



ESG Trends in the Banking Sector

PRI & SSF Networking Lunch on Sustainable Investment

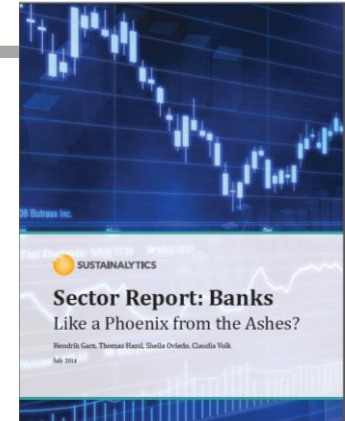
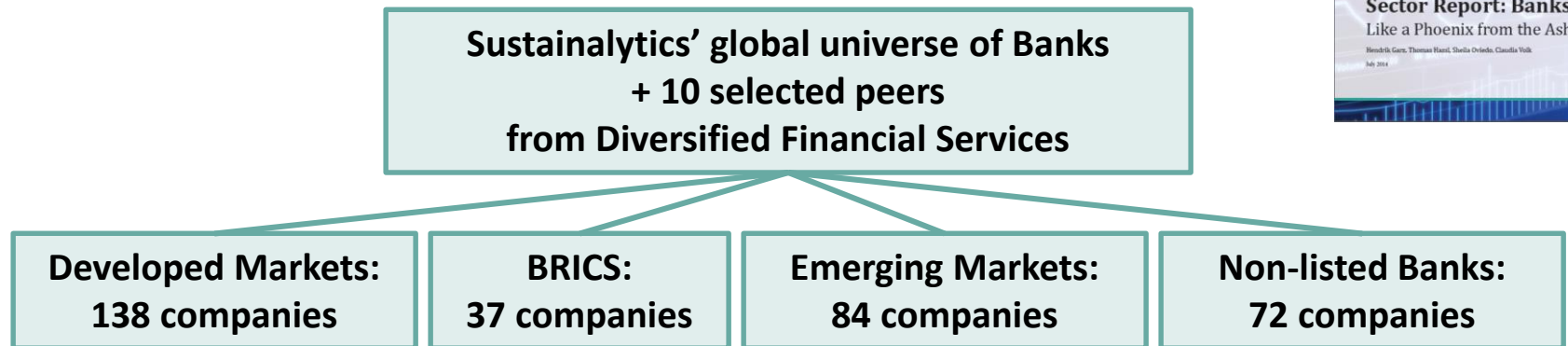
Zurich, 25 November 2014

Claudia Volk, Associate Director, Financials

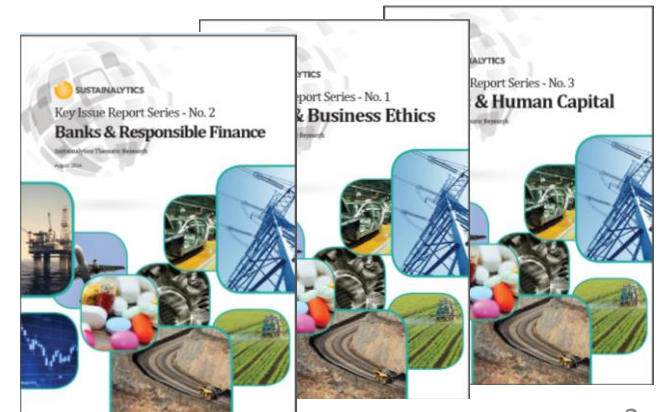


Report Parameters

- **Authors:** Sustainalytics Financials Research team in collaboration with Thematic Research team
- **Reference Universe:**

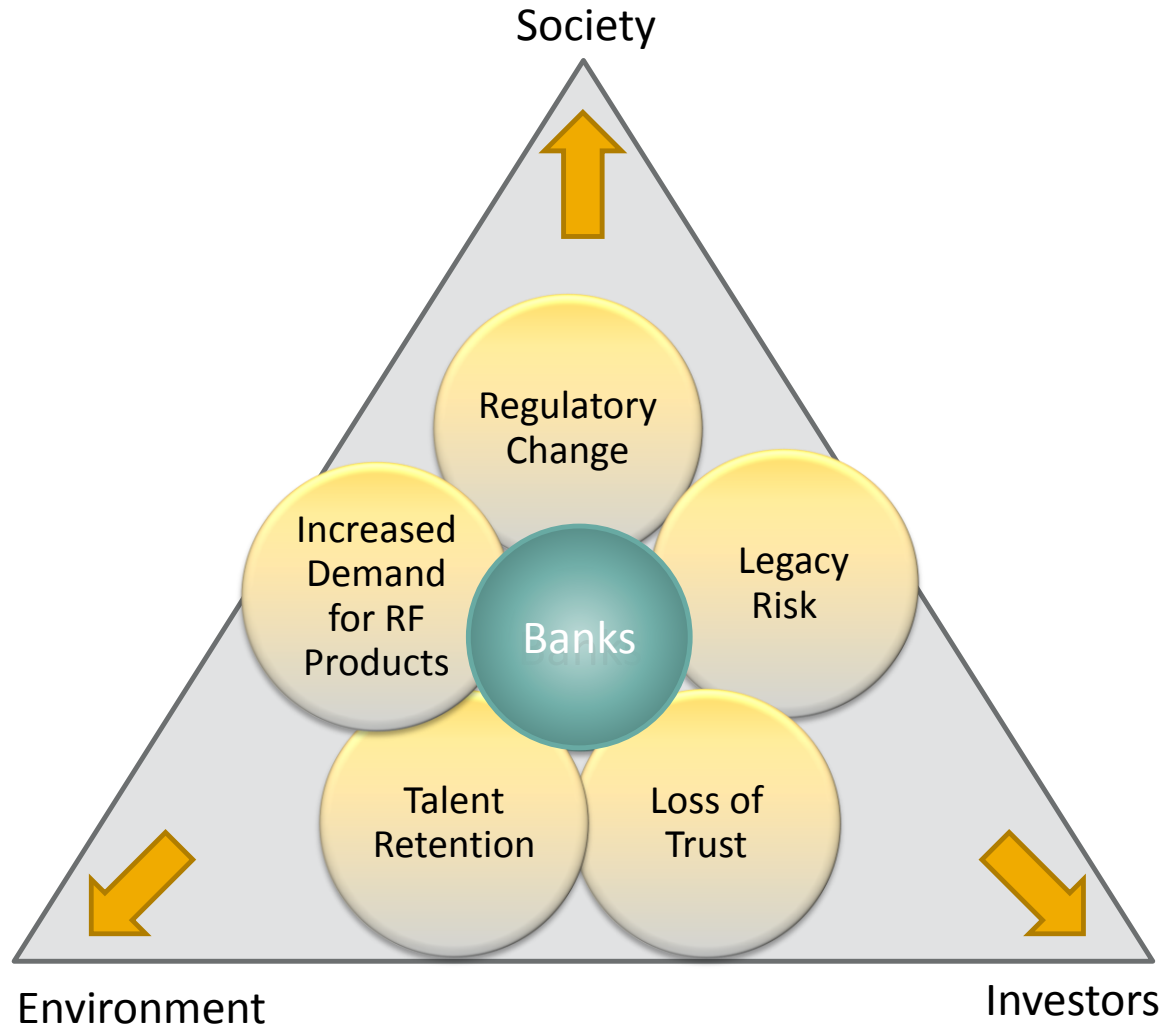


- **Weight Matrix:** Default Weight Matrix Banks
- **Update** financial & ESG data: 11 June 2014
- Publication date: 24 July 2014
- **Additional publications:** Summary report + 3 Key Issue Reports



