

ESG at S&P Global Ratings

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S&P Global
Ratings

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Agenda

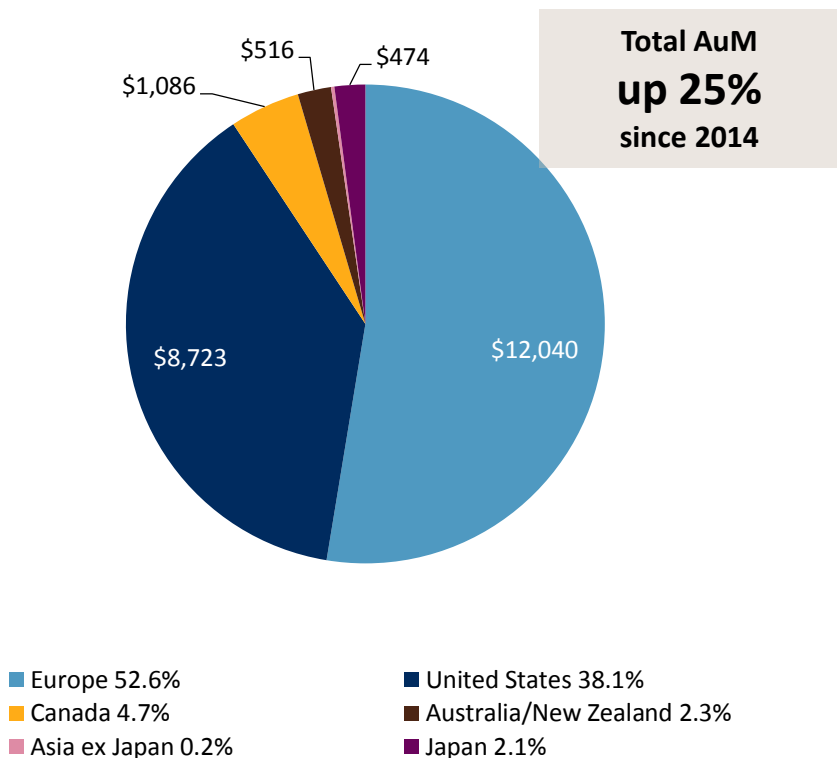
- How does S&P incorporate ESG factors in ratings?
- What are the challenges to integrate ESG factors in investment decision?
- A general analytic framework of S&P ESG Evaluation

ESG in Ratings

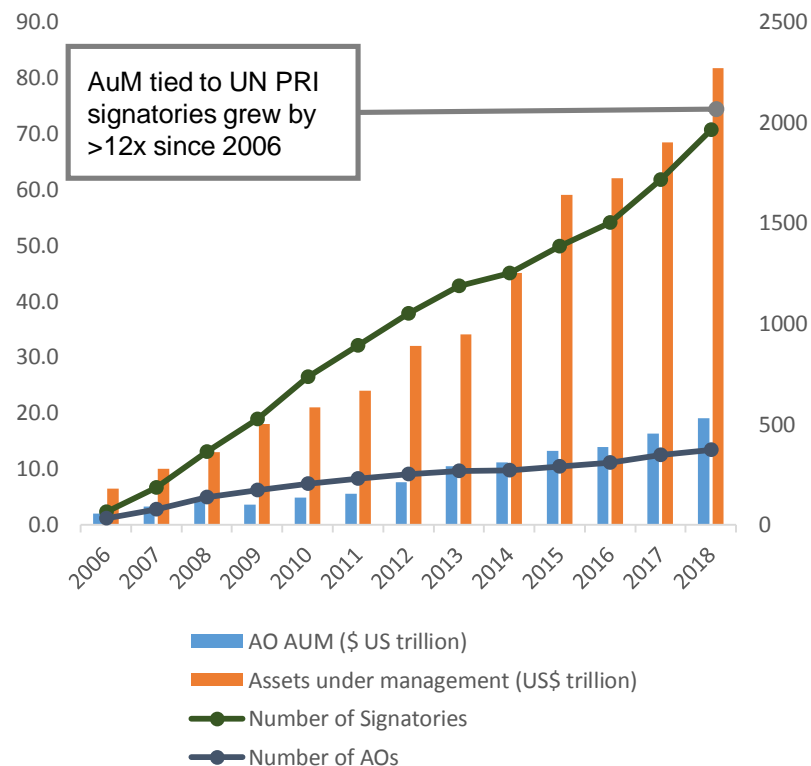


Investor Focus is Driving Growth of ESG Data & Insights

Responsible Investment Strategy Assets by Region; Total AuM \$23 Trillion, 2016



Number of Signatories (RHS) and Associated AuM (LHS, USD \$ Trillion)

