S&P Global
Ratings

S&P Global Ratings' Proposal For Environmental, Social, And Governance (ESG) Evaluations

Sept. 24, 2018

Overview

S&P Global Ratings is in the final stages of testing its new Environmental, Social, and Governance (ESG) Evaluation analytic approach. Our proposed analysis for an ESG Evaluation is both quantitative and qualitative. We aim to provide deep insight into an entity's ESG exposure and its capability to manage this exposure by:

- Leveraging our global analytical teams' knowledge and understanding of sectors and regions to develop our ESG Risk Atlas;
- Incorporating the results of an entity-specific ESG diagnostic questionnaire to capture relevant data;
- Leveraging our existing understanding of an entity's business and peers; and
- Engaging in a substantive dialogue with management, including members of the board as appropriate.

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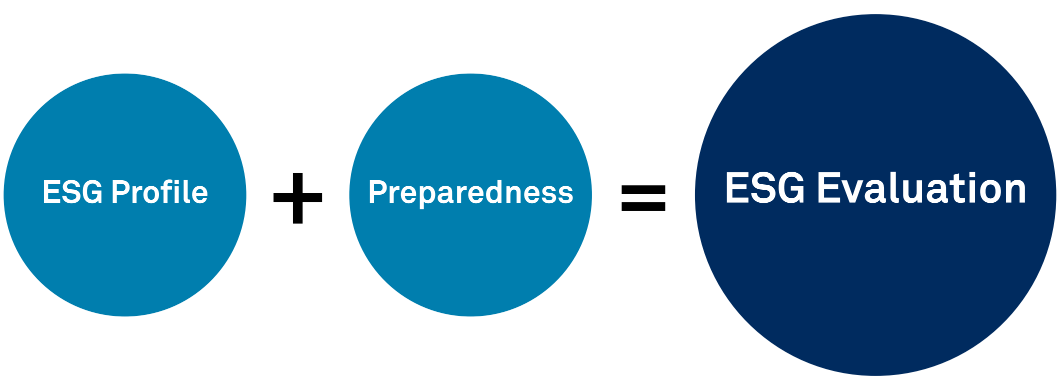
Chart 1

ESG Evaluation



Our ESG Evaluation combines our opinion of an entity's relative exposure to observable ESG-related risks and opportunities (the ESG "Profile"), with our qualitative opinion of the entity's long-term preparedness for ESG related opportunities and disruptions (ESG "Preparedness"). In our analysis, we take a broad view of Governance to include potentially material risks or opportunities that the entity faces.

The final outcome will be a qualitative opinion from S&P Global Ratings' analysts based on their sector and country knowledge and analysis, with entity-level analytical adjustments, and will be informed by interactive discussions with senior management, including members of the board.

The Evaluation will utilize data that entities supply directly through a new ESG Diagnostic questionnaire and incorporate environmental and other data from S&P Global Trucost and other S&P Global divisions.

The proposed ESG Evaluation is not a credit rating, a measure of credit risk, or a component of our credit rating methodology. However, the information we gather for an ESG Evaluation can inform our credit analysis of rated entities.

The ESG Evaluation will be a stand-alone, on-request service and separate from our credit ratings.

Summary of Analytic Approach

Our proposed ESG Evaluation is a cross-sector, relative analysis of an entity's ability to operate successfully in the future and optimize long-term stakeholder value in light of its natural and social environment and the quality of its governance. Our definition of stakeholders for a particular entity goes beyond shareholders to include other groups as appropriate such as employees, the local community, government, regulators, customers, and suppliers. Our analysis is grounded in financial materiality by assessing the potential of ESG risks and opportunities to effect stakeholders that can have a financial impact, either directly or indirectly, on an entity.

Our Evaluation considers ESG factors that are grounded more generally in an assessment of financial materiality.

Under our proposed approach, we first establish an ESG Profile for a given entity, which assesses the exposure of an entity's operations to observable ESG risks and opportunities, taking account of the governance structure in mitigating risks and capitalizing on opportunities.

Second, we assess the entity's long-term Preparedness, namely its capacity to anticipate and adapt to a variety of long-term plausible disruptions. Such disruptions are not limited to environmental and social scenarios, but could also include technological or political changes where relevant. This is because, in our opinion, high-quality corporate governance includes the full spectrum of potential risks and opportunities an entity faces.

