

OVERVIEW OF SUSTAINALYTICS' MATERIAL ESG ISSUES



Overview of Sustainalytics' Material ESG Issues

Sustainalytics' ESG Risk Ratings are made up of three building blocks that contribute to the overall rating for a company. These building blocks include corporate governance, material ESG issues and idiosyncratic issues. The primary building block of the ESG Risk Ratings is Sustainalytics' 20 material ESG issues, which are underpinned by 300 ESG indicators.

The ESG Risk Ratings assess companies on material ESG issues. An issue is deemed material in the rating if it has the potential to have a significant impact on the enterprise value of a company within a given subindustry. We believe assessing companies on material ESG issues is critical given the importance of focusing on areas that have the most potential to endanger enterprise value.

Material ESG issues focus on a topic or set of related topics that require a common set of management initiatives or a similar type of oversight. For example, the topics employee recruitment and development, diversity, engagement and labor relations fall under the material ESG issue "human capital," because they are all employee-related and require human resources initiatives and oversight.

We recognize companies have varying levels of exposure to different issues, and that for investors it is vital to understand what issues drive exposure as well as how a company is managing relevant ESG issues. The first chart below provides insight into how much each material ESG issue contributes to unmanaged risk. The second chart is an analysis of the number of events in our ratings universe for five selected material ESG issues. The charts are examples of ways that investors can use data on material ESG issues to better understand a company's ESG Risk Rating.

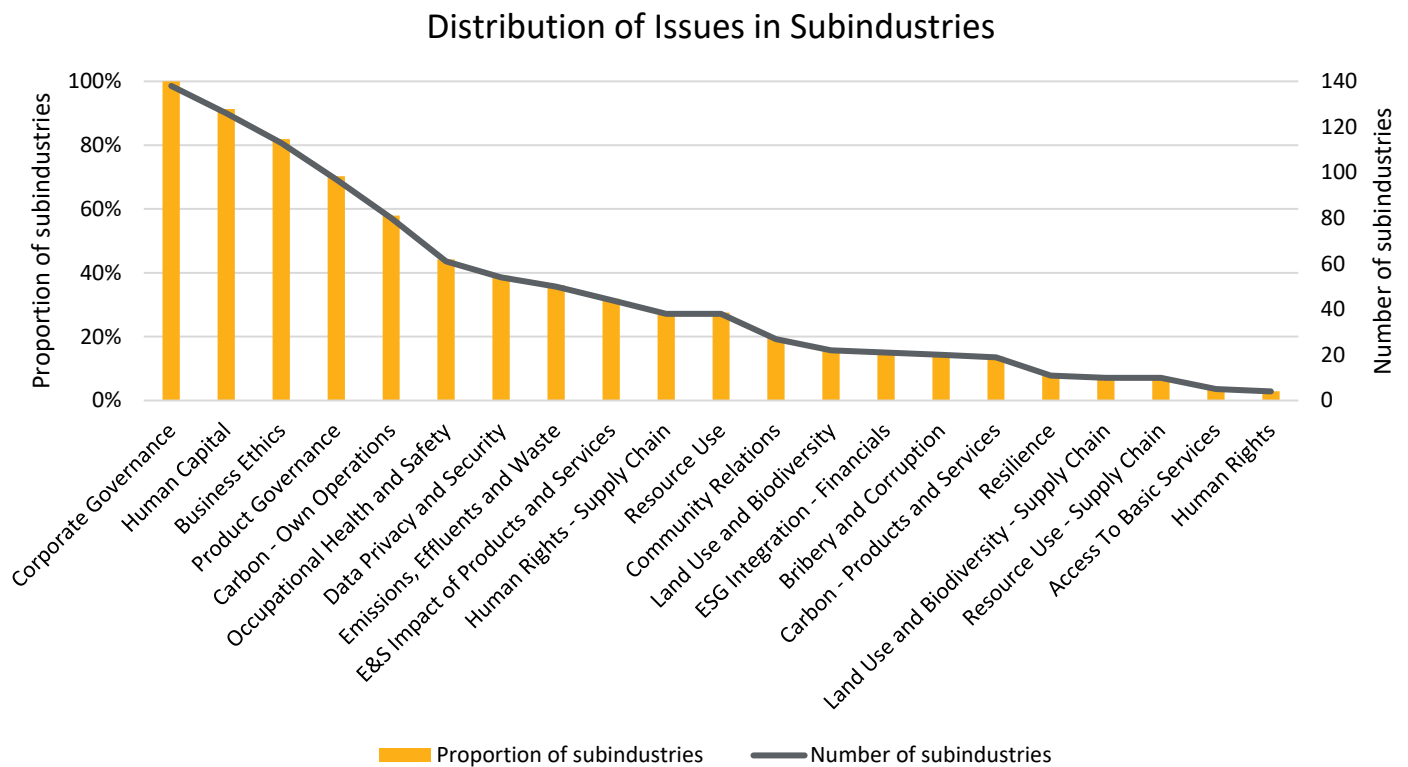


Figure 1: Overview of all material ESG issues contribution to unmanaged risk. (Source: Sustainalytics, January 2021)

