Bond Case Briefs

Municipal Finance Law Since 1971

Fitch Ratings Launches Summary Sheet of Changes to ESG Relevance Scores.

Fitch Ratings-London-15 October 2021: Fitch Ratings has summarised changes to ESG Relevance Scores (ESG.RS) for the first nine months of 2021. Across the Fitch rated universe there were nearly 380 instances of an ESG.RS being changed, split nearly equally between scores improving and deteriorating. In some cases, an issuer or issue will see a deterioration and subsequent improvement, but they are counted as unique changes.

Changes to scores related to environmental issues accounted for 19% of score changes, with slightly more than half being improvements to scores, mostly from a '3' to a '4' and a few to a '5'. This indicates that a general issue was having a material impact on the credit rating, either in conjunction with other factors ('4') or was a key rating driver ('5').

'Exposure to Environmental Impacts' was the most frequent cited issue, with the highest concentration around US public finance (USPF) entities, specifically utilities affected by the extreme cold weather in Texas in February 2021. With 27 scores increasing, this was the highest concentration in any asset class around a single general issue.

There were also some increases in ESG.RS that reflected a positive impact on the credit rating. These were driven by sustainable building practices that led to a rise in scores in two US structured finance CMBS issues and a non-bank financial institution transaction that focused on sustainable infrastructure.

Improvements in ESG.RS occurred for a variety of reasons and usually scores moved from a '4' to a '3'. Most instances were in corporates, with smaller concentrations in financial institutions and public finance. The reduction in ESG.RS scores were due to clear and updated emissions targets, divestment from coal-fired power generation and reduced exposure to extreme weather.

Changes to scores related to social issues accounted for 14% of all changes. Financing and leasing issuers had a high prevalence of deterioration in scores around 'Customer Welfare' due to exposure to high-cost consumer lending and to compliance risks. Under general social issues, there were instances of score increases reflecting a positive impact on the rating (signified with a '+' next to the score), mainly revolving around a business's positive impact on access and affordability of financial or housing services to under-banked or under-served populations. These can be beneficial through a financial institution's central policy role or through access to state-guarantees to provide banking services to citizens with lower incomes.

The largest share of score changes was in governance, with nearly two-thirds of all score changes, in line with the wider trend of Governance issues being the dominant drivers of elevated ESG risks in credit ratings. The split was equal between scores being raised and lowered.

Half of all score changes within governance were improvements, but nearly 20% of these were instances of the score falling from a '5' to a '4', indicating that the issue was still pertinent for the credit rating. Most decreases were in corporates often due to material weakness in internal controls or owners’ strong influence on management.

North American entities experienced material weakness in internal controls. APAC issuers had problem that caused delays in finalising refinancing and independence risk at board level. European and South American companies had concerns over concentration of ownership and reorganisation. There was also a concentration in ‘Management Strategy’ and ‘Financial Transparency’ issues.

For further details, please see a sample of “ESG.RS Changes Summary 9M 2021” available at www.fitchratings.com. The full list of ESG.RS changes, including rationales and links to the relevant RACs, is available for Fitch Solutions feed subscribers.

Marina Petroleka
Senior Director, Sustainable Finance
+44 20 3530 1464
30 North Colonnade, Canary Wharf
London, E14 5GN

Kwok Wan
Associate Director, Sustainable Finance
+44 20 3530 1593

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email: adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com