IACPM/Bain Collaboration: ESG as a Source of Strategic Value Creation

Survey Findings (March 2023)

Avishek Nandy
Maria Teresa Tejada

IACPM

BAIN & COMPANY

IACPM/Bain survey was focused on understanding how financial institutions are leveraging ESG as a source of strategic value creation

56
GLOBAL PARTICIPATING INSTITUTIONS

Mix of global, regional, and local institutions across the Americas, EMEA, and APAC

$40T
IN TOTAL ASSETS COVERED

- Commercial banks
- Development banks
- Retail banks
- Fund/asset managers
- Insurers/re-insurers

100+
SURVEY QUESTIONS

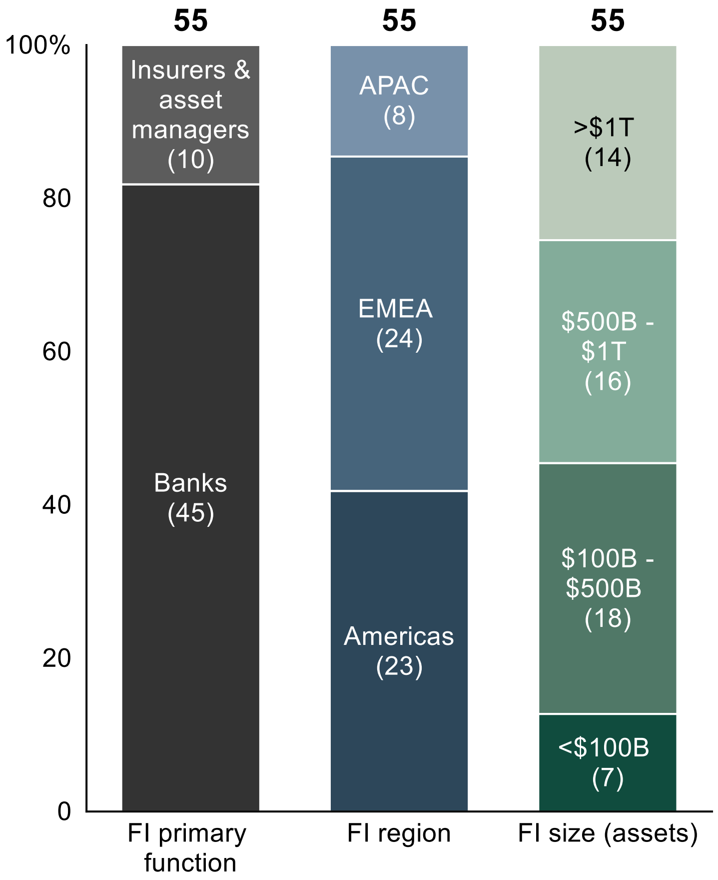
Completed by senior credit portfolio mangers and other professionals across the institution

6
KEY SURVEY TOPICS

Questions focused on ESG commitments, strategy and capital planning, value creation levers, methodology, governance and incentives, and implementation

Diverse participation across type, geography & asset class

PERCENT OF RESPONDENTS



IACPM/Bain survey was broadly structured around six focus topics

Commitments/Disclosure/ Communications

How are public commitments to net zero helping to inform aspirations, plans and progress?

Strategy & Capital Planning

How are banks' climate risk commitments/targets helping inform strategic priorities/choices? How are strategic and capital planning processes being used to address climate risk?

Value Creation & Capabilities

How do you measure franchise value/loss tied to sustainability and monitor execution? What are key levers to generate (or protect) value?

Measurement

How are banks identifying/assessing climate risk? How is transition risk quantified, managed and mitigated?

Governance/Operating Model

What governance changes are needed (e.g., committees, incentives) to frame and mobilize the organization? What changes are required to operating models to evolve to a more business-led target state?

Implementation

How are banks integrating climate risk factors into core banking processes to decarbonize portfolios? To what extent are these considerations impacting decisions around clients, products and processes?

