

# How Environmental, Social, And Governance Factors Help Shape The Ratings On Governments, Insurers, And Financial Institutions

October 23, 2018

## Key Takeaways

- For the two years to July 31, 2018, environmental, social, and governance (ESG) factors directly influenced the ratings on 147 global sovereigns, local and regional government, insurers, and banks.
- ESG factors were equally relevant for all asset classes; Governance was the most prevalent ESG risk.
- These factors affected issuers in developed and developing markets similarly.
- Most ESG-led rating actions were negative.
- Our existing criteria enable us to incorporate existing and emerging ESG credit factors.

Environmental, social and governance (ESG) risks--and opportunities-- are a material part of credit analysis, whether for banks or insurers, or for sovereign and local and regional governments (LRGs). The ESG acronym is increasingly coming to the forefront with investors, regulators, and politicians around the globe. And for good reason--these three letters encapsulate myriad risks (and opportunities) that affect the creditworthiness of rated issuers. Some, like governance risks, have existed for a very long time in one form or another. Others, like social or environmental considerations, are not new, but have gained importance recently. This is due to changing regulations (prudential or environmental) or simply evolving behaviors and preferences from customers and citizens.

S&P Global Ratings performed a two-year review of ESG factors, and how they influenced, positively or negatively, the creditworthiness of rated global sovereigns, LRGs, banks, and insurers. For that period, from July 31, 2016-July 31, 2018, we found 147 cases globally where these factors resulted in a rating action. The conclusion is clear: ESG factors affect all types of issuers, everywhere. Furthermore, governance risks, based on our observations, were behind the majority (65%) of these rating actions. Our existing criteria already allow us to accurately analyze how issuers are faring on this ESG front and reflect this in ratings.

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## ESG: Simple Acronym, Complicated Risks

### E Risk: The most tangible

Environmental risks (E risks) can influence the creditworthiness of issuers in multiple ways. The Task Force on Climate-Related Financial Disclosures (TCFD), a group of experts commissioned by Governor of the Bank of England, Mark Carney, divided them into two subgroups, as part of its final report from June 29, 2017:

- "Physical risks," which include the direct financial and operational implications for organizations or sovereigns from natural catastrophes, but also long-term climate change; and
- "Transition risks," which include all the policy, legal, technological, and reputational challenges from the transition to a low-carbon economy, and their associated costs.

For sovereigns, LRGs, insurers, and banks, we are tailoring these definitions below given their diversity.

We consider environmental degradation or a diminishing natural resource base unlikely to undermine economic and social indicators or political institutions such that it would destabilize the sovereign rating within a horizon of 5-10 years. That said, we believe that climate change and other ecological issues could have significant implications for sovereign ratings in the decades to come. Although it poses a negligible direct risk to sovereign ratings in advanced economies for now, on average, ratings on many emerging sovereigns (specifically those in the Caribbean or Southeast Asia) will likely come under significant additional pressure. One example came with the weakened economic growth prospects in the Turks and Caicos Islands following the devastating impact of hurricanes Irma and Maria in 2017, which resulted in an outlook revision to stable from positive in June 2018. Of course, what happens in emerging and developing countries can have repercussions for advanced economies as well, for example, through trade and migratory flows.

Concentrated economies can also face big ESG repercussions. A sovereign or LRG with high agricultural output is more susceptible to weather-related events, and ones with resources depending on an environmentally unfriendly industry (such as mining) could suffer from limited budgetary flexibility and contingent liabilities.

Environmental factors could affect sovereign creditworthiness in other ways--for instance, countries reducing their reliance on imported energy in favor of renewable energy could find external metrics improving.

With respect to insurance, S&P Global Ratings identify the intricate and complex relationships with greenhouse gas emissions, climate change, natural resource contamination and scarcity, pollution, and biodiversity impact on insurers' operating models and their exposure through their counterparties via investments and insurance contracts with other (re)insurers. Our focus on E risk within insurance ratings goes beyond weather-related phenomena, given that most insurance business models, by definition, are exposed to natural catastrophe risks across sectors (for instance, property damage, fatality, or medical spending). With E risk, we look to anticipate additional operational costs for insurers due to inability to operate or recover from investments vulnerable to environmental issues. As well, insurers may incur sizable claim settlements due to climate-related liability exposure. Climate change could end up affecting human mortality and morbidity in significant ways. Rising temperatures, heavy rains, and droughts can pose health risks, possibly leading to increased deaths. For example, populations exposed to areas affected by

**Climate change and other ecological issues could have significant implications for sovereign ratings in the decades to come.**

extreme heat or poor air quality could experience a shift in health threats stemming from reduced food and water quality.

Like insurers, banks could be vulnerable to what the TCFD would define as "acute risk," that is, deterioration in the quality of its loan exposures or securities investments and attrition of its revenues base immediately after a severe natural catastrophe. But it could result from loan portfolio concentration, or securities investments in potentially environmental unfriendly sectors (such as mining and arctic drilling), whose main players could see their financial health deteriorating if the legal, technological, or reputational context changes rapidly.

### **S Risk: The broadest and most developing factor**

For organizations, social risks (S risks) and opportunities are those linked to the interactions between a company, its stakeholders, and the broader society, whose behaviors, priorities, and expectations evolve. It encompasses the analysis of turnover (in particular of key personnel), the firm's reputation as an employer and how it manages its people, and the vulnerability to long disruptions due to inefficient social dialogue, like through prolonged or otherwise bitter strikes. But it also captures changing consumer preferences and priorities, which new technologies and social media can exacerbate, rapidly reshaping and transforming industry dynamics and competitive positions. We believe that, for banks and insurance companies, mis-selling practices and other type of conduct risks (such as those perceived as abusive commercial practices, especially vis-à-vis individual customers) are an important social risk, for which we believe regulators and the society in its entirety are less inclined to accept.

For sovereigns or LRGs, predictable policymaking is often linked to the cohesiveness of civil society, as demonstrated by social mobility, social inclusion, the prevalence of civic organizations, the degree of social order, and the capacity of political institutions to respond to societal priorities. Social cohesion-related factors can also include conflicts and terror attacks. Social inclusion fosters the stability and effectiveness of policymaking, and underpins a productive economy where skills and jobs bolster growth, national savings, and public finances. On the other hand, where a country has a significant shortfall in basic public services and infrastructure, its public finances are likely to come under prolonged stress. Changes in social cohesiveness often trigger, follow, or go hand-in-hand with material governance changes.

