VIEW POINT

ESG GOES MAINSTREAM IN BANKING!

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Introduction

Environmental, social, and governance (ESG) is evolving and becoming more relevant among banks and financial services firms. Banks, investors and regulators had started focusing on ESG even before the pandemic. The focus will continue given the enormous risks and concerns it poses for banks and the financial services ecosystem.

Banks globally have started to incorporate sustainability as part of their core operations by including ESG considerations across various aspects including managing risk, designing products, formulating vision statements and strategic planning. COVID-19 has amplified the significance of ESG and has also changed the dynamics of global economy. Businesses are beginning to think differently with the importance shifting from profits to people. It has become very clear that economic stability is directly influenced by environment and social issues. Going forward ESG will become the central focus in the global economic equation.

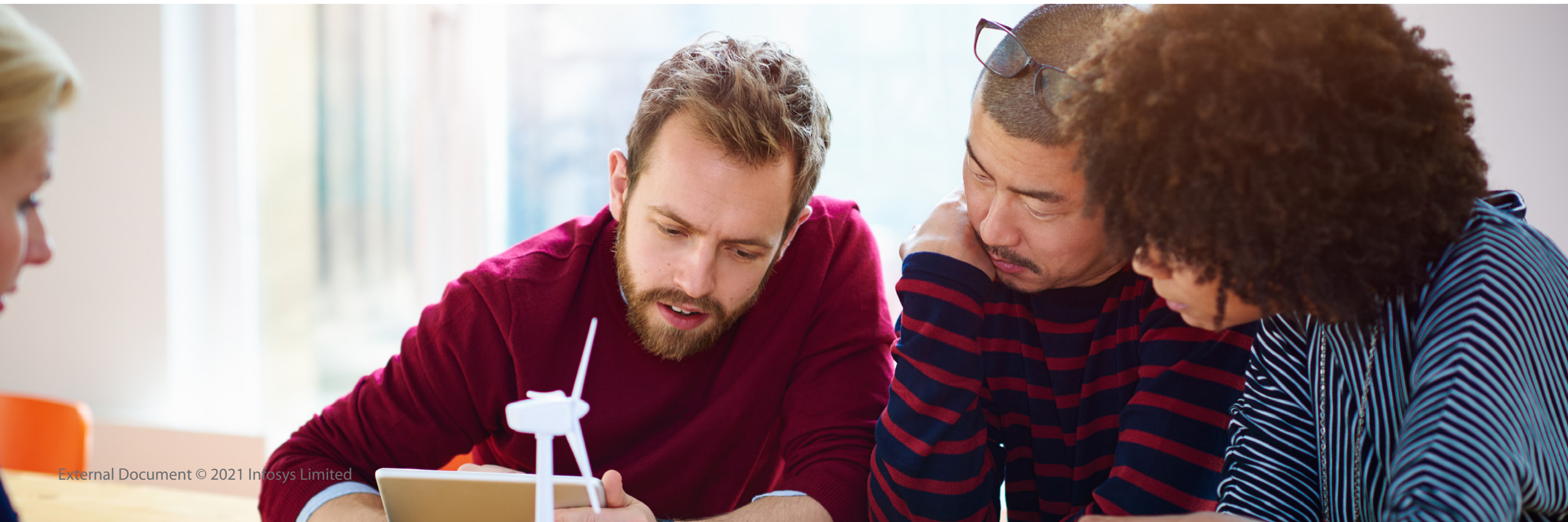
Increasing relevance of ESG

Industries globally have been focusing on ESG initiatives to transform into an environment friendly and sustainable economy. The push from various stakeholders involving governments, investors, regulators, and customers have put pressure on companies to give attention to ESG bringing these initiatives to the forefront in the banking industry in the last couple of years. Many banks have increased their commitment to various ESG themes in 2020. Pressure on banks from stakeholders increased as they wanted their companies to echo their views and beliefs on sustainability. Banks across the globe have turned their focus to being transparent and accountable and have started to highlight their ESG initiatives to stakeholders through annual ESG reports.