Our final ESG Evaluation score will combine an entity's ESG Profile with our long-term Preparedness assessment, thereby indicating our view of how effectively the entity is set up to manage its ESG exposure and opportunities. The ESG Evaluation thus provides an opinion on an entity's relative exposure to observable ESG-related risks and opportunities, and our qualitative opinion of the entity's long-term Preparedness for opportunities and disruptions. Importantly, ESG Evaluations are not to be confused with credit ratings, which are separate opinions on creditworthiness (see box titled "How ESG Factors Affect The ESG Evaluation And Credit Quality" on page 3). However, the information we gather for an ESG Evaluation may inform our credit analysis of rated entities.

We are testing a ranking system which will equate the highest numeric position with the lowest exposure to ESG risks. An entity with a higher ESG Evaluation score would generally be seen to have:

- Mature, effective, and well integrated ESG policies and processes at all management levels.
- Best-practice strategic and operational execution.
- Integration of ESG risks with enterprise risk management.
- Well-mitigated (or non-material) environmental and social risks.
- A best-practice, forward-looking, and strategic governance framework and policy implementation.
- Agility and Preparedness to adapt to potential disruptions and opportunities.

How ESG Factors Affect The ESG Evaluation And Credit Quality

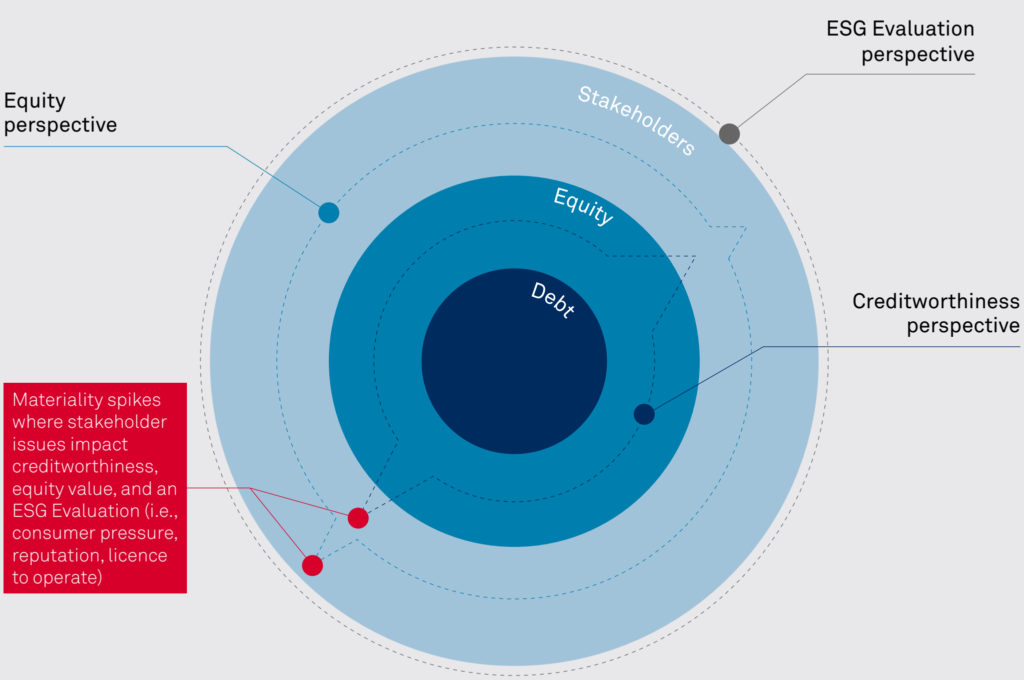
Our ESG Evaluation analysis will consider the entity's capacity to operate successfully in the future and is grounded in the materiality of how ESG factors could affect stakeholders and potentially lead to a financial impact on the entity. Our credit rating is a forward-looking opinion about an entity's overall creditworthiness, which focuses on the entity's capacity and willingness to meet its financial commitments as they come due. We already incorporate an analysis of ESG factors into our credit ratings when these factors are sufficiently material and visible--see box titled "ESG In Credit Ratings" on page 4.

We expect that the ESG Evaluation analysis will provide additional or complementary insights to the treatment of ESG factors when we apply our credit rating methodologies. For example, the percentage of water an entity recycles, or the degree of supply-chain audits for compliance with human rights conventions, may not be meaningful for our assessment of creditworthiness, but could affect the stakeholders of a company, financial institution, or government entity. Ultimately, the effect on stakeholders could translate into a future financial impact on the entity, which is a particular focus for the ESG Evaluation, but may be too uncertain or not material enough to incorporate in our credit rating analysis.