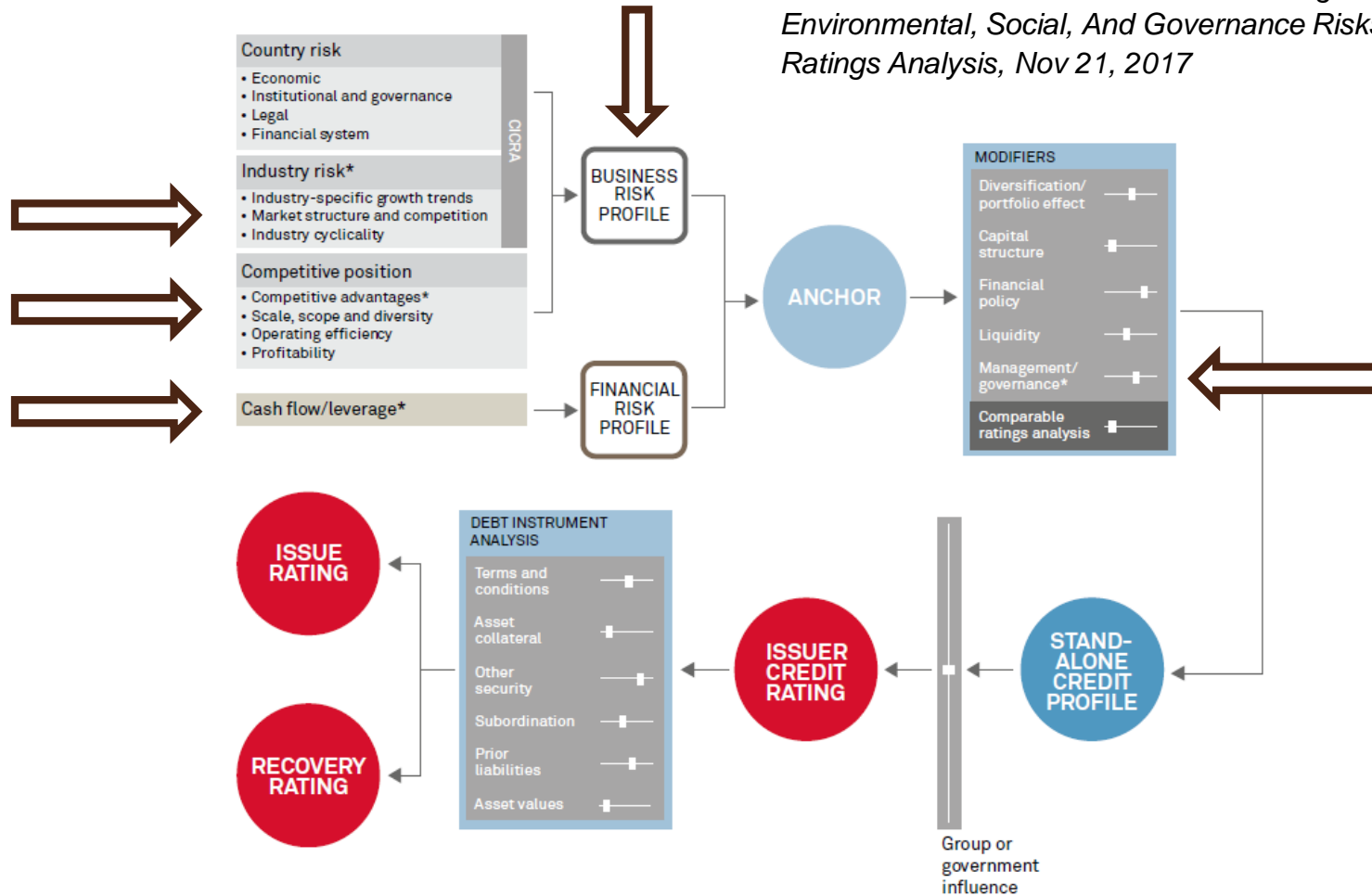


Source: Global Sustainable Investment Alliance (GSIA) Global Sustainability Investment Review 2016; UN Principles for Responsible Investment 2018

ESG in Credit Ratings

There are around **100 references** to ESG factors **across 40 sectors** in the sector level Key Credit Factors.

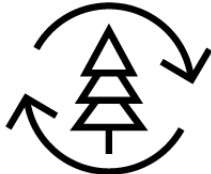
Credit FAQ: How Does S&P Global Ratings Incorporate Environmental, Social, And Governance Risks Into Its Ratings Analysis, Nov 21, 2017



ESG & Credit – Look Back Study Series

Corporate Ratings Impacted By ESG Factors

June 2015 - June 2017



Environmental



Social



Governance

ESG

ESG reference

717

346

262

1325

Rating driver

106

42

77

225

ESG & Credit – The Trend and Impact Seem to be Changing

Rating impacts of environmental factor (June 2015 - June 2017):

Positive rating actions		Negative rating actions	
CreditWatch Positive placement	5	CreditWatch Negative placement	4
Outlook Revised to positive	11	Outlook revised to negative	9
Outlook revised to stable from negative	11	Outlook revised to stable from positive	3
Upgrade	20	Downgrade	43
Total	47	Total	59
Percentage of total actions in the positive direction	44%	Percentage of total actions in the negative direction	56%

Relatively balanced impact (compared with 79% negative last review) indicating potential increased awareness and mitigation actions.

ESG & Credit – Transparency in Rating Reports

- We are planning to add an ESG section to about 2,000 corporate credit reports.
- We are making it easier for those who use our opinion to see how ESG figures in the credit equation.
- We've been analyzing E, S, and G factors in credit for a long time. We're not asking for anything in addition to what issuers already disclose to us.
- We will be highlighting ESG exposure that might affect cash flow, profitability, debt levels, or business risk and how severe that exposure is and the likelihood of a problem occurring from it:
 - We will state if a company has no notable material credit exposure to ESG factors

S&P Launches E&G Sections in Corp. Credit Rating Reports

Continental AG: Global Auto Supplier

Environmental, Social, and Governance Factors

“Environmental factors are important to our analysis on Continental and could have negative credit implications over the medium term. The global auto industry will be subject to **tightening government regulations** in Europe that address **environmental risks, vehicle safety, and energy independence**. The profitability of Continental and the industry in general is further constrained by **high-cost new technologies to improve fuel economy** and make future vehicles more environmentally sustainable, as well as the available resources needed to deploy these technologies on a large scale. As a tier one supplier, Continental sells lightweight components, **green tires**, and powertrain components that help to **reduce CO2 emissions**. These accounted for about 40% of the company's €44 billion sales in 2017.

Although the **transition from internal-combustion-engine (ICE) vehicles to pure EVs** is still in the early stages, traditional suppliers like Continental **need to participate in this emerging market to secure their future market position**. We expect margin pressure through high R&D spending (about 10% of sales in the auto group) in the next few years given the extensive upfront development costs that Continental will need to absorb until EVs achieve sufficient scale. However, we do not see negative credit implications at the moment as the company has a track record of high R&D spending in recent years (see chart 1).

