Bond Case Briefs

Municipal Finance Law Since 1971

Fitch Ratings Focuses on ESG Standards with New Scoring System.

Agency finds only 3% of corporate ratings have changed as a direct result of ESG considerations.

Fitch Ratings is launching a new scoring system that will incorporate environmental, social, and governance (ESG) factors into the ratings of each individual entity the credit ratings agency grades.

The new ESG Relevance Scores aim to "transparently and consistently display both the relevance and materiality of ESG elements to each respective rating decision," according to a report from Fitch.

To begin, the ratings agency incorporated the new scoring system into more than 1,500 non-financial corporate ratings and found that 23% of its current corporate ratings are being influenced by individual ESG issues, with just under 3% currently having one of those subfactors single-handedly leading to a change in the rating, according to the report.

The new scoring system will encompass banks, non-bank financial institutions, insurance, sovereigns, public finance, global infrastructure, and structured finance.

The new system may influence impact investing, a method in which investors seek to engage in companies and organizations with the intention to generate a measurable beneficial social or environmental impact. According to data from the United Nations' Principles for Responsible Investments organization, 465 investors made impact-related investments in 2016, representing $1.3 trillion in combined assets under management, up from 280 and $800 billion in 2014.

One major area of impact investing is investments in energy efficiency businesses, which continues to grow. A study by the International Energy Agency (IEA) concluded that investments of $230 billion were made in energy efficiency businesses in 2016. The investments were partitioned between transportation ($61 billion), industry ($37 billion), and buildings ($133 million).

The importance of ESG is also reflected in the international needs for affordable housing and social development. According to a study by the PRI, between $300 billion and $400 billion in mortgage issuance a year could be needed by 2025 to fund acquisitions of new affordable housing–equitable to approximately 7% of global new mortgage origination volume in 2025.

"The scores do not make value judgements on whether an entity engages in good or bad ESG practices, but draw our which E, S, and G risk elements are influencing the credit rating decision," said Andrew Steel, global head of sustainable finance.

Some organizations, such as the California Public Employees' Retirement Systems (CalPERS) and the California State Teachers' Retirement System (CalSTRS), have been pressured to divest from investments that do not meet generally accepted ESG standards. The two pensions were mandated to divest from investments in coal companies after California Gov. Edmund Brown Jr. enacted legislation requiring them to do so in 2015.

CHIEF INVESTMENT OFFICER

January 7, 2019