Vigeo Eiris - Methodology
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# ESG Assessment Methodology

# Executive Summary

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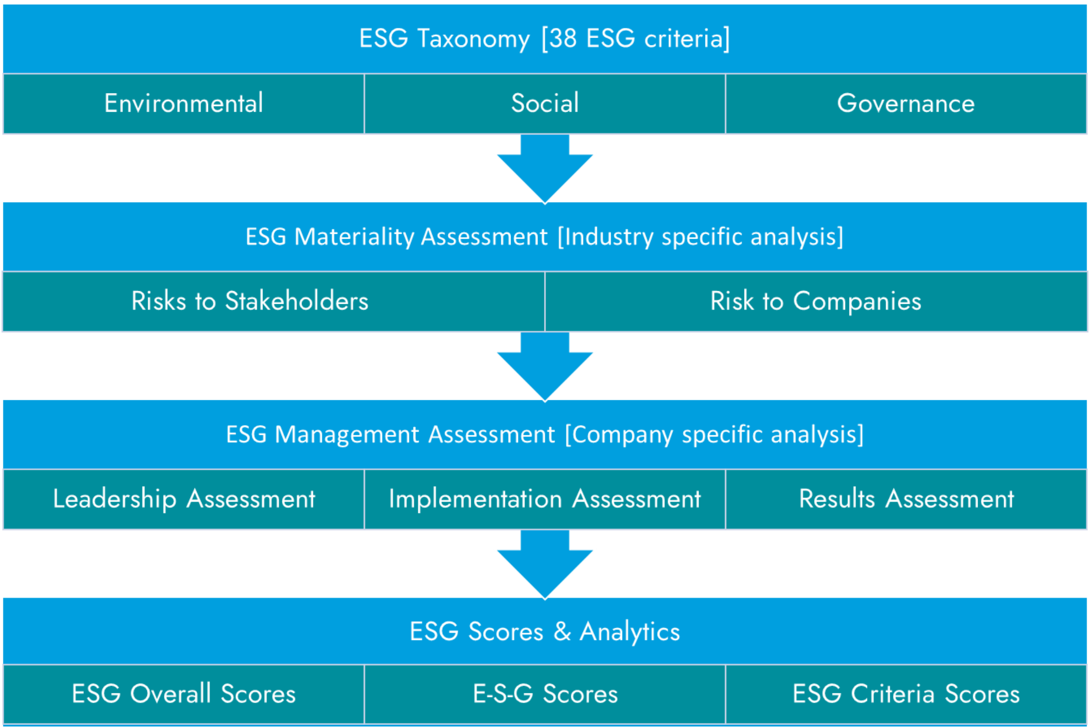
# 1. What do we measure?

VE's ESG scores measure the degree to which companies take into account and manage material Environmental, Social and Governance factors[1]. Companies with higher ESG scores are stronger at managing relationships with their stakeholders. They are also less likely to experience business disruption or miss opportunities due to a failure to consider and meet their stakeholders' expectations. This, in turn, can better position them to mitigate risks and create sustainable value for shareholders over the medium to long-term. In order to generate our scores, we analyse and score up to 38 distinct ESG criteria that are framed within 40 industry specific models.

Figure 1: The Flow of our ESG Assessment Analysis and Output




[1] Factors are defined as those business risks and opportunities that affect sustainable value creation for the company and/or its stakeholders.

# 2. ESG Criteria

The table below shows the 38 ESG criteria, the management of which we assess to generate our company scores.

