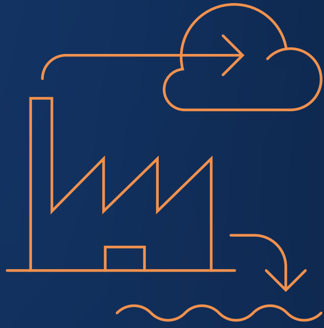
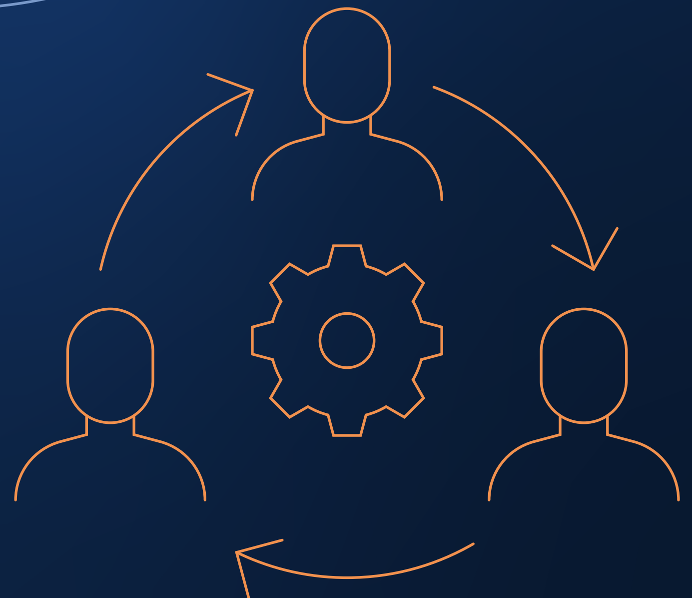
MORNINGSTAR | SUSTAINALYTICS





ESG Risk Ratings Methodology Addendum

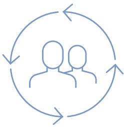
Descriptions of Material ESG Issues

Version 2.1 | 06 May 2024

Descriptions of Material ESG Issues (MEIs)

MEI.0.CG Corporate Governance

Corporate Governance encompasses the mechanisms, processes and policies by which a company is managed and overseen to ensure its ability to mitigate risks, increase long-term value creation and safeguard its reputation. It focuses on whether a company is run in a transparent and accountable way and whether its leadership acts in the best interests of stakeholders. Effective corporate governance ensures that a strong board provides strategic direction, oversees management and protects shareholder rights. It also involves structures that safeguard ownership interests, align management incentives with long-term value creation, and foster reliable financial reporting to maintain investor confidence. Poor corporate governance practices at high-profile companies have resulted in value destruction through record fines, bankruptcies, or the dilution of existing shareholder equity. A company's ownership structure, especially the concentration of ownership among major shareholders and its listing status, are primary drivers of Corporate Governance risk.



MEI.0.SG Stakeholder Governance

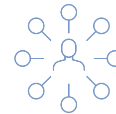
Stakeholder Governance encompasses the mechanisms, processes and policies used by a company to manage its extra-financial risks and broader stakeholder relationships beyond focusing solely on shareholders. It focuses on how companies manage their key environmental and social impacts through policies, programmes and adherence to certain standards, and how they report on these practices. Public and private companies across all industries are increasingly expected to demonstrate how they have considered their business impact on a broad range of stakeholders, beyond focusing solely on the needs of shareholders. Inadequate stakeholder governance structures expose companies to heightened scrutiny, and demand for transparency and action.

MEI.1 Access to Basic Services

Access to Basic Services refers to a company's ability to ensure access to health care products and services and manage risks related to cost effectiveness and price transparency. As healthcare costs continue to rise globally, public payors are increasingly pursuing regulatory interventions that focus on increasing price transparency and ensuring cost effectiveness. Companies that ensure their products have a strong value proposition are more likely to meet public payor expectations for cost-effectiveness in addition to patient needs. On the other hand, companies that rely on price gauging to drive revenue growth or fail to price products and services in line with patient value may face increased regulatory and operational risks. Access to Basic Services risks typically depend on how medically important a company's products and services are, their cost-effectiveness, history of pricing and alignment with patient value, and the state of regulatory oversight of pricing in a company's main markets.

