ESG In Credit Ratings Deep Dive:

ESG Factors Drove 13% Of Corporate And Infrastructure Rating Actions Since 2020

S&P Global Ratings

March 13, 2024

This report does not constitute a rating action

This analysis reviews past rating activity (comprising rating or outlook changes, or CreditWatch placements) that was related to environmental, social, and governance (ESG) credit factors and that involved nonfinancial corporate and infrastructure issuers. We consider rating actions between April 2020 (when S&P Global Ratings began specifically tagging ESG factors in its rating actions) and December 2023. We consider ESG credit factors as those ESG factors that can materially influence the creditworthiness of a rated entity or issue and for which we have sufficient visibility and certainty to include in our credit rating analysis.

Key Takeaways

- **Rating actions:** ESG factors were cited as a rating driver in 13% of all corporate and infrastructure rating actions between April 2020 and December 2023. More than three-quarters of the ESG-related rating actions were negative. We provide the full list of ESG-related rating actions in this report below.
- **ESG factors:** Rating actions related to health and safety accounted for 83% of ESG-related rating actions since April 2020--largely as a result of COVID-19. But governance factors were also a key driver, having played a part in 28% of ESG-related rating actions in 2023.
- **Rating action severity:** ESG-related rating actions generally mirrored the pace of corporate and infrastructure rating actions overall--but with the notable exception of one-notch downgrades. Nearly 32% of ESG-related corporate and infrastructure rating activity was one-notch downgrades, compared with only 21% for all corporate and infrastructure ratings actions.
- **Climate related risks:** Up to now, they've only driven a low number of credit rating actions--but the number did double in 2023. And it may increase in the years ahead as more disruptive regulations potentially emerge and as issuers make the generally costly low-carbon transition. An increase may also reflect the more frequent and severe physical risks that could stem from climate change.

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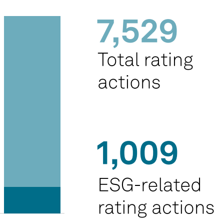
Temperature Check

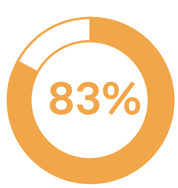
Takeaways from a deep dive into ESG-related nonfinancial corporate and infrastructure rating actions

Corporate and infrastructure rating activity

April 2020-December 2023

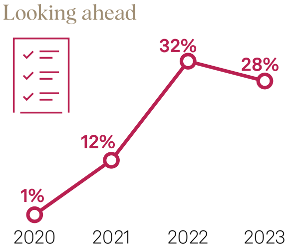


ESG-related rating activity



of corporate and infrastructure ESG-related rating activity stems from COVID-19-related impacts

Looking ahead



Proportion of governance-related rating actions are on the rise

spglobal.com/ratings/creditmarketresearch

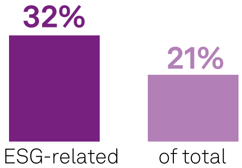
Corporate and infrastructure rating activity

13%

of rating activity was ESG-related

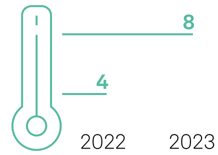
Credit severity

Corporate and infrastructure one-notch downgrades



Looking ahead

Climate transition-related rating actions increased in 2023



S&P Global Ratings includes a reference in its credit rating rationales when one or more of the below ESG factors were key drivers behind a change to the credit rating, outlook, or CreditWatch status. We consider ESG credit factors as those ESG factors that can materially influence the creditworthiness of a rated entity or issue and for which we have sufficient visibility and certainty to include in our credit rating analysis. They are not assessments of entities' sustainability profile or ESG performance.

By the numbers: ESG-related corporate and infrastructure credit rating actions

Between April 2020 and December 2023

Total credit rating actions

7,529
All credit rating actions

3,672 Positive rating actions ▲
3,857 Negative rating actions ▼

Total ESG-related credit rating actions

1,009
Total ESG-related credit rating actions

239 Positive rating actions ▲
770 Negative rating actions ▼

Positive ESG-related credit rating actions

Key ESG dimension	Key factor	Key region
201 Social	201 Health and safety	140 North America

Negative ESG-related credit rating actions

Key ESG dimension	Key factor	Key region
650 Social	641 Health and safety	404 North America

ESG-related rating actions are those where ESG credit factors were a key driver of the decision to change a credit rating, outlook, or CreditWatch status. S&P Global Ratings considers ESG credit factors to be those ESG factors that may influence the capacity and willingness of an issuer to meet its financial commitments. Rating actions include changes in ratings, CreditWatch placements, and outlooks between April 1, 2020, and Dec. 31, 2023. ESG--Environmental, social, and governance.
Source: S&P Global Ratings.

