

SECTOR IN-DEPTH

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Multilateral Development Banks - Global ESG credit impact is neutral for most, positive for many MDBs

On 7 December 2021, we published scores reflecting exposure to environmental, social and governance (ESG) considerations – and their impact on credit ratings – for multilateral development banks (MDBs). An Excel report with the scores is available [here](#).

Credit impact is predominantly neutral or positive, with very few negative cases.

For more than half of rated MDBs the credit impact from ESG factors is limited, while for one-third it is positive. This reflects MDBs' policy mandates, which contain their exposure to credit-relevant social and environmental risks, and generally strong governance profiles. All of these MDBs exhibit resilience, marked by robust financials and very strong member support. The MDBs for which ESG factors have a negative credit impact have greater exposure to environmental risks and weaker governance profiles, often with more limited resilience.

Environmental exposure is limited for about half of rated MDBs. For all MDBs, exposure to environmental risk is indirect, through their asset and investment portfolios. Portfolio diversification is the main mitigation mechanism, underpinning Neutral-to-Low or Moderately Negative environmental issuer profile scores (IPS) for 38 of 39 rated MDBs. Physical climate and, less often, carbon transition drive higher risk. Rarely, elevated borrower exposure or concentrated MDB portfolios lead to more acute environmental risk.

Social risk is low for three-quarters of MDBs, with positive exposure for the rest.

Strong social IPS reflect MDBs' policy mandates, which tend to incorporate economic and social development goals, and which MDBs credibly adhere to. For many, established community engagement mechanisms support our assessment of responsible production. In nine cases, exceptional strength in responsible production, and demographic and societal trends create positive credit exposure.

Governance poses limited risk or is a strength for most. Positive governance scores for 36% of rated MDBs reflect strengths in financial strategy and risk management, and a track record of highly credible management. Only two MDBs have negative overall governance scores, reflecting weaknesses in financial strategy and risk management, and management credibility and track record. Unlike large global banking groups or multinational corporations, MDBs tend to have relatively simple organizational structures, and there is no negative impact from compliance and reporting concerns.

Assessing exposure to ESG considerations and their impact on credit quality

Under our cross-sector ESG rating methodology, we assign two types of ESG scores:

- » **Issuer profile scores (IPS)** are opinions of an issuer's or transaction's exposure to environmental, social and governance considerations. The IPS incorporate meaningful mitigating or strengthening actions related to those specific exposures.
- » **Credit impact scores (CIS)** communicate the impact of ESG considerations on the credit rating of an issuer or transaction. The CIS are based on our qualitative assessment of the impact of ESG considerations in the context of the issuer's or transaction's other credit drivers that are material to a given rating.

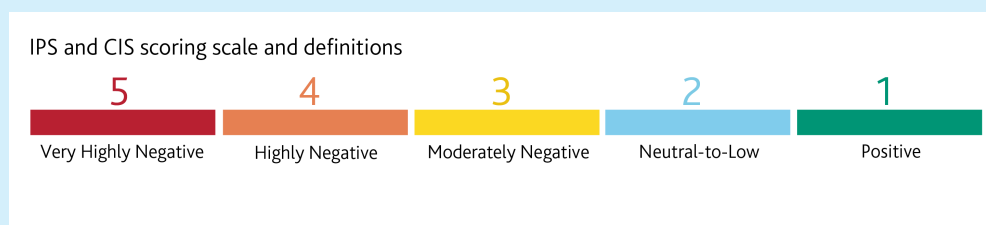
Both scores run on an asymmetric five-point scale whereby 1 is Positive, 2 is Neutral-to-Low, 3 is Moderately Negative, 4 is Highly Negative and 5 is Very Highly Negative (see Exhibit 1). An Excel file with the scores is available [here](#).

Additional commentary on each issuer's scores can be accessed on the corresponding issuer page on Moodys.com. We will publish scores for an increasing number of issuers and transactions across sectors in the coming months.

For an overview of general considerations and metrics used when assessing ESG risks for MDBs, please see the Appendix of this report.