Figure 2: ESG criteria

| ESG Pillars and the associated ESG Criteria | | |
|---|---|---|
| **Environment** | **Social** | **Governance** |
| Environmental Strategy | Social Dialogue | Anti-Corruption |
| Accidental Pollution | Employee Participation | Anti-Competition |
| Green Products | Reorganization | Lobbying |
| Biodiversity | Career Management | Board of Directors |
| Animal Testing | Remuneration | Audit & Internal Controls |
| Water | Health & Safety | Shareholders |
| Energy | Working Hours | Executive Remuneration |
| Atmospheric Emissions | Information to Customers | Product Safety (G) |
| Waste | Customer Relations | |
| Local Pollution | Suppler Relations | |
| Transportation | Social Standards on the Supply Chain, | |
| Use & Disposal of Products | Social & Economic Development | |
| Environmental Standards in the Supply Chain | Societal Impacts of Products & Services | |
| | Philanthropy | |
| | Fundamental Human Rights | |
| | Fundamental Labour Rights | |
| | Non-Discrimination | |
| | Child & Forced Labour | |
| | Product Safety (S) | |

On each of these ESG criteria, we generate scores from 0-100. The scores available allow users to easily identify areas of stronger and weaker management approaches that in turn expose companies to different types of risk. These criteria have been set within our framework for over 10 years providing a long back-history of performance data to understand trends at company and sector level.

Each criterion has a defined set of 'Principles of Action'. These determine the active content of our analysis and articulate the actions that we would expect a high-performing company to undertake in this dimension. We derive these principles from universally recognized norms and standards emanating from organizations such as the UN, ILO and OECD. Amongst others, these include:

- The Ten Principles of the Global Compact of the United Nations, 1999
- The OECD Guidelines for Multinational Enterprises, 2011
- The Fundamental Conventions of the International Labour Organization
- The Universal Declaration on Human Rights, 1948
- The Sustainable Development Goals of the United Nations, 2015

### Figure 3: Example - Health and Safety Criterion

Figure 3 illustrates the principles of actions underlying the Health and Safety criterion (a Social criterion), and the international guidelines from which these principles are derived.

| | Standard Setters & Standards | | |
|---|---|---|---|
| PRINCIPLES OF ACTION | The ILO<br><br>[International Labour Organisation] | The OECD<br><br>[Organisation for Economic Cooperation and Development OECD] | The GRI<br><br>[Global Reporting Initiative] |
| 1. Define and continually improve health and safety systems and ensure they are known and respected. | ILO Decent Work Agenda 2015-2030 | OECD Guidelines for Multinational Enterprises – Employment and Industrial Relations Theme | GRI Standard - 403 Occupational Health and Safety |
| 2. Put in place systems to prevent accidents and occupational diseases. | ILO Occupational Health & Safety Convention (1981) | | |
| 3. Put in place systems to prevent psychosocial risks and work related to stress. | | | |

By framing our methodology around the expectations for corporate social responsibility that have been set by standard setters, we ensure that we are assessing issuers on elements that they are objectively considered to be responsible for.

# 3. ESG Materiality Assessment

We recognize that the challenges facing companies are not uniform. Our assessment models are therefore customized to a range of industry specific models. In each industry framework, the 38 generic ESG criteria are assigned a weight from w0 (not relevant to the sector) to w3 (highly material to the sector). Weighting is based on the significance/ prominence of relevant stakeholder rights in international reference texts, as well as industry-specific risks to the company and its stakeholders (see Figure 5). On average, a given sector has 25 criteria deemed relevant to it, with an industry-specific materiality weight assigned to each criterion.

Figure 4: 40 industry frameworks

| 40 Industry Frameworks | | | |
|---|---|---|---|
| Infrastructure | Finance | Food & Health | Telecommunications, Media and Technology |
| Real Estate | Diversified Banks | Food | Technology & Hardware |
| Heavy Construction | Retail & Specialised Banks | Beverage | Software & IT |
| Home Construction | Development Banks | Tobacco | Publishing |
| Local Authorities | Specific Purpose Banks | Health Care | Broadcasting & Advertising |
| Building Materials | Insurance | Pharmaceuticals & Biotechnology | Telecommunications |
| | Financial Services General | Luxury Goods & Cosmetics | |
| Energy & Utilities | Services | Industrials | Basic Resources |
| Waste & Water | Business Support Services | Aerospace | Chemicals |
| Electric & Gas | Hotel & Leisure | Automobiles | Mining & Metals |
| Oil & Gas | Specialised Retail | Electric Components & Equipment | Forest Product & Paper |
| Energy | Supermarkets | Industrial Goods & Services | |
| | Travel & Tourism | Mechanical Components & Equipment | |
| | Transport & Logistics | | |

