage the transparency, accuracy, and comprehensibility of marketing statements, advertising and labelling of products and services. It could include issues from advertising standards and regulations, ethical and responsible marketing practices, and misleading or deceptive labelling. This category also extends to fair lending and selling practices that should serve the best interest of customers with transparency, as opposed to discriminatory or predatory selling and lending practices against vulnerable and underserved populations.

Customer privacy addresses the management of risks relating to the use of personally identifiable information (PII) and other customer data used for secondary purposes. The scope of this category includes social issues that may arise from a company's approach to collecting customer data, obtaining consent, managing user and customer expectations regarding how their data is used, and managing evolving data-privacy regulations.

Data security looks at the broader management of risks related to collection, retention and use of sensitive, confidential and/or proprietary customer data. It includes social issues that may arise from incidents such as data breaches in which PII and other customer data may be compromised.

1 Exploring Materiality, SASB Standards, Value Reporting Foundation.

FitchRatings | Sustainable Fitch

The European Commission has been working to develop a Social Taxonomy that aims to identify and provide a framework for capturing social issues in investments. A draft from July 2021 takes different stakeholders, including workers, consumers and communities, into account. “Promoting consumer interests” is listed as one of the main objectives in this version of the Social Taxonomy, which emphasises key aspects of respecting and supporting human rights of consumers. In relation to the consumer objective, the taxonomy recommends it include topics when developing criteria for “doing no significant harm” on safety and quality of products and services, protection of consumers’ personal data and privacy as well as cybersecurity, and responsible marketing practices.[2]

Beyond the Customer Welfare general issue, which is the focus of this report, it is worth noting that several other general issues across Fitch’s ESG.RS framework, including Environment and Governance general issues, can have an impact on consumers, such as the quality and safety of products and services, as well as customer privacy and data security. The fact that these are captured across the spectrum of Fitch’s ESG.RS categories reflects the wide reach of the issues. For reference, these ESG categories include:

EXAMPLE: FITCH’S PHARMACEUTICALS ESG.RS TEMPLATE

This template is an example of Fitch’s framework to address ESG considerations for corporates in the pharmaceutical sector. Customer Welfare is one of the ESG general issues that could impact the credit profiles of issuers in this sector. In our opinion, customer welfare considerations are credit-relevant to all issuers operating in the pharmaceuticals sector. This is reflected in the baseline ESG.RS of ‘3’ assigned to them for this general issue, indicating that, as a minimum, this has a low negative impact on the rating.

General issue	Sector-specific issue
Greenhouse gas (GHG) emissions and air quality	n.a.
Energy management	Energy use in manufacturing
Water and wastewater management	Water usage in manufacturing process
Waste and hazardous materials management; ecological impacts	Management of product lifecycle and potential impact on food/water supply, supply chain management -product
Exposure to environmental impact	Manufacturing facilities and inventory exposure to extreme weather events
Human rights, community relations, access and affordability	Wellbeing of clinical trial participants, patient access and affordability
Customer/Patient welfare – fair messaging, privacy and data security	**Drug safety and side effects, ethical marketing, data safety in clinical trials, counterfeit drug management**
Labour relations & practices	Impact of labour negotiations and employee (dis)satisfaction; employee recruitment and retention
Employee wellbeing	n.a.
Exposure to social impacts	Pressure to contain healthcare spending growth; highly sensitive political environment
Management strategy	Strategy development and implementation
Governance structure	Board independence and effectiveness; ownership concentration
Group structure	Complexity, transparency and related- party transactions
Financial transparency	Quality and timing of financial disclosure

Source: Fitch Ratings

2 Draft Report by Subgroup 4: Social Taxonomy, European Commission Platform on Sustainable Finance, July 2021.

FitchRatings | Sustainable Fitch

EXPOSURE TO SOCIAL IMPACTS (SOCIAL GENERAL ISSUES)

A growing number of consumers seek products that provide health and safety benefits while having a positive impact on society. This could drive long-term shifts in consumer preference towards sustainable products with better transparency and disclosure along supply chains, which could affect customer welfare.

Exposure to Social Impacts also tackles regulatory changes, political environment and social pressure in sectors that might drive changes in business operations, i.e. customer-related legislation, increasing consumer demand for environmentally friendly and socially responsible products.

WASTE & HAZARDOUS MATERIALS MANAGEMENT, ECOLOGICAL IMPACTS (ENVIRONMENTAL GENERAL ISSUES)

Hazardous materials that are used for the design and production of products can negatively impact the health and safety of consumers. In most developed markets, customers have a right to seek redress when their health and safety is affected.

Waste management and assessing the ecological impact on the local environment along a product's supply chain are considered as part of the assessment of an issuer's customer welfare issues.

MANAGEMENT STRATEGY (GOVERNANCE GENERAL ISSUES)

Management strategy can drive an issuer's execution, implementation and internal control systems to ensure customer welfare. Poor execution can lead to weak controls of product quality, inability to manage business restructuring, and a weaker financial profile. Operational failures in controlling product quality and safety, and marketing strategies could reduce customer welfare and increase credit risks.

Sector-Specific Credit Issues Defined

Fitch analysts evaluate whether a customer-related general issue is credit-relevant and material for their rated issuers and transactions. Using the ESG scoring templates, analysts allocate a score between ‘1’ and ‘5’ for the general issues.

The sector-specific ESG credit issues for Customer Welfare - Fair Messaging, Privacy & Data Security can be categorised into the four major core customer-related credit issues:

1. **Customer/patient welfare:** This category addresses concerns including health and nutrition of foods, beverages and pharmaceutical products, antibiotic use in animal production, and management of controlled substances. The category addresses an issuer’s ability to provide consumers with products and services that are aligned with societal expectations. It also addresses qualities inherent to the design and delivery of products and services where customer welfare may be in question. Specific issues include:

- Ability to provide products with health and nutrition benefits
- Align with societal expectation considering shifting consumer preferences
- Product quality internal controls
- Prevention of counterfeit products
- Customer satisfaction

2. **Product safety and marketing:** This category addresses an issuer’s ability to manage the accuracy, comprehensibility of marketing statements, advertising and labelling of products and services. Sector specific issues can be placed into two broad categories:

- Unintended characteristics of products sold or services provided that may create health or safety risks to end-users. It mainly looks at a company’s ability to offer manufactured products and/or services that meet customer expectations with respect to their health, age and safety characteristics. Examples include:
  - Product testing;
  - Liability, management of recalls and market withdrawals, and related compensation policies.
  - Chemicals/content/ingredient management in products.

- Social issues that may arise from a failure to manage the transparency, accuracy, suitability and comprehensibility of marketing statements, advertising, and labelling of products and services. Examples include:
  - Breach or misrepresentation of advertising standards and regulations;
  - Ethical and responsible marketing practices, misleading or deceptive labelling.

3. **Lending practices and price transparency:** This category addresses issues over discriminatory or predatory selling, mis-selling and lending practices. This may include deceptive or aggressive lending and selling in which incentive structures for employees could encourage the sale of products or services that are not in the best interest of customers or clients. Examples include:

- Aggressive selling practices from lenders;
- Lending practices towards underserved communities and populations;
- High interest rates;
- Excessive or hidden fees;
- Hidden balloon payments;
- Equity stripping.

4. **Customer Privacy & Data Security:** This issue can be placed into two broad categories:

- Risks related to the secondary (unauthorised) use of PII and other customer or user data. Examples include:
  - Collecting data;
  - Obtaining consent (e.g., opt-in policies);
  - Managing user and customer expectations regarding how their data is used;
  - Managing evolving regulation around data usage.
- Social issues that may arise from incidents such as data breaches in which PII and other user or customer data may be exposed. It addresses an issuer's strategy, policies and practices related to IT infrastructure, staff training, record keeping and cooperation with law enforcement, and other mechanisms used to ensure security of customer or user data. Examples include:
  - Issuer's data privacy management protocols;
  - Assessment of issuer's cyber risk exposure to potential breaches;
  - Designated data privacy officers and training programmes to enhance employees' security awareness;
  - Organisation's cyber culture.

Credit Relevance, Risk and Materiality

Customer-related issues can materialise as a single credit risk or a combination of credit risks if they are not identified and managed properly or adequately by issuers. Customer-related issues are endogenous in a company's operations and influenced, among other factors, by the extent it integrates ESG considerations.

Customer issues are relevant to a wide range of asset classes and issuer types (see Appendix), although consumer-facing businesses are more exposed to risks in these areas. These include corporates involved in fast-moving consumer goods (FMCG), retail, pharmaceuticals and healthcare; financial institutions, ranging from banks to finance leasing companies; as well as issuers of structured-finance products. Issuers with a broader exposure to consumer data management are more easily affected in these areas as well.

The distribution of Fitch's ESG. RS in the table below indicate that high relevance of customer-related issues (scores of 4 and 5) occur more frequently for corporates, structured finance and financial institutions. At the time of writing, corporates and structured finance are the only two asset classes with issuers carrying ESG Relevance Scores of 5 across Fitch's rated universe, indicating the issues are a key rating driver that has had a significant, detrimental impact on the rating decision.

FitchRatings | Sustainable Fitch

TRANSMISSION MECHANISM FOR CUSTOMER-RELATED ISSUES

Customer related issues

- Defective product Product safety incidents
- Changing consumer behaviour
- Unethical supply chain sourcing
- Aggressive selling practices
- Product mislabelling and mis-selling
- High-cost consumer lending
- Customer privacy management

Customer-related credit issues
ESG relevant Score = 2
(credit relevant to sector)

- Customer safety and health
- Shifting customer demand
- Supply chain management
- Ethical marketing practices
- Advertising standards compliance
- Regulations on lending practices
- Data privacy regulations

Credit Risks
ESG relevant Score = 3, 4, or 5
(credit material)

- Business risk Demand risk
- Macroeconomic risk
- Operational and cashflow risk
- Regulatory and litigation risk
- Refinancing risk
- Reputational risk

Source: Fitch Ratings

DISTRIBUTION OF ESG RELEVANCE SCORES BY NUMBER OF ISSUERS – 'CUSTOMER WELFARE - FAIR MESSAGING, PRIVACY & DATA SECURITY'

Score	1	2	3	4	5
Corporates	363	114	1141	28	4
Structured finance	559	2258	1372	167	8
Infrastructure	4	129	1118	23	0

As of 30 September 2021
Source: Fitch Ratings

PERCENTAGE DISTRIBUTION OF ESG RELEVANCE SCORES – 'CUSTOMER WELFARE - FAIR MESSAGING, PRIVACY & DATA SECURITY'

Score	1	2	3	4	5
Corporates	48.97%	5.82%	44.73%	0.36%	0.10%
Structured finance	19.33%	32.68%	44.78%	2.93%	0.28%
Infrastructure	0.28%	9.13%	89.24%	1.34%	0.00%

As of 30 September 2021
Source: Fitch Ratings

CUSTOMER/PATIENT WELFARE

The safety and wellbeing of customers or patients are key issues for issuers whose business models depend on customers. This includes most companies in the healthcare, consumer goods, retail, food and beverage, and tobacco industries. Product categories, quality and the associated health and nutrition benefits could have economic and financial impacts for issuers in these areas.

The UN Sustainable Development Goals lists 17 priority policy outcomes for the 2030 Agenda for Sustainable Development. Objective 12 "Ensure sustainable consumption and production pattern" could be an indicator of shifting consumer behaviour to reduce material footprint and waste in society to improve customer welfare and sustainability.

Relevance to Sectors

Growing public awareness about a product's quality and health and nutrition benefits is particularly evident in the food and non-food retail, pharmaceutical and healthcare sectors. For example, issuers from the alcoholic beverages and tobacco sectors are affected by more responsible consumption of their products by consumers. This is largely driven by the expanding middle-class population who prefer more healthy and nutritious products.

Concerns about the use of antibiotics in the animal production, packaged food and protein sectors is growing among consumers. Rising demand for higher-quality products could pressure issuers' long-term business models and strategies if they do not adapt where needed.

Impact on Credit Ratings – Case Studies

Issuers from certain sectors, such as tobacco, food and alcoholic beverages, are subject to higher regulatory risks, including changes to excise duties, which are considered as event risks in Fitch's rating analysis. The regulatory risk profile for the tobacco and alcohol sectors, combined with social responsibilities to their customer bases, can drive ESG.RS of '4' for the Social - Customer Welfare general issue, potentially affecting the evolution of ratings.

The focus on safety and wellbeing of customers will remain important after the Covid-19 pandemic as consumer behaviour shifts. Consumers will be the main force driving changes in business models aside from regulatory pressure. The growing population of people with middle-to-high incomes, particularly in emerging markets, is likely to increase demand for more healthy and nutritious products and more balanced lifestyles, which will lead to long-term product changes for corporates.

PRODUCT SAFETY & MARKETING

Regulations from the European Commission identify "product safety" as any product which, under normal or reasonably foreseeable conditions of use, does not present any risk or only the minimum risks compatible with the product's use, considered to be acceptable and consistent with a high level of protection for the safety and health of persons.[3] This takes into account the characteristics of the products; the effect on other products; the presentation of the product in the labelling; and the categories of consumers at risk when using the products, particularly children and the elderly.

INDUSTRY EXAMPLE: TOBACCO INDUSTRY'S HIGH REGULATORY RISKS

The U.S. Food and Drug Administration (FDA) intends to issue proposed product standards in 2022 to ban menthol as a characterising flavour in cigarettes and ban all characterising flavours (including menthol) in cigars. This is considered one of the most powerful moves against the tobacco industry and is aimed at reducing disease and death from smoking.

Fitch thinks the ban will not affect ratings in the near to medium term. The ban could accelerate the secular decline in cigarette sales volumes, but would face a long timeframe to implementation given the potential for litigation by the tobacco industry. Fitch also expects the industry to continue its focus on migrating consumers to "next generation products" to mitigate the long-term decline in traditional cigarettes, as the ban on menthol-flavoured tobacco products spreads globally.

ISSUER EXAMPLE: THE COCA-COLA COMPANY

The Coca-Cola Company (A/Stable) has an ESG.RS of "4" for Social - Customer Welfare, and, Social - Exposure to Social Impacts due to consumer concerns about health and nutrition, shifting consumer preferences as well as regulatory pressure on beverage makers to reduce sugar consumption. This has affected the demand for certain beverages with higher level of sugar, and has a negative impact on the credit profile.

These customer-related issues have caused beverage companies, including Coca-Cola, to increase investments in R&D to modify portfolios by accelerating reformulation of hundreds of brands to adapt to changing consumer behaviour.

The OECD adopted the Recommendation on Consumer Product Safety in July 2020, outlining key elements that should be at the core of consumer product safety frameworks at domestic and international levels.[4] It emphasises consumers' right to safe products, to be informed by evidence and data sources and specific attention to vulnerable customers. This recommendation follows a number of consumer product safety authorities that have established product safety mandates in recent years, to better protect consumers from unsafe products.

Fair labelling and ethical marketing refer to the practices that all “consumer commodities” be labelled to disclose net content, identity of commodities, and name and place of business of the product’s manufacturer, packer or distributor. It seeks to promote fairness, responsibility and honesty in marketing practices to consumers.