The survey has a particularly focus on climate within the Environmental pillar of ESG.

Key Takeaways and Findings (1/2)

Executive summary is based on 100+ question survey distributed to and answered by 56 financial institutions globally which represent a significant part of the market with a combined ~US$40T in assets. It is also contextualized with multiple conversations with the IACPM, its Advisory Council, Board and individuals within those institutions. The survey has a particularly focus on climate within the Environmental pillar of ESG.

External momentum behind ESG has been building & will continue to grow…

A External pressures driving ESG momentum globally with strong shareholder, customer and regulatory pressure:

- **Shareholders, customers & regulators influence on ESG strategy**, and this will **grow further** as over 50% of FIs believe influence of these stakeholders will grow, with regulators the highest at ~80%
- **Some regional influences with non-America FIs more influenced by regulators, while Americas by shareholders though all expect regulators to grow in influence:** 100% of Americas FIs rank Shareholders as top 3 influence of ESG, vs. 30% for regulators; Non-Americas FIs select Shareholders in ~40-75% of cases, while Regulators in ~60-75%
- However, **geopolitical forces and economic headwinds** coupled with tension between energy security and energy transition are making **alignment and progress much more challenging** and are further contributing to the challenges faced by FI

...FIs less aligned on ESG pillars as value drivers, differences remain between "offense vs defense" drivers

B Multiple view-points exist on whether ESG pillars represent "upside to be captured" or "downside risks to be managed" with **less consensus globally on elements that drive value** or **how value is delivered**

- **Regional differences exist, with value creation focus in EMEA on Environmental transition/climate risk (~55%),** whereas Americas more likely to leverage **Social pillar (~50%),** and APAC **more balanced on role of ESG as key value driver**
- Some FIs expect **direct impact on bottom-line:** ~55% expect reduction to cost of risk/cost of funding from Net Zero strategy
- **Banks are launching green products** (project finance, ESG bonds) & expect to continue to **expand green portfolio** to commercial loans & retail products such as car loans, mortgages & deposits in next 3 years; little regional difference in products

...banks are taking concrete steps incorporating risk into operations & products…

C FIs particularly exposed to transition risk and are beginning to incorporate climate risk factors into their **credit/insurance underwriting/origination**, in addition to **credit portfolio mgmt. & stress testing scenarios**

- **65% of banks are still to incorporate climate risk** factors into credit decisions
- **70%+ FIs consider physical and transition risk when performing portfolio mgmt. and capital planning** analyses; most common scenarios are extreme rainfall & flooding and climate policy & regulation; Transition risk is primary concern of exposure EMEA & APAC institutions more likely to have incorporated risk factors into their core activities like credit underwriting with ~45% incorporating vs ~20% in Americas

Key Takeaways and Findings (2/2)

… and continued actions need to be taken to align “operations” with “aspirations”

D ESG **risk factors currently not yet consistently incorporated into day-to-day decision making**

- **Limited integration of climate factors and ESG scores in credit underwriting processes**; most FIs do not integrate climate factors (~65%) in underwriting processes currently
- ~80% of FIs have identified physical and transition risks, but only ~50% have quantified risk exposure
- ~35% of FIs currently use risk appetite metrics to define ESG risk appetite/tolerance

E Execution is challenging - **lack of consensus on frameworks, methodologies & tools** have hampered full incorporation into operations; this is exacerbated by **inconsistent regulation globally**

- Banks expect to **shift to proprietary methodologies** for physical & transition risk from ~55% today to 65-70% in 3 years
- **Limited consensus on which targets to employ**: Limited consensus on the types of targets, with banks using a mix of relative or absolute targets & industry experience suggests questionable value of 10- and 30-year forecasting horizons
- However, ~50% of FIs expect to limit credit-underwriting to low-carbon/ESG aligned customers by 2050