Our analysis of corporate governance is a core feature in the application of our credit rating methodology. It is also a critical and fundamental element of the ESG Evaluation. Application of the proposed ESG Evaluation analytical approach will provide our assessment of an entity's near-term governance structure in the ESG Profile, and the influence of governance on the entity's longer-term strategy, planning, and resulting culture in Preparedness.

Chart 2

ESG Evaluation Perspective, Creditworthiness Perspective and Equity Perspective



ESG In Credit Ratings

For more information on how we integrate ESG risks into our credit rating analysis, see "Corporate Methodology," published Nov. 19, 2013, and related articles. Our Key Credit Factor articles address sector-specific ESG factors that can affect our credit analysis. We address governance in "Management and Governance Credit Factors for Corporate Entities and Insurers," published Nov. 13, 2012. Related articles also include our analysis of which ESG risks have most affected credit ratings and rating actions in the past several years, such as "ESG Risks In Corporate Credit Ratings--An Overview," published Nov. 16, 2015. (See the section titled "Related Research--ESG In Credit Ratings" on page 9.) Going forward, we plan to enhance the transparency of how and when ESG factors are material to our credit rating opinion.

ESG Diagnostic

Entities that request an ESG Evaluation will be asked to complete our detailed ESG diagnostic questionnaire, which will provide us with a comprehensive understanding of their current ESG exposure, policies, practices, metrics, disclosure practices, and how they have handled past ESG-related controversies.

This data may be information that is publicly available, or information that entities disclose to us on a confidential basis. Our research has shown that available public ESG data is of uneven quality, and often inconsistent, and we believe that the diagnostic questionnaire, combined with our discussion of the responses with management, will equip us to assess the materiality of ESG factors more effectively and develop a more informed opinion.

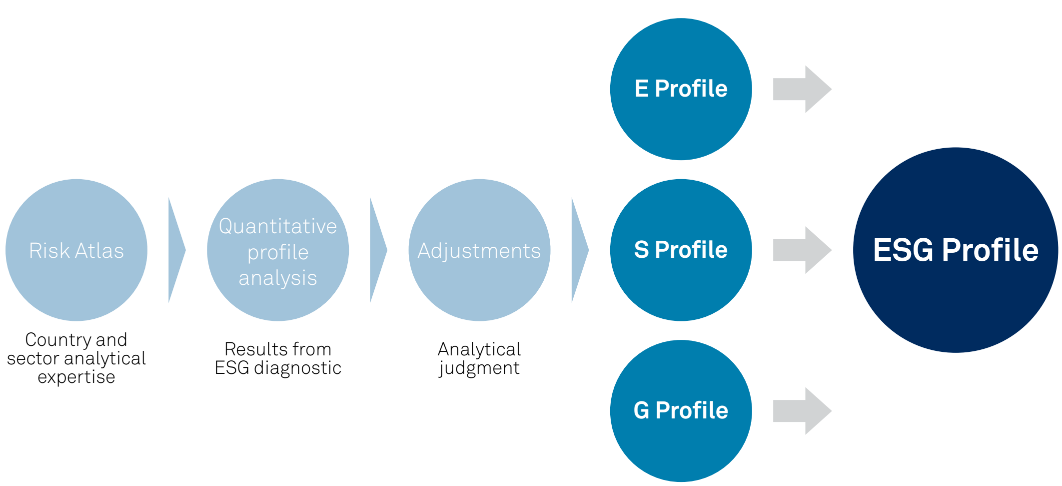
The diagnostic questionnaire, combined with the responses of management, will equip us to assess the materiality of ESG factors.

ESG Profile

We expect to rank an entity's ESG Profile based on our view of the degree to which the entity has greater or lesser overall exposure to ESG-related risks and opportunities. This ranking takes into account our view of the near- to medium-term effectiveness of the entity's current strategic and governance framework and trends in its operational performance.

