Swisscanto
Sustainability rating
(white paper)

Committed to sustainability since 1998 | Swiss edition

Zürcher Kantonalbank

Sustainable pioneer

Sustainable investment has been part of Zürcher Kantonalbank's asset management philosophy and the Swisscanto product brand for more than 20 years. We launched the first sustainable investment fund back in 1998. Zürcher Kantonalbank was one of the first full-service banks in Europe to sign the six Principles for Responsible Investments (PRIs) of the United Nations in 2009 and in 2015 became one of the first Swiss banks to sign the Montréal Carbon Pledge investor initiative on disclosing the carbon footprint of its funds. As a pioneer, we have implemented the integration of the goals of the Paris Climate Agreement in the active investment products of traditional asset classes and have set ourselves a CO_2e reduction target of at least 4 percent per year since 2020.

Our sustainability rating

The field of sustainable investments has developed strongly. Climate change has become the focus of public attention. It is still challenging for many investors to gain a holistic understanding of the various aspects of an investment's sustainability performance. We expect an increased demand for more differentiated sustainability ratings.

That is why we have developed the Swisscanto Sustainability Rating, which, in addition to assessing the classic ESG criteria, aims to take into account additional aspects and deliberately set itself apart from conventional ESG ratings. Our sustainability rating is flexible enough and is intended to ensure high informative value across different asset classes and types. In order to take their particularities into account, we use tailored data sets for each asset class.

Conventional ESG ratings improve comparability, but they primarily capture the operational sustainability efforts of a company or state – i.e. how sustainably a company or state is managed. However, important aspects such as the contribution of products and services to environmental and social challenges or even controversial business practices and areas are often only insufficiently taken into account in an ESG score.

In the sustainability assessment of companies, for example, a tobacco producer may fulfil all requirements in the areas of corporate governance, talent management, environmental management system and transparency and achieve a high ESG rating. However, it is questionable whether such a company is considered sustainable by the public on the basis of the products offered. In addition, knowledge regarding a reduction of air pollution or an increase in CO_2e efficiency is not sufficient to assess sustainability performance if this company simultaneously pollutes groundwater or violates labour rights.

In terms of countries, while many developed countries have reached a high standard of living, they have made important progress in various dimensions of human development and perform well in the ESG rating. On a per capita basis, however, the carbon emissions of developed countries are significantly higher at 11.42 tonnes CO_2e than those of developing countries at 6.69 tonnes CO_2e.

In order to obtain a more holistic picture, we carry out an integrated assessment and supplement the ESG rating with additional important information.

Holistic rating concept

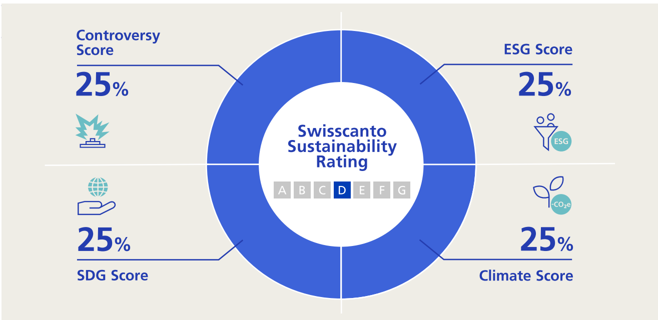
The Swisscanto sustainability rating examines an investment based on the following four pillars (or scores) of our sustainability analysis and offers deep insights into the sustainability performance of countries and companies:

- ESG score: How sustainably is the company or state managed?
- Controversy score: To what extent do publicly controversial business areas, questionable business practices or violations of international standards exist?
- Climate score: To what extent does the company or state have a negative impact on the environment in terms of CO_2e emissions?
- SDG score: What positive contribution do the companies or states make with their activities towards achieving the 17 UN Sustainable Development Goals?

We explain the four different scores in greater depth on the following pages.

Rating scale

The investment funds, investment groups and mandates we manage are categorised in the ratings A to G according to the investments underlying the respective product; an A rating corresponds to the highest and a G rating to the lowest degree of sustainability. The classification results from the individual evaluations of the four scores, which are included in equal parts in the overall evaluation of the Swisscanto Sustainability Rating. The simple presentation is intended to enable investors to see at a glance how the respective product is classified in terms of sustainability according to our parameters.



Source: Zürcher Kantonalbank, own illustration

Sustainable management (ESG score):

We also take the classic ESG rating into account, but include the three additional scores in the overall assessment. For this purpose, we assess a comprehensive catalogue of criteria for the individual countries and companies. The focus is on the question of how sustainably the management runs the company or the government runs the state, whether procedures and processes are institutionalised and to what extent the activities are measured and optimised. The assessment covers three areas: environment (E), social (S) and corporate governance (G).