Industry Trends – At the crossroads

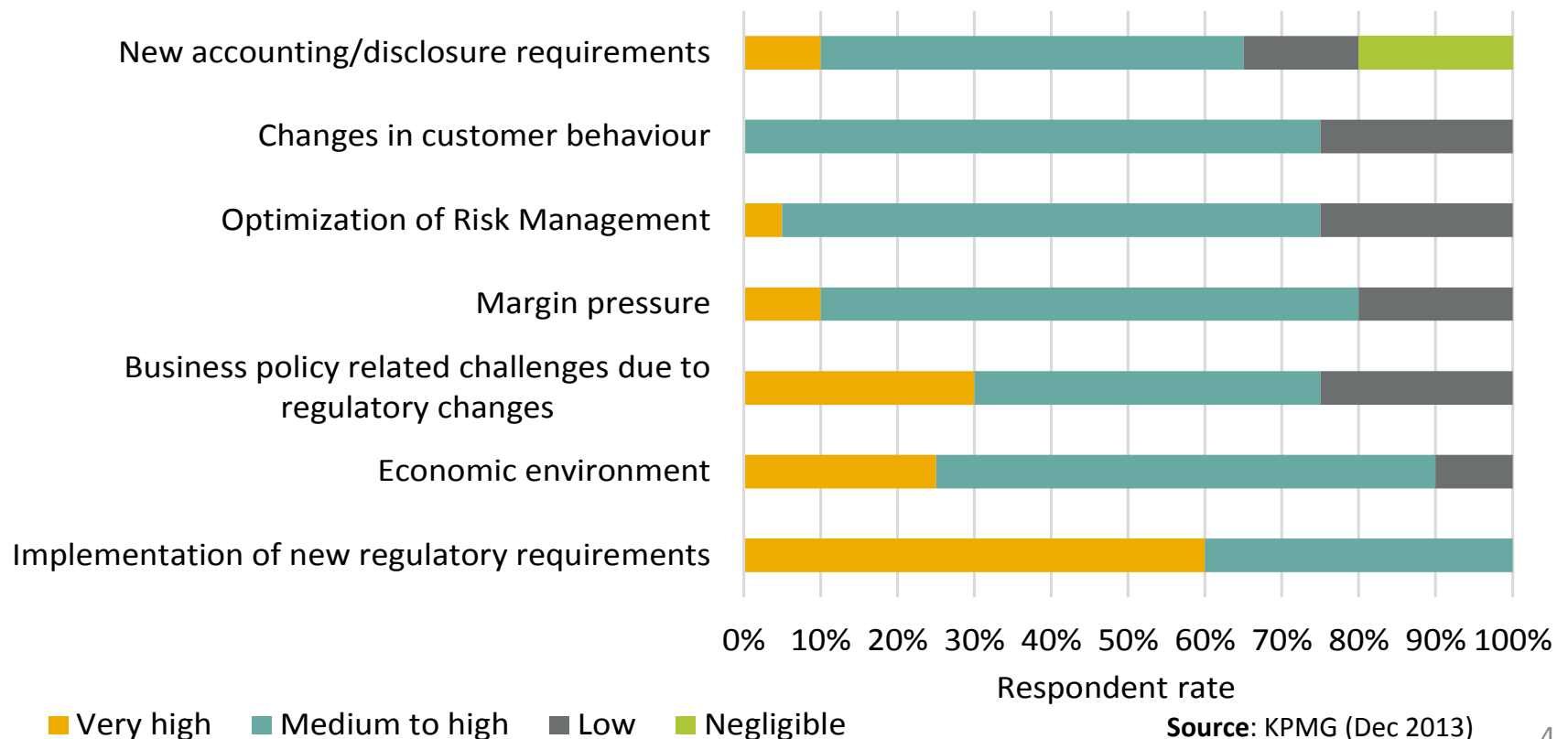
Industry trends - main drivers



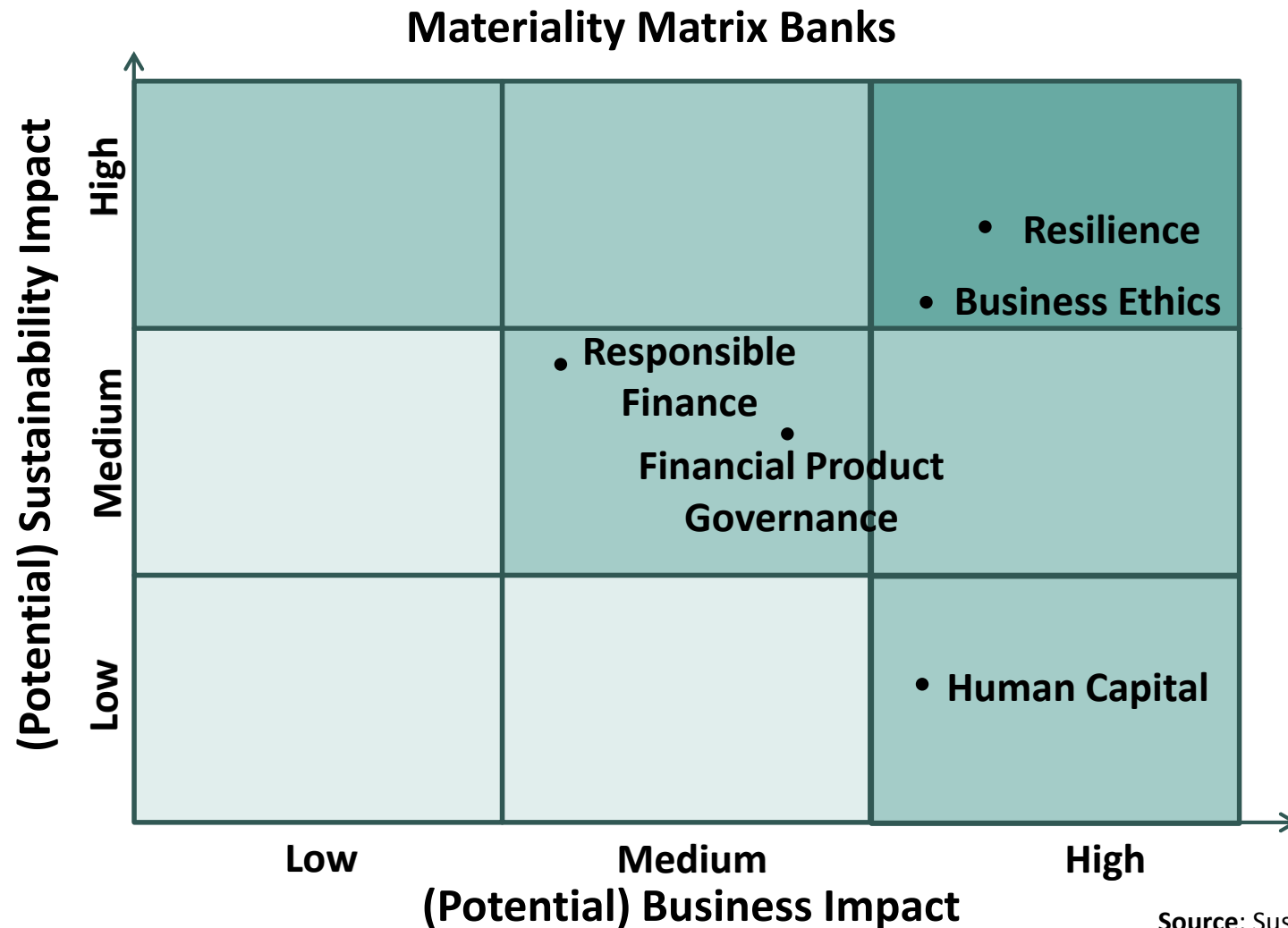
Regulatory Changes - A key driver for business

- Direct and indirect costs due to regulatory changes amongst German banks (2010-15): about EUR 9bn; RoE: -2.4%-points (KPMG survey)

Challenges for mid-term business success (2013-15)

