

CRISIL's ESG scoring methodology

November 2023

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 that can easily integrate into analysis and risk management processes.

We have used our proprietary ESG methodology of assessing 600+ KPIs to score 1,000 companies across ~65 sectors. This evaluation is based on publicly available information released by the companies through their websites, exchange filings, annual reports, investor presentations, sustainability reports, 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, hence CRISIL also provides a Disclosure score category across companies we score. This becomes imperative for financial institutions and corporates to understand the level of transparency in terms of reporting non-financial disclosures.

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 that good governance practices are the bed rock to drive environment and social agenda of any company. Companies are scored on a scale of 0-100, where 100 is the highest.

In case of Environment and Social assessments, the final score is a combination of the company and the sector scores, where sector scores have a 40% weight in the company's E score and 25% in its S 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 nuanced sector-specific parameters into our assessment, while at the same time retaining the cross-sector comparability of the final scores.

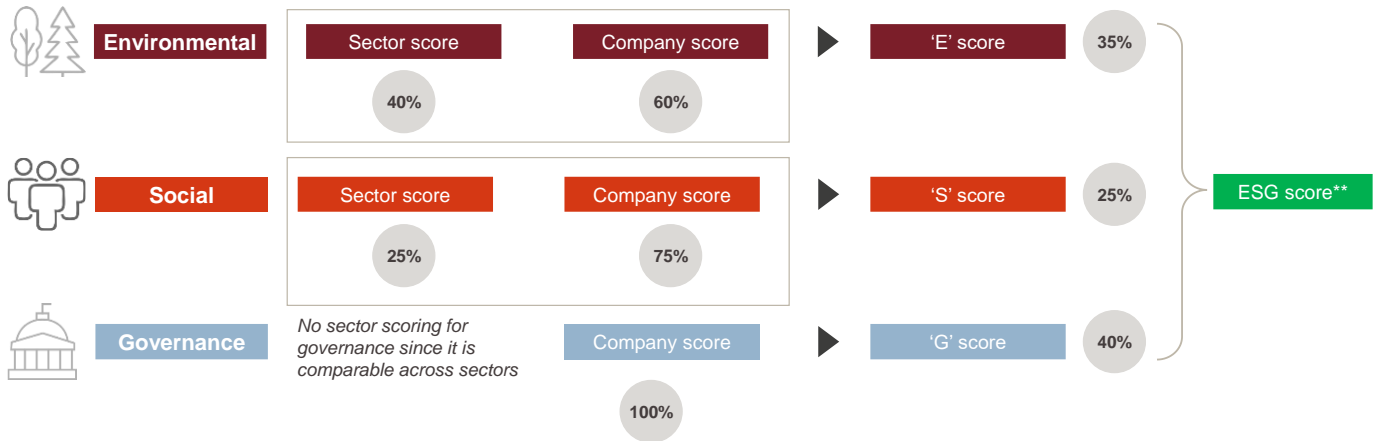
Given India's Net Zero target of 2070, many Indian companies have aligned their sustainability strategies to help achieve this target. Transition or Parivartan parameters especially such as climate change policy, net zero targets, trend in emission intensity, use of green/alternate raw materials, green product offerings, investments etc. are embedded within CRISIL's evaluation framework to assess the change in quantitative and qualitative metrics toward achieving these sustainability goals. Hence, CRISIL has not provided a separate transition score for fiscal 2022 evaluations.

Enhancing the ESG evaluation framework

In the assessment of companies for the fiscal year ending 2022, CRISIL has enhanced ESG assessment framework- The parameters assessed for fiscal year ended 2022 on environment category increased from 35 to 65 which includes sector specific parameters that are material to the industry, that for social category increased from 40 to 100 including the BRSR linked parameters such as worker related parameters, complaints from various stakeholders, data security related issues, etc., and from 60 to 100 for corporate governance category, compared to fiscal year ended 2021. This includes using more digitized approach of scoring, the incorporation of sector-specific

