



# SUSTAINABLE FITCH

BRUNEL Banking Conference – ‘Where ESG  
Matters in Credit for Financial Institutions’

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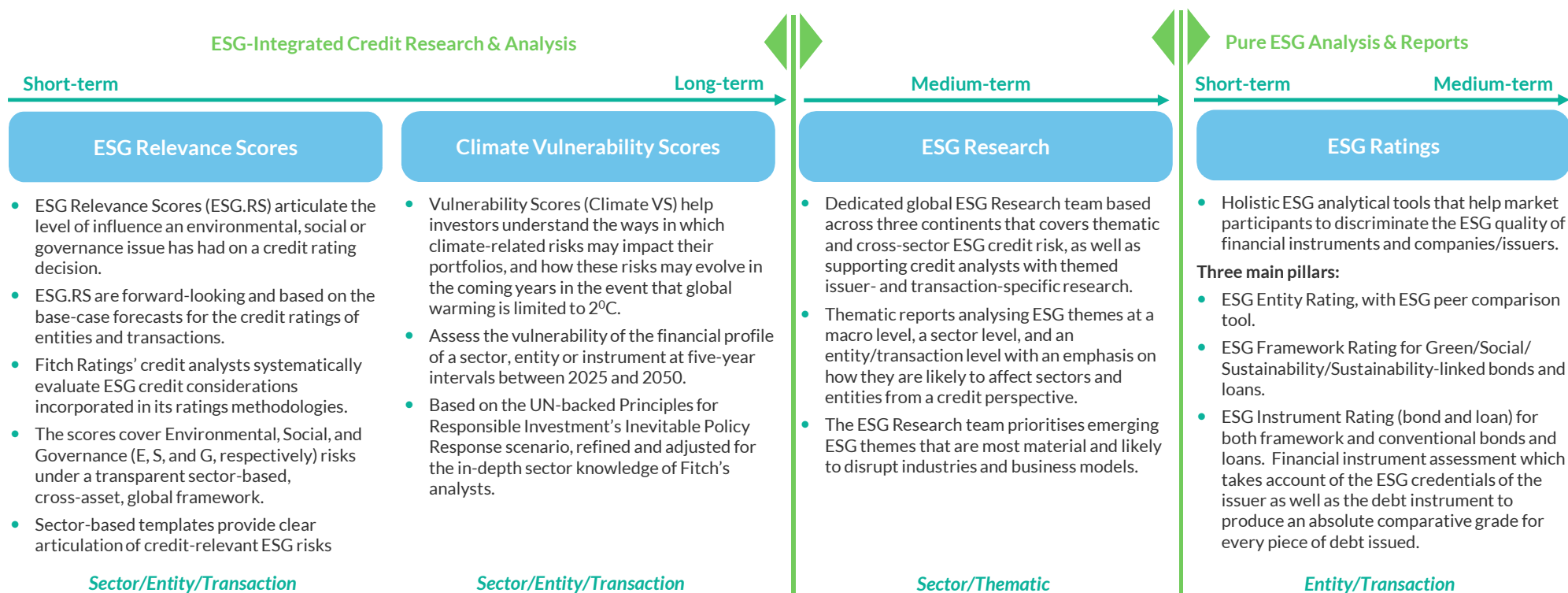




# AGENDA

- How does Fitch Ratings assess ESG impact on credit ratings?
- What are our ESG Relevance Scores and how do they work?
- Examples of how ESG can affect a financial institution's credit profile
- Looking ahead to ESG Impact Trends

# Fitch Group: ESG Solutions



# ESG Relevance Scores: Key Concepts



## Focus on Credit and Rating Impact

- Not concerned with ESG merit of company or how much it talks about, cares about or invests in its ESG profile.
- There is no moral or ethical opinion attached to the ESG.RS (eg 'How 'green' is this company?').



## Highlight Relevance and Materiality

- Scores of '1' and '2' are different forms of irrelevance to the credit (sector versus entity).
- Scores of '3', '4' or '5' signal different materiality (impact) on the credit rating; these scores are relevant to the sector and issuer.



## Observations on Rating Decisions

- ESG.RS are observations on the rating decision that has been taken, not inputs into the rating process.
- Fitch has “extracted the existing ESG issues from its ratings criteria, and assessed their credit impact in order to transparently display how this sub-category of risks affects individual credit rating decisions”.