ESG score for companies

The ESG assessment is conducted using an industry-specific model. Different sets of indicators, factors and respective weightings apply to each industry. In total, 37 indicators are calculated based on 320 factors. The environmental dimension (E) primarily covers climate strategy, pollution and management of natural resources. In the social dimension (S), the focus is on human capital, stakeholder engagement and product-related social outcomes. The governance dimension (G) examines and evaluates the principles of good corporate governance and business ethics. Questions regarding the organisation and independence of the board of directors, compensation, shareholder rights and accounting practices and standards are included.

The data is generally disclosed by the companies themselves in accordance with international standards (Global Reporting Initiative, Carbon Disclosure Project, Sustainability Accounting Standards Board (SASB), International Integrated Reporting Council (IIRC) etc.) and obtained by us via independent third-party providers.

We work with proprietary ESG scores, which we calculate based on raw data from independent third parties. From the large number of indicators supplied, we limit ourselves to the financially relevant aspects that we consider important from a risk and opportunity point of view. Industry-related ESG data biases are removed using our scoring methodology.

ESG score for states

Until now, ESG criteria have hardly been systematically taken into account when selecting government bonds. States are often only assessed on the basis of a credit rating. However, we have been dealing with the sustainability analysis of countries since 1999. We are convinced that framework conditions such as the existence of resources, legal certainty, property rights, education and good governance play a central role in long-term economic growth and thus also in the future creditworthiness of states. With our ESG score for states, we systematically assess the relevant ESG aspects.

The ESG score for states is based on an assessment of around 80 environmental, social and governance factors (ESG). The environmental dimension mainly focuses on the consumption and efficient use of resources such as water and waste as well as on climate change, mobility and biodiversity (nature conservation and agriculture). The social dimension assesses the standard of living and the health of the population as well as equality. The governance dimension takes into account indicators pertaining to a country's international commitment, the treatment of human rights, security and stability (e.g. citizens' rights and electoral behaviour). The data comes from various independent sources (such as the WHO, World Bank, UNEP, OECD, etc.).

Carbon intensity (climate score)

This pillar measures the greenhouse gas intensity (CO_2e)[1] of a company or state. The CO_2e intensity indicates how heavily the companies or states are polluting the environment with greenhouse gases. The total CO_2e emissions per year are determined and standardised with the respective turnover (for companies) or GDP (for states). The more CO_2e-intensive the company or state is, the worse the rating. The GHG Protocol (Greenhouse Gas Protocol) serves as the basis for our assessment, which is internationally recognised as the standard for accounting for greenhouse gas emissions. The GHG Protocol covers greenhouse gases regulated under the Kyoto Protocol: carbon dioxide, methane, nitrous oxide, fluorinated hydrocarbons, perfluorinated hydrocarbons. The emissions are assigned to Scopes 1-3 (see graphic) along their source of origin.

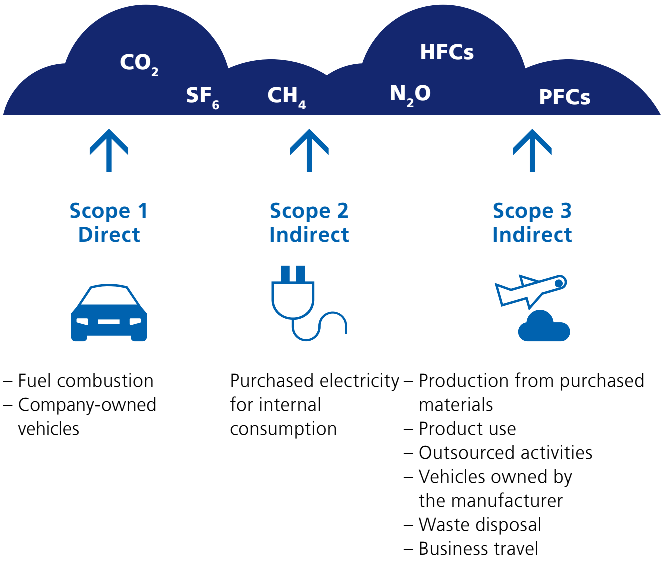
[1] CO_2 equivalents (CO_2e) are a unit of measurement to standardise the climate impact of the greenhouse gases carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O) and fluorinated greenhouse gases (CFCs). All of these gases remain in the atmosphere for different lengths of time and do not contribute equally to the greenhouse effect.