All corporate and infrastructure ESG-related rating actions: download table >

Key Rating Action Trends

1. ESG-related rating actions have been more negative than positive and have generally mirrored overall rating activity trends

Approximately 13% of all corporate and infrastructure rating actions between April 2020 and December 2023 were associated with ESG factors, with over three-quarters of ESG-related actions being negative (downgrades, negative outlook revisions, or CreditWatch negative placements).

A significant majority of ESG-related rating activity was influenced by social factors (84%), which is no great surprise given the influence of COVID-19-related risks--particularly health and safety factors--during this period. In fact, health and safety were cited in 98% of our rating actions related to social risks during this time. They were most often cited because of COVID-19 lockdown measures and mobility limitations around the world, which put downward pressure on many corporate sectors, most notably consumer-reliant sectors.

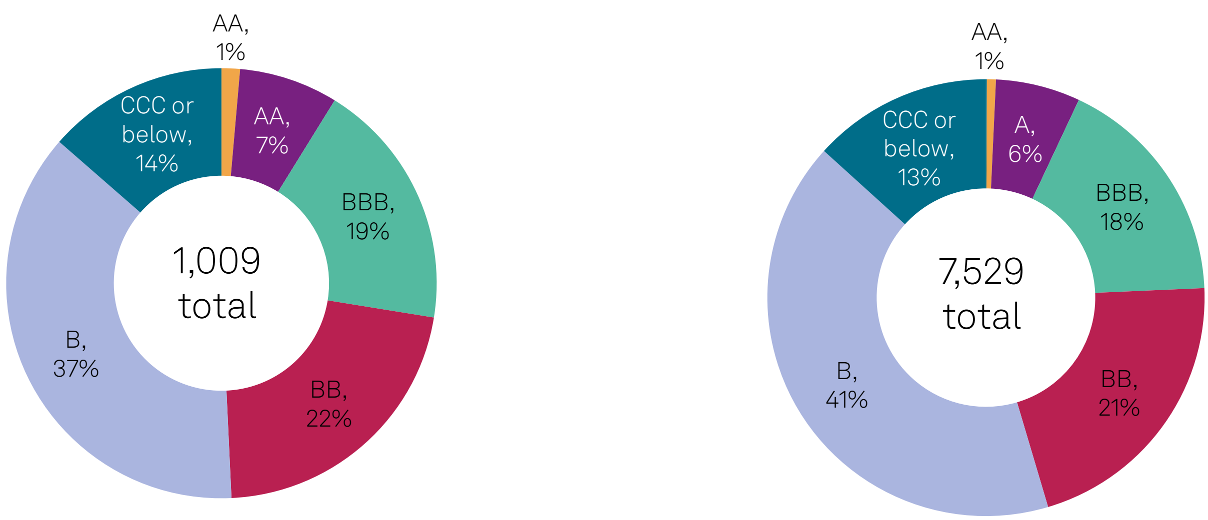
Approximately 13% of all corporate and infrastructure rating actions between April 2020 and December 2023 were associated with ESG factors.

Chart 1 and 2

The rating distribution of ESG-related rating actions broadly mirrors that of total rating actions

ESG-related corporate rating activity by rating category

Overall corporate rating activity by rating category



Data reviews rating activity between April 1, 2020, and Dec. 31, 2023. ESG--Environmental, social, and governance. Source: S&P Global Ratings.

In terms of the distribution of rating actions, we found that ESG-related rating activity largely aligned with that of the broader rated corporate and infrastructure universe. Rating activity was largely concentrated among lower-rated issuers with speculative-grade ratings, with the largest concentration (37%) being within the 'B' rating category and a not insignificant 14% across issuers rated 'CCC' or below.