This report is not intended to provide a summary of the methodology. For a full explanation of our methodological approach, please see [General Principles for Assessing Environmental, Social and Governance Risks Methodology](#).

Exhibit 1



Source: Moody's Investors Service

Credit impact is predominantly neutral or positive, with very few negative cases

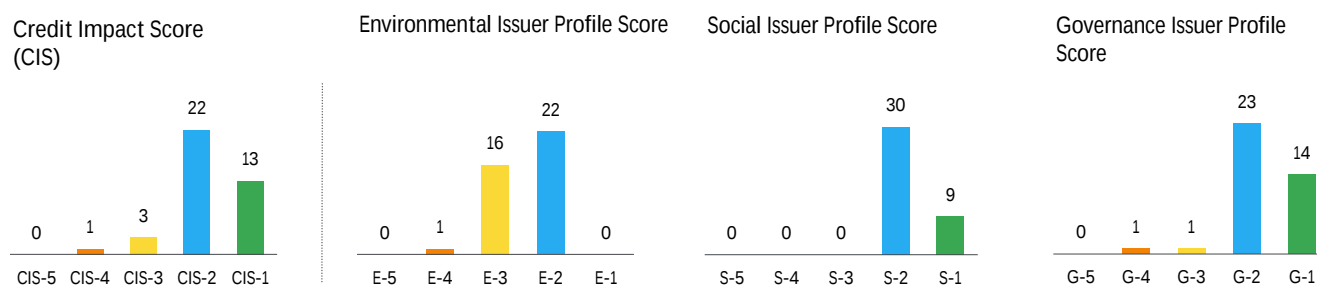
We have assigned ESG scores to 39 MDBs, many of which are global or large regional institutions; there are also a number of smaller regional MDBs which often have more specialized mandates.

Limited exposure to ESG factors, combined with resilience from financial capacity and shareholder support, results in a Neutral-to-Low impact on the credit ratings of 22 MDBs, as reflected in their CIS-2 scores. But there are also 13 entities for which ESG factors have a Positive rating impact, measured as a CIS-1. Only three MDBs have a Moderately Negative CIS, and just one is subject to Highly Negative impact on its credit profile from ESG factors (see Exhibit 2).

The distribution of MDBs' CIS differs from large global universal¹ and investment banks, which have far fewer Positive scores and more entities with Moderately Negative and Highly Negative CIS. Out of the 155 banks scored so far, only six issuers have Positive CIS, while 130 are scored Neutral-to-Low, 15 Moderately Negative and four Highly Negative.²

Exhibit 2

ESG factors mostly have Neutral-to-Low and sometimes Positive credit impact on MDBs