Extract from an ESG scorecard for states

Environment		Social		Governance	
Sector	**Example Indicator**	**Sector**	**Example Indicator**	**Sector**	**Example Indicator**
Energy	Energy consumption per capita	Standard of living	Distribution of income	International engagement	Military spending
Water	Water consumption per capita	Health	Adolescent smokers	Safety and stability	Political rights
Resources	Hazardous waste	Education and culture	Education expenditure	Human rights	Human rights conventions
etc.		etc.		etc.	

Source: Zürcher Kantonalbank, own illustration

Overview of the evaluation of CO_2e emissions according to the GHG Protocol:



Source: ghgprotocol.org

Climate score for companies

In the case of companies, the GHG Protocol provides for the documentation of Scope 1 and Scope 2. Today, the data is generally publicly available. It measures emission sources in Scope 1, such as company-owned power plants or vehicle fleets. Emissions resulting from the generation of energy or energy obtained externally, such as electricity and heat from energy services, belong to Scope 2. Scope 3 concerns emissions from upstream and downstream parts of the value chain. Due to poor data quality and lack of standardisation, no Scope 3 data is currently taken into account.

Climate score for states

For countries, we measure all CO_2e emissions released in the respective country. The calculation is based on the economic activities and documented use of CO_2e-emitting materials of each state. Essentially, the following aspects are considered: stationary energy (mainly from the local consumption of fossil fuels), transport, disposal, industrial processes and product use, as well as all other emissions that occur outside the geographical borders as a result of activities within the borders. The data allows the emissions from different states to be directly compared.

Controversy score

The controversy pillar indicates whether there are suspected breaches of standards in companies and states. We identify what we regard as unethical, harmful business models in companies and violations of international standards in states. In addition, we determine whether there could be financial risks or reputational risks due to the nature of the business model. The focus in the case of states is on questionable practices with regard to human rights, environmental and geopolitical issues.

Controversy score for companies

The controversy score for companies consists of two sub-indicators (weighting as shown below). The issue score sub-indicator records the number of potential problem areas (issues). The issue score analyses around 15 issues in the environmental dimension, around 30 issues in the social dimension and around 60 issues in the governance dimension. Issues concern, for example, workplace safety, working conditions and product safety, as well as environmental pollution. It also takes into account, among other things, shortcomings with regard to remuneration issues, shareholder rights and the independence of the board of directors and management.

The exclusion score sub-indicator measures whether the company violates one of the exclusion criteria of our blacklist for the Responsible or Sustainable product line.

Presentation of controversy score for companies

Component	Weighting	Description
Issue score	50%	Number of issues/risk flags in which a company is involved
Exclusion score	50%	Application of our exclusion criteria

Source: Zürcher Kantonalbank, own illustration

Controversy score for states

The controversy score for states is assessed using a number of factors. Based on various parameters – namely free elections, freedom of expression and religion, freedom of assembly, equality before the law and guaranteed property rights – the Freedom House Index measures the relevant liberties in the respective countries. We also include the use of the death penalty in the assessment. We distinguish states which still practise the death penalty from those which do not practise it but which allow it in the constitution, as well as those without the death penalty. We also take into account socio-economic risk dimensions such as money laundering, corruption and political risks. With regard to energy, we examine whether the nation state has ratified the Paris Climate Agreement and whether it is dependent on nuclear energy and electricity from coal. Military expenditure by the state is an important criterion.

Controversy score for states

Indicator	Weighting	Description
Freedom House Index	20%	Level of democracy and freedom in states
Death penalty Score	20%	Whether a state practises the death penalty
Corruption Perception Index	10%	Corruption criterion
Political governance risk management score	10%	Evaluates the management of a state's governance risk factors
Paris Agreement Score	6.67%	Paris Climate Agreement signed and ratified
Nuclear power Score	6.67%	Nuclear energy in the energy mix and planned new capacity
Electricity from coal score	6.67%	Share of coal in the energy mix
Military spending score	20%	Military expenditure relative to GDP

Source: Zürcher Kantonalbank, own illustration

Issuers with a positive contribution (SDG score)

The SDG pillar measures the contribution of a company or state to sustainable development. It shows whether and to what extent companies and states serve at least one of the 17 official United Nations' Sustainable Development Goals (UN SDGs). While the ESG score measures "how", the SDG score focuses on "what". The SDG score therefore measures the actual effect of a company or state solving societal and environmental problems and not how a country or company deals with sustainability aspects.

The United Nations' 17 Sustainable Development Goals (SDGs), which were put into effect by the UN member states on 1 January 2016, serve as a reference. Key objectives include strengthening economic growth, reducing inequalities, creating equal opportunities and ensuring the long-term preservation of our livelihoods and ecosystems.

