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SynTao Green Finance

An Evolving Process: **Analysis of China A-share ESG Ratings**

2020

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Contents

1 Executive Summary

Great importance has been attached to ESG investing by regulatory authorities, financial institutions, listed companies, and industry associations in China. According to the survey conducted by the Asset Management Association of China (AMAC), 87% of institutional investors are aware of ESG investing. ESG performance has become an important dimension to measure the investment value of listed companies in the market. Based on the SynTao Green Finance *STαR ESG Database*[1] and its *ESG Risk Radar System*[2], this report studied more than 1,700 listed companies and in particular, reviewed and analyzed the 2018-2020 ESG rating results of A-share companies represented by the CSI 800 index[3] constituent stocks. The major findings are:

- Both the number of ESG reports issued and the disclosure rate at indicators level increase, while the qualitative disclosure is still in a better shape than quantitative disclosure, and the voluntary disclosure information are to be enhanced.
- The overall ESG performance of A-share listed companies is steadily improving, but it is still in a developing stage. Scores for active ESG management and information disclosure moves up significantly, but ESG risk exposure over the same period of time also increases.
- Top ESG-rated listed companies shows a faster improvement of ESG performance than the bottom ones.
- 61.6% of the CSI 800 constituent companies have ESG controversies during the past year. Environmental pollution, product (service) problems, and business ethics are the most frequently seen ESG controversies.
- There is a significant correlation between ESG performance and the stock prices in A-share market.

[1] The SynTao Green Finance *STαR ESG Database* includes ESG rating and scoring details of A-share, H-share, overseas listed Chinese companies, and bond issuers.

[2] The SynTao Green Finance *ESG Risk Radar System* monitors, categorizes, and provides risk assessment for real-time and historical controversies of A-share, H-share, overseas listed Chinese companies, and bond issuers.

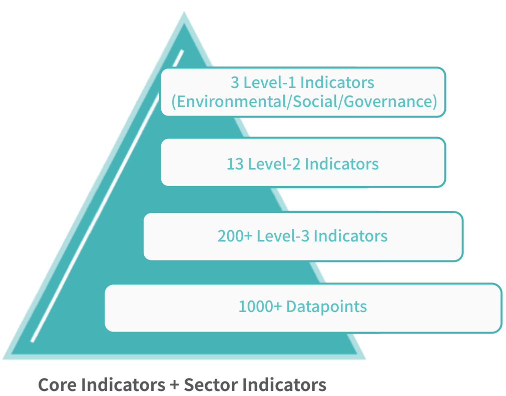
[3] The CSI 800 Index is compiled by CSI Co., Ltd., and its constituent stocks are composed of CSI 500 and CSI 300. The CSI 800 Index comprehensively reflects and is representative of the overall status of large, medium, and small market capitalization companies in the Shanghai and Shenzhen stock markets.

1.1 Purpose of the Research

By conducting an in-depth analysis of ESG performance and rating results of A-share listed companies, SynTao Green Finance aims to unpack and understand the dynamics of ESG performance in A-share market, to provide decision-making basis for multiple stakeholders in their responsible investment practices, and to empower the ESG investing in China.

1.2 Overview of the ESG Rating Methodology Employed

SynTao Green Finance developed its proprietary ESG rating system, combining the widely recognized international standards with local considerations. The localization efforts give the particular system an edge in producing a more differentiated ESG rating result for Chinese companies. The rating framework consists of three levels of indicators. Level-1 indicators are environmental (E), social (S), and corporate governance (G). Level-2 indicators include 13 ESG issues under the E, S, and G. At level-3, there are altogether more than 200 core and sector indicators. In addition, level-3 indicators are labeled with either ESG management or ESG risk exposure. ESG management indicators evaluate the ESG disclosure quality and the active ESG management measures of the rated companies. ESG risk exposure indicators evaluate the ESG risk level, sourcing from government supervision and punishment, news articles from media, and researches from NGOs and industry associations[4], etc.



Level 1	Level 2	Level 3 (examples)
E Environmental	Environmental Management	Environmental Management System Certification, Water Conservation Objective, Green Product (Service) and Revenue
	Environmental Disclosure	Energy Consumption and Conservation, Waste gas Emission and Reduction
	Environmental Controversies	Negative Incidents regarding Water Pollution / Air Pollution / Solid Waste Pollution
S Social	Employee	Freedom of Association, Anti-Discrimination
	Supply Chain	Responsible Supply Chain Management
	Community	Community Communication
	Product	Fair Trade Product, Genetically Modified Food
	Philanthropy	Enterprise Foundation, Donation
	Social Controversies	Negative Incidents regarding Employees / Clients / etc.
G Governance	Business Ethics	Whistleblowing Policy, Overseas Tax Payment
	Corporate Governance	Board Diversity, Auditor Independence
	Governance Controversies	Negative Incidents regarding Business Ethics / Corporate Governance

Figure 1 An Example of Indicators of SynTao Green Finance ESG Rating Framework

Source: STGF *STαR ESG Database*, SynTao Green Finance

The active management and risk exposure data is collected and graded according to the above framework. The approach quantifies the ESG performance of rated companies and produces the final ESG ratings as well as the respective scores.