MEI.4 Business Ethics

Business Ethics encompasses business practices, that may be legal or illegal, and result in a financial benefit to an individual specifically or a company while having a negative impact on society or other company stakeholders. It focuses on how companies manage risks related to unethical business conduct, such as anti-competitive practices, bribery and corruption, money laundering, fraud or intellectual property rights violations. As regulators and authorities are placing more scrutiny on companies' compliance systems, unethical conduct can result in substantial financial penalties and legal fees if a company is caught violating regulations. Public exposure of unethical behaviour can damage a company's reputation, trigger boycotts and erode sales. Internally, it can lead to a demoralized workforce and high turnover. Business Ethics risk is driven primarily by the nature of a company's activities, the state of its corporate culture, the location of its operations and the structure of the market in which it operates.



MEI.5 Community Relations

Community Relations focuses on how companies engage with local communities by assessing how they involve local communities in business decisions, minimize adverse impacts on their wellbeing and foster sustainable community development over the long term. While companies can be drivers of economic growth, their activities may also have a negative impact on local communities through pollution, unequal economic benefits, and cultural disruption. Such adverse impacts may trigger community opposition, which can pose a significant financial risk to companies, through production disruptions or project cancellations. Furthermore, neglecting responsible environmental and social management exposes companies to substantial financial penalties, compensation costs, and long-term restoration liabilities. Community Relations risk is driven primarily by the nature of a company's activities and the location of its operations.

MEI.6 Data Privacy and Cybersecurity

Data Privacy and Cybersecurity covers a company's data governance practices, including the collection, use, management and protection of data, to ensure compliance with regulations, safeguard against breaches and address ethical concerns on data use. While customers' personally identifiable data collection empowers personalized services and innovation, organizations must navigate a complex landscape of increased risk and responsibility to safeguard customer information, encompassing data breaches, regulatory scrutiny and potential ethical concerns around data monetization. Data Privacy and Cybersecurity risk is driven by three main aspects: the processing of customers' personal information, the vulnerability of a company's infrastructure to a potential cyberattack or data breach, and whether a company operates in a critical infrastructure industry.

MEI.7 Emissions, Effluents and Waste

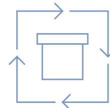
Emissions, Effluents and Waste encompasses a company's practices to minimize non-greenhouse gas emissions, waste and wastewater discharges across its operations, as well as its preparedness and response measures for potential pollution emergencies. Public health concerns and stricter regulations are driving increased scrutiny of companies that rely on potentially polluting materials. Companies that fail to manage pollution effectively face financial and reputational risks. Improper waste disposal or accidents can lead to clean-up costs, fines, operational disruptions and even shutdowns. Additionally, negative publicity from environmental scandals can damage companies' reputations, impacting consumer trust and profitability. Emissions, Effluents and Waste risk is primarily driven by the types of pollutants a company releases as part of its own operations and the level of damage they inflict.

MEI.8 Carbon – Own Operations

Carbon - Own Operations encompasses the management of risks linked to a company's energy use and greenhouse gas (GHG) emissions within its operational control, excluding emissions during the use phase/end-of-life cycle of its products. The issue underscores a company's commitment to lowering GHG emissions and energy use through direct strategic actions, innovative technology integration, and clear target setting. There has been increasing public scrutiny and political drive to curb global GHG emissions, in line with the goals of the Paris Agreement. Companies, therefore, should adapt their business models to mitigate the long-term risks associated with transitioning to a low-carbon future. Companies that do not adequately comply may face negative repercussions, including stranded assets, fines, penalties or reputational damage. Carbon - Own Operations risks can manifest across four key domains: regulations and carbon taxes, disclosure, lack of certification and lack of investment in carbon-reducing technologies.