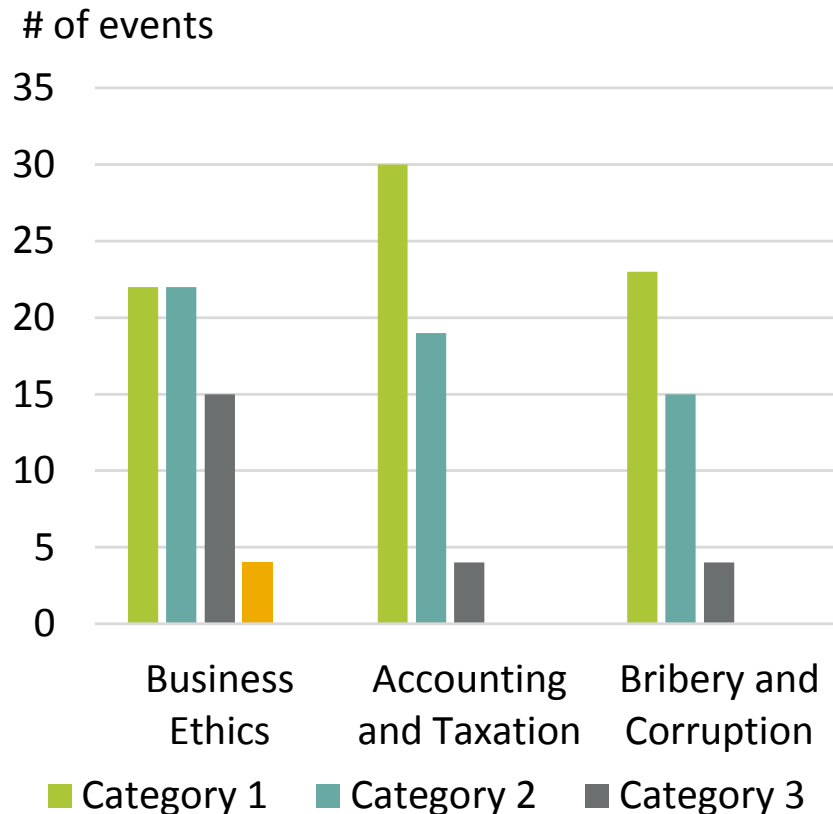


Key ESG issues for the Banking sector



Business Ethics – Mind the gap

Controversies overview

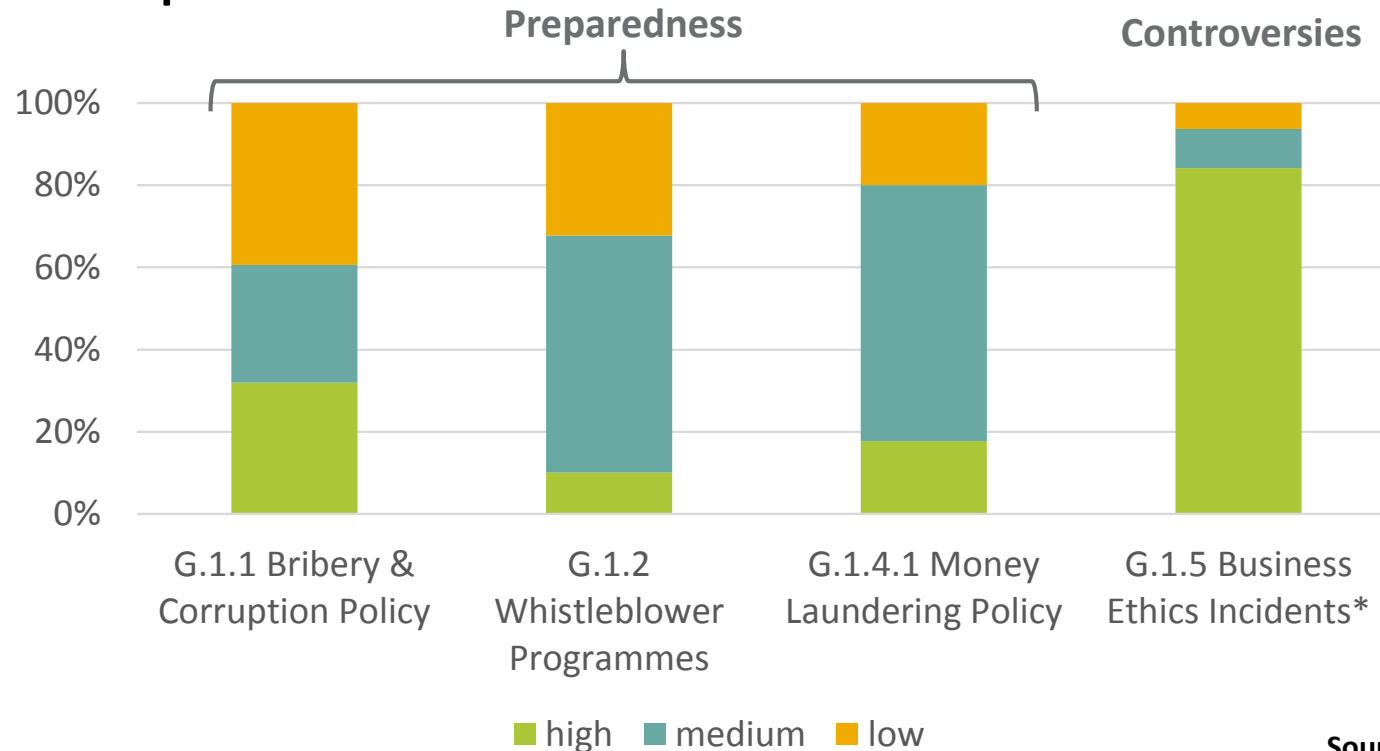


- **Multiple ethical controversies**
– affecting business partners, customers and the society – have raised significant legal and reputational costs
- **Examples:** Key interest rate (Libor, etc.) and commodity price manipulations, money laundering, tax evasion, conflict of interest, corruption

Source: Sustainalytics

Business Ethics (cont'd)

Sector performance

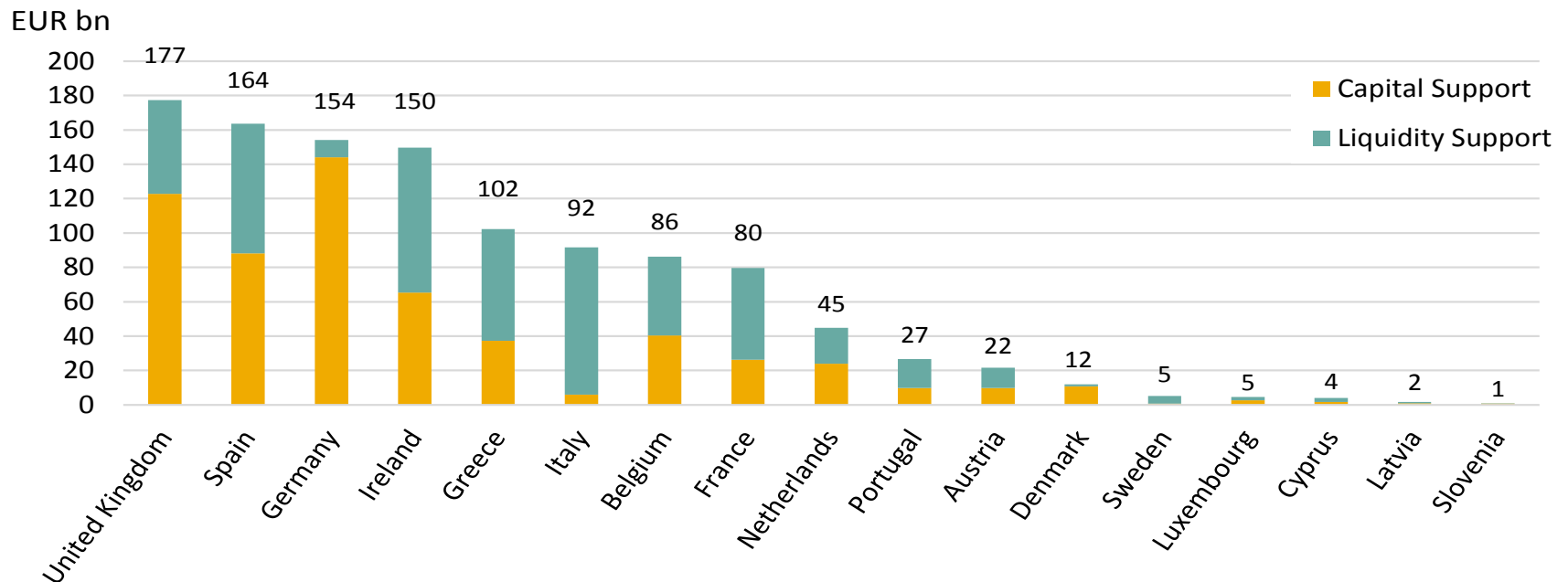


Source: Sustainalytics

- **Corporate culture** as the deeper rooted challenge
- **Leaders:** several development banks (World Bank, IADB), SEB, NAB
- **Laggards:** especially large global players with complex operations

Resilience – Finding the right balance

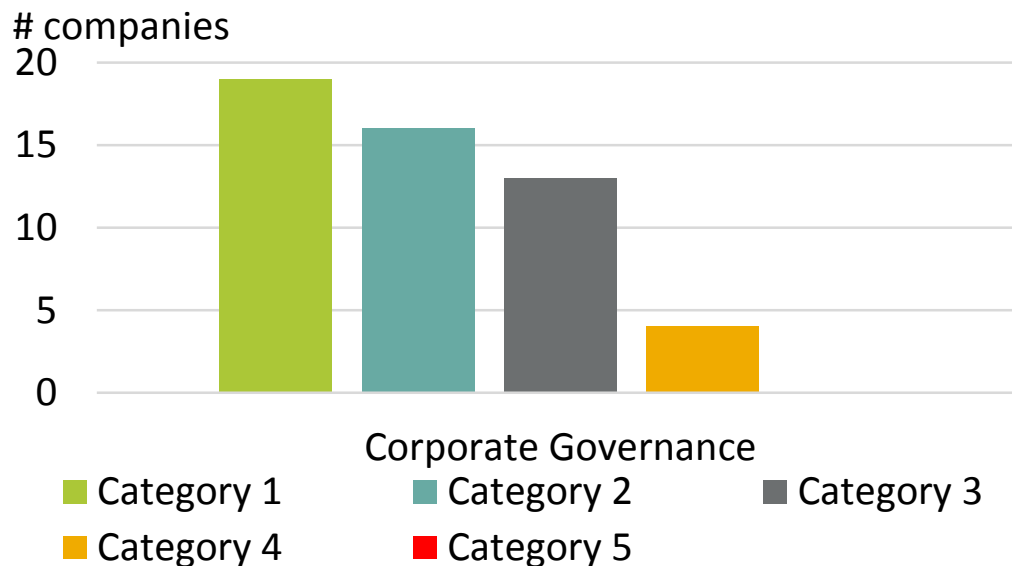
EU - state aid used by member countries (2008 – 2012)



