Features of ESG rating of Russian companies

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Abstract. The article is devoted to the comparative assessment of the existing ESG rating methodologies, which are developed by the largest statistical agencies, which are specializing on the ESG rating calculation. The purpose of the study is to highlight the main strengths and weaknesses of the existing methodologies in order to take it into consideration during the development of the Russian national ESG scores’ assessment methodology.

Keywords: ESG scoring methodologies; ESG rating agencies; ESG factors’ assessment.

1 Introduction

ESG ratings were firstly developed in the 1980s as a tool for investors to review companies for their environmental, social and corporate performance [9].

There is no single standard ESG rating system for companies, but there are a number of different ESG rating agencies, all of which provide clients with investment ratings based on the company's ESG performance. It is worth mentioning that ESG ratings from different providers differ significantly because of differences in approaches towards the analysis of ESG ratings between different rating agencies: KLD, Sustainalytics, Moody's ESG (formerly Vigeo-Eiris), S&P Global (formerly RobecoSAM), Refinitiv and MSCI. Each ESG rating agency prefers to break down the concept of ESG performance into different metrics and organize them into different hierarchies. For example, in the first level of disaggregation, Moody's ESG, S&P Global, MSCI, and Sustainalytics have three dimensions (E, S, and G), Refinitiv has four, and KLD has seven. This fact and the discrepancies in indicators associated with them significantly complicate the task for investors [15]. The purpose of the analysis of the methodologies of the largest rating agencies is to explain and consider each of the approaches for the further development of the brand-new Russian national methodology based on the existing Russian and foreign experience.

Even in the most difficult geopolitical conditions, the ESG agenda in Russia should be developing, since the implementation of sustainable projects allows meeting the requirements of new partners (including Asian ones). Under these conditions, ESG ratings indicators can become important benchmarks for investors.

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The purpose of the article is to analyze the features of the formation of ratings by foreign rating agencies, to identify the problems of their formation, to formulate conclusions.

2 Materials and Methods

ESG rating points are calculated both for each company and for the markets of individual countries. Rating agencies conduct a detailed analysis of various environmental, social and managerial factors that together make up the image of ESG companies.

At the moment the scores of ESG rating can significantly impact not only on the investment attractiveness of a companies’ stocks, but also affect the cost of debt’s size.

As it was confirmed in some research “the cost of debt for borrowing firms is associated with their ESG score/rating. Firms that have low ESG scores are considered to be riskier, in the sense that they are exposed to liabilities related to Environmental, Social and Corporate factors that ultimately increase their probability of default” [7,8].

In addition a firm's global extra-financial performance is negatively related to its likelihood of dealing with adverse ESG-related events [3,10].

For both institutional and hedge fund investors, the biggest hurdle to incorporating an ESG investment framework is overwhelmingly the lack of ‘quality’ reliable data. The large number of external ESG data providers (>150 worldwide) differ substantially in terms of the range of companies “covered” (and the number of indicators/parameters tracked for these companies), rating methodologies, the amount of information they disclose regarding their ranking/weighting process, and the degree to which (if at all) they interact with the companies. ESG scores can vary widely among ESG data providers for the same company, which adds to the confusion for investors. Half of the differences are explained by different selection and weighting of relevant topics, and the other half is explained by selection of different indicators for these topics. Most importantly for investors, it’s uncertain to what extent third-party scores incorporate announced company actions or strategy shifts that could change its future ESG-standing [2,11].

ESG rating providers are companies that provide assessments of the degree of sustainability of issuers of shares and debt obligations based on their disclosure in accordance with the principles of sustainable development. Some ratings are based on quantitative methodologies that use and weigh numerous indicators provided either by the issuers themselves or from open sources. Major suppliers of ESG information include MSCI, Sustainalytics, Bloomberg, Refinitiv, etc. This also includes traditional rating agencies such as Moody's, S&P and Fitch [5].

An example of a Refinitiv rating. The generalized methodology of ESG assessment is a five-step process [14].