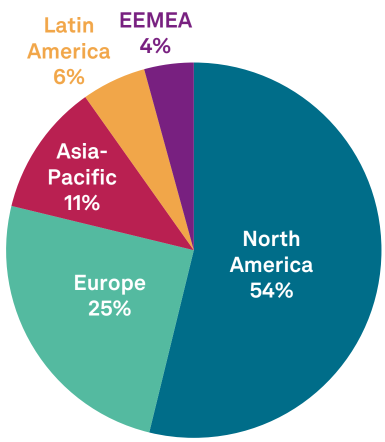
We observed the same trend across regions, with the U.S. seeing the majority of rating activity--whether it was ESG-related activity or non-ESG-related. The U.S. was followed by Europe, Asia-Pacific, Latin America, and EEMEA (Eastern Europe, the Middle East, and Africa).

The findings and similarities with corporate rating actions overall suggest that ESG factors and the associated rating actions shouldn't be viewed in isolation, but as part of a wider assessment of corporate issuers' creditworthiness.

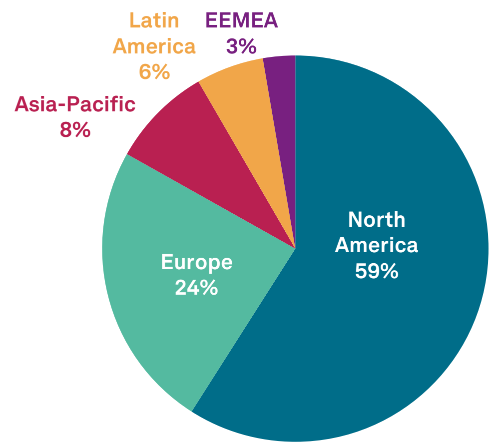
Chart 3 and 4

Geographic distribution of ESG related rating actions broadly mirrors that of total rating actions for corporate and infrastructure issuers

North America represented the highest share of ESG-related rating activity



North America represented the highest share of rating activity overall



Data reviews rating activity between April 2020 and December 2023. ESG--Environmental, social, and governance. EEMEA--Eastern Europe, the Middle East, and Africa. Source: S&P Global Ratings.

2. The severity of ESG-related rating actions has resembled the severity of corporate rating actions overall--most of the time

Chart 5

Upgrades and downgrades by severity (no.)

ESG-related rating actions versus corporate rating actions overall

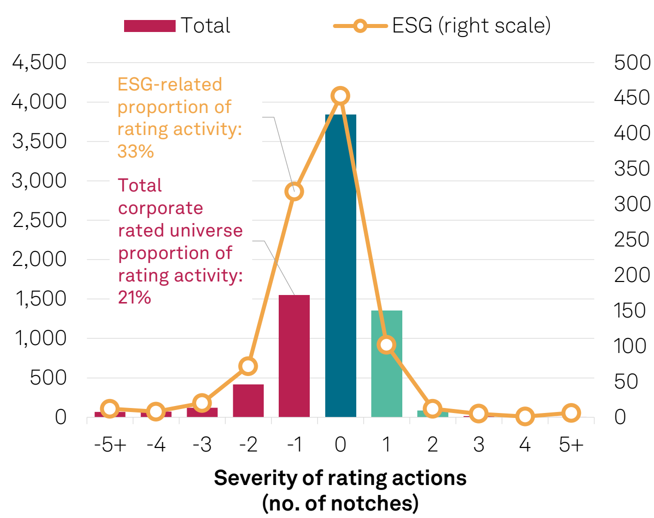
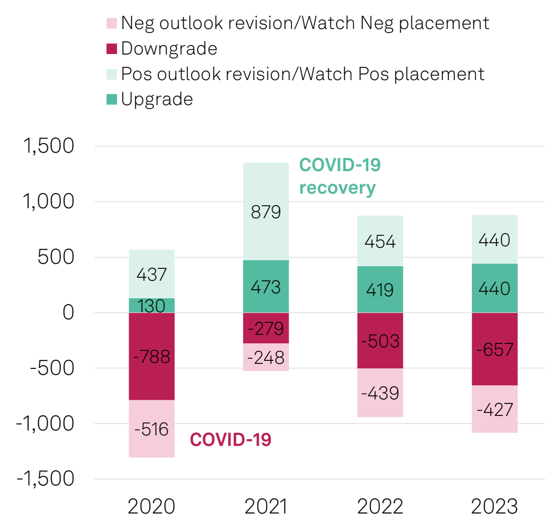


Chart 6

Corporate rating actions overall by type and year (no.)