Source: European Commission

- **Severe impact** on various stakeholders, incl. tax payers and societies
- **Significant regulatory changes** a key driver for reducing vulnerability
- **Soft factors** – corporate culture, incentive system – also important

Controversies overview

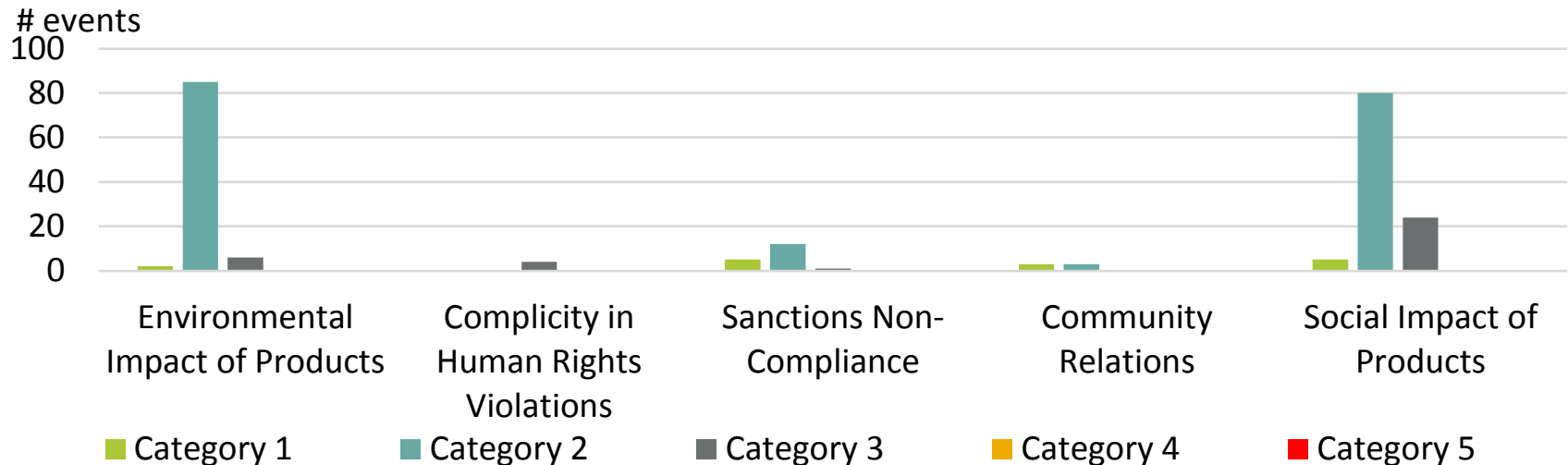


Source: Sustainalytics

- **Most severe controversies:**
Banca Monte dei Paschi, Bankia, Dexia
(recent cases: Banco Espirito Santo, Corporate Commercial Bank)

Responsible Finance – Acknowledging stewardship

Controversies overview



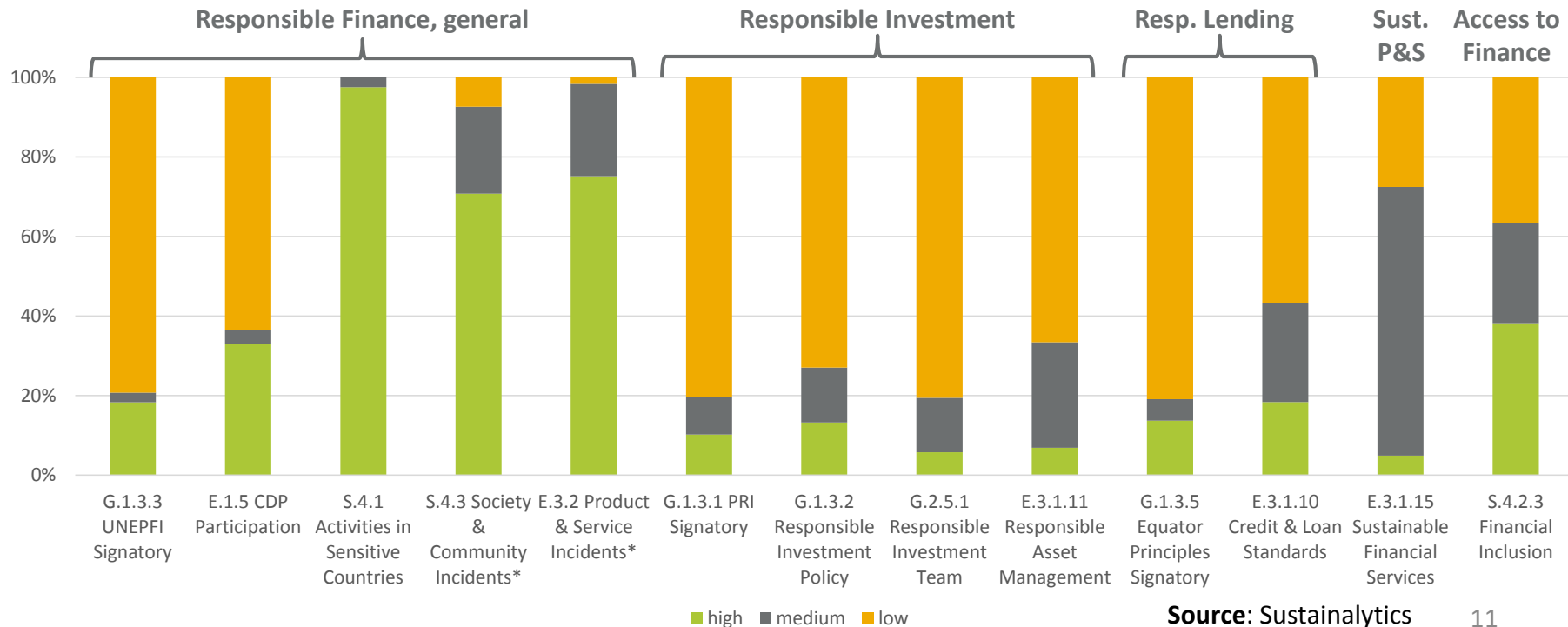
Source: Sustainalytics

- **“The cold heart”** of the economy
- **Exposure:** very broad, but mostly indirect

Responsible Finance (cont'd)

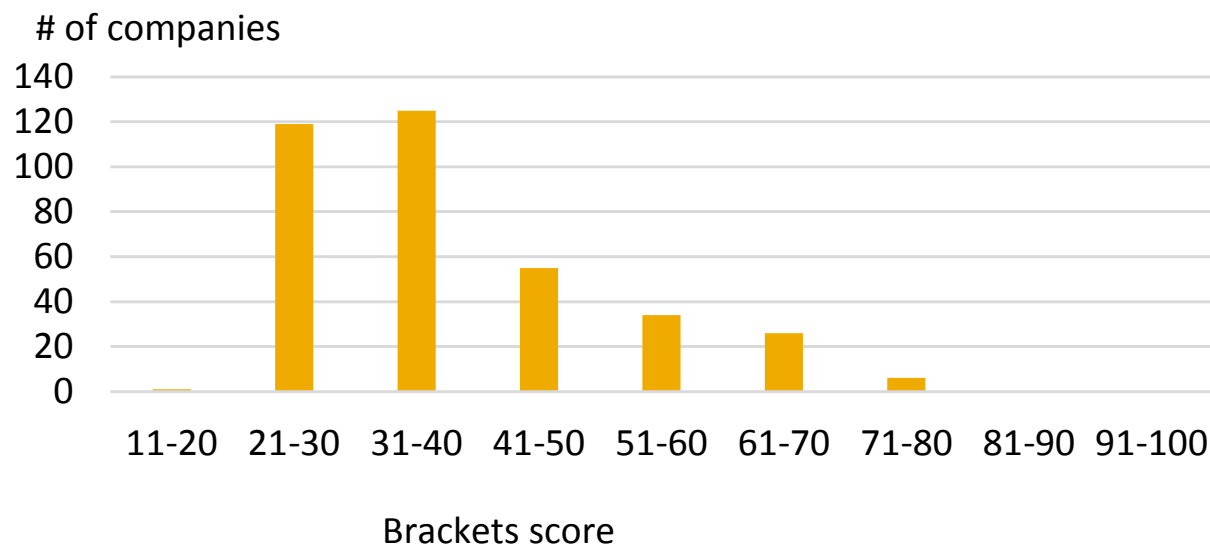
- **Trend:** Continually gaining traction: mainly risk, but also opportunity considerations; promoting sustainable development; fiduciary duty
- **Performance:** Still room for improvement

Sector performance



Responsible Finance (cont'd)