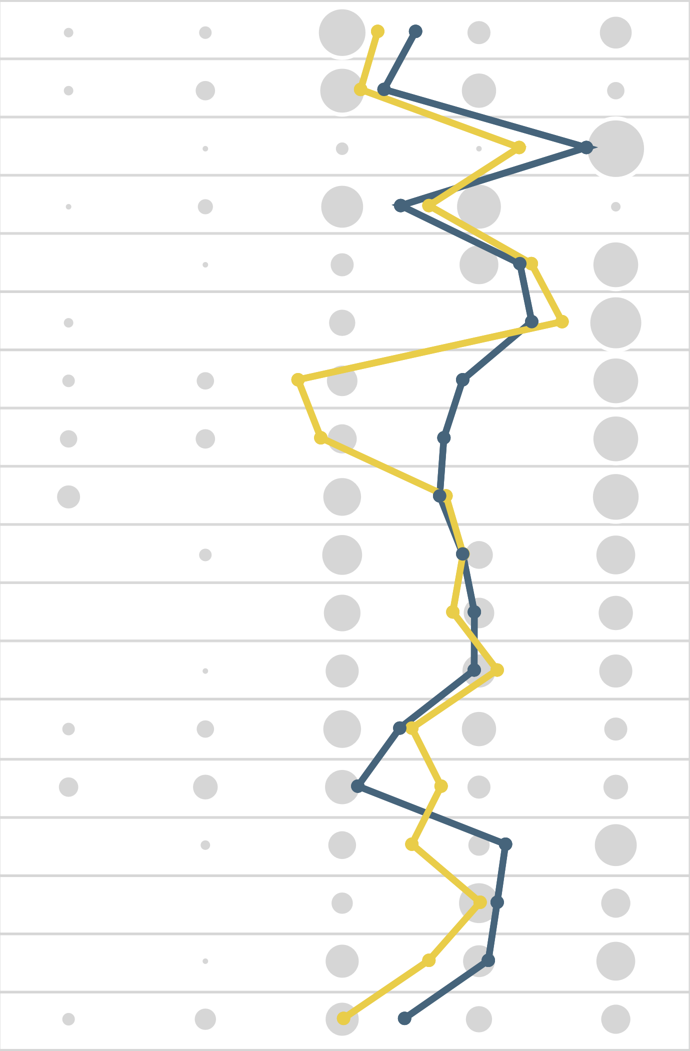
F **Operating model challenges and unclear decision rights continue to weigh on FIs:** Addressing governance gaps, empowering business decision makers and incorporation of ESG into performance management

- **FIs yet to better empower business**: ~40% drive ESG through group-led centralized team & are yet to embed ESG within business
- **Missing line 1.5 risk oversight for climate risk, with lack of clarity in responsibility for identifying and addressing climate risk**: ~55% of FIs believe there are unclear roles and accountabilities for managing climate risk between business (including lack of Line 1.5 support) and corporate functions
- **Climate metrics not widely used in performance management**: ~50% of FIs that have made public Net Zero commitments have not integrated climate metrics into performance management

Benchmarking across study participants
(survey responses compared to other FIs)