Data reviews rating activity between April 1, 2020, and Dec. 31, 2023. '0' represents rating affirmations with a positive or negative outlook revision. In chart 6, negative numbers represent negative rating actions (downgrades, negative outlook revisions, and CreditWatch negative placements). ESG--Environmental, social, and governance. Source: S&P Global Ratings.

While the data indicates that ESG-related rating actions tracked the wider population of rating actions in terms of rating category and region, it also indicates that ESG-related rating actions may be more severe. Overall corporate rating activity and ESG-related rating activity largely mirrored one another (see chart 5), but when it comes to one-notch downgrades (the largest cohort of rating actions), we see a material difference between overall corporate rating activity and rating actions driven by ESG factors. In particular, one-notch downgrades made up 32% of ESG-related corporate and infrastructure rating activity while only 21% of total corporate and infrastructure rating activity incurred a one-notch downgrade.

One-notch downgrades made up 32% of ESG-related corporate and infrastructure rating activity while only 21% of total corporate and infrastructure rating activity.

S&P Global Ratings believes the impact of COVID-19 specific to ESG-related rating actions is almost exclusively related to health and safety factors. For the corporates and infrastructure sector, rating actions related to health and safety accounted for 83% of ESG-related rating actions since April 2020. Notably, 88% of positive outlook revisions in 2021 were related to health and safety; we attribute this to the reversal of negative rating actions on entities in 2020 largely stemming from the COVID-19 pandemic--a reversal that occurred as restrictions were lifted, the world began to recover, and people resumed their activities.

For the corporates and infrastructure sector, rating actions related to health and safety accounted for 83% of ESG-related rating actions since April 2020.

The material impact of COVID-19 on rating actions in recent years and the dominance of health and safety (88%) as the key ESG factor could inadvertently mask other important emerging trends. By removing actions related to health and safety, we can isolate ESG-related rating activity that isn't related to COVID-19 and analyze it further.

The number of ESG-related corporate and infrastructure rating actions falls sharply from 1,009 when we include rating actions related to health and safety to just 167 when actions relating to health and safety are excluded--a decline of 84% (see chart 8).

However, rating action severity trends remain broadly similar when analyzing the smaller number of rating actions that didn't involve health and safety; the number of ESG-tagged rating actions that were one-notch downgrades is only slightly more pronounced when normalizing the data by removing rating actions linked to health and safety. One-notch downgrades made up 33% of these rating actions (ESG-related rating actions excluding those involving health and safety), just one percentage point higher than for ESG-related rating actions in totality. The differential could indicate that ESG factors lead more quickly and more often to a downgrade than is the case across the general rated universe.

However, an important caveat is that the removal of rating actions related to health and safety also changes the year-over-year trends by removing the bulk of negative rating activity in 2020 and positive rating activity in 2021 as conditions stabilized and subsequently improved post-pandemic. But even when we removed health and safety-related impacts (both negative and positive), the trend was still predominantly negative. This substantiates our broader assertion that ESG-related rating activity is predominantly negative, whether or not rating actions related to health and safety are included.

Even when we removed health and safety-related impacts (both negative and positive), the trend was still predominantly negative.

An even deeper dive into the ex-COVID-19 data highlights another trend--namely, that governance factors represented the majority (65%) of ESG-related downgrades that weren't linked to health and safety. Moreover, governance factors--rather than environmental or social factors--have been the main driver of multiple-notch downgrades, although we note that the dataset is limited.