MEI.8.PS Carbon - Products and Services

Carbon - Products and Services encompasses a company's management of energy efficiency and greenhouse gas (GHG) emissions of its products and services during their use phase, excluding carbon risks related to financial services. The issue emphasizes the measures taken by a company to increase the energy and/or fuel efficiency of its products or services. In the accelerating shift towards a low-carbon economy, companies that lag in carbon risk management and in adaption to a low-carbon business model face significant challenges. These include potential misalignment with evolving regulatory frameworks, increased regulatory scrutiny, declining sales due to consumer preferences, and exposure to litigation and financial penalties. Carbon - Products and Services risk is driven by three key aspects: the regulatory environment, the carbon footprint of products and services, and customer demand.



MEI.9 E&S Impact of Products and Services

Environmental and Social (E&S) Impact of Products and Services captures how a company manages the environmental and social impacts stemming from its products and services, from design choices to disposal, addressing both inherent risks (e.g. tobacco) and those created by use (e.g. packaging waste). Heightened sustainability regulations and surging consumer demand for eco-friendly offerings create a double-edged sword for businesses. Non-compliance with regulations can incur significant fines and reputational damage, while neglecting the consumer shift can threaten market share and long-term viability. E&S Impact of Products and Services risks are driven mainly by the regulatory environment, the level of consumer demand for sustainable products and services, and the choices made at the design stage regarding product or service life cycle impact (use, materials, disposal).

MEI.12 Human Rights

Human Rights encompasses a company's management of and respect for fundamental human rights within its own operations and includes proactive measures to prevent, mitigate and remediate adverse human rights impacts. Human rights, which includes civil and political rights, economic, social and cultural rights, and child and forced labour, has been a long-standing issue for companies across all industries. Stringent regulations are increasingly being implemented worldwide, mandating companies to actively address these issues. Companies that fail to demonstrate ethical operations and respect for human rights throughout their business practices can risk erosion of their market share, encounter talent acquisition struggles, and face increased scrutiny from investors, consumers, civil society and other crucial stakeholders. Factors such as a company's operating environment (e.g. weak labour laws) and the nature of the work (e.g. manual labour) significantly influence the risk of human rights violations.

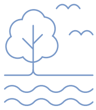
MEI.12.SC Human Rights - Supply Chain

Human Rights - Supply Chain encompasses a company's management of fundamental human rights issues occurring within its supply chain and includes proactive measures to prevent, mitigate and remediate adverse human rights impacts. The issue emphasizes the measures taken by a company to respect civil and political rights as well as economic, social and cultural rights, including freedom from child and forced labour within its supply chain. While companies tend to have less control of second and lower tier suppliers, stricter regulations and consumer demand are prompting firms to be more accountable for and transparent about their supply chains. The primary drivers of human rights risks within a company's supply chain stem from the chain's structure and geographic reach, alongside the nature of the outsourced work.

Descriptions of Material ESG Issues (MEIs)

MEI.13 Human Capital

Human Capital encompasses a company's management of its human resources, from acquiring and retaining top talent, to providing advancement opportunities in a diverse and equal work environment, and adopting an inclusionary corporate culture. It also captures a company's management of its labour relations, including upholding freedom of association and non-discrimination practices, alongside adherence to working hours and minimum wage regulations. Effective Human Capital management safeguards companies against legal ramifications stemming from employee rights violations, mitigates financial losses due to demotivation and decreased productivity, and prevents operational disruptions caused by a disengaged workforce. Human Capital risk is driven primarily by a company's labour structure, which is based on its labour and skill intensity, the propensity for work stoppages and level of diversity within the workforce.



MEI.14 Land Use and Biodiversity

Land Use and Biodiversity focuses on how a company manages land use in its own operations and how it minimizes potentially adverse impacts of that use on the functioning of ecosystems and biodiversity. The impact humans and businesses have had on natural capital is reaching unprecedented and unsustainable levels. Companies rely on the use of land, on the availability of natural resources, and on the functioning of ecosystems to continuously provide those resources as inputs in their operations. If natural systems fail or become unstable, companies' ability to depend on land and natural resources regularly and at stable prices can be jeopardized, potentially leading to business disruptions, as well as operational, legal, regulatory and financial risks. Land Use and Biodiversity risks are driven by a company's type of business and how heavily it relies on land, wildlife and natural ecosystems.