# General Issues in ESG Relevance Scores Framework

Environmental	Social	Governance
GHG Emissions & Air Quality (EAQ)	Human Rights, Community Relations, Access & Affordability (SCR)	Management Strategy (GEX)
Energy Management (EFM)	Customer Welfare; Fair Messaging, Privacy & Data Security (SCW)	Governance Structure (GGV)
Water & Waste Management (EWT)	Labour Relations & Practices (SLB)	Group Structure (GST)
Waste & Hazardous Materials Management; Ecological Impacts (EHZ)	Employee Wellbeing (SEW)	Financial Transparency (GTR)
Exposure to Environmental Impacts (EIM)	Exposure to Social Impacts (SIM)	Political Stability & Rights (GPS)
Water Resources Management (EWR)	Human Rights & Political Freedoms (SHR)	Rule of Law, Institutional & Regulatory Quality, Control of Corruption (GRL)
Biodiversity & Natural Resources Management (EBN)	Human Development, Health & Education (SHD)	International Relations & Trade (GIR)
Natural Disasters & Climate Change (ENC)	Employment & Income Inequality (SEI)	Creditor Rights (GCR)
	Public Safety & Security (SPS)	Data Quality & Transparency (GDQ)
	Demographic Trends & Population Demographics (SDT)	Transaction & Collateral Structure (GTC)
	Privacy & Data Security (SPD)	Transaction Parties & Operational Risk (GOR)
		Data Quality & Privacy (GDT)
		Policy Status & Mandate Effectiveness (GSM)

Applies to all analytical groups
Applies to Corporates, Financial Institutions (FI), International Public Finance (IPF; Government-Related Entities), US Public Finance (USPF; Revenue, Infrastructure), Structured Finance (SF) & Covered Bonds, Supranationals
Applies to Sovereigns, IPF (Local & Regional Governments), USPF (Tax), Supranationals
Applies to Corporates, FIs, IPF (Government-Related Entities), USPF (Revenue & Infrastructure), Supranationals
Applies to SF & Covered Bonds
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Applies to Sovereigns, IPF (Local & Regional Governments), USPF (Tax), Supranationals, SF & Covered Bonds
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Applies to Sovereigns, IPF (Local & Regional Governments), USPF
Applies to Sovereigns, SF & Covered Bonds, USPF, IPF (Local & Regional Governments)

# ESG Relevance Scores: Definitions

Score	Relevant to Sector	Relevant to Issuer	Material to Rating	Description
5	Yes	Yes	Key Rating Driver	<ul style="list-style-type: none"> <li>Highly relevant to the rating. A key rating driver</li> </ul>
4	Yes	Yes	Rating Driver	<ul style="list-style-type: none"> <li>Moderately relevant to the rating. Not a key rating driver by itself, but has a moderate impact on the rating in combination with other factors</li> </ul>
3	Yes	Yes	Minimal	<ul style="list-style-type: none"> <li>Minimally relevant to the rating. Either has a very low impact or is actively managed in a way that results in no impact on the entity rating</li> </ul>
2	Yes	No	No	<ul style="list-style-type: none"> <li>Irrelevant to the entity rating but relevant to the sector</li> </ul>
1	No	No	No	<ul style="list-style-type: none"> <li>Irrelevant to the entity rating and irrelevant to the sector</li> </ul>

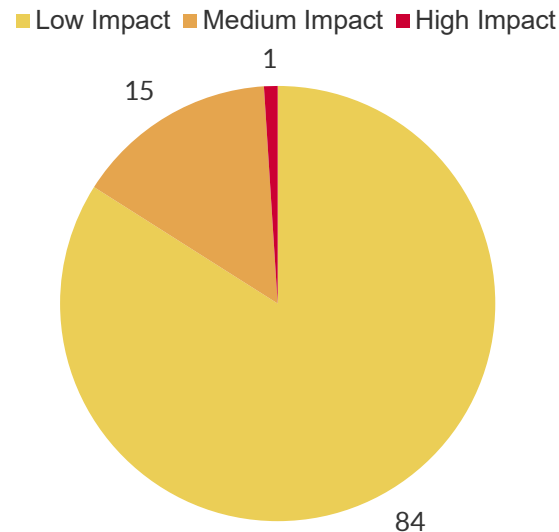


# ESG Credit Impact Is Limited for Financial Institutions

- At end-2021:

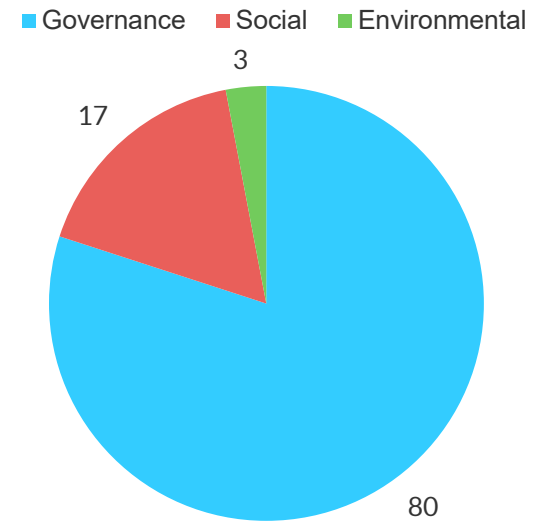
- ESG factors affected only 16% of FI ratings
- Governance issues have greatest impact
- Social impact is slightly relevant
- Environmental issues have minimal credit impact

