ESG Risk
Assessments & Insights

2025

ESG Rating Methodology

Contents

Overview of ESG Rating Methodology

Investors and stakeholders increasingly acknowledge that using Environmental, Social and Governance (ESG) factors in investment analysis is beneficial to portfolio selection as there is a strong correlation between ESG and financial performance of companies.

Businesses that have robust ESG risk management procedures are more likely to increase shareholder value and long-term shareholder returns. Hence, stakeholders track the ESG performance of their company are keen to assess the ESG performance of prospective investment opportunities as well as track the ESG performance of their existing investments on an ongoing basis.

Scope of ESG ratings

To assess a company's ESG risk management, investors and stakeholders need to understand the company's strategy and performance of ESG indicators. To provide meaningful insights, ESG Ratings must cover:

1. Details of all environmental risks, for example Air Emissions, Water Efficiency, environmentally responsible supply chain, Environmental management, and so on, how the strategy translates to superior ESG performance measured by achievement of numerical targets. The evaluation must consider the materiality of risks, susceptibility of a company to specific ESG risks and the company's strategy to manage these risks. The efficacy of a company's risk management framework can be assessed by scrutinizing the results of the company's environment management practices. Usually, the outcomes are evident through reductions in emissions, reduction in waste, better use of water, etc. and if the results are aligned with the targets the company has set for itself, the ESG risk management framework can be assumed to be effective.

2. Similarly, for social compliance, the evaluation must examine how a company manages Human Right, Occupational health & safety, Employee development, etc. For example, does the company take employee health and safety, career development and labor rights into consideration while developing its policies, plant location and investment outlays? Is the company engaged in community support and development? Does it require its supply chain to follow ESG principles?

3. For governance, the evaluation must cover Board structure, Board committee, Auditor independence, amongst others. For example, the choice of its board members, independence, diversity and experience, shareholder rights measured by their ability to vote on important issues, etc. Again, the evaluation must cover both materiality of risks, susceptibility to risks and the company's risk management framework.

ESGRisk.ai ’s approach to ESG ratings

ESGRisk.ai’s ESG Rating model and report are designed to quantify ESG performance on a uniform scale across industries, based on industry-specific benchmarks and peer performance analysis. This approach helps investors and other stakeholders quickly understand and quantify an issuer’s ESG risk exposure and risk management framework.
While all data used for ESG ratings provided by ESGRisk.ai is collected and analyzed from publicly available sources, ESGRisk.ai also provides subscribers an option to review data used for ESG Rating of their company and provide feedback to ESGRisk.ai for any corrections, if needed.

ESGRisk.ai’s ESG rating provides a summary of the company’s ESG strategy, programs/initiatives, results and controversies across 34 Key Issues, including GHG emissions, water efficiency, environmental management, ESG oversight, human rights, supply chain, Minority shareholders’ rights, among others. The ESG ratings are based on a wide range of 1108 indicators that have been selected and assigned weights based on their materiality and relevance to specific industries.

Indicators are weighted and scored based on the company’s key issue specific performance. Scores are aggregated using materiality and polarity to derive the ESG rating. This document details the approach to ESGRisk.ai ’s ESG ratings.

What provides predictive power to ESG rating models?

ESGRisk.ai's analysis covers risks in the present as well as foreseeable future and evaluates not only past performance but also the ESG risk identification and mitigation strategies, processes and the overall ESG risk management framework of the company, thus allowing assessments to predict the ability of the company to foresee and manage ESG risks as and when they occur, thereby giving assessments adequate predictive power beyond traditional financial metrics.

Summary of a comprehensive ESG rating assessment

ESGRisk.ai defines ESG Rating as an objective and comparative opinion on the ability of an entity to mitigate Environment, Social and Governance (ESG) risks on its business operations and financial performance over the long term. Essentially, it is a comprehensive and relative assessment of the risk management practices adopted by a business entity to guard against the adverse impact of environmental, social and governance factors. Therefore, an ESG Rating can be a reliable indicator of long term and sustainable shareholder value. The assessment also includes a benchmarking of the ESG practices of the entity with that of the listed peers in the specific industry.

