

Credit Ratings Agencies Increasing their Focus on ESG Risks

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Fitch Ratings announced on Monday that it has launched a new integrated scoring system that shows how environmental, social and governance (ESG) factors, such as climate change, human rights and labor issues, impact individual credit rating decisions.

Its ESG Relevance Scores are sector-based and entity-specific. Fitch has started with over 1,400 non-financial corporate ratings, which it is initially making publicly available at www.fitchratings.com/site/esg. In contrast to other third-party ESG ratings available in the market today, Fitch states that these scores do not reflect judgments as to whether an entity has positive or negative ESG practices, but rather discloses how an environmental, social and/or governance issue specific to the entity influences its current credit rating. The ESG Relevance Scores aim to be transparent and to allow investors to agree or disagree with the way in which it has treated ESG at the entity and sector level.

Fitch's initial research indicates that 22% of its current corporate ratings are influenced by E, S or G factors, with approximately 3% currently having a single environmental, social or governance factor that itself led to a change in the rating.

Due to increased demand, credit raters have been generally exploring ways to incorporate ESG factors into their ratings. For instance, S&P Global Ratings has for some time incorporated ESG risk and analysis into its credit ratings of public finance entities. S&P Global Ratings, Moody's Investor Service and Fitch Ratings, along with various other smaller or regional credit rating agencies, have signed onto the United Nations-launched Principles for Responsible Investment's ESG In Credit Ratings Initiative, which initiative aims to enhance the systematic and transparent consideration of ESG issues in fixed-income markets.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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