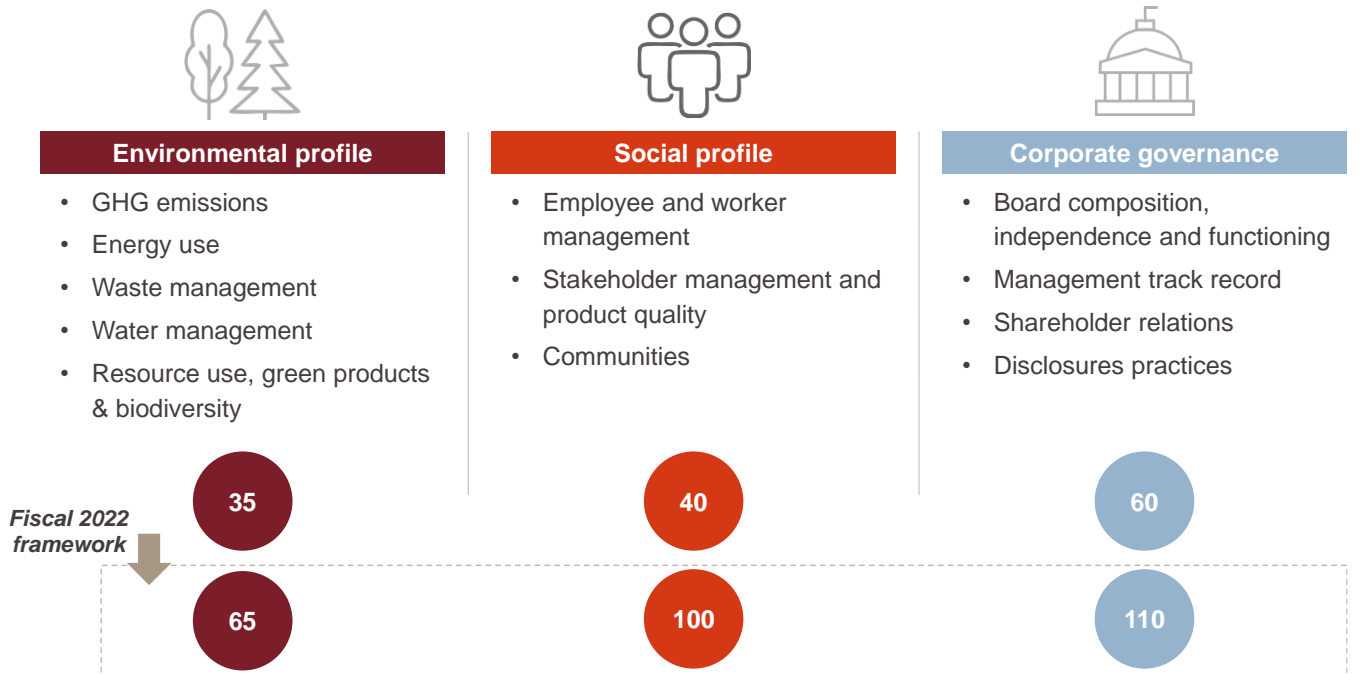
data points for more comprehensive evaluation, & integration of BRSR parameters to refine scoring, and the development of a digitized controversy framework to apply a deflator to company scores.

Company assessment framework



** On a scale of 0-100, with 100 being the highest and 0 the lowest

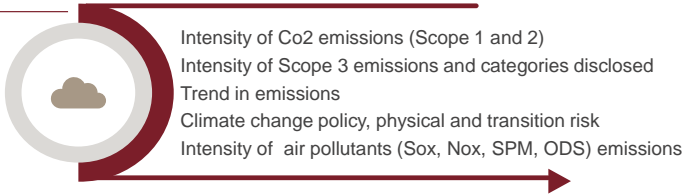
CRISIL evaluation framework comprises of 275 assessment parameters and 500+ data points across E, S and G



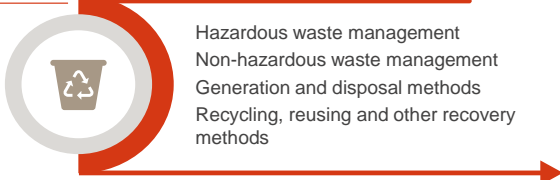
Note: The framework has been enhanced with an increase in the number of parameters assessed in fiscal 2022.

Environment benchmarking across 5 key pillars

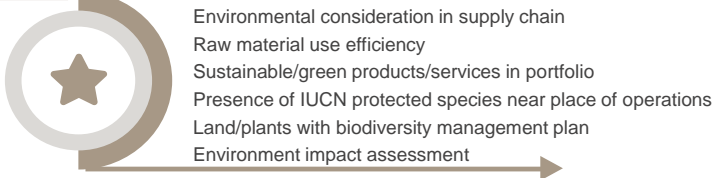
GHG emissions



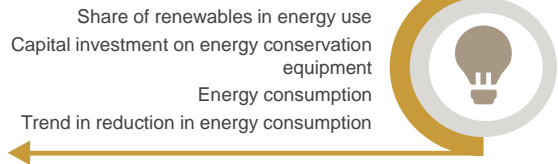
Waste management



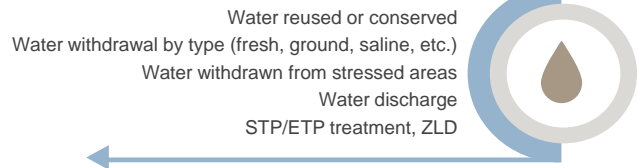
Resource use, green products and biodiversity