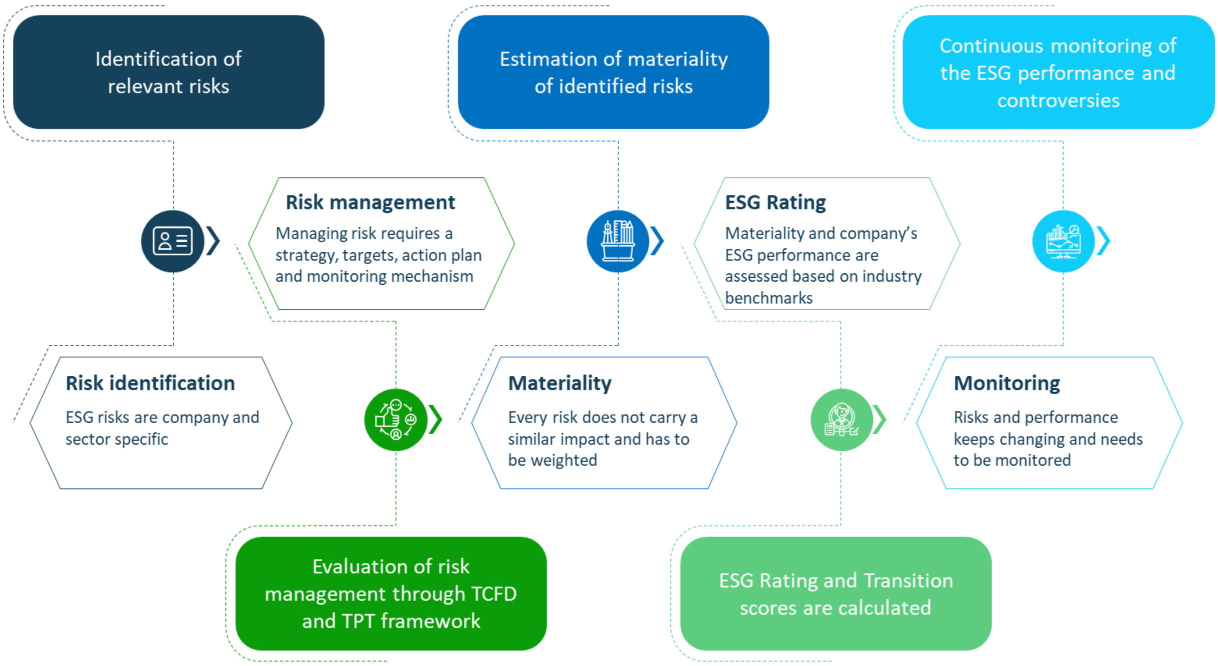

Figure 1: ESGRisk.ai framework for ESG rating.

Understanding ESGRisk.ai's ESG data taxonomy

A comprehensive assessment for ESG rating requires identifying all material ESG risks and evaluating the company's risk management practices to proactively address these risks. Since every company has exposure to a wide variety of risks and each risk impacts a company to varying degrees, the evaluation of exposure and scoring of the risk management process must be structured in a hierarchy where individual data points pertaining to the risk exposure and management can be aggregated to evaluate the performance. ESGRisk.ai aggregates data in three levels, viz.: The Key Issue, Theme and Category level, each of which is the next level of aggregation for hierarchical risk evaluation.

