Sovereign Risk Monitor

An augmented credit risk model

Overview

Sovereign credit risk analysis poorly manages to systematically integrate climate and ESG metrics. There is a growing demand from investors, regulators, and academics to better consider the importance of ESG metrics on solvency analysis. Since 2013, we have pioneered a new quantitative risk monitoring methodology combining ESG factors and financial risk.

Based on an advanced quantitative methodology covering 151 countries, the Sovereign Risk Monitor offers an augmented assessment of the sovereign credit risk. Calibrated and back tested since 2000, this exclusive quantitative model has demonstrated a high correlation to financial market data (5 years CDS, 2 year, and 10 year yields).

Benefits

- **Integrates new risk factors:** ESG indicators are retained in the model based on their financial materiality on sovereign credit default risk.
- **Increased correlation & prediction vs risk metrics:** our model allows for greater representation of borrowing costs (yields) than traditional credit assessments.

Features

Comprehensive coverage

151 countries covered, with historical data covering over 85 quarters from Q4 1999 to present.

Data granularity

Scores available on multiple levels, allowing insights to be drawn at pillar, sub-pillar, and theme levels.

Transparent methodology

Our quantitative framework provides clarity on the materiality of ESG factors in sovereign credit risk assessment.

Flexible access

Access our data directly via sftp. Yield Book clients can access data within the Yield Book Add-In and API as well as in LSEG Datastream to facilitate incorporation of sustainability into investment decision-making.

Sovereign Risk Monitor: model structure

The Sovereign Risk Monitor combines traditional macro-financial data with the ESG factors that present material risk to sovereign solvency. The quantitative model is comprised of two profiles, covering both Economic/Financial and Sustainability considerations. The weights for each indicator are estimated using an econometric modelling technique called Partial Least Squares (PLS) regressions. Country exposure to ESG and financial risks is weighted according to its level of wealth (Developed market vs. Emerging).

Economic & financial 50%

4 Themes

Economic performance	**40%**
Fiscal flexibility	**30/25%**
Financial system	**20/10%**
External performance	**10/25%**

- Economic prosperity
- Monetary policy
- Fiscal policy
- Budget balance
- Credit quality
- Credit gap
- External balance sheet
- Exchange

Sustainability 50%

3 Themes

Environmental	30%
Social	30%
Governance	40%

- Climate physical risk
- Energy policy
- Air & Water
- Societal
- Health
- Employment
- Corruption
- Political stability
- Regulatory quality

Using Sovereign Risk Monitor

The Sovereign Risk Monitor can be used to integrate ESG considerations in sovereign bond investments, including active portfolio management and improved pricing models.

Risk Management

The Sovereign Risk Monitor enables investors identify the ESG risks that present a material risk to sovereign credit, offering a complement to traditional credit assessments.

Portfolio evaluation and manager due diligence

When selecting and evaluating asset managers, institutional investors are increasingly assessing how they integrate ESG aspects into their processes. The Sovereign Risk Monitor can help assess the range, average, and variance of asset manager portfolios with respect to ESG integration on sovereign bonds.

Improved Pricing Models

By integrating new factors with material impact on sovereign credit risk not currently captured by CRA ratings, the Sovereign Risk Monitor allows investors to improve internal pricing models.

Active Portfolio Management

The Sovereign Risk Monitor data set can be used to help establish ESG eligibility criteria for an investment universe or can be applied into a proprietary quant or fundamental model.

Internal research

The risk and return relationships of different ESG aspects will vary. The Sovereign Risk Monitor provides a granular and comprehensive data set for research and analysis that allow users to develop their own views on how, or how not, to integrate new risks such as climate change on sovereign debt.

Contact us

To learn more, visit lseg.com; email info@lseg.com; or call your regional Client Service Team office:

EMEA +44 (0) 20 7866 1810

North America +1 877 503 6437

Asia-Pacific

Hong Kong +852 2164 3333

Tokyo +81 3 4563 6346

Sydney +61 (0) 2 8823 3521

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LSEG DATA & ANALYTICS

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