CRISIL’s ESG risk assessment methodology

CRISIL’s ESG scores are designed to support financial institutions and corporates to measure and monitor inherent ESG risks across their financial exposures – both equity and debt. They also provide standardised and sanitised ESG information, including benchmarks that can easily integrate into analysis and risk management processes.

We have used our proprietary ESG methodology to score companies across sectors. This evaluation is based on publicly available information released by the companies through their websites, exchange filings, annual reports, investor presentations, sustainability reports, Carbon Disclosure Project (CDP) filings, etc. It also factors in other material ESG information available in the public domain through reliable sources, such as data reported by industry associations, regulators and various government agencies. The assessment is based on quantitative as well as qualitative disclosures.

Since this is an objective evaluation based on publicly available information, the quality of disclosures provided in the public domain is an important determinant of the ESG score. We strongly recommend and encourage all companies under our coverage to report maximum possible ESG-related information in the public domain. This is in sync with good governance principles and best practices around transparency – an important pillar of our ESG assessments.

Each company under our coverage is monitored on a continuous surveillance basis for ESG material events that could potentially lead to a change in scores.

Scoring framework

To arrive at the overall company ESG score, relevant weights are assigned to E (35%), S (25%) and G (40%) attributes, to reflect the relative importance of factors. Governance has been assigned the highest weightage as we believe the governance of a company is what drives E&S at companies. Companies are scored on a scale of 0-100, where 100 is the highest.

In case of E and S assessment, the final score is a combination of the company and the sector scores. For instance, the final E score for a company is arrived at by applying the sector E score overlay on the company E score. The company E score assesses its material environment parameters in relation to its peers within the sector. The sector E score is an indicator of how the sector fares relative to other sectors on various environment issues. This approach allows us the flexibility to bring sector-specific parameters into our assessment and make it extremely nuanced, while at the same time retaining the cross-sector comparability of the final scores.
CRISIL integrates over 100 parameters and 350+ data points across E, S and G components for our evaluation.

### Key E parameters assessed

#### Energy and emissions
- Intensity of CO2 emission (Scope 1+2+3; kg CO2, sector-specific metric)
- Intensity of air pollutants (includes SOx, NOx, SPM, and ODS)
- Emission trend (% reduction over past 3 years)
- Energy consumption (MWh per sector-specific metric)
- Trend in capital investment in energy conservation equipment (for energy conservation equipment per sector-specific metric)

#### Waste generation and recycling
- Hazardous waste generation
- Waste recycling level
- Non-hazardous waste generation, eco-friendly materials used, and other waste management initiatives undertaken

#### Water use
- Water recycling as a proportion of overall water consumption
- Water consumption trend
- Water withdrawal trend (fresh water, groundwater, and saline water)

#### Resource use and biodiversity
- Raw material use efficiency (per sector-specific metric)
- Diversity in raw material sourcing
- Land use (forest, arable land) and natural resources use
- Biodiversity (operations at hotspots, presence of rare species, and impact due to operations)

#### Compliance/controversy checks – deflators
- Instances of emission-related show cause notices issued by regulatory authority
- Compliance with discharge/dumping of effluent/sluice as per norms prescribed by regulators, which includes safe disposal and sale to CPCB certified recyclers
- Instances of waste-related show cause notices issued by regulatory authorities
- Violation of environmental laws/notices issued by CRZ, NGT, etc.

*Weightage for parameters varies depending on nature of sectors/business mix*
Factoring in sector-specific nuances and materiality

The ESG risk assessment framework for each sector includes sector-specific parameters that have been developed based on our multi-decade experience in industry research as well as global reporting frameworks such as Sustainability Accounting Standards Board (SASB), Global Reporting Initiative (GRI) and CDP. For a parameter to be considered material, CRISIL applies filters both from a risk perspective (how it may negatively impact a company's financial risk and return profile) as well as an impact perspective (how the issue may impact the country's ESG landscape). Weightages of individual parameters vary across sectors, depending on the materiality and relevance.

