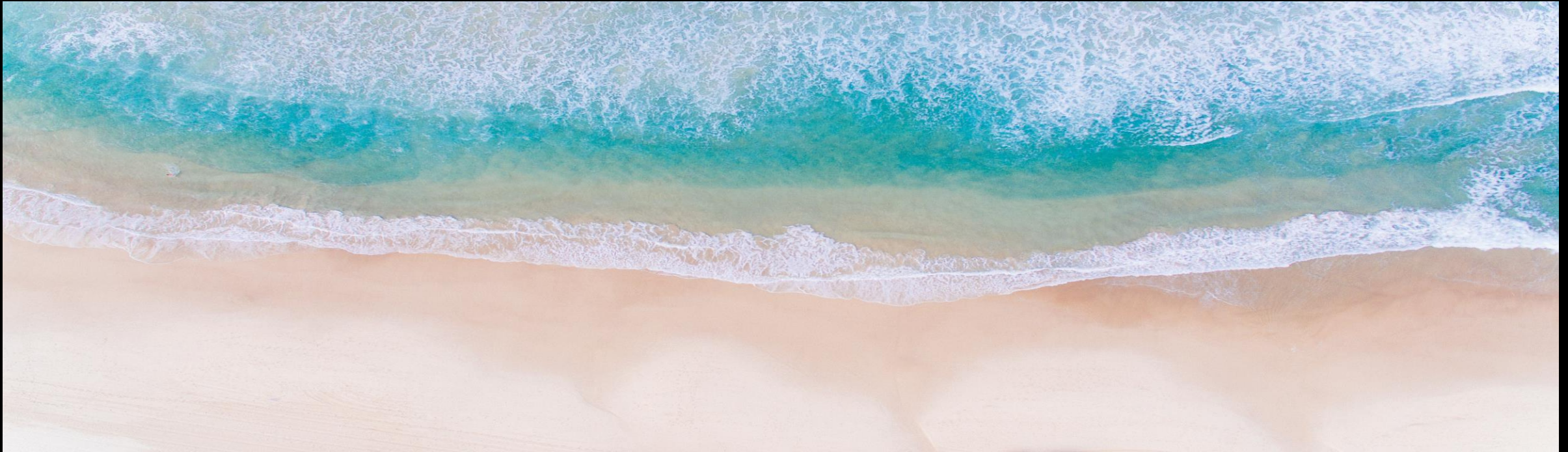


The Evolution of Environmental, Social and Governance (ESG) Factors and Credit Risk Assessment

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Supervision, Risks & Profitability
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Growing Regulation and Best Practices on ESG and Credit Risk

- *“Financial market participants should be required to **disclose specific information** regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts”*

Source: [Regulation \(EU\) 2019/2088](#) of the European Parliament and of the Council of [27 November 2019](#) on sustainability-related disclosures in the financial services sector

- *“Institutions should incorporate **ESG factors and associated risks in their credit risk appetite and risk management policies**, credit risk policies and procedures, adopting a holistic approach”*

Source: Guidelines on loan origination and monitoring, [EBA, 29 May 2020](#)

- *“EBA recommends that institutions set out appropriate criteria for the assessment of the creditworthiness of counterparties, taking **ESG factors and ESG risks into account**”*

Source: Report on management and supervision of ESG risks for credit institutions and investment firms, [EBA, 23 Jun 2021](#)

- *“La funzione di **Risk Management incorpori i fattori climatici e ambientali** nella valutazione dei rischi e monitoraggio elaborando report su tipo e livello di materialità [...]”*

Source: Aspettative di vigilanza sui rischi climatici e ambientali, [Bank of Italy, 8 April 2022](#)

S&P Global Ratings Approach to integrate ESG in Credit Ratings (1)

The intersection of ESG & Credit



- ESG credit factors are those ESG factors that can materially **influence the creditworthiness** of a rated entity or issue, with sufficient **visibility** to materialize;
- However, **not all ESG factors materially influence creditworthiness**;
- **Examples of ESG credit factors include:** Climate transition risks and pollution & waste (Environmental); Health & Safety and Human capital (Social); Governance structure and risk management culture (Governance).