Chart 3

ESG Profile Components

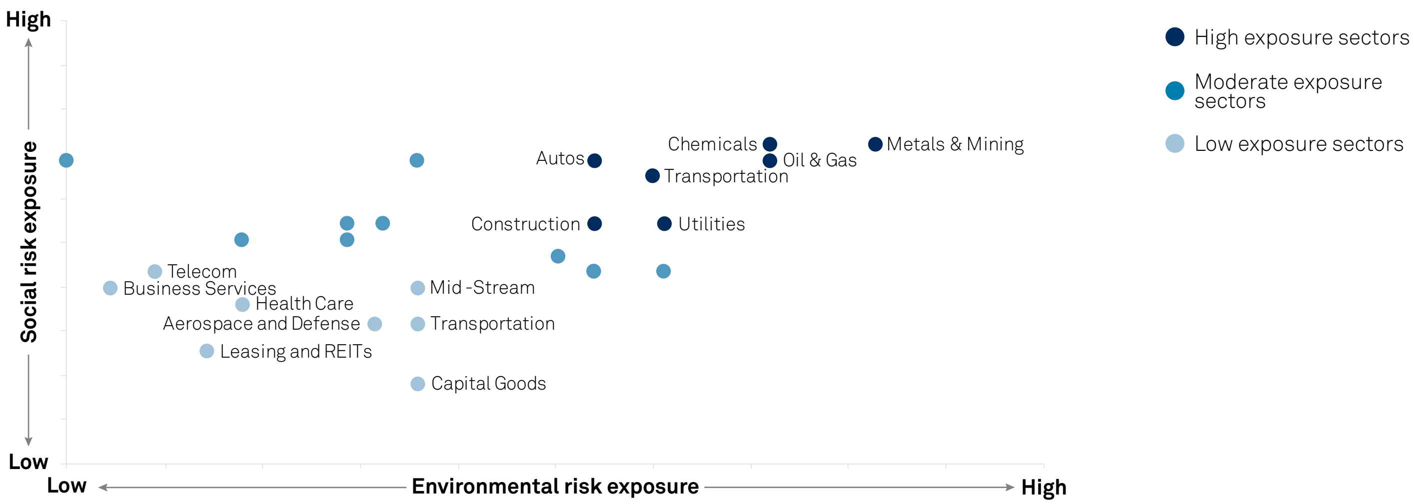


ESG Risk Atlas By Country And Sector

Our ESG Profile analysis starts with a global assessment of ESG-related exposure by sector and region, which we call the ESG Risk Atlas. There is a sector Risk Atlas and a country Risk Atlas. The sector-level analysis draws on the vast knowledge and experience of our analytic community and public data to develop a global matrix of ESG exposures by sector. We expect to refresh our sector Risk Atlas on a regular basis, and in time, we may provide more sector differentiation if meaningful. Chart 3 below indicates our current assessment of the relative social and environmental risk exposure for selected sectors.

Chart 4

Indicative Sector Risk Atlas

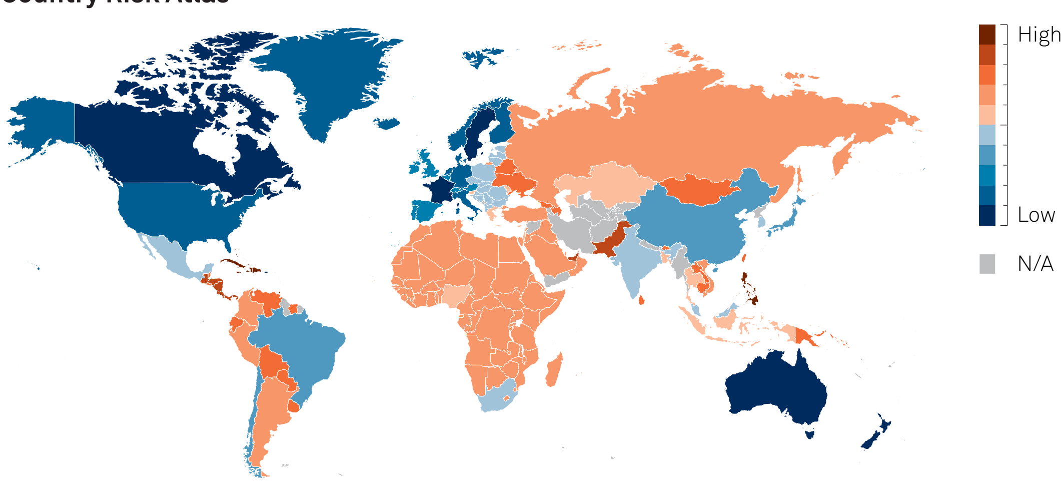


Our country Risk Atlas combines our sovereign analytical team's assessment of a country's institutional strength and capability with external assessments, including:

- The ESG regulations database from the UN's principles for responsible investment; and
- The UN's global assessment report--published data on the relative severity of the average annual loss to a nation's capital stock from natural disasters.