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### **G Risk: The factor that most frequently arises in our analyses**

Governance risks (G risks) are not new and their impact can be severe for commercial organizations, sovereigns, or local and regional governments.

When evaluating institutions and governance for sovereigns and local and regional governments, we consider the effectiveness, stability, and predictability of policymaking, political institutions, and civil society. We also analyze institutional accountability and transparency, which has a direct bearing on sovereign or LRG creditworthiness. Transparent, accountable institutions reinforce the stability and predictability both of political institutions and the political framework. Monetary policymaking, particularly central bank independence, can also be significantly affected. Having transparent processes and data is similarly important because this enhances the reliability and accuracy of information. It also helps reveal any major shifts in a country's policymaking or the timely emergence of threats to a sovereign or LRG's creditworthiness.

For private-sector players such as banks, finance companies, and insurers, we believe board member composition, vision and values, and transparency offer insight to governance effectiveness. Our evaluation on G risk focuses on the balance of authority, independent oversight,

awareness of risks at all levels, and quality of internal control and risk management functions. We also believe that a board with diverse skills and backgrounds that reflect the needs of the business and its diverse set of stakeholders (such as customers, employees, and community members), is more likely to succeed. Timely and adequate disclosure of a company's operating and financial performance and governance facilitates stakeholder understanding of that company's prospects. Openness regarding nonfinancial performance (for example, taxation) is also key to understanding material ESG risks and opportunities. Finally, independent reputable auditors can provide stakeholders comfort regarding the quality of internal control and risk management functions.

### How Our Criteria Capture ESG Factors

S&P Global Ratings incorporates these considerations into its ratings methodology and analytics, enabling analysts to factor in short-, medium-, and long-term impacts--both qualitative and financial--into their considerations at a number of points in their credit analysis. We continuously monitor the impact of ESG factors, as we do all relevant factors, on an entity's credit profile.

Our ratings are forward-looking and incorporate our financial forecasts. These forecasts reflect the period over which we consider we have a clear view of an entity's potential financial performance, taking into account capital structure, and the potential impact of relevant factors (including ESG risks and opportunities). Generally, our forecasts cover up to two years for speculative-grade corporate entities (those rated 'BB+' and below) and no more than five years for investment-grade issuers ('BBB-' and above). We also consider whether the credit profile is sustainable beyond those periods. If we have a high degree of certainty about risks or opportunities that happen beyond the typical forecast period, we factor those into our ratings, and potentially our financial forecasts, as appropriate.

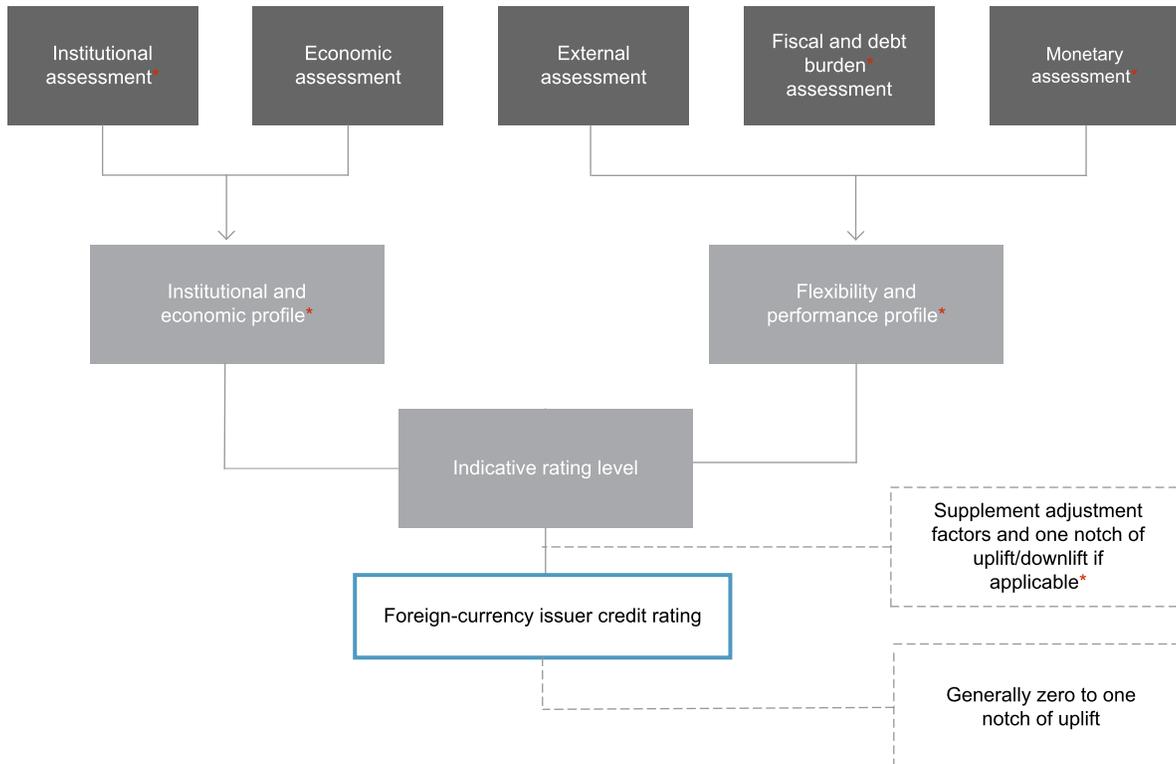
Therefore, we factor the impact of ESG risks and opportunities, if sufficiently visible and material, into our financial forecasts. In some cases, our view of the materiality and visibility of ESG risks and opportunities, and how effectively an entity is mitigating those risks, extends beyond our forecast timeframe. Our qualitative rating considerations could still capture these factors if we are fairly certain about their risks and opportunities. We monitor the impact of these ESG factors and our view will evolve as new information becomes available, or as the issuer's fundamentals change.