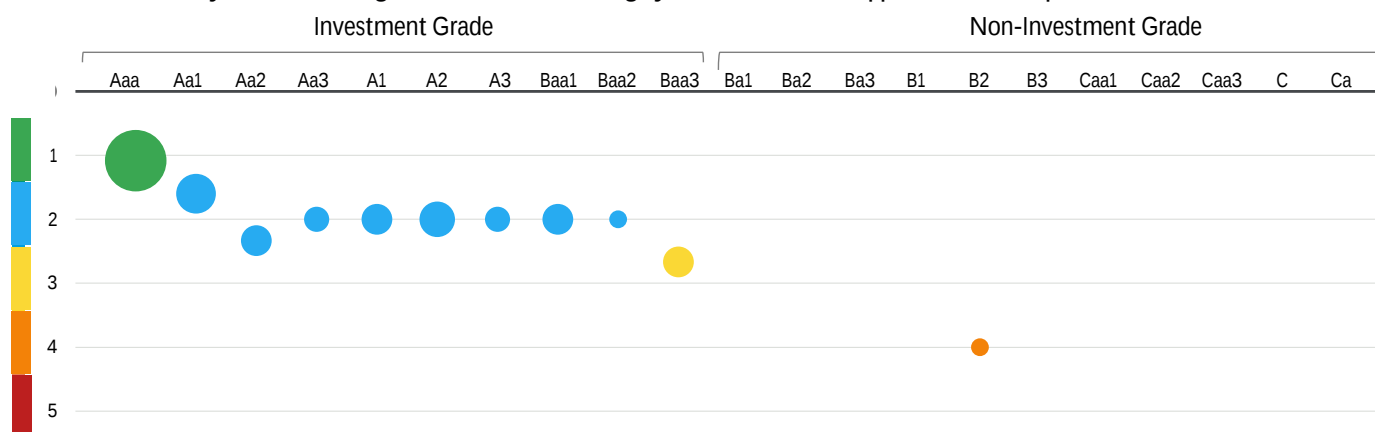


Source: Moody's Investors Service

All MDBs except for one are rated investment grade, and a large number have comparatively high credit ratings of A3 and above, based on their robust fundamentals and very strong member support.

Exhibit 3

Rated MDBs are nearly all investment grade and ESG factors largely have a neutral or supportive credit impact



Location and color of each bubble indicate the average CIS for the scored issuers in a given rating category. Size of each bubble indicates the number of scored issuers in a given rating category.

Source: Moody's Investors Service

The correlation between CIS and MDBs' credit ratings (see Exhibit 3) reflects in particular the significance of strong governance and member support in shaping both resilience to challenges from ESG considerations and general credit quality, along with – in most cases – limited direct exposure to environmental factors, and overall Positive or at worst Neutral-to-Low risks from social considerations.

Issuers with a **Neutral-to-Low** CIS tend to have largely neutral social and governance exposure, along with neutral or limited environmental risk, and reasonably strong resilience.

One such MDB is [Eurasian Development Bank](#) (Baa1 stable), which has a Moderately Negative environmental IPS, stemming from material carbon transition risk in its operating region – 76% of total development-related assets are in [Russia](#) (Baa3 stable) and [Kazakhstan](#) (Baa2 stable) – mitigated by an increasing share of renewable energy projects and some portfolio diversification. This is combined with Neutral-to-Low IPS for both social and governance risk, and, in general, moderate resilience.

Other examples include [Islamic Development Bank](#) (Aaa stable), [Black Sea Trade and Development Bank](#) (A2 stable) and [Africa Finance Corporation](#) (A3 stable).

Positive credit impact for MDBs is largely driven by supportive social and/or governance exposure. In addition, all MDBs with Positive CIS exhibit broad resilience, marked by robust financials and very strong member support.

One example is the [International Bank for Reconstruction and Development](#) (IBRD, Aaa stable), better known as the World Bank, which has Positive exposure to social risk and very strong governance, and Neutral-to-Low exposure to environmental risk. IBRD's resilience to ESG risks is supported by its very diverse global membership and the particular importance assigned to the entity by large non-borrowing members, including the [US](#) (Aaa stable), [Japan](#) (A1 stable) and [Germany](#) (Aaa stable).

Large MDBs that are key players in their region or have a global reach and display characteristics that qualify them as standard setters usually have a Positive credit impact from ESG considerations. These include entities such as the [African Development Bank](#) (Aaa stable), the [Asian Development Bank](#) (ADB, Aaa stable), the [European Bank for Reconstruction and Development](#) (EBRD, Aaa stable), the [European Investment Bank](#) (EIB, Aaa stable) and the [Inter-American Development Bank](#) (Aaa stable).

A few other entities also have a Positive credit impact from ESG considerations, including the [Asian Infrastructure Investment Bank](#) (Aaa stable) and the [European Stability Mechanism](#) (ESM, Aa1 stable).

For the handful of MDBs with **Moderately Negative** or **Highly Negative** CIS, these are driven by greater exposure to environmental risks or weak governance practices, coupled with more limited resilience.

[Arab Petroleum Investments Corporation's](#) (APICORP, Aa2 stable) Moderately Negative CIS takes into account its Highly Negative environmental exposure from carbon transition via borrower exposure, mitigated by opportunities to fund a growing pipeline of renewables projects. This is combined with Neutral-to-Low social risk and sound governance, which are supported by the presence of an ESG framework.