Chart 7

Upgrades and downgrades by ESG factor and severity

Among total ESG-related rating actions

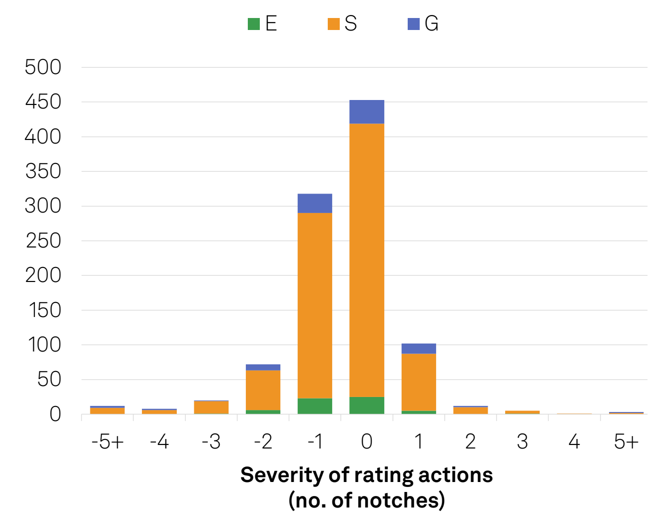
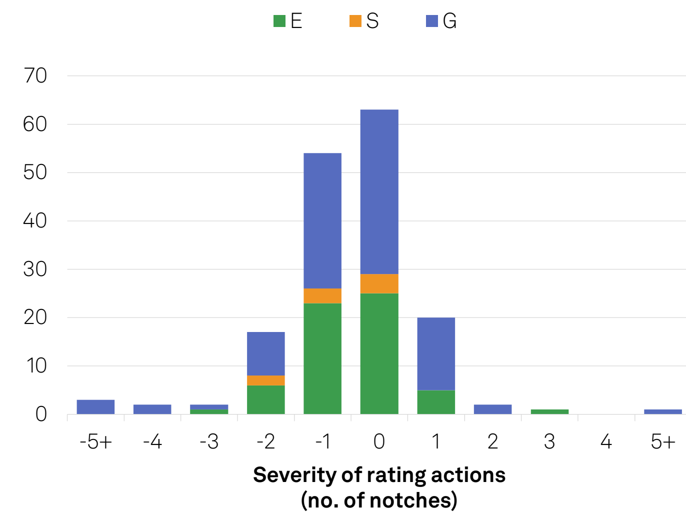


Chart 8

Upgrades and downgrades by ESG factor and severity

Among ESG-related rating actions that did not involve COVID-19



Data reviews rating activity between April 2020 and December 2023. '0' indicates a positive or negative outlook revision.
ESG--Environmental, social, and governance. Source: S&P Global Ratings.

Spotlight on most severe rating downgrades

During the observation period, seven entities experienced downgrades of three or more notches that were associated with ESG factors but that weren't related to health and safety. All of those downgrades cited a governance factor as the primary ESG factor driving the rating action. Each of these severe downgrades involved an issuer with a speculative-grade rating at the time of the action, and nearly all were from the 'B' category or below.

Table 1

Multinotch ESG-related downgrades (excluding those related to health and safety)

Month	Issuer	Sector	Rating from	Rating to	Region
December 2021	Serba Dinamik Holdings Bhd.	Energy	CC	D	Asia-Pacific
March 2022	Schur Flexibles GmbH	Materials	B	CCC-	EMEA
March 2022	SPX Flow Inc.	Capital goods	BB	B-	North America
October 2022	Metalcorp Group S.A.	Metals, mining, and steel	B	SD	Europe
January 2023	Americanas S.A.	Retail and restaurants	B	D	Latin America
February 2023	99 Cents Only Stores LLC	Retail and restaurants	CCC+	SD	North America
August 2023	Hawaiian Electric Industries Inc.	Utilities	BB-	B-	North America

EMEA--Europe, the Middle East, and Africa.

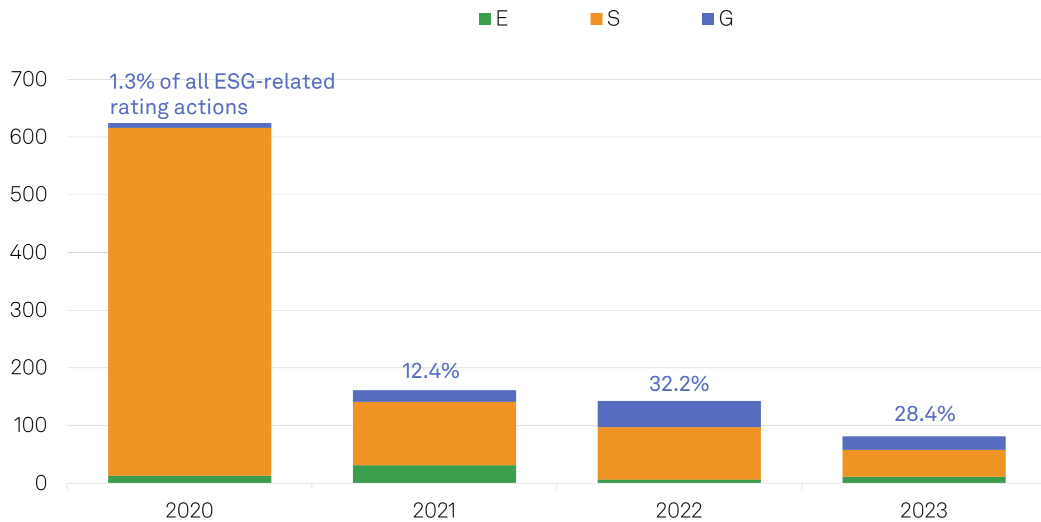
3. Governance remains a key driver for ESG-related actions