Four key areas for comparison across financial institutions

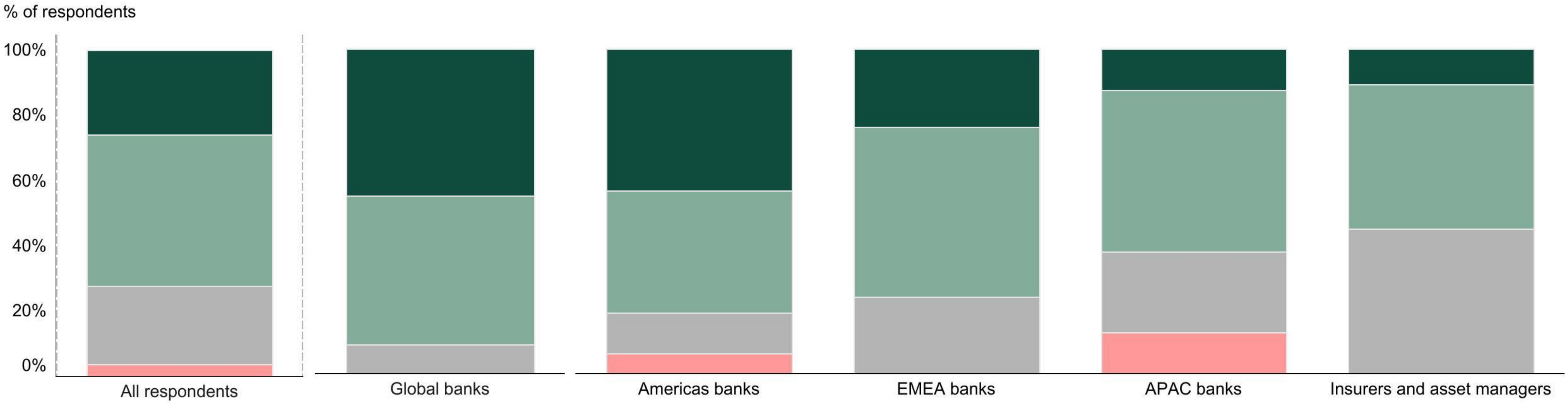
I. **ESG vision & ambition**	1. ***Environmental transition*** *posture is "****offense****" or "****defense****" (Q12_1)*	*Defense*	*Offense*
	2. ***Social*** *posture is* ***"offense"*** *or* ***"defense"*** *(Q12_4)*	*Defense*	*Offense*
	3. ***Explicit public commitment to Net Zero*** *(Q13 & Q15)*	*No plans for future*	*Already made*
	4. ***Self-assessment*** *of FI's current ESG position vs competition (Q36)*	*Significantly lagging*	*Significantly ahead*
	5. ***Self stated ambition*** *of FI's future ESG position vs competition (Q37)*	*Significantly lagging*	*Significantly ahead*
II. **Incorporation of ESG into risk processes**	6. **Currently considers** physical and transition risk in **credit portfolio mgmt.** *(Q44/Q47/Q50)*	*Neither physical or transition risk*	*Both physical and transition risk*
	7. *Has identified, assessed and quantified exposure to* ***physical risk*** *(Q64)*	*Has not done any of three*	*Has done all three*
	8. *Has identified, assessed and quantified exposure to* ***transition risk*** *(Q64)*	*Has not done any of three*	*Has done all three*
	9. *Has defined* ***Environment*** *KPIs and KRIs (Q68 & Q70)*	*Not defined KPIs or KRIs*	*Defined both KPIs / KRIs*
	10. ***Currently*** *uses or plans to use risk appetite metrics to define ESG risk appetite/tolerance (Q72 & Q73)*	*No plans to use in future*	*Currently in use*
	11. *Currently integrates climate factors or plans to into its* ***credit underwriting process*** *to inform risk ratings (Q95/Q96/Q97)*	*No plans to use in future*	*Currently in use*
III. **Incorporation of ESG into operating model**	12. *Expects institution to* ***have appropriate governance*** *in place to achieve Net Zero targets (Q81)*	*Doesn't expect to have in place*	*Already in place*
	13. ***Has*** *defined* ***clear roles & accountabilities*** *to manage climate risk (Q85_1)*	*Strongly disagree*	*Strongly agree*
	14. ***Has*** *defined a* ***line 1.5 control function*** *in the business (Q85_3)*	*Strongly disagree*	*Strongly agree*
	15. *Has integrated or plans to integrate climate metrics into performance management scorecards (Q86)*	*No plans for future*	*Already integrated*
IV. **Decarbonization**	16. ***Self assessed likelihood to*** *reach Net Zero targets (Q18_2)*	*Not at all likely*	*Extremely likely*
	17. *Has* ***defined targets and methodology*** *to identify and quantify* ***Scope 3*** *emissions (74_3)*	*No plans to implement in future*	*Currently defined targets & methodology*
	18. ***Provides credit underwriting*** *solely to low-carbon/ESG-aligned customers by 2050 (Q109/Q110)*	*Strongly disagree*	*Strongly agree*