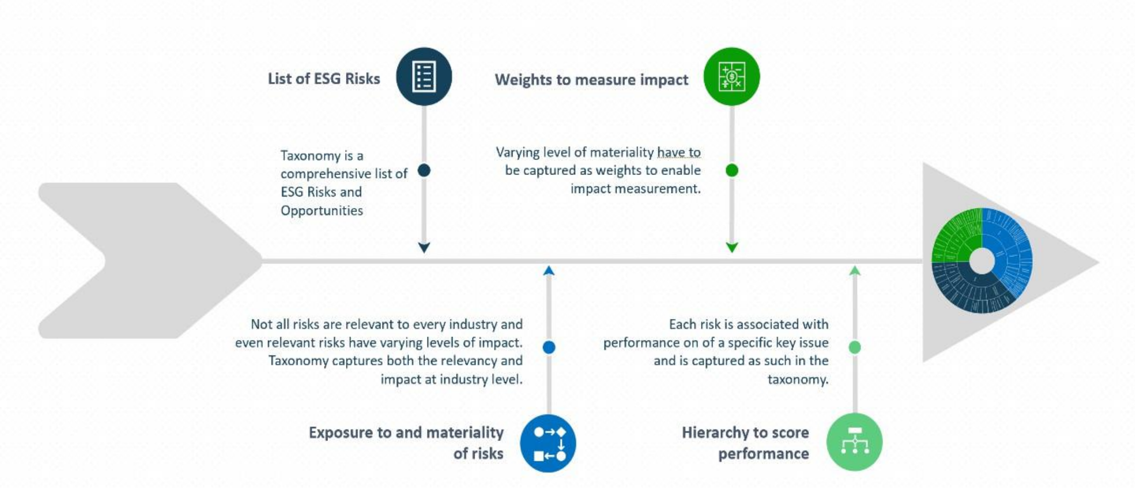

Figure 2: Overview of ESGRisk.ai's data taxonomy.

