

# Measuring impacts of ESG risks in your credit portfolio

Partnering with Moody's for the Journey  
**Kulvinder Panesar**, Director, Advisory Services

April, 2023

# Our ESG Mission

**Deliver** comprehensive, consistent and actionable ESG insights to augment risk management frameworks

**Enable** our clients to make confident business decisions about ESG

**Prepare** experts for an uncertain future with an agile toolkit of solutions

# Defining ESG

## The Three Pillars of Sustainability



# ESG is more critical than ever



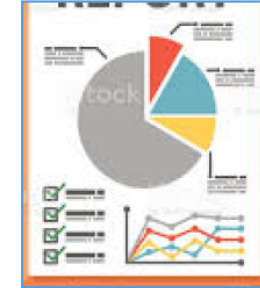
Achieving  
Business Resilience



Green Recovery  
Funding



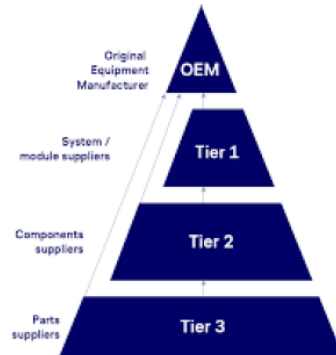
ESG-aligned companies  
have better returns



Increased ESG Reporting  
requirements



Integrating  
Climate Risk in ERM



Addressing ESG impact  
in global value chains



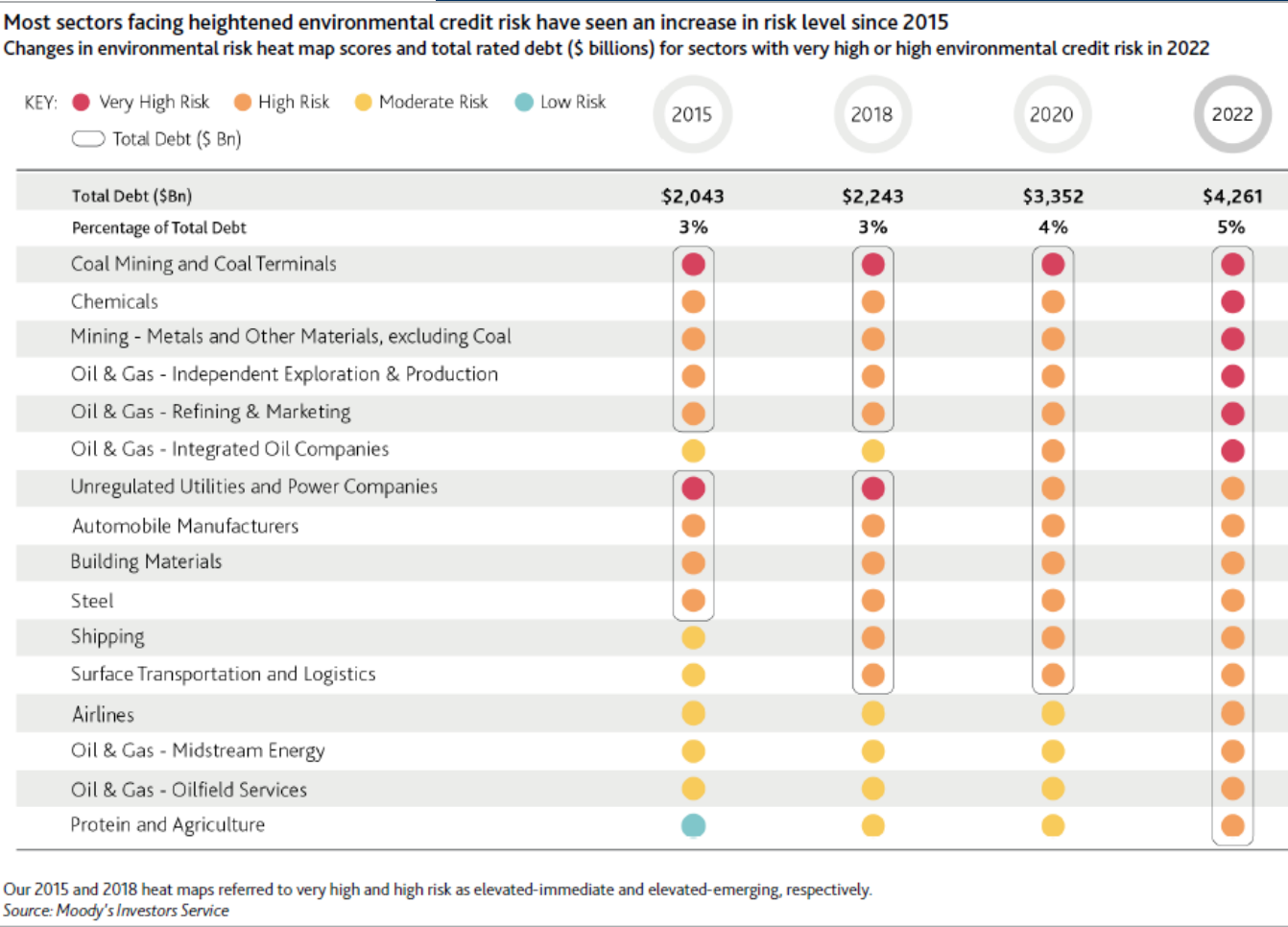
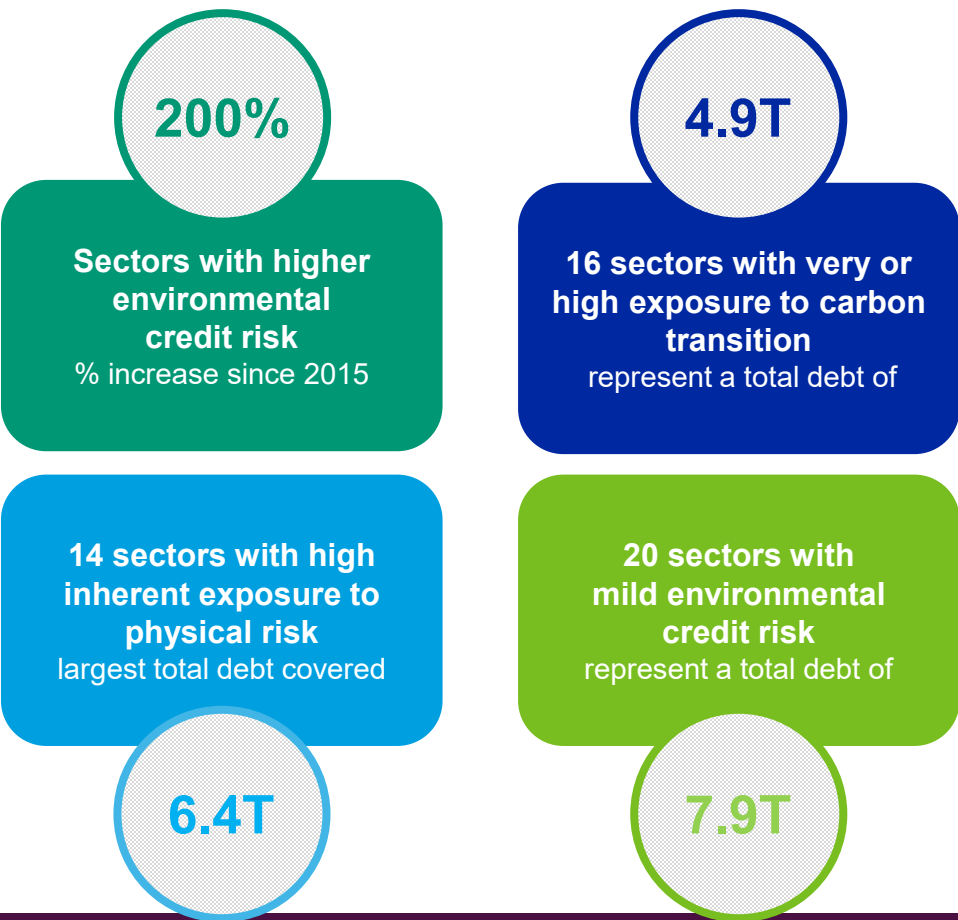
Sustainable Finance  
for corporates and SMEs