Source: S&P Global Ratings

S&P Global Ratings Approach to integrate ESG in Credit Ratings (2)

ESG Credit Indicators

- ESG credit indicators provide **additional disclosure and transparency** at the entity level and reflect S&P opinion of the influence that ESG factors have on our credit rating analysis.
- They are **not a sustainability rating** or ESG evaluation.

Credit impact					ESG factor	
E-1	E-2	E-3	E-4	E-5	Climate risk	
S-1	S-2	S-3	S-4	S-5	--	
G-1	G-2	G-3	G-4	G-5	Transparency	
Positive	Neutral	Moderately negative	Negative	Strongly negative		

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S&P Global Ratings Approach to integrate ESG in Credit Ratings (3)

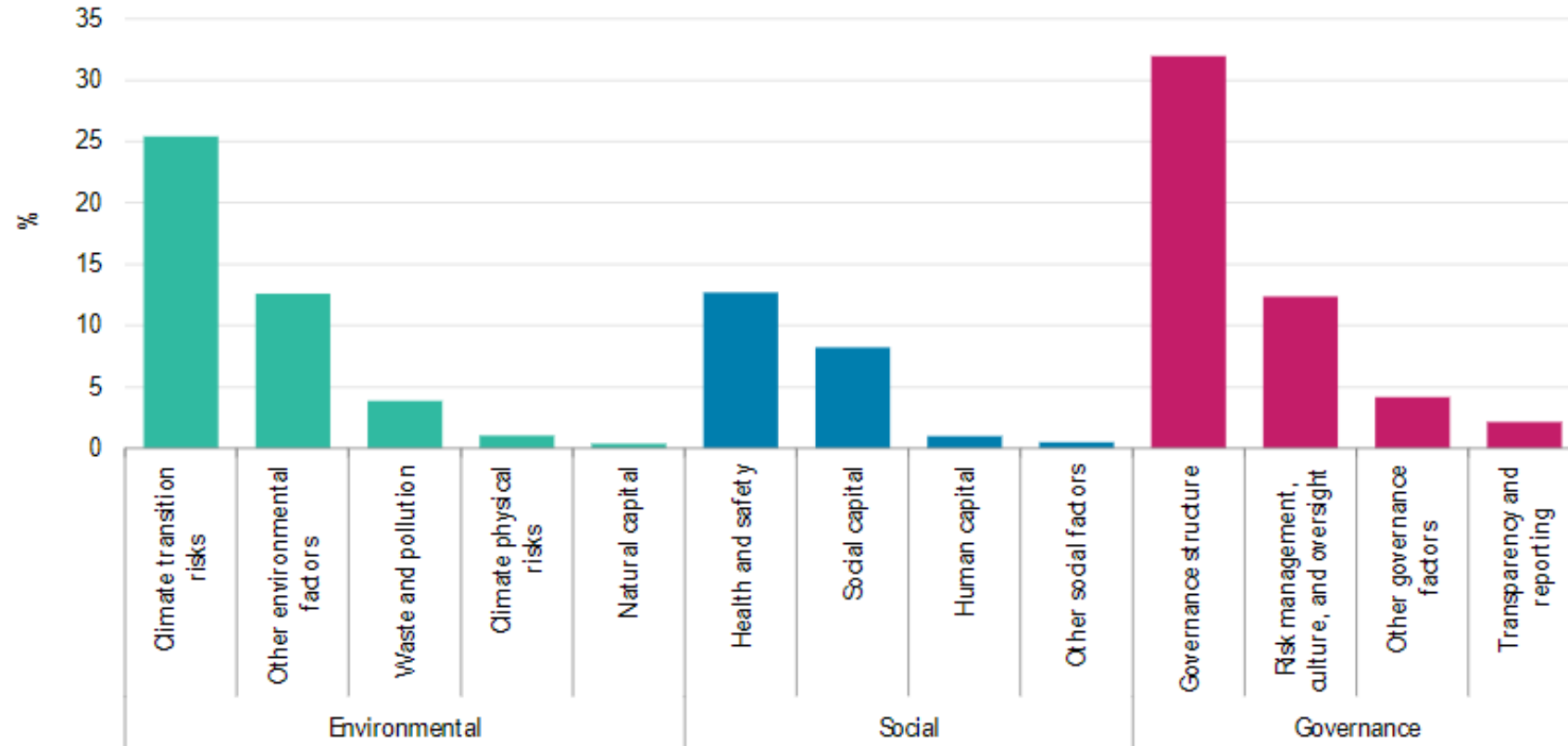
Increasing Evidence of ESG Impacting on Credit Risk