## ESG in sovereign credit rating criteria

Chart 1

### Sovereign Issuer Credit Rating Framework

Five Key Areas To Determine A Sovereign's Creditworthiness



\*Factors most likely to include consideration of environmental, social, and governance risks. Source: S&P Global Ratings. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

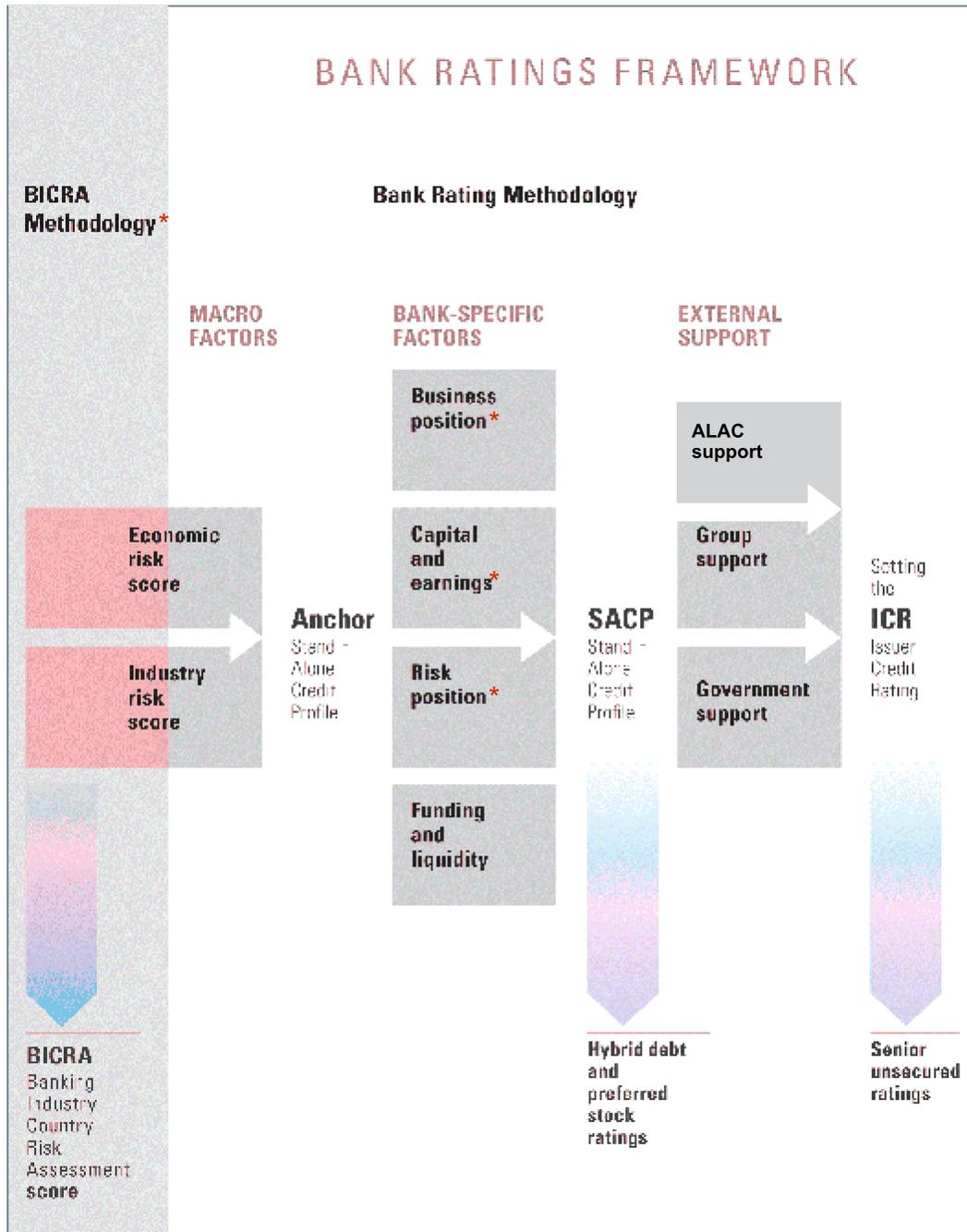
Institutional quality and governance effectiveness is a key factor for sovereign ratings (see chart 1). Indeed, it accounts for roughly one-quarter of the indicative sovereign rating (see "Sovereign Rating Methodology," published Dec. 18, 2017). As an example, the outlook revision to stable from negative on Poland in December 2016 reflected the reduction in the near-term risks over a further weakening of key institutions, most importantly Poland's central bank, caused by the government's efforts to change and control the country's key independent institutions.

Environmental and social considerations both matter, and could be significant, but they have a less structured place in our methodology than the quality of governance. We believe that a growing sense of economic exclusion and unequal distributional outcomes have promoted political polarization across a number of advanced economies. Although it is difficult to disentangle from

other factors, social inclusion is likely to support ratings, because it fosters the stability and effectiveness of policymaking, and underpins productive economies. Of note are our views of the very strong financial management of the Canadian city of Vancouver, which introduced a long-term rolling operating plan and measureable standards that help the administration achieve its long-term objectives. This led to an upgrade to 'AAA' from 'AA+' in February 2017. On the other hand, where a country has a significantly lacking basic services and infrastructure, its finances are likely to come under prolonged stress. Our methodology indicates that in these circumstances, we should lower the public finances assessment.

## ESG in bank rating criteria

Chart 2



\*Factors most likely to include consideration of environmental, social, and governance risks. ALAC: Additional loss absorbing capacity. Source: S&P Global Ratings. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

The starting point for assigning a rating to a bank in a given country (see chart 2) is the anchor we derive by applying our BICRA methodology (see "Banking Industry Country Risk Assessment Methodology And Assumptions," published Nov. 9, 2011). This macroanalysis of the industry and economic risks in a given market could, for instance, be affected by deficiencies in the overall quality of a banking system's governance and transparency, or material system-wide effects related to climate change. For example, in several cases in Russia and other countries in the Commonwealth of Independent States (CIS), management and governance shortcomings contributed to bank failures (see "How Management And Governance Lapses Contributed To Bank Failures In Russia And The CIS," published Oct. 12, 2017, on RatingsDirect). Our anchors, or starting points in rating those banks, reflect these structural weaknesses, including opaque ownership, business models that rely too heavily on new business at unsustainable margins, inflated capital values, and extensive engagement in related-party lending.

