

Creditreform Rating AG Rating Methodology

ESG Rating

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Creditreform 
Rating

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The rating methodology for ESG ratings is still at the draft stage and will only be finalized and made available to the public after a pilot phase has been carried out and the relevant regulatory requirements have been taken into account. This version is dated October 2023.

1 Introduction

Creditreform Rating AG (hereinafter also "CRA") has been performing ratings since its foundation in 2000 and is a recognized European rating agency.

In order to enable interested parties, investors and the interested public to understand the rating assessments of CRA, we disclose here the present rating methodology for the ESG rating of companies and financial service providers.

A rating methodology is understood as the classification of rating objects into a certain rating class. An ESG rating by CRA refers to a specific company, taking into account its existing corporate structure. The sustainability of both non-financial companies and financial companies in general is assessed. In the context of this methodology, the term 'company' is therefore used both for non-financial companies and financial service providers. The ESG rating provides a comparable assessment of sustainability across accounting/sustainability reporting standards, industries, countries, legal forms and size classes.

CRA's ESG ratings take into account all the information deemed relevant by CRA and its analysts to derive a measure of corporate sustainability. This approach leaves some room in the analysis with regard to the information to be used, thus allowing CRA to take into account the fact that the development of regulatory requirements at the European and international levels is ongoing, and will gradually become mandatory for companies as well as for rating agencies themselves in the coming years. The rating methodology for ESG ratings refers to ratings that process information about the respective company that is actively or passively provided by the company or a third party, or that is publicly available. Participation of the company in the analysis process and the determination of results is categorically excluded, with the exception of a rating interview, which is an elementary component of the rating process.

ESG ratings are well-founded opinions on the sustainability of a company. They are not recommendations to buy, sell or hold a financial instrument. An ESG rating is not a second-party opinion for a green bond, nor is it a legal opinion. The term "sustainability" is defined by the three areas of environmental, social and governance, which are, in this case, the objects of analysis.

2 Scope

An **ESG Rating** by CRA refers to a specific, economically active company. For this methodology, the term 'company' refers to both non-financial companies and financial service providers. This rating methodology defines the general methodological analytical framework for conducting an ESG rating.

3 Rating statement

This CRA rating system is based on the fundamental question as to what extent the company can be assessed as sustainable and capable of transformation. Accordingly, the ESG rating represents an assessment of the extent to which significant opportunities and risks for the environment, stakeholders and the company itself can arise from the sustainability of the business model of the company being assessed, both currently and in the future.

CRA uses a notation / rating scale for ESG ratings with rating classes from A to E, which is divided into 15 sustainability levels. This rating scale for CRA's ESG ratings, presented below, is a ranking, and each notation is a measure that reflects CRA's assessment of the degree of sustainability of a company.

Rating class	Rating	Assessment
A	A1	High sustainability and transformation capability, significant sustainability opportunities
	A2	
	A3	
B	B1	Strongly satisfying sustainability and transformation capability, high sustainability opportunities and low sustainability risks.
	B2	
	B3	
C	C1	Satisfactory sustainability and transformation capability, balanced sustainability opportunities and risks.
	C2	
	C3	
D	D1	Sufficient sustainability and transformation capability, low sustainability opportunities and higher sustainability risks.
	D2	
	D3	
E	E1	Low sustainability and transformation capability, high to very high sustainability risks
	E2	
	E3	
NR	NR	Rating suspended, expired, currently suspended due to insufficient information or company no longer exists (merged, liquidated)

The ESG rating can also be qualified as "restricted". This qualification is added to the rating if final documents or information for the rating are not yet available, but are expected in the short term. The addendum indicates that the rating was assigned subject to outstanding documents or information, but that these were included in the rating with certain assumptions (e.g., based on draft versions). The addendum also indicates that if the content of the final documents or assumptions differs from that of the preliminary documents or assumptions, the company rating will be subject to an open review.

4 Rating methodology

CRA arrives at its assessment of a company's ESG sustainability by analyzing company-specific sustainability factors using qualitative and quantitative approaches.