Social factors do not play a major role in our credit assessment, however we monitor the risk related to product liability issues linked to road and vehicle safety. This is particularly relevant for the company's auto and tire divisions because Continental was forced to recall steer tires for commercial vehicles in 2018. However, these recalls have not significantly affected the company's operating results, **reputation**, or creditworthiness.

We do not view governance factors as a credit concern because Continental's public disclosure and governance framework is consistent with accepted standards and there are no other governance related issues.”

Example

Challenges In ESG Investing



What Are Investors Asking For?

“Which of the following factors limit your firm’s ability to use ESG information in your investment decisions?”

It is all about data!

Response	All (N = 368)	AUM Size			Region		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
		Large	Small	Diff.	US	Europe	Diff.
1 Lack of comparability across firms	44.8%	49.2%	42.7%		45.8%	49.3%	
2 Lack of standards in reporting ESG information	43.2	51.6	39.0	*	42.1	48.6	
3 The cost of gathering and analyzing ESG information	40.5	41.8	39.8		40.2	45.0	
4 ESG information disclosed by firms is too general to be useful	39.4	45.1	36.6		42.1	42.1	
5 Lack of quantifiable ESG information	37.8	43.4	35.0		40.2	40.0	
6 Lack of comparability over time	34.8	38.5	32.9		38.3	35.7	
7 The disclosure of ESG information by firms is too infrequent to be useful	28.3	27.9	28.5		31.8	28.6	
8 Lack of reliability of data/lack of audit and assurance	26.4	46.7	16.3	**	31.8	27.1	
9 There is too much disclosure, making it difficult to filter out what is material	16.6	16.4	16.7		14.0	20.0	
10 Our clients’ mandates prevent us from using ESG information	1.4	0.8	1.6		1.9	1.4	

Source: Amel-Zadeh & Serafeim, “Why and How Investors Use ESG Information: Evidence from a Global Survey,” 2017

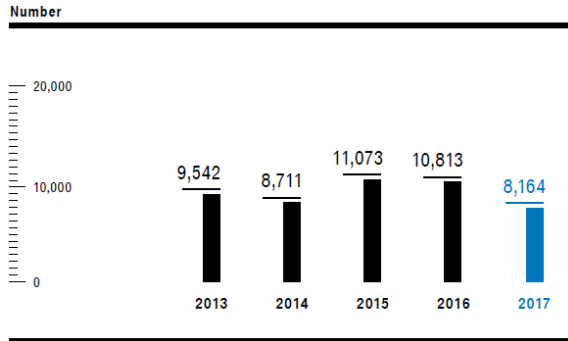
What Are The Challenges?

- Entities do not report ESG data in a standardized manner.
- E&S data often does not cover all the company's operations.
- Entities tend to change their ESG reporting indicators over time, which may limit analysis of historical performance.
- Some entities don't require independent assurance of their ESG data.
- Some sustainability reports are used more as a communication tool than a reporting tool.

Current State of ESG Reporting – An Example of Health & Safety

Total days of work missed due to occupational accidents¹

→ T 4.21



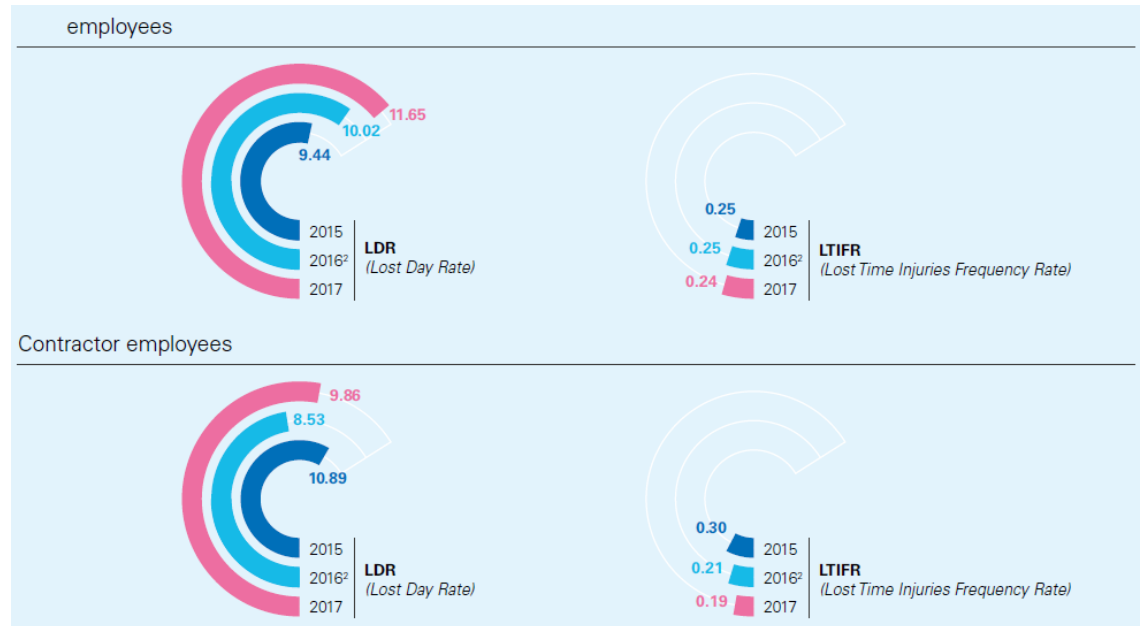
2017			
By Business	Fatal accidents ^(a)	Accidents with at least one day of medical absence ^(a)	Frequency Rate 1 (FR1) ^(a)
	1	207	2.4
	1	99	1.1
	-	54	1.1
	-	49	3.4
Total	2	409	1.7

Safety indicators

2017

TRIR ^(a) : number of recorded injuries per million hours worked	0.88
Group company employees	0.89
Employees of external contractors ^(b)	0.88
LTIR ^(c) : number of lost time injuries per million hours worked	0.58
SIR ^(d) : average number of days lost per lost time injury	27.57 ^(e)
Number of occupational fatalities	1

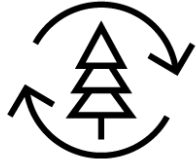
- (a) TRIR: Total Recordable Injury Rate.
- (b) As defined in point 5.4.4.1 of this chapter.
- (c) LTIR: Lost Time Injury Rate.
- (d) SIR: Severity Injury Rate.
- (e) Excluding Saft Groupe.