### Key S parameters assessed

- **Employee and worker management**
  - Gender diversity and attrition rate
  - Safety (lost time injury frequency rate)
  - Wage equality (CEO-to-median pay ratio)
  - Training to employees – skill and safety (training hours per employee and % of employees trained)
  - Permanent vs temporary employee
  - Unionisation (employee participation in management-recognised employee unions)

- **Supply chain management**
  - Customer satisfaction – NPS, CSI, and feedback
  - Product innovation (% of R&D expenditure)
  - Vendor management – procurement from locals/MSMEs, fairness, ESG screening, and pending dues to MSMEs
  - Ease of access – network and inclusion

- **Communities**
  - Employment generation
  - Corporate social responsibility spend and taxes paid
  - Grievance/complaint redressal, families affected because of company's projects, and compensation offered to the affected families

- **Compliance/controversy checks – defectors**
  - Child labour, discrimination, strikes, product recalls, irresponsible marketing (banned substance, minimum wages, and sale of sin goods), and non-compliance

Weightage for parameters varies depending on the nature of sectors/business mix.

### Key G parameters assessed

1. **Board composition**
   - Board skill matrix – competency evaluation and skill/functionality mapping
   - % of non-executive directors on Board and committees
   - Integrity – investigations or indictment by law enforcement agencies, debarrence/suspension by authorities

2. **Board independence**
   - Conflict of interest segregated roles of chairman and CEO
   - Degree of independence – background of independent directors – association with the company (ex-employee, independent consultant, executive at a parent/sister company, tenure)
   - Independent chairman or lead independent director in case of executive chairman
   - Role allocated to independent directors

3. **Board functioning and experience**
   - No of Board/committee meetings held and attendance
   - Independent directors' meeting without management
   - Average Board tenure – directors with 10+ years tenure

### Examples of key sector-specific E metrics

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Parameters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airlines</td>
<td>- Share of sustainable aviation fuel in overall fuel mix&lt;br&gt;- Initiatives to use materials to make airplanes lighter</td>
</tr>
<tr>
<td>Cement</td>
<td>- Thermal substitution rate&lt;br&gt;- Clinker ratio</td>
</tr>
<tr>
<td>Consumer retail</td>
<td>- Number of stores with green building certification&lt;br&gt;- Product end-of-life</td>
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</tbody>
</table>
Handling non-availability or non-disclosure of quantitative information

Non-disclosure of quantitative information by a company for a specific parameter is assigned a default non-disclosure score, which is the lowest score possible for any parameter. In case there is some qualitative disclosure or material information available, CRISIL will notch up the score for that parameter depending on the specificity, level of depth, and action-oriented nature of the information.

Negative scores or deflators for compliance lapse, regulatory actions, controversies, or similar events

A negative score or a deflator is assigned to the overall E, S or G company score, where the company has been involved in any controversies, or there have been any compliances lapses or regulatory actions against it. Depending on the severity of the incident, the potential impact from an ESG risk perspective and recency of the event (3-5 years in most cases; 10 years in extremely controversial incidents with an overhang), appropriate deflators are assigned to the company’s score. For instance, in case a company has been fined by the pollution control board for non-compliance with effluent treatment norms, we will assign a deflator to its E score, while any involvement in insider trading by the promoters or management would trigger a deflator to its G score.

Examples of key sector-specific S metrics

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Parameters</th>
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<tbody>
<tr>
<td>Airlines</td>
<td>On-time performance (Bengaluru, Delhi, Hyderabad, and Mumbai)</td>
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<tr>
<td></td>
<td>% of passenger affected (of total pax carried) due to denial of boarding</td>
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<tr>
<td></td>
<td>% of passenger affected (of total pax carried) due to cancellation</td>
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<td></td>
<td>Safety rating by independent authority</td>
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<td></td>
<td>Aviation accidents/incidents reported (as % of total departure)</td>
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<td>Pharma</td>
<td>Adverse regulatory actions (number of warning letters and import alerts)</td>
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<tr>
<td></td>
<td>Number of Abbreviated New Drug Application (ANDAs) filed</td>
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<tr>
<td></td>
<td>Access to affordable healthcare</td>
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<tr>
<td>Lending</td>
<td>% of rural branches</td>
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<tr>
<td></td>
<td>% of semi-urban branches</td>
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<tr>
<td></td>
<td>Advances given in India</td>
</tr>
<tr>
<td></td>
<td>Priority sector lending (%)</td>
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</table>
Handling unique corporate structures

- **Holding companies and diversified companies**: Such companies are assessed on the basis of a ‘sum of the parts’ approach, considering the underlying companies or businesses to which they have exposures. The weights are assigned to specific subsidiaries or businesses considering their contribution to assets as well as revenue. In cases where the holding or diversified company has its own disclosures and the reporting boundary includes all its underlying companies or businesses, the overall score is calculated based on the parent company’s disclosures.