[4] SynTao Green Finance developed its proprietary *ESG Risk Radar System*, applying AI and expert opinions to collect and analyze regulatory and violation information from government agencies, and articles on negative incidents from creditable media; categorizes controversies into ESG themes and provides corresponding risk assessment.

2 A-share ESG Information Disclosure Exhibits a Steady Improvement

2.1 Growing Issuance of ESG Reports

Driven both by policies and market demands, ESG information disclosure of listed companies shows an increasing trend. According to SynTao Green Finance' s statistics, from 2009 to 2020 (as of June 15), the number of ESG reports[5] issued grows from 371 in 2009 to 1,021 in 2020, which indicates a continuous and stable increase. In 2020, about 27% of the listed companies issued ESG reports. More than 86% (259) of CSI 300 constituent companies have released reports, indicating that leading companies already have a strong awareness of ESG disclosure.

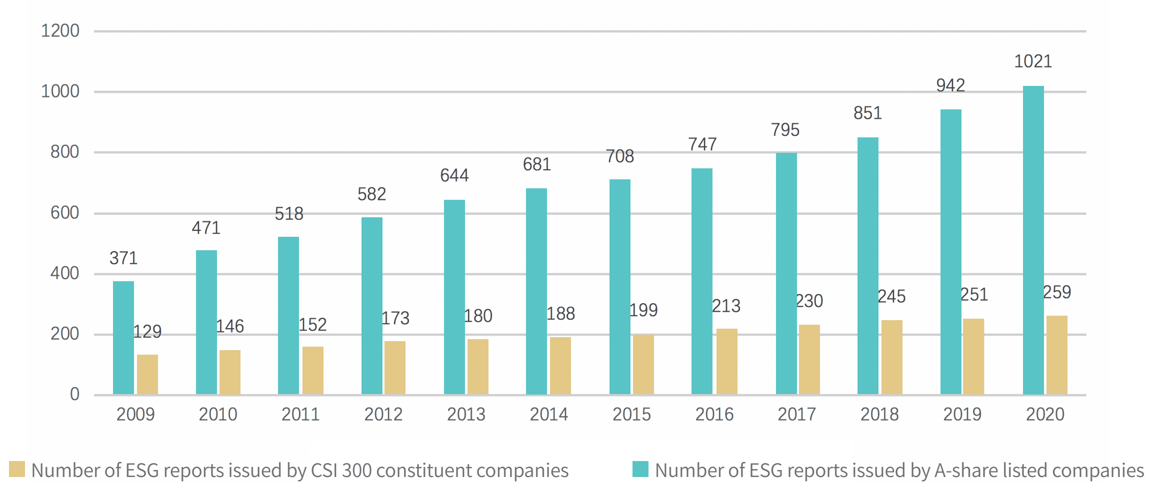


Figure 2 Number of ESG Reports Issued by A-share Companies (2009-2020)

Source: SynTao Green Finance, SynTao MQI Database

2.2 The Status Quo on ESG Disclosures at Indicators Level

The ESG indicator-level disclosure of CSI 300 constituent companies improves in 2020 compared with that in 2018. The disclosure rate of environmental indicators increases from 40.4% to 49.2%, the disclosure rate of social indicators increases from 28.9% to 35.4%, and the disclosure rate of corporate governance indicators increases from 66.3% to 67.9%.

[5] The “ESG report” referred to in this paper includes reports named after “Social Responsibility Report”, “Sustainability Report”, etc.