Distribution of scores



Leaders

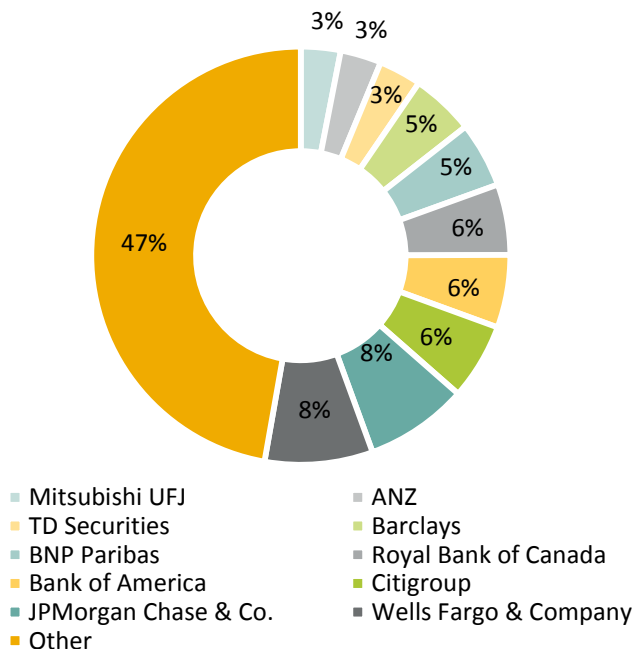
Top 5 companies: Responsible Finance (RF)

Leaders	Country	MCap (USD m)
KfW	Germany	n.a.
Banco Santander (Brasil) S.A.	Brazil	26,669
DNB ASA	Norway	31,877
Westpac Banking Corporation	Australia	100,029
Skandinaviska Enskilda Banken AB	Sweden	30,294

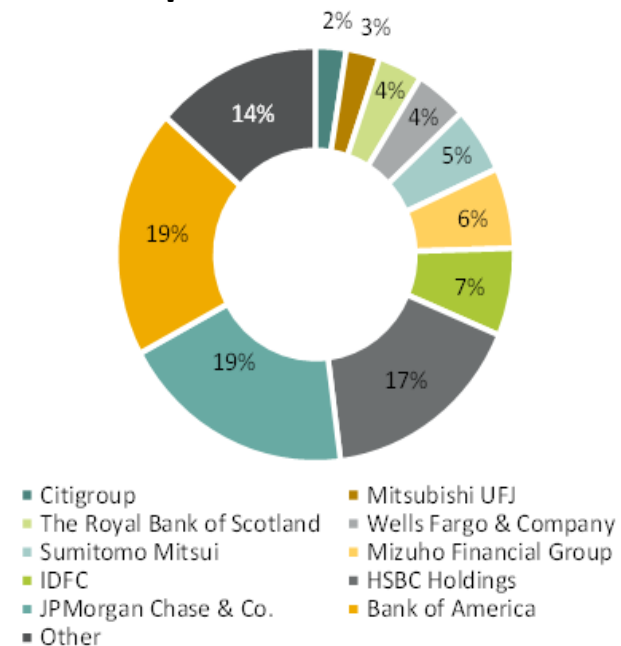
Spotlight: Syndicated Loans

- **Background:** Banks' credit books are black boxes \Rightarrow Syndicated loan market a 'test' to assess banks' ESG attitudes & responsibility
- **Two ideas:** 'Stranded assets' and 'ESG sub-prime' (poor quality loans)

Deals with issuers from O&G sector



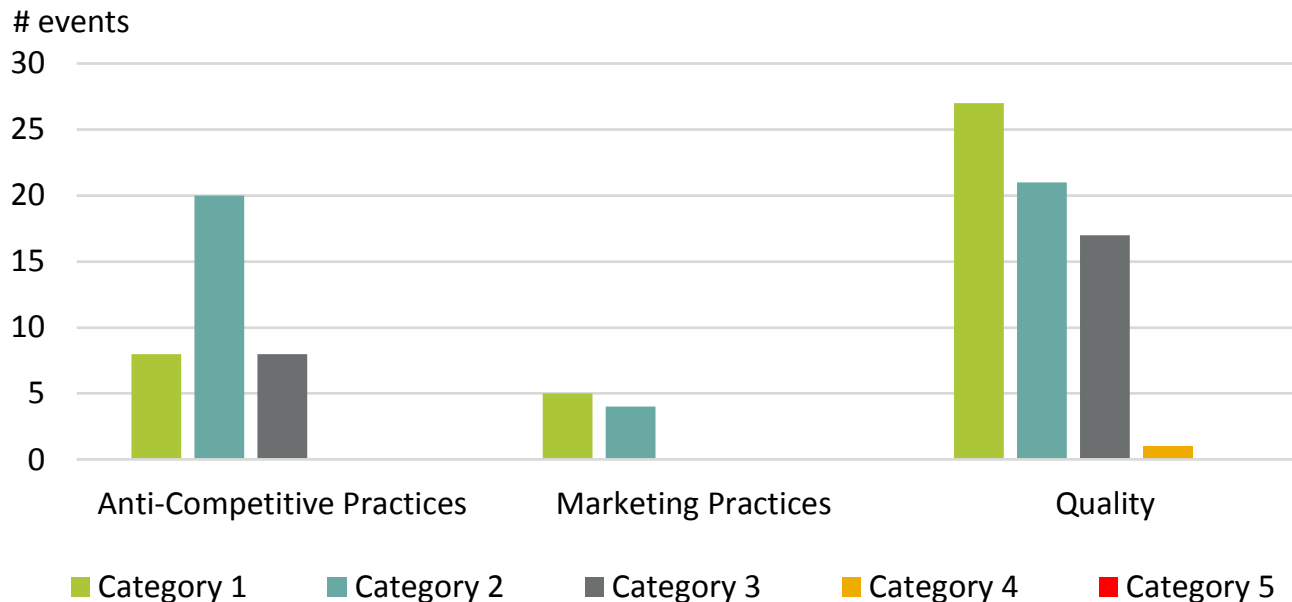
Market share of underwriters in "ESG sub-prime" market



Source: Sustainalytics, based on Bloomberg data

Financial Product Governance – The paradox of trust & loyalty

Controversies overview



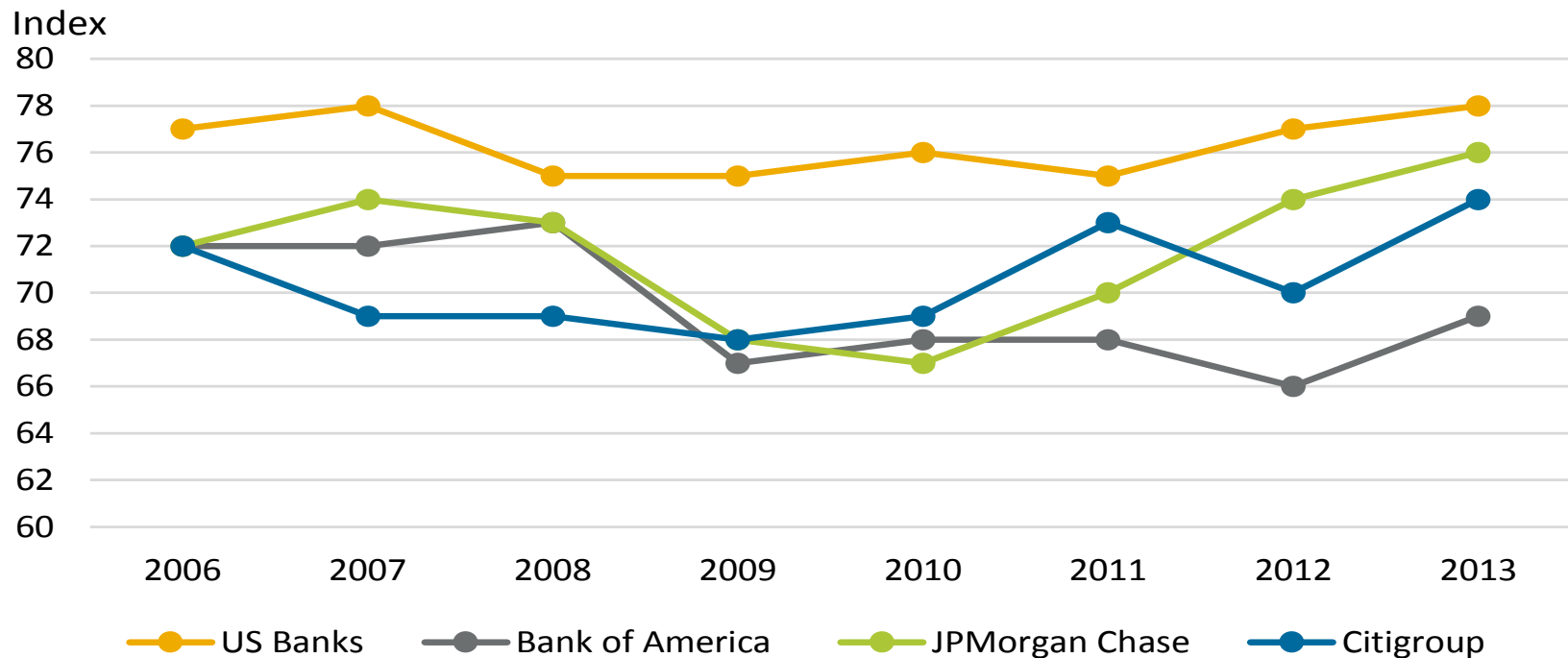
Source: Sustainalytics

- **Severe impact** on customers and communities due to irresponsible behavior
- **Most significant cases** include undisclosed product risks, fraud and misconduct (e.g. for mortgage-related products), excessive fees, predatory lending, conflicts of interest, and price manipulations