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ESG Rating								
CCC	CC	C	B	BB	BBB	A	AA	AAA

ESG rating for  
firms of all sizes

# Environmental Heatmap: Covered Debt in 2022

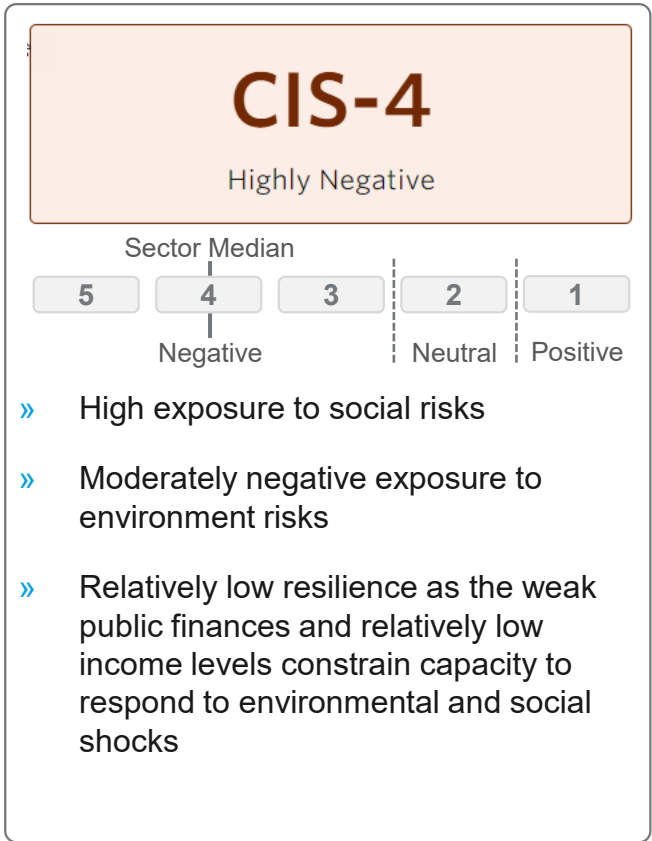
Source: MIS - Sector in depth research:  
Sectors with heightened credit risk account  
for twice as much debt as in 2015