Figure 5: ESG Criteria weighting approach[2]

| Weighting Criteria | | | |
|---|---|---|---|
| **Nature of stakeholders' rights, and expectations** | **Risks to stakeholders** | **Risks to companies** | **ESG Criterion Weight** |
| Framed as fundamental stakeholder rights in international reference texts.<br><br>*For example –*<br>*Human Rights*<br>*Labour Rights* | Stakeholders in the sector are highly exposed if companies do not manage their responsibilities.<br><br>Companies are using high volumes of raw materials or emitting high volumes from an environmental perspective (high environmental footprint) | High risk to a company's reputation, human capital, operational efficiency or exposure to legal risk. | W3<br>Highly Material |
| Framed as important in international reference texts<br><br>*For example -*<br>*Anti-Competition,*<br>*Responsible Lobbying* | Stakeholders in the sector are moderately exposed if companies do not manage their responsibilities.<br><br>Companies are using moderate volumes of raw materials or emitting moderate volumes from an environmental perspective (moderate environmental footprint) | Moderate risk to a company's reputation, human capital, operational efficiency or exposure to legal risk. | W2<br>Moderately Material |
| Minor interests and expectations from society<br><br>*For example -Philanthropy* | Stakeholders are marginally exposed.<br><br>There is a low environmental footprint. | Low risk to a company's reputation, human capital, operational efficiency or legal risk. | W1 / 0<br>Low Materiality |

The overall weight of the criterion (w0 to w3) is determined by reference to a sum of the numerical levels assigned to the three aspects – nature of rights, stakeholder risks and company risks. The weights of criteria are important because a company's ESG Overall Score is based on the weighted average of the scores in the criteria under review. The weights of our sector frameworks are regularly reviwed to ensure their suitability.

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[2] Our materiality methodology is aligned with the double materiality perspective advocated by the European Non-Financial Reporting Directive. The approach ensures that a company's management of vulnerable/peripheral stakeholders are not excluded from our analysis. This approach helps ensure that we are measuring sustainability impact as well as ESG risk management.

# 4. ESG Management Assessment

A three-pillar managerial questioning framework is applied to each ESG criterion[3].

- Quality of leadership
  - *Visibility of the commitments*: existence of defined, understandable and accessible policies related to the criterion
  - *Exhaustiveness of the commitment:* the degree of alignment between the company policies and the principles of action expected for a high performing company
  - *Ownership of the commitment*: assignment of accountability to a person or a department for the realization of the stated objectives

- Extent of implementation
  - *Means allocated*: sufficiency of processes and measures put in place to ensure that the organization is capable of achieving its stated objectives
  - *Geographical coverage*: comprehensive coverage of all business locations
  - *Scope*: the extent to which processes and measures put in place cover all of the relevant principles of action expected for a high performing company

- Results (measures of effectiveness)
  - *KPI indicators*: objective assessment of company's performance relative to its stated objectives and its sector
  - *Stakeholder feedback*: occurrence of controversies related to the principles of action under review
  - *Controversy management*: nature of company's response to any *allegations (e.g., non-communicative, reactive, proactive).*

| | | | |
|---|---|---|---|
| Criterion Score x/100 | Leadership Assessment | - Visibility<br>- Exhaustiveness<br>- Ownership | 33% of the criterion score |
| | Implementation Assessment | - Means<br>- Coverage<br>- Scope | 33% of the criterion score |
| | Results Assessment | - KPIs<br>- Stakeholder Feedback<br>- Controversy Management | 33% of the criterion score |

[3] The systematic application of this questioning framework ensures that we generate scores on companies that are holistic in nature. We integrate a qualitative view on commitments, systems, a quantitative view using KPI analysis and supplement those aspects with feedback from third party sources for our controversy analysis.