The US Federal Trade Commission (FTC) and the FDA jointly direct the Fair Packaging and Labelling Act (FPLA) to regulate labelling practices among consumer products. Product safety incidents in recent years have raised public awareness and regulatory pressure on issuers to improve customer safety and wellbeing by enhancing labelling and marketing standards.

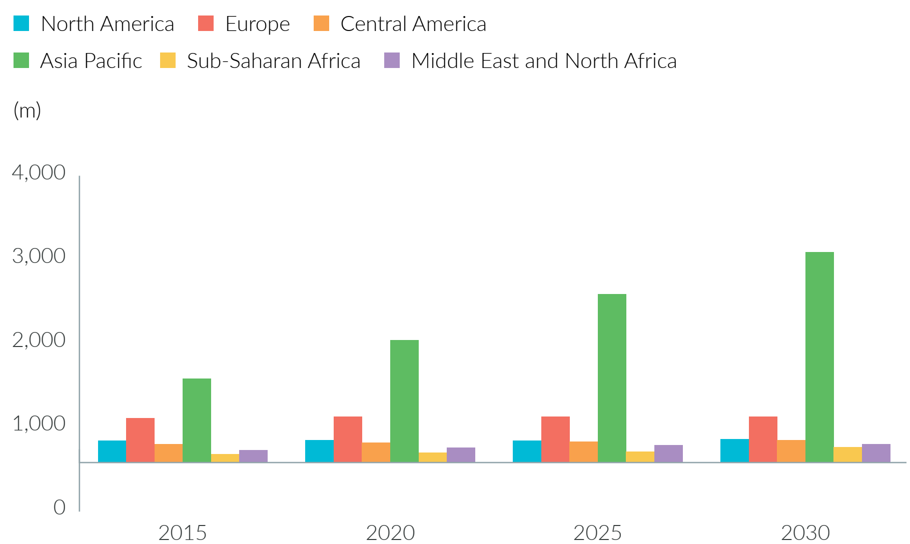
Relevance to Sectors

Product safety and marketing can be relevant to a variety of consumer-focused sectors, and can pose substantial risks to issuers via litigation, reputational damage, compliance with regulation and financial costs. Sectors that are more exposed to this risk include pharmaceuticals, healthcare, natural resources, auto suppliers and manufacturers, aerospace and defence, and financial institutions.

Impact on Credit Ratings – Case Studies

Product safety is most directly linked to litigation risks as a result of inferior goods that lead to accidents, or mislabelling or mis-selling of products. Litigation costs and settlements can have significant negative effects on issuer credit profiles. Reputational damage can lead to longer-term deterioration of an issuer's business operations.

MIDDLE-CLASS POPULATION BY REGION’



Source: Fitch Ratings, Brookings Institute.

3 Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on General Product Safety.

4 Communique on Product Safety Pledges, OECD, 2021.

Rising public awareness of previous product incidents and regulatory scrutiny will continue to pressure on manufacturers to raise the safety standards of their products, which could lead to increases in capex and opex.

LENDING PRACTICES AND PRICE TRANSPARENCY

Following the economic fallout from the Covid-19 pandemic, many consumers and SMEs faced sharp falls in income, impairing their ability to service debt and leading to social and political unrest. With the increasing political and societal concerns regarding customer welfare, the likelihood of more restrictive consumer protection legislation is rising.

There have been growing regulatory efforts to protect borrowers against discriminatory and predatory lending practices in developed markets, such as EU and US. Consumer lenders and debt purchasers in many markets face additional regulations in the wake of the pandemic and the increased focus on consumer protection.

Legislation seeks to balance creditors' rights with maintaining adequate credit availability for the under-banked population. Consumer-protection legislation and enforcement are typically more developed in more advanced markets. In Fitch's view, these risks could affect the resilience of the business models and related Issuer Default Ratings (IDRs) of consumer lenders.

ISSUER EXAMPLE: WHIRLPOOL CORP.

The home appliance manufacturer, Whirlpool Corp. (BBB/Stable), faces potential litigation costs. It faces legal claims over the role played by a Hotpoint-branded appliance in the Grenfell Tower fire in London that killed 70 people in 2019. Whirlpool has an ESG.RS pf '4' for Customer Welfare due to the potential regulatory and legal proceedings, which could negatively affect its credit profile and are relevant to its ratings.

ISSUER EXAMPLE: BAYER AG

The German pharmaceutical company Bayer AG (BBB+/Stable) has an ESG.RS of '4' for Customer Welfare due to its significant payouts related to the glyphosate litigation in the US. Some legal uncertainty remains around potential payouts to claimants after the judicial decision to reject Bayer's proposal to agree and pre-fund a settlement mechanism for future glyphosate claims. This has a negative impact on Bayer's credit profile and is relevant to the ratings.

ISSUER EXAMPLE: PACIFIC GAS AND ELECTRIC COMPANY

Pacific Gas and Electric Company (PG&E, BB/Stable) is a US investor-owned utility company. The company has an ESG.RS of 5 for Customer Welfare due to the impact of wildfires sparked by utility equipment in recent years, and the utility's poor safety record and the adverse effect on customers, which have a negative impact on the credit profile, and is highly relevant to the rating and has resulted in negative rating actions.

PG&E has accrued losses of USD375 million and USD800 million from the Zogg and Kincade fires, respectively. Significantly, from a credit perspective, criminal charges have been filed against PG&E following the fires. Fitch believes an adverse outcome in criminal proceedings would heighten reputational risk and could lead to additional fines, penalties and other measures that could be negative to the credit profile.

FitchRatings | Sustainable Fitch

CASE STUDY: DECADES-LONG US OPIOID CRISIS

The US opioid epidemic started in the late 1990s as several pharmaceutical companies began marketing pain relievers to a wider range of patients, such as those suffering chronic pain. Historically drugs in this category were used for severe pain or end-of-life care. Over time, it became clear that manufacturers' claims of non-addicting formulations were not accurate, as abuse of these medications became widespread. According to the Centers for Disease Control and Prevention (CDC), nearly 500, 000 people died from opioid overdoses in the US from 1999 to 2019.

Pharmaceutical companies face significant legal settlements associated with lawsuits and claims brought by states and municipalities related to the distribution of prescription opioid pain medications.

Several Fitch-rated pharmaceutical companies in the US have an ESG.RS of '4' for Customer Welfare due to their exposure to loss contingencies related to the ongoing litigation. However, the effects of the litigation costs on companies will vary with their financial flexibility and ability to pay the settlements. Fitch views litigation risk around the opioid crisis as rising. Purdue Pharma L.P. (not rated) and Mallinckrodt plc (not rated) filed for bankruptcy in 2021 in part due to the opioid crisis. Fitch thinks companies with a concentration in this market will suffer further credit distress due to litigation risks and declining revenue from prescription of these drugs.

Relevance to Sector

Regulatory changes, mainly in relation to interest-rate caps and payment holidays for high-cost consumer lenders, have so far led to a limited number of negative rating actions, mostly in EMEA. The managements of high-cost consumer lenders have started to pay more attention to incorporating customer welfare in their business conduct. Failure to do so could ultimately result in considerable risk from substantial conduct fines or franchise damage (see Fitch's special report High-Cost Consumer Lender ESG Risks Rise).

Fair lending practices are more likely to bring reputational advantages and access to funding from international lenders, which will benefit lenders' businesses and franchises over time.

The US Consumer Financial Protection Bureau published new rules governing collection and disclosure procedures in November 2020. The European Leveraged Finance Association and the Principles for Responsible Investing launched a guidance note on ESG disclosure for debt collectors in January 2021, to improve the transparent pricing disclosure and repayment options. Fitch expects regulators to continue to highlight the importance of fair collection practices for high-cost consumer lenders, particularly in developed markets.

Impact on Credit Ratings – Case Studies

High-cost consumer lenders face increasing scrutiny and pressure from regulators and society. Fitch believes that tighter regulatory measures, such as lending rate caps, could weaken high-cost consumer lenders' ability to adequately price risk. This measure could lower lenders' profitability, undermine loan collection efforts or force them to exit higher-risk segments, and ultimately push the sector to compete with larger competitors, notably banks.

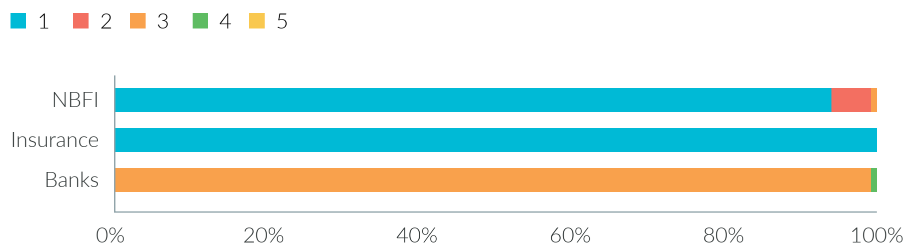
Fitch captures consumer lenders' risks from potential regulatory intervention under the ESG.RS for Customer Welfare. A score of "4" or "5" indicates greater exposure to fair lending practices, repossession practices and related regulatory/legal risks, which have a negative impact on the credit ratings.

In structured finance transactions, assignment of scores for the Social - Customer Welfare general issue is weighted heavily towards residential mortgage-backed securities (RMBS) transactions in which a significant percentage of mortgages have interest-only features, which can be considered predatory if borrowers are not financially sophisticated to understand how these features can affect their mortgage payments. These types of loans have typically been in legacy transactions that exhibited performance deterioration during the 2007-2008 financial crisis.

FitchRatings | Sustainable Fitch

Twelve National Collegiate Student Loan Trusts (NCSLTs) rated by Fitch under our US student loan asset-backed securities (ABS) portfolio have ESG.RS of '5' for Social - Customer Welfare due to an action filed by the Consumer Financial Protection Bureau (CFPB) against the trusts for illegal debt collection practices. According to the CFPB, consumers were sued for collection on their private student-loan debt that companies could not prove was owed or which obligations were beyond the statutes of limitation for legal action. On 18 September 2017, a proposed consent judgement was filed with the courts to settle all matters in the dispute. The proposed judgement requires an independent audit of all student loans in the 12 NCSLTs' portfolios. The NCSLTs could be required to make an aggregate payment of at least USD19.1 million, if the proposed judgement is confirmed. This will have a negative impact on the credit profiles of the rated notes and is highly relevant to the ratings, resulting in a rating cap at 'BBBsf' on the 12 transactions.

DISTRIBUTION OF ESG RELEVANCE SCORES FOR CUSTOMER WELFARE AMONG RATED FINANCIAL INSTITUTIONS



As of 31 December 2021
Source: Fitch Ratings

ISSUER EXAMPLE: PROVIDENT FINANCIAL PLC

Provident Financial Plc (BB/Negative) is a UK company that focuses on high-cost consumer lending. It has an ESG.R.S. of '4' for both Customer Welfare - Fair Messaging, Privacy & Data Collection and Exposure to Social Impacts. This reflects its business focus, which is under increasing regulatory scrutiny, in particular loans to low-income individuals. Provident has announced its exit from the home credit business, in which it has operated for more than 100 years, due to increasing restrictions. The exit also reflects social disapproval for this type of lending.

In Fitch's US Public Finance portfolio, 17 issuers have Social - Customer Welfare ESG.RS of '4[+]'. These issuers are from the community development and social lending sectors in the US, specifically in the tax-exempt housing sector. Issuers in these sectors operate mortgage programmes extended by various US state housing finance agencies that focus on customer welfare, fair lending practices, homebuyer education strategies and counselling initiatives. Fitch thinks that the agencies' focus on customer welfare strengthens loan performance by reducing delinquencies, which is positive for the issuers' credit profiles and ratings.

DATA PRIVACY & SECURITY

Data privacy and security refers to: an issuer's ability to properly use and protect the privacy of customers' personal information, and its strategy to enhance the resilience of IT policies and infrastructure against potential data incidents and cyber-attacks.

The rising number of data breaches in recent years has escalated concerns and costs around data privacy and protection. Regulators across the globe have been expanding rules around data protection and privacy. The scope of regulatory changes has been broad, covering issues such as the rights and obligations of businesses and individuals in the handing of personal data, penalties and enforcement, and rules around consent.

FitchRatings | Sustainable Fitch

SELECTED FITCH-RATED HIGH-COST CONSUMER LENDERS AND DEBT PURCHASERS/SERVICERS

Issuer	Country	Long-Term IDR	Customer Welfare (ESG.RS)
Debt Purchasers and Servicers			
Encore Capital Group, Inc.	US	BB+/Stable	4
PRA Group, Inc.	US	BB+/Stable	4
High-Cost Consumer Lenders			
Credito Real, S.A.B. de C.V., SOFOM, E.N.R.	Mexico	RD	4
Banco Compartamos, S.A., Institucion de Banca Multiple	Mexico	BB+/Stable	4
Manappuram Finance Limited	India	BB-/Stable	4
Financiera Independencia, S.A.B. de C.V., SOFOM, E.N.R.	Mexico	BB-/Stable	4
IDFinance Spain S.A.	Spain	B-/Negative	4

Source: Fitch Ratings

The EU was one of the first regions to undertake a comprehensive overhaul of data protection rules. The General Data Protection Regulations, which came into force in 2018, identifies and governs key aspects of how personal data are processed, stored and used, and to ensure transparency, accountability and security.

Following the EU's lead, other jurisdictions, including Brazil, China and Japan, are setting up and legislating similar data protection regulations in light of rising public awareness of data privacy.

Relevance to Sector

Sectors that are highly customer-facing or dependent on processing customer information have higher financial obligations due to rising public awareness about personal information and data privacy regulations.

The rapid increase in cyber-attacks also raises the need to shore up data protection. All sectors are vulnerable, but this is especially so for industries that are digitalising rapidly and where large amounts of sensitive and valuable customer data are handled.

In healthcare, the digital transformation, especially in developed markets, makes the industry particularly vulnerable to breaches, given the highly sensitive information handled and stored (see Relentless Cyber Attacks to Pressure NFP Hospitals' Operations). However, as Fitch Solutions notes, the intense pressure the global healthcare industry has been under due to Covid-19, means that cyber defences and preparedness may lag, though heavier regulatory guardrails may mitigate some broader risks.[5]

Financial institutions, particularly banks, can also be exposed to data breaches that affect millions of customers and create material business interruptions with significant incident costs in the long term (see Fitch Ratings' special report Quantifying U.S. Bank Systemic Cybersecurity Risk).

Impact on Credit Ratings – Case Studies

The credit impact has been limited, reflected in only two Fitch-rated issuers having received ESG.RS of '4' on account of Privacy and Data Security specific issues. This shows data protection regulations, including the EU's General Data Protection Regulation (GDPR), are often relevant but, thus far, only rarely material to a rating.

The UK's Information Commissioner's Office (ICO) initially indicated that it would impose a fine of GBP183 million on British Airways Plc (BB/Negative), following the theft of data of half a million of the airlines' customers in 2018. However, the fine was ultimately reduced to GBP20 million in October 2020.