- “**Royal Dutch Shell PLC** Downgraded To 'A+/A-1' [...] on increasing risks from the energy transition and weak industry profitability” Feb 18, 2021
- “**Boeing Co.** Rating Lowered To 'BBB' On Weaker Cash Flows Due To MAX Grounding” Mar 16, 2020
- “**Volkswagen** Ratings Lowered To 'A-/A-2' On Governance” Oct 12, 2015
“**Volkswagen** Downgraded To 'BBB+' from 'A-' On Adverse Emissions Impacts” Dec 01, 2015
- “**Swedbank AB** Downgraded To 'A+/A-1' On Regulators Finding Anti-Money-Laundering Deficiencies” Mar 27, 2020

Impact of ESG Credit Factors

Climate Transition Risks And Governance Structure Are The Most Cited Risks Of Global Corporates

% of rated universe



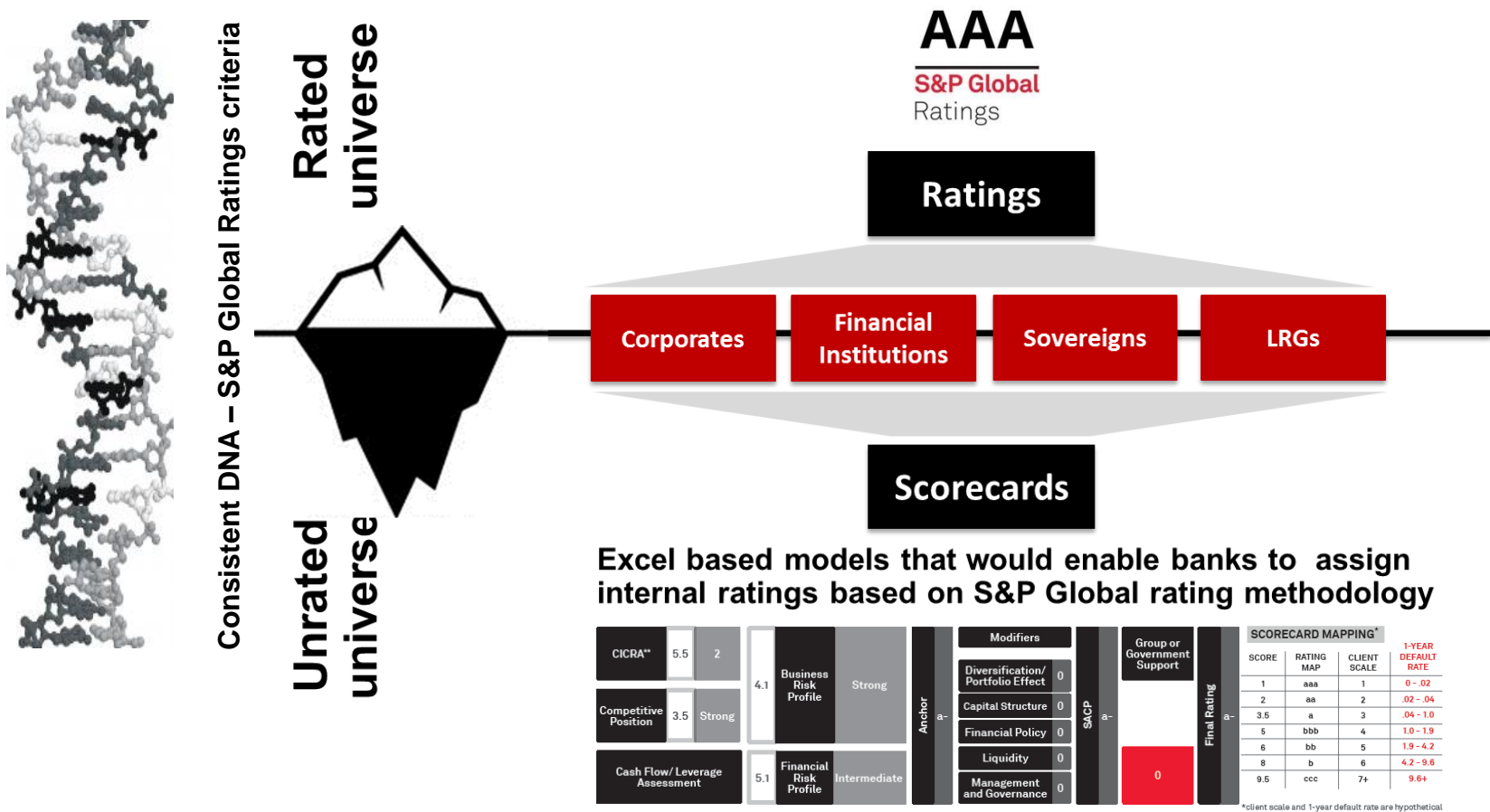
Source: S&P Global Ratings.