[ECOWAS Bank for Investment and Development's](#) (EBID, B2 stable) Highly Negative CIS is driven by Highly Negative governance with a track record of weak risk management. The MDB also faces Moderately Negative environmental risk from its exposure to sectors that utilise hydrocarbons, and the concentration of its operations in countries with elevated physical climate risk.

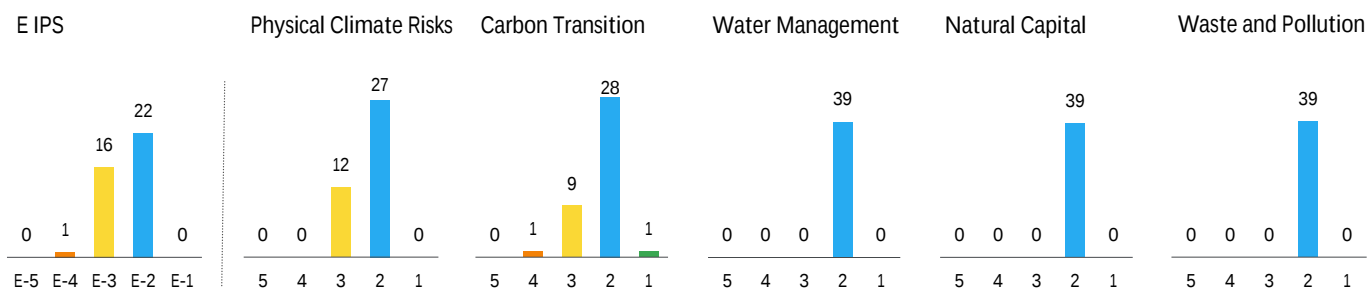
Environmental exposure is limited for about half of rated MDBs

For most MDBs, environmental risk is Neutral-to-Low or Moderately Negative, stemming from limited indirect exposure through the location and operations of borrowers, sectors in which projects are financed, and the credit profiles of sovereign sponsors (see Exhibit 4).

The main mitigants are portfolio diversification and risk management to reduce and ultimately halt the financing of projects that are exposed to environmental risk, which has made significant progress over recent years.

Unlike, for example, a corporate issuer with a large manufacturing presence in certain geographies, the physical location of an MDB's headquarters or offices does not drive our assessment of environmental risk.

Exhibit 4

Environmental risk is Neutral-to-Low or Moderately Negative for most MDBs

Source: Moody's Investors Service

Similar to other financial institutions, we view physical climate and carbon transition as the two key environmental risk categories for MDBs. For the other three categories (water management, natural capital, and waste and pollution), we do not see meaningful differentiation between MDBs and assign Neutral-to-Low subcategory scores to all entities.

For MDBs, as for rated issuers in other sectors, there are currently no positive environmental IPS, because in our view environmental factors present more risk than opportunity. However, as opposed to issuers active in more directly exposed sectors, MDBs may benefit more from increased demand for environmentally or more broadly ESG-focused products. An MDB could in principle receive a Positive environmental IPS if it significantly benefited from related credit relevant considerations. For instance, an entity that focused extensively on addressing the negative effects of physical climate change and because of that enjoyed significantly lower funding costs than its peers could theoretically be considered a candidate for an E-1 IPS in the future.

The distribution of MDBs' environmental risk category scores is very similar to that of commercial banks, with the exception of carbon transition risk. Banks are in general more exposed to the potential negative implications of decarbonization on loan quality and asset prices, through sector or geographic concentration as well as political and social pressure. MDBs, on the other hand, often fund infrastructure which is affected indirectly through the economic and financial impact on the country as a whole.

We use average weighted sovereign and sector scores for the different environmental risk categories as a starting point to gauge the exposure of development-related assets. Given MDBs' mandate to support development and fill gaps where commercial financiers might not be willing or able to take risks, they might even experience increased demand for financing, supporting their relevance and issuer profiles.