# 5. ESG Score Generation

The diagrams within this section show how we develop our scores from the 'bottom up'. We begin with the generation of the ESG criteria scores, followed by the E-S-G scores and finally the ESG Overall Score.

## Figure 6: Criterion level scoring

This illustrates how a criterion-level score might be determined using our managerial questioning framework. Each of the dimensions outlined below are separately scored from 0 to 100. A score for each pillar is generated first. The criteria level score is then the average of the 3 pillar scores.

| Criterion Score = 61/100 | | |
|---|---|---|
| Leadership Pillar [72/100] 33% of criterion score | Implementation Pillar [76/100] 33% of criterion score | Results Pillar [34/100] 33% of criterion score |
| Visibility score (65/100) 20% of pillar score | Means score (65/100) 40% of pillar score | KPI Trends score (0/100) 30% of pillar score |
| Exhaustiveness score (65/100) 60% of pillar score | Coverage score (65/100) 30% of pillar score | Stakeholder feedback score (30/100) 35% of pillar score |
| Ownership score (100/100) 20% of pillar score | Scope score (100/100) 30% of pillar score | Controversy management score (65/100) 35% of pillar score |

Product safety criterion is assigned a total score of 61 of 100, based on the pure average of scores in the three pillars.

Figure 7: E-S-G Level Scoring

The scores for the environment, social and governance pillars are derived from the weighted average of the ESG criteria that sit beneath them. So, taking this example, the S score of 47 = ((30 x 2) + (45 x 3) + (65 x 2) + (50 x 1))/ (2+3+2+1).

| E SCORE - 58/100 | S SCORE - 47/100 | G SCORE - 28/100 |
|---|---|---|
| Environmental Management<br>[50/100]<br>(w3) | Labour Rights<br>[30/100]<br>(w2) | Board<br>[10/100]<br>(w3) |
| Water<br>[62/100]<br>(w2) | Non-Discrimination<br>[45/100]<br>(w3) | Audit & Internal Controls<br>[10/100]<br>(w3) |
| Energy<br>[62/100]<br>(w3) | Reorganisations<br>[65/100]<br>(w2) | Shareholders<br>[50/100]<br>(w3) |
| Environmental Supply Chain<br>[62/100]<br>(w1) | Economic Development<br>[50/100]<br>(w1) | Corruption<br>[75/100]<br>(w2) |

Figure 8: The ESG Overall Score

The ESG Overall Score is the weighted average of all the criterion scores under review in the issuer's sector specific framework.

| ESG Overall Score 45/100 | | |
|---|---|---|
| Environmental Management<br>[50/100]<br>(w3) | Labour Rights<br>[30/100]<br>(w2) | Board<br>[10/100]<br>(w3) |
| Water<br>[62/100]<br>(w2) | Non-Discrimination<br>[45/100]<br>(w3) | Audit & Internal Controls<br>[10/100]<br>(w3) |
| Energy<br>[62/100]<br>(w3) | Reorganisations<br>[65/100]<br>(w2) | Shareholders<br>[50/100]<br>(w3) |
| Environmental Supply Chain<br>[62/100]<br>(w1) | Economic Development<br>[50/100]<br>(w1) | Corruption<br>[75/100]<br>(w2) |

# 6. Controversy Monitoring and Alerts

ESG controversies[4] are systematically integrated into our ESG Assessments. They are monitored daily by a dedicated team. From a transparency perspective, all companies are able to view the controversies that are impacting their ESG Assessment via our VE Connect platform. Here they can view the sources, the analysis and provide additional feedback to us.