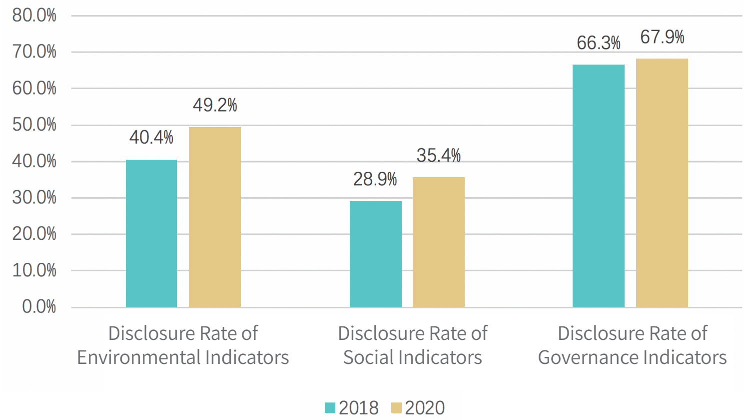


Figure 3 ESG Disclosure of CSI 300 Constituents Improves at the Indicators Level

Source: *STGF STαR ESG Database*, SynTao Green Finance

At the indicators level, the disclosure rate of most ESG indicators increases compared with that in 2018. However, statistics show that qualitative disclosure is better than quantitative disclosure. In addition, the disclosure rate of most voluntary disclosure indicators[6] is still less than 50%.

[6] Voluntary disclosure indicators refer to those ESG information not mandatorily required for disclosure by regulators, as only a limited scope of data such as the pollutant discharge, environmental violation and corporate governance information fall into the mandatory scope for a number of rated companies given the current regulations.

Table 1 Disclosure Rates of CSI 300 Constituents

ESG Pillars	Level-3 Indicators	Disclosure Rate in 2018	Disclosure Rate in 2020
Environmental (E)	Environmental Management Objective	81.6%	95.0%
	Policies on Energy Efficiency and Renewable Energy Application	77.7%	91.3%
	Greenhouse Gas Emission Management System	25.2%	55.0%
	Energy Consumption and Conservation	39.4%	40.7%
	Energy Intensity (Energy Consumed for Every Unit of Economic Output)	27.1%	34.7%
	Total Water Consumption and Conservation	31.6%	36.0%
	Greenhouse Gas Emission and Reduction	26.1%	34.0%
	Wastewater Discharge and Reduction	46.4%	61.7%
	Waste Gas Emission and Reduction	38.9%	57.7%
	Solid Waste Discharge and Reduction	36.3%	30.0%
Social (S)	Collective Bargaining	25.2%	36.0%
	Anti-forced Labor	32.6%	43.3%
	Child Labor Prohibition	32.3%	42.3%
	Equal Pay for Equal Work	24.5%	28.0%
	Diversity Promotion	17.4%	40.0%
	Number of Female Employees	35.5%	44.0%
	Employee Turnover Rate	13.2%	17.7%
	Non-regular Employee Ratio	14.5%	5.7%
	Professional Training for Employees	66.1%	71.0%
	Responsible Supply Chain Management	13.2%	31.3%
	Supply Chain Supervision System	25.2%	30.0%
	Enterprise Foundation	19.7%	19.7%
	Donation	88.7%	90.3%
Corporate Governance (G)	Anti-corruption and Bribery Policy	65.8%	94.0%
	Whistleblowing Policy	25.8%	42.7%
	Sustainable Development Commitment	5.8%	6.0%
	ESG Information Disclosure	80.0%	86.0%
	Director and Senior Management Compensation	97.4%	99.7%
	Division of Powers between Chairman of the Board and CEO	75.8%	76.3%
	Independent Compensation Committee	82.9%	97.3%
	Independent Audit Committee	88.4%	98.7%
	Board of Director and ESG	11.0%	33.3%

Source: SynTao Green Finance; ESG Data in China (Recommendations for Primary ESG Indicators)

3 ESG Ratings of CSI 800

3.1 ESG Ratings of A-share Companies are Improving Steadily

Based on the SynTao Green Finance *STαR ESG Database*, the ESG ratings of CSI 800 constituent companies keep improving from 2018 to 2020. The proportion of companies with ESG ratings above B+ increases from 8% in 2018 to 17% in 2020; the proportion of companies with ESG ratings below C+ decreases from 25.2% to 12.4%.