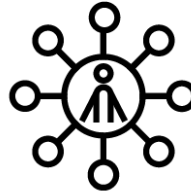
ESG Evaluation



ESG Evaluation



Environmental



Social



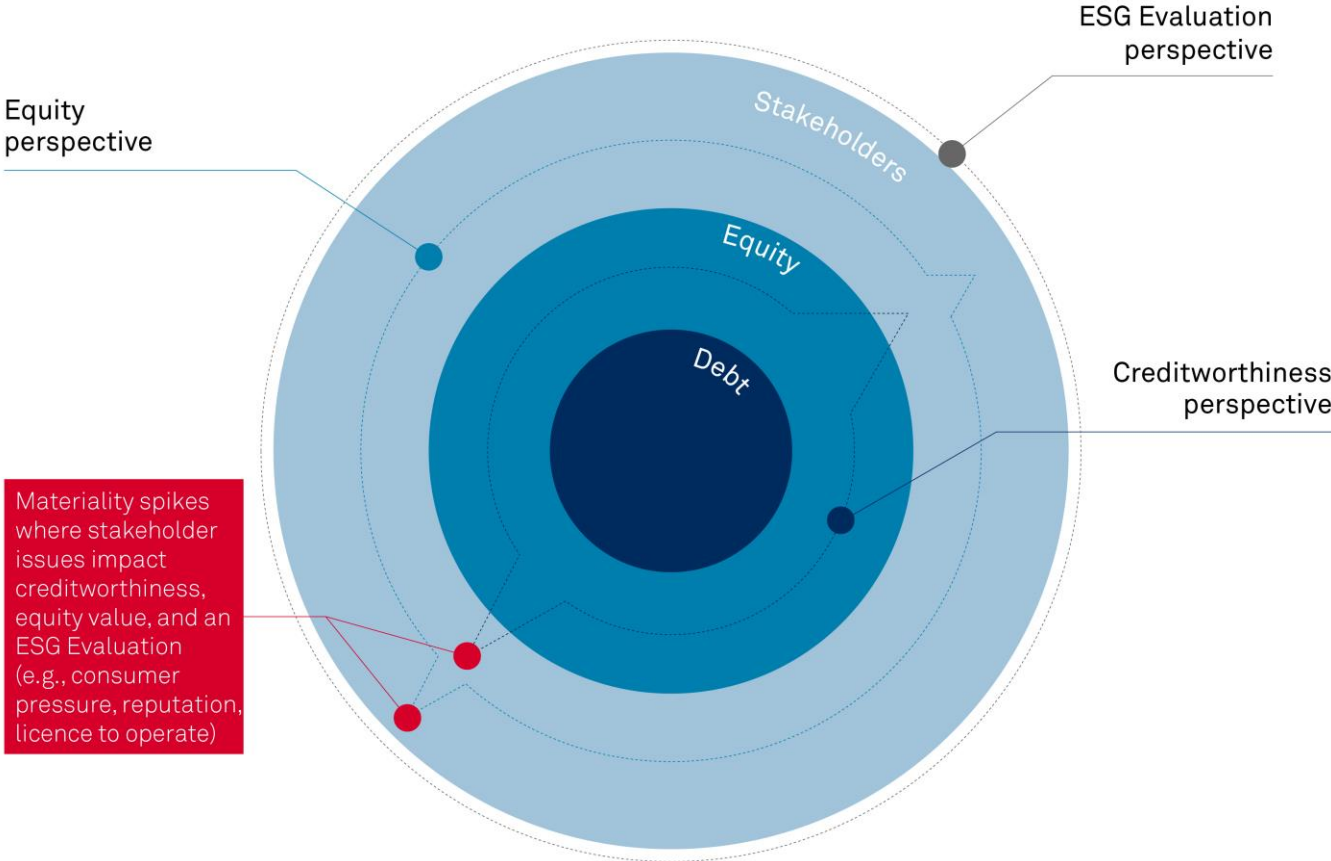
Governance

ESG Evaluation is a **cross sector relative analysis** of an entity's capacity to operate successfully in the **future** and optimize long-term **stakeholder** value in light of its natural and social environment and quality of its governance.

Our analysis is **grounded in financial materiality** by assessing the potential of **ESG risks and opportunities** to effect stakeholders that can have a financial impact, either directly or indirectly, on an entity.














ESG Evaluation - A Broader Perspective

ESG Evaluation Perspective, Creditworthiness Perspective and Equity Perspective.