Understanding ESG

ESG refers to a firm's commitment to do more than just make profits. It looks to contribute to the environment and social causes and to conduct themselves responsibly. Three key components include:

Component	Areas covered	Metrics Tracked[1]
Environmental	• Carbon Footprint • Water Conservation • Energy Management • Ecological Impact • Waste Management	• Amount of GHG emissions; % carbon emission reduction against baseline • Reduction of water usage (Liters) • Amount of energy used • Amount of waste generated • Waste recycled
Social	• Employment • Human Rights/ Equality • Safety • Social Responsibility • Community Support	• Employee attrition • Lawsuits related to employee matters • Fatality rates • Incident rates related to employee health and safety • # of SMBs funded • Percentage of branches in low-income neighborhoods • Social and environmental financing facilitated
Governance	• Business Ethics • Fair Business Practices • Data Privacy • Inclusivity • Pay inequality	• Fines and litigation related to business ethics • Number of data breaches • Data security fines • % Board/Executive management diversity - By Gender, Race/Ethnicity, etc. • Wage disparity



Key Frameworks

One of the main challenges which banks face while reporting ESG activities is the availability of measurable metrics. It is critical to benchmark the company's ESG initiatives against established reporting frameworks. Thanks to the efforts of various organizations, there has been a good progress in the availability of various ESG metrics for benchmarking. Most banks publishing ESG reports follow a combination of various available frameworks. Some of the well-known frameworks include:

- **Global Reporting Initiative** is an independent standards organization that helps companies to understand and report the effect of their business on ESG issues. The GRI standards help companies to report their ESG initiatives in a consistent and credible way.
- **Sustainability Accounting Standards Board** enables companies to identify, manage and report sustainability efforts to stakeholders. In Nov 2020, SASB and The International Integrated Reporting Council (The <IR> Framework) merged[2] to form Value Reporting Foundation (VRF). The aim of VRF is maintaining a reporting framework by adopting principles-based guidance for reporting structure and content from The <IR> Framework and specific metrics to track and monitor non-financial risks and areas of opportunities from the SASB Standards.
- **Task Force on Climate-related Financial Disclosures** was launched by Financial Stability Board in 2015 to aid companies to voluntarily disclose climate-related business threats and opportunities. Recommendations of TCFD are based around 4 major themes - strategy, governance, risk and metrics. The recommendations are aimed at helping companies with better risk assessment, capital allocation, and strategic planning.
- **World Economic Forum's Stakeholder Capitalism Metrics** can be used by companies to structure reporting against ESG indicators. The metrics were commissioned by the WEF's International Business Council (IBC), and have been developed by Bank of America[3], Deloitte, EY, KPMG and PwC, after an extensive consultation process with various stakeholder groups including investors and NGOs.

Other than the above-mentioned frameworks, some banks also align their ESG actions and commitments with the United Nation's 17 Sustainable Development Goals. Many banks start their ESG reporting journey with one of the frameworks and along the way add other frameworks to improve their ESG reporting transparency. Many of the larger banks report against a combination of frameworks to adhere to demands of various stakeholder groups and to enable a holistic assessment of their ESG activities. However, reporting against multiple standards is achieved over a period and require robust and mature ESG function at the company. Some of the banks which report against multiple frameworks are: Barclays PLC (TCFD, GRI and SASB) HSBC (TCFD, SASB), BofA (GRI, SASB, TCFD) and DBS (TCFD, GRI)

Key ESG Elements

It is evident that banks cannot have a wait-and-watch approach to ESG. Expectations of investors, customers and regulators are evolving fast, and already many top banks are ahead in the ESG race. Key action areas banks need to look at are:

- **Understand the current position and set goals**

  Banks need to understand their current standing in terms of ESG and set goals accordingly. They are required to find the right metrics to track and set short term and long-term goals. Banks should try to understand key stakeholders' ESG expectations and create awareness of ESG practices with the board, management and employees. Also find the relevant data, capabilities, processes and expertise to manage ESG and set goals. For instance, Barclays is targeting to finance £150bn by 2025 around Social & environmental areas, achieved £124.2bn as of 2020[4]

- **Develop an ESG strategy and make it part of business goals**

  ESG risks cannot be ignored. Strong action plans must be developed by banks and this needs to be integrated with their overall business strategy. The strategy must have a certain level of flexibility and must be actionable and measurable. For instance, Bank of America is planning to invest $1 trillion by 2030[5] in initiatives related to sustainable economy. Goldman has adopted ESG financing as part of their core strategy and is planning to deploy $750 bn in sustainable financing, investing and advisory activity by 2030[6]