Financial Product Governance (cont'd)



American Customer Satisfaction Index



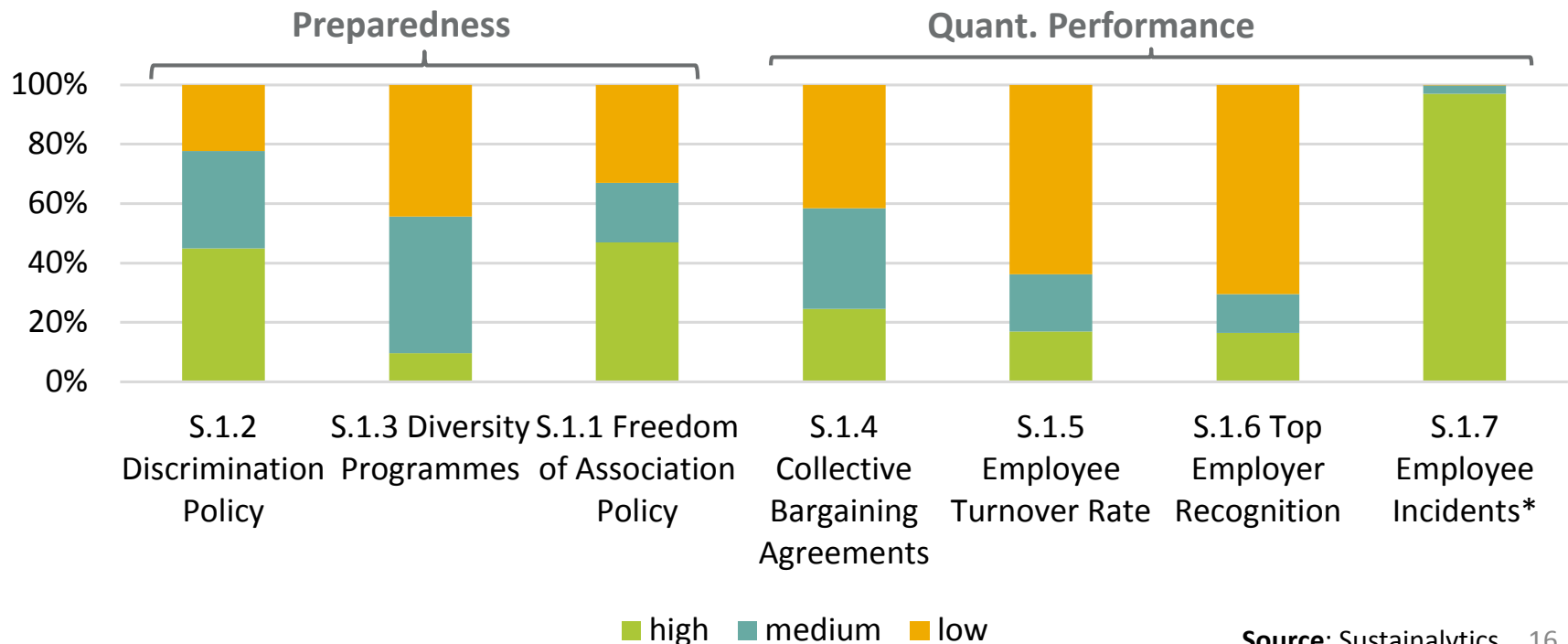
Source: ASCI, 2013

- **General trust** in banks has been hit but customer loyalty remained high
- **Regulatory changes** directed towards customer protection

Human Capital – Hiring capacity

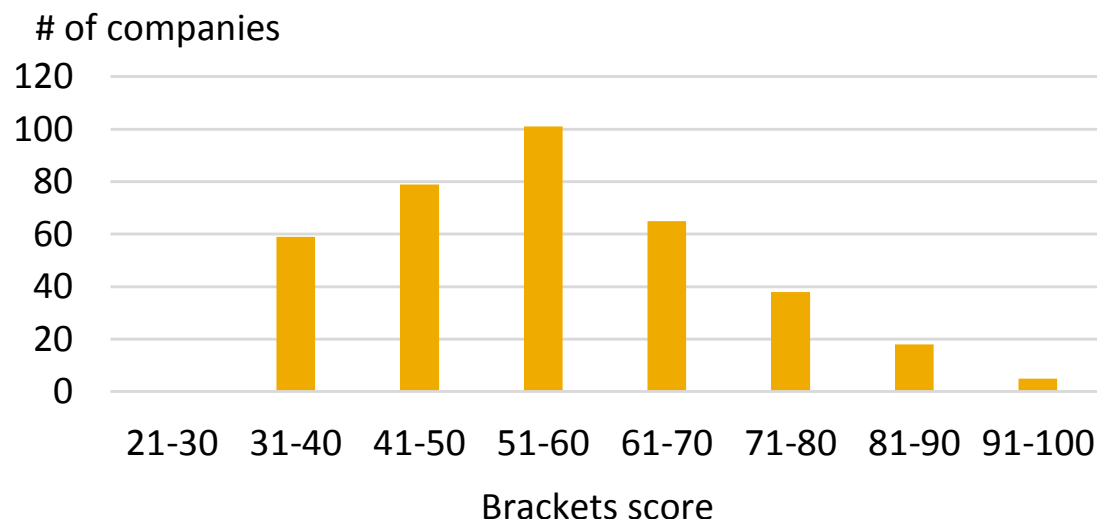
- Key for a bank's profitability and long-term survival
- Steering the corporate culture and the way employees act an increasingly important task for HR managers

Sector performance



Human Capital – Hiring capacity

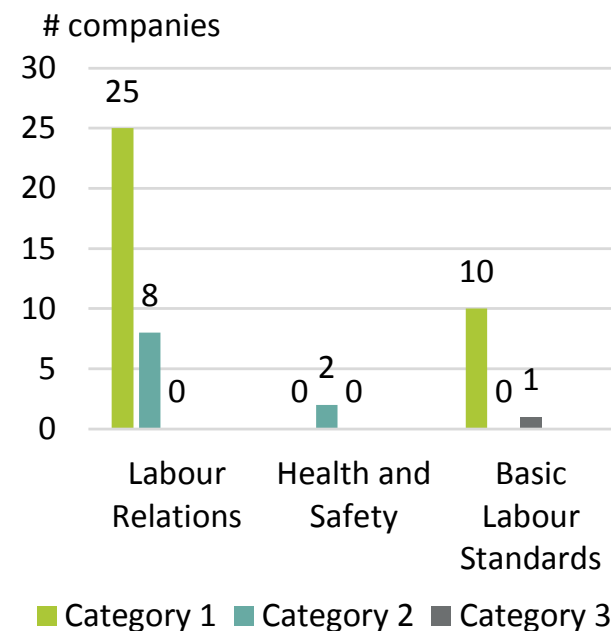
Distribution of scores



Human Capital: Leaders

Leaders	Country	MCap (USD m)
Cif Euromortgage SA	France	n.a.
Intesa Sanpaolo S.p.A.	Italy	58,526
Caisse centrale Desjardins	Canada	n.a.
Skandinaviska Enskilda Banken AB	Sweden	30,294
ABN AMRO Group N.V.	Netherlands	n.a.