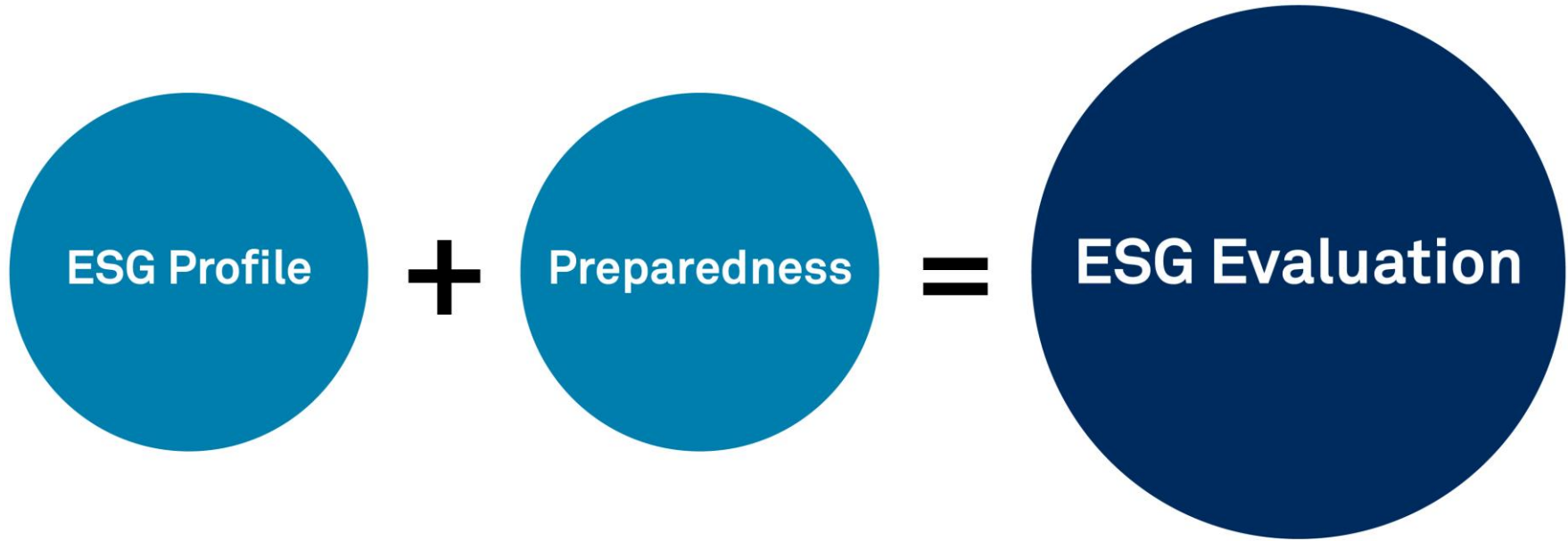


ESG Factors

ESG Factors

Environmental	Social	Governance
 Biodiversity	 Customers	 Reporting
 Carbon	 Human capital	 Structure
 Waste	 Human rights	 Transparency
 Water	 Safety	 Values
	 Social cohesion	

ESG Evaluation - Proposed Analytical Approach



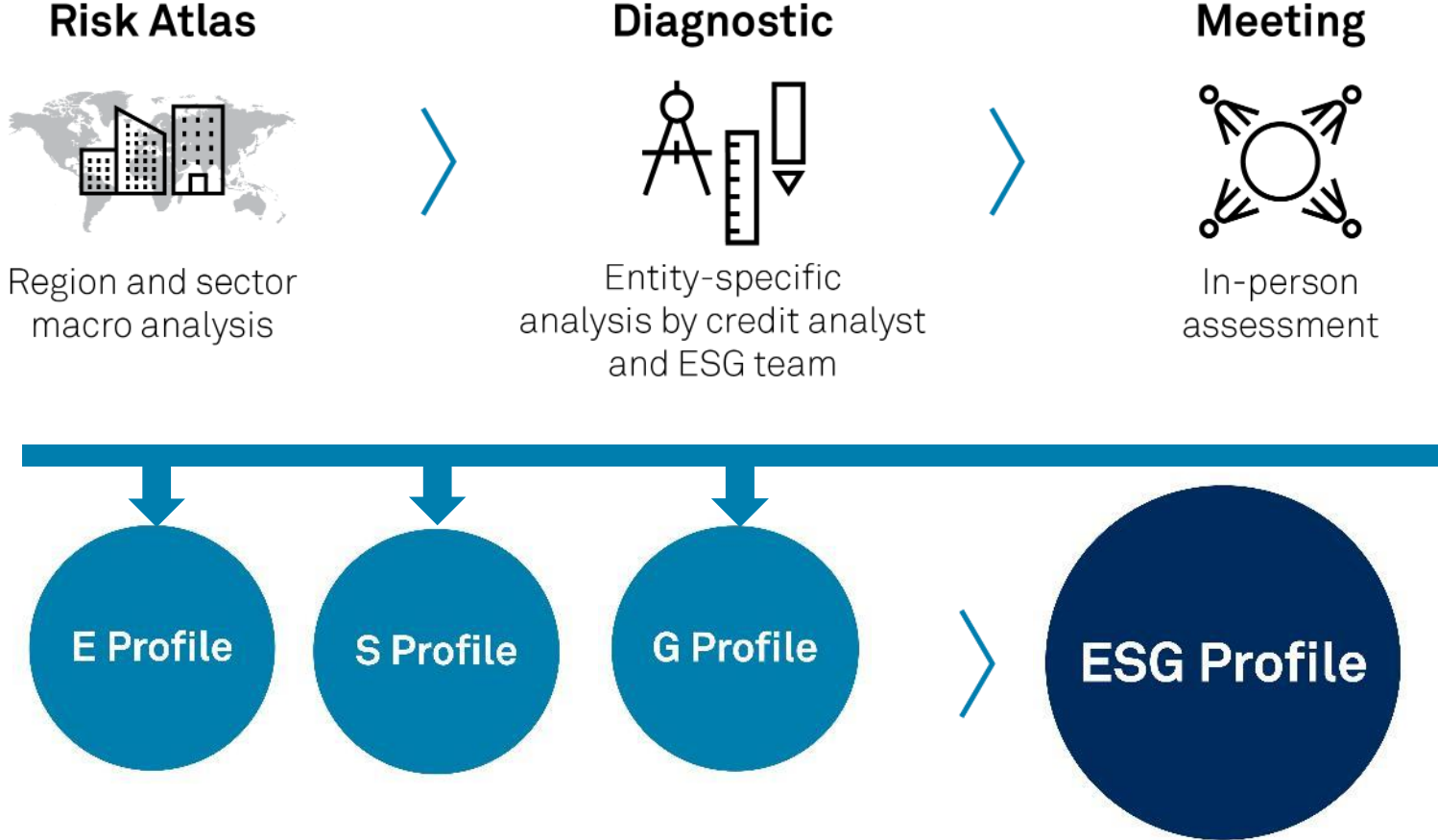
Focus on

- Financial Materiality
- Stakeholder Value

Differentiators

- Analyst knowledge of companies
- Meeting with management
- Forward looking
- Preparedness assessment