- **Setting right expectations**

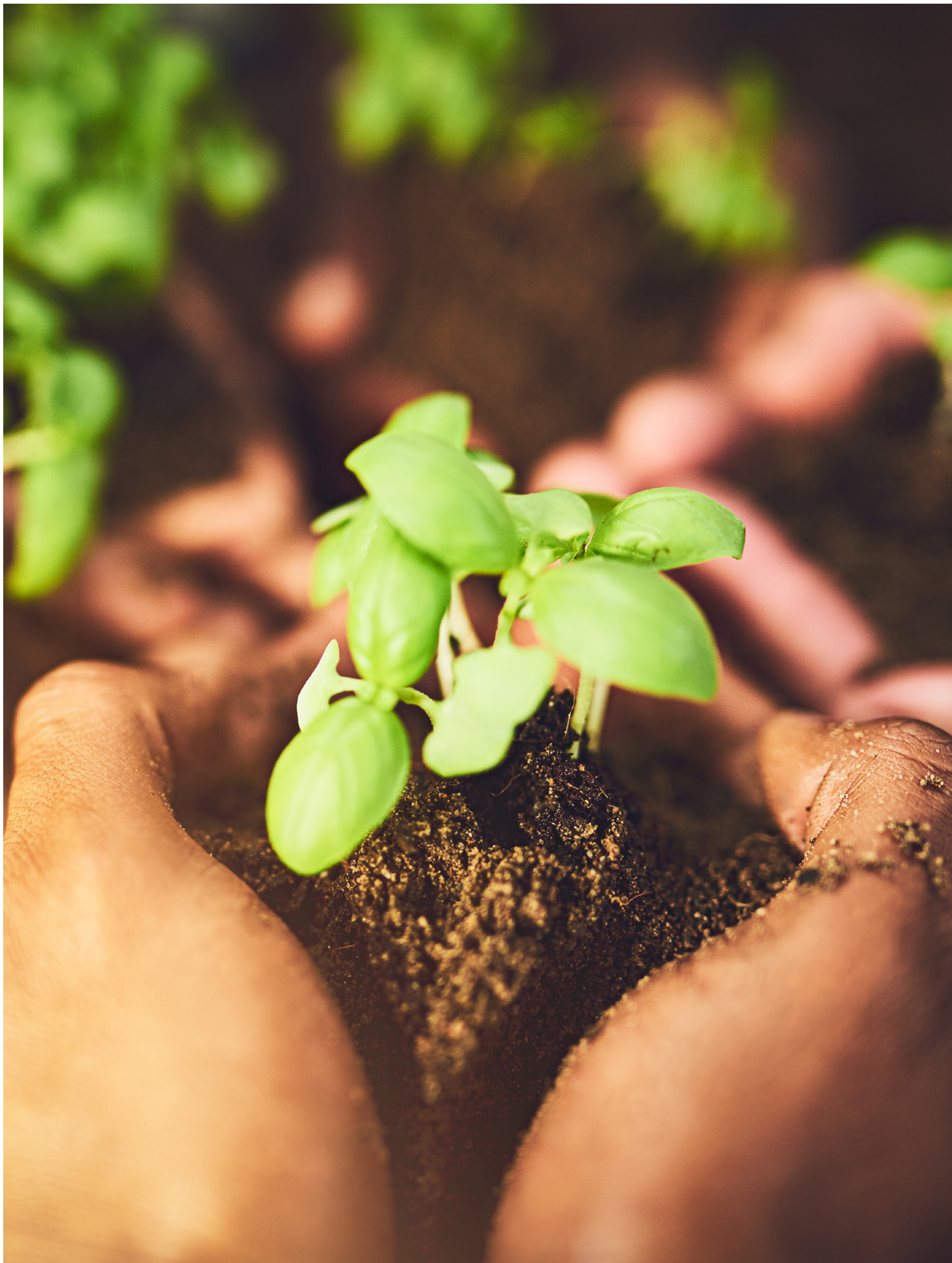
  Banks should proactively reach out to regulatory and supervisory authorities and understand the specific targets or required ESG expectations which will help in setting the right expectations. Banks should gather information around metrics and ESG standards. ESG is gaining traction and hence setting the right expectations will greatly balance the situation and help to progress further in a structured manner. For instance, OCBC expects to enhance the integration of climate-related considerations into their ESG Risk Assessment processes by 2022[7]

