# ASSOCIATION OF MUTUAL FUNDS IN INDIA

AMFI/281-B/ESG Rating/02/2022-23

May 19, 2022

To,

ESG Risk Assessments & Insights Limited,
905, Lodha Supremus,
Lodha iThink Techno Campus,
Kanjurmarg East,
Mumbai – 400093.

Kind Attention: Mr. Prosenjit Ghosh

Dear Sir,

**Sub: Empanelment as ESG Rating Provider for AMCs**

This refers to your mail dated May 17, 2022 requesting AMFI to empanel your company as an ESG Rating Provider (ERP) and the presentation made to AMFI's ESG Working Group.

In this regard, we are pleased to inform you that, based on the information provided in your aforesaid letter/email and the presentation, it has been decided to empanel your company as a recognised ESG Rating Provider (ERP) to members of AMFI, i.e., to the Asset Management Companies (AMCs) of SEBI registered mutual funds for the purposes of providing ESG Ratings services in accordance with SEBI and AMFI guidelines.

Please note that the above recognition / empanelment is valid for a period of three years or until SEBI comes out with the proposed regulations / guidelines for accreditation of ERPs, whichever is earlier.

Further, as an AMFI-empanelled ERP, you will be required to follow certain common minimum standard / approach for ESG Rating Methodology as mentioned in the Annexure A hereto and cover at least top 1000 listed entities by the end of the calendar year 2023. AMFI reserves the right to amendment the aforesaid requirement / terms and conditions based on a regulatory changes / development or as deemed appropriate by AMFI in future.

Please also note that AMFI role is only limited to empanelment of ERPs pursuant to SEBI directive, and it is entirely upto the AMCs to engage the services of your company based on their own evaluation. Further, please note that *AMFI neither endorses, nor is responsible for the efficacy or appropriateness of the ESG Scoring methodologies employed by your company,* and the company shall invariably state accordingly in any external communication related to this empanelment.

Please acknowledge receipt and your acceptance of the aforesaid terms and conditions.

With best regards,

**N. S. Venkatesh**
**Chief Executive**

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## ANNEXURE A

## I. Common approach for ESG Rating Methodology - Key parameters

a. The ESG Rating methodology should have various Environmental ("E"), Social ("S") as well as Governance ("G") parameters as tabulated in the next section.

b. It should provide an aggregate ESG score, a pillar level score for each of "E", "S" and "G" factors, as well as the material issue level scores. (For instance, if carbon emissions as well as water consumption are a part of "E" pillar, then scores should be available for carbon emissions and water consumption factors individually, as well as for the "E" pillar as a whole. The ESG score would be a weighted average combination of the "E", "S" and "G" pillar scores.)

c. It should have a sector level overlay on individual company scores. This would enable sector level ESG risks/opportunities to be captured in the company scores. For instance, if a bank does not have many water reduction related initiatives, then its score may be low, but a sector level overlay would reduce the weight on water for a bank since it is not material to the sector and even out the score

d. Industry comparison should be available in the report either in the form of peer comparison or with respect to industry averages

e. It should capture ESG controversies as a negative scoring layer and the subsequent resolution of the controversies should reflect in the rating change

f. The ESG rating should be updated at least once every year. Controversies, material / significant events and developments, such as resignations of independent directors, notices from pollution control board, etc. should be captured and reviewed immediately and the ESG Ratings updated promptly – within .... days.

g. Management indicators should cover policies, practices, performance against metrices as well as future targets and strategies of a company in each area.

h. Trendline data of last three years should be captured in the methodology.

i. ESG scores should either be available in public domain or sent to the companies in confidence, so that the companies can discuss their ratings with the rating agency.

j. The ESG rating agency should cover at least top 1000 listed entities by the end of the calendar year 2023.

k. The ESG rating agency and its related parties should not take up any consulting assignments for improvement of ESG Ratings of any company that they rate to ensure transparency and unbiased approach.