Legend **Response distribution for all institutions** *(larger bubbles indicate higher frequency):* **All institutions average:** **APAC average:**

Most institutions agree that Net Zero will have a positive impact on value creation within 3 years, if it is not doing so already

Q59: *How would your institution rate the following statement:*
In 3 years' time, your institution expects ***its Net Zero strategy to positively impact value creation****.*



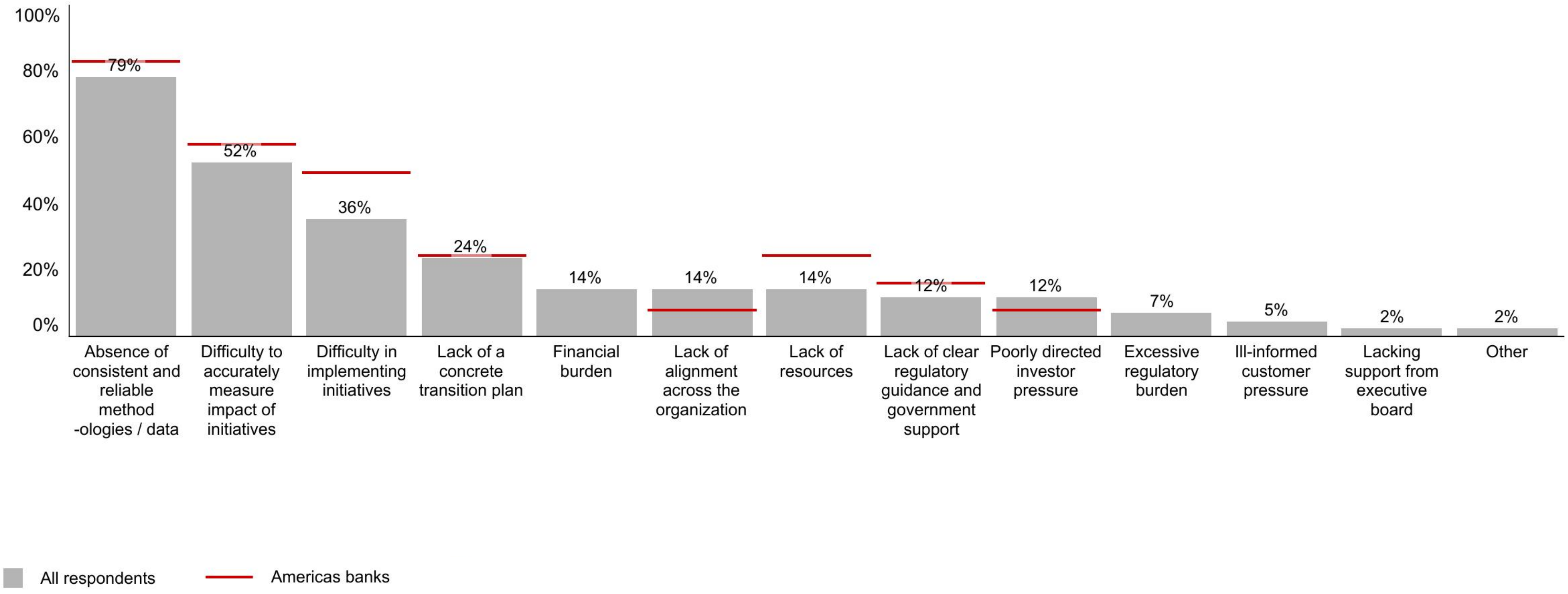
Legend: Strongly agree | Agree | Neither agree nor disagree | Disagree | Strongly disagree

