

Climate Vulnerability in Corporate Ratings Criteria

Sector-Specific

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Scope

These criteria describe Fitch Ratings' methodology to augment its ability to identify climate-related risks in the global, non-financial Corporates sector using a Climate Vulnerability Signal (Climate.VS). These criteria apply globally to new ratings and the surveillance of existing ratings.

Key Rating Drivers

Climate.VS does not directly affect an entity's rating derivation. The levels merely signal to what extent a sector, or issuer based on the sectors in which it operates, could be exposed to credit-relevant climate transition risks between 2025 and 2050 under a specified scenario, and, therefore, be subject to a potential rating impact if the risks were left unmitigated.

Where risks are assessed as elevated, analysts embark on differentiated, issuer-specific analysis to determine if and how climate transition risks could affect issuer ratings over the medium term. This analysis considers, among other things, the issuer's plans to manage climate transition risk and how this may affect its creditworthiness.

If climate transition risk is deemed to be a current Key Rating Driver in the issuer-specific analysis, the weight ascribed to this factor in the overall rating derivation will vary, in line with the approach described in the *Corporate Rating Criteria*.

Climate Vulnerability

The Climate.VS reflects Fitch's views on the relative vulnerability of global corporate sector and issuer creditworthiness to a rapid low-carbon transition between 2025 and 2050. We draw on the UN Principles for Responsible Investment Inevitable Policy Response (IPR) Forecast Policy Scenario (2021) as the core scenario for our analysis. Under this scenario, global warming is limited to 2°C above pre-industrial levels by 2050.

Our sector-specialist credit analysts combine this scenario with their analytical insight to generate a view on how these risks develop between 2025 and 2050.

Climate.VS focuses on transition risks rather than climate-driven physical risks. This reflects our view that policy, market and regulatory risks are likely to have a more severe impact on corporates as a whole in the first half of this century than physical risks.

It considers the "financial materiality" i.e. the potential effect of climate risks on an issuer's creditworthiness and financial performance, rather than the issuer's broader impact on the economy, environment and people.

Climate.VS is used in the rating process as a screener with the goal that all relevant climate transition-related factors are considered in our analysis. Specifically, issuers that have a Climate.VS level of 45 and above for the year 2035 receive further analytical scrutiny in our rating committees and disclosure in our rating reports, covering potentially relevant climate risks and whether these risks are directly incorporated in the rating derivation – and, if so, how and with what impact, and, if not, why not.

This analysis includes a more differentiated assessment of how Fitch believes a company is placed to cope with climate risk. However, in many cases, the lengthy timescale involved in the climate transition and the high level of uncertainty regarding how it will play out limits, or postpones, the impact of climate risks on current credit ratings.

Related Criteria

[Corporate Rating Criteria \(October 2022\)](#)

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Climate Vulnerability Signals for Sectors – Distribution Grid

Definition	Overall vulnerability level	Winners and losers	Business model disruption	Revenue	Costs	Other policy concerns	Risk of stranded assets	Mitigants	Finance
90 Climate-risk factors pose existential or default-equivalent threat to the credit profile.	One or more climate-related factors have the potential in a credible scenario to pose an existential threat to core business activities.	Very high failure risk for majority of entities with no diversification.	Very high. Very little potential for reinvention beyond exiting business.	Potential for complete destruction of demand under credible downside scenarios.	Market or policy-driven costs could make the business model uneconomic.	Substantial likelihood of severe regulatory intervention which will eliminate profitability, with the potential for outright bans on core product.	High risk that assets will become uneconomic before the end of their intended service life.	Few or no cost-effective mitigants. Complete business transformation required. Potential for government mitigation due to market incentive or social concerns.	Climate-related pressures on providers of finance likely to make standard financing options unavailable.
70 Climate-risk factors present significant challenges and likely to lead to deterioration of the credit profile.	Major changes to markets, regulation and business model likely to threaten profitability for an extended period.	Significant numbers of entities likely to fail or become uneconomic.	Very high, only limited number of entities likely to manage transition to a profitable model.	Potential for demand destruction, policy-induced changes to relative prices of substitutes, price pressure.	Significant rises in costs, potentially threatening profitability.	Real possibility of policies with meaningful negative effect, e.g. targeting demand reduction, raising costs, or boosting substitutes.	Risk that some assets will become uneconomic before the end of their intended service life.	Some mitigants available which, if successful, allow businesses to survive.	Climate-related pressures reduce access to finance, making many conventional sources inaccessible, but some higher cost sources remain.
50 Climate-risk factors present challenges and may weaken the credit profile.	Solid demand drivers but material changes to products or production methods needed that may disrupt profitability.	Minority of entities which manage the transition poorly will see significantly reduced profitability or, in extreme cases, fail.	Material risks for most entities due to technology or business model transition.	Any demand pressure due to changing habits, policy and substitutes likely to be moderate at a sector level.	Costs likely to rise during transition but businesses remain fundamentally profitable, although profitability is depressed during transition.	Policies targeted at shaping nature of product/industry.	Limited risk of stranded assets materialising if insufficient or poorly judged investment/mitigation.	The technology for mitigation exists, but is dependent on investment/further development.	Climate-related factors reduce the availability of funding, but limited amounts remain available through mainstream sources.
30 Climate-risk factors are not expected to affect the credit profile materially, but some adaptation may be needed.	Fundamental demand drivers neutral to positive, despite major changes to existing business models or heavy investment being required.	Majority of entities will successfully transition with little impact on profitability.	Major investment needed to mitigate risks but low risk and predictable.	Fundamental demand drivers solid.	Potential for increased costs due to investment but likelihood these can be passed on.	Limited policy threat. Potentially a key sector likely to obtain policy support.	Minority of outdated assets only.	More likely to receive direct/indirect government support.	Climate-related factors unlikely to affect funding availability if companies manage their exposures.
10 Climate-risk factors are neutral to positive to the credit profile.	Climate trend neutral to positive for sector prospects.	Possibility of business failure due to climate-related trends very low.	Limited or zero business model change required.	Clearly neutral or potentially positive effect on demand.	No or negligible impact from climate-related trends.	No foreseeable negative policy implications; potential upside from policies.	Negligible risk to asset base.	None needed.	Climate-related factors do not affect funding for sector; potential for sector to benefit from additional capital availability.