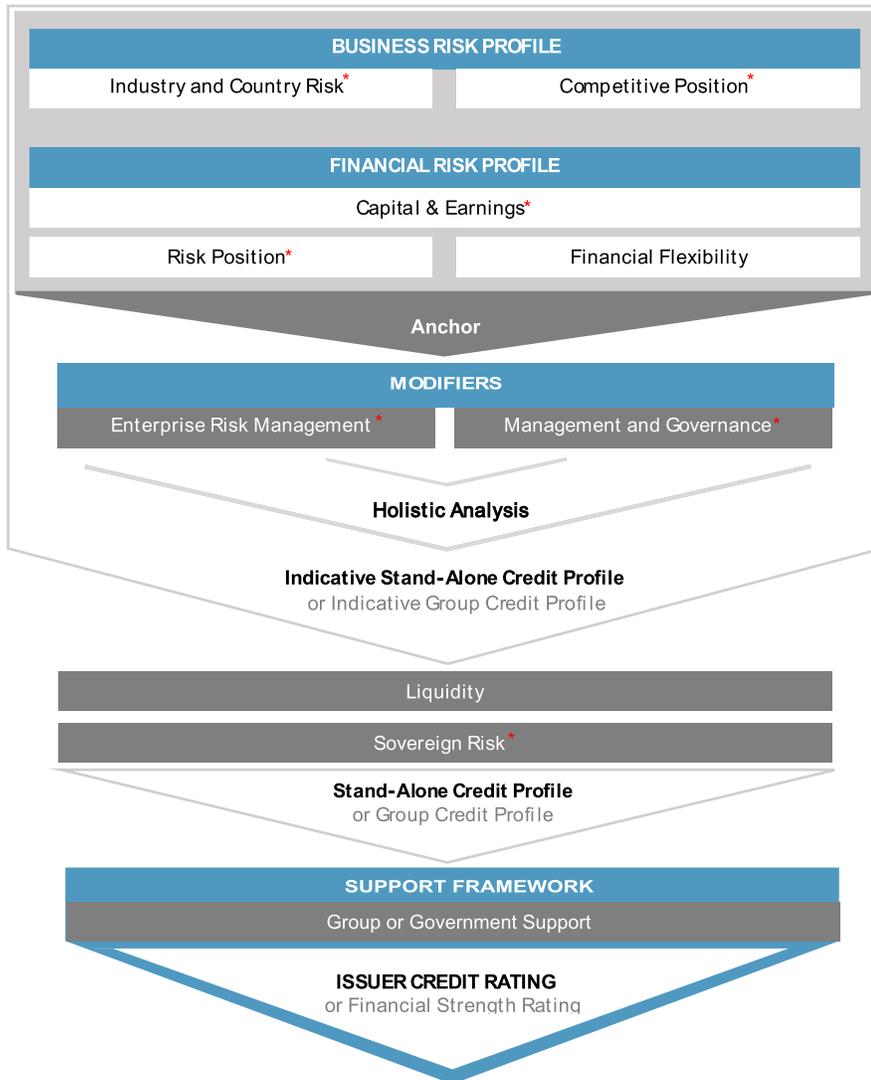
As part of our analysis of a bank's business position, we consider its governance, an important component of our assessment of the quality of management and strategy. The risk of ineffective governance is not region-specific or inherent to countries with a weak institutional framework. For instance, some financial institutions in developed economies, including those in Western Europe and the U.S., have uncovered governance issues, perhaps the most recent being Wells Fargo Corp. in the U.S. The downgrade to the bank in February 2018 was partially due to governance issues and followed news that Wells entered a cease-and-desist consent order with the Federal Reserve that restricted the company's asset growth to its total asset size at the end of 2017 until it sufficiently improves its governance and controls. This unprecedented asset cap on a large bank underscores the continued elevated regulatory risks for Wells, and the ongoing ramifications of its governance and control issues as well as the complexities of improving compliance and operational risk controls throughout its very large organization. However, this is far from being an isolated case. Other large banks have had similar issues, before or during the observation period. BNP Paribas was fined in 2014 for allegations of breaching U.S. sanctions between 2002 and 2008 and failure to maintain adequate anti-money laundering practices from 2008-2013. HSBC was fined in 2012 for failing to maintain an effective anti-money laundering program and to conduct appropriate due diligence on its foreign correspondent account holders.

Although our capital assessment looks at expected credit- and market-risk elements of a bank's activities, our assessment incorporates risks that our capital model does not capture directly. Therefore, we consider ESG factors in our assessment of risk position. For example, we could revisit our ratings if we anticipate that a bank will suffer losses due to the impact of climate change on its loan and investment portfolios. This could include losses from climate-risk-related exposures from assets acting as collateral for loans. The risk position assessment might also weaken if, in our view, the bank is exposed to significant legal risks. Costly litigation from mis-selling or other conduct issues has given rise to risks not related to the credit quality of loans and investments, even for traditional banking activities in developed countries. Another recent example, which is outside the observation period but still relevant, is the case of Danish lender Danske Bank. We revised our outlook on the bank to negative from stable in September 2018 after further disclosures of money laundering issues in Estonia and increasing risks of upcoming fines and penalties.

**The risk of ineffective governance is not region-specific or inherent to countries with a weak institutional framework.**

## ESG in insurance rating criteria

Chart 3



\* Factors most likely to include consideration of environmental, social, and governance risks. Source: S&P Global Ratings. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

Our insurance methodology (see chart 3) takes a similar approach to our corporate and bank criteria frameworks, weaving analysis of ESG risks and opportunities into several aspects of the overall rating process.

In assessing an insurer's business risk profile, we analyze the risks inherent to the insurance markets in which it operates. The insurance industry and country risk assessment incorporates our view of the insurance markets' economic, political, and financial system risks; its regulatory framework; and its growth prospects. Climate change could affect all of these factors. Exposure to ESG risks could also affect the strength of the insurer's brand name, profitability, and competitive

position.