A relatively high proportion of ESG-related corporate and infrastructure rating activity was attributed to governance factors--for instance, they represented 28% of ESG-related rating actions in 2023. Assessing governance is a key component of our corporate credit methodology framework, and we recently updated our criteria (see Methodology: Management And Governance Credit Factors For Corporate Entities, published Jan. 7, 2024).

Chart 9

Governance drove a number of rating actions in recent years

All ESG-related rating actions by year and ESG factor (no.)



Data reviews rating activity between April 1, 2020, and Dec. 31, 2023. ESG--Environmental, social, and governance.
Source: S&P Global Ratings.

Chart 10

Governance-related rating actions by year and governance factor (no.)

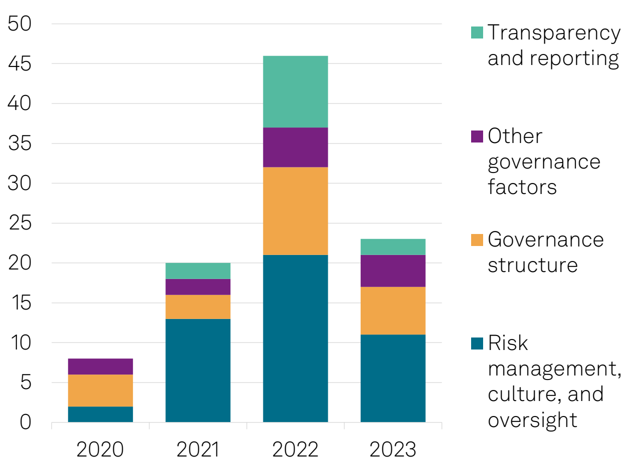
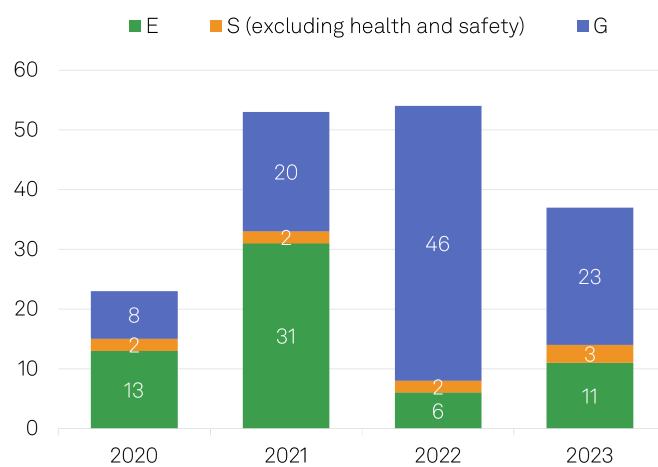


Chart 11

Among rating actions that didn't involve health and safety, governance factors dominated (no.)



Data reviews rating activity between April 1, 2020, and Dec. 31, 2023. ESG--Environmental, social, and governance. Source: S&P Global Ratings.

Given some of the recent trends highlighted in charts 9-11, we expect that governance factors will continue to be a prominent driver of rating actions.