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## II. ESG Parameters

**(to be included/weighted in company scoring subject to sector level materiality)**

The assessment on all the E, S and G factors should be a combination of policy frameworks, historical performance and future targets and strategies. The methodology should also combine risks, management of risks and controversies. The parameters for each of the pillars viz. Environmental, Social and Governance are as follows:

| Environmental ** | Social | Governance |
|---|---|---|
| 1. Air emissions (NOx, SOx, PM, VOCs) | 1. Labour/Employee Relations | 1. Board independence |
| 2. Energy Consumption | 2. Health and Safety | 2. Board diversity |
| 3. GHG emissions/Carbon emissions | 3. Community Relations | 3. Constitution of Board Committees |
| 4. Water Consumption | 4. Gender Diversity | 4. Split Chairman/CEO Roles |
| 5. Waste-water generation | 5. Product/Service Quality | 5. Independent Director resignations before term |
| 6. Solid Waste generation | 6. Privacy and Data Security | 6. Independent Director attendance |
| 7. Hazardous Waste generation | 7. CSR | 7. Independent Director over-boarding |
| 8. Deforestation/Biodiversity | | 8. Independent Director tenure on the board |
| | | 9. Director Remuneration |
| | | 10. Auditor resignations before term |
| | | 11. Audit qualifications on financial statements |
| | | 12. Related party transactions |

** A Pictorial flowchart to explain how to arrive at "E" pillar score is shown in Fig. 1 in **Annexure B.**

**Controversies w.r.t. all material issues should be captured with a negative score attached to the same.**

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## III. Broad Principles of Scoring of Parameters

### Scoring of Individual factors:

The factors provided in the above table need to be scored individually based on the company's inherent sectoral risks as well as the company's existing and future efforts to mitigate the risks. For example, if "air emissions" or "water consumption" are being rated as factors under the "E" pillar, then they should incorporate the following variables:

i. Sector Risk: For example, Cement sector would have a high risk of air emission than IT sector. This variable risk from the sector perspective should be captured in the score

ii. Company Policy: This means that a broad policy statement regarding a company's focus on any individual factor like air emissions should be clearly articulated in a publicly available policy document

iii. Company's initiatives and programs: While policy documents lay out a broad approach towards management of a factor, availability of specific programs and initiatives, substantiate the policies. The companies should be rated against such initiatives too

iv. 3-year trend data: To avoid the risk of greenwashing, at least last three years' trendline should be considered to see whether the policies and initiatives are having the desired impact on the factors such as air emissions or water consumption

v. Company's future strategy and targets: While a company may be doing well today, the methodology should also consider the future strategy and targets for improvement. This may be aligned to India's broader commitments to global goals like the Climate Commitments or the SDGs. This should also cover the company's performance against the set targets periodically

vi. Controversies: Despite having lower risks, and higher management practices, companies may still get exposed to incidents that may result in brand value deterioration, regulatory penalties, lawsuits or other kinds of negative value. Such incidents should have a negative bearing on the score of a factor/pillar/company

### 1. Scoring of "E" pillar:

Figure 1 provides a flow chart which gives guidance on how scores may be arrived at for each pillar "E", "S" and "G" by taking into account the guiding factors behind each score. For the flowchart, the example taken here is Cement Sector, the factors taken here as examples are air emissions and water consumption and the pillar taken is Environment. In this example, a cement company is being rated. It has a specific weight on air emissions, water consumption and other environmental factors according to sectoral materiality. Air emission sectoral risk is combined with the company's policies to mitigate air emission, its specific initiatives /programs to reduce air emissions, its actual data where reduction has happened in last three years and its future strategy and targets to reduce air emissions.

A negative overlay of controversies is combined to arrive at a factor score for air emissions. Similarly, another factor score is arrived at for water consumption. The combination of all these individual environmental factor scores will lead to the Environmental pillar score. This pillar weight should be the sum of the total pillar weight allotted to "E" under ESG rating.

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## 2. Scoring of "S" pillar:

The methodology should follow the same process to calculate the social factor scores as well and combine them into an "S" pillar score. For instance, cement sector risk for labour relations, company's policies, practices, trendlines, targets and controversies would lead to a factor score for labour relations. This will be combined with other social factor scores like health and safety to give the "S" pillar score.

## 3. Scoring of "G" pillar:

For governance factors, sectoral risk scores do not need to be considered as governance factors are important for every sector. Similarly, most G factors would not have a separate policy or initiatives for improvement. Therefore, for Governance parameters, the companies should be rated against each factor based on the current year's performance. For example, if the board is independent at the time of rating, then it would deserve better score, however, if there are subsequent resignations of independent directors, then the "Board Independence" factor score would reduce in real time and subsequently the "G" pillar score would change too. Similarly, in case the Director's remuneration is much higher than the industry average then it should invite reduction in "Director Remuneration" factor score, however, if in subsequent disclosures, the remuneration improves, then the factor score should increase in real time and the "G" pillar score would show that change. Negative scoring on controversies will be applicable in governance factors too. All the "G" factors would be weighted and would be combined to arrive at the "G" pillar score.