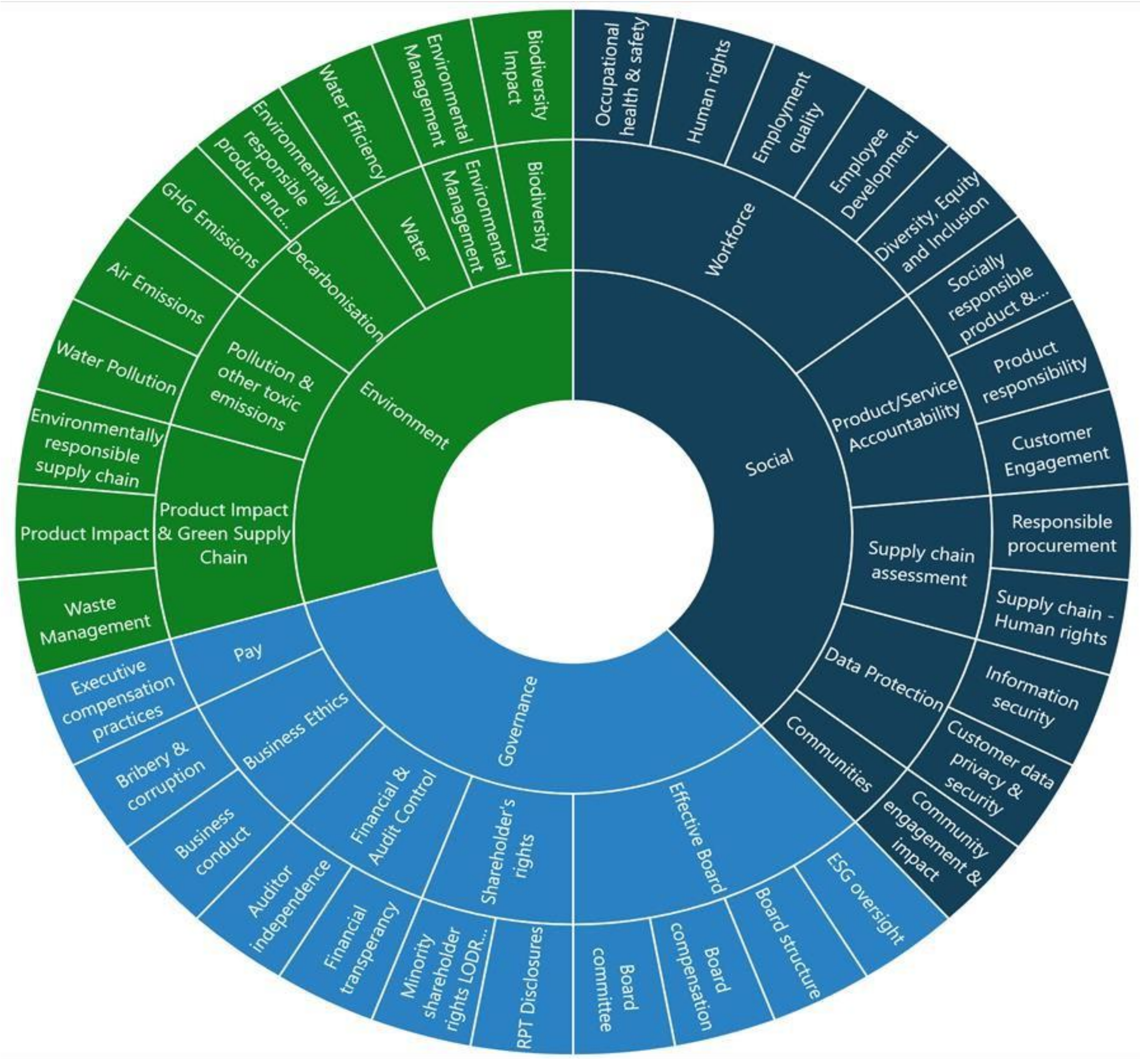

Figure 3: Visual representation of ESGRisk.ai's Data taxonomy.

As evident from the above chart, ESGRisk.ai 's ESG ratings are based on three categories, 16 themes with – 6 in Environment, 5 in Social and 5 in Governance.

The performance on these 16 themes is assessed by measuring across 9 functions like strategy, governance, risk management, ambition, action etc. on 34 key issues and 1108 data points as shown in Figure 4 below.

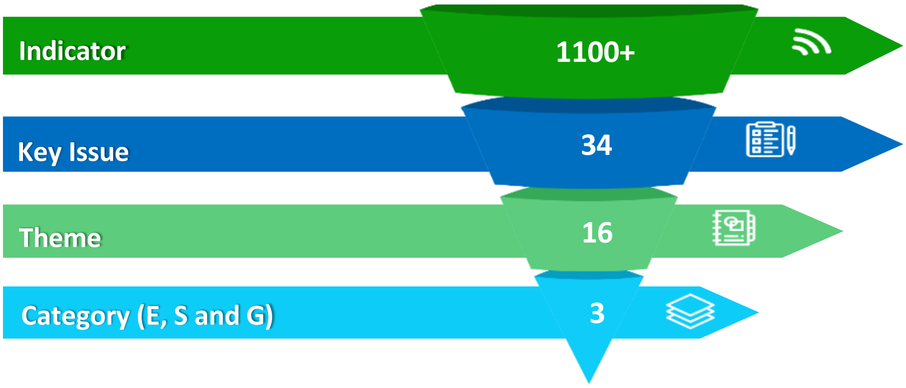

Figure 4: Four levels of ESGRisk.ai's data taxonomy.

We have used a combination of TPT and TCFD* framework and their disclosure requirements, for identifying the relevant factors to be measured.

TPT framework was introduced in October 2023. It provides a holistic approach to assessing ESG performance by considering multiple factors. Transparency ensures that companies are open about their practices, performance evaluates their current ESG performance, and targets look at their goals for improvement. It holds companies accountable for their ESG practices. Companies can identify and address ESG risks proactively, reducing the likelihood of negative impacts on their business operations. It offers a structured and comprehensive approach to ESG ratings, helping companies improve their ESG performance & manage risks. This is a global framework aligned with IFRS S2 (Final Climate related disclosure standard) issued by the ISSB.

TCFD framework provides a structured approach to climate-related disclosure, the TCFD framework enables companies to make more informed decisions and communicate risks and opportunities to their stakeholders.

* TPT is the 'The Transition Plan Taskforce' and TCFD is the 'Task Force on Climate-Related Financial Disclosures'.

Guidelines on Information Sources for the ESG Rating

ESGRisk.ai bases its ESG ratings on company disclosures and publicly available information.

Information Source	Frequency of Update
Annual Report/Annual Returns	Annual
CSR, BRSR report	Annual
AGM notice, press releases, vote results	Annual
Company website	Daily
News	Daily
Stock exchange disclosures	Daily

Table 1: Information sources for ESGRisk.ai

ESGRisk.ai ’s ESG ratings and quality process

All data collected and analysed for the ESG rating assessment of a company’s ESG performance are from publicly available sources. Once the data is collected, there is an in-depth quality assurance process at each stage.