- **Risk Mitigation**

  Banks need to have a risk mitigation plan and the bank executives and board members should ensure that ESG risks are evaluated during all decisions. Banks globally are following their larger peers with the increased incorporation of ESG considerations into corporate governance frameworks and lending and investment decisions. For instance, the recent increase in social bond issuance reflects this trend.

- **ESG Reporting**

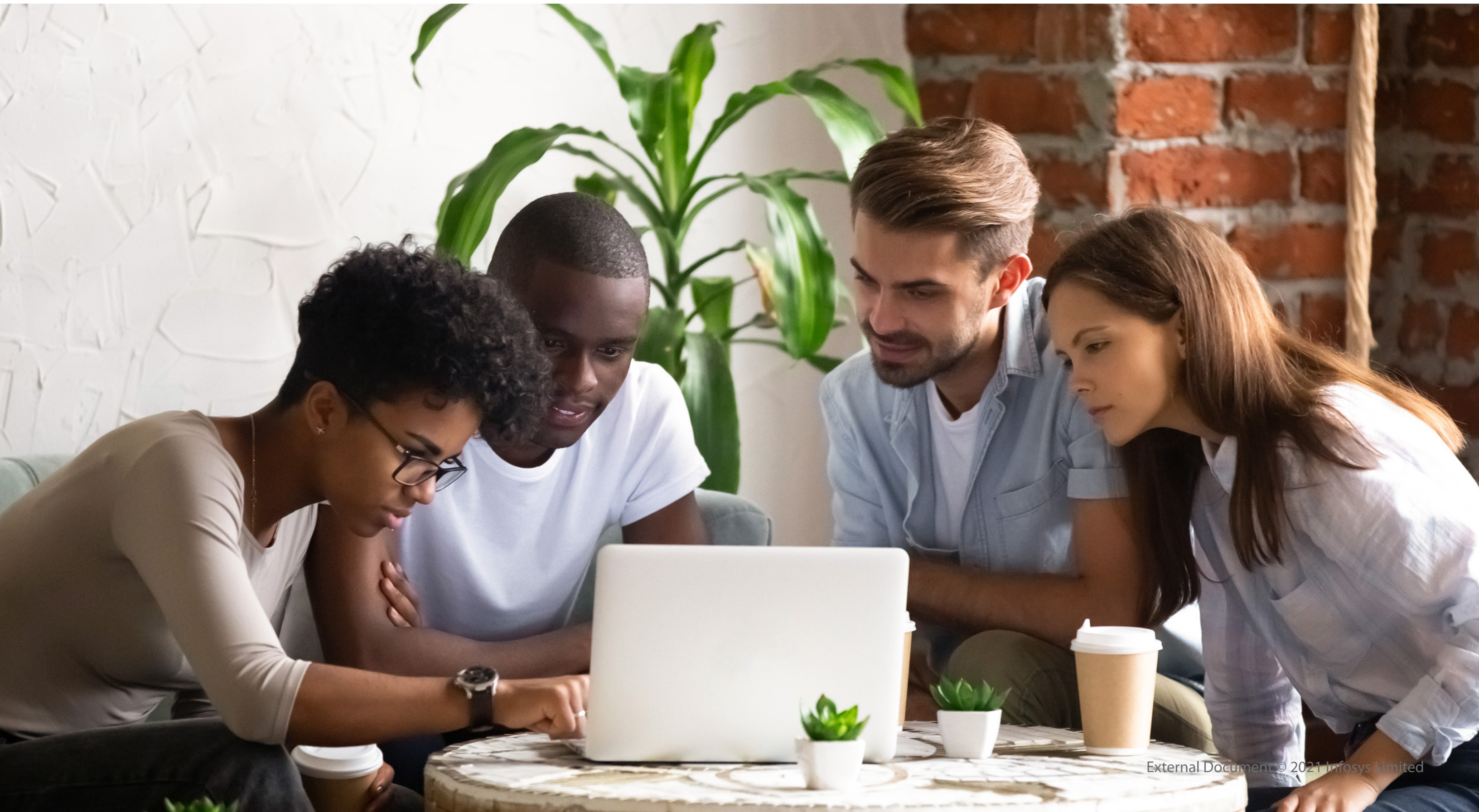
  To respond to the shift in ESG focus, companies must publish a statement of purpose, provide investors with integrated financial and ESG reports, increase the involvement of middle managers in ESG issues, invest in robust IT systems, and improve internal systems for measuring and reporting ESG related information. Banks should also keep up its commitment to ESG principles and reporting standards in a fair and consistent manner.