Chart 5

Country Risk Atlas



Quantitative Profile Analysis

The output from the ESG diagnostic builds on the sector and country analysis to inform our quantitative analysis for separate environmental, social, and governance profiles to reflect:

- Our assessment of the entity's relative progress on relevant metrics;
- Our assessment of the coverage and quality of the entity's policies and procedures;
- Our assessment of the overall quality of the entity's disclosures;
- Our assessment of the transparency of the entity's financial and nonfinancial reporting; and
- Our controversy and event analysis, which examines ESG-related controversies and business disruptions and provides an assessment of the entity's exposure to ESG-related controversies and events.

Within each of these factors, we have selected multiple key performance indicators (KPIs) relevant for each profile, as summarized in table 1. KPIs for the environmental profile include greenhouse gas emissions; water usage, scarcity, and decontamination; waste, pollution, and toxicity; and land use and biodiversity. Our proposed approach and analysis of environmental exposures and performance leverages data and insights provided by S&P Global Trucost.

Table 1

ESG Factors

Environmental	Social	Governance
Biodiversity	Customers	Reporting
Carbon	Human capital	Structure
Waste	Human rights	Transparency
Water	Safety	Values
	Social cohesion	

KPIs for social risk and opportunities generally factor in data about the satisfaction and data privacy of customers, human capital management, human rights, safety management, and social cohesion. Our environmental and social analysis includes an assessment of how the entity manages ESG-related exposure in its supply chain. In our governance assessment, we have identified the key features of a best-practice governance framework; the composition of the governing body, usually the board; the policy framework; level of transparency; and reporting. We plan to assess how many of these features are present to evaluate the entity's governance structure.

Analytical Adjustment

While it is likely that an entity's response to the diagnostic questionnaire will be based on past ESG performance indicators and data, our forward-looking sector- and country-based analysis will also inform the ESG Profile. Furthermore, we believe that the coverage and quality of an entity's policies, procedure, and targets are good forward-looking indicators of ESG exposure. After discussions with management, analysts will review the diagnostic results and make adjustments to each profile where appropriate. These adjustments allow us to provide a more forward-looking opinion and to reflect any entity-specific features (for instance subsector characteristics) that would not be otherwise addressed.

The coverage and quality of an entity's policies, procedure, and targets are good forward-looking indicators of ESG exposure.