Controversies overview



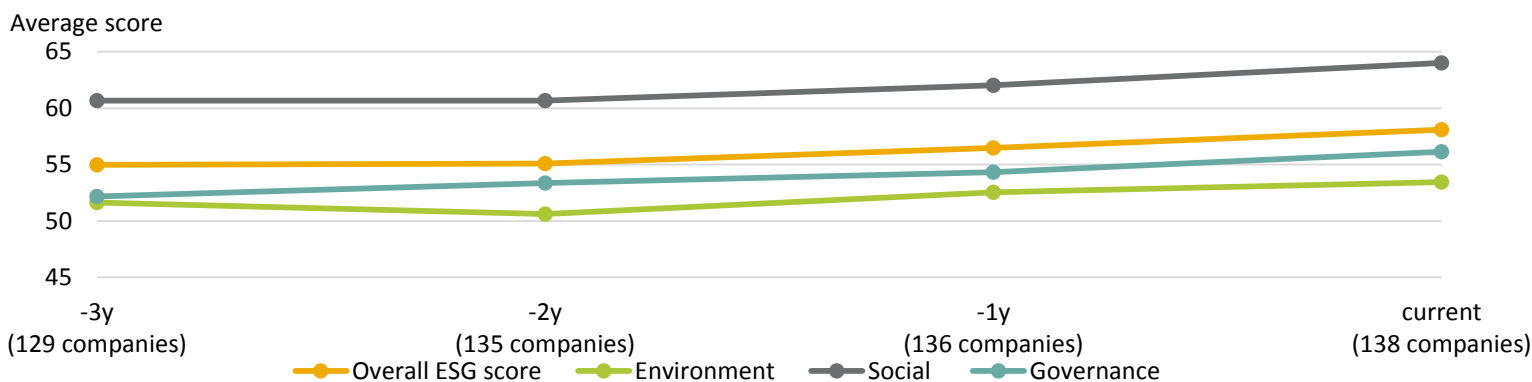
Source: Sustainalytics

Bottom-Up-Analysis

Industry Leaders (total universe)

Company	Country	MCap (USD m)	Score
National Australia Bank Limited	Australia	71,817	83.7
Skandinaviska Enskilda Banken AB	Sweden	30,294	83.6
CaixaBank, S.A.	Spain	34,800	83.2
Westpac Banking Corporation	Australia	100,029	83.0
KfW	Germany	n.a.	82.3
DNB ASA	Norway	31,877	81.7
Banco Santander (Brasil) S.A.	Brazil	26,669	79.5
Banco Bilbao Vizcaya Argentaria, S.A.	Spain	77,828	78.2
Nedbank Group Ltd.	South Africa	10,003	78.2
Inter-American Development Bank	United States	n.a.	77.7

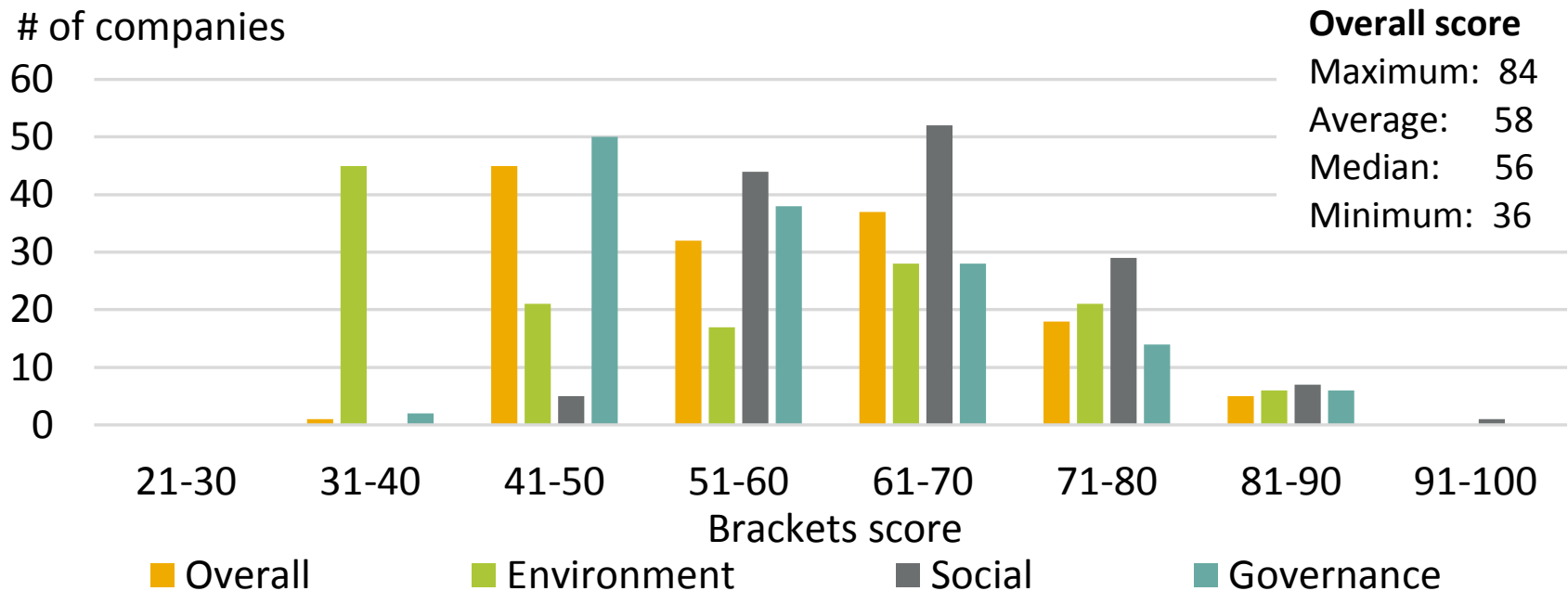
Momentum



Source: Sustainalytics

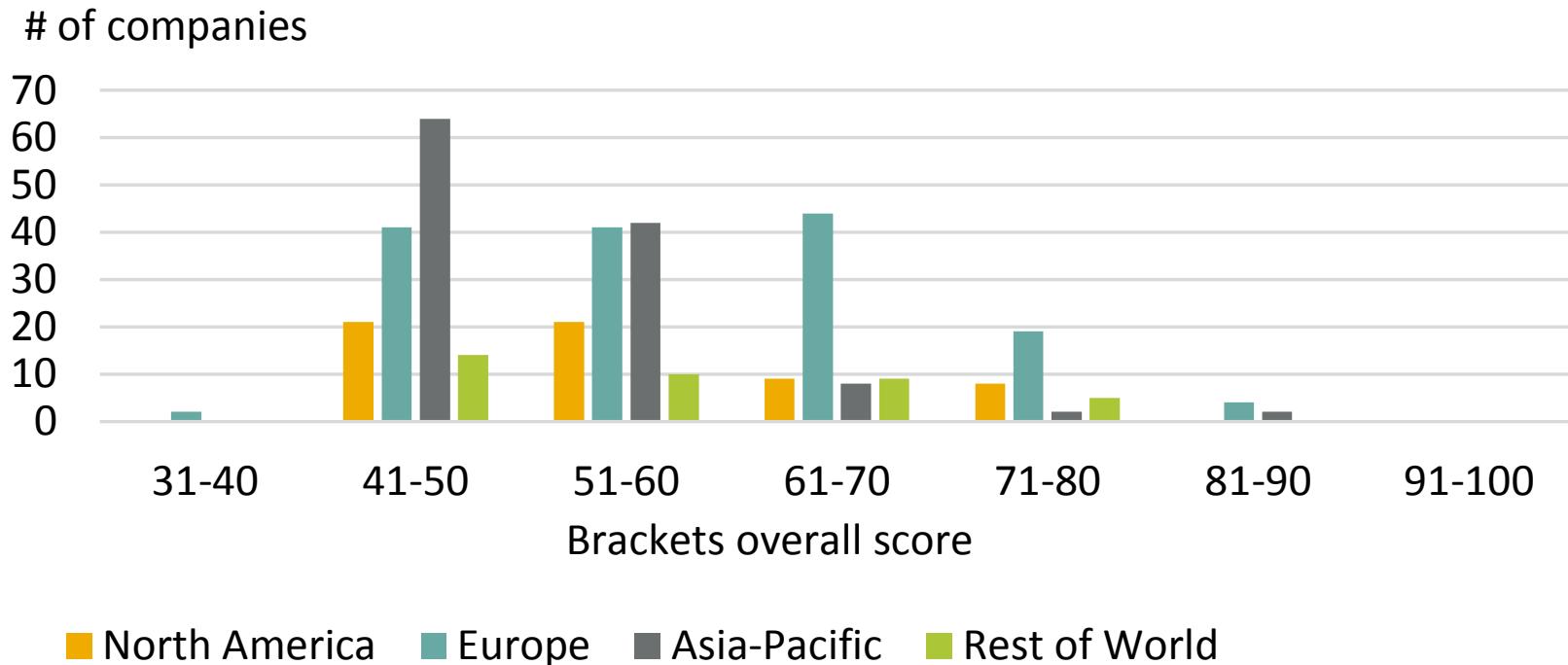
Bottom-Up-Analysis (cont'd)