FitchRatings | Sustainable Fitch

Fines in the EU imposed for breaches of the GDPR have been rising. Luxembourg's data regulator fined Amazon.com, Inc. (AA-/Stable) EUR746 million in July 2021 for improper use of customer data for targeted advertising. This is the largest fine under the GDPR. Meta's WhatsApp also faces a EUR225 million fine by Ireland's Data Protection Commission over transparency obligations on information processing between WhatsApp and other Meta companies. With regulations and enforcement starting to fall into place, Fitch expects to see a rise in fines related to GDPR breaches.

RECENT DATA PRIVACY REGULATIONS (ENACTED AND/OR PROPOSED)

Region	Name	Date
Australia	Treasury Laws Amendment (Consumer Data Right) Act 2019	Enacted July 2020
	Privacy Amendment (Notifiable Data Breaches) Act 2017 (Cth)	Enacted February 2018
California (US)	California Consumer Privacy Act	Enacted January 2020
EU	General Data Protection Regulation	Enacted May 2018
New York (US)	New York Privacy Act	Proposed 2019 but did not pass
India	Personal Data Protection Bill	Proposed December 2019
Canada	Digital Charter (Amendment to Personal Information Protection and Electronic Document Act)	Proposed January 2020
South Korea	Amendment to Personal Information Protection Act	Enacted August 2020
Brazil	General Data Protection Law	Enacted August 2020
China	Personal Information Protection Law	Enacted November 2021
Japan	Protection of Personal Information	Enacted June 2020

Source: Fitch Ratings

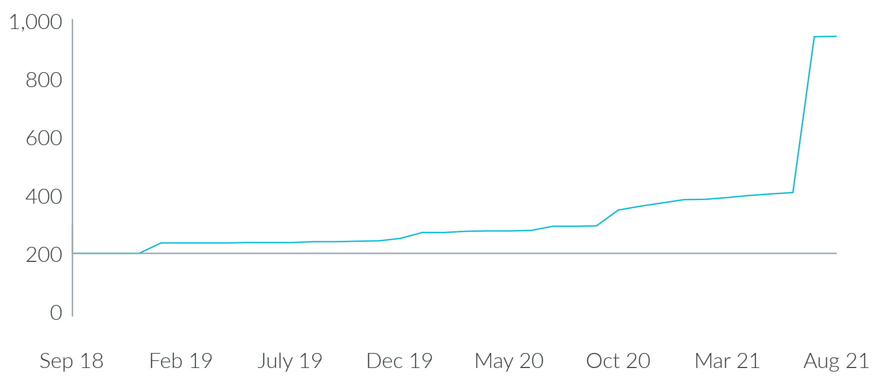
5 From Security to Resilience: Cyber Risks in A Connected World, Fitch Solutions, July 2021.

FitchRatings | Sustainable Fitch

GDPR FINES PICK UP AFTER PANDEMIC PAUSE

Cumulative GDPR fines as of August 2021

(EURm) 1,200



Source: Fitch Ratings, enforcementtracker.com, provided by CMS Law.Tax

INVESTOR EXAMPLE: VANGUARD GROUP

The Vanguard Group, one of the world's largest investment management companies with USD7.2 trillion of assets under management at 13 January 2021, engages with companies on customer-related issues.

It asked one of its investee companies, US healthcare company Johnson & Johnson, for a report on the board's oversight of opioid-related risks. Vanguard engaged with Johnson & Johnson through reviewing existing disclosures about its corporate response to the opioid epidemic, and encouraging improvement of the board's governance of financial and reputational risks related to the epidemic.

Vanguard voted at Bayer AG's 2019 annual meeting to express a lack of confidence in the company's ability to oversee new business, particularly in relation to product safety and customer welfare concerns after Bayer's acquisition of Monsanto in 2018. Vanguard's approach encouraged Bayer to disclose more information on how the company monitors legal and reputational risks. Vanguard's focus on the importance of material risks on social matters incentivised the investee company to improve oversight of material ESG risks.

ISSUER EXAMPLE: CAPITAL ONE FINANCIAL CORPORATION

Only two Fitch-rated issuers, Capital One Financial Corporation (A-/Stable) and Marriott International (rating withdrawn in September 2020), have ever received an ESG.RS of '4' for Customer Welfare – Fair Messaging, Privacy and Data Security. These related to data breaches in 2019 and 2018, respectively.

For Capital One, the data breach and related USD80 million fine were considered relevant to the ratings, but the ESG.RS for Capital One subsequently revised to '3' as the data breach did not result in any noticeable damage to its franchise.

EXPOSURE TO SOCIAL IMPACTS

SHIFTING SOCIAL NORMS PERTINENT FOR CREDIT ISSUES

‘Exposure to social impacts captures credit issues arising from shifting consumer preferences driven by a desire to avoid harm or do good. These shifts are largely outside issuers’ direct control and can be highly dynamic over time. They can affect demand for products and services, impair operations and alter market shares. Mitigation of credit risks for issuers rely on awareness of these shifts over time and actions to shield operations and limit exposure.’

Marina Petroleka, Global Head of ESG Research, Sustainable Fitch

Social Impacts Relevant for Variety of Sectors

A review of the ESG.RS portfolio across Fitch-rated issuers and transactions reveals certain non-financial corporate sectors have a higher concentration of scores of ‘4’ and ‘5’ for SIM, indicating medium and high impact, respectively, from these issues on the credit rating. These include pharmaceuticals, energy and natural resources, and tobacco; sectors that have historically been at the forefront of either regulatory action to manage social impacts, or face various levels of social resistance. With the proliferation of social media, the technology sector is also becoming increasingly exposed to regulatory and consumer shifts in attitudes. Some non- bank financial institutions (NBFIs), as well as certain pools of RMBS transactions, have a higher concentration of scores that indicate medium and high impact from SIM.

The concentration reflects these sectors being more exposed to shifting consumer preferences, social norms and related regulatory interventions in an effort to reduce wider societal harms, as is the case for tobacco, for instance, or they are sectors whose operations and assets typically meet local or broader community resistance as is the case for midstream energy or mining.

FitchRatings | Sustainable Fitch

Risk Mitigation Rests on Awareness of Shifting Societal Norms

Unlike other Social general issues in Fitch's ESG.RS, the elements that comprise SIM are mainly external, most often outside the direct control of issuers or entities and brought about by shifts in societal norms, preferences and expectations. This explains the focus of this report on the exposure of issuers to these forces.

Mitigation of risks associated with elements under social impacts (strikes, boycotts, shifting consumer and market preferences) therefore rests heavily on the level of awareness on the part of the issuers of these underlying shifts, and actions to manage their operations and business to limit their exposure.

FITCH ESG RELEVANCE SCORES

ESG.RS Scale

Score	Impact on credit	Description
1	None	Irrelevant to the entity, transaction or programme rating and irrelevant to the sector.
2	None	Irrelevant to the entity, transaction or programme rating but relevant to the sector.
3	Low	Minimally relevant to rating; either very low impact or actively managed resulting in no entity, transaction or programme rating impact.
4	Medium	Relevant to the entity, transaction or programme rating but not a key driver; has a rating impact in combination with other factors.
5	High	Highly relevant, a key rating driver that has a significant impact on the entity, transaction or programme rating on an individual basis.

Source: Fitch Ratings

ESG.RS – Definition of General Issues

Fitch's ESG.RS indicate the materiality and relevance that an Environmental (E), Social (S) or Governance (G) risk element has had on the credit rating outcome, on a scale of '1' (irrelevant) to '5' (a key rating driver).

Where an E, S or G issue has had an impact, indicated by a score of '4' or '5', the vast majority of times this impact is negative, meaning that it has weighted on the rating; in cases of an ESG.RS of '5' it has been a key rating driver in a rating action, such as an Outlook change or a credit rating downgrade.

Social general issues in Fitch's ESG.RS refer to the interactions between an issuer and its different stakeholder populations, both within the entity and in the market, community and broader society.

These issues are allocated in five general issue categories (see chart) that cover most asset classes. There are a further six Social general issue categories that apply only to sovereigns, local and regional governments (LRGs), infrastructure and US public finance tax-supported entities (Tax).

FitchRatings | Sustainable Fitch

FITCH RATINGS ESG.RS – SOCIAL GENERAL ISSUE CATEGORIES

Exposure to Social Impacts (SIM)
• Social Resistance • Shift in Consumer/Market Preferences
Employee Wellbeing (SEW)
• Health and Safety • Engagement, Diversity & Inclusion
Human Rights, Community Relations, Access & Affordability (SCR)
• Human Rights & Community Relations • Access & Affordability
Customer Welfare (SCW)
• Customer Privacy • Data Security • Product Quality & Safety • Customer Welfare • Fair Messaging and Product Labelling
Labour Relations & Practices (SLB)
• Labour Practices • Supply Chain Management (Labour issues)

Note: These Social general issues apply to the corporates, financial institutions, structured finance, international public finance (IPF) government related entities (GRE) and USPF revenue-supported entities (revenue)and infrastructure asset classes.

Source: Fitch Ratings

Defining the SIM General Issue

SIM refers to two, broad categories that relate to shifts in societal norms.

SOCIAL RESISTANCE OR PRESSURE

This addresses the impact of social resistance or pressure, such as strikes and boycotts, on an issuer's ability to carry out projects or operations.

Examples include protests against oil pipeline projects, campaigns for reduced vehicle ownership and use in cities, boycotts of a meat processing company or the protein sector as a whole due to unethical treatment of animals.

Companies in financial services also face potential exposure to social pressures. This is especially the case for those whose core positioning and products have resulted in social backlash and political disapproval, from lending to sub-prime or more vulnerable borrowers to, more recently, student loans companies.

SHIFT IN CONSUMER PREFERENCES

This addresses the impact of shifting consumer preferences on an issuer's ability to maintain its sales, revenue base, public support or reputation.

Examples include consumers favouring companies that use recycled materials in the manufacturing of products, or healthy lifestyle trends leading consumers to increasingly purchase organic products while reducing their purchase and consumption of non-organic food items.

For consideration in this category, shifts or changes in preference are generally required to be driven by a consumer or market desire to 'avoid harm' or 'do good', rather than for purely economic or aesthetic reasons.

SECULAR SHIFTS IN SOCIETAL NORMS DETERMINE EXPOSURE TO SOCIAL IMPACTS

Unlike other social general issues that we have explored, SIM issues reflect exposure to social risks and opportunities that largely, though not exclusively, stem from external factors.

While they can be driven by an issuer's decision-making process about its products or services and the impact they may have, they cannot be mitigated or controlled to the same extent. Something that may have been socially acceptable in previous times may no longer be so.

In other words, whether these stem from shifts in consumer preferences or market norms, or social resistance, such as boycotts to strikes, companies will need to be aware of shifts or trends in societal norms that prompt secular changes. These can in turn have an impact on their operations, revenues, profitability and reputation arising from the way they position their products, services or indeed their entire brand.

For instance, a greater emphasis on health and wellbeing, increasing rejection of products tested on animals or products containing raw materials associated with harmful social impacts, and alignment, or a lack of, with political parties and ideologies can all be captured under the SIM general issue. They can affect issuers' credit profiles and ratings, usually negatively.

The sectors that have typically been at the forefront of exposure to social impacts are pharmaceuticals, healthcare, tobacco, and food and drink, particularly those affected by shifting trends on wellbeing (e.g. organic, vegan/vegetarian and non-GMO diets), as well as financial services (in connection with sub-prime borrowers).

This is a highly dynamic general issue, as societal norms, preferences and expectations shift, and regulatory interventions adapt to mitigate issues that can cause wider societal harms or grievances. It is most likely that sectors that are minimally affected may face rising pressures as their reach and prevalence grows. A good example is the technology or media sectors, which are facing more intense scrutiny from regulators on such issues as competitive positioning, misinformation and harm to children or minorities, as well as the shift in societal and generational attitudes towards social media consumption.

If and when such issues arise and have an impact on a credit rating they can be captured under the SIM category.

SOCIAL ISSUES MOVE UP THE AGENDA FOR DISCLOSURES

Compared with environmental risks, there is sometimes a perception that social issues are more difficult for relevant entities to identify or address. In reality, there is a long history of social science and public policy, which both use measurable data to assess social risks.

As awareness of sustainability in the private sector grows and wider stakeholder priorities are incorporated in management or investment decisions, the inclusion of these metrics into risk management and ESG disclosures is also expanding.

EU Social Taxonomy Can Mainstream Social Issues Approaches

The EU's social taxonomy proposal is a key piece of draft regulation that may move social issues into the mainstream and create some basis for alignment.[1] The taxonomy aims to identify and direct capital towards economic activities that either address or avoid negative outcomes or generate positive social outcomes.

Similar to its environmental taxonomy, the framework will include "do no significant harm" alongside the primarily social objectives. The broad areas the social taxonomy proposal covers are Decent Work; Adequate Living Standards; Inclusive and Sustainable Communities, all of these areas have related sub-objectives. The proposal also links an entity's social activities to operating and capital expenditure, and turnover.

As taxonomies develop, so are mandatory disclosures. The European Commission's regulations on Corporate Disclosures (CSRD) that are due to take effect for the largest companies as of 1 January 2023, will introduce reporting on social issues. The draft European Sustainability Reporting Standards, which will be the basis for CSRD reporting, include proposals for reporting requirements along four Social issues: an entity's workforce; workers in the value chain; affected communities; and consumers and end users. The proposals have been put out to a public consultation that ends in August 2022.

CDSB Looking to Fill a Gap in Social Disclosures

The Climate Disclosures Standards Board, now merged with the International Sustainability Standards Board (ISSB) under the auspices of the IFRS, included Social issue metrics in January 2022 in an expanded CDSB Framework. Its assessment was that disclosures on Social issues were most being done on a highly ad hoc and non-harmonised basis by reporting entities. When the consultation was launched CDSB's assessment of the state of play in the market was that when it came to disclosures on Social issues, most were being done on a highly ad hoc and non-harmonised basis by reporting entities, thus raising questions about their verifiability, consistency, comparability and connection with financial risks and opportunities.

1 Final Report on Social Taxonomy – Platform on Sustainable Finance, February 2022 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/280222-sustainable-finance-platform-finance-report-social-taxonomy.pdf

FitchRatings | Sustainable Fitch

The ISSB, will work on delivering standards on other sustainability issues, likely including social issues, in its proposals once the climate-related disclosures have been finalised by end-2022.

While the issues captured under Fitch's Exposure to Social Impacts general issue in the ESG.RS refer to broader societal shifts or social resistance to projects or issues, the work on advancing social taxonomies and more harmonised and clearer disclosures on social metrics and impacts will also influence the availability and transparency of information on a plethora of social issues, thus potentially influencing societal attitudes and norms.

Sector-Specific Credit Issues

Of the nearly 60 ESG sector-specific templates where SIM has an ESG.RS of '2' or above, nearly half indicate that this is a relevant issue as it pertains mainly to shifts in consumer or market preferences. A further 20 relate mainly to social resistance, while for some sectors both elements that make up SIM are equally material (see *Appendix*).

Social impact issues can materialise in and overlap with other ESG issues. In some instances, more than one general risk issue under Social issues will be identified as relevant and material for an issuer's credit profile.

