

VP Bank Sustainability Score (VPSS)

In addition to returns and risk, sustainability is an increasingly important criterion in investment decisions. However, there is no uniform definition. This is why VP Bank has developed a sustainability score that measures the level of sustainability of an investment on the basis of multiple dimensions. The aim is to have as broad a basis as possible. Investors might also use the score as an indicator for opportunities and risks from a sustainability perspective. And it allows a comparison between different financial products, such as stocks, bonds or funds.

VP Bank incorporates sustainability criteria into the assessment of investments. Our belief is that sustainable investing is beneficial to all investors if put into practice properly. Numerous scientific studies¹ have shown a neutral or positive performance effect.

While there is no uniform definition of sustainability, there is a broad consensus that ESG factors best summarise the criteria. Specialised rating providers determine the extent of an enterprise's impact on the environment (E), how it behaves when dealing with different stakeholders (S) and how high the quality of the corporate governance (G) is. The VP Bank Sustainability Score (VPSS) is broad based because sustainability is more than ESG for us. More specifically, the score consists of five sub-components:

1. ESG rating
2. ESG momentum
3. Business practices
4. Business activity
5. Sustainable Development Goals und Impact

Each of these sub-categories is assessed based on a specially developed methodology. The VP Bank Sustainability Score was designed in such a way that, in addition to its obvious positive impact on sustainable economic activity, investments with a high value also have a better long-term risk-opportunity-ratio.



1. ESG rating

The starting point of the VP Bank Sustainability Score is the ESG rating by MSCI, a data provider. It is based on the basic components environment (E), social affairs (S) and governance (G). This classification results in a sustainability profile of an enterprise, a state or state agency or a fund. ESG factors show how, for example, a company is prepared to deal with future risks such as climate change or changes in society like shifting consumer habits. Factors are varying depending on the sector and the asset class.

¹ Peace, Busch and Bassen (2015): ESG and financial performance; aggregated evidence from more than 2000 empirical studies; Journal of Sustainable Finance & Investment, Volume 5, Issue 4, p. 210-233, and Clark, Feiner and Viehs (2015): From the stockholder to the stakeholder; How sustainability can drive financial performance

Results: Our rating scale ranges from "insufficient" to "excellent".

Minimum requirement: All individual securities must have at least a BB rating in order to qualify for our recommendation lists. We exclude the lowest two rating grades within the ESG Rating Methodology, B and CCC. In addition to this minimum requirement for individual securities, we also set a high standard for the portfolios of the VP Bank Risk Optimised ESG funds.

In the case of third-party funds and ETFs, a certain minimum proportion of the portfolio has to be covered by MSCI. The proportion of securities with a B and CCC rating should be lower, but at most the same as that of the regional benchmark. Breaching of certain levels will lead to a reduction of the score.



2. ESG Momentum

The momentum indicator measures to what extent and in what direction the ESG rating has changed. We reward companies, governments or sovereign debtors that improve their sustainability rating. Those who pay little or no attention to the ESG aspects resulting in a downgrade will be penalised. Scientific studies² have shown that investments with a positive ESG momentum tend to perform better than the overall market. Taking the rating momentum into account, preference will be given to those who could benefit from an ESG rating premium in the future. This leads to a better timing since many professional investors are only paying attention to ESG ratings and are not allowed to buy shares or corporate bonds under their statutes until the rating has been issued.

Results: Improvement or worsening of score.

Minimum requirement: None. The momentum indicator affects the overall score positively or negatively, but does not result in an exclusion of a recommendation.

In the case of third-party funds and ETFs, we pay attention to the net result of the securities held with a rating improvement less those with a deteriorating rating.



3. Business practices

Bribery, exploitation and child labour are examples for business practices that are illegal or a breach of international standards. This sub-component assesses the behaviour and business policy of a company. VP Bank is guided by the three internationally recognized standards "UN Global Compact", "United Nations Guiding Principles for Business and Human Rights" and "International Labour

² Giese et al, Foundations of ESG Investing (2019): How ESG Affects Equity Valuation, Risk, and Performance The Journal of Portfolio Management; Volume 45

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Organization (ILO) Labour Standards", as well as the controversies identified by MSCI. The latter are assessed separately, as certain aspects are not included in the ESG rating at all or to a low degree. For example, in our methodology, the violation of competition law investigated by the authorities may lead to an exclusion of a security if the violation is classified as "very severe". In other cases, bonus points are awarded for good business conduct and deductions are made for "severe" controversies.