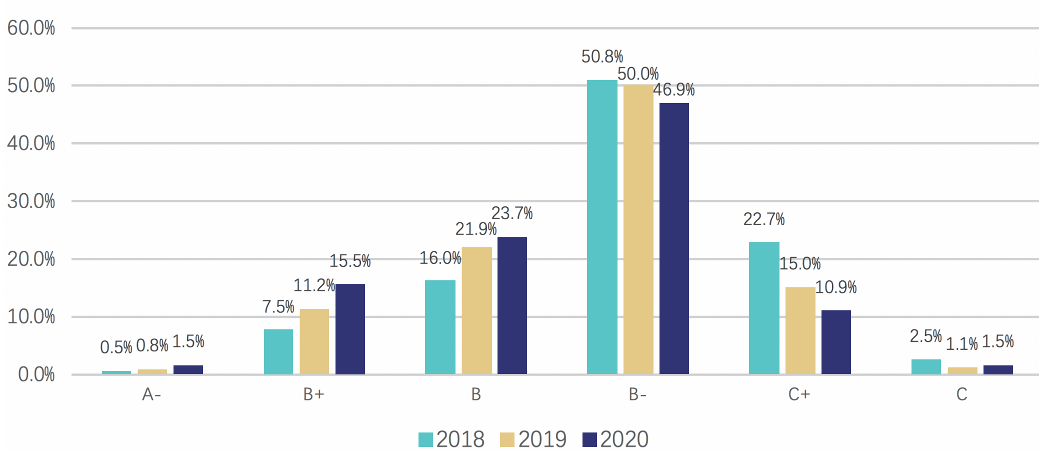


Figure 4 ESG Ratings Distribution of CSI 800 Constituents (2018-2020)

Source: *STGF STαR ESG Database*, SynTao Green Finance

Note: SynTao Green Finance ESG ratings are categorized into A+, A, A-, B+, B, B-, C+, C, C-, and D.
There are no companies who have earned ratings higher than A-, and lower than C.

Comparing the 2020 ESG rating results of CSI 800 constituent companies to 2019, 19.5% of the rated companies get upgraded, 14.6% downgraded, and 65.9% maintained their rating. The average ESG score increases 5% in the past three years if taking 2018 ESG score as benchmark, which implies a steady improvement of the ESG performance of A-share listed companies.

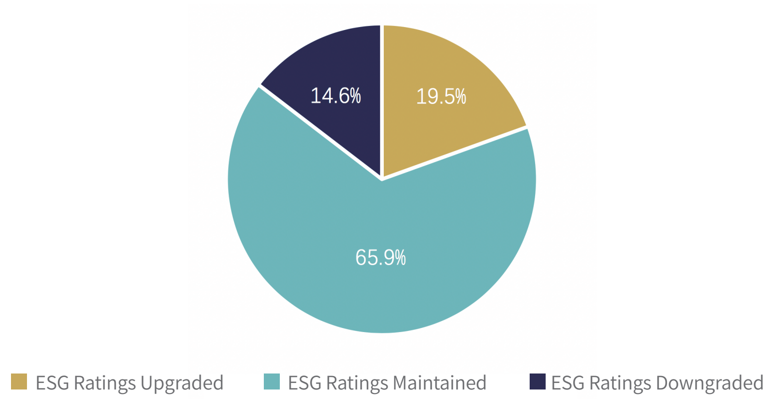


Figure 5 ESG Rating Momentum of CSI 800 Constituents (2020)

Source: *STGF STαR ESG Database*

When breaking down the ESG performance of A-share listed companies into active management and risk exposure, it is found that over the past three years, ESG management and disclosure performance recorded a significant increase of 23% compared to the status in 2018. During the same time that the active ESG management and information disclosure improves, the ESG risk exposure, represented by controversies of listed companies, on the other side, also increases year by year, and recorded an increase of 7% in total for three years. The statistics indicate that with more public exposures, ESG controversies have an obvious influence on the volatility of stock prices in the past three years, and that staying away from problematic companies is a critical focus of the capital market in recent years.