After quality assurance, primary analysis is done to arrive at score using the data and model. These initial ESG ratings along with the peer comparison are used by the analyst to review the company’s performance on ESG parameters for assigning ESG ratings. The ratings assigned by the analyst are then reviewed for quality and process compliance. The ESG rating and analysis is presented to a rating committee, which comprises of members with sustainability expertise to meaningfully assess the ESG performance. The rating committee approach ensures ESG assessment of an entity by experienced professionals, thereby ensuring objectivity of the rating. Once approved by committee, rating is published on India 360 portal.

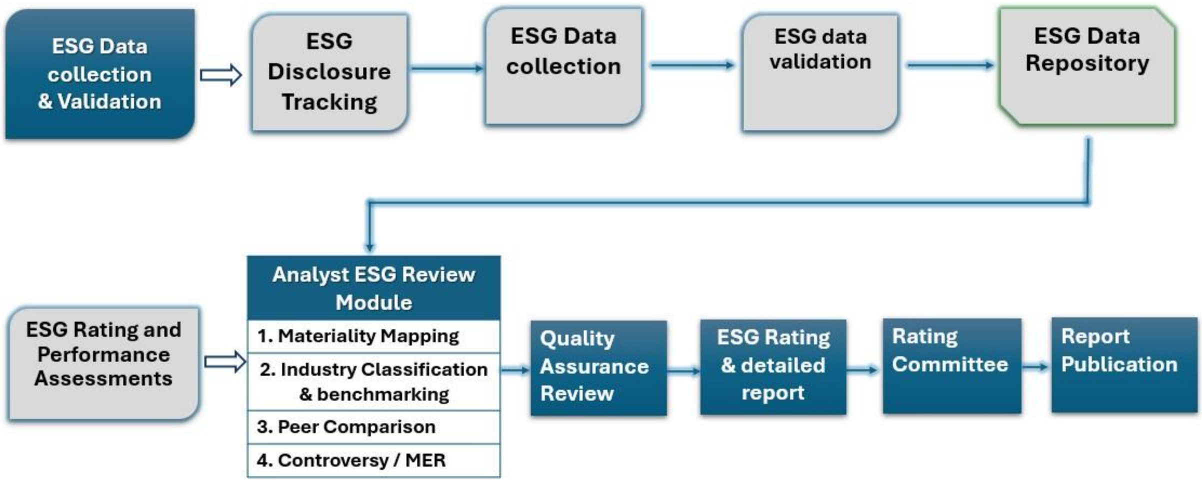

Figure 5: ESGRisk.ai's ratings and quality process.

ESGRisk.ai ’s approach to surveillance and rating updates

Although most of the data for ESG ratings is sourced from annual disclosures, some of the data sources provide event-based updates. To reflect changes to ratings from data that are dependent on ad-hoc information, ESGRisk.ai continuously monitors controversies and corporate events. With every update on controversies or corporate events, ESGRisk.ai reviews and updates the ESG rating for the company, adjusting the rating as necessary based on the new information.

The ESGRisk.ai’s ESG rating framework evaluates the company’s performance across 1100+ data points, that aggregate to key issues and themes which are then combined to evaluate the performance on E, S and G. The score on each key issue is a combination of the company's risk management framework to deal with a specific ESG risk and materiality of the risk to the industry in which the company operates.

At times despite a robust risk management framework and robust program implementation, there may be certain events that expose gaps in the ESG risk management framework. These events usually come to light through controversies and are also factored in our assessments. Thus, again the report is updated with new ratings and published as well.

Components of ESGRisk.ai 's ESG rating

The ESGRisk.ai's ESG rating is comprehensive and includes the following steps:

1. Assigning relevancy and materiality to the KIs and then the ESG risk factors
2. Scoring each factor and then aggregation at the KI level
3. Assigning ratings
4. Assigning the transparency score of the company

Above steps are detailed in the sections that follow.

Indicator Materiality and Relevancy

The materiality and relevance of indicators vary across industries. Hence for assessments, weights corresponding to the indicator's materiality in a specific industry are assigned. They range from very high materiality to marginal material. For example, GHG emission reduction is considered as very high materiality for mining companies while GHG emissions are only marginally material for real estate and financial services companies. Diversity and inclusion strategy on the other hand is not highly material for mining companies but is of very high materiality for financial services and real estate companies.