Within our ESG.RS framework and sector-specific scoring templates, we find connections between these credit issues and the following general issues.

ESG.RS SCORING TEMPLATE – TOBACCO

Environmental (E)	
General issue	**Sector-specific issue**
GHG Emissions & Air Quality	n.a.[a]
Energy Management	Energy use in manufacturing
Water & Wastewater Management	Water usage in manufacturing
Waste & Hazardous Materials Management; Ecological Impacts	General manufacturing waste
Exposure to Environmental Impacts	**Crop yield affected by climate change**
Social (S)	
Human Rights, Community Relations, Access & Affordability	n.a.[a]
Customer Welfare - Fair Messaging, Privacy & Data Security	Excessive tobacco consumption (consumer health); product labelling and marketing
Labour Relations & Practices	Impact of labour negotiations and employee (dis)satisfaction
Employee Wellbeing	n.a.[a]
Exposure to Social Impacts	Regulatory impact related to negative consequences from tobacco use
Governance (G)	
Management Strategy	Strategy development and implementation
Governance Structure	Board independence and effectiveness; ownership concentration
Group Structure	Complexity, transparency and related-party transactions
Financial Transparency	Quality and timing of financial disclosure

[a] Issue not relevant for this sector as part of the ESG.RS scoring template; equivalent to an ESG.RS of '1'.

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

ESG.RS SCORING TEMPLATE – MINING

Environmental (E)	
General issue	**Sector-specific issue**
GHG Emissions & Air Quality	Regulatory risk - emission standards
Energy Management	Energy use in operations
Water & Wastewater Management	Water usage in operations (including exposure to regions with water scarcity)
Waste & Hazardous Materials Management; Ecological Impacts	Total amount of tailings and mineral processing waste produced; management of tailings dams
Exposure to Environmental Impacts	Exposure to extreme weather events
Social (S)	
Human Rights, Community Relations, Access & Affordability	Relationships with local communities and/ or land right holders
Customer Welfare - Fair Messaging, Privacy & Data Security	n.a.*
Labour Relations & Practices	Impact of labor negotiations and employee (dis)satisfaction
Employee Wellbeing	Worker safety and accident prevention
Exposure to Social Impacts	Social resistance to major projects or operations that leads to delays and cost increases
Governance (G)	
Management Strategy	Strategy development and implementation
Governance Structure	Quality and timing of financial disclosures
Group Structure	Board independence and effectiveness; ownership concentration
Financial Transparency	Complexity, transparency and related-party transactions

Source: Fitch Ratings

HUMAN RIGHTS, COMMUNITY RELATIONS, SOCIAL ACCESS & AFFORDABILITY (SCR)

This category addresses management of the relationship between issuers and the communities in which they operate, including management of direct and indirect impacts on core human rights and the treatment of indigenous peoples. These are issues that also give rise to incidents of Social Resistance and therefore can manifest as relevant and material under Exposure to Social Issues.

Sectors where these may be relevant include Mining, as the example of the disruption to Peruvian mining operations further down this report illustrates, or other extractive industries and asset-heavy sectors where operations need often careful stakeholder management, including with local communities, or can have complex land rights issues.

FitchRatings | Sustainable Fitch

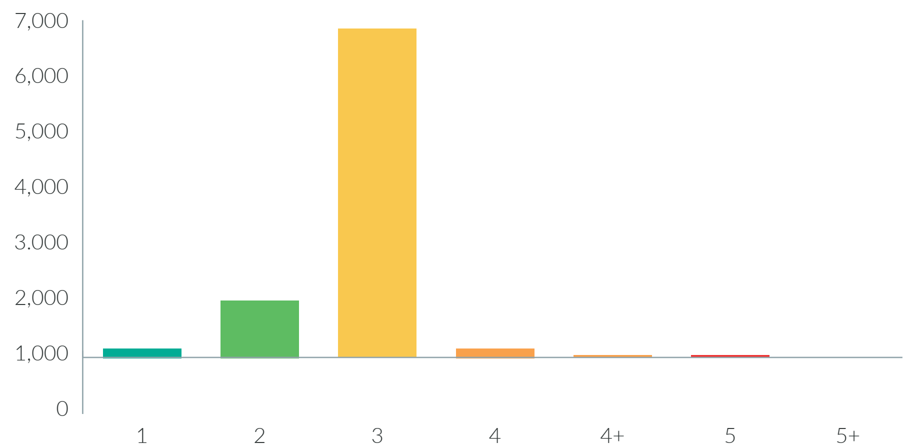
CUSTOMER WELFARE (SCW)

This general issue category captures social risk issues as they may pertain to Consumers their rights and safety. It covers privacy, data security, product safety and fair messaging and product labelling. Given the importance of shifting consumer preferences in the Exposure to Social Impacts general issue, issues that affect consumers can also lead to shifts consumer behaviours. Coca Cola, referenced further down in this analysis, is an example of an issuer where Fitch assigns a score of '4' for Exposure to Social Impacts as consumption of sugar moderates on health and wellbeing grounds and has a score of '4' under Customer Welfare as it pertains to the relevance and materiality of more stringent product labelling.

DISTRIBUTION OF SCORES FOR SIM - ALL ASSET CLASSES

4Q21

(No. of Issuers/Transactions) 8,000



Source: Fitch Ratings

How Social Impacts Relate to Credit Risks

Social impacts can materialise as a single credit risk or as a combination of credit risks. A review of the SIM general issue reveals that across all asset classes, just under 2% of issuers (or transactions in the case of structured finance) have a score of '4' and just 0.1% have a score of '5'.

It is worth noting that it is generally the case that the vast majority of issuers will have an ESG.RS of '3' for any ESG general issue. This indicates that the issue is minimally relevant to the rating itself, as the credit impact is either low or mitigated effectively. For SIM, 82% of issuers have a score of '3'.

Focusing on the few sectors and issuers with a score of a '4' or '5' and looking at the rated universe by asset class reveals a concentration of scores of '4' for SIM around certain sectors, mainly corporates, NBFIs and RMBS. There were ESG.RS for SIM for 3% of RMBS transactions, 3.5% of corporate issuers and 4% of NBFIs.

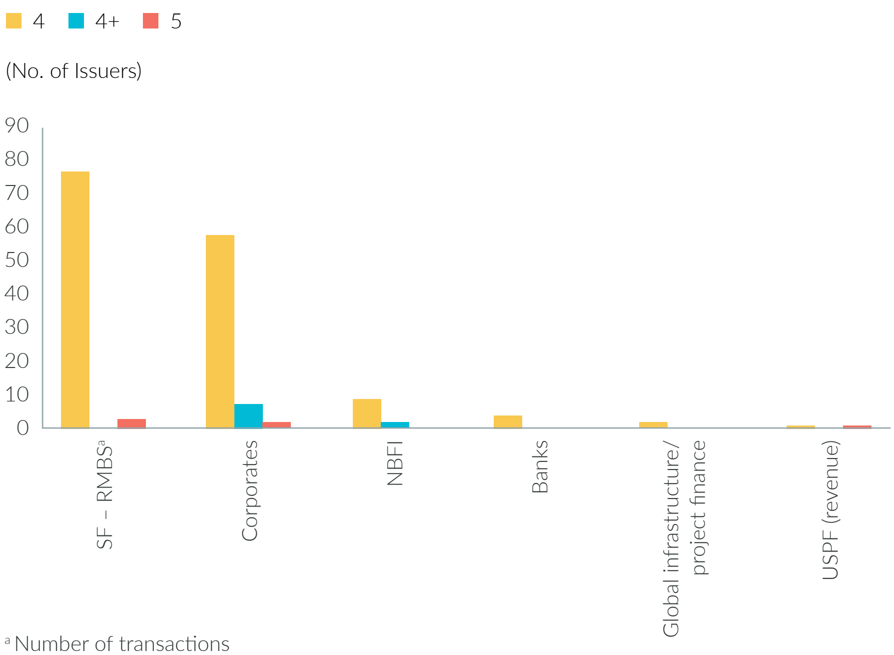
Among corporates, this includes sectors that have been exposed to shifting consumer preferences, changes in regulations in terms of consumer protections, as well as those that are typically at the forefront of social resistance. Issuers in the pharmaceutical, healthcare, oil and gas, and tobacco sectors have the highest share of scores of '4' for SIM.

In RMBS, the concentration of scores of '4' is seen in certain legacy vintages issued before 2007. The loans in these pools are seasoned and reflect small numbers of remaining borrowers that likely had limited credit opportunities/ credit access for refinancing subsequent to origination. However, considerations for small pools are being revised as increased refinance opportunities exist that will likely result in a revision to the SIM general issue for these transactions.

FitchRatings | Sustainable Fitch

CORPORATES, STRUCTURED FINANCE LEAD SIM CREDIT IMPACTS

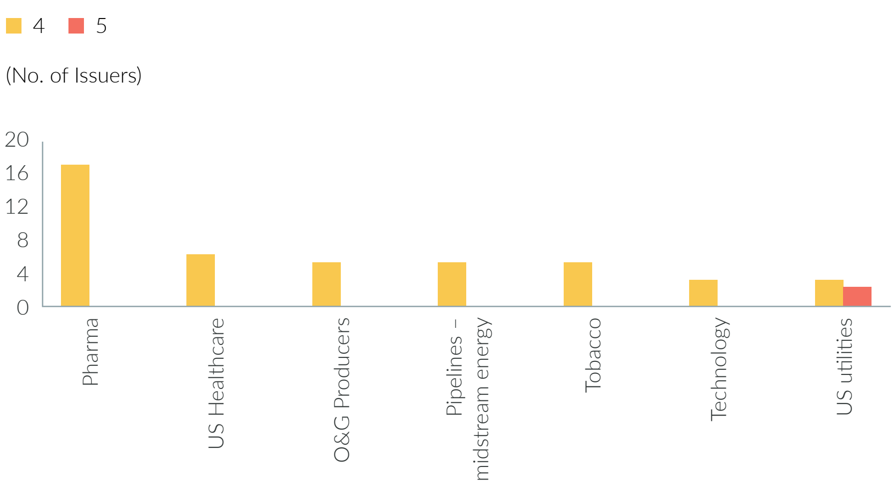
SIM scores of '4' and '5', 4Q21



[a] Number of transactions
Source: Fitch Ratings

PHARMA AND HEALTHCARE MOST AFFECTED

SIM scores of '4' and '5' – Non-Financial Corporates, 4Q21



Source: Fitch Ratings

SIM AMONG MOST MATERIAL ESG RISK ISSUES FOR CORPORATES

Looking across all ESG general issues, SIM has the third-highest percentage of scores of '4' among corporate issuers (3.5% of all rated issuers), after two Governance general issues – Governance Structure (6.7%) and Group Structure (5%).

For some corporate sectors, often those that are more exposed to social risk issues, the share of issuers with a score of '4' for SIM is higher than the average of 3.5% for all corporates. About 11% of issuers in the food, beverages and tobacco sectors have a score of '4' for SIM, the highest percentage of scores of '4' across all E, S or G general issues, alongside Customer Welfare.

For issuers in retail, consumer and healthcare, SIM is by a wide margin the E, S or G issue with the biggest impact, with nearly 18% of issuers in this group having a score of '4'.

What all of these ESG.RS and clusters around sectors indicate is that there are certain key risks and issues captured under this category that have a material impact on credit ratings. While still only accounting for a minority of scores, the dynamic nature of SIM in terms of capturing shifts in consumer preferences suggests that it can over time and as social norms, preferences and priorities change impact the credit profiles of different sectors.

These shifts are therefore pertinent credit risks that can have an impact on issuers' revenues and profitability, market share, or financial flexibility or financial structure. They may also necessitate changes in management and/or corporate governance to adjust or adapt the business.

Relevance and Materiality of Sector-Specific Exposure to Social Impacts

The table below shows a range of issues that can be classified under the two broad categories of SIM – Social Resistance, and, Shifting Consumer Preferences – and how they can transmit into credit specific risks.

This part of the report provides insights and case studies on how these core issues affect issuers from several sectors and how social impact-related credit issues transpire as credit risks and can affect the creditworthiness of issuers as reflected in changes to scores and their rationales in the ESG.RS.

Shifts in consumer preferences, regulatory changes, or having operations in sectors that typically face resistance do not mean that issues will translate into credit-relevant issues and credit risks. Although mainly exogenous, the issues captured under SIM can be actively managed to mitigate credit risks, which is what we observe most often, so less than 2% of all issuers and transactions, across all asset classes, have a score of '4' or '5' for SIM.

SOCIAL RESISTANCE

Social resistance has been a pertinent credit risk for asset-heavy sectors where setting up new facilities can encounter resistance in the forms of strikes or protests. Mines, pipelines, electricity generation (renewables and hydrocarbon based), upstream oil and gas, are typically the sectors most exposed in terms of credit impact as these disruptions can impair project operations and profitability as well as raise reputational risks for the companies involved.

TRANSMISSION MECHANISM FROM SOCIAL IMPACTS ISSUES TO CREDIT RISKS

Social Impacts – Issues	Social Impacts – Credit Issues	Social Impacts – Credit Risks
Protests	Social resistance to projects	Profitability risk
Brand boycotts	Shifting consumer/market preferences	Operational and cashflow risk
Supply-chain transparency	Nutritional concerns	Industry risk
Misinformation, social media reach	Animal welfare/ethical treatment of animals	Demand risk
Wellbeing and health	Supply chains – sourcing of materials and labour conditions	Macro risks
Animal welfare concerns	Environmental concerns	Market position
Pharmaceuticals price inflation	Healthcare spending and pharmaceuticals price inflation	Financial flexibility and structure
Fair lending practices	Social and/or political backlash on companies' activities (e.g. lending to vulnerable populations)	Reputational risk
Vegetarianism/veganism	Regulatory interventions on products wider social harms (e.g. sin taxes)	Litigation risk

Note: This list is not exhaustive, but aims to show a range of social issues or trends that may become relevant and material for credit metrics. For consideration in this category, shifts or changes in preferences are generally required to be driven by a consumer or market desire to 'avoid harm' or 'do good'. See Appendix for list of sectors and Social Impacts – Credit Issues.

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

However, if we consider social resistance in a broader context, then social resistance can be extended to cover consumer pull back from brands or companies associated with negative societal impacts. This is where social resistance crosses over into shifting consumer preferences.

Relevance to Sectors

Midstream Energy – O&G Pipelines

Oil and gas pipeline projects have been at the forefront of meeting social resistance. Traversing across various jurisdictions, often across state and international borders, pipelines projects tend to face resistance from local communities. Delays can occur due to environmental impact assessment and permitting issues as well as issues with land rights.

Apart from the potential higher project costs and executions risks that this carries, projects can also face political risks to their development, further accentuating delays, cost overruns and adding reputational risks. A notable example is Keystone XL – an extension to the Keystone pipeline to carry oil from the oil sands in the Canadian province of Alberta to the US Gulf Coast – which was at the centre of an intense political backlash for several years before the US Biden administration revoked the permit for Keystone XL in January 2021.

Alternatively, when pressures subside, are managed or projects complete, the pressure on credit profiles eases and this is reflected by a lowering of the ESG.RS.