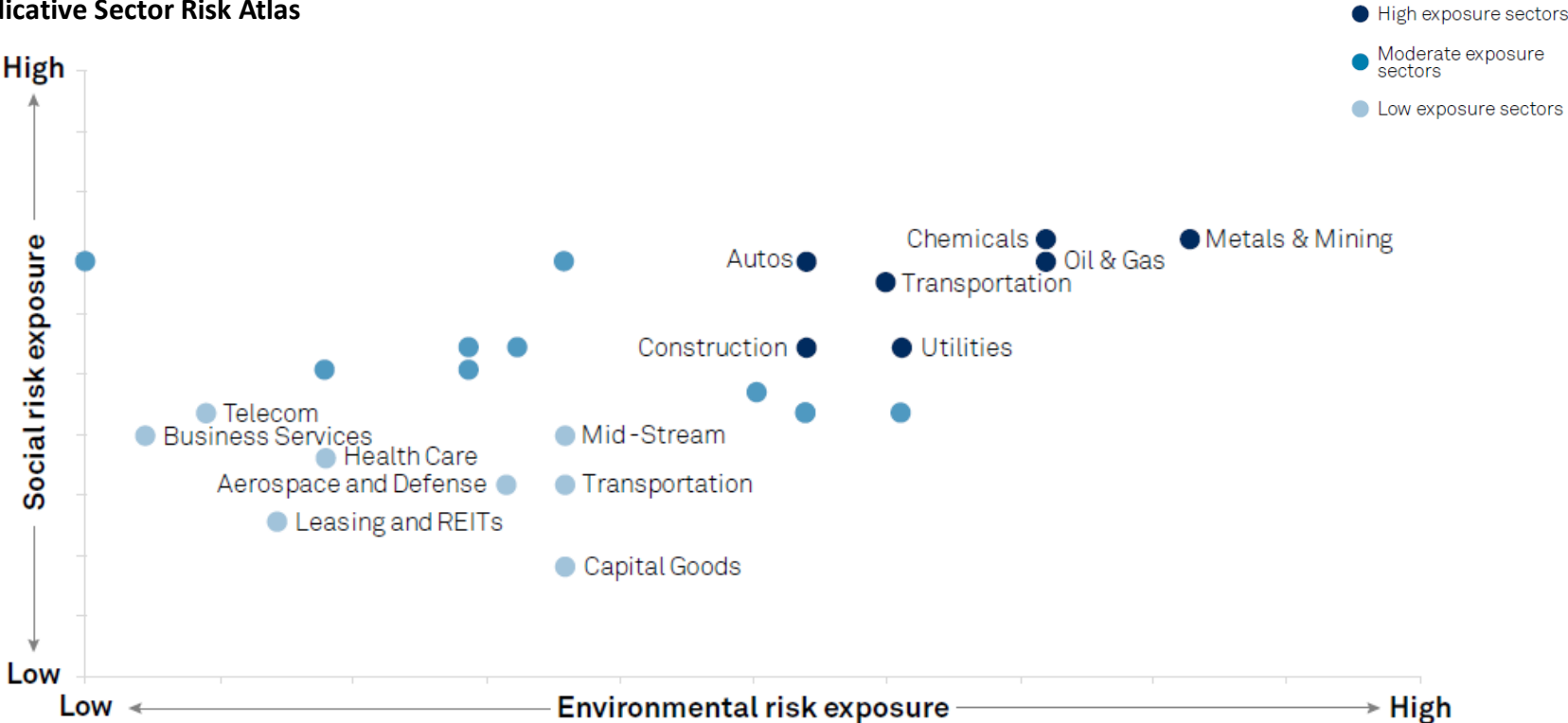
ESG Evaluation - Profile



Risk Atlas – Sector

Sector Exposure Score reflects our assessment of the **relative potential environmental & social risk exposures for a sector.**