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Corporate Scorecard Methodology with ESG Credit Indicators

Our unique DNA across rated and unrated universe

Scorecards allow to manage unrated exposures using a consistent “risk language”



What is a **Credit Assessment Scorecard with ESG Indicators**?



Tool to assess:
ESG Credit Indicators, and
their influence on credit quality



Includes detailed **ESG Sector and
Country Heat Maps**



Broadly aligned with **S&P Global
Ratings criteria and ESG
Principles**



**Well-documented and
transparent**



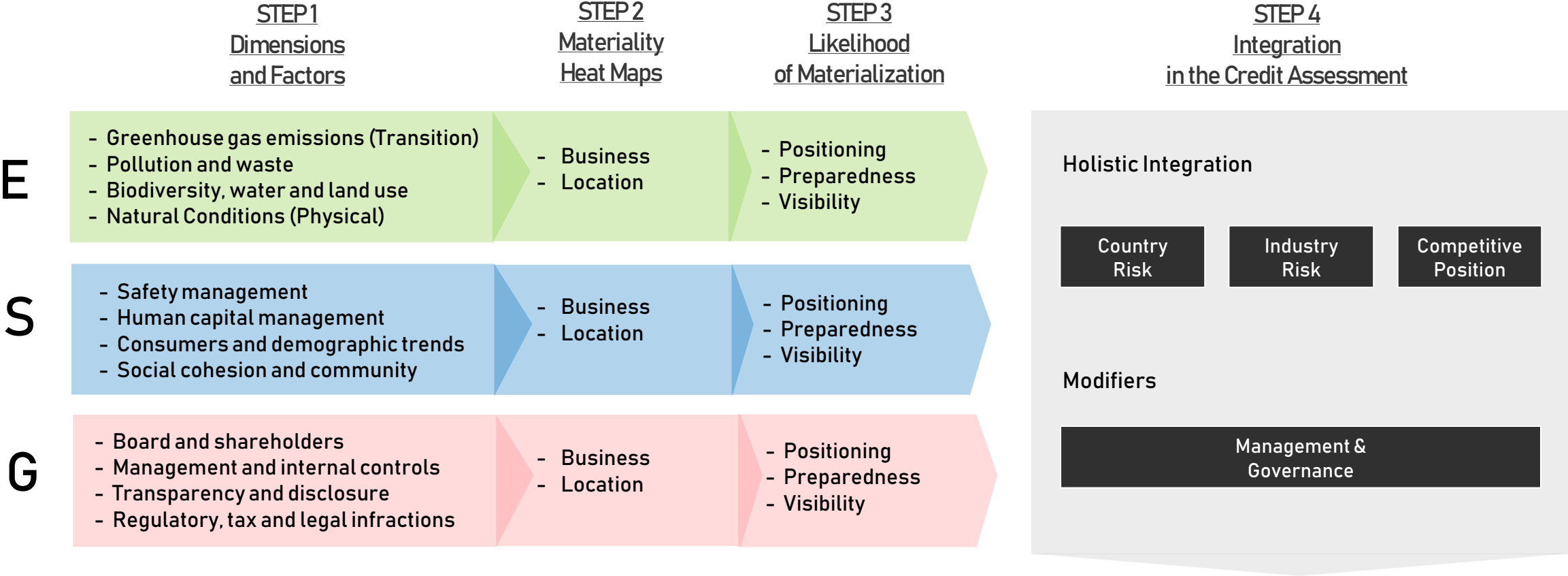
Coverage of **multiple sectors and
geographies**