Number of Events in Each Material ESG Issue

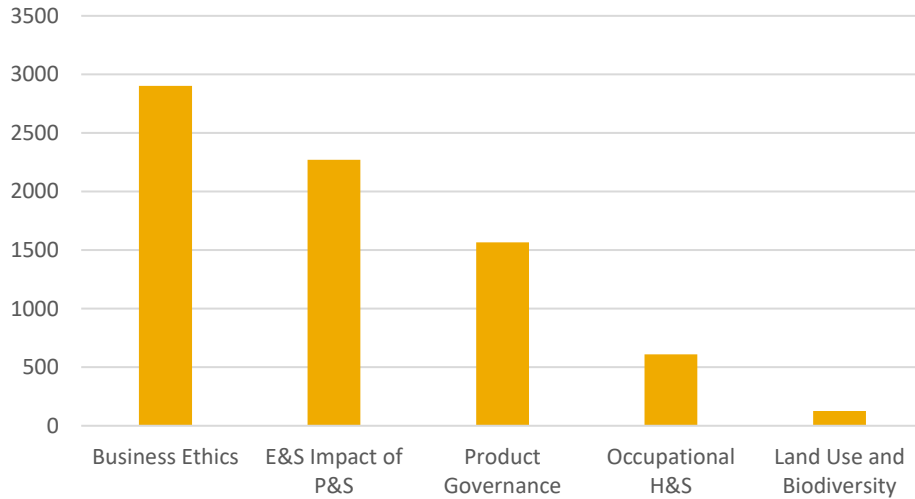


Figure 2: A selection of 5 material ESG issues and the total number of events tracked for companies in the Ratings universe. (Source: Sustainalytics, June 2020)

There is a correlation between the levels of unmanaged ESG risk for the various material ESG issues and the frequency of related incidents. For example, Business Ethics accounts for the third highest level of unmanaged risk as well as some of the highest levels of ESG controversies. In contrast, companies tend to be better at managing Occupational Health & Safety issues, which is also why we see fewer related incidents.

How Material ESG Issues Figure into Sustainalytics' ESG Risk Ratings

For each subindustry, Sustainalytics evaluates the exposure of up to 10 material ESG issues. These issues are made company-specific by accounting for differences in the company's product portfolio, financial health and geographic footprint, etc. For each company, we determine both its exposure to an issue and how well it is managing that issue. The exposure and management assessments are combined to determine the unmanaged ESG risk for that ESG issue. Ultimately, the ESG risk scores for all material ESG issues are combined with ESG risk scores for corporate governance and idiosyncratic risk to arrive at an overall risk assessment or the ESG Risk Rating.

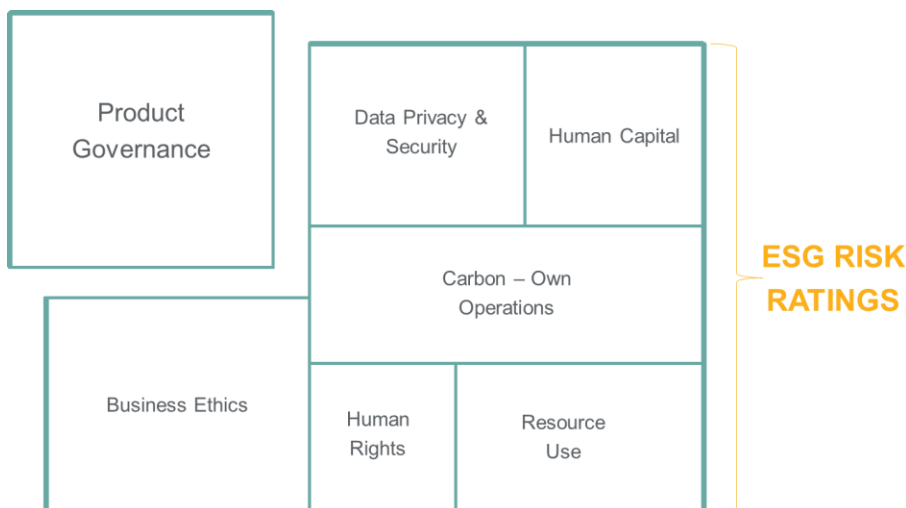


Figure 3: Schematic display of how risk scores for multiple issues are combined to form the ESG Risk Ratings.

Material ESG issues are key to understanding the range of ESG risks facing companies. These issues can be evaluated thematically to understand ESG risk for a subindustry or across all industries. Each issue can have value as a standalone assessment to determine which risks are unmanageable, the trends for an issue, and the degree to which a topic is susceptible to controversies. Combined together, the material ESG issues can serve as a powerful signal for a company's overall unmanaged ESG risk.