Sustainable Development Goals of the United Nations (SDGs)

Source: United Nations, https://sdgs.un.org/goals

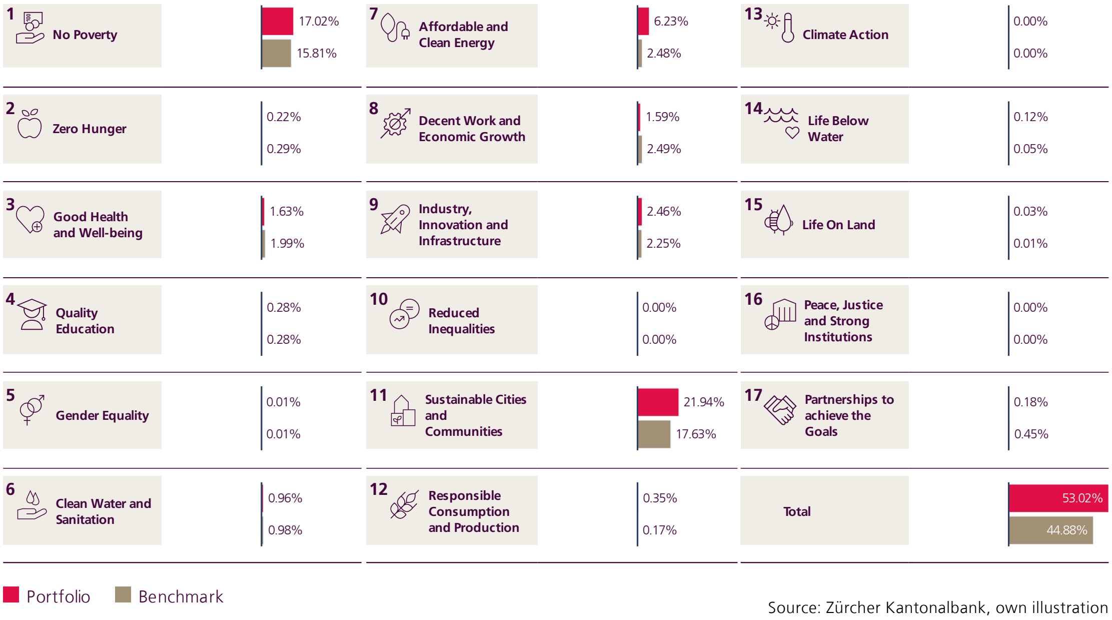
SDG score for companies

To assess whether a company makes a positive contribution, we have developed a proprietary analysis model for companies. We have identified six core topics. The core themes reflect humanity's major areas of concern. Specifically, we differentiate between: energy, resources, mobility, health, knowledge and finance.

We have also expanded our six core topics with the SDGs. We map the products and services of the companies there and assign them to established (e.g. solar) as well as emerging (e.g. hydrogen) future technologies. The allocation is based on a number of quantitative indicators aggregated into an overall assessment. The overall assessment, in turn, indicates the amount of the company's contribution to all SDG topics.

High ratings are given to companies that make a significant positive contribution to one or more of the core themes with a large proportion of their production of products and services. Companies in certain sectors, such as consumer staples, the healthcare sector or certain industrial sectors, typically have an advantage here. In order to take this distortion into account, we also examine products and services for their negative impact on the SDGs and take this into account in the overall assessment.

Example Sustainability Reporting: Overview of SDG sales contributions



Source: Zürcher Kantonalbank, own illustration

SDG score for states

States are assessed directly along the SDGs. We use the ratings from the SDG Index[2] for this purpose. The same objectives apply to all 193 UN member states, regardless of whether they are developed or developing.

The more and the better a state meets the objectives, the higher its SDG score. In total, around 110 sub-indicators are included in the evaluation. However, the data situation and comparability have been challenging so far. The necessary information is not available for all countries, which is why 37 countries have not yet been evaluated.

Many developing countries are not yet achieving basic objectives such as combating hunger and providing safety. Potential for improvement in industrialised countries is identified in particular in the areas of responsible consumption and CO_2e emissions per capita. The top placements in the ranking are occupied by the highly developed Nordic countries Sweden, Denmark and Finland. Switzerland also ranks at the top with a high SDG score. In contrast, poorly developed African countries such as Chad, South Sudan and the Central African Republic are found at the bottom of the ranking.

Increased transparency

The Swisscanto sustainability rating of the respective Swisscanto investment product is publicly available on the factsheets accessible via our Swisscanto product page (https://products.swisscanto.com/). Here we provide a clear transparency instrument for Swisscanto investment products.

Contact

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[2] See also: sdgindex.org