The relevance of the individual factors in the aggregation of a rating statement is determined by the analysts and is dependent on the characteristics of the respective company and company-specific features. Against the backdrop of a changing regulatory environment, it also is also taken into account whether a company has already formulated appropriate policies in the context of ESG sustainability.

CRA focuses on the following sustainability areas for ESG ratings:

- Environmental
- Social
- Governance
- Future readiness
- Transparency
- For financial service providers: sustainability of loan and investment portfolios

CRA applies consistent analysis procedures in the ESG rating. The strengths, weaknesses, opportunities and risks with regard to the sustainability of the company are derived from the examination of the sustainability areas. Insofar as financial companies are analyzed, CRA also analyzes the credit and/or investment portfolio with regard to its sustainability.

4.1 Initial evaluation based on quantitative ESG assessment

The quantitative starting point of the ESG rating is formed by a quantitative assessment of the ESG key figures of the company under analysis. In this process, ESG factors are quantitatively assessed via a combined best-in-class and best-in-universe benchmarking. This enables an objective initial assessment of sustainability as well as a high degree of comparability of the analyzed company with comparable companies and the overall economy. Beyond this initial assessment, ESG factors are also quantitatively classified and evaluated in the further analysis steps.

4.2 Sustainability areas analyzed

4.2.1 Environmental

In the Environmental pillar, the following five topics are analyzed in terms of existing policies, implemented measures, targets, and quantitatively measurable impacts:

- Climate change
- Pollution and emissions

- Water and marine resources
- Biodiversity and ecosystems
- Resource use and circular economy

The analysis and evaluation of transition risks and physical risks is a component of the "Climate Change" analysis area; here, the aforementioned risks for the company are analyzed and evaluated using specific climate change scenarios as a basis. In addition, the key performance indicators related to EU taxonomy are evaluated (provided that the company reports the corresponding data points).

4.2.2 Social

In the Social pillar, the following four topics are analyzed in terms of available guidelines, implemented measures, goals and quantitatively measurable impacts:

- Own employees
- Employees in the value chain
- Affected communities
- Consumers and end users

4.2.3 Governance

In the Governance pillar, the following two topics are analyzed:

- Management's approach to sustainability issues
- Corporate governance and business conduct

4.2.4 Future readiness

Since transitioning to a climate-neutral, sustainable economy is a lengthy process, most likely spanning decades, it is conceivable that companies will require significant development in the field of sustainability. Consequently, a pivotal criterion for the ESG rating lies in evaluating a company's preparedness and capacity for the transformation moving forward. The future-readiness and transformation capability assessment is derived primarily from targets in the relevant areas and the measures already taken to achieve or improve performance targets in selected ESG areas. In analyzing the targets, it is above all relevant to the rating whether the targets are formulated in a specific, measurable, appropriate and timely manner, and whether plausible measures and milestones have been defined for the respective targets. Accordingly, the evaluation of the company's progress towards its ESG targets is vital to the monitoring process of an ESG rating.

4.2.5 Transparency

Companies are not regularly required to prepare sustainability reports - even the expansion of sustainability reporting obligations under the Corporate Sustainability Reporting Directive (CSRD) will only affect

a small share of economically active companies in Europe for the time being. However, as capital market participants and other stakeholders require sustainability information from all companies with which they interact, or else plan to do so, the voluntary creation of additional transparency in the ESG rating is considered beneficial. Thus, disclosure of additional sustainability information generally has a positive impact on a company's rating assessment.

4.2.6 Sustainability of loan and investment portfolios

Financial service providers can have a direct impact on the environment and stakeholders through their business activities, but also through the selection and management of their loan and/or investment portfolio. Accordingly, when assessing the sustainability of financial service providers, not only the sustainability of the financial company analyzed must be taken into account, but also, in particular, the sustainability of its loan and/or investment portfolio. This is ensured by conducting a quantitative sustainability analysis of the portfolio, and by analyzing and evaluating the objectives, strategies and measures for the sustainability-oriented management of the portfolio of the financial services company under analysis.

4.3 Selection and analysis of relevant ESG factors

For the analysis of sustainability, both quantitative and qualitative aspects are examined. Based on the current status of sustainability, which is derived from the quantitative key performance indicator analysis, the focus is placed on concrete goals, as well as strategies and measures for achieving these goals. In this way, a statement can be made with regard to the company's ability to transform, while considering the ongoing process of developing towards a sustainable economy.