# South Africa ESG Credit Risk

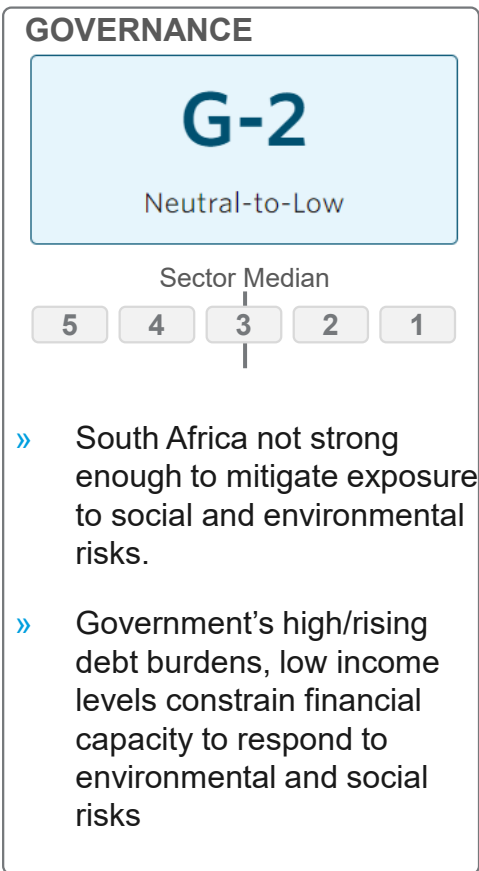
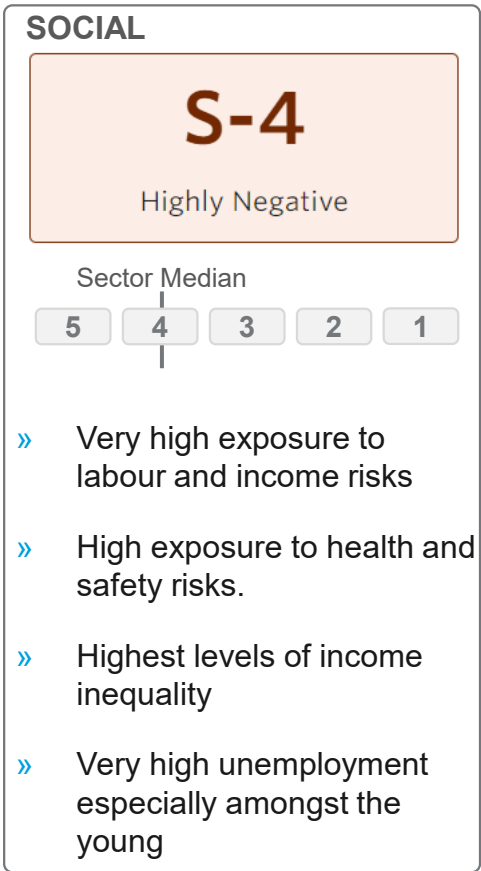
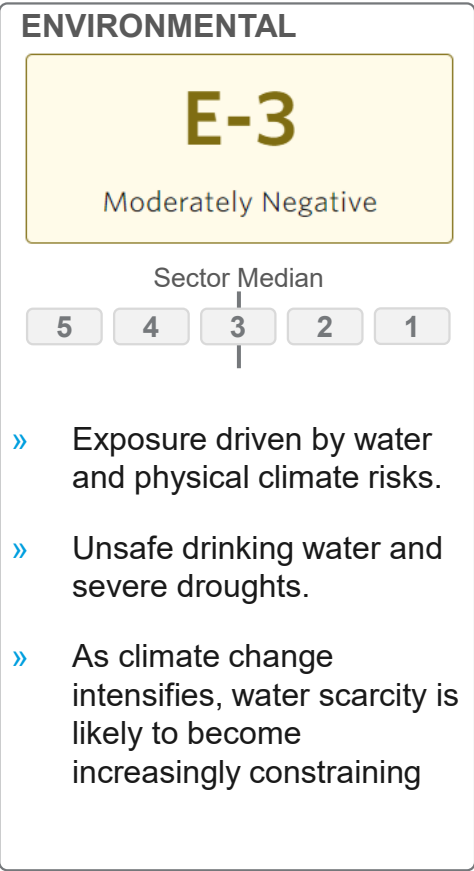
## Credit Impact Score

Outputs of the credit rating process that communicates whether and how much ESG considerations impact the credit rating



## Issuer Profile Scores

Inputs to the credit rating process which assess exposure to credit material E, S and G considerations



Sector Medians reflect the calculated sector median for scored entities in the Sovereigns - Emerging Markets ESG credit sector  
Source: Moody's Investors Service



# ESG and Climate regulations are picking up globally



KEY  
REGULATIONS



Climate/ESG Disclosures



Green Taxonomies



Supply Chain Due Diligence

# Why ESG is relevant for South Africa

South African Reserve Bank (SARB) has provided guidance on the integration of ESG into banks' risk management frameworks and processes

South African National Treasury unveiled its Green Taxonomy, largely building on the EU framework, aimed to be brought into law in 2023

## Regulatory Requirements

01



## Reputation and Brand Image

02



## Risk Management

03



## Sustainable Development

04







“available data should be used to identify and develop the weaknesses of players who are already on their team”