The ESGRisk.ai materiality and relevancy framework ensures a company's ESG rating is not negatively impacted if the company does not disclose their risk management framework on issues that are not considered material to that specific industry. Vice versa, the company's ESG rating is adversely impacted if it does not report on issues that are material.

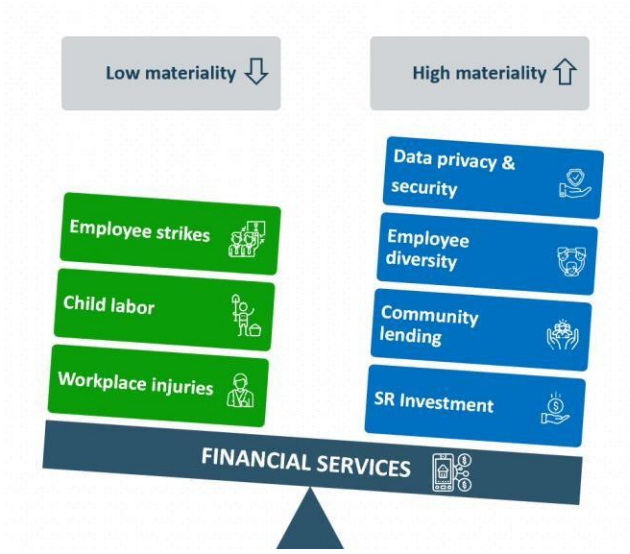

Figure 6: Example of materiality in financial services.

On an average, the environment, social and governance weightages are as follows:

Category	Environment	Social	Governance
Weightages	29%	37%	33%

Assigning Functional Weights

Considering the model that uses disclosures under TCFD and TPT frameworks, the weight reflects the key aspects in evaluating the principles highlighted by these two frameworks.

To evaluate key aspects of the risk management framework, ESGRisk.ai assesses a company's:

1. **Strategy/Ambition** – by evaluating policies and governance frameworks that the company has instituted to address crucial ESG risks and issues.
2. **Targets to measure performance** (results) against the objectives set by the company.
3. **Company's compliance** with specific sections of the Company's Act 2013 or SEBI guidelines
4. **Performance/Action** – by evaluating programs or initiatives that the company has put in place to address key issues.

   Results/Accountability – by evaluating quantitative information reported by the company on specific ESG issues such as energy use, total CO2 emissions, women employees, fatalities, training costs, etc. Results are usually measured against the targets set by the company.

Scoring Framework

ESG rating - This is the overall ESG rating assigned to a company taking into consideration all material indicators based on the sector to which it belongs to, and the weights assigned to the indicators under the respective sector/industry.

Transition Score - Score would reflect the changes that the company has made over recent years or concrete plans/targets to address the risk and opportunities involved in transitioning to more sustainable operations.

Core ESG Score – Core is a subset of the comprehensive Business Responsibility and Sustainability Report (BRSR) as defined by SEBI, for the top one thousand listed Indian companies, which comprises of specific set of key performance indicators (KPIs)/metrics across the nine ESG attributes. Core ESG Score is based on third-party assured/assessed or audited data disclosed by the Company

Core Transition Score - Score depicting transition using the third party assured or assessed or audited data disclosed by the Company.

ESGRisk.ai incorporates its transition assessment in its ESG ratings and Core ESG ratings, Hence, as per SEBI regulations, ESGRisk.ai does not separately offer Combined Score or a Core Combined Score.

Within each category, each indicator is scored based on two aspects, viz. its function in the risk management framework indicator and the risk it represents.

A company's risk management framework is evaluated using its strategy/compliance/targets, programs/initiatives, as well as the results of the same measured against targets set by the companies themselves.

To ensure comparability of companies within the industry, quantitative indicators will be normalized. This will be done consistently within industries in the universe. Examples of common normalization factors used in the model are percentage, ratio to people / revenue or conversion to standard units.