Source: Bain/IACPM ESG survey

Data, measurement and execution are by far the main issue FIs see in achieving Net Zero commitments

Q19: *What does your institution consider as the biggest challenges it currently faces in meeting its Net Zero commitments?* ***[select up to 3]***

% of respondents that have made an explicit public Net Zero commitment

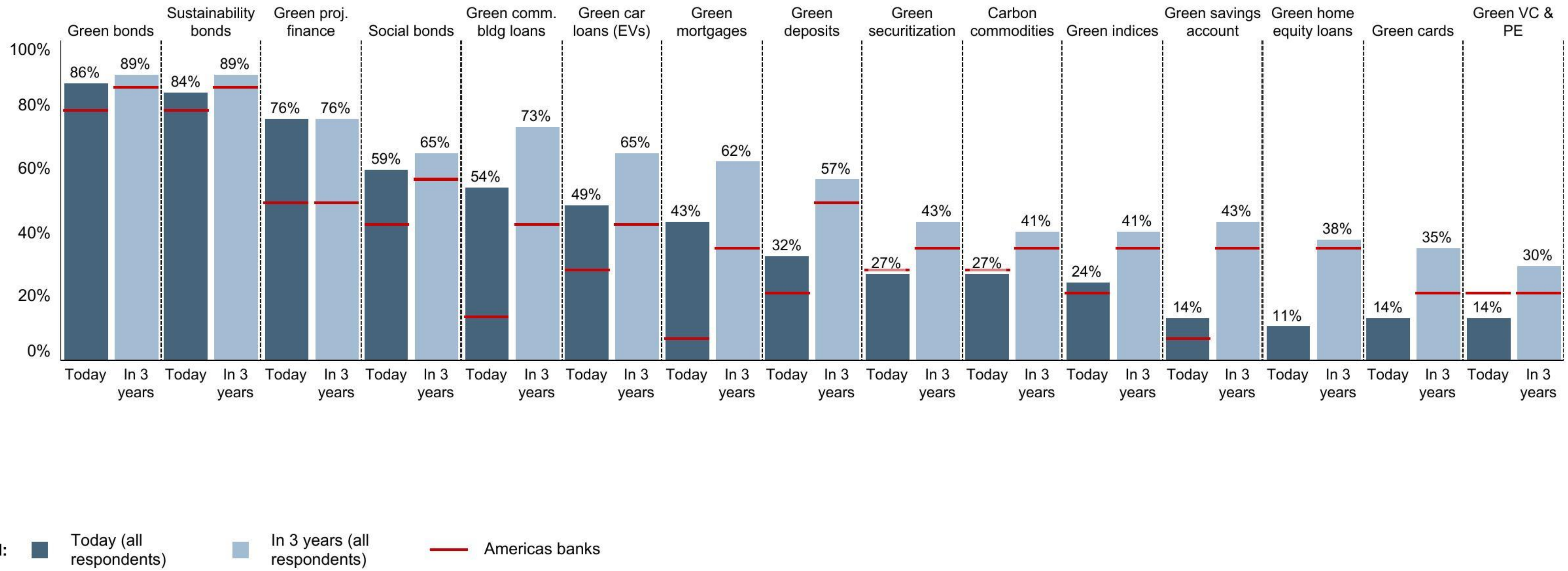


Notes: Respondents with an explicit public Net Zero commitment determined using responses from Q13
Source: Bain/IACPM ESG survey

Green and Sustainability bonds by far most used; retail-oriented products expected to significantly grow in usage

***Q104:** What kind of green products and services does your institution have or plan to have in the next 3 years?*

% of respondents



Note: Question was only asked to banks, as defined by responses to Q3.; "In three years time" bar includes all "today responses", even if not explicitly selected.
Source: Bain/IACPM ESG survey

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