Energy use



Water management



Social evaluation on material aspects

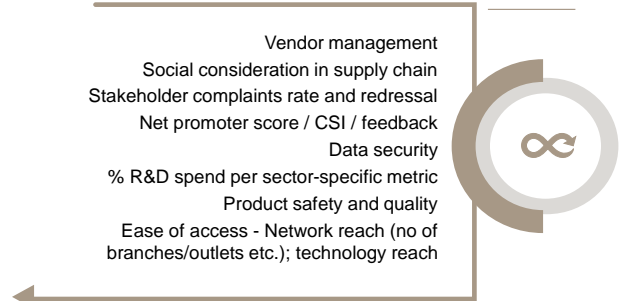
Employee and worker management



Communities



Stakeholder management and product quality

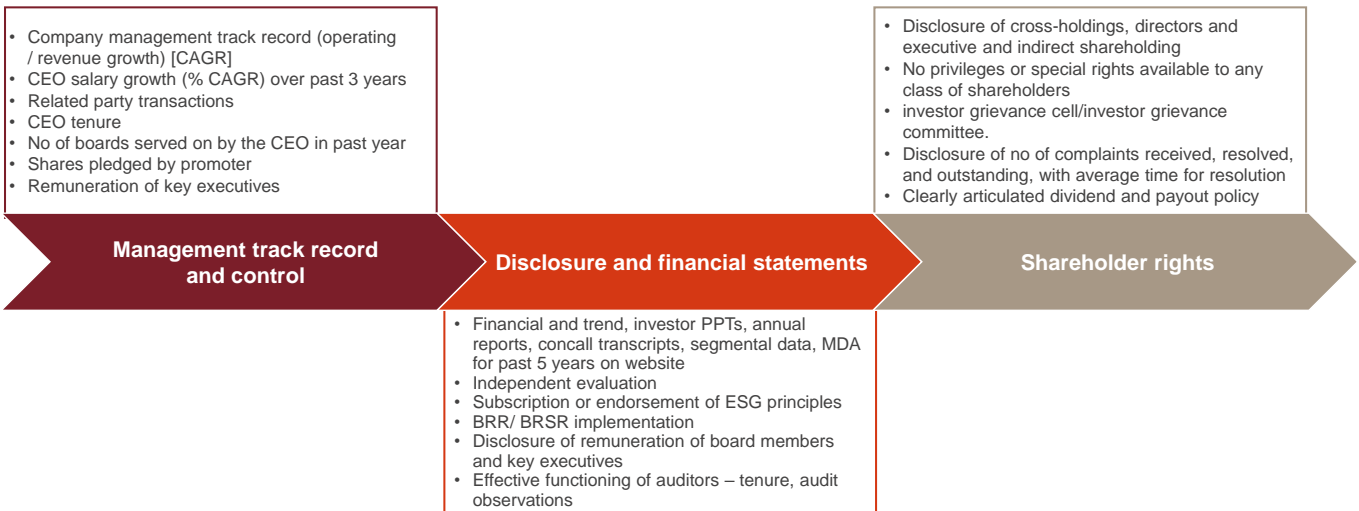


In-depth governance evaluations

Board composition and functioning



Management track record, transparency & Shareholder rights



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), etc. 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.

CRISIL leverages its sector expertise in ESG evaluation, including sector-specific parameters for evaluation.

<p>Cement</p> <hr style="width: 20%; margin: auto;"/> <ul style="list-style-type: none"> • <i>Thermal substitution rate</i> • <i>Clinker ratio</i> • <i>Waste heat recovery system</i> • <i>PAT regulations (Perform, achieve and trade)</i> 	<p>Airlines</p> <hr style="width: 20%; margin: auto;"/> <ul style="list-style-type: none"> • <i>Share of sustainable aviation fuel in overall fuel mix</i> • <i>Initiatives to use materials to make airplanes lighter</i> • <i>On-time performance</i> • <i>Percentage of passengers affected due to denial of boarding and cancellation</i> • <i>Safety rating by independent authority</i> • <i>Aviation accidents/ incidents reports</i>
<p>Banks/ NBFCs</p> <hr style="width: 20%; margin: auto;"/> <ul style="list-style-type: none"> • <i>Financed emissions and negative sector exposure</i> • <i>Funding to green projects</i> • <i>Rural and semi-urban reach</i> • <i>Priority sector lending</i> 	<p>Pharmaceuticals</p> <hr style="width: 20%; margin: auto;"/> <ul style="list-style-type: none"> • <i>Product recalls</i> • <i>Adverse regulatory actions (number of warning letters and import alerts)</i> • <i>Number of Abbreviated New Drug Application (ANDAs) filed</i> • <i>Access to affordable healthcare</i>

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.