Indicators are then weighted based on their industry materiality and relevancy, e.g.: if not relevant or material to an industry, the indicator will be assigned a weight of 0. Weightages to the material indicators will be assigned basis its relevance to the industry. More details regarding indicator materiality and relevancy are provided in the sections Indicator Materiality and Relevancy.

Results are usually quantitative and cannot be scored in isolation to industry benchmarks. Hence ESGRisk.ai consistently uses a comparison-based approach for scoring results, where the comparison of performance iswith other peers in the specific industry. In such cases the weight is assigned using a percentile approach.

All the DP scores are aggregated to generate scores at key issue level and further used to get the ESG ratings for the company along with the other scores.

Scoring controversies

Controversies are unfailing indicators of the gaps in an issuer's risk management framework. The inability to foresee and manage a risk is starkly evident when the company faces controversies arising from its inability to address adverse events when they are encountered in the normal course of business.

A company's involvement in controversial events that have an impact on the environment or society are also considered in the assessment of the ESG rating.

Controversies have varied levels of impact and the issuers themselves have varying approaches to managing adverse events. ESGRisk.ai's model evaluates the fragility of the risk management framework based on the magnitude of the controversy's impact. The controversy impact is categorized as low, medium, high and very high. The deductions are made to the scores computed using the latest disclosures.

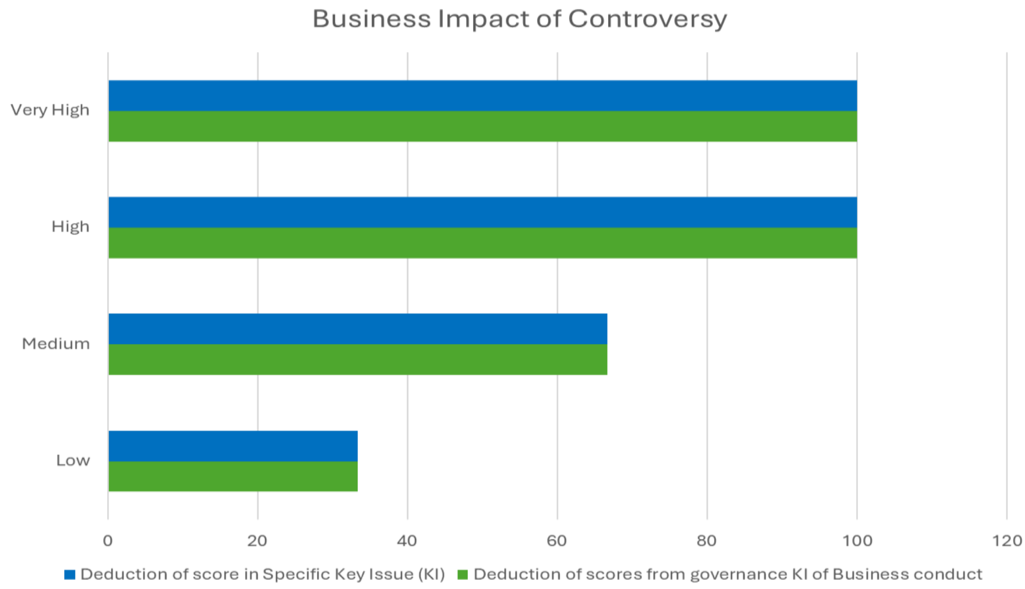

Figure 7: Impact of controversies on scoring

Treatment of controversy cases where remediation action has been taken by the company.

Any such case where remediation action has been taken by the company, but the negative news was not captured earlier as the same was not reported by any news media sources or company's corporate announcements at the time when the incident had originally occurred, will be treated as follows:

- The original event occurred less than 2 years ago from the date of remediation: In such cases, the controversy will be assessed as per the current methodology and ratings will be assigned accordingly.
- The original event occurred 2 or more years ago from the date of remediation: In such cases, the controversy will be treated as an extenuating circumstance and will be recorded as a "Low" impact controversy.

Note that the controversy and impact will be assessed by the analyst and impact may vary case to case from the points mentioned above.