The majority of MDBs have Neutral-to-Low exposure to physical climate and carbon transition risk. Examples include EIB and [Nordic Investment Bank](#) (Aaa stable).

[Eurofima](#) (Aa2 stable) is an exception, with a Positive score for carbon transition, driven by its exclusive focus on the railway sector for which the fight against climate change strongly improves prospects and thus has the potential to increase Eurofima's policy relevance. [EU](#) (Aaa stable) member states are already implementing a set of measures to promote medium- to long-haul rail travel, and several municipalities are limiting car use and encouraging use of subways and suburban trains.

Moderately Negative scores stem from indirect exposure to physical climate or carbon transition risk for a significant proportion of the MDBs' borrowers, which is only partially offset by diversified portfolios, and cases where institutions' mandates mean they will continue to have higher exposure, mainly because of a geographical focus on highly exposed regions.

For instance, the [Caribbean Development Bank's](#) (CDB, Aa1 stable) Moderately Negative environmental IPS is driven by physical climate risk, as the concentration of its portfolio in a region which is subject to extreme weather events may weaken its asset quality. The CDB's top sovereign borrowers have high environmental risk scores denoting that they are prone to severe physical climate-related shocks.

Other examples include the ADB, the [Central American Bank For Economic Integration](#) (Aa3 stable) and the [West African Development Bank](#) (Baa1 negative).

In rare cases, particularly high borrower exposure to environmental risk and/or a concentrated MDB portfolio could drive Highly or Very Highly Negative environmental risk.

At present, only APICORP has a Highly Negative environmental IPS given its exposure to carbon transition risk. This relates to its portfolio that is concentrated in the oil, gas and petrochemical sectors, increasing the risk of stranded assets, and its shareholders who have heavy economic and fiscal reliance on hydrocarbon production and exports, which could challenge their capacity to provide support to the institution down the road.

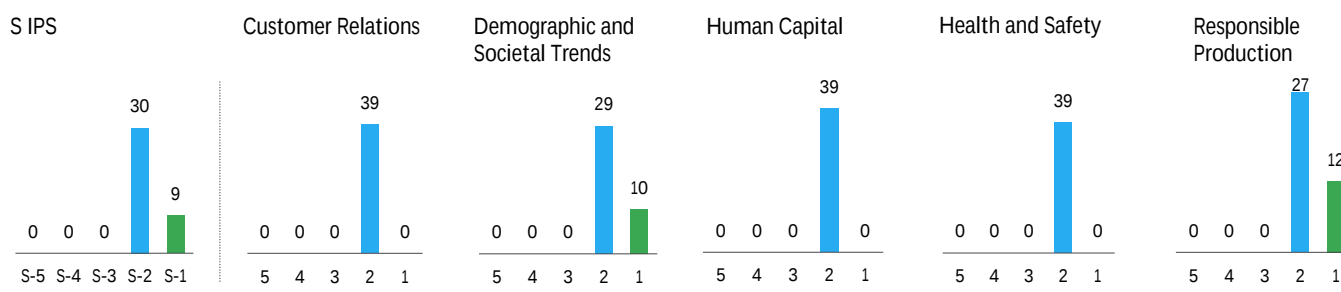
Social risk is low for three-quarters of MDBs, with positive exposure for the rest

For most MDBs, social risk is Neutral-to-Low across all five subcategories; for some, the social IPS is even Positive, as these institutions benefit from exceptional strength in responsible production and supportive exposure to demographic and societal trends (see Exhibit 5). No MDB scores weaker than Neutral-to-Low for social risk or any of its subcategories.

This represents a clear difference from commercial banks, where a majority of issuers have Highly Negative social IPS, mainly driven by customer relations risks related to data privacy, risk of legal action on mis-selling, and exposure to data security breaches.