Source: Fitch Ratings

Methodology

Sectors and issuers are evaluated at five-year milestones between 2025-2050 to produce a curve that illustrates our view on relative vulnerability at various points in the transition. Climate.VS values range between 0-100. The higher the value on the curve at a specified year, the more vulnerable the credit profile to climate-related risks.

Issuer Climate.VS curves are derived from Sector Climate.VS curves, based on an analysis of revenue sources in the last full fiscal year.

This revenue split is then used to create a weighted average at five-year intervals, weighted by revenue and potential rating impact by sector. For the minority of sectors, where it is impossible to generate a meaningful revenue split for issuers, or such a split may be misleading, we will estimate a revenue split based on other factors, such as production volumes.

Climate.VS levels reflect our current view of transition risks inherent in each sector in a specified future year. They include no further remedial action beyond that at a sector level. We assume that companies take reasonable steps to mitigate climate-related risks in the sectors in which they are already present. This could include, for example, investing in proven alternative production technologies. These assumptions are set out in 13 Fitch Ratings sector-level Climate.VS reports describing the risks and potential responses across over 120 subsectors.

The actual rating impact by the referenced year may be more or less severe, depending on the issuer's climate transition strategy and degree of preparedness, as described in the next section.

Illustrative Unmitigated Credit Rating Impact

The illustrative impacts and definitions for an entity below give our view of the potential impact on the credit rating of a company by the year to which the Climate.VS relates, if corrective action is not taken. For example, a company with a Climate.VS of 70 in 2040 would face a high probability of a multi-notch downgrade by 2040 if the scenario plays out, unless the company mitigates the risk appropriately.

The illustrative rating impact is applicable to companies with average exposure to climate-related risks for their sector. Within each sector, there could be big differences in the potential rating impact, depending on the level of preparedness and specific exposure of each company. In addition, the illustrative rating impact at each level reflects the potential rating impact by a given future year, whereas credit ratings are forward looking.

These company-specific considerations will be captured in our differentiated assessment of the issuer where its Climate.VS for 2035 is 45 or above, and disclosed accordingly in our research.

Entity Climate.VS – Illustrative Corporate Rating Implications

	10	30	50	70	90
Illustrative Credit Rating Impact	No downward rating pressure.	Ratings unchanged in vast majority of cases.	Rating impact expected to be limited to one notch in most cases.	High probability of multi-notch downgrade.	Potential multi-category rating impact and high default risk.

Note: This illustrates the potential rating impact under the scenario by the specified year for a representative corporate with mid-investment grade credit profile, and a flat or slowly increasing Climate.VS in subsequent periods
Source: Fitch Ratings

Criteria Disclosure

In rating reports, we disclose the issuer's Climate.VS, and, if it is 45 or above for 2035, we further disclose the nature of the potential climate risks to the issuer, and whether these risks are directly incorporated in the rating derivation – and if so how and with what impact, and if not why not. We will disclose how the issuer's published transition plans (if any) may affect the issuer's creditworthiness. Where credit-relevant climate risks are a Key Rating Driver, these will continue to be disclosed in the Rating Action Commentary.

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature or other factor relevant to the assignment of a rating and the methodology applied to it are included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Limitations

Ratings, including Rating Watches and Outlooks, assigned by Fitch are subject to the limitations specified in Fitch's Ratings Definitions and available at <https://www.fitchratings.com/site/definitions>.

Rating Assumption Sensitivity

Changes in Climate.VS does not directly affect issuer ratings.

Appendix 1: Data Sources

For Climate.VS, our core regulatory and policy risk scenario is the IPR's Forecast Policy Scenario that limits global warming to 2°C released in October 2021. The IPR is a consortium that develops scenarios around the policy response to climate change. The scenario is available here <https://www.unpri.org/sustainability-issues/climate-change/inevitable-policy-response>

We also rely on the issuer's previous fiscal year revenue splits to determine the weighted-average Climate.VS.

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