From a methodological perspective, all controversies are systematically assessed along the same axes

- The Severity of the controversy
- The Frequency of controversies on this ESG issue
- The Responsiveness of the company to this controversy

The final output is an assessment on the Controversy Risk Mitigation capacity of the company

- At case level (the event)
- At ESG criterion level (all events on a given ESG criterion)
- At E-S-G level (all events within the E, S and G pillars)
- At Overall level (all controversy events)

Where necessary, VE produces ALERTS that provide quantitative and qualitative analysis outlining precisely how the event has been assessed and how it has impacted an ESG Assessment.

Figure 10: Types of Alert

| Alert Type | Impact | Trigger |
|---|---|---|
| Downgrading | Assessment deteriorates | An event negatively impacting stakeholders that is of sufficient gravity that it reduces our opinion on the company's capacity to manage the relevant E-S and/or G responsibilities. |
| Upgrading | Assessment improves | An event leads to a sustainable and positive impact on stakeholders. An event that represents a positive radical change in stance from a company in favour of CSR objectives. |
| Confirmation | No change to assessments | An event takes place that gains widespread media coverage requiring a response from the Agency. However – the response is that we confirm the pre-existing assessment on the company. |
| Monitoring | No change to assessments | An event takes place gaining widespread media attention and requiring a public response from the Agency. However, the scope of the company's responsibilities/culpabilities remains unclear and so no change is made to the assessment. |

4 public information from traceable and liable sources that incriminates a company on ESG issues within the scope of our ESG Assessment. Such incriminations may relate to specific facts or events, to their conflicting interpretations, legal procedures or unproven claims

# 7. Data Collection

Our ESG Assessments integrate qualitative and quantitative data, management and performance data and self-reported and third-party data. Examples of the sources used are provided below.

Figure 10: Sources of data

- Corporate Reporting: CSR Reports, Annual Reports, 10K forms, Codes of Conduct/Ethics, internal policies, collective bargaining agreements etc.
- Direct company contact: Non-confidential information provided by companies in response to the VE Connect questionnaire, or during the natural course of the rating process.
- Stakeholder websites: information from key stakeholder sources such as the Carbon Disclosure Project and the Business and Human Rights Resource Centre.
- Factiva press database: news stories about the companies extracted from hundreds of global press sources.

# 8. ESG Assessment Process

Our ESG Assessments follow a 4-step process:

- Information Collection: 2 months before any analysis begins, Companies have access to our online portal VE Connect where they are able to see their previous ESG assessments and their current assessment framework. They are able to ask questions and request additional support from their dedicated ESG analyst. Over this 2-month period we encourage companies to provide responses to the questionnaire or to provide us with links to the key documents necessary for the assessment.
- Analysis: at the end of the 2-month period, our ESG analysts produce the draft assessment of the issuer.
- Draft Review: once the draft assessment has been produced and quality checked, it is provided to the issuer. They have the opportunity to review and provide commentary on the document.
- Assessment closure and publication: the commentary from the company is assessed and where necessary, integrated into the final ESG assessment. Additional quality checks are conducted and then the updated assessment goes live.

# 9. Deliverables

The deliverables of our ESG Assessment include:

- PDF reports at company level integrating quantitative and qualitative analysis
- PDF sector reports integrating quantitative and qualitative analysis
- PDF reports at portfolio level integrating quantitative and qualitative analysis
- Excel datasets with quantitative data

The results of our ESG Assessments are made accessible to investors:

- Via our VE DataLab platform
- Via FTP
- Via API

The results of our ESG Assessments are made accessible to companies:

- Via our VE Connect platform. Here they can download their ESG Scorecard which contains their most up to date scores.

# 10. Find out more

To find out more about our ESG Assessments please use the following contact details below:

- Investors: If you are interested in understanding more about our offer or require a trial access to our data and platforms, please contact Richard.porte@vigeo-eiris.com

- Companies: if you would like free access to your ESG Scorecard or want to know more about our products and services for companies, please contact Nicolas.moriceau-gomez@vigeo-eiris.com

- Press: for press enquiries, please contact Savannah.rowe@vigeo-eiris.com

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