Results: Exclusion or improvement or worsening of score.

Minimum requirement: A breach of the above mentioned international standards or a «very severe" controversy leads to an exclusion from our stock and bond recommendations. VP Bank ESG funds also exclude direct investment in such companies.³

In the case of third-party funds and ETF recommendations, the accepted share of investments held by the fund with breaches of international standards and «very severe" controversies is very low.



4. Business activity

For this sub-category, the business lines of a corporation are analyzed. The main focus is on ethical criteria that are matched against the revenue or the practices of a company. There is a gradual approach in the VP Bank methodology. "Critical" business areas are defined as tobacco, gambling, thermal coal, nuclear⁴ and controversial weapons. Above a 5 % threshold these activities lead to an exclusion, yet a tie to controversial weapons is enough to be excluded. This means that a company cannot be recommended to buy, because of its business activities. "Borderline" businesses include pornography, small arms, nuclear energy, genetically modified organisms (GMOs), oil sands⁴, for-profit- prisons⁴ and fur⁴. Again, a threshold of 5% of the portfolio or revenue applies, if not measurable, the mere link to any of these issues will reduce the score. Conventional weapons, fossil fuels⁴ and animal welfare are classified as "questionable" and may have a negative impact on the score if the level exceeds 5% or if there is a link. All of these areas of business are being questioned if there is a greater focus on sustainability. Accordingly, there is a risk that investors will exit such assets on a large scale, which may lead to higher capital costs and lower performance. Companies that do not operate in any of the above mentioned areas will receive a bonus.

Results: Exclusion or improvement or worsening of score.

Minimum requirement: Companies that breach thresholds in business areas we classify as "critical" won't be recommended. VP Bank ESG funds are not allowed to invest in

³ In case of a downgrade, the adjustment will take place with the next rebalancing.
⁴ available on a single title level only

such assets.³

The portfolio of third-party funds and ETFs may only contain a very small proportion of companies operating in areas considered "critical".



5. SDG and Impact Score

Truly sustainable companies not only operate sustainably, but their activities also contribute to the achievement of the UN's Sustainable Development Goals (SDGs). The SDGs are the core of the 2030 Agenda and take into account the economic, social and environmental dimensions of sustainable development. The SDG and Impact Score therefore compares a company's products and activities or dedicated impact solutions with the 17 UN development goals and measures the extent to which they contribute to or contradict the achievement of the goals. The measurement is done separately for each of the 17 goals. These are then combined to form the SDG and impact score. Critical activities are defined for each goal. For the activities, the negative impact tends to be measured on the operational side, for example on the basis of controversies that can be assigned to an SDG. For the activities, on the other hand, both negative and positive aspects of revenue generation are measured.

Results: Depending on the score, there is an improvement or a worsening of the overall result.

Minimum requirements: None. The SDG and impact score affects the overall score positively or negatively, but does not lead to exclusion.

On a fund level, there exists an aggregated version of each SDG and impact score.



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Whether on a security, on a portfolio or on a fund level, the sustainability assessment results in a sustainability score (as described above). The scale ranges from -1 to 10, where -1 is "insufficient", 0 is "not covered". Scores from 1 to 10 are divided into five buckets.

10	Excellent
9	
8	Very Good
7	
6	Good
5	
4	Average
3	
2	Below Average
1	

0	Not covered
-1	Insufficient

Exclusion

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VP Bank Sustainability Score - the components



ESG Rating

- Analysis of the dimensions Environment, Social and Governance
- Sector specific criteria

ESG Momentum

- Change of the ESG-Ratings

Business Practices

- Analysis of business conduct and controversy
- Compatibility with international standards

Business Activity

- Comparison of business activities with ethical aspects

SDG and Impact Score

- Comparison of company activities with the UN Sustainable Development Goals
- Exposure to Impact-Themes

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