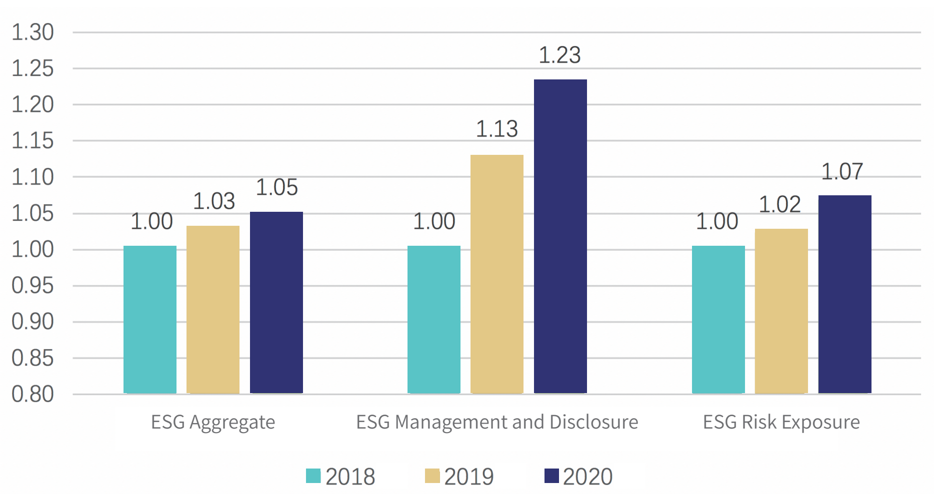


Figure 6 ESG Performance of CSI 800 Constituents over 2018-2020

Source: *STGF STαR ESG Database*

Based on the ranking of ESG ratings of the CSI 800 constituent companies, the top 100 companies in the ranking are constructed as the “High ESG 100 Portfolio”, the bottom 100 companies are constructed as the “Low ESG 100 Portfolio”. Analysis was conducted on the ESG performance of two portfolios in the past three years. It is found that the ESG performance of the “High ESG 100 Portfolio” improves faster with a relatively stable average annual growth rate, which recorded a total increase of 8% in the three years. The ESG performance of the “Low ESG 100 Portfolio” has a narrower increase, a total of 4% in the same period of time. It shows that the top-rated companies are advancing faster than that of the bottom-rated companies, in the context of an overall improvement of ESG performance in A-share market.

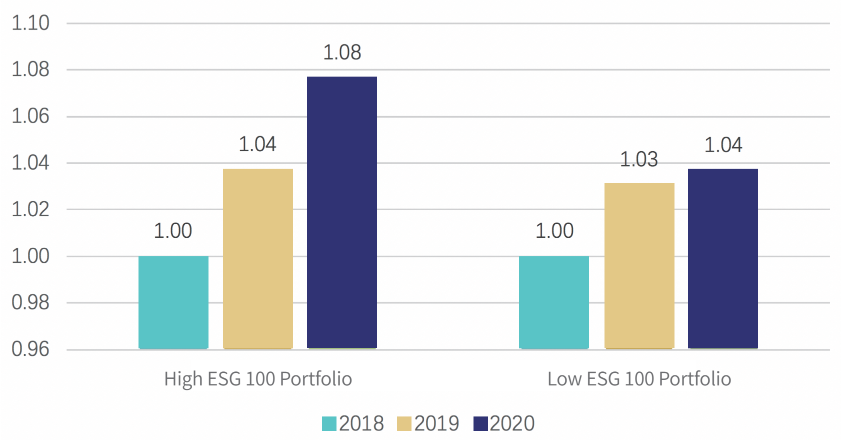


Figure 7 Relative Performance of High ESG 100 vs. Low ESG 100 Portfolio over 2018-2020

Source: *STGF STaR ESG Database*, SynTao Green Finance ESG Research

3.2 Momentum Observed in the Environmental (E), Social (S) and Governance (G) Performance Respectively

Looking at the performance of A-share listed companies from the E, S, and G aspects in the past three years, improvements can be seen in all three pillars, of which the environmental performance improves more rapidly than the social and governance performance. Figure 8 shows the relative E/S/G performance changes of CSI 800 constituent companies, and the scores of environmental, social and governance improves 7%, 3% and 4% respectively.

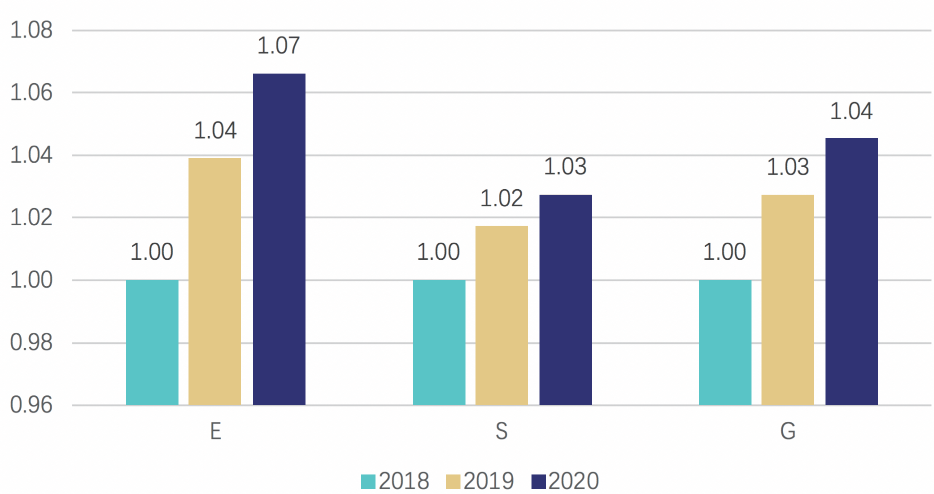


Figure 8 Relative E/S/G Performance of CSI 800 Constituents over 2018-2020

Source: *STGF STaR ESG Database*

3.3 ESG Performance by Industries

The five industries[7] with the highest average ESG score in 2020 are: Financials; Electric, Heating, Gas and Water Utilities; Mining; Transportation, Warehousing and Postal Services; and Pharmaceuticals. The five industries with the lowest average ESG score are: Real Estate; Food and Beverage; Other Services; Services-Communications, Software, and Information Technology; and Construction. Taking the average ESG score of CSI 800 constituent companies as a benchmark, the relative ESG performance of different industries is shown in Figure 9 below.