MEI.14.SC Land Use and Biodiversity - Supply Chain

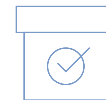
Land Use and Biodiversity - Supply Chain focuses on how a company handles relationships with its suppliers regarding their management of land use and the potentially adverse impacts of that use on the functioning of ecosystems and biodiversity. Many companies rely on their suppliers to provide them with goods and services derived from land use, which depend on the availability of natural resources and the functioning of ecosystems to continuously supply these resources as inputs into their value chain. If these systems fail or become unstable, companies may face greater volatility in their supply chains as the physical availability or price stability of these inputs is jeopardized, potentially leading to business disruptions. Land Use and Biodiversity - Supply Chain risks are driven by a company's type of business and how heavily it relies on land, wildlife and natural ecosystems as inputs in its supply chain. Even industries whose operations do not directly use land or rely on wildlife may face such risks in their supply chain if their suppliers' operations do.

MEI.16 Occupational Health and Safety

Occupational Health and Safety refers to a company's ability to ensure its workforce is safe and healthy and to mitigate the risk of occupational hazards such as employee injuries or fatalities. A company's workforce is often its greatest asset. Investing in workforce health and safety can help mitigate the risk of workplace accidents and fatalities and their associated operational costs, delays and stoppages, as well as potential regulatory and legal risks. At the same time, a positive record on workforce safety may help a company position itself as an attractive employer, particularly in industries that require specific skillsets or face workforce shortages. Occupational Health and Safety risks are typically higher in industries with a higher prevalence of health hazards, as indicated by fatality and injury rates.

MEI.17 ESG Integration - Financials

ESG Integration - Financials covers the integration of environmental, social and governance criteria into financial and real estate decision-making as investors aim to lower their risk, maximize returns, and find profitable investment opportunities. Companies that structurally ignore ESG risks in their investing and financing decisions, such as those associated with climate change, human rights violations, or weak corporate governance, may face a multitude of adverse consequences. These include the risk of assets becoming stranded or losing their value in the wake of physical or transition risks, resulting in financial losses and missed opportunities. Additionally, greenwashing claims expose companies to legal, financial and reputational risks. ESG Integration risk is primarily driven by two factors: the characteristics of a company's portfolio or assets, and the evolving regulatory and enforcement landscape surrounding ESG issues.



MEI.18 Product Governance

Product Governance encompasses a company's management of the entire lifecycle of its products and services to prevent and mitigate risks and consequences for its customers and end-users. Customers have certain expectations about the quality and usability of the products and services they purchase. If companies do not adequately manage the product development lifecycle, and this leads to low quality products, product malfunctions, or products and services that are not suitable or fit for customers' intended purposes, companies can face various negative repercussions. Product Governance risks can manifest across four key domains: product and service characteristics, operational environment, product and service impacts, and marketing and communication.

MEI. 19 Resilience

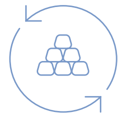
Resilience focuses on the ability of financial institutions to withstand negative shocks arising from changes in economic conditions. It measures financial stability and the management of related risks with an emphasis on capital requirements. Following the financial crisis in 2008, the interconnectedness of financial institutions became apparent, to the extent that the failure of one bank could trigger financially distressed conditions in general, and even the failure of another bank. Since that period, regulators globally have instituted enhanced reporting and capital requirements to reduce the likelihood of similar systemic financial crises occurring again. Banks that have more concentrated portfolios, whether in term of their sector, geography, or on a specific product or service, may be more likely to face shocks if there are sudden changes in the market environment.

MEI.21 Water Use - Own Operations

Water Use - Own Operations focuses on how a company directly uses water in its production and operations, and how it manages contextual, localized water risks that could affect other water users in the same watershed, especially at sites most at risk. Exacerbating freshwater scarcity presents a material risk to operational continuity. Companies may face production disruptions, rising water costs, necessary investments in water treatment systems, and regulatory fines for exceeding water usage allowances. To navigate this growing challenge and ensure long-term profitability, sustainable water management strategies are essential. Risks associated with water use arise from a company's operational dependence on water for the production of goods or services, the geographical availability of water, and competing demands for water as a shared resource.