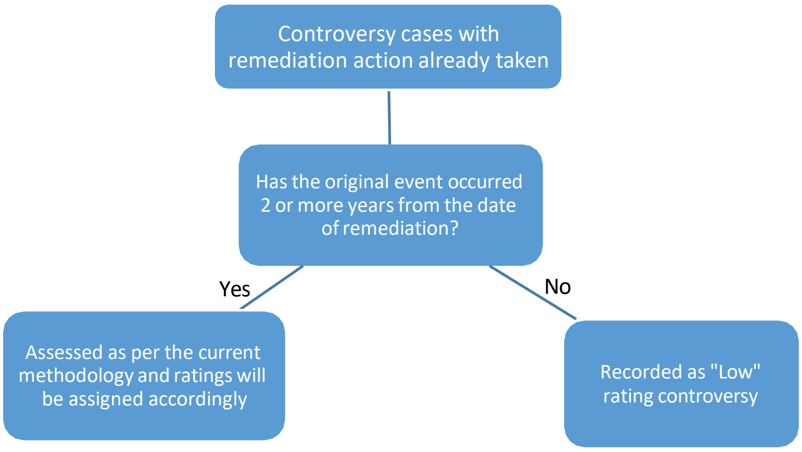

Figure 8: Flowchart for treatment of controversy after remedial actions

Assigning ESG rating

Figure 9: Process of arriving at final ESG Rating

The analyst proposes at the company's final ESG rating, following the below steps:

- Review and change the industry classification if required. Both relevancy and materiality are industry specific and assigning the correct industry code is crucial to evaluate the appropriate risks. ESGRisk.ai 's analysts, based on the company's reviews and exposure to different industry segments, confirm or change the industry classification.
- Review and change the materiality of indicator if needed. Ever so often, companies are exposed to specific risks due to operational reasons (for example over-dependence on hazardous materials for manufacturing) or business reasons (for example trade with countries that are ranked poorly on corruption indexes). In such cases the materiality of certain risks may have to be increased. Hence, the analysts review the business construct and change the risk materiality where relevant.

- Select different peers if needed to make the comparison more meaningful. This is being done to make the analysis more representative of a company's ESG risk given the business exposure. For example, if a company is processing tobacco as well as manufacturing confectionary, the peer selection may have to cover multiple industries.

ESG Rating Scale		Class	What the ESG rating signifies
High End	Low End		
100	71	Excellent	An ESG leader who demonstrates an **exceptionally strong** track record in managing material ESG risks through a robust risk management framework
70	61	Strong	An ESG leader who demonstrates a **strong** track record in managing material ESG risks through a robust risk management framework
60	46	Adequate	A company who demonstrates an **adequate** track record in managing material ESG risks but has an inadequate risk management framework
45	31	Inadequate	A company who has a **below average** track record in managing material ESG risks along with an inadequate risk management framework
30	0	Poor	A company who has a **poor** track record in managing material ESG risks along with inadequate risk management framework

Table 2: Classification of ESG Rating.

Finally, based on the above table, the analysts propose a rating and write a summary explaining the category specific and the overall risks and strengths of the company's ESG risk assessment which is taken to ESG rating committee. The rating is then assigned by the committee and then published on ESGRisk.ai's website. The detailed rating report is accessible to the subscribers through India 360 portal.

Scoring a company's ESG disclosures and transparency

Based on the company's disclosure of indicators, ESGRisk.ai will compute and publish two transparency scores, one will score the level of overall disclosures and the second will score the BRSR disclosures, relevant in the Indian context.

Overall transparency score: The overall transparency score is calculated as:

Number of indicators where performance can be ascertained through disclosures / Total material indicators.

BRSR transparency score: BRSR transparency score is based on indicators that correspond with BRSR disclosures and is calculated as

Number of indicators corresponding to BRSR disclosures material to the industry where company has performed or complied / Total material indicator corresponding to BRSR disclosures.

Methodology maintenance and update

In regular intervals, ESGRisk.ai reviews the materiality of each indicator assigned to each industry as well as their weights. Revision is a forward-looking process to identify emerging issues and reduce or eliminate issues that are receding in prominence. As part of the review, ESGRisk.ai updates its clients about proposed changes and seeks their feedback.

Intermediate reviews will be performed on a discretionary basis.

ESG Risk
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