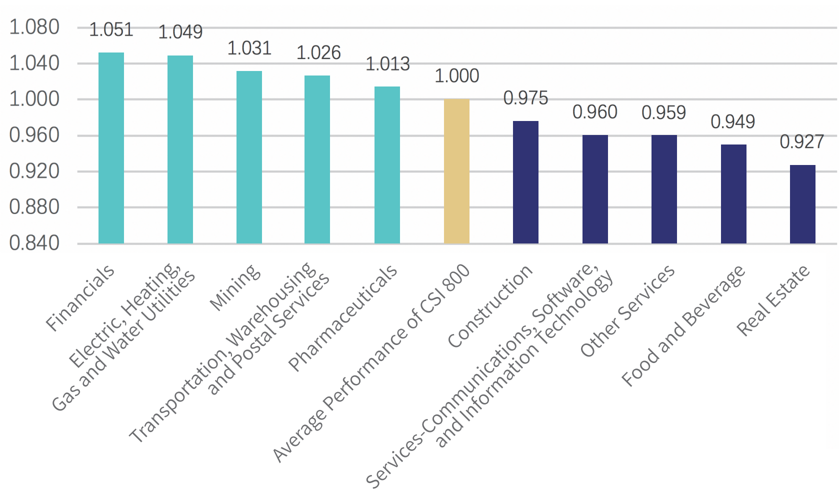


Figure 9 Relative ESG Performance by Industries (CSI 800, 2020)

Source: *STGF STαR ESG Database*

[7] To improve data validity, each industry listed here includes more than 20 listed companies.

4 ESG Risk Analysis of A-share Listed Companies

4.1 ESG Risk Analysis of the Historical Controversies

In recent years, the number of environmental, social and governance controversies of list companies exposed keeps growing, which characterizes an increasing ESG risk. According to SynTao Green Finance *ESG Risk Radar System*, there are 19,770 A-share ESG controversies in total from June 2012 to June 2020, involving 1,293 listed companies, of which environmental, social and governance controversies account for 43%, 33% and 24% respectively (Figure 10).

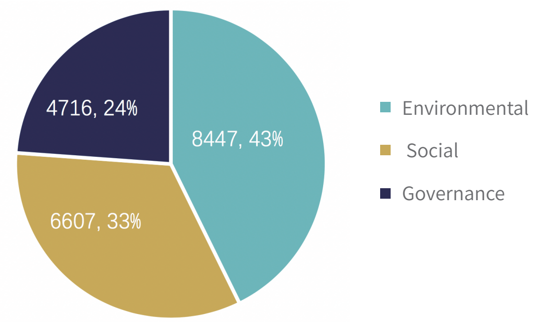


Figure 10 ESG Controversies of A-share Listed Companies (2012.06-2020.06)

Source: STGF *ESG Risk Radar System*

Note: The above statistics sample covers more than 1,700 A-share companies (same hereinafter).

An in-depth analysis of the categories of ESG controversies shows that air pollution, water pollution and compliance are the most frequently seen categories in environmental controversies; product quality, customer rights and employee rights are the most frequently seen categories in social controversies; corporate governance and business ethics are the most frequently seen categories in governance controversies.

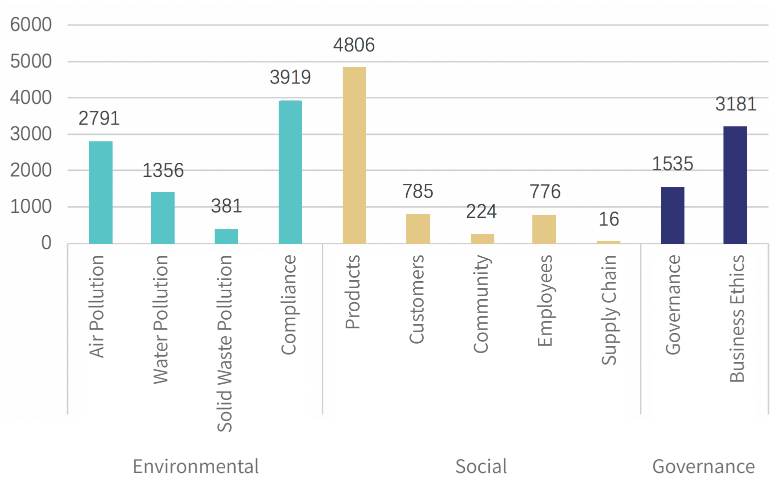


Figure 11 Controversies of A-share Market by ESG Categories (2012.06-2020.06)

