

## ESG Ratings

A large and increasing number of the world's investors are integrating environmental, social, and governance, or ESG, to understand risks and opportunities.

Can you spot the difference in the financials of these two companies?

They seem identical, but an ESG lens can help investors identify risks not picked up by conventional financial analysis.

Risks that could impact financial performance, because of operational costs or cost of litigation.

Different ESG risks can impact different industries, however corporate governance, due to its universal importance, is examined for all industries.

ESG ratings focuses in on what's significant to a company's bottom line, and comparable with its peer group.

So, what are significant ESG risks? Here's an example. Water is important to everyone, but it only poses a significant risk to certain industries.

Water could determine whether a mining company remains profitable, or even afloat. But it's less important to the consumer finance industry.

So, water risk would not determine their MSCI ESG rating, but cyber security may.

We look at the company's exposure to industry-specific risks, based on its business activities, size of its operations, and where it operates.

Then we look at how a company is managing their risks.

It's a balancing act.

Companies that fail to manage ESG risks have historically experienced higher costs of capital, more volatility, and accounting irregularities.

How do we collect the data?

MSCI ESG ratings is not about hammering companies for all of their data. Nor is it about asking for their opinion.

We collect the most relevant, publicly available data, and use a precision approach , designed to ensure that MSCI ESG ratings...pinpoints the most significant risks a company faces.

We collect data from thousands of sources. We also consider controversies that may indicate performance failures.

How do we calculate the MSCI ESG rating?

We assign percentage weights to each ESG risk, according to our assessment of their time horizon and impact.

The ESG scores are then combined and normalized relative to industry peers to achieve the overall ESG rating.

So, what does a poor ESG rating look like? For example, a mining company that fails to manage ESG risks may:

1. Mismanage water resources, waste and emissions.

2. Demonstrate severe lapses in safety.
  
3. Have a self-serving board with evidence of corruption.

ESG ratings helps investors identify companies that are leading or lagging within their industry, which may flag opportunities...or risks not captured by conventional financial analysis.

Investors can use ESG ratings for: Fundamental or quant analysis, Portfolio construction and risk management, Engagement and thought leadership, and benchmarking and for index-based products.

To find out more about MSCI ESG research and ESG ratings, visit our website.

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