The company analyzes more than 450 ESG indicators processed manually for each company, while each measure is verified for standardization of information and ensures that it is comparable across the entire spectrum of companies. All final ESG scores are updated weekly. Of the 450 indicators analyzed by ESG, a subset of 186 indicators is allocated, the most comparable and significant by industry. The number of indicators varies in each industry group E,S and G.

Further, the breakdown into 10 industry criteria is carried out. There are ten similar industry groups in total. There are three of them in the "Environment" category: greenhouse gas emissions, innovation, and resource use. There are four categories in the "Social policy" category: human rights, responsibility for product quality, human resources, community. In
the category of "Corporate Governance" there are again three: management, shareholders, corporate social responsibility strategy.

Breakdown by 186 industry indicators, divided into three categories E, S and G and ten industry criteria.

Each industry group is assigned an individual weight depending on the contribution to a particular ESG criterion, see Figure 1.

![ESG Score Chart](https://www.refinitiv.com/content/dam/marketing/en_us/documents/methodology/refinitiv-esg-scores-methodology.pdf)

**Figure 1.** Breakdown by 186 industry indicators, divided into three categories E, S and G according to the Refinitiv rating methodology.


The aggregated ESG rating indicator is the relative sum of the weights of the categories, which vary depending on the industry for environmental and social categories. As for management, the weighting factors remain the same in all industries. The weights of categories E, S, G are normalized as percentages in the range from 0 to 100.

ESG scores are aggregated based on the weights of 10 categories, which are calculated based on the final matrix of values. To calculate the overall indicators by components and ESG, the weights of categories by industry are applied using objective logic based on available data. The rating allows you to identify companies focused on achieving high ESG criteria and vice versa outsiders [6].

ESG views display either percentage scores or letter scores. The rating allows you to quickly compare the company's performance with its competitors and see the strengths and weaknesses of various criteria included in the ESG. For example, a company with a score >0.916 will get an A+ grade, while a company with a score <0.083 will get a D grade (see Figure 2.).

All ESG data sources that are used to calculate ESG rating scores are reliable and diverse. Basically, the Refinitiv rating agency receives information from annual financial reports of companies; websites of companies and non-governmental organizations; stock exchanges; corporate social responsibility (CSR) reports and reliable news sources. All data is checked for possible errors at the stages of data entry and subsequent processing using automated analytical tools (including Data science tools). In addition, along with the weekly review, daily data quality checks are carried out. These measures ensure the reliability of the data used to calculate the ESG.

Main differences in ESG scoring methodologies based on the industrial principle.
Individual approach towards ESG scores attribution means that considering peculiarities of certain industries rating agencies make some adjustments towards the base strategy of valuation [12]. The main adjustment comes from the weighting methodology.

<table>
<thead>
<tr>
<th>Range of points</th>
<th>Rating class</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.0 &lt;= score &lt;= 0.083333</td>
<td>D -</td>
<td>“D” score indicates poor relative ESG performance and insufficient degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.083333 &lt; score &lt;= 0.166666</td>
<td>D</td>
<td>“C” score indicates satisfactory relative ESG performance and moderate degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.166666 &lt; score &lt;= 0.250000</td>
<td>C -</td>
<td>“C” score indicates good relative ESG performance and above average degree of transparency in reporting material ESG data publicly.</td>
</tr>
<tr>
<td>0.250000 &lt; score &lt;= 0.333333</td>
<td>C</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.333333 &lt; score &lt;= 0.416666</td>
<td>C +</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.416666 &lt; score &lt;= 0.500000</td>
<td>B -</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.500000 &lt; score &lt;= 0.583333</td>
<td>B</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.583333 &lt; score &lt;= 0.666666</td>
<td>B +</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.666666 &lt; score &lt;= 0.750000</td>
<td>A -</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.750000 &lt; score &lt;= 0.833333</td>
<td>A</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.833333 &lt; score &lt;= 0.916666</td>
<td>A +</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
<tr>
<td>0.916666 &lt; score &lt;= 1</td>
<td>A +</td>
<td>“A” score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly</td>
</tr>
</tbody>
</table>

**Figure. 2.** Breakdown by 186 industry indicators, divided into three categories E, S and G according to the Refinitiv rating methodology


It is fair to assume that different industries require individual approaches towards ESG components estimation. For example, it seems rather logically that for Metals and Mining industry it is more relevant to provide higher weights in the valuation model for environmental issues comparing to banking and financial services industry, where it is more relevant to attribute higher weights for governance issues.