EQM Midstream Partners, LP (BB/Negative) has an ESG.RS of '4' for SIM due to continued environmental permitting challenges for the Mountain Valley Pipeline, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors. This project has encountered several setbacks leading to large schedule delays and cost overruns, mainly due to permitting and environmental challenges.

In April 2022, Fitch affirmed Canadian pipeline operator Enbridge Inc.'s (ENB) Long-Term Issuer Default Rating (IDR) at 'BBB+'/Stable. ENB's ESG.RS for SIM has changed to '3' from '4'. While ENB is exposed to social resistance to major projects as part of its regular business, the company completed the L3R project in late 2021 and does not have any individual large growth projects planned, resulting in the revision of the relevance score. This factor no longer has an impact on the ratings.

Mining

Mining operations are also often the targets of protests, strikes, boycotts or are embroiled in political infighting.

In an analysis of the challenges facing Peru's mining sector, Fitch noted that social conflicts, regulatory risks and low business confidence are constraining investments in the country's mining sector and curbing its growth. This may lead to a review of the ESG.RS of Fitch-rated miners if social unrest puts pressure on their long-term strategies.

Peru's copper production fell by 18% in February 2022 from December 2021 as blockades of mining operations spread from greenfield sites to producing mines.

Fitch-rated Peruvian miners, including Southern Copper Corporation (SCC) (BBB+/Stable), Nexa Resources S.A., Minsur S.A. (both 'BBB-'/Stable), Volcan Compania Minera S.A.A. (BB/Positive), and Compania de Minas Buenaventura S.A.A. (BB/Stable), are under pressure to increase output, sustain cost structures or extend mine lives. Should social unrest affect their long-term plans, ESG.RS may increase for SIM, Community Relations, Social Access & Affordability (SCR) to levels that may affect ratings.

FitchRatings | Sustainable Fitch

SHIFTING CONSUMER PREFERENCES

Shifting consumer or broader market preferences can cover an expansive list of topics as well as discretionary shifts, including subtle changes to tastes, trends and norms. It can also cover regulatory interventions that shift consumer behaviour based on price or tax signals, for example, sin taxes on tobacco, alcohol, beverages and foods high in sugar content, or tax incentives for electric vehicles.

For the purposes of assessing impacts to credit profiles, any such shifts in preferences, whether discretionary, regulatory or both, can be captured under the SIM category. The score will reflect the relevance and materiality of these shifts on the issuer or transaction.

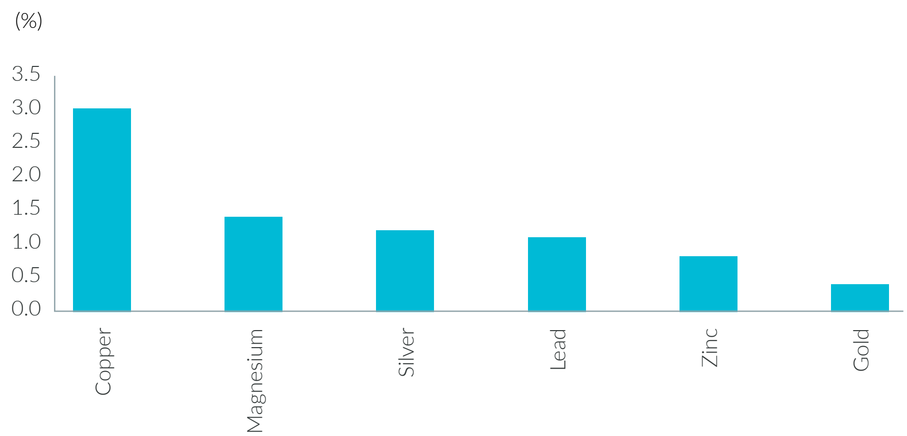
Relevance to Sectors

Technology

Chinese internet and technology majors have faced extensive regulatory tightening by Chinese authorities towards the sector. In its 2022 Outlook for the APAC Technology sectors, Fitch noted that regulatory risk in China's internet sector will continue to evolve and remain elevated, as the government has made antitrust enforcement a priority in its latest five-year plan. We also expect more government intervention in various internet segments to modify content and behaviour. New and tightening regulations will add pressure on industry revenue growth and profitability and costs for compliance may increase.

PERUVIAN MINING PRODUCTION LOST FROM SOCIAL UNREST

2021



Source: Fitch Ratings, BCRP, MEM

FitchRatings | Sustainable Fitch

Pharmaceuticals

Issuers in the pharmaceuticals sector have the highest concentration of ESG.RS of '4' for SIM among corporates, accounting for nearly 30% of all scores in the asset class.

This mainly relates to shifting consumer and regulatory pressures placing more scrutiny on the sector across jurisdictions to contain medicines price inflation and reduce the cost of healthcare spending. A persistently highly sensitive political environment for pharmaceutical and healthcare companies, particularly in the US, and social pressure to contain costs or restrict pricing have a negative impact on credit profiles.

The Fitch-rated issuers with ESG.RS of '4' for SIM include Merck & Co., Inc. (A+/Stable), Pfizer Inc. (A/Stable), Amgen Inc. (BBB+/Stable), Jazz Pharmaceuticals, Inc. (BB-/Positive) and Teva Pharmaceutical Industries Limited (BB-/Stable).

The regulatory tightening in China's internet sector and pressure this can create on revenue growth, profitability and compliance costs is reflected in the increase in ESG.RS for SIM for Fitch-rated Chinese internet and technology companies.

Baidu, Inc. (A/Stable), Alibaba Group Holding Limited (A+/Stable) and Tencent Holdings Limited (A+/Stable) all have an ESG.RS of '4' for SIM. They are all exposed to heightened regulatory risk as the Chinese government is focusing on antitrust enforcement and strengthening control of content and behaviour on the internet, which has a negative impact on their credit profiles and is relevant to their ratings.

FitchRatings | Sustainable Fitch

Non-bank Financial Institutions

Social risks generally affect a higher share of NBFI ratings than their banking peers. There has been a rising level of scrutiny by consumers and policy makers for several pockets of financial services in the non-bank segments that deal with more vulnerable population groups, or groups that may have a propensity to take on levels of debt that may become unmanageable. As social attitudes harden to the burden of student loans or very high interest lending to vulnerable populations, these sectors may face higher social barriers to operations as well as heightened regulatory, legislative and litigation risks.

STUDENT LOAN SERVICERS

Navient Corporation (BB-/Stable) is one of the largest non- government owners and servicers of student loan assets in the US. The company is exposed to higher levels of public dissatisfaction with the rising burden of student loans as well as a consistent decline in US student enrolment numbers since 2010.

The company is exposed to higher levels of public dissatisfaction with the rising burden of student loans as well as a consistent decline in US student enrolment numbers since 2010, both of which are factors that can affect the company's growth prospects as well as operating environment.

In January 2017, after conducting a review of the servicing practices of student loans that included an investigation of Navient over the prior three years, the Consumer Financial Protection Bureau (CFPB) announced a lawsuit (enforcement action) against Navient. The CFPB seeks injunctive relief, restitution to borrowers, refunds, damages and civil money penalties. The state attorneys general in California, Illinois, Mississippi, Washington, Pennsylvania, and New Jersey have also filed lawsuits against Navient.

Fitch believes the enforcement action against Navient creates an additional layer of uncertainty, including not only the potential monetary restitution to borrowers and fines, but the potential reputational risk an adverse judgement could have on current and future client relationships, particularly government contracts.

Navient has an ESG.RS of '4' for SIM due to its exposure to shifts in social or consumer preferences as a result of social positions, or social and/or political disapproval of core activities that affects the rating.

HIGH COST CONSUMER LENDING

Provident Financial plc (BB/Stable) focuses on non-prime lending to underbanked segments of the population in the UK. Its main sectors are consumer and auto loans segments.

Provident has an ESG.RS of '4' for both SIM and Customer Welfare stemming from a business model focused on high-cost consumer lending. This exposes the group to shifts of consumer or social preferences and to increasing regulatory scrutiny, in particular on loans to low-income individuals. This has a moderately negative influence on the pricing strategy, product mix, and targeted customer base.

DIVERSIFICATION AS PART OF CREDIT RISK MITIGATION

Diversification or pro-active operational shifts are key mitigation tools for issuers exposed to shifting societal dynamics, which can buttress profitability and defend market share, to the extent that this is within an issuer's control.

With rising regulatory and tax interventions (so-called sin taxes), as well as consumer awareness on negative health impacts of high sugar content foods and especially carbonated drinks, companies in the non-alcoholic beverages sectors have been among the most active in expanding portfolios and adjusting to shifting food choices.

Given the significant importance and high exposure of carbonated soft drinks, including those with higher sugar levels in its beverage portfolio, The Coca-Cola Company (A/Stable) is exposed to a societal shift towards healthier products.

Coca-Cola has an ESG.RS of '4' for SIM due to the shifting consumer preferences with reducing sugar consumption, which has affected the demand for certain beverages with higher levels of sugar.

These trends have caused beverage companies, including Coca- Cola, to increase investment in R&D to modify and extend portfolios by accelerating reformulation of hundreds of brands.

As a result, the company remains focused on building platforms across its total beverage portfolio beyond sparkling drinks, including hydration, coffee, tea, energy, nutrition, dairy and plant- based products, as well as alcohol-based product extensions.

COMMUNITY-RELATED ISSUES

CREDIT RISKS ASSOCIATED WITH THE PROVISION OF ESSENTIAL SERVICES AND CONSUMPTION OF COMMUNITY RESOURCES

‘Economic activities that affect the physical space communities occupy and other elements of peoples’ livelihoods, well-being or identities may be at higher risk of a community-related issue having a financially material impact.’

Nneka Chike-Obi, APAC Head of ESG Research, Sustainable Fitch

Access, Affordability Most Common Issue

Fitch considers access and affordability to be a community ESG issue for around 30 Fitch-rated sectors. The majority of affected issuers are involved in the provision of core services or essential infrastructure, such as housing, education and healthcare.

Heavily regulated sectors, like utilities and pharmaceuticals, can face constraints in their ability to adjust pricing where implicit or explicit price-controls are in play. The provision of services tied to social policies can be positive for an issuer’s credit profile due to government support.

Highly Relevant in Structured Finance

Fitch rates 170 structured finance transactions that have an ESG.RS of ‘4’ or ‘5’ for SCR, indicating that they are relevant to the credit rating. Most of these are residential mortgage-backed securities and covered bonds programmes and relate to housing affordability and the execution of social programmes.

Elevated Risk for Energy, Extractive Industries

Extractive industries and energy generation can have wide-ranging implications for communities due to the potential impact on land, air and water quality as well as on sites of cultural heritage.

Several issuers in these sectors have elevated ESG.RS across the three main categories of community-related issues: access and affordability, human rights and community relations. In some cases, poor community relations have led to protests, infrastructure damage and other actions that affect operations and uptime.

Defining Community-Related General Issues

The field of sociology defines communities as groups of people who share a common geographic space and a number of additional interrelated interests, such as culture, economics, beliefs and values. Community related issues are those where an entity's operations are highly dependent on or have a significant impact on community resources. These include human capital, natural capital, raw materials, tax revenue, political and regulatory environment, cultural heritage and customer demand.

From a sustainable finance perspective, community-related issues are distinct from other ESG topics because of the nexus between people and place. Economic activities that affect the physical space communities occupy and other elements of their livelihoods, well- being or identities may be at higher risk of a community-related issue having a financially material impact.

There are several frameworks that consider community in the context of economic development. For instance, goal 11 of the UN's sustainable development goals – sustainable cities and communities – aims to strengthen efforts to protect and safeguard the world's cultural and natural heritage.

The International Council on Monuments and Sites – a professional organisation for conservationists – supports goal 11 by emphasising the relationship between a city's heritage and economic life. The Council states that this can, "enhance the cultures, identities, and sense of belonging of local communities [and] create job opportunities and sustainable livelihoods."[1]

The UN's sustainable development goals also address access and affordability of basic services: healthcare (goal 3), education (goal 4), water and sanitation (goal 6) and energy (goal 7).

Another framework is the European Commission's Social Taxonomy, published in 2022. The Commission has three core objectives, one of which is inclusive and sustainable communities and societies. This objective considers land, indigenous and human rights as well as access to basic infrastructure. This objective is to be achieved via the proposed sub-objectives of job creation, mitigation of negative impacts on communities and socially inclusive due diligence.

In addition, all entities seeking to align with the social taxonomy must meet the 'do no significant harm' principle in relation to communities.
For example, a transportation project to improve a population's access to economic opportunities should avoid involuntary resettlement.

Human rights is an important community-related issue, especially for companies operating in jurisdictions where the rule and enforcement of law varies. The UN's Universal Declaration of Human Rights – the primary international standard – addresses 30 core civil, political and social rights, including citizenship, speech, religion, privacy, employment and education. Article 29 identifies the importance of community in relation to human rights: "Everyone has duties to the community in which alone the free and full development of his personality is possible."

The UN Guiding Principles on Business and Human Rights, published in 2011, discuss how companies should consider human rights in the course of business. They also clarify that a company's human rights-promoting activity outside of the course of business, such as corporate social responsibility, does not offset a failure to respect human rights throughout their operations[2]. The UN has encouraged governments to develop national action plans to create a policy environment that is supportive of the UN's guiding principles in domestic markets and in global supply chains.

1 Heritage and the Sustainable Development Goals: Policy Guidance for Heritage and Development Actors, The International Council on Monuments and Sites, March 2021

2 Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework, United Nations, 2011.

FitchRatings | Sustainable Fitch

Development finance institutions often set the standards for community-related investment issues, given the nature and scope of their activities in emerging economies and post-conflict regions. British International Investment (formerly CDC Group plc) provides guidance to investors on how to manage and mitigate community risks and identifies the sectors where these risks are most common. Best practice land-use change and natural resources includes environmental and social impact assessments, community consultations, compensation, provision of social services and benefit sharing.

The community-related general issue within Fitch's ESG.RS is SCR. There are three distinct sub-topics under this broad category: community relations, that is, an issuer's relationship with and impact on communities local to its operations; human rights, which relate to any effects on the civil, cultural, economic or social rights of individuals from an issuer's operations; and access and affordability. This refers to how available an issuer's products or services are to the communities it intends to serve. SCR applies to a range of entities, including corporates, financial institutions, infrastructure developers and revenue-supported public finance entities.

There are several other ESG.RS general issues that affect communities:

BIODIVERSITY AND NATURAL RESOURCE MANAGEMENT

This issue applies to sovereigns and government entities. Indigenous peoples often have strong relationships with natural capital assets related to food production, traditional practices and spiritual beliefs. Government policies on the commercial exploitation of such assets can risk communities' way of life.

EXPOSURE TO ENVIRONMENTAL IMPACTS

Environmental changes caused by business activities or infrastructure development can negatively affect local communities and contribute to a breakdown in the issuer/community relationship.

EXPOSURE TO SOCIAL IMPACTS

This category refers to social attitudes or actions by the community that have a negative financial impact on an entity. Effects on the community and affordability and access are common contributing issues and can result in delays or cost overruns for issuers.