4. Energy and utilities are the sectors most affected by ESG factors that aren't related to the pandemic

Chart 12

Environmental factors have affected energy and utilities the most

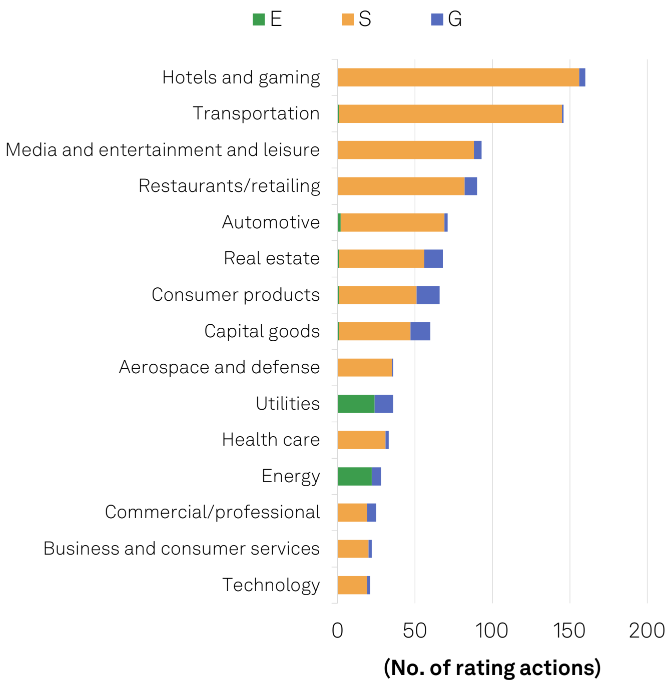
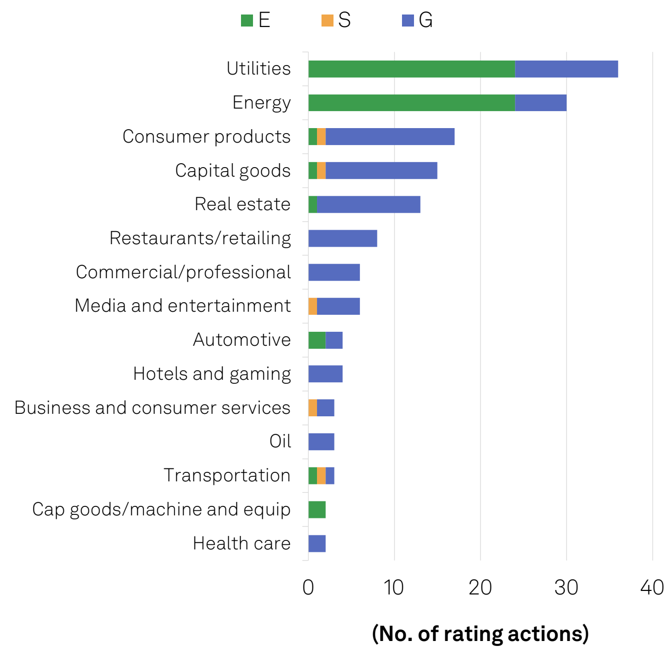


Chart 13

Prominence of ESG-related rating actions in energy and utilities climbs when COVID-19-related actions are excluded



Data reviews rating activity between April 1, 2020, and Dec. 31, 2023. Commercial/professional--Commercial and professional services. Media and entertainment includes leisure. ESG--Environmental, social, and governance. Source: S&P Global Ratings.

When ESG-related rating actions stemming from COVID-19 are excluded, the ESG-related rating activity in the utilities and energy sectors becomes more pronounced relative to the ESG-related activity in other sectors. Utility and energy companies have been under more strain given strenuous climate change initiatives across the globe and an increase in climate change-related events.

5. ESG factors are less of a driver of rating actions outside the U.S. and Europe

Table 2

ESG-related rating activity by region and factor (no.)

April 2020-December 2023

	Global	North America	Europe	Asia-Pacific	Latin America	EEMEA
Environmental factors	**61**	**41**	**10**	**5**	**4**	**1**
Climate transition risks	36	18	10	4	3	1
Physical risks	20	18		1	1	
Natural capital	2	2				
Waste and pollution	3	3				
Other environmental factors						
Social factors	**851**	**458**	**222**	**93**	**48**	**30**
Health and safety	844	454	220	93	48	29
Social capital	3	2	1			
Human capital	4	2	1			1
Other social factors						
Governance factors	**97**	**44**	**20**	**17**	**4**	**12**
Governance structure	24	15	3	3	1	2
Risk management, culture, and oversight	47	20	13	8	1	5
Transparency and reporting	13	2	1	6	1	3
Other governance factors	13	7	3		1	2

Data as of Dec. 31, 2023. The darker blue indicates a higher proportion of rating activity of the ESG factor by region within their respective environmental, social, and governance groupings. EEMEA--Eastern Europe, the Middle East, and Africa.
Source: S&P Global Ratings.