In order to provide more relevant results of valuation the Refinitiv rating department developed the list of industries of weighting values distributed concerning industries’ peculiarities. There are a lot of scientific papers and researches, which prove that the industry of company plays an essential role in ESG scoring process, as it is impossible to develop a valid approach towards estimation of the same ESG parameters, which constitute the ESG score of a certain company, without segregating them by divisions. This segregation is usually performed by the attribution of weights to ESG parameters, which are taken into consideration in process of calculation, based on the rule “the bigger weight – the more significant impact a certain parameter makes considering its ESG risks and opportunities”.

To prove this statement the analysis of MSCI’s materiality map was performed [13]. As MSCI’s materiality map is concerned this analytical tool represents the main ESG components and categories and estimates their individual impact on the ESG rating of companies from different industries, by assigning to each one the individual weight. The analysis is performed based on four industries - Banking Services, Electric Utilities & IPPs, Metals & Mining and Oil & Gas.
It is necessary to admit, that these industries do not have identical match to the names of industries, presented by the MSCI’s ESG Industry Materiality Map. However, MSCI presents the data for several sub-industries, which can be classified as components of the observable industries. It is necessary to admit, that each sub-industry from the list below cannot be excluded because of the diversity of companies presented in the analysis. In other words, there is a minimum one company from the list of the analysed companies, which operational activities can be connected with the sub-industries.

3 Results

It is necessary to highlight several important results:

- **Banking services**: the key ESG component for the ESG rating calculation is S factor with a weight more than 50%; the second one is G component with a weight of 37,8%; and the lowest weight is assigned to the E factor. Based on these results, there is a hypothesis, that S and G components could be significant (in the econometric estimation) and E factor may turn out to be insignificant.

- **Electric Utilities & IPP**: considering the ESG rating calculation, there are two main ESG components, which have equally high weight of 39,5% - E and G components. So, it is expected that E and G factors influence companies’ financial metrics significantly, while S component may have a statistically insignificant;

- **Metals & Mining**: all three ESG components have approximately equal weights (about 30 %), that is why it can be assumed that all three ESG factors potentially can cause a significant impact on the investment attractiveness of companies from this industry;

- **Oil & Gas**: E component has the highest weight (equal to 43%), the second component sorting by the weights assigned by the MSCI’s ESG Industry Materiality Map is G factor with a weight of 34,1%, and the lowest weight is assigned to the S component (22,9%). As the difference between the first two ESG components, according to their weights, is rather low, it can be assumed that both of these factors can influence financial metrics of Oil & Gas companies significantly.

An individual approach to assigning ESG points means that, taking into account the peculiarities of certain industries, rating agencies make some adjustments to the basic evaluation strategy. The main adjustment comes from the weighting methodology. It is fair to assume that different industries require individual approaches to the evaluation of ESG components. For example, it seems quite logical that it is more appropriate for the metallurgical and mining industries to indicate higher weights in the assessment model for environmental issues compared to the banking and financial services industry, where it is more logical to give higher weights to corporate governance issues (see table 1.)

According to the Refinitiv ESG assessment methodology, the social component (S) is more important than the corporate governance factor (G) for the electric power industry. However, the weights of all three ESG components are quite high.

**Table 1.** Distribution of weights of ESG components for the observed industries according to the methods of Refinitiv and MSCI.
When calculating the ESG rating of oil and gas companies, the social (S) factor acquires the greatest weight (39.5%), the environmental (E) component receives the second largest weight (35.5%), and the management factor (G) has the least weight. The weights of MSCI differ from Refinitiv in the direction of a more significant weight of the social factor for the banking industry, as well as higher weighting factors in management factors for metal producers and the oil and gas industry.