Jan Van Haaren, Chief Analytics Officer at SciSports

# Phased Approach to Transformation

Integrating ESG into your business  
for competitive advantage

## Governance

- » Board and management understand ESG-related financial risk exposures
- » Monitor risk, ways these risks could evolve within the bank's strategy, risk appetite, financial, capital and operational plans
- » Clear accountability for managing and controlling exposure to ESG risk

## Policy, Procedures and Limits

- » Manage and track, risk appetite, concentration limits, credit exceptions related to ESG risk
- » Automated policy fields ensure consistent application of credit policy
- » ESG specific areas in lending for CRE, Mortgage, C&I should be focused initially

## Strategic Planning

- » Overall business strategy and risk appetite should consider ESG related financial exposures over various time horizons
- » Gauge impact of ESG-related financial risk exposures on the bank's financial condition, operations (including geographic locations), and business

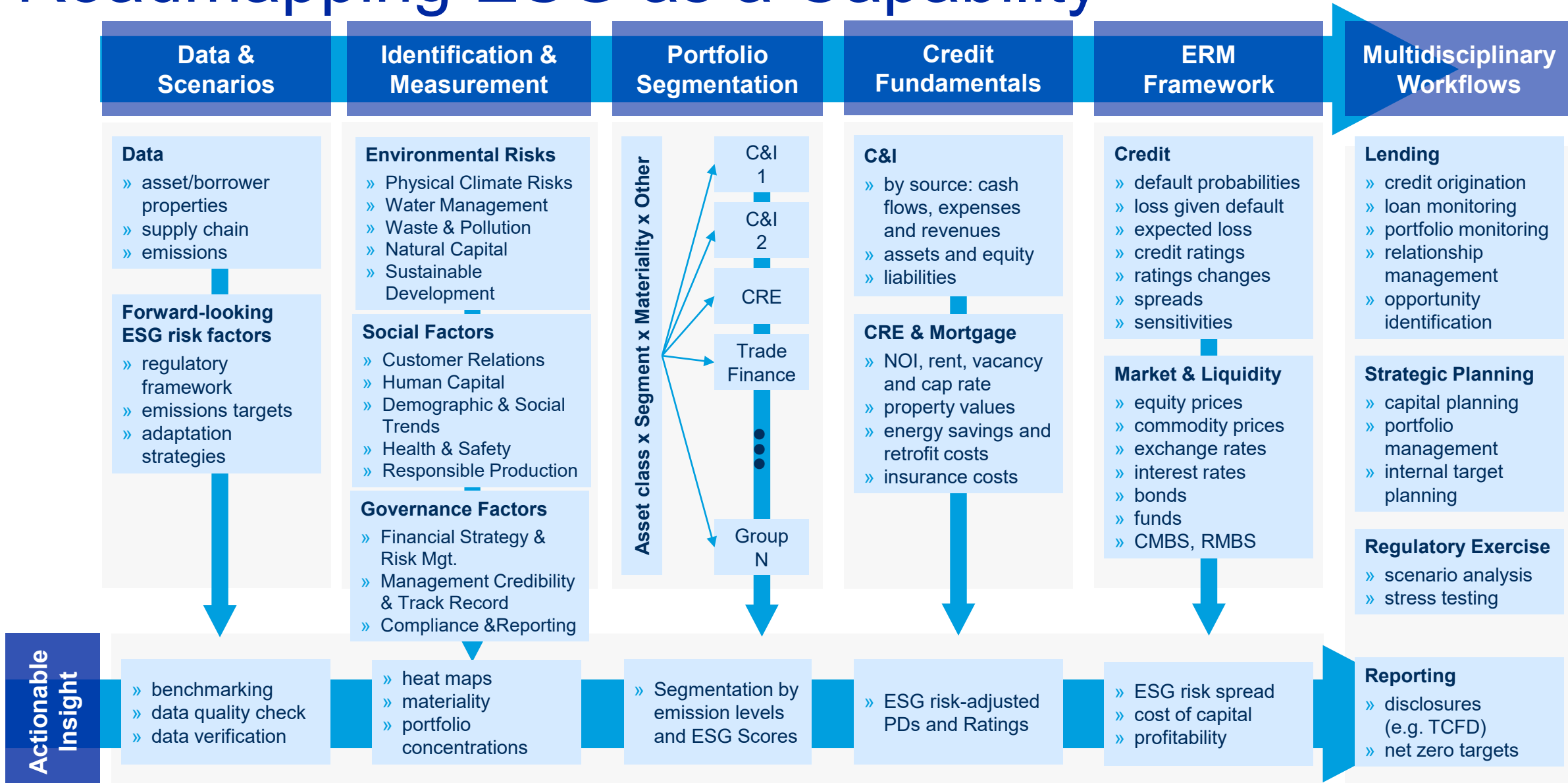
## Risk Management

- » Develop processes to measure and monitor material ESG-related financial risks and to inform management about the materiality of those
- » Key risk metrics, limits and other KPI
- » Exposure analysis, heat maps, ESG risk dashboards, and scenario analysis.