"The responsibility to respect human rights requires that business enterprises:

- Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur
- Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts."

UN Guiding Principles on Business and Human Rights, 2011

SECTORS FREQUENTLY ASSOCIATED WITH COMMUNITY ISSUES

Cultural heritage	**Indigenous peoples**	**Land acquisition and involuntary resettlement**
Agribusiness and forestry	Agribusiness and forestry	Agribusiness and forestry
Energy and utilities	Construction	Construction
Extractive industries	Extractive industries	Extractive industries
Infrastructure	Infrastructure	Infrastructure
Pharmaceutical	Pharmaceutical	Manufacturing

Source: Fitch Ratings

HUMAN RIGHTS AND POLITICAL FREEDOMS

Government entities are evaluated on their policies on social stability and human rights protection. These policies can influence the way land rights, indigenous rights and access to essential services are managed within a jurisdiction.

LABOUR RELATIONS AND PRACTICES

The relationship between an issuer and its employees can be influenced by community-related factors, such as socioeconomic impacts or the effect on local businesses.

Sector-specific issues represent the primary transmission mechanism of a potential credit impact to the issuer.

For example, Fitch considers two sector-specific issues under SCR for renewable energy infrastructure issuers. The first is product affordability and access; how does an issuer's activity affect the cost and availability of its services – in this case, power – to the local community? The second is operating proximity to areas of conflict or indigenous lands. Most of these issues are evaluated in the context of community impacts that lead to delays, cost overruns or operational disruption.

ESG.RS TEMPLATE: RENEWABLE ENERGY (INFRASTRUCTURE)

Environmental (E)	
General issue	**Sector-specific issue**
Exposure to Environmental Impacts	Exposure to extreme weather events, resulting in loss of revenues, increased costs, and project construction delays
Social (S)	
Human Rights, Community Relations, Access & Affordability	**Product affordability and access; operating proximity to areas of conflict or indigenous lands**
Customer Welfare - Fair Messaging, Privacy & Data Security	n.a.
Labour Relations and Practices	Impact of labour negotiations and employee (dis)satisfaction; quality of contractors
Employee Wellbeing	Worker safety and accident prevention
Exposure to Social Impacts	Social resistance to projects that leads to delays or cost increases, and/or unfavourable regulatory regimes
Governance (G)	
Management Strategy	Operational implementation of strategy informed by sponsor strength/experience and ability to effectively manage risks; involvement of local parties
Governance Structure	Board independence and effectiveness; ownership concentration; ring fencing
Group Structure	Complexity, transparency and related-party transactions
Financial Transparency	Quality and timeliness of financial disclosure; reliability, level of detail and scope of information (informed by data sources, use of expert reports)

Source: Fitch Ratings

Sector-Specific Credit Issues

Fitch uses the ESG scoring template to allocate a relevance score between '1' and '5' for each general issue. When there is a material financial impact associated with a community-related issue, Fitch assigns a corresponding relevance score to indicate that this factor contributed to the credit rating decision, either in conjunction with other factors (score of '4') or as a primary driver (score of '5').

SCR addresses an issuer's management of social risks related to the population and community adjacent to its operations or project development. The sector-specific credit issues under SCR fall into three broad categories:

Human rights:
- Operating proximity to areas of conflict or indigenous lands
- Operations in politically sensitive regions
- Wellbeing of clinical trial participants

Community relations:
- Land rights
- Impact of operations on communities
- Relationships with local communities

Access and affordability:
- Low-income access
- Product affordability and access
- Government/agency issuance or provision for social good
- Risk-based pricing/repricing
- Services for underbanked/ underserved communities
- Lending to borrowers with limited or no access to other external sources of finance

How Community-Related Issues Relate to Credit Risk

Community related issues can create credit risks for issuers if they significantly affect credit factors, as with all ESG.RS general issues; see the graphic below of the transmission mechanism of community-related issues into credit risks.

TRANSMISSION MECHANISM FOR COMMUNITY-RELATED ISSUES

Community-related issues

- Land rights
- Indigenous peoples
- Cultural heritage
- Affordability
- Taxpayer burden
- Demographic shifts
- Employment loss
- Economic downturn
- Plant/facility closures
- Health and healthcare

Community-related credit issues
ESG relevant Score = 2
(credit relevant to sector)

- Relationship with local communities
- Impact on communities where products are sourced
- Operating proximity to areas of conflict, indigenous lands, or politically sensitive regions
- Wellbeing of clinical trial participants
- Risk-based pricing/repricing
- Services geared to underserved communities
- Social programs
- Product or service affordability and access
- Provision for social good

Credit Risks
ESG relevant Score = 3, 4, or 5
(credit material)

- Business risk
- Demand risk
- Industry risk
- Macro risk
- Operational risk
- Supply and resource management risk
- Technical risk

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

Relevance and Materiality of Sector-Specific Community-Related Issues

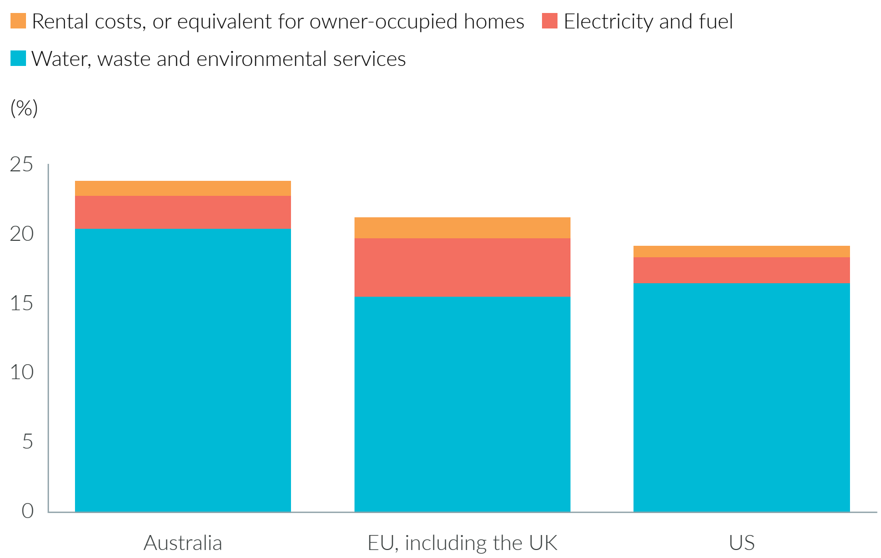
Community issues are relevant to a wide range of sectors and issuer types; see Appendix. These can be grouped into three core community-related credit issues:

- Access and affordability; services to low-income or underserved communities.
- Human rights; operations in proximity to indigenous peoples, conflict or politically sensitive regions.
- Relations with and impact on local community.

Economic activity that involves land-use changes, resource extraction, large-scale construction or the provision of essential services entail the greatest exposure to community-related credit risk. In some sectors, such as extractive industries, companies operate in politically sensitive regions due to the location of the resources, meaning that community issues can persist over long periods of time. Community issues are most material to entities in the energy, natural resources, utilities, healthcare, consumer finance and infrastructure sectors within Fitch's rated universe.

HOUSING-RELATED EXPENDITURE

Percentage of household consumption expenditure, 2020



Source: Fitch Ratings, OECD

ACCESS AND AFFORDABILITY

Access and affordability are relevant to the highest number of issuers in the community-related sub-sectors within Fitch's rated universe. There are around 30 Fitch-rated entities that are affected, most of which are involved in the provision of basic infrastructure and services. These entities cover a range of asset classes, including corporates, financial institutions, infrastructure, public finance, supranational and structured finance.

Housing and utilities account for a large share of household spending in developed market economies, and consumers are often sensitive to changes to access and affordability for these services. Around 20% or more of household consumption in Australia, the EU and the US went towards housing, electricity, fuel, water and other domestic utilities in 2020. The regulated nature of many utilities may limit issuers' ability to adjust prices, which can hurt issuers' credit profiles.

Patient access and product affordability can be relevant for healthcare-related issuers, like pharmaceutical and medical product manufacturers, healthcare providers, hospitals and life plan communities. This can relate to the type of customer for drug and product manufacturers; for example, a national health system that provides no- or low-cost treatments has a strong negotiating position and commitment to affordable pricing. Fitch has observed pricing pressure on generic drug manufacturers, like Teva Pharmaceutical Industries Limited (BB-/Stable), amid customer consolidation into larger buying groups capable of extracting large price reductions.

FitchRatings | Sustainable Fitch

Impact on Credit Ratings

SCR issues can be credit-positive for government-sponsored entities that execute essential social objectives, such as Fannie Mae (AAA/Negative) and Freddie Mac (AAA/Negative), which provide liquidity to the US secondary mortgage market, and BNG Bank N.V. (AAA/Stable), which lends to Dutch housing associations and other public entities.

Access and affordability issues for mortgage-related products include housing affordability, government-supported entity or agency sponsorship and the provision for social good. Issuances related to social policy can benefit from a similar positive credit impact as government sponsored entities. Fitch-rated government- supported entity transactions that address access and affordability, while driving strong performance, contribute to reduced expected losses in the rating analysis. Fitch assigned a rating of 'AAA' to the Indiana Housing and Community Development Authority (IN)'s April 2022 single-family mortgage revenue bonds, which were issued as social bonds and received an SCR score of '4+', because of mortgage payment guarantees from government-sponsored entities.

Access and affordability characteristics can also have a negative credit impact. UK RMBS securitisation, Formentera Issuer PLC, has an SCR score of '4', amid limited verification of borrowers' ability to afford mortgage payments; 26% of the pool consists of loans where an owner-occupier's income was self-certified and nearly 15% of the pool comprises borrowers with adverse credit, such as a county court judgement or bankruptcy order.

DISTRIBUTION OF ESG.RS FOR SCR ISSUES AT END-2021

Score	1	2	3	4	5
Corporates	470	28	1130	18	4
Financial institutions	440	890	7	7	0
Infrastructure	7	24	316	1	0
Structured finance	559	2258	1372	167	8
Public finance	0	0	1146	7	1

Source: Fitch Ratings

FUEL AFFORDABILITY IN A REGULATED PRICE ENVIRONMENT

The Indonesian government sets the fuel price that state-owned oil company, PT Pertamina (Persero) (BBB/Stable), can charge customers. Fuel prices are politically sensitive in Indonesia, an emerging economy with a population of 274 million and a GDP per capita of less than USD 4,000. Fuel prices have led to social unrest in the past, with related protest in 2005, 2008, 2012 and 2013. The government has allocated IDR134 trillion to energy subsidies for 2022. Fitch assigned the issuer an SCR score of '4', as it bears the burden of under-recoveries to maintain fuel-price affordability for the Indonesian population.

FitchRatings | Sustainable Fitch

Entities that offer basic services and commodities may have limited room to adjust prices, leading to affordability issues for consumers. Fitch downgraded Pinnacle West Capital Corporation and its regulated utility subsidiary, Arizona Public Service Company, to 'BBB+'/Negative in November 2021. Both companies have SCR scores of '4', as regulated power prices limit the companies' ability to set their own rates. The Arizona Corporation Commission voted to reduce customer rates and authorised returns on equity in 2021, which had negatively affected the issuers' credit profiles.

Fitch's Sports Facilities, Leagues and Teams Rating Criteria identifies a number of access and affordability issues. For instance, local demographic and economic conditions are important factors in assessing revenue risk, particularly for revenue streams like corporate purchases, premium suites and season tickets. Fitch is unlikely to assign a credit rating above 'BBB' to a sports facility issuer, because of the "discretionary nature of sports revenues [...] due to team performance or local, regional, national or global economic conditions and the single site of the facility."

Nine Fitch-rated multilateral development banks have an SCR score of '4+'. This indicates that the banks' financing activities for emerging economies and roles as lenders of last resort have a positive impact on their credit profiles. This is because these activities support the banks' policy importance to their shareholders, the majority of which are sovereigns.

COVID-19 PANDEMIC SUPPORT FOR DEVELOPING COUNTRIES

Asian Development Bank (AAA/Stable) allocated USD20 billion to a Covid-19 pandemic response option for developing member countries and USD9 billion to an Asia-Pacific vaccine access facility in April 2020. This was one of the largest policy responses to the pandemic among Fitch-rated supranationals.

The facility was fully allocated as of May 2022, with the largest portions distributed as loans, grants and technical assistance to countries in Southeast Asia (USD11.5 billion), South Asia (USD9.6 billion) and Central and West Asia (USD7.9 billion).

Both facilities are funded principally through debt issuance. In affirming the bank's rating in 2021, Fitch forecast a modest rise in non-performing loans in the medium term, but expected such loans to stay below the 'Very Low' rating criteria threshold

FitchRatings | Sustainable Fitch

HUMAN RIGHTS

Human rights is the main SCR issue for 10 sub-sectors in Fitch's rated universe, all related to energy or extractive industries.

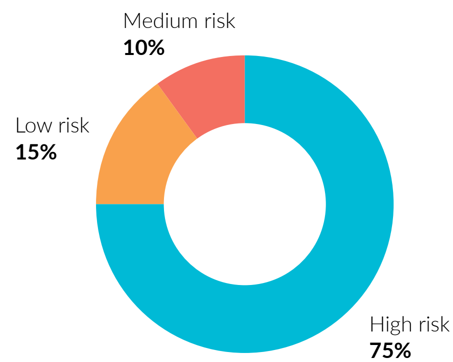
The political and regulatory conditions of the countries where extractive industry companies operate due to the location of natural resources contribute to human rights risk exposure. Many resource-rich regions have a high incidence of conflict or political instability. The UN environmental programme believes that natural resources play a key role in creating and sustaining conflict and in creating perverse incentives that prevent conflict resolution.

The First Peoples Worldwide NGO reviewed 52 Russell 1000 Index listed oil, gas and mining companies in 2014 to identify exposures to indigenous peoples' rights. Of the 313 countries with at least two projects, 75% had weak legal protections for indigenous peoples, indicating a high risk of impact on those communities as a result of business operations. Many high-risk countries have large natural- resource reserves, such as Ghana, Russia, Indonesia and Colombia.

Failure to manage human rights can financially impact an issuer. This may be caused by higher staff hours to address human rights-related issues – for instance, for extra security or higher pay for workers to cross through protest zones – work stoppages as well as physical damage and violence. A 2014 Harvard Kennedy School study of extractive-industry companies associated with community problems estimated that production delays at a major mining project with capex

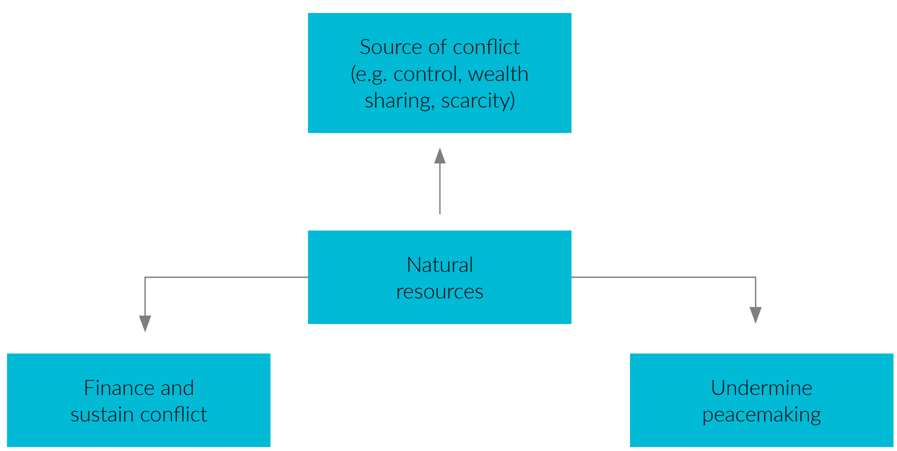
EXTRACTIVE INDUSTRY PROJECT SITES BY INDIGENOUS RIGHTS RISK

Number of project sites in sample = 313



Source: Fitch Ratings, Indigenous Rights Risk Report

RELATIONSHIP BETWEEN NATURAL RESOURCES, THE ENVIRONMENT AND CONFLICT



Source: Fitch Ratings, UN

of USD3 billion-5 billion cost an estimated USD20 million a week[3]. This did not include costs associated with addressing negative publicity, repairing physical assets or responding to legal challenges.