Source: STGF *ESG Risk Radar System*

4.2 ESG Risk Analysis of CSI 800 Constituents

Taking CSI 800 constituent stocks as the statistical data sample, over the period of June 2019 to June 2020, SynTao Green Finance *ESG Risk Radar System* recorded ESG controversies of 2,866, with 493 listed companies involved, accounting for 61.6% of all 800 constituent companies. Among them, environmental controversies amount to 1,036, accounting for 36%; social controversies 1,155, accounting for 40%; governance controversies 675, accounting for 23.6%. The risk assessment[8] on these ESG controversies shows that a larger proportion of social and governance controversies are rated with medium and high risk, accounting for 13% and 22% of the total medium and high risk controversies respectively.

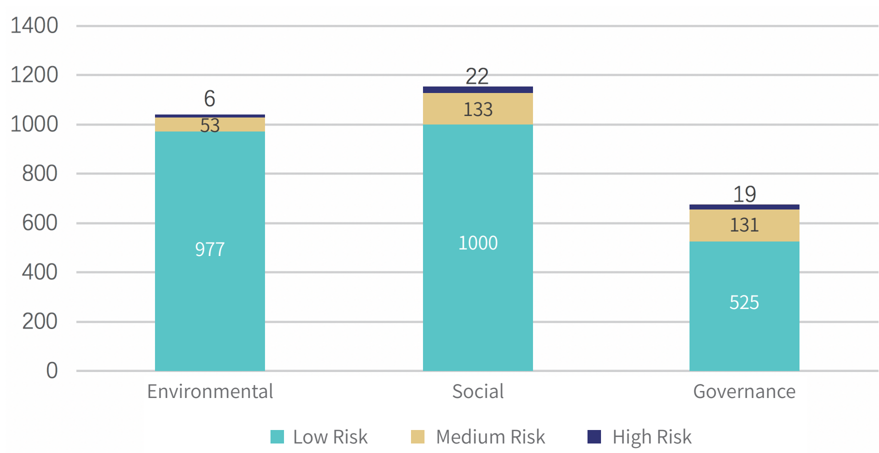


Figure 12 ESG Controversies of CSI 800 Constituents (2019.06-2020.06)

Source: STGF *ESG Risk Radar System*

Air pollution, water pollution, product quality and business ethics are found to be the frequently-used labels for ESG issues attached to controversies happened and reported during the previous year.

[8] Based on materiality, the risk of controversies is assessed in the matrix of the nature of industry, frequency of occurrence, social impact, corporate responsibility, and responses to controversies. The risk level is categorized into low, medium, and high.

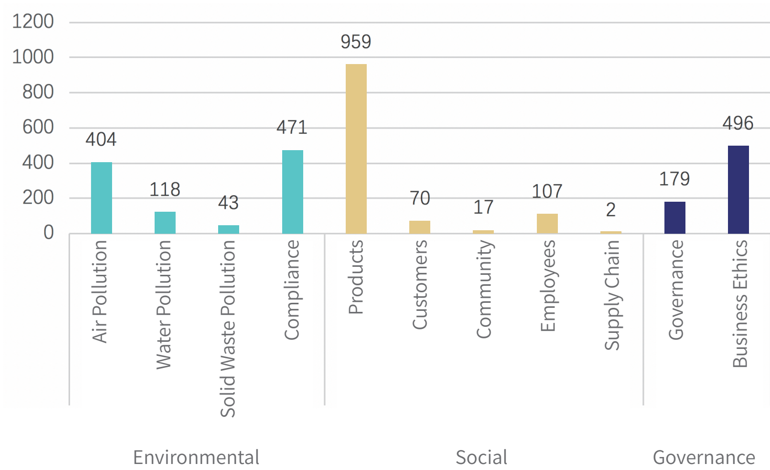


Figure 13 Controversies of CSI 800 Constituents by ESG Categories (2019.06-2020.06)

Source: STGF *ESG Risk Radar System*

The analysis of the impact of controversies on stock price found that, on the day and the following day when the controversy of high/medium risk occurs, some stock price goes up and some goes down compared to the benchmark, while, the times of going down is 60% more than that of going up. When speaking of going down, the relative price decline is 2.36% in total for the two consecutive days.