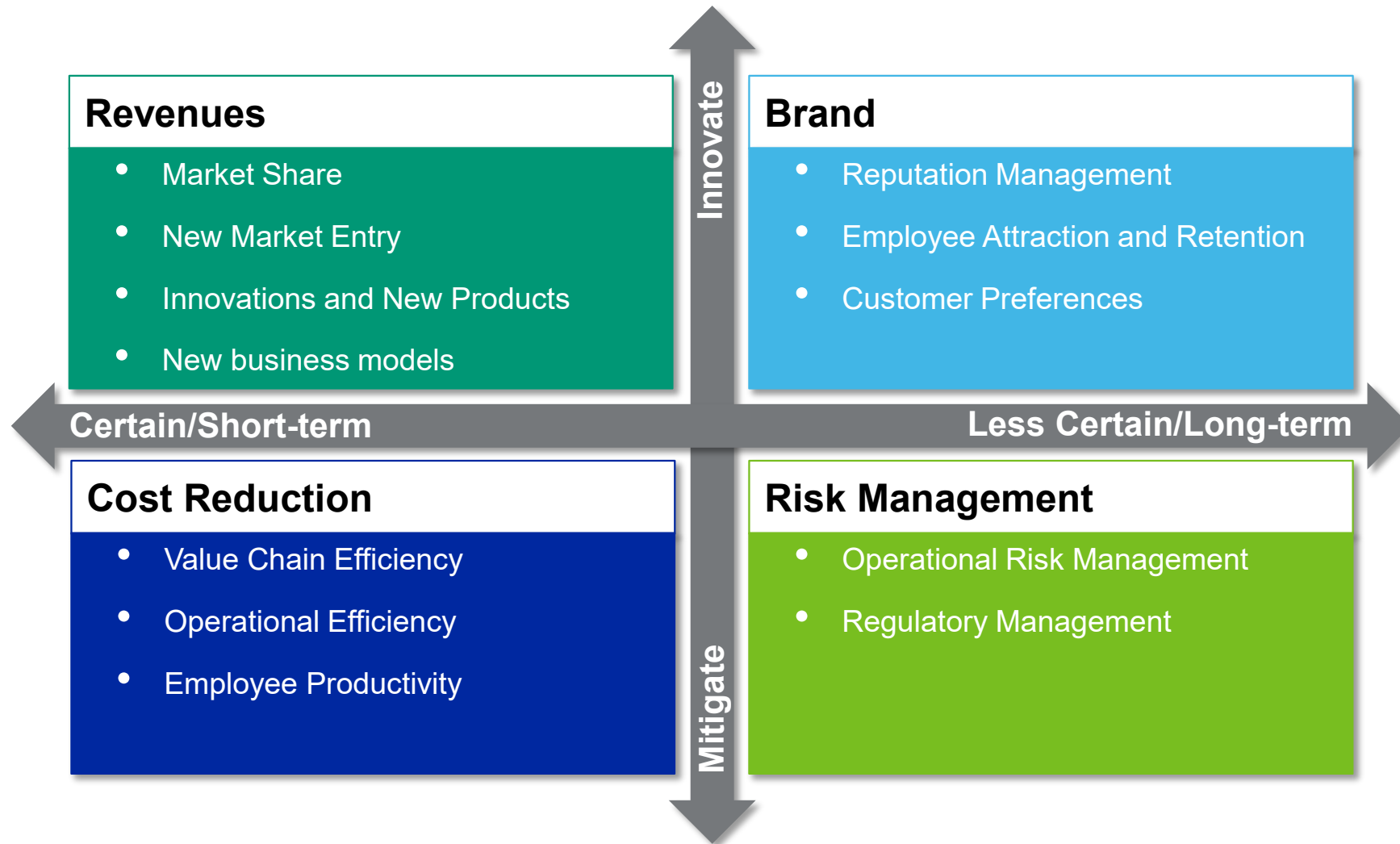
## Reporting and Disclosures

- » Incorporate ESG related financial risk information into internal reporting monitoring and escalation processes
- » Report and disclose aggregated risk data that reflect exposures to ESG and climate risks to enable the management body, board, investors and stakeholders to make informed decisions.

# Roadmapping ESG as a Capability



# Impact of ESG on the bottom line





# Identifying ESG drivers of credit risk



01

## ENVIRONMENT

- » Carbon Transition
- » Physical Climate Risks
- » Water Management
- » Waste & Pollution
- » Natural Capital

02

## SOCIAL

- » Customer Relations
- » Human Capital
- » Demographic & Social Trends
- » Health & Safety
- » Responsible Production

03

## GOVERNANCE

- » Financial Strategy & Risk Management
- » Management Credibility & Track Record
- » Organization Structure
- » Compliance & Reporting
- » Board Structure, Policies & Procedures

# Our approach to incorporate ESG into Credit



## Moody's ESG methodologies

Leverage Moody's ESG methodologies for identifying key ESG drivers for assessing credit risk for Corporates, Financial Institutions and SMEs



## Data

Automated factor population powered by Moody's ESG Score Predictor and MESG analyst driven assessment scores