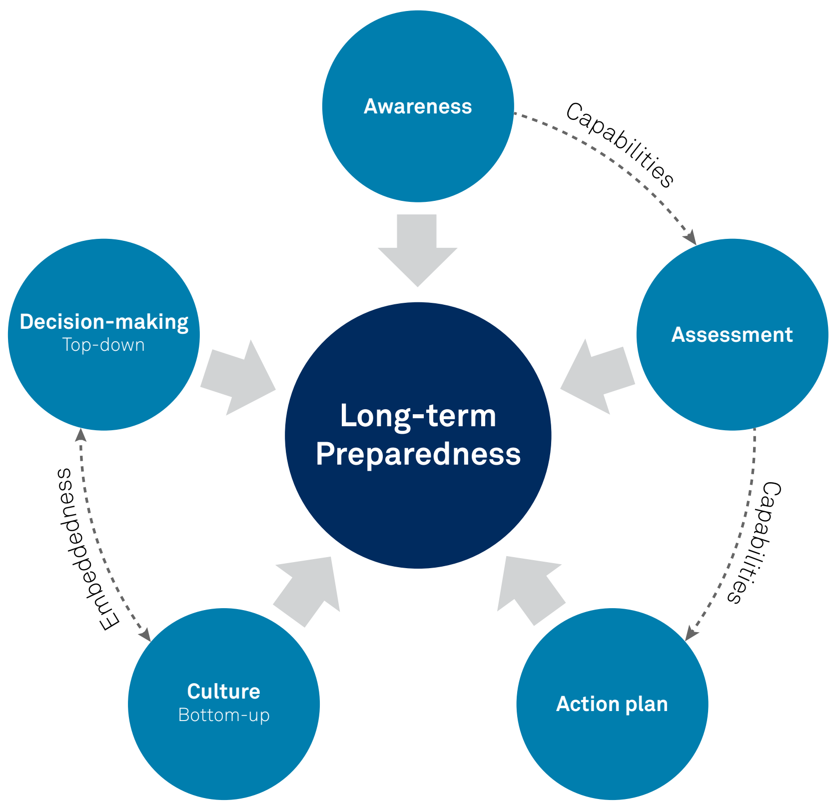
Long-Term Preparedness

Our long-term Preparedness evaluation will reflect our qualitative view of an entity's capacity to anticipate and adapt to a variety of long-term plausible disruptions and hence support the long-term sustainability of the entity. Such disruptions are not limited to environmental and social scenarios, but could also include technological, political, or other scenarios where relevant. This is because, in our opinion, high-quality corporate governance includes the full spectrum of potential risks and opportunities an entity faces.

First, we expect to assess senior management's and the board's capabilities with respect to their awareness and assessment of long-term risks and opportunities, associated long-term planning, and risk management processes. We also consider the extent to which the entity's board and management have embedded environmental, social, and other long-term strategic considerations and potential future scenarios into both their decision-making and the entity's culture.

Chart 6

Long-Term Preparedness



Our qualitative long-term Preparedness assessment will be informed by discussions with senior management and the board and will include a deeper dive into the effectiveness of the governance framework, as well as the extent to which ESG factors have been integrated into management's decision-making processes. Our assessment will be carried out by our analysts together with members of our sustainable finance team, drawing on our experience in identifying key potential risks, opportunities, and considerations for entities in a particular region and sector.

Alignment With Disclosure Recommendations From The Task Force On Climate-Related Financial Disclosures

At an entity's request, we expect to indicate in our reports the extent to which the entity has aligned its financial disclosures with the 11 recommendations by the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD). As part of our ESG Evaluation and at an entity's request, we will comment on the proportion of metrics and targets that the entity discloses relative to the TCFD's suggested disclosure list.

The degree of alignment with the TCFD's recommendations could also inform the ESG Evaluation.

We expect the outcome of our alignment assessment to be "fully aligned", "partially aligned", or "not aligned". An assessment of fully aligned would reflect our belief that the entity has made all 11 of the TCFD's recommended disclosures and will continue to report them. An assessment of not aligned indicates that the entity has not made any of the TCFD's recommended disclosures in either its financial filings or other public reports. Where we believe the entity has partially aligned its disclosures with the TCFD's recommendations, we will indicate which recommendations it has implemented and the source of our information (see the example in the table below). Therefore, we weight the TCFD's recommended disclosures, metrics, and targets equally to arrive at the final TCFD alignment score.

The degree of alignment with the TCFD's recommendations could also inform the ESG Evaluation.

Table 2

TCFD Sample Alignment Assessment

Governance	Strategy	Risk management	Metrics and targets
The board's oversight of climate-related risks and opportunities	Climate-related risks and opportunities identified over the short, medium, and long term	Processes for identifying and assessing climate-related risks	Disclose metrics used to assess climate-related risks and opportunities in line with its strategy and risk management process
Not aligned	**Fully aligned**	**Fully aligned**	**Fully aligned**
Management's role in addressing and managing climate-related risks and opportunities	Impact of climate-related risks and opportunities on the organization's businesses, strategy and financial planning	Process for managing climate-related risks	Disclose Scope 1, Scope 2 and, if appropriate, Scope 2 greenhouse gas emissions and the related risks
Fully aligned	**Fully aligned**	**Fully aligned**	**Fully aligned**
	Resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2 degree or lower scenario	How are processes for identifying, assessing and managing climate-related risks integrated into the organization's overall risk management	Targets used to manage climate-related risks and opportunities, and performance against targets
	Fully aligned	**Fully aligned**	**Fully aligned**

Related Research

- Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)

ESG Evaluation

- The Rise Of ESG Considerations In Fixed Income, Sept. 10, 2018
- Proposal For Environmental, Social, And Governance (ESG) Assessments, Sept. 5, 2016

ESG In Credit Ratings

- How Social Risks And Opportunities Factor Into Global Corporate Ratings, April 11, 2018
- Credit FAQ: How Does S&P Global Ratings Incorporate Environmental, Social, And Governance Risks Into Its Ratings Analysis, Nov. 21, 2017
- Credit FAQ: How The Recommendations Of The Task Force On Climate-Related Financial Disclosures May Figure Into Our Ratings, Aug. 16, 2017
- ESG Risks In Corporate Credit Ratings--An Overview, Nov. 16, 2015

Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

This report does not constitute a rating action.

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