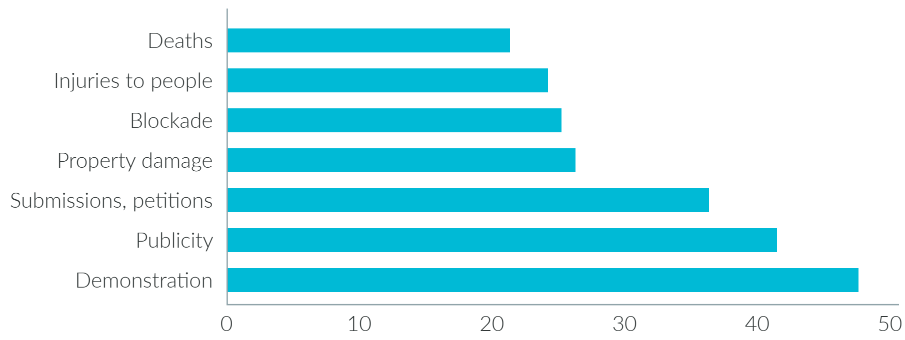
Human rights at pharmaceutical companies revolve around the wellbeing of clinical trial participants. This includes ethical considerations when engaging people from low-income, minority or underprivileged communities, with a number of incidents raising awareness of informed consent and the importance of trial safety.

For instance, in 1996, 11 Nigerian children died in a clinical trial for an antibiotic called Trovan, manufactured by Pfizer Inc. (A/Stable). The government of Kano State sued on behalf of affected families, claiming a failure to obtain informed consent, and reached a settlement with Pfizer in 2009.

In another example, a 2011-2012 rotavirus vaccine study by Indian pharmaceutical manufacturer, Bharat Biotech International Limited, saw one-third of its 2,000 juvenile participants receiving a saltwater placebo instead of an existing vaccine from a different company. International best-practice for medical ethics, such as the Declaration of Helsinki, limits placebo use to studies where there is no other proven treatment.

MANIFESTATIONS OF COMPANY-COMMUNITY CONFLICT

N=50 extractive industry operations



Source: Fitch Ratings, R. Davis and D. Franks, Harvard Kennedy School 2014

FitchRatings | Sustainable Fitch

Impact on Credit Ratings

Rio Tinto Plc (A/Stable) faced a parliamentary inquiry in 2020 over its destruction of an Aboriginal cultural-heritage site in Western Australia's Juukan Gorge. The demolished rock shelters showed evidence of human settlement going back 46,000 years. The inquiry found the company had legal permission to demolish the site, but determined that it failed to adequately consult with the indigenous community prior to the demolition. Fitch did not change the company's credit rating due to a lack of associated financial liability, but noted that " this assumes, as a minimum, that Rio Tinto will more carefully manage its relations with local communities and be more sensitive to their heritage in the future."

Ongoing conflict between minority ethnic communities and oil companies in Nigeria's Niger Delta has affected independent exploration and production company, Seplat Energy Plc (B/Stable). Physical attacks on infrastructure by local groups caused the Trans Forcados pipeline to shut down for 305 days in 2016 and 182 days in 2017. The pipeline is the region's primary export access to the Forcados Oil Terminal. This negatively affected the company's upstream operation and reduced its 2017 uptime to only 50%. Fitch lowered Seplat's SCR score to '4', from '5', in November 2021 following its "deeper communication and cooperation with local communities."

LITIGATION OVER PIPELINE NEAR TRIBAL LANDS

US gas pipeline operator, Energy Transfer LP (ET, BBB-/Stable), has an ESG. RS of '4' for SCR because of litigation related to its 36% ownership of the Dakota Access Pipeline.

The Standing Rock Sioux tribe claimed the pipeline violates elements of the 1868 Fort Laramie Treaty between the Sioux Nation and the US government, and its construction put artefacts and burial grounds at risk. Intense protests in 2016 were followed by lawsuits between the pipeline operators, environmental NGOs and native American communities.

In March 2020, a federal court ruled in favour of the Standing Rock Sioux and ordered a new environmental impact study that took tribal issues into consideration. The Supreme Court rejected an appeal by ET over this decision in February 2022.

3 Costs of Company-Community Conflict in the Extractive Sector, Davis Rachel and Daniel M. Franks, Corporate Social Responsibility Initiative Report No. 66, Harvard Kennedy School, 2014.

FitchRatings | Sustainable Fitch

COMMUNITY RELATIONS

Community relations can be a serious issue for issuers whose operations affect social goods and community resources. In addition to extractive industries and energy, chemicals and commodity processing can damage water, air and soil quality. The US Environmental Protection Agency identified Harris County, Texas (AAA/ Stable), home to the city of Houston as well as hundreds of chemical manufacturing plants and several large oil and gas refineries, as having unacceptable levels of air pollution that pose health risks to the community[4]. The American Chemistry Council, an industry trade association, collaborated with the county government to improve air quality monitoring, including in low-income areas.

Fitch also considers local community relationships when rating US public-finance higher education issuers. The importance of town- gown relations has a long history and can involve issues like tax- exempt status, development of public spaces into campus facilities and political tension if the positions of students or faculty oppose those of the local community. Universities can manage the challenges by contributing to the local community and economy, such as through the sources of influence outlined by Michael Porter at Harvard Business School, as shown in the following table.

COLLEGE AND UNIVERSITY IMPACT ON REGIONAL ECONOMIC DEVELOPMENT

Source of Influence	Example/Reference
Employer	Yale University's New Haven Hiring Initiative
Purchaser	University of California's Small Business First procurement programme
Real estate developer	LeDroit Park Initiative, Washington, D.C. (Howard University, Fannie Mae)
Workforce developer	Continuing education programmes
Advisor and network builder	Northwestern University's Kellogg Small Business Advisory Initiative
Technology transformer and incubator	Silicon Valley

Source: Fitch Ratings, M. Porter - Forum Futures 2007

Impact on Credit Ratings

Ongoing social conflict in Peru led Fitch to review the ESG.RS of rated metals and mining companies in April 2022. Much of the disruption related to local communities' dissatisfaction with compensation, land and resource access. Fitch has not yet taken any rating action, but it could raise SCR scores if it believes the social unrest will affect the long-term development plans of rated issuers and impact credit quality. Southern Copper Corporation's (BBB+/Stable) Cuajone mine halted operations in February 2022 after community members blocked the mine's water and railroad access and made demands for USD5 billion in compensation and 5% of its annual profit. The Peruvian government declared at state of emergency in April 2022 and the communities agreed to lift the blockade and entered into a supervised dialogue with the miner.

4 A Closer Look at Air Pollution in Houston: Identifying Priority Health Risks, Environmental Protection Authority, 2005.

FitchRatings | Sustainable Fitch

APPENDICES FOR PART I

APPENDIX A: LABOUR-RELATED ISSUES AND THEIR IMPACTS

SOCIAL, FINANCIAL AND ECONOMIC IMPACTS

Labour issue	ESG credit issues	Social impact	Financial and economic impact
Strikes: breakdown in negotiations between workers and management, leading to stoppages	• Impact of labour negotiations and employee satisfaction • Workforce diversity	• Disruption to transport, other businesses, and public order/ safety due to picket lines or protests • Reduced access to goods or services • Reduced access to essential public services e.g. healthcare, education • Productivity losses among users reliant on disrupted goods or services.	• Loss of revenue due to work stoppages • Decreased productivity • Increased costs to hire temporary workers to cover striking staff • Short-term loss of market share to competitors that could become permanent • Increased costs for legal services and arbitration
Unionisation: internal action by employees to form or join a union	• Impact of labour negotiations and employee satisfaction • Pension obligations and related litigation • Worker safety and accident prevention • Workforce diversity	• Increased attractiveness to potential job applicants • Health and safety improvements • Increased political influence for union members • Improved pay transparency	• Increased costs for compensation and benefits • Increased costs for legal services and arbitration • Increased costs for promoting alternatives to unionisation
Large share of **contract, seasonal, and third-party labour** not covered under same standards and benefits	• Quality of contractors • Worker safety and accident prevention	• Political intervention and regulatory pressure. • Social tensions between employees and contractors. • Reduced upward mobility within companies. • Reputational damage.	• Lower costs for compensation and benefits. • Fines, civil or criminal penalties due to misclassification or breaches of labour laws. • Fines, civil or criminal penalties due to safety issues.

FitchRatings | Sustainable Fitch

Labour issue	ESG credit issues	Social impact	Financial and economic impact
Health and safety: high or increasing incidence rates	• Worker safety and accident prevention • Employee recruitment and retention • Tenant safety and wellbeing • Pension obligations and related litigation	• Political intervention and regulatory pressure • Reputational damage. • Reduced interest and loyalty from fans (e.g. sports and entertainment).	• Fines, civil, or criminal penalties. • Increased costs for health or medical insurance premiums, and other medical costs. • Decreased productivity. • Increased costs for health and safety training. • Loss of revenue and market share in sectors where customer health and safety is simultaneously affected (e.g. transportation and healthcare).
Supply chain: evidence of poor and/or illegal labour standards in Tier 1, 2, and 3 suppliers	• Quality of contractors • Legal and regulatory compliance in operational geographies • Worker safety and accident prevention • Supply-chain management – labour	• Exploitation of minority or marginalised populations. • Violations of human rights. • Loss of right to an education for children. • Increase in violent and sexual crime. • Reputational damage. • Consumer shift towards more transparent competitors.	• Fines, civil, or criminal penalties. • Import restrictions due to violation of international trade laws. • Increased costs from switching to suppliers or regions with better labour practices.
Staff turnover: high or increasing rate, difficulty in recruiting and retaining workers	• Employee recruitment and retention • Workforce diversity	• Overworking of remaining employees. • Reduced engagement of remaining employees.	• Increased costs associated with recruitment, training and human resources. • Reduced productivity.
Ageing workforce: larger share of older adults in employee population	• Pension obligations and related litigation • Employee recruitment and retention	• Increased need for private childcare as older relatives remain in the workforce. • Increased demand for skills retraining.	• Increased costs for compensation and benefits. • Increased costs for health or medical insurance premiums, and other medical costs. • Reduced productivity.
Senior executive/ **worker pay and representatin gap**	• Board/employee compensation and composition • Workforce diversity	• Political intervention and regulatory pressure. • Consumer shift towards competitors with more representative/egalitarian management.	• Reduced access to capital from banks with diversity requirements for lending. • Reduced access to stock exchanges with diversity requirements.

FitchRatings | Sustainable Fitch

Labour issue	ESG credit issues	Social impact	Financial and economic impact
Discrimination: mistreatment of employees based on race, gender, orientation, religion, or other characteristic	• Employee recruitment and retention • Workforce diversity	• Exploitation of minority or marginalised populations. • Political intervention and regulatory pressure. • Reputational damage.	• Fines, civil or criminal penalties. • Increased costs associated with recruitment, training and human resources. • Reduced productivity.
Minimum wage and working conditions – regulatory increases	• Board/employee compensation and composition • Legal and regulatory compliance in operational geographies • Worker safety and accident prevention Supply-chain management – labour	• Increased income and improved livelihoods for lowest-wage workers in society. • Reduced income inequality. • Reduced dependence on social welfare among wage earners. • Employer incentives to relocate jobs to lower- cost areas. • Employer incentives to increase automation, technological alternatives.	• Increased costs for compensation and benefits. • Reduced productivity if regulation limits hours worked. • Disproportionate impact on smaller companies less able to afford higher wages than larger corporations. • Reduced profitability.

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

APPENDICES FOR PART I

APPENDIX B: SECTOR-SPECIFIC LABOUR-RELATED CREDIT ISSUES

ASSOCIATED SECTORS – LABOUR RELATIONS AND PRACTICES

Labour negotiation and employee satisfaction	Labour negotiation and employee satisfaction (cont)	Workplace recruitment, retention, diversity and inclusion	Labour practices with contractors	Employee health and safety
Aerospace & Defence	Insurance – Life	ABS – Aircraft	GIG – Hydro	Airlines
Airlines	Insurance – Non Life	ABS – Auto	GIG – Oil & Gas Production	Asia Pacific Utilities
Alcoholic Beverages	IPF – GREs	ABS – Consumer Unsecured	GIG – Pipeline & Energy Midstream	APAC Regulated Network Utilities
APAC Property & Real Estate	IPF – LRGs	ABS – Equipment	GIG – Power Transmission	Australia Regulated Networks
APAC Regulated Network Utilities	LATAM Utilities	ABS – Secured	GIG – Social Infrastructure	Building Materials
Asia Pacific Utilities	Lodging	ABS – SME	GIG – Solar/Wind	Building Products
Australia Regulated Networks	Medical Products	ABS – SME CDO	GIG – Sports	Chemicals
Auto Suppliers	Mining	ABS – Future Flow Receivables	GIG – Thermal Power	Chinese Homebuilders
Automotive Manufacturers	NBFIs	ABS – Oil Vessel-Backed	GIG – Transportation	Commodity Processing & Trading
Banks	Non-Alcoholic Beverages	ABS – Sprint Spectrum	GIG – Water/Wastewater	EMEA Regulated Networks
Building Materials	Non-Food Retailing	ABS – Timeshare Loan		EMEA Utilities
Building Products	Oil & Gas Production	ABS – Utility Tariff Bonds		LATAM Utilities
Business Services	Oil Refining & Marketing	Airlines		Mining
Business Services DAP	Oilfield Services	Business Services		Oil & Gas Production
Chemicals	Packaged Food	Business Services DAP		Oilfield Services