Our assessment of an insurer's financial risk profile includes our prospective view of capital adequacy. Applying our capital model criteria, we incorporate a risk charge to capture the impact of 1-in-250-year catastrophe losses (that is, the level of annual losses that has a probability of 0.4% of being exceeded) in our evaluation of capital adequacy. Although climate change might affect the magnitude or frequency of extreme weather events, there is no scientific agreement about the precise quantitative impact the industry can use in its natural catastrophe models. The uncertainty in an insurer's capital and exposure management relating to catastrophe models could lead us to conclude that risks are understated in our capital analysis, affecting our capital and earnings assessment.

The financial risk profile assessment also incorporates our analysis of the insurer's risk position. Here, we measure risks not captured in the capital and earnings analysis and risks that could make capital more volatile. If we conclude that exposure to climate change (or other ESG risks) is material and contributes to above-average volatility in prospective capital adequacy, we might lower our risk position assessment.

Our analysis also incorporates our view of an insurer's management, governance, and enterprise risk management. How well insurers prepare themselves to deal with the challenges from ESG risks is a relevant consideration in these assessments.

## **The Results Are In: ESG Matters**

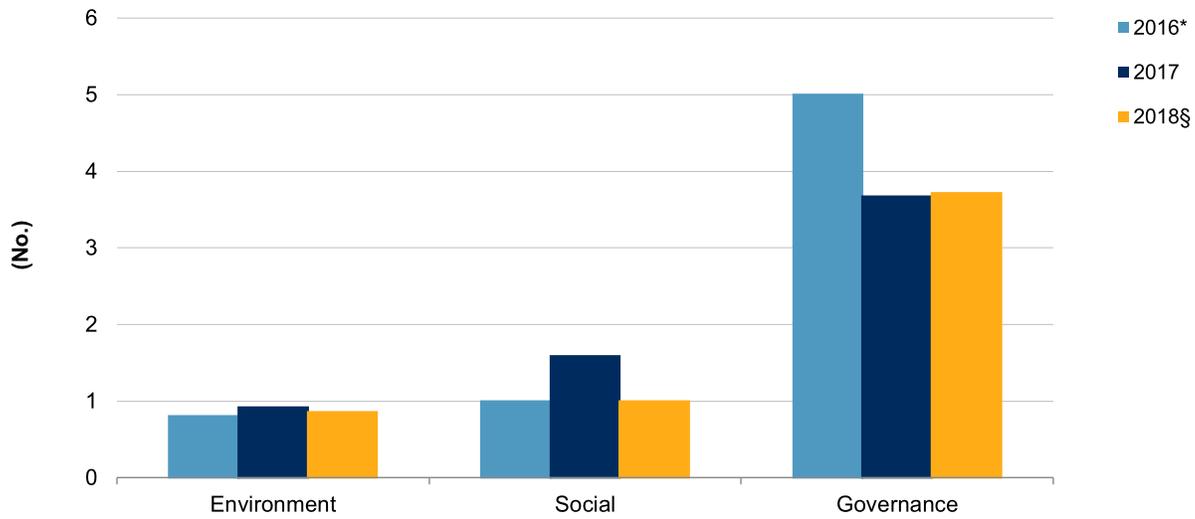
In our lookback analysis, we reviewed our research updates, published as part of a rating change, an outlook revision, or a CreditWatch placement, to illustrate where and how ESG factors have featured in our credit analysis. Over the two-year study period, we found 147 rating actions in which one or more ESG factors influenced our raising or lowering the ratings, placing them on CreditWatch, or an outlook revision.

## **ESG is important across all asset classes**

Of our sample rating actions, 41% relate to banks, 40% to sovereign and LRGs, and 19% to insurance companies (see charts 4 and 5).

Chart 4

### Average Number Of Cases Per Month In The Sample Period

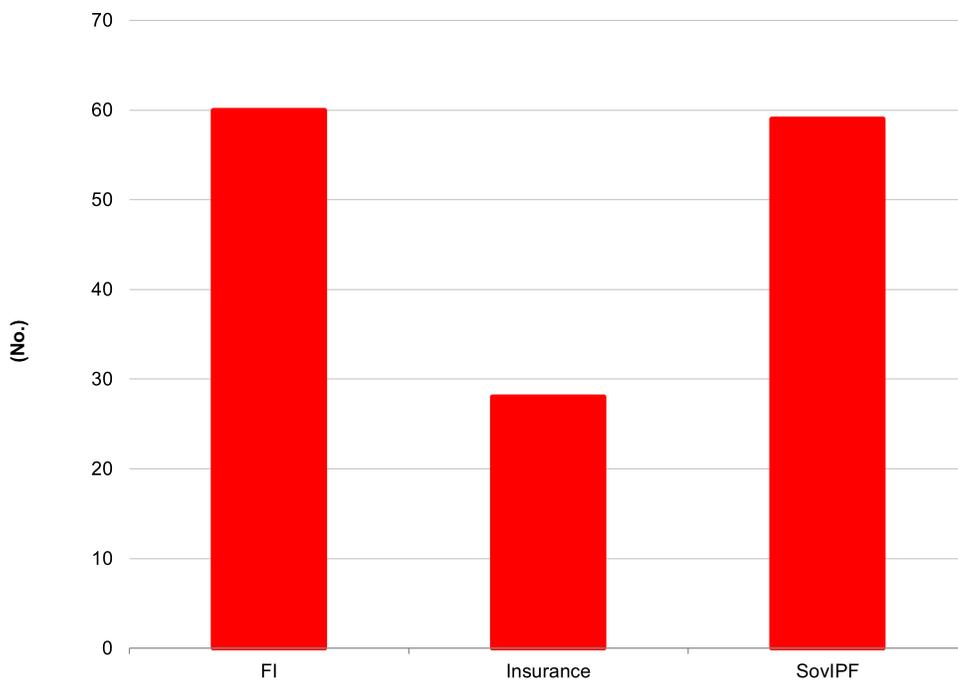


\*Period covers July 28-Dec. 31, 2016. §Period covers Jan. 1-July 28, 2018.

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Chart 5

**Number Of Cases By Asset Class**



FI--Financial institutions. SovIPF--Sovereigns and international public finance.