- **Unlisted companies**: On environmental and social parameters, unlisted companies are scored the same way as listed companies. On governance, disclosure-related parameters have a lower weightage, since unlisted companies are not mandated by regulations to disclose them. However, all other governance parameters such as Board independence, gender diversity and attendance are scored in the same manner as listed companies. This is because governance best practices are equally important from an unlisted company perspective, especially keeping in mind the interests of debt investors and other stakeholders.

- **DFIs**: Since DFIs are government organisations and mandated by certain government legislations in terms of appointment of independent directors, we have considered government-nominee directors as independent directors in arriving at the governance scores. Most DFIs are not encouraged to appoint non-government-linked directors.
Output

The output of our scoring is a rationale report on each company which details the underlying reasons for the scores. It shows where the company leads or lags on certain parameters vis-à-vis its peers in the sector and gives insights on potential areas for improvement.

The ESG scores, along with the detailed rationale report, underlying data reported by the company, and benchmarks is available through CRISIL’s online data and analytics platform, Quantix.

Why CRISIL’s ESG risk assessment framework is unique

- **Considers Indian specificities**: CRISIL’s ESG framework has been thoughtfully designed contextualising India-specific nuances, including regulations, availability of information, and materiality of issues. The framework compares companies with their domestic peers; hence, the benchmarks and scale are India-specific in nature. Global benchmarks and best practices are tracked, but only as a guide to indicate the potential to improve from the current levels.

- **Uses relevant third-party data sources**: A significant number of ESG material data points are available through third-party sources but not necessarily reported by the company. We look for and weave them into our assessment framework. For instance, in case of the pharma sector, we look at information available through the United States Food and Drug Administration website for warning letters, import alerts, etc.

- **Assesses reporting boundaries**: In India, it is common for companies to report E and S data for only a part of their business operations. Hence, it becomes extremely critical to assess the reporting boundaries. In case the company does not report information for 100% of its operations, we notch down the score on the basis of the significance of the information reported.

- **Faces a rigorous committee process**: Given the substantial amount of subjective judgement required in ESG analysis, CRISIL prides itself on the in-house sectoral capabilities and rich databases we have collected over decades of research on Indian companies and sectors. To aid our assessment, every company goes through a rigorous committee process where sector leaders from the Industry Research team help strengthen the analysis, sector frameworks and parameters, and give additional insights based on their understanding of the companies/sectors.
Limitations of our framework

- **Disclosure bias:** The ESG scores are based on publicly available information only. Therefore, they are subject to disclosure bias, i.e., companies that have better disclosures will potentially get higher scores as opposed to companies with no/poor disclosures, irrespective of their actual impact on E,S and G parameters. We do not work with any ESG information shared by companies on a bilateral basis. In order to uphold one of the key governance pillars of transparency for all stakeholders, we encourage companies to improve their public disclosures on ESG, which is also in line with SEBI’s approach of implementing the BRSR.

- **Listed company bias:** Listed companies are mandated by regulations to disclose more information in the public domain, especially for governance related parameters. This could result in unlisted companies receiving lower scores owing to limited disclosures. We expect unlisted companies to follow best practices when it comes to governance and disclosures. Within listed companies, we recognise that large-cap companies tend to get higher scores as they have access to more resources to both, make better disclosures and perform better. We expect the BRSR to resolve some of the disclosure-related limitations with regard to smaller companies.

- **Coverage bias:** Our ESG benchmarks are a function of the number of companies covered in a particular sector and the quality and quantity of disclosures within the sector. Hence, a material change in the coverage or the disclosure of ESG information within a sector can lead to a deviation in scores on a year-on-year basis. However, over a period, as the coverage increases significantly and companies improve their disclosures, this bias is expected to fade. Companies are chosen mainly based on, but not limited to, three factors: market cap, occurrence in mutual funds, and debt issued.

- We will continue to fine-tune our approach and methodology keeping in mind availability of data as well as global best practices in the dynamic field of ESG.
About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India’s foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Research

CRISIL Research is India’s largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India’s most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our large network sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

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