FitchRatings | Sustainable Fitch

Labour negotiation and employee satisfaction	Labour negotiation and employee satisfaction (cont)	Workplace recruitment, retention, diversity and inclusion	Labour practices with contractors	Employee health and safety
Chinese Homebuilders	Pharmaceuticals	IPF – GREs		Oil Refining & Marketing
CMBS	Pipeline and Energy Midstream	Lodging		Pipeline and Energy Midstream
Commodity Processing & Trading	Protein	Pharmaceuticals		Protein
Consumer Products	Restaurants	Technology		Shipping Companies
Diversified Industrials & Capital Goods	Shipping Companies	US Healthcare Providers		Steel
Diversified Media	Steel	USPF – Acute Hospital and Health Systems		US Homebuilders
EMEA Real Estate & Property	Technology	USPF – Higher Education		US Utilities
EMEA Regulated Networks	Telecommunications	USPF – Life Plan Communities		GIG – Hydro
EMEA Utilities	Tobacco			GIG – Oil & Gas Production
Food Retailing	US Equity REITS & REOCs			GIG – Pipeline & Energy Midstream
Gaming	US Healthcare Providers			GIG – Power Transmission
GIG – Hydro	US Homebuilders			GIG – Social Infrastructure
GIG – Oil & Gas Production	US Utilities			GIG – Solar/Wind
GIG – Pipeline & Energy Midstream	USPF - Acute Hospital and Health Systems			GIG – Sports
GIG – Power Transmission	USPF – Higher Education			GIG – Thermal Power
GIG – Social Infrastructure	USPF – Not-for-Profit CCRC			GIG – Transportation
GIG – Solar/Wind	USPF – Public Power			GIG – Water/Wastewater
GIG – Sports	USPF – State and Local Government			IPF – GREs

FitchRatings | Sustainable Fitch

Labour negotiation and employee satisfaction	Labour negotiation and employee satisfaction (cont)	Workplace recruitment, retention, diversity and inclusion	Labour practices with contractors	Employee health and safety
GIG – Thermal Power	USPF – Water & Sewer			USPF – Acute Hospital and Health Systems
GIG – Transportation				USPF – Higher Education
GIG – Water/Wastewater				USPF – Not-for-Profit CCRC
				USPF – Public Power
				USPF – Water & Sewer

ABS: asset-backed securities; GIG: global infrastructure group; USPF: US public finance

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

APPENDICES FOR PART I

APPENDIX C: LABOUR DATA SOURCES AND TOOLS

EXAMPLES OF LABOUR DATA SOURCES AND TOOLS

Data/tool	Description	Source examples
Entity employment and labour relations disclosure	Disclosure of workforce demographics, employee relations, human resources policies, risk management.	Public disclosure in reports and financial filings, e.g. annual reports, sustainability reports, regulatory filings; GRI 401 – Employment; GRI 402 – Laboor/Management Relations; GRI 405 • Diversity & Equal Opportunity; GRI 407 • Freedom of Association and Collective Bargaining
Entity health and safety disclosure	Publicly available qualitative and quantitative information, metrics and targets on an entity's policies, initiatives, strategies, risk management, performance.	Public disclosure in reports and financial filings, e.g. annual reports, sustainability reports, regulatory filings; GRI 403 - Occupational Health and Safety
Entity modern slavery statement	Disclosure of policies, risk exposure, and incidents of modern slavery.	Statements under UK Modern Slavery Act, Australia Modern Slavery Act, California Transparency in Supply Chains Act; voluntary disclosures
ESG-integrated credit rating scores	Scores that articulate the level of influence a labor-related issue has on a credit rating decision.	Fitch ESG.RS
ESG ratings	Ratings of bond issuers on their ESG quality.	Fitch ESG ratings (Entity, Framework, Instrument); ESG rating providers
Sentiment-based data and ESG controversies	Scores that are based on either positive, news flow, negative news flow, or number of reported water-related controversial incidents such as pollution incidents or fines.	Bloomberg; Factset; RepRisk
Macroeconomic labour data	Data on employment rates, workforce participation, injury and accident rates, etc.	Regional or national statistics offices e.g. US BLS, Eurostat, UK Office for National Statistics; World Bank; ILO
Materiality frameworks	Sector-specific or regional frameworks that identify relevant labour-related risk factor.	Fitch ESG Dashboards; Fitch ESG Sector Discovery Tool; SASB Materiality Map
Labour-related indices	Thematic indices based on a labor-related theme e.g. diversity and inclusion, human rights.	Benchmark providers; index providers; ETF providers

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

APPENDICES FOR PART II

APPENDIX A: SECTOR-SPECIFIC CUSTOMER-RELATED CREDIT ISSUES

SECTORS ASSOCIATED WITH CUSTOMER WELFARE – FAIR MESSAGING, PRIVACY & DATA SECURITY ISSUES

Customer/patient safety & wellbeing	Product safety & marketing	Lending practices and price transparency	Data privacy & security
Alcoholic Beverages	Aerospace & Defence	Banks	ABS - aircraft
Diversified Media	Airlines	ABS - aircraft	ABS - auto
Diversified Media	Alcoholic Beverages	ABS - auto	ABS - equipment
Food Retailing	APAC Regulated Network Utilities	ABS - equipment	ABS - SME
Gaming	Asia Pacific Utilities	ABS - SME	ABS - SME CDO
GIG - Social Infrastructure	Australia Regulated Networks	ABS - SME CDO	ABS-Credit Card
GIG - Sports	Auto Suppliers	ABS-Credit Card	ABS-Future Flow Receivables
GIG - Transportation	Automotive Manufacturers	ABS-Future Flow Receivables	ABS-Oil Vessel-Backed
Insurance- Life	Building Materials	ABS-Oil Vessel-Backed	ABS-Sprint Spectrum
Insurance- Non-Life	Building Products	ABS-Sprint Spectrum	ABS-Timeshare Loan
Lodging	Chinese Homebuilders	ABS-Timeshare Loan	ABS-UK Student Loan
Packaged Food	Commodity Processing & Trading	ABS-UK Student Loan	ABS-US Student Loan
Pharmaceuticals	Consumer Products	ABS-US Student Loan	ABS-Utility Tariff Bonds
Restaurants	Diversified Industrials & Capital Goods	ABS-Utility Tariff Bonds	Aerospace & Defence
Telecommunications	EMEA Regulated Networks	Consumer ABS - secured	Airlines
Tobacco	EMEA Utilities	Consumer ABS - Unsecured	APAC Property & Real Estate
US Healthcare Providers	Food Retailing	CVB Commercial	APAC Regulated Network Utilities
USPF - Acute Hospital and Health Systems	GIG - Water/Wastewater	CVB Residential	APAC Utilities
USPF - Not-for-Profit CCRC	IPF - GREs	Insurance- Life	Australia Regulated Networks
	LATAM Utilities	Insurance- Non-Life	Automotive Manufacturers
	Medical Products	Medical Products	Banks
	Non-Alcoholic Beverages	MICH	Business Services

Customer/patient safety & wellbeing	Product safety & marketing	Lending practices and price transparency	Data privacy & security
	Non-Food Retailing	NBFIs	Business Services DAP
	Packaged Food	Pharmaceuticals	Chinese Homebuilders
	Pharmaceuticals	RMBS	Consumer ABS - secured
	Protein	US Healthcare Providers	Consumer ABS - Unsecured
	Restaurants	USPF - Acute Hospital and Health Systems	CVB Commercial
	Tobacco	USPF - Higher Education	CVB Residential
	US Healthcare Providers		Diversified Media
	US Homebuilders		EMEA Real Estate & Property
	US Utilities		EMEA Regulated Networks
	USPF - Acute Hospital and Health Systems		EMEA Utilities
	USPF - Not-for-Profit CCRC		Food Retailing
	USPF - Public Power		GIG - Social Infrastructure
	USPF - Water & Sewer		GIG - Sports
			GIG - Transportation
			Insurance- Life
			Insurance- Non-Life
			IPF - GREs
			LatAm Utilities
			Lodging
			MICH
			NBFIs
			Non-Food Retailing
			Pharmaceuticals
			RMBS
			Technology
			Telecommunications
			US Equity REITS & REOCs
			US Healthcare Providers
			US Homebuilders
			US Utilities
			USPF - Acute Hospital and Health Systems

FitchRatings | Sustainable Fitch

Customer/patient safety & wellbeing	Product safety & marketing	Lending practices and price transparency	Data privacy & security
			USPF - Higher Education
			USPF - Not-for-Profit CCRC
			USPF - Public Power
			USPF - Water & Sewer

Note: ABS = asset-backed securities; CCRC = continuing-care retirement communities; CVB = covered bonds; DAP = data analytics and transaction processing; GIG = global infrastructure group; GRE = government related entities; IPF = international public finance; MICH = multi-issuer cedulas hipotecarias (Spanish multi-issuer mortgage covered bonds); REOCS = real estate operating companies; USPF = US Public Finance

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

APPENDICES FOR PART II

APPENDIX B: CUSTOMER-RELATED ISSUES AND THEIR IMPACTS

SOCIAL, FINANCIAL AND ECONOMIC IMPACTS

Customer-related issue	ESG credit issues	Social impact	Financial and economic impact
Product quality and safety	• Products and services to meet customers' expectations of product safety and quality	• Increased demand for diverse offerings of high-quality products and services	• Increasing pressure to maintain traditional product offerings • Increased costs for quality control of product offerings • Increased legal costs for potential safety accidents from counterfeit products
Changing consumer behaviour	• Consumer demand shifting towards products that provide health and nutrition benefits	• Improving focus on health and wellbeing of product offering • Potential regulatory pressure on certain products and goods, e.g., sugar and tobacco	• Loss of revenue due to shifting consumer preference • Increased costs for R&D for new products that meet customers' expectations of quality and health benefits
Demand in Responsible Sourcing	• Supply chain management	• Consumer shift towards more transparent competitors that consider their environmental and social concerns • Reputational damage • Increasing regulatory pressure to make disclosures on supply chain management	• Increased compliance costs for additional disclosure requirements • Increased operational costs for sourcing from responsible suppliers • Increased revenue from customers looking for responsible and sustainable themed alternative products
Selling practices – Selling products and services to maximise business revenue	• Selling products in the best interest of customers • Deceptive selling practices	• Exploitation of customer welfare • Reputational damage • Regulatory pressure to conduct fair selling practices	• Fines and penalties for mis-selling practices
Product labelling – writing and displaying information on a product's packaging	• Advertising standards compliance • Ethical marketing practices	• Exploitation of customers through inaccurate labelling and messaging • Reputational damage	• Increased fines and penalties in the event of unethical marketing • Increased legal costs caused by unethical marketing

Customer-related issue	ESG credit issues	Social impact	Financial and economic impact
Lending practices – fair treatment of customers when making credit- related decisions	• High-cost consumer lending • Debt servicing by vulnerable and underserved populations	• Increasing regulatory pressure to ensure fair debt collection • Socio-economic impact on low- income communities	• Increased costs for debt collection • Increased costs for disclosures
Customer privacy – information privacy relates to consumers of products and services	• Data breach incidents • Data privacy regulations • Security of customer information • Cybersecurity of organisations	• Increasing regulatory pressure on handling and storing customer data, and reporting data breach incidents within specified timeframes.	• Increased costs from data breach incidents • Increased costs for enhancing customer information security within organisations • Increased costs for long-term internal compliance and risk management

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

APPENDIX FOR PART III

APPENDIX – SECTOR-SPECIFIC SOCIAL IMPACT ISSUES

ASSOCIATED SECTORS – EXPOSURE TO SOCIAL IMPACTS

Shift in consumer/market preferences	Social resistance/social pressure
US REIT	US utilities
US healthcare	Steel
Tobacco	Telecoms
Restaurants	US homebuilders
Protein	Infrastructure – midstream energy
Pharma	Refining and marketing
Packaged food	Upstream energy
Retail (non-food)	Mining
Beverages (non-alcoholic)	Electricity generation
Technology	Chinese homebuilders
Gaming	Infrastructure – oil and gas production
Retail (food)	Infrastructure – thermal power
Diversified media	Infrastructure – toll roads
Consumer	Infrastructure – airports
Auto suppliers	Infrastructure – ports
Auto manufacturers	Infrastructure – water and wastewater
Beverages (alcoholic)	Infrastructure – power transmission
Banks	Infrastructure – renewable energy
Insurance – life and non-life	USPF – water and sewer
Non-bank financial institutions	USPF – public power (wholesale and retail)
USPF – hospitals	Infrastructure – sports facilities
USPF – higher education	Chemicals
CMBS	IPF – government-related entities
RMBS	Infrastructure – social infrastructure
ABS – unsecured – student loans/credit cards/consumer	Supranationals
ABS – secured – SMEs/equipment/consumer/auto/aircraft	
Infrastructure – sports facilities	
Chemicals	
IPF – government-related entities	
Infrastructure – social infrastructure	

Source: Fitch Ratings, ESG Sector Template Compendium 2022

FitchRatings | Sustainable Fitch

APPENDICES FOR PART IV

APPENDIX: SECTOR-SPECIFIC COMMUNITY-RELATED CREDIT ISSUES

Access and affordability	Human rights	Community relations
ABS – Consumer Unsecured	Mining	Chemicals
ABS – Credit Card	Oil & Gas Production	Commodity Processing & Trading
ABS – Future Flow Receivables	Oil Refining & Marketing	Mining
ABS – Oil Vessel Backed	Oilfield Service	USPF - Higher Education
ABS – Sprint Spectrum	Pipeline and Energy Midstream	
ABS – Timeshare Loan	Pharmaceuticals	
ABS – UK Student Loan	GIG - Oil & Gas Production	
CMBS	GIG - Pipeline & Energy Midstream	
RMBS	GIG - Power Transmission	
Covered Bonds – Commercial	GIG - Renewable Energy	
Covered Bonds – Residential	GIG - Thermal Power	
Covered Bonds - MICH		
APAC Regulated Network Utilities		
APAC Utilities		
Australi Regulated Networks		
EMEA Regulated Networks		
EMEA Utilities		
LatAm Utilities		
Medical Products		
Pharmaceuticals		

Access and affordability	Human rights	Community relations
US Healthcare Providers		
US Utilities		
GIG - Social Infrastructure		
GIG - Renewable Energy		
GIG - Sports Facilities		
GIG - Sports Leagues		
GIG - Thermal Power		
GIG - Toll Roads		
GIG - Transport (incl. Airports, GARVEE, ports)		
IPF – Government-related Entities		
USPF - Hospitals		
USPF - Housing		
USPF - Higher Education		
USPF - Life Plan Communities		
USPF - Public Power (Retail and Wholesale)		
USPF - Water & Sewer		
Banks		
Supranationals		

Source: Fitch Ratings

FitchRatings | Sustainable Fitch

DISCLAIMER & DISCLOSURES

FitchRatings | Sustainable Fitch

CONTACTS

Sustainable Finance

Nneka Chike-Obi
Head of APAC ESG Research
nneka.chikeobi@sustainablefitch.com

Marina Petroleka
Global Head – ESG Research
marina.petroleka@sustainablefitch.com

Jingwei Jia
Associate Director – ESG Research
jingwei.jia@sustainablefitch.com

Business Development

Mark Oline
Global Head of Business Development
mark.oline@fitchratings.com

Aymeric Poizot, CFA, CAIA
Global Head of Investor Development
aymeric.poizot@fitchratings.com

Fitch Ratings

Sophie Coutaux
Senior Director – Corporates
sophie.coutaux@fitchratings.com

Marcy Block
Senior Director – Public Finance/GIG
marcy.block@fitchratings.com

FitchRatings | Sustainable Fitch