Exhibit 5

Social risk is largely Neutral-to-Low and can be Positive



Source: Moody's Investors Service

These strong scores for MDBs reflect the nature of and credible adherence to their policy mandates, which generally entail economic and social development policy goals. Often these focus on sustainable and responsible production features, although they vary with the primary operating environment and the policy mandate of the specific institution.

Considerations include the existence and implementation of strong environmental and social safeguard policies; the continuous improvement of existing community and stakeholder engagement mechanisms; and the potential impact on an MDB's issuer profile from changing demographic and societal trends, predominantly through their influence on an institution's relevance and shareholder support.

Furthermore, MDBs are usually characterized by a diverse and inclusive workforce environment and do not have material difficulties in hiring the right personnel, which limits their exposure to human capital-related risks. Similarly, MDBs face very limited health and safety risks given their reliance on knowledge workers, and unlike many private sector companies are not exposed to a high degree of customer relations risk.

As such, for the sector as a whole, social risks are unlikely to translate into a meaningful credit impact undermining the institutions' reputation, shareholder support or access to financing.

MDBs with Neutral-to-Low social IPS include [Fondo Latinoamericano de Reservas](#) (FLAR, Aa2 stable), [Gulf Investment Corporation G.S.C.](#) (A2 stable) and [North American Development Bank](#) (Aa1 negative).

In nine cases, strength in responsible production, and demographic and societal trends lead to Positive social exposure for MDBs. All of the nine entities with an S-1 IPS demonstrate exceptional strength in those two subcategories and can be seen as global benchmark setters.

The EBRD, for example, has Positive scores for both responsible production, and demographic and societal trends. It supports private enterprise in transition economies, often being among the first to promote societal development objectives and acting as a sticky anchor investor or lender. The EBRD's use of standard setting policies and public consultation processes, as well as transparent and detailed reporting on projects and an independent evaluation office also help to ensure buy-in from key stakeholders. The EBRD does not face any issues attracting highly skilled personnel and there are no health and safety considerations that would affect the issuer profile, either negatively or positively.

Likewise, the EIB's Positive social IPS reflects strengths in responsible production as well as benefits from demographic and societal trends. While the EIB has faced and continues to face disputes with stakeholders and controversies, these have generally led to improvements in the bank's stakeholder engagement mechanisms.³ The EIB issued its first sustainability awareness bond in 2018,⁴ to support development of social policy objectives and its mandate benefits from being the EU's Climate Bank.

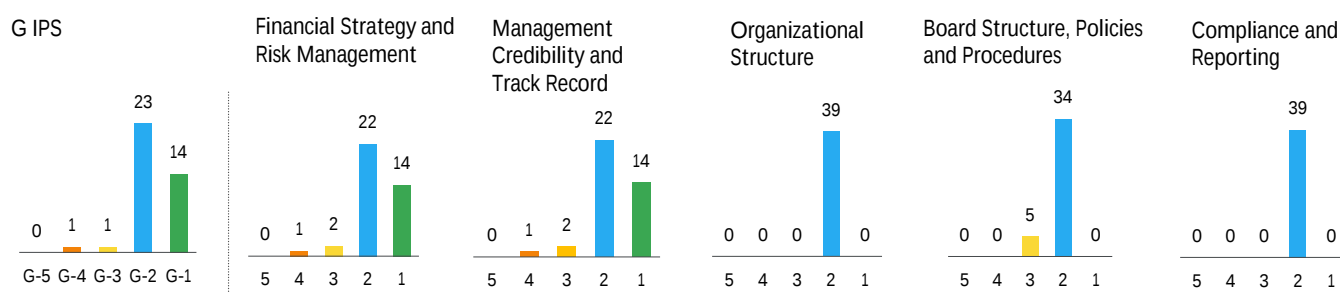
Other MDBs with Positive social IPS include the World Bank and its associated institutions [International Development Association](#) (IDA, Aaa stable) and the [International Finance Corporation](#) (IFC, Aaa stable), and smaller MDBs such as the [Council of Europe Development Bank](#) (Aa1 stable).