ESG Initiatives by Banks

Periodic progress tracking is a critical step in ensuring that the long-term ESG goals are met by the banks. Publishing details of ESG initiatives also helps banks to update their stakeholders of their sustainability efforts. Many banks have started publishing annual ESG reports. Some of the key ESG initiatives reported by leading banks in 2020 are:

Area	Initiatives
Environment	• BNP Paribas provided €17.8bn in financing to the renewable energy sector[8] • ICBC continued to promote paperless meetings and trainings; saved around 3 million sheets of paper[9] • Fifth Third Bank attained carbon neutrality for its Scope 1, 2 and 3 business travel emissions[10] • DBS commissioned 3 new solar installations increasing their renewable energy generation capacity by 427 KWp[11] • HSBC is planning to integrate climate risk into their Group-wide risk management framework[12]
Social	• Barclays helped to enhance life skills of 2.33m people in the UK[13] • Fifth Third Bank facilitated $7.4 bn in US Paycheck Protection Program[10] • Citigroup committed more than $100 mn in pandemic related relief and economic recovery efforts[14] • M&T in partnership with the Charitable Foundation, awarded $34.9 million in charitable grants; also the bank's employees spent a total of 51,656 hours volunteering[15] • Wells Fargo supported 3.6 million consumer and SMB customers by deferring payments and waiving fees[16]
Governance	• OCBC maintained gender balance in their organization with 41% male and 59% female employees[7] • More than 22,000 eligible Wells Fargo U.S. employees took advantage of enhanced childcare benefits[16] • Deutsche Bank spent € 37.3 million for employee training[17] • Santander won the Top Employer award from Top Employers Institute and was also named as a Great Place to Work [18] • At Maybank, 25% of Board members and 34% of top management positions were held by women[19]



Conclusion

ESG will continue to gain prominence in the years ahead due to increasing concerns about climate change across the globe as well as evolving regulatory push. Analysts believe that ESG will become fully mainstream soon. Though ESG reporting has not become mandatory across the world, many banks have started publishing it to showcase their commitment to the ESG cause and to build trust and confidence with their customers, employees and communities.

Management of sustainability performance requires accurate data collection and reporting. But many companies find ESG reporting complex, time consuming and costly. Technology can help banks streamline their ESG reporting and help them to focus their attention on improving their sustainability performance than reporting. Many banks have adopted digital technologies and are experimenting with distributed ledger technology (DLT) to make ESG data collection and sustainability reporting more efficient.

Banks that perform well on ESG are well-positioned for the future and have better chances of marketing their products and services to a global consumer base, that are getting increasingly vocal on issues such as environmental protection, human rights and corporate transparency. Banks should put ESG at the heart of everything they do and it should be integrated holistically from strategy to action.

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About the Authors

Souna Uthappa

Senior Client Solution Manager, Financial Services, Infosys Ltd

Souna has 18+ years of industry experience. She has played varied roles across finance, proposals / pursuit management, client visits, knowledge management, research, etc. - leading to an enriched professional experience. At Infosys, Souna is currently associated with financial services (FS) and enables leadership, sales, pre-sales, marketing, and domain teams to drive business effectively through proactive and on-demand business development and research services.

Naveen P V

Senior Client Solution Manager, Financial Services, Infosys Ltd

Naveen has over 16 years of industry experience in business research, pre-sales and consulting. In his current role he provides actionable intelligence to Infosys sales leaders on clients, prospects, technology innovations, regulations and financial services industry trends. He has extensive experience in providing research support for strategy development, consulting assignments and RFP responses.

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For more information, contact askus@infosys.com