MEI.21.SC Water Use - Supply Chain

Water Use - Supply Chain focuses on how effectively a company incorporates and manages water-related risks within its supply chain. Exacerbating freshwater scarcity presents a material risk to operational continuity. Companies may face production disruptions at their suppliers' facilities, leading to shortages of materials or finished goods for their own production. Additionally rising water-related costs across the value chain may impact companies' bottom line. Risks relating to the use of water in the supply chain arise from suppliers' operational dependence on water for the production of materials or finished products, the geographical availability of water at suppliers' operating sites and competing demands for water as a shared resource.



MEI.22 Raw Material Use

Raw Materials Use encompasses a company's management of raw material inputs (excluding energy and petroleum-based products) in the production process. It includes the selection, use and efficiency of raw material inputs. It focuses on measures taken to ensure long-term profitability amid increased raw material demand and supply challenges, as the low-carbon transition is expected to drive exponential growth in demand for a number of critical raw materials. A company's sustainable raw materials management strategy is key to navigating this growing challenge. Raw Material Use risks are primarily determined by a company's required raw material inputs and the nature of its activities. Raw materials can face higher risk based on three main aspects: physical scarcity, unequal endowment of raw materials across countries paired with geopolitical risk, and structural excess demand intensity.

About Morningstar Sustainalytics

Morningstar Sustainalytics is a leading ESG data, research, and ratings firm that supports investors around the world with the development and implementation of responsible investment strategies. For more than 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG information and assessments into their investment pro-cesses. The firm also works with hundreds of companies and their financial intermediaries to help them consider material sustainability factors in policies, practices, and capital projects. Morningstar Sustainalytics has analysts around the world with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit **www.sustainalytics.com**.

To learn more about MEIs, visit https://www.sustainalytics.com/material-esg-issues-resource-center

Europe:
Amsterdam (+31) 20 205 00 00
Copenhagen (+45) 32 72 52 81
London (+44) 20 3514 3123
Frankfurt (+49) 69 3329 6555
Paris (+33) 1 184880642
Stockholm (+46) 8 505 323 33

Americas:
Boston (+1) 617 603 3321
New York (+1) 212 500 6468
Toronto (+1) 416 861 0403

Asia Pacific:
Sydney (+61) 2 8320 9436
Tokyo (+81) 3 4510 7979

Copyright © 2024 Morningstar Sustainalytics. All rights reserved.

The information, methodologies, data and opinions contained or reflected herein are proprietary of Sustainalytics and/or content providers, intended for internal, non-commercial use and may not be copied, distributed or used in any other way, including via citation, unless otherwise explicitly agreed in writing.They are provided for informational purposes only and (1) do not constitute an endorsement of any product or project; (2) do not constitute investment advice, nor represent an expert opinion or negative assurance letter; (3) are not part of any offering and do not constitute an offer or indication to buy or sell securities, to select a project or make any kind of business transactions; (4) are not an assessment of the issuer's economic performance, financial obligations nor of its creditworthiness; (5) are not a substitute for a professional advise; (6) past performance is no guarantee of future results; (7) have not been submitted to, nor received approval from, any relevant regulatory bodies.

These are based on information made available by third parties, subject to continuous change and therefore are not warranted as to their merchantability, completeness, accuracy, up-to-dateness or fitness for a particular purpose. The information and data are provided "as is" and reflects Sustainalytics' opinion at the date of its elaboration and publication.Sustainalytics nor any of its content providers accept any liability for damage arising from the use of the information, data or opinions contained herein, or from the use of information resulting from the application of the methodology, in any manner whatsoever, except where explicitly required by law.

Any reference to content providers names is for appropriate acknowledgement of their ownership and does not constitute a sponsorship or endorsement by such owner.

A list of our content providers and their respective terms of use is available on our website. For more information visit **https://www.sustainalytics.com/legal-disclaimers**.

Sustainalytics may receive compensation for its ratings, opinions and other deliverables, from, among others, issuers, insurers, guarantors and/or underwriters of debt securities, or investors, via different business units. Sustainalytics has put in place adequate measure to safeguard the objectivity and independence of its opinions. For more information visit **Governance Documents** or contact **compliance@sustainalytics.com**.