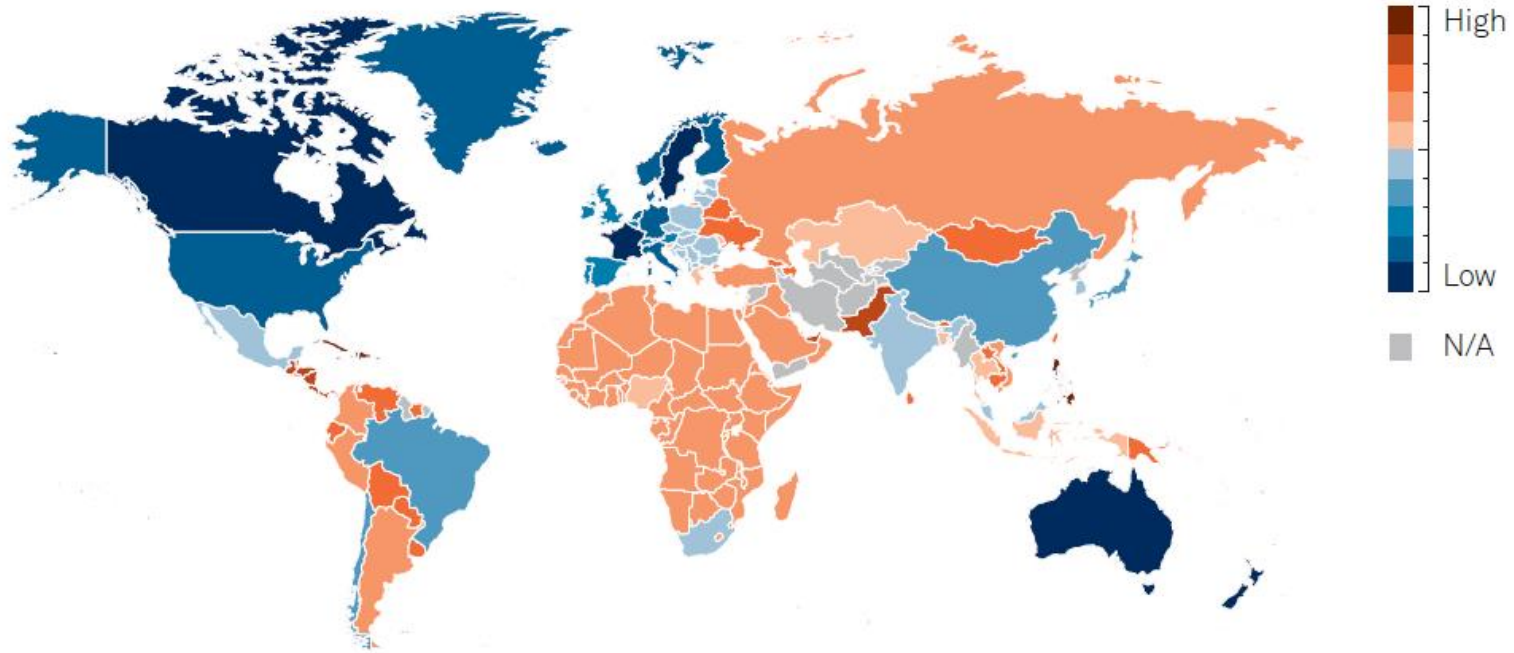
Indicative Sector Risk Atlas



Risk Atlas – Geography

Regional Exposure Score considers **regulatory, institutional and physical risks** inherent in a region and draws on our analytical opinions of institutional strength of a jurisdiction and relevant external data.

Indicative Country Risk Atlas



ESG Profile: Risk Atlas

ESG Profile: Entity-Specific Analysis

Preparedness

Final Score

ESG Diagnostic

The ESG Diagnostic is our main tool to collect comparable environmental, social and governance data on companies.



Focuses on collecting comparable and consistent data across sectors and geographies to inform our ESG Evaluation score



Draws on, but is not limited to, existing sustainability reporting frameworks such as the Global Reporting Initiative (GRI)



Leverages S&P internal data on the business, environmental and governance profiles of companies



Includes a “Not applicable” option to take into account sector and company specificities