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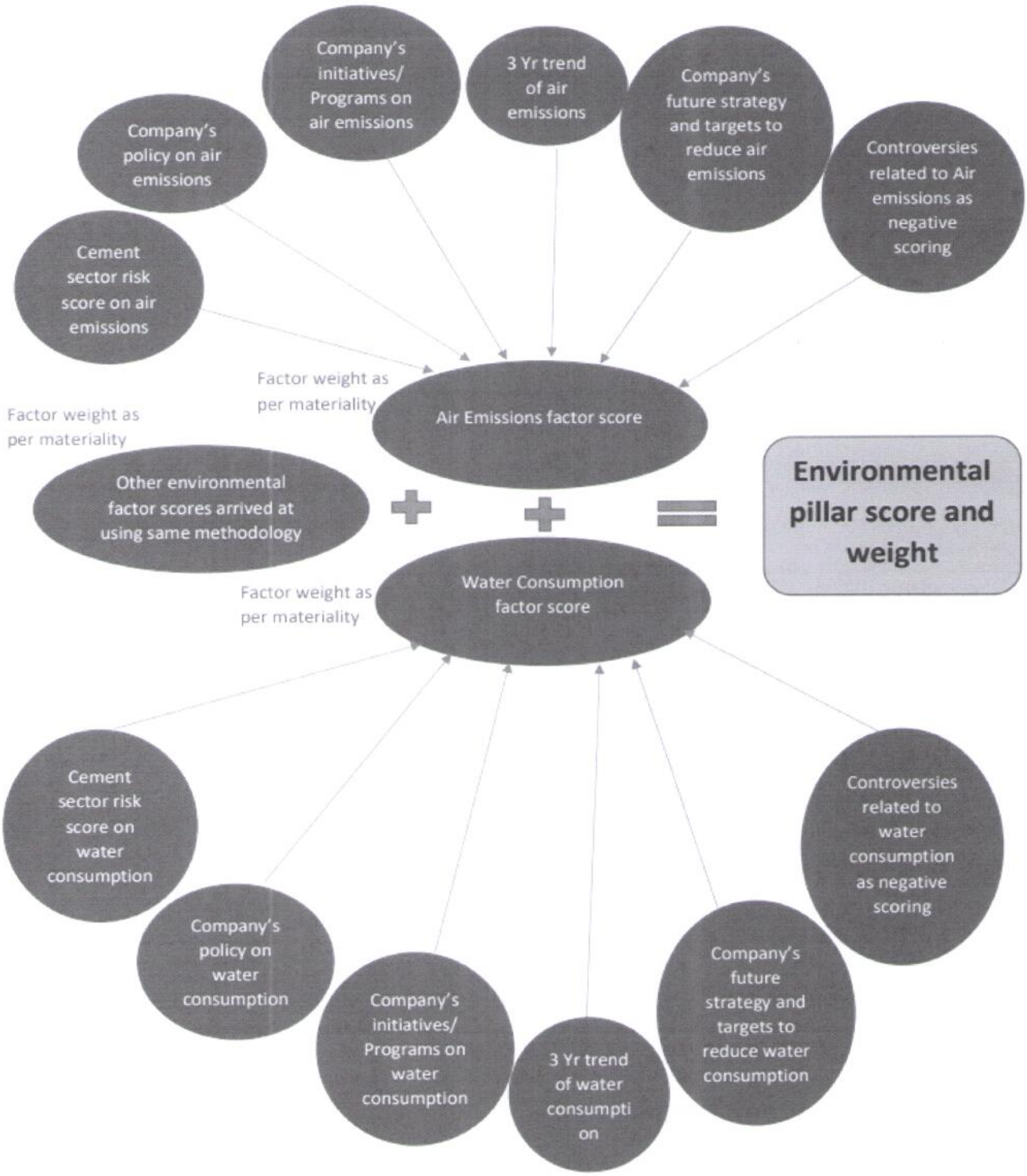
**ANNEXURE B**

**Fig 1: Flowchart to explain how to arrive at "E" pillar score**

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