Deflators for compliance lapse, regulatory actions, controversies, or similar events

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. CRISIL takes into consideration if there is any regulator involved, the negative impact of the controversy, impact of the incident leading to shut down of operations of the company, the amount of penalty levied by the regulator as a percentage of profit after tax (PAT) or Net Worth, repeated occurrence of the incident, etc. Instances of deflator on environment would include companies being fined by the pollution control board, national green tribunal, coastal regulation zones, etc for non-compliance. On S would include safety incidents, child labour issues, worker strikes, community protests, sale of sin goods etc. Governance deflators would be a function of any insider trading instances, regulatory fines or investigations, regulatory actions on promoters or directors etc.

Handling Defence sector

Lack of disclosures by companies operating in this space on revenue share of defence related products or exports to conflict prone nations limits our ability to assess the extent of impact on communities or society. Plus, we take into consideration the importance of defence products/ services in lieu of national security and do not assign deflators for companies in the sector.

E	<ul style="list-style-type: none"> • Pollution control boards, National Green Tribunal and other regulatory notices and penalties • Issues brought up by the community
S	<ul style="list-style-type: none"> • Sale of sin goods • Worker protests • Community protests • Child labour issues • Safety-related incidents
G	<ul style="list-style-type: none"> • Regulatory actions or investigations on promoters, directors or company • Fraud by employees/ promoters • Legal battle between promoters

Handling unique corporate structures

Diversified companies:

Companies, which are present in more than two business segments, with at least two of the segments contributing more than 20% of the total revenue, are classified in the Diversified segment.

The CRISIL ESG evaluation of such companies is based on a ‘Sum-of-the-parts’ approach, considering the underlying companies/businesses they have exposure to, where weights are assigned in proportion to their asset base.

The corporate governance pillar is evaluated at a company level on a consolidated basis, while the environment and social pillars are evaluated in two ways:

- When the company’s non-financial disclosures are bifurcated into business segments/subsidiaries:
 - The subsidiaries/business segments are scored separately, benchmarking them against the respective sector peers
 - The overall environment and social score are the weighted average of respective environment and social scores arrived for the business segments/subsidiaries
- When the company’s non-financial disclosures are not bifurcated into business segments/subsidiaries:
 - The environmental and social pillars are evaluated at a company level on a consolidated basis
 - The overall sector score are the weighted average of respective environment and social sector scores for the business segments

Holding companies:

Our holding company classification is based on RBI’s guidelines of core investment companies (CIC), where all the CIC that fall under our coverage are classified as holding.

The corporate governance pillar is evaluated at a company level on a consolidated basis. The environmental and social pillars of the holding companies are evaluated in two ways:

- When the holding company has made non-financial disclosures:
 - If such disclosures accounts for majority of the underlying business, we score the environmental and social pillar, benchmarking them against the respective sector peers
- When the holding company has not made non-financial disclosures, we follow the ‘Sum-of-the-parts’ approach based on the share of amount invested by the holding company in the investee companies:
 - If the share of investment in the investee company is more than 10%, we evaluate the environmental and social pillar of the investee company against its respective peers
 - If the share of investment in the investee company is less than 10%, and the company has not been evaluated in our coverage universe, we use the average environmental and social scores of the sector
- **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.
- Further, 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, UAE 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.

For more information, visit www.crisil.com

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About CRISIL Market Intelligence & Analytics

CRISIL Market Intelligence & Analytics, a division of CRISIL, provides independent research, consulting, risk solutions, and data & analytics. Our informed insights and opinions on the economy, industry, capital markets and companies drive impactful decisions for clients across diverse sectors and geographies.

Our strong benchmarking capabilities, granular grasp of sectors, proprietary analytical frameworks and risk management solutions backed by deep understanding of technology integration, make us the partner of choice for public & private organisations, multi-lateral agencies, investors and governments for over three decades.

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