Figure 14 Rises and Falls of Stock Prices Following the Occurrence of Medium and High-Risk Controversies (2019.06-2020.06)

Note: The timeline referred in the chart includes the day and the following day after controversies exposure.

5 A Significant Correlation Found Between ESG Ratings and the Stock Price Performance in A-share Market

5.1 A Comparison of CSI 300 High ESG vs. Low ESG Portfolios

SynTao Green Finance selects from CSI 300 constituents the top 50 and bottom 50 ESG rated companies over the rating period of 2015 to 2019, and constructs “CSI 300 High ESG 50 Portfolio” and “CSI 300 Low ESG 50 Portfolio” using the free float capitalization-weighted method. From January 2016 to May 2020, the “CSI 300 High ESG 50 Portfolio” outperformed the CSI 300 benchmark by 23.2%, while the “CSI 300 Low ESG 50 Portfolio” underperformed the benchmark by 2.1%, which shows a significant positive correlation between the ESG ratings and stock prices. During the same period, the “CSI 300 High ESG 50 Portfolio” experienced a maximum drawdown of 27.9%, superior to that of the “CSI 300 Low ESG 50 Portfolio”, whose maximum drawdown was 35.1%.

Figure 15 Performance of CSI 300 High ESG 50 vs. Low ESG 50 Portfolios

Source: SynTao Green Finance, Wind

5.2 A Comparison of CSI 800 High ESG vs. Low ESG Portfolios

SynTao Green Finance selects from CSI 800 constituents, the top 100 and bottom 100 ESG rated companies from 2018 to 2019, and constructs “CSI 800 High ESG 100 Portfolio” and “CSI 800 Low ESG 100 Portfolio” using the free float capitalization-weighted method. From July 2018 to May 2020, the “CSI 800 High ESG 100 Portfolio” outperformed the CSI 800 benchmark by 3.1%, while the “CSI 800 Low ESG 100 Portfolio” underperformed the benchmark by 3.6%. During the same period, the “CSI 800 High ESG 100 Portfolio” experienced a maximum drawdown of 17.5%, superior to that of the “CSI 800 Low ESG 100 Portfolio”, whose maximum drawdown was 23.7% instead.

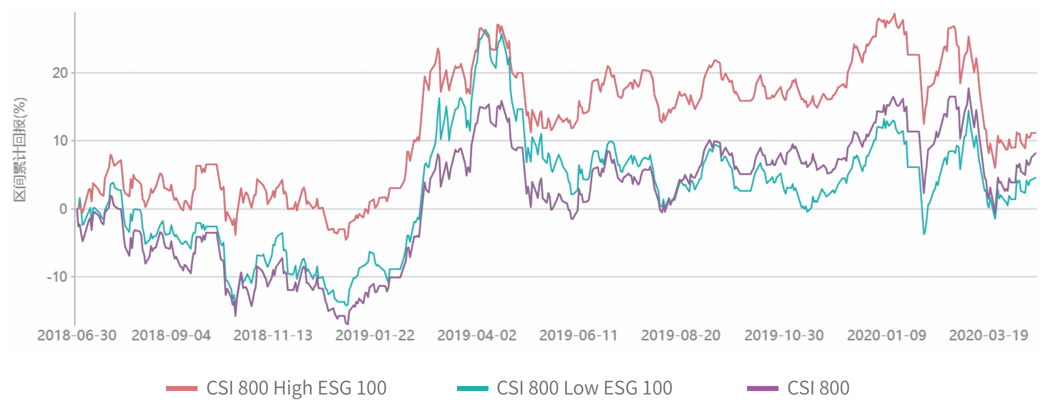


Figure 16 Performance of CSI 800 High ESG 100 vs. Low ESG 100 Portfolios

Source: SynTao Green Finance, Wind

The back testing above indicates that a positive correlation exists between the listed companies’ ESG performance and stock prices in the A-share market, which would drive the further development of ESG investing in China.

Written by

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SynTao Green Finance is a leading ESG service provider in China that is dedicated to professional services in green finance and sustainable investment. It is committed to providing professional services ranging from ESG data and rating, green bond assurance, to the consulting and researching services in the sustainable investment and green finance areas. SynTao Green Finance is the initiator of China Social Investment Forum (China SIF), a signatory to the UN Principles for Responsible Investment (PRI), and a founding member of the Green Finance Committee (GFC) of China Society of Finance and Banking. It advocates for the establishment of a responsible capital market in China and supports the country in policy researches and practices to establish a green finance system.

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