**Governance factors dominate, except in insurance**

G risks are by far the dominant of the three factors observed among the sovereign-LRG and bank rating actions we analyzed. In both cases, about 70% were governance-related. For banks, it can be because of board turnover or inefficiency, corruption or fraud-related scandals, insufficient risk framework jeopardizing the company's reputation, and financial irregularities (for example, allegations of money laundering, breach of regulations, tax evasion, and less-than-robust reporting systems).

S risks are, predictability, more pronounced for banks and insurers, as companies are more subject than sovereigns and LRGs to behavioural and technological changes. For financial institutions, most of those rating actions are due to enhanced customer protection measures from regulators to combat perceived abusive lending practices or fines to punish mis-selling activities. In February 2018, U.K.-based Brighthouse Group defaulted less than two years after the Financial Conduct Authority (FCA) tightened regulations, notably customer acceptance criteria and more stringent sign-up process, and increased its oversight on nonbank lenders to low-income individuals. The capped interest rates on new loans and more stringent collection procedures led to drastic cash flow reduction and, ultimately, default. Generally, S factors tend to be essentially negative for lenders (both banks and nonbanks), but more positive for insurers, for which conduct issues seem to have been less prevalent during our analysis period, although conduct risk has

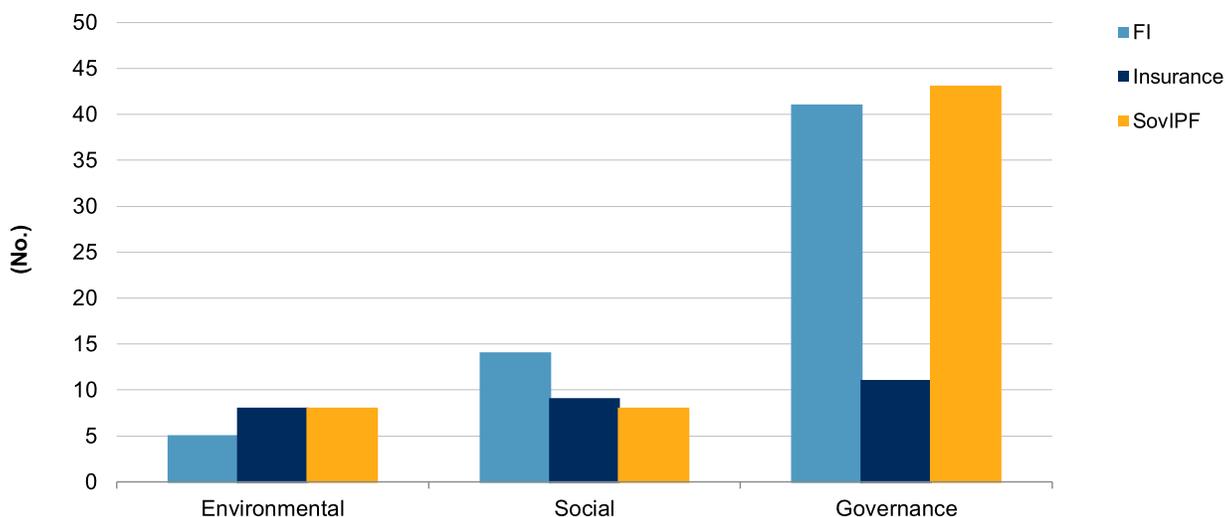
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been a factor for insurers historically. Instead, brand reputation and customer satisfaction triggered some positive rating actions. Within the financial institution sector, about half of the rating actions connected to S and G risks related to nonbanks (unregulated or lightly regulated entities), which suggests that proactive and efficient prudential supervision reduces, but does not eliminate, these risks.

About 40% of the E risks we found were in insurance. The three factors were broadly balanced in our analyses. Most of the rating actions reflected insurers' and reinsurers' exposure to natural catastrophe events and to what extent their capital buffers and reinsurance protection are able to sufficiently absorb their sizable losses. Most of the rating actions over the lookback period related to North America (U.S. and Bermuda) domiciled insurers and reinsurers with meaningful exposure in California, Texas, Florida, and the Caribbean, where wildfires and severe hurricanes led to increased underwriting losses in 2017. By and large, however, many of the rated insurers possessed the capital and resilience to overcome expensive hurricane or wildfire seasons. As a result, the 2017 catastrophe losses resulted only a handful of negative rating actions (see chart 6).

Chart 6

### Breakdown Of Cases By Factor



FI--Financial institutions. SovIPF--Sovereigns and international public finance.  
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### ESG factors are significant across the globe

Of rating actions in which ESG factors played a role, 40% were in Europe, the Middle East, Africa, Russia, and the CIS countries (see chart 7). But overall, we believe there is no particular region globally where those factors have played a disproportionate role. In addition, there is no bias between developed and developing markets.

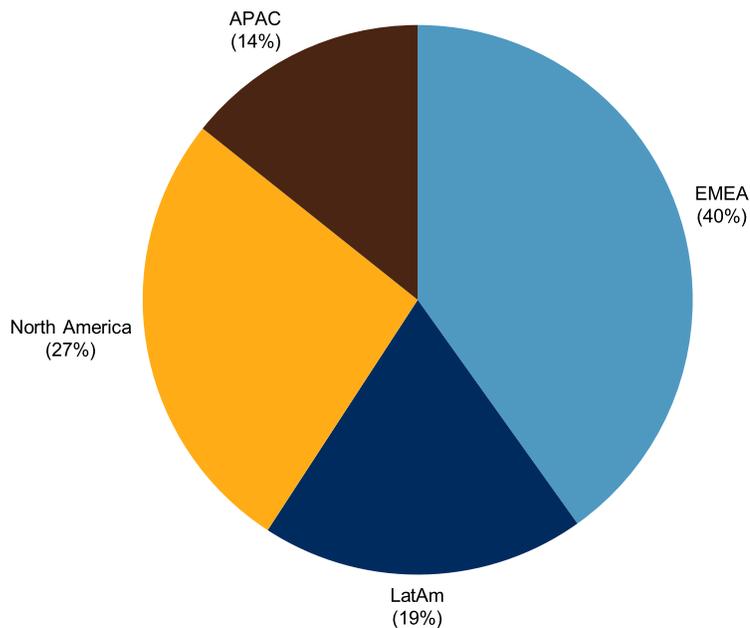
However because our ratings factor in structural weaknesses, which could be E-risk, S-risk, or G-risk-related, and which tend to mean the ratings are relatively low to begin with. Examples

include pervasive or endemic corruption; weak governance in a given country (or in its financial services sector); significant shortfalls in basic public services and infrastructure, which necessitate massive investments not yet disbursed; a deficient bank or insurance regulator or history of political-, geopolitical-, and community-related instability. Therefore, if a governance issue or social unrest breaks out in a country where those risks are the norm, our ratings likely reflected those as a structural weakness, which means lower ratings from the start. Conversely, if they occur in a country generally immune from those risks, negative ratings pressure is more likely.