Governance poses limited risk or is a strength for most

For the vast majority of MDBs, exposure to governance risk is either Neutral-to-Low or Positive (see Exhibit 6). Only two MDBs have a governance score weaker than Neutral-to-Low. As for commercial banks, financial strategy and risk management, and management credibility and track record are the most relevant categories of governance risk for MDBs, and the distribution of scores is similar. MDBs with Positive governance IPS are all those where we have a positive adjustment for quality of management in the methodology scorecard.

Exhibit 6

Most MDBs have Neutral-to-Low or Positive governance IPS



Source: Moody's Investors Service

A majority of MDBs have a G-2 IPS, based on subcategory scores of "2" across the board. A handful of MDBs with Neutral-to-Low governance IPS have Moderately Negative subcategory scores for board structure, policies and procedures because of their concentrated ownership.

In the case of [International Investment Bank](#) (IIB, A3 stable), concentrated ownership leads to a Moderately Negative score for board structure and policies, although Russia's share has been declining. This is, however, balanced by other considerations: IIB has further strengthened its governance and risk framework in the past few years to increase its effectiveness and to comply with international

best practices. Management is credible and has a good track record in fulfilling the objectives of its multiyear planning as well as prudent and robust financial and risk management. This results in an overall Neutral-to-Low score for governance.

Other MDBs with concentrated ownership are [African Local Currency Bond Fund](#) (Baa2 stable), Eurasian Development Bank, [International Bank for Economic Co-operation](#) (IBEC, Baa3 positive) and the [North American Development Bank](#) (Aa1 negative).

Meanwhile, IBRD's Positive governance IPS is driven by very high quality of management and best-in-class financial strategy and risk management practices, having one of the longest track records of strong and credible management among MDBs. Other MDBs with Positive governance IPS include ADB, EIB and [The Currency Exchange Fund NV](#) (TCX, A1 stable).

For just two MDBs, the governance IPS is Moderately Negative or Highly Negative, reflecting weaknesses in financial strategy and risk management, and management credibility and track record.

[East African Development Bank's](#) (EADB, Baa3 stable) Moderately Negative governance IPS reflects a risk management framework that is currently weaker than its peers, as illustrated by portfolio quality deterioration during periods of stress.

EBID's Highly Negative governance IPS takes into account a track record of weak risk management, as is evident from its elevated nonperforming loans. While the bank has recently instituted a change of leadership and policies to improve its operations, a track record of sound performance has yet to be established. EBID is the only MDB with a negative adjustment for quality of management in the credit rating methodology scorecard.

Finally, there are two entities with Moderately Negative scores in one of the key management categories.

Our assessment of FLAR's financial strategy and risk management reflects the recent increase in nonperforming assets as a result of the nonaccrual on its [Venezuela](#) (C stable) exposure, which has since been resolved but led to a small contraction in FLAR's balance sheet.

The Moderately Negative score in management credibility and track record for [Islamic Corporation for the Development of the Private Sector](#) (ICD, A2 stable) highlights that although the revamp of ICD's risk management function in 2014 has reduced asset performance risks, weaknesses from legacy assets remain and a long track record of solid performance has yet to be established.

Appendix: Considerations and metrics informing our ESG qualitative assessments

An overview of the types of considerations and metrics that inform our assessment of ESG risks and our IPS for MDBs.⁵