## Calibrated

Calibrated and tested against Moody's Investor Service Credit Impact Scores and additional SMEs portfolio



Transparently communicates impact of ESG considerations on credit rating of an entity



# Moody's ESG Credit Risk Scorecard

Easy to use and transparent framework

## ESG INTEGRATION INTO CREDIT ANALYSIS

### ESG CROSS-SECTOR FACTORS

#### Overall Environment Credit Risk Score



- » Carbon Transition
- » Physical Climate Risks
- » Water Management
- » Waste & Pollution
- » Natural Capital
- » Contribution to Sustainable Development

#### Overall Social Credit Risk Score



- » Customer Relations
- » Human Capital
- » Demographic & Social Trends
- » Health & Safety
- » Responsible Production

#### Overall Governance Credit Risk Score



- » Financial Strategy & Risk Management
- » Management Credibility & Track Record
- » Organization Structure
- » Compliance & Reporting
- » Board Structure, Policies & Procedures

### ESG CREDIT RISK SCORE\*

- 1 Credit Positive
- 2 Credit Neutral-to-low
- 3 Moderately Credit Negative
- 4 Highly Credit Negative
- 5 Very Highly Credit Negative

### ESG CREDIT RISK RATING NOTCHING ADJUSTMENT

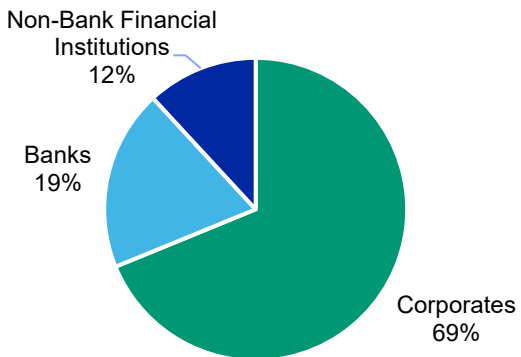
The ESG Credit Risk score translates to an appropriate notching adjustment to the baseline credit rating of an entity.