**ESG Impact on Global Financial Institution Ratings (%)**  
End-2021



Source: Fitch Ratings

**Governance Issues Dominate**  
High & Medium ESG Impact on Global FI Ratings at End-2021 (%)



Source: Fitch Ratings

# Examples of Governance Impact on FI Ratings

## Governance impact is never positive for FI credit

- Credit Suisse Group AG (BBB+/Stable); 'Governance Structure' scored at '4', as governance issues contributed to recent downgrade
- Wells Fargo & Company (A+/Stable); 'Management Strategy' scored at '4' due to process of remediating risk control issues and response to regulatory findings
- ORIX Corporation (A-/Stable), one of Japan's largest non-bank financial companies, is scored '4' for Group Structure to reflect its complex organisational structure
- Vietnam Joint Stock Commercial Bank for Industry and Trade (BB-/Positive), one of the largest state-owned Vietnamese banks, is scored '4' for 'Financial Transparency' to reflect issues surrounding quality and accuracy financial reporting standards





# Examples of Social Impact on FI Ratings

## Some positive impact from social issues:

- International Personal Finance plc (BB-/Stable), a UK-based high cost consumer finance provider, is scored '4' for 'Exposure to Social impacts' as its business model exposes the company to shifts in consumer preference and regulatory scrutiny
- IDFinance Spain S.A. (B-/Stable), a Spanish online consumer finance lender targeting underbanked borrowers, is scored '4' for 'Customer Welfare, fair messaging & data security' to reflect regulatory scrutiny around pricing structures
- Freddie Mac and Fannie Mae (both AAA/Negative), two US government-sponsored entities that play core roles in the country's housing finance system, are scored '4[+]' for 'Human Rights, Community Relations, Access & Affordability' because their public missions underpin government support for them
- BNG Bank N.V. (AAA/Stable), a large Dutch policy bank, is scored '4[+]' for Human Rights, Community Relations, Access & Affordability' because its role in financing housing associations at low cost underpins government support for the bank



# Examples of Environmental Impact on FI Ratings

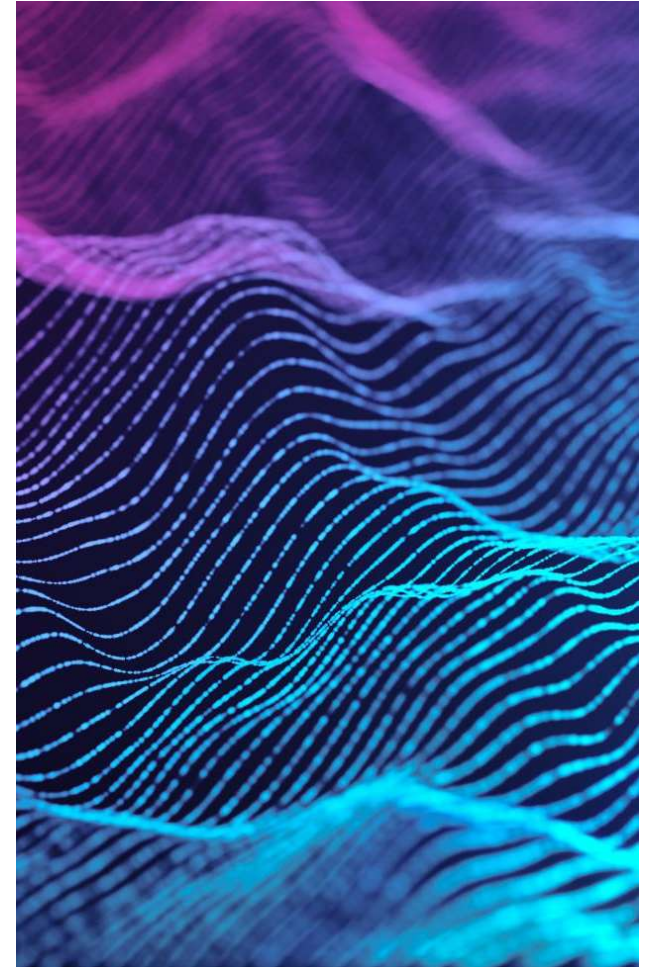
## Rare cases of environmental impact:

- Banks' well-diversified loan and investment portfolios, plus mitigating factors such as insurance cover, minimise physical climate-related risks associated with extreme weather events
- Kenyan bank ratings are negatively affected by 'Exposure to environmental impacts', scored at '3', to reflect the risk of droughts and related locust plagues on agricultural loans, for example
- TechnoLeasing LLC (B-/Stable), a Kazakhstan agricultural equipment lessor, is scored '4' for 'Exposure to environmental impacts' due to higher credit risk associated with weak harvests in periods of poor weather



# Looking Ahead to ESG Impact Trends

- **Governance** issues likely to continue to dominate
- **Environmental** impact is likely to increase for banks as borrowers' transition pathways force up costs and alter debt repayment capacity, regulatory climate change stress-testing heightens awareness and possible prudential regulation change, and increased requirements for environmental disclosure adds to transparency. The insurance sector will likely face additional environmental impacts through market value disruption and mounting extreme weather-related claims (physical risk)
- Positive **Social** impact likely to continue to feed through to FI credit ratings given that social issues and sustainability strategies are rising in prominence for investors, regulators, and stakeholders generally





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