4.3.1 Consideration of European sustainability reporting standards

CRA derives the factors to be analyzed in the areas of environmental, social and governance primarily from the European standards for sustainability reporting (the European Sustainability Reporting Standards [ESRS] of the Corporate Sustainability Reporting Directive [CSRD]), but is not limited to these factors. Accordingly, sustainability factors are analyzed according to the principle of *double materiality*, i.e., the sustainability-related effects of the company's activities on its environment and stakeholders are analyzed in the same way as the effects resulting from the area of sustainability on the financial performance of the company itself. The analysis structure of the individual ESG factors is largely based on the ESRS. Sustainability aspects from all subcategories in the areas of environmental, social and governance of the ESRS are therefore analyzed.

4.3.2 Mandatory and optional ESG factors

For the analysis of ESG factors based on the ESRS, a two-stage approach is used that distinguishes between mandatory and optional ESG factors. This takes into account the fact that in the current regulatory

framework not all companies are required to prepare a sustainability report, which means that information on certain ESG factors may not be available for every company. For mandatory criteria, failure to provide information is scored negatively, for optional factors, failure to provide the information is scored neutrally, while providing additional information in these areas can positively impact the rating result. The analysis structure and the selection of ESG factors analyzed always enables a sound and reliable sustainability rating - even for companies without a sustainability report. This is ensured by the fact that all ESG factors which we classify as mandatory are compiled and, if not present at the company, compulsorily queried and subsequently taken into account in the analysis.

4.3.3 Industry-specific and -independent analysis of ESG performance

Sustainability factors regularly have industry-specific features and characteristics. Accordingly, not all sustainability aspects are of equal importance for all industries, but industry-specific differences in the importance of individual ESG factors can be derived. The selection made by CRA of relevant sustainability aspects for companies in individual industries is supported by the criteria of the Sustainability Accounting Standards Board (SASB), which represent an internationally established assessment of the industry-related relevance of sustainability issues. In the assessment, the performance of the company under review is compared both with its industry (best-in-class) and with the economy as a whole (best-in-universe). On the one hand, this makes it possible to take into account industry-specific characteristics and, on the other, to evaluate ESG performance across industries.

4.3.4 Scenario-based analysis of transition risks and physical risks

In the environmental pillar, transition risks and physical risks, among others, are analyzed and evaluated. These risks are analyzed over a sufficiently long time horizon (usually up to the year 2050) using established and science-based scenarios provided by the Network for Greening the Financial System (NGFS), among others.

4.3.5 Analysis process for ESG factors

The sustainability analysis examines, among other things, whether policies or guidelines exist for relevant sustainability aspects, whether measures have already been implemented for concrete improvement in relevant sustainability areas, what targets and measures the company has defined, and what quantitatively measurable impact the company has had on the environment and stakeholders. In order to assess the targets, it is checked whether the target is specific (i.e., clearly formulated), measurable (underpinned by quantitative variables), realistic and appropriate (in relation to global and European sustainability targets), and timed (concrete time reference of target achievement compared to a baseline). Also assessed here is whether, based on the company's financial performance, it is plausible that the company will be able to implement the measures necessary to achieve the targets.

5 Continuous monitoring, follow-up rating and validity

The ESG rating is subject to monitoring after publication and is valid for one year (365 days) unless CRA suspends or withdraws it (NR), or the client terminates the assignment for the rating before its validity expires. During this period, the analyst team continuously monitors the company's performance. The aim is to ensure that the rating is up-to-date. To this end, the analysts remain in direct contact with the company and request relevant information, which is subsequently evaluated. Independent research, such as in the trade and business press, is also carried out. If significant events or developments occur during the monitoring period that have a positive or negative impact on the rating from CRA's perspective, the rating can be revised. If, in the view of CRA, the company provides monitoring information of insufficient quality or at inappropriate intervals, the rating may be suspended by decision of the Rating Committee (NR). Events or developments that have led to changes in sustainability performance of the rated entity may result in an adjustment of the rating.