\*The ESG Credit Risk Score is an output of the scorecard that transparently communicates the impact of ESG considerations on the credit rating of an entity.

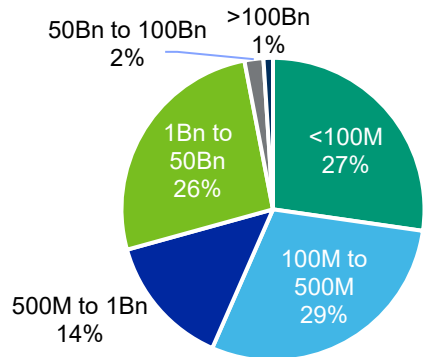


# South Africa Sample Portfolio

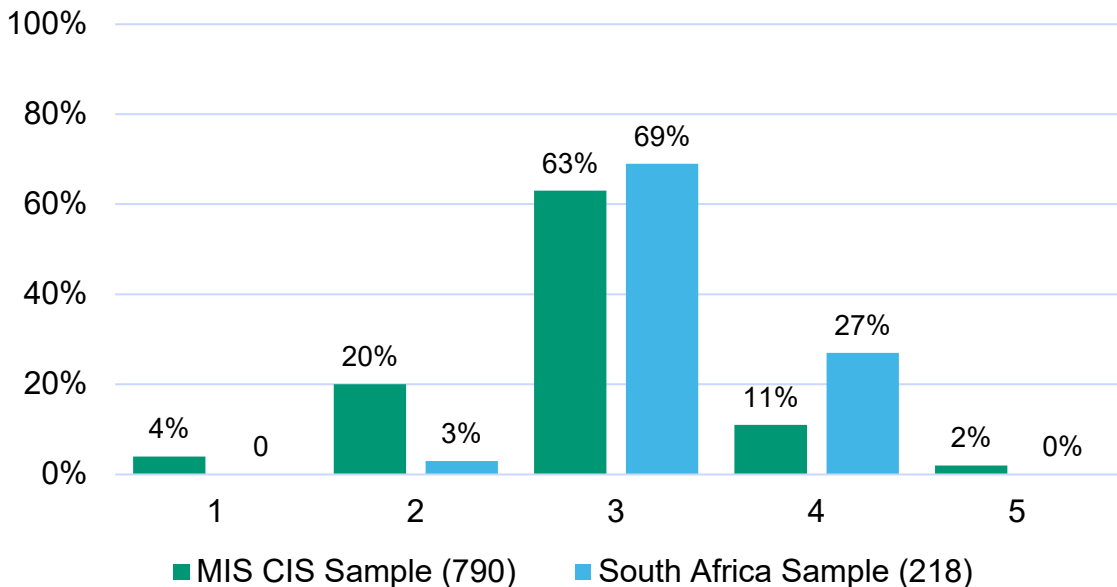
South Africa Sample Segment Breakdown



South Africa Sample by Asset Size



ESG Credit Risk Scorecard Distribution



- » Average ESG Credit Risk for South Africa sample portfolio was 3 indicating moderately credit negative impact to ESG which is higher than MIS CIS sample
- » Translates to no overall notch impact to the portfolio overall
- » However, some entities identified with high credit negative impact to ESG risks need to be reviewed/managed

	Average ESG Credit Risk Score	Average Notching Impact to Baseline Rating
MIS CIS Sample (790)	2.86	0
South Africa Sample (297)	3.25	0

# Concluding Thoughts

- » ESG is a real risk and has a credit impact. Bank need to take these risks into account in their risk management frameworks and processes
- » There is the opportunity to do something now rather than later when there could be more detrimental financial impact
- » An opportunity to align target segments in their portfolio to more sustainable industries and contribute to sustainable development goals in the country and region.



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