Breakdown by ESG Theme



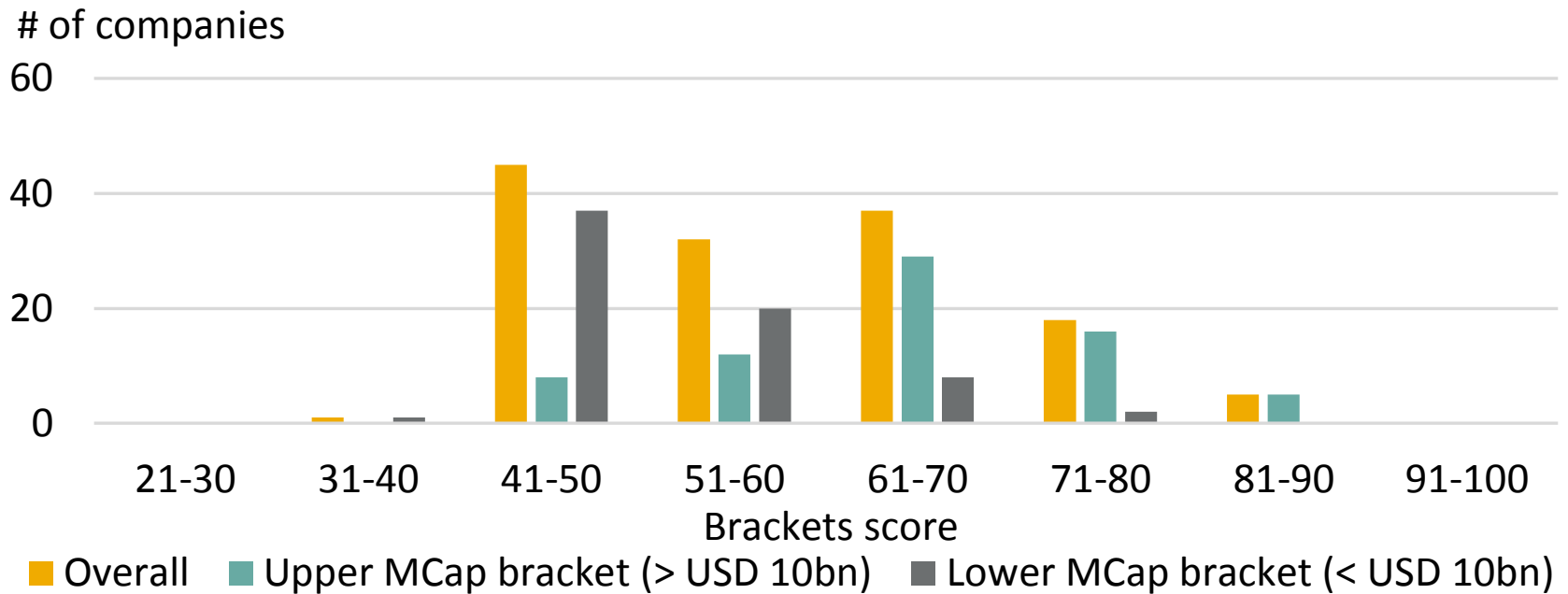
Bottom-Up-Analysis (cont'd)

Geographical Breakdown



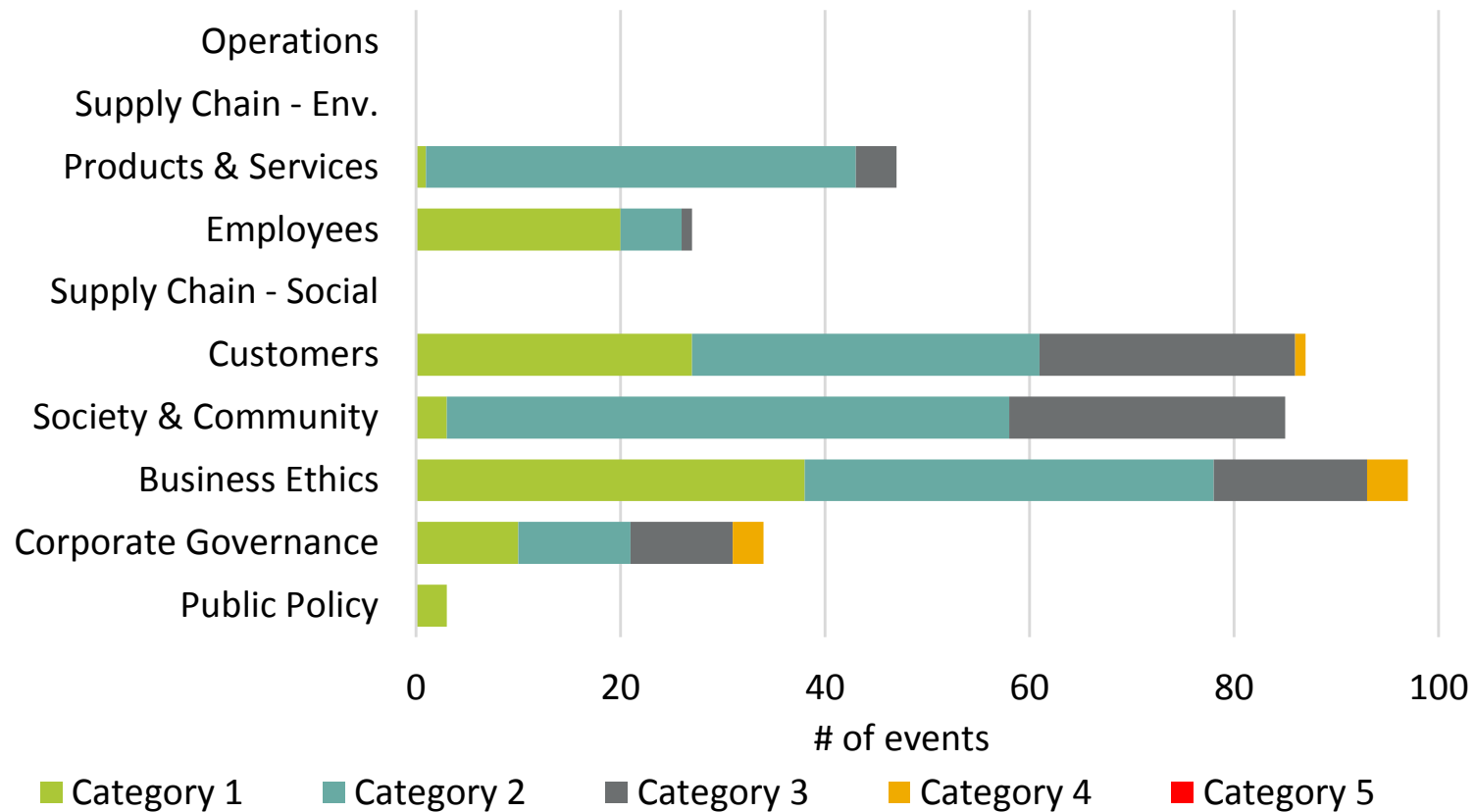
Bottom-Up-Analysis (cont'd)

Breakdown by market cap



Bottom-Up-Analysis (cont'd)

Controversies - overview



Wrap-up: Impact areas of Banks

Key ESG Issue	Areas of Sustainability Impact												
	GHG Levels	Air Quality	Land	Water Quality	Water Availability	Biodiversity	Animal Welfare	Local Communities	Customers	Employee Health & Safety	Labour Rights & Conditions	Contractors & Supply Chain	Human Rights
Business Ethics													
Resilience													
Responsible Finance	###	###	###	###	###	###	###			###	###	###	###
Financial Product Governance													
Human Capital													






no major impact
 major impact
 severe impact
 ### mostly indirect impact

Wrap-up: Impact areas of Banks

Key ESG Issue	Areas of Business Impact							
	Regulatory Environment	Litigation Risks	Reputational risks	Client Demand	Asset Risks	Operational Risks	Employee Motivation	Hiring Capability
Business Ethics	major impact	major impact	major impact	major impact	major impact	severe impact	major impact	major impact
Resilience	major impact	major impact	major impact	major impact	major impact	severe impact	major impact	major impact
Responsible Finance	major impact	major impact	major impact	major impact	major impact	no major impact	major impact	major impact
Financial Product Governance	major impact	major impact	major impact	major impact	no major impact	no major impact	major impact	major impact
Human Capital	no major impact	no major impact	major impact	no major impact	no major impact	major impact	severe impact	severe impact

no major impact
 major impact
 severe impact
 ### mostly indirect impact

Key ESG issues: High exposure, significant management gaps

-  **Business Ethics:** High risks are here to stay – regardless of reforms; the litmus test is whether banks are prepared to forego lucrative business opportunities.
-  **Resilience:** Regulatory pressure will remain high; but stability of banks is also related to “soft factors” that are typically only partly addressed by regulators.
-  **Responsible Finance:** Lots of room for improvement yet; however, we expect RF practices to gain traction in the banking industry and – in the long-run - become the norm rather than the exception.
-  **Financial Product Governance:** The pendulum is swinging back to more regulation – and higher costs; banks, thus, have begun to reposition themselves; one key factor for a changing culture will be incentives.
-  **Human Capital:** More stringent regulations expected, weakening the attractiveness of the industry further; thus, a shift towards a more strategic approach in HR management appears pivotal.

Thank you!

**Thank you for listening
and please feel free to ask your questions!**

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Associate Director, Research Products

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