Still, rising social risks, in combination with weaker overall governance and policymaking, contributed to downgrades to the Democratic Republic of Congo in August and Venezuela in July 2017. More positively, and also illustrating combined social and governance impacts, the May 2017 upgrade of Indonesia to 'BBB-' benefited from both significant shifts in tax policy and measures taken to address basic infrastructure and service needs.

Chart 7

### Geographic Breakdown Of Cases



EMEA--Europe, the Middle East, and Africa. LatAm--Latin America. APAC--Asia-Pacific.  
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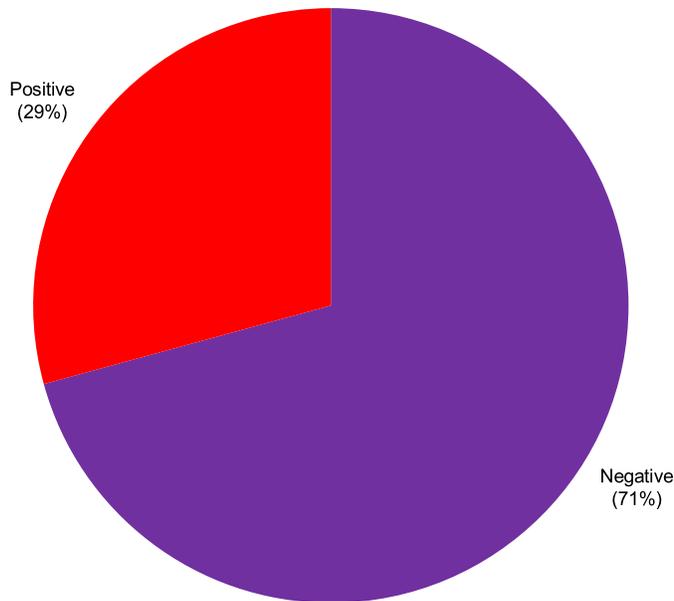
### Downside stress is high, but the upside is substantial in some areas

Of the 147 rating actions in our review, 71% were negative (see chart 8). This indicates that, across the sovereign-LRG, banks, and insurance sectors, those factors have appeared more as risks than opportunities so far. If for sovereigns and LRGs, the number of positive and negative actions is

balanced (53% positive versus 47% negative), it is more skewed to the negative for insurance (61% versus 39%) and almost entirely negative for banks (93% versus 7%). The balanced direction of sovereign rating actions partly reflects how improvements in previously deteriorated E, S, and G risks can help improve ratings or outlook, as in the cases of Poland or Indonesia.

Chart 8

**Negative Versus Positive Rating Actions**



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**Looking Ahead: How ESG Factors Will Continue To Affect Our Views**

ESG factors have been significant components of our analyses, as this study indicates. Our criteria cover them prominently, in different ways across different sectors. And there's no sign this is going to change anytime soon.

### Case Studies

#### Wells Fargo Corp.

- Date of the rating action: Feb. 7, 2018
- Country: U.S.
- Action: Downgrade to A-/Stable/A-2 from A/Negative/A-1 (holding company level)
- Factors: Social and Governance
- Asset class: Bank

On Feb. 2, Wells Fargo & Co. became subject to a consent order from the Federal Reserve that caps the company's asset growth until it further enhances its governance and compliance and risk management to the standards required by the regulator. This unprecedented asset cap on a large bank underscores the continued elevated regulatory risks for Wells (the holding company), and the ongoing ramifications of its retail sales practices issues, as well as the complexities of improving compliance and operational risk controls throughout its very large organization. We are lowering our ratings on Wells by one notch to 'A-/A-2', recognizing that the duration and severity of these regulatory, governance, and reputational issues are not commensurate with the previously peer-leading ratings on Wells.

#### Bank of Valletta plc (BOV)

- Date of rating action: Aug. 1, 2018
- Country: Malta
- Action: Downgrade to BBB/Negative/A-2 from BBB+/Negative/A-2
- Factors: Governance
- Asset class: Bank

The downgrade reflects our view that allegations of money laundering against Pilatus Bank, a small Malta-based international bank, and our perception of poor transparency at some banks in the country, have increased reputational and operational risks for the Maltese banking sector. The European Banking Authority recently concluded a formal investigation against the Maltese Financial Intelligence Analysis Unit (FIAU), finding that the FIAU neither imposed effective, proportionate, and dissuasive sanctions nor any other supervisory measures to correct the defects it had identified to ensure Pilatus Bank's compliance with EU anti-money-laundering rules. The EBA has also pointed to some inefficiency in the MFIA's supervisory practices and effective responsiveness, specifically in due diligence on AML systems and controls during authorization processes. Even if potential weaknesses in Malta-based internationally oriented financial institutions do not pose direct risks for the domestic financial stability, like BOV, the jurisdiction's reputation could be at risk, in our opinion.

In addition to those systemic issues, BOV allocated a €75 million precautionary litigation provision in the first half of 2018. The litigation began in April 2015 concerning shares held in trust at the bank by owners of a company whose subsidiaries included the Italian shipping company Deilemar Compagnia di navigazione SpA, which entered bankruptcy in 2012. On July 20, 2018, BOV announced that the Italian court has rejected its appeal and confirmed that a precautionary warrant ("sequestro conservativo") of €363 million, requested in March 2018, would be seized. The amount of any judgment or settlement, if any, is uncertain. If the lawsuit succeeds, we believe the financial effect could be substantial relative to BOV's total equity of €962 million as of Dec. 31, 2017.