### 4 Discussion

In recent years, ESG issues have become increasingly important in the investment and financial analysis of companies. Regardless of which market the company operates in: the market of developed or developing countries, it, as a rule, must disclose information about the factors of sustainable development. Companies should prepare information disclosing the results of the ESG policy, which are then used by analytical agencies to form ESG ratings.

One of the most significant advantages of using ESG scores calculated by rating agencies is the independence of their assessment. Since ESG ratings are mainly used by investors to identify financially stable and sustainable companies, it is important to identify the presence of a problem associated with significant differences in the methodologies for assessing ESG factors.

As rating agencies develop their own methodology, the variety of possible sources of information they use on issues related to ESG creates problems for investors, since estimates may differ significantly from agency to agency [1,10].

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### 5 Conclusion

1. A large number of independent analytical agencies that are rating providers (currently there are about 150 in the world) often offer a heterogeneous number of evaluation

<table>
<thead>
<tr>
<th>Components / Industry name</th>
<th>E - Environment</th>
<th>S - Social</th>
<th>G - Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Refinitiv</td>
<td>MSCI</td>
<td>Refinitiv</td>
</tr>
<tr>
<td>Banking industry</td>
<td>14.0%</td>
<td>10.7%</td>
<td>44.5%</td>
</tr>
<tr>
<td>Electric power industry</td>
<td>43.0%</td>
<td>39.5%</td>
<td>33.0%</td>
</tr>
<tr>
<td>Metal producers and mining industry</td>
<td>38.0%</td>
<td>35.9%</td>
<td>34.0%</td>
</tr>
<tr>
<td>Oil and gas industry</td>
<td>35.5%</td>
<td>43.0%</td>
<td>39.5%</td>
</tr>
</tbody>
</table>

Source: Composed by the author.
parameters and indicators included in the methodology. There is also a difference in the amount of information they disclose regarding ranking methods and weight assignment. In addition, the degree of their interaction with rating companies is also ambiguous.

2. Strong differences in ESG ratings from different suppliers for the same company. Half of the differences are due to different approaches to choosing the weights of the relevant criteria, and the other half is due to the choice of various indicators included in these criteria.

3. There is no signal to determine the changes taking place in the company. It is unclear to what extent the assessments of third-party analytical agencies reflect changes in strategy that affect the company's sustainable development and the future state of ESG factors.

4. Investors increasingly need additional information to understand the position of an ESG company in the market.

Currently, several indices and indicators have been developed and administered by expert structures in Russia in relation to sustainable development, environmental measurement of corporate responsibility, disclosure of information regarding environmental impact. There are such ratings as: rating of "Social efficiency of the largest Russian companies"; ESG rating of the Russian corporate sector; rating of environmental responsibility of oil and gas companies; rating of environmental responsibility of mining companies.

Below are four of the five Russian rating agencies with ESG methodologies accredited by the Bank of Russia:
- RAEX Europe.
- "Expert RA".
- Analytical Credit Rating Agency (ACRA).
- National Rating Agency (NRA).

To the list of rating agencies approved by VEB. The Russian Federation as independent verifiers, two rating agencies are included - ACRA and Expert RA.

Three rating agencies operating in the Russian market are included in the list of independent verifiers of the International Association of Capital Markets (ICMA), evaluating securities for compliance with the principles of "green" bonds, social principles and principles of sustainable development. These are RAEX Europe, "Expert RA" and ACRA.

Thus, the following conclusions can be drawn regarding the development of ESG-rating in the Russian Federation.

1. ESG is an emerging new national idea, where the social agenda comes to the fore.
2. The implementation of national projects in Russia, as well as the achievement of carbon neutrality goals, are formed in the strategy of the SIR until 2050 [4].
3. Russian business will develop in the direction of ESG, taking into account national geographical, territorial, climatic and social features and independently created methods for rating and accounting of carbon units, regardless of European requirements and standards [4].
4. Russian investors, due to the new geopolitical situation, will not change their views on following the ESG principles when assessing the investment attractiveness of Russian companies, especially in conditions of unprecedented volatility in the stock market and taking into account the new conditions for Russian companies to operate.
5. Banks will be interested to introduce ESG-rating techniques as soon as possible in order to attract demand for corporate credit products with minimal diversification of rates.
References