May inform our credit rating analysis, if relevant

ESG Profile: Risk Atlas

ESG Profile: Entity-Specific Analysis

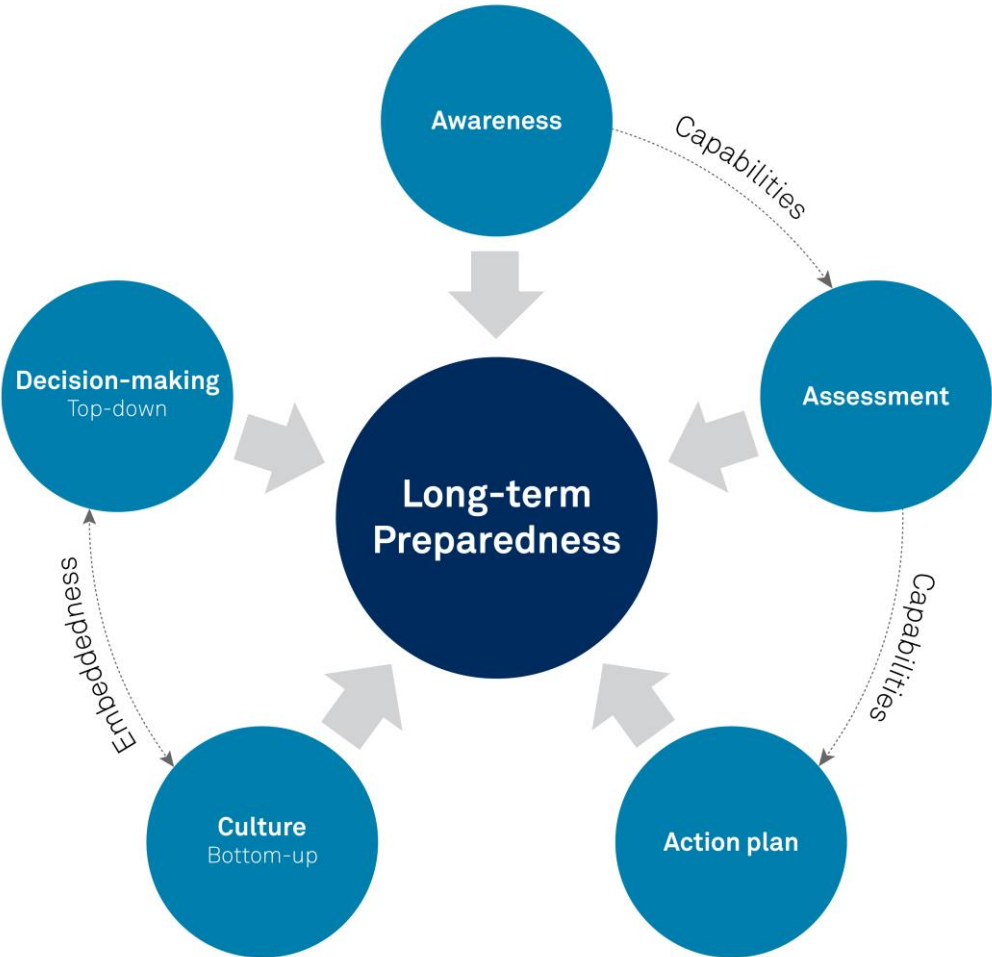
Preparedness

Final Score

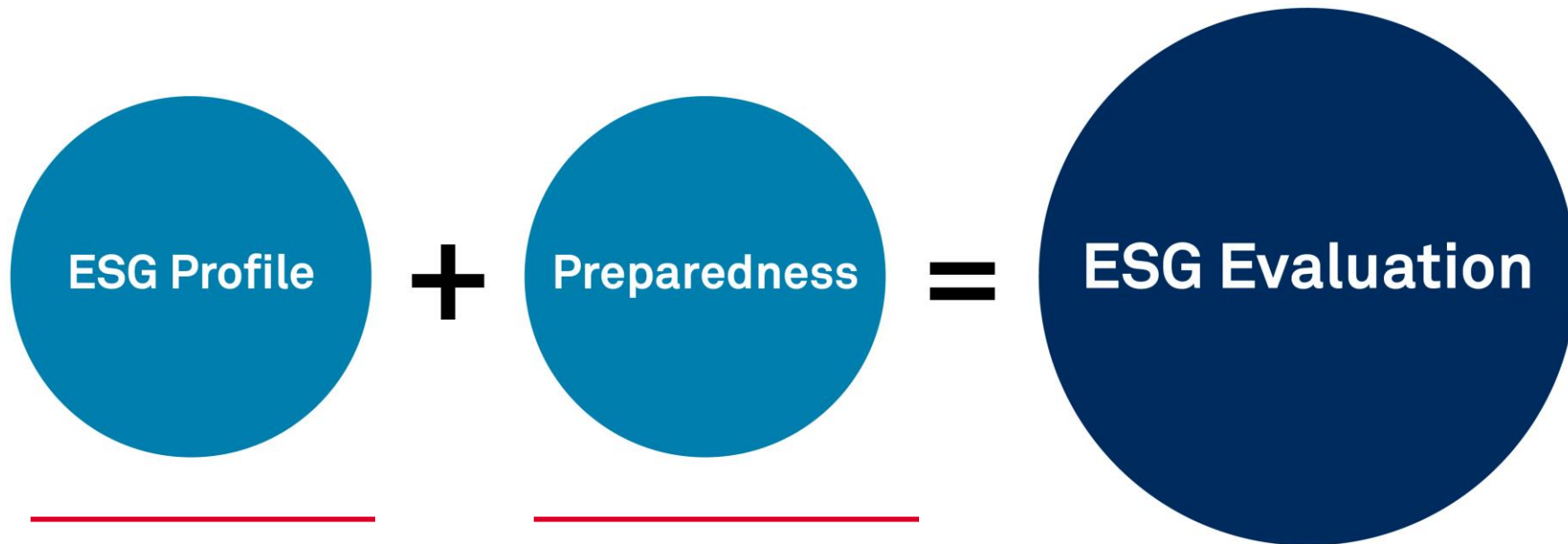
Preparedness – Emerging & Strategic Risks



Preparedness – Two Concepts; Five Factors



ESG Evaluation – Final Score



- Assesses exposure to observable ESG risks & opportunities
- Considers governance structure in mitigating risks & capitalizing on opportunities

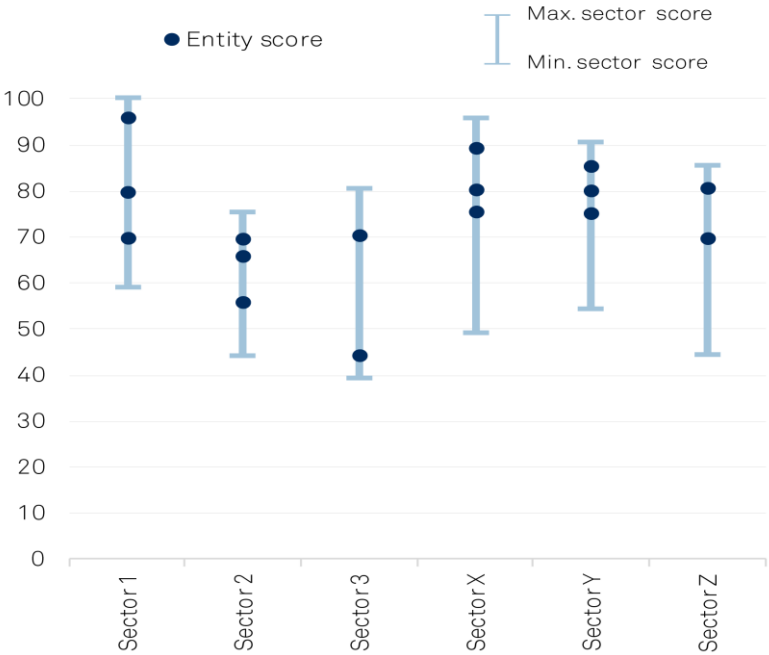
- Assesses the capacity to anticipate and adapt to a variety of long-term plausible disruptions
- Disruptions not limited to environmental or social scenarios



ESG Evaluation – How Can We Respond To Data Limitation?

- Collect standardized ESG data that allows us to perform **cross-sector** and **peers comparison**.
- Leverage existing S&P ESG databases.
- Leverage existing knowledge in our analytical base on ESG.
- Create a **quality experience** for issuers by pre-populating the ESG diagnostic.
- Create a centralized **ESG database** to inform our credit ratings, ESG Evaluations and other research.
- Rely on **analytical judgment** rather than quantitative analysis while we develop a consistent and comprehensive ESG database.

ESG Evaluation – Comparability & Alignment



Thank you

If you would like more information please visit
www.spglobal.com/sustainable-finance



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