#### Banco Agropecuario (Agrobanco)

- Date of the rating action: Sept. 5, 2017
- Country: Peru
- Action: Outlook revision to BBB-/Negative/A-3 from BBB-/Stable/A-3; we then withdrew the ratings at the issuer's request
- Factors: Environmental
- Asset class: Bank

The negative outlook reflected the rapid asset quality deterioration that's pressuring Agrobanco's liquidity and business stability prospects. The outlook also reflected our view that the bank's financial conditions are weakening from increased delinquency levels, poor interest collection, and tighter liquidity conditions for the next 12-24 months, while management adjusts the bank's strategy and winds down its problematic portfolio in the next few quarters.

Agrobanco is exposed to the cyclical nature of agribusiness that took a toll on asset quality in recent years. The bank's portfolio has deteriorated rapidly since fourth-quarter 2016. Nonperforming loans spiked to close to 7% by the end of the year and close to 9% as of June 2017, compared with the industry's averages of 2.9% and 3.1%, respectively. This was mainly due to the bank's discontinued portfolio (large and midsize agricultural commodity producers, mainly grapes and coffee) stemming from drought conditions in late 2016, and El Niño's effect in first-quarter 2017 amid still unfavorable international commodity prices. We believe that Agrobanco is more vulnerable to economic cycles and climate changes than its peers given its higher exposure to agribusiness.

### **Wethaq Takaful Insurance**

- Date of the rating action: June 12, 2018
- Country: Kuwait
- Action: Downgrade to B/Watch Neg/B from B+/Watch Neg/B
- Factors: Governance
- Asset class: Insurance

The downgrade follows Wethaq's publication of its first-quarter 2018 financial statements. The report includes two qualified opinions: One on doubtful debts amounting to Kuwaiti dinar (KWD) 1.6 million (\$5.3 million) not provided for, and one on its investment property under its Egyptian subsidiary, which has no financial statements or information available. These audit qualifications indicate financial reporting deficiencies and increase the possibility of other unknown issues, which could lead us to negatively reassess the company's liquidity and capital adequacy. Furthermore, these developments indicate a weakness in Wethaq's governance structure due to management's inability to resolve its financial reporting issues with external auditors. Further financial reporting issues or unexpected volatility in capital and earnings could lead us to revise our assessment of management and governance to weak.

### **Lloyd's of London Ltd.**

- Date of the rating action: Oct. 12, 2017
- Country: U.K.
- Action: Outlook revision to A+/Negative/-- from A+/Stable/--
- Factors: Environmental
- Asset class: Insurance

Lloyd's announced an estimate of net losses of £3.3 billion from hurricanes Harvey and Irma. We expect further major losses from Hurricane Maria and other potential catastrophe events in fourth-quarter 2017. These losses are significant relative to those of peers and the company's annual earnings, and emphasize the market's exposure to catastrophe risk. Lloyd's capitalization, in our view, had already deteriorated in 2016-2017 due to higher catastrophe exposure and premium growth--the latter in part due to foreign exchange movements. Expense and attritional loss ratios remained high in first-half 2017, while the effect of reserve releases on the result, although still positive, is diminishing. Management will require members to inject more capital into their market operations as part of the "coming into line" exercise in late 2017, before business plans for 2018 can be approved. Stronger rates in the wake of the hurricane losses could also help the market's results for fiscal 2018 and further rebuild capital.

### **Greece**

- Date of the rating action: July 20, 2018
- Country: Greece
- Action: Outlook revision B+/Positive/B from B+/Stable/B
- Factors: Governance
- Asset class: Sovereign

The positive outlook reflects our opinion that Greece's policy predictability is improving, as are its economic prospects. In 2016 and 2017, the government ran primary fiscal surpluses, and the multiyear recession ended in 2017. However, in our view, growth policies, rather than additional fiscal measures, will be the key determinants of long-term debt sustainability for Greece. Over the next three years, we project real GDP growth of 2.0%-2.5%.

However, stronger results could follow if the government does more to improve the business environment so as to attract stronger investment inflows from abroad.

#### **Turks and Caicos Islands (TCI)**

- Date of the rating action: June 20, 2018
- Country: Turks and Caicos Islands
- Action: Outlook revision to BBB+/Stable/A-2 from BBB+/Positive/A-2
- Factors: Environmental
- Asset class: Sovereign

The outlook revision reflects our view that the likelihood TCI's creditworthiness could strengthen within the next two years has fallen. Reports estimate that total damage, losses, and other costs associated with hurricanes Irma and Maria, which both made landfall on TCI in September 2017, are about \$558 million, or about 55% of TCI's GDP. The large majority of these costs will likely be shouldered by the private sector--and tourism in particular--which rebounded relatively quickly following the hurricanes.

Nevertheless, TCI's weakened economy will be less likely to enhance the government's policy flexibility to offset the territory's structural vulnerabilities in the near term.

#### **Indonesia**

- Date of the rating action: May 19, 2017
- Country: Indonesia
- Action: Upgrade to BBB-/Stable/A-3 from BB+/Positive/B
- Factors: Social and Governance
- Asset class: Sovereign

We raised the ratings to reflect our assessment of reduced risks to

Indonesia's fiscal metrics. The government's new focus on realistic budgeting has lowered the risks that budget deficits will widen significantly when government revenue disappoints.

At the same time, we expect better revenue collection to result from the data collected during the just-concluded tax amnesty. We also expect increased control over fiscal spending with subsidy reforms being extended to electricity subsidies from 2017. These developments should ensure that the fiscal deficit remains below 2.5% of GDP over the next three-to-four years despite the government's intention to expand its infrastructure program to address the existing shortfall in infrastructure and basic services. Together with the greater focus on realistic budgeting, we believe that this will contain the risk of fiscal slippage leading to larger fiscal deficits than what we currently project. Despite the broader vulnerabilities of the economy to external shocks, we consider strong public finances a cornerstone of our investment-grade rating on Indonesia.

This report does not constitute a rating action.

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