Seventy-nine percent of ESG-related corporate rating activity globally has come from the U.S. (54%) and Europe (25%), with the remaining 21% coming from Asia-Pacific, Latin America, and EMEA. This is not surprising, as similar regional differences exist in the wider population of rating actions simply as a result of the number of outstanding ratings in the U.S. and Europe relative to other regions.

Looking Ahead

6. Climate transition risks may become more prominent

Chart 14

Risk management and climate transition risks led when health and safety factors were excluded

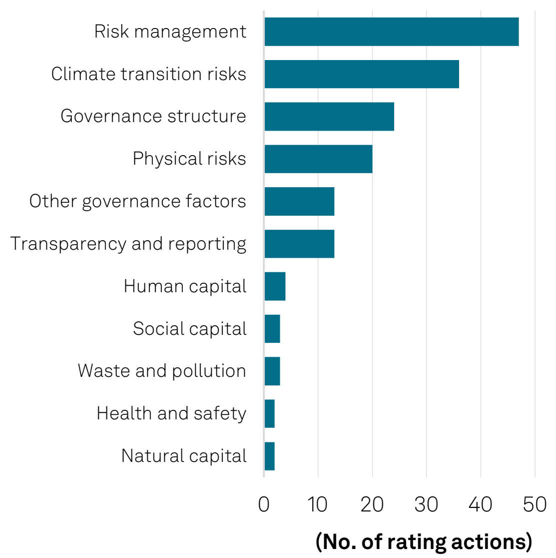
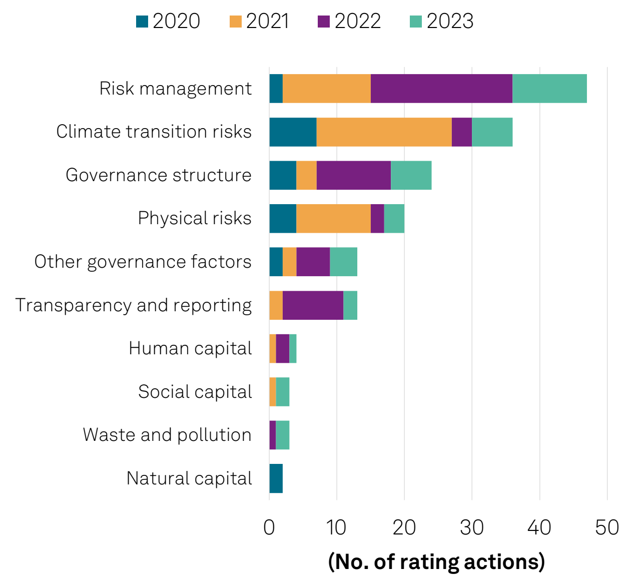


Chart 15

The number of rating actions citing climate transition risks grew in 2023



Risk management--Risk management, culture, and oversight. Source: S&P Global Ratings.

Risk management, culture, and oversight, the second most-cited ESG factor, are inherent day-to-day responsibilities of companies that ensure the stability of their operations and financial outcomes. When risk management falters or is insufficient, this governance factor can become material in our credit rating analyses and lead to rating and outlook changes.

Despite the uptick last year in corporate and infrastructure rating actions citing climate transition risks, the total number of rating actions since April 2020 falling in this category (36) remains rather immaterial (see "Why Climate Risks Are Changing So Few Corporate Ratings," published April 12, 2023). While we think climate transition and physical risks are important considerations in our credit analyses, the sense of urgency to combat climate change has so far been insufficient. But if net zero and other climate initiatives begin to accelerate, and if that results in additional regulatory changes, companies could fall under higher pressure to rapidly adapt, which could lead to increased rating activity in the future. As of now, it has yet to materialize.

All that said, we anticipate that the number of environment-related rating actions, particularly ones involving climate transition and physical risks, may continue to grow in 2024 and beyond. Notably, the uptick in rating activity in 2023 involving the physical impacts of a changing climate could set the stage for more climate-related rating activity should the frequency of natural disasters, such as wildfires and hurricanes across the globe, remain elevated.

Related Research

ESG In Credit Ratings January 2024: 2023 In Review, Jan. 12, 2024

North American Wildfire Risks Could Spark Rating Pressure For Governments And Power Utilities, Absent Planning And Preparation, Nov. 29, 2023

Why Climate Risks Are Changing So Few Corporate Ratings, April 12, 2023

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