Excel-based

Transparent and Structured Approach to Integrate ESG in Credit Assessment (1)

Leveraging on Sector and Country average data, adjusted by entity specific positioning and time-horizon



Source: ESG in Credit Risk Assessments – Credit Assessment Scorecards – S&P Global Market Intelligence

Transparent and Structured Approach to Integrate ESG in Credit Assessment (2)

Leverage S&P Ratings, Trucost, CSA and World Bank data to develop rankings, benchmarks and scores

<i>Factors</i>		<i>Materiality HeatMaps</i>				<i>Likelihood</i>	<i>Impact</i>		
<i>Dimension</i>	ESG Factors	Sector Mix		Country Mix		Entity Positioning and Preparedness	ESG Factors Time Horizon	ESG Credit Metrics	
		<i>Score</i>	<i>Weight</i>	<i>Score</i>	<i>Weight</i>			<i>Weight</i>	<i>Score</i>
E	Greenhouse gas emission	1.2	95%	3.1	5%	Leading	3 to 5 years	25%	E1
	Pollution and waste	1.6	95%	3.4	5%				
	Biodiversity, water, and land use	1.8	95%	2.2	5%				
	Natural Conditions (Physical / Climate)	-	-	4.1	-				
S	Safety management	3.6	75%	1.9	25%	Weak	1 to 2 years	36%	S4
	Human capital Management	2.8	75%	2.6	25%				
	Social cohesion and community	3.4	75%	2.1	25%				
	Consumer and demographic trends	2.2	75%	2.9	25%				
G	Shareholders and Board	2.3	25%	2.0	75%	Adequate	3 to 5 years	39%	G2
	Management and Control	2.9	25%	2.2	75%				
	Transparency and disclosure	3.4	25%	1.7	75%				
	Legality and regulation	4.0	25%	2.3	75%				

Source: ESG in Credit Risk Assessments – Credit Assessment Scorecards – S&P Global Market Intelligence

ESG in Credit Risk: Developments

Specific actions for corporate loan analytics and credit risk management

Clarify methodological approach and train credit analysts

- Define ESG credit risk factors
- Introduce ESG sector materiality map
- Integrate ESG more structurally and transparently in the credit assessment

Ensure consistency of definitions, data and models

- Clarify connection between credit and ESG assessments
- Shifting focus of assessments on the overall sustainability of borrowers' business models

Enhance models, data and criteria as new evidence becomes available

- Build robust and flexible methodological framework to evolve over time

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