Exhibit 7

ESG Components	Key Risk Categories for MDBs	General Considerations	Metrics - Illustrative Examples
Environmental	Carbon Transition	Exposure of investment/ lending portfolio to carbon-intensive counterparties or hydrocarbon-reliant economies Reputational risks related to failure to adapt the business model to stakeholders' expectations on carbon transition	Include indicators related to share of investment/ lending portfolio exposed to carbon-intensive counterparties, sectors or economies; duration and other structural features of the exposure
	Physical Climate Risks	Exposure of investment/ lending portfolio to counterparties, sectors or regions susceptible to climate events or environmental long-term trends Presence of core physical assets in areas subject to climate hazards Presence of specific financial protections (e.g., reinsurance, catastrophe bonds/ insurance-linked securities, etc.)	Include indicators related to share of investment/ lending portfolios exposed to counterparties, sectors or regions susceptible to climate hazards; duration and other structural features of the exposure; and financial protections
Social	Demographic & Societal Trends	Government social agendas (including mandated policy role) that could affect demand for, supply of or commercial viability of an MDB's products and services or its operational environment Trends in social values (e.g., sustainable finance, financial inclusion), that could affect demand for financial products and services or access to capital	Include indicators related to share of products or services that gain opportunity from prevalent social trends (e.g., sustainable or responsible finance, financial inclusion) or are threatened by prevalent social trends (e.g., energy-intensive products, investment in arms manufacturing or tobacco)
	Responsible Production	Exposure to products or projects subject to financial or reputational impact, for example because of potential disputes and controversies Diversity, reputation, legality and social acceptability of dealings with suppliers/ service outsourcing that form part of the value chain Quality of broader community relationships	Include indicators related to disputes and controversies related to products, services and supply chain products and services
Governance	Financial Strategy & Risk Management	Appropriateness of strategy and risk management for the nature of business activities Quality and depth of risk culture and risk management, including credit, market, operational and funding risks oversight Capital and liquidity management and buffers against regulatory requirements Level of business opacity and complexity and challenges posed to risk management	Include indicators related to financial targets; risk tolerance (e.g., risk limits, internal stress testing); evidence of risk control failures (e.g., deterioration of asset quality and performance)
	Management Credibility & Track Record	Management quality and experience, turnover, succession planning and key-person risk Predictability and reliability of enacted financial policy (including commitment to credit profile) Track record of strategy execution	Include indicators related to management turnover and experience; track record of operational and financial performance, including compared to targets
	Board Structure, Policies & Procedures	Ownership structure and control with potential for limiting board effectiveness (e.g., lack of transparency in ownership structure, presence of concentrated shareholding, private equity or activist investors)	Include indicators related to shareholder composition and transparency (e.g., controlling shareholder); incidence of conflict of interest, board members' independence and tenure, board diversity, board meeting attendance

Sources: Include proprietary information (e.g. methodology factor scores), assessments from third party sources, issuer's public filings and non-public information

Moody's related publications

ESG heat maps, methodology and research

- » [Financial Institutions – Global: ESG issues have limited credit impact for most large financial institutions](#), December 2021
- » [ESG – Global: Environmental heat map: Updates to scores for certain sectors](#), October 2021
- » [ESG – Global: Social heat map: Updates to scores for certain sectors](#), October 2021
- » [General Principles for Assessing Environmental, Social and Governance Risks Methodology](#), October 2021
- » [Sovereigns – Global: Explanatory Comment: New scores depict varied and largely credit-negative impact of ESG factors](#), January 2021

Sector research

- » [Supranationals – Middle East: Growth in Islamic finance to support Shariah-compliant MDBs by increasing funding access, opportunities for expansion](#), March 2021
- » [Supranationals – Global: Gains from MDB credit enhancement tools vary with scope, effectiveness and usage](#), March 2021
- » [Supranationals – Global: Stress-testing confirms broad resilience of MDB ratings](#), September 2020

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Endnotes

- ¹ A universal bank acts as both a commercial and an investment bank, and may provide additional financial services.
- ² See [Sector In-Depth: Financial Institutions – Global: ESG issues have limited credit impact for most large financial institutions](#), 8 December 2021
- ³ The EIB Group's [Complaints Mechanism website](#) lists all open and closed complaints. A [public consultation on the EIB Group's Environmental and Social Sustainability Framework](#) was held over the summer of 2021, and the bank updated its [EIB Group Transparency Policy](#) in November 2021.
- ⁴ See [EIB's innovative issuance establishes foundation for a longterm sustainability bond programme](#), 11 September 2018
- ⁵ Also see [General Principles for Assessing Environment, Social and Governance Risks Supplement – Financial Institutions](#), 19 October 2021

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