Bank Governance Leadership Network

April 2020

BGLN VIEWPOINTS

Sustainability and purpose in banking

> *"The conversation around climate risk has moved incredibly quickly. The difference from even just six months ago is really striking. It continues to be very much an evolving area, but one that is getting attention from senior levels across the financial system."*
>
> — Participant

> *"This is not just about responding to climate change, it's about how to create a sustainable business."*
>
> – Director

Before the COVID-19 pandemic swept the world, environmental, social, and governance (ESG) issues were garnering increasing attention from bank leaders and their regulators, as well as their investors. There is growing recognition that climate change in particular poses significant risks for banks and the financial system broadly. In the past, banks have often approached climate change through the lens of corporate social responsibility, but a new sense of urgency is pushing environmental sustainability to the forefront of risk discussions. Many banks are working to integrate sustainability into their core businesses by incorporating environmental considerations into risk management processes, product design, purpose statements, and long-term strategies. An executive said, *"As a bank we want to tackle so much when it comes to sustainability, including things like financial inclusion, but really climate change is the biggest priority due to the pressing nature of the risk."*

As efforts to assess and mitigate climate risk continue, banks are also pursuing emerging opportunities. A director explained, *"This is not just about responding to climate change, it's about how to create a sustainable business and find the opportunities that attract customers and can enable you to be a winner for the future."* For global banks, the challenges of response are compounded by inconsistent levels of urgency around climate risk across geographies, by a lack of standard industry practices, and by limited agreement on common calculations and core metrics to track progress.

On February 26 (London) and March 4 (New York), BGLN participants met to discuss the ways large banks are approaching climate risk and sustainability more broadly: How are emerging climate risks affecting banks and the financial system? What challenges do banks face as they respond? What are the opportunities in green finance? How are governance structures being adapted? How are firms measuring and tracking performance? This *ViewPoints* synthesizes the key themes to emerge from each of these meetings and from conversations with network participants beforehand and immediately afterwards. This *ViewPoints* is organized around the following sections:

- **Responding to evolving climate risks**
- **Grappling with challenges to response**
- **Exploring opportunities in green finance**
- **Articulating and operationalizing sustainability approaches**

Responding to evolving climate risks

"We need to start asking smarter questions, even if we don't have the answers yet."

– Executive

Despite uncertainty regarding the timing and severity of climate change and its economic and financial impact, there is a growing sense of urgency that banks must prepare now. For the first time, the top five global risks in terms of likelihood and impact in the World Economic Forum's 2020 global risk report were related to climate change (infectious diseases were also among the top ten).[1] In a speech in 2019, Sarah Breeden, Bank of England executive director sponsor of climate change, who joined the discussion in London, said:

> The size of those future risks will be determined by the actions we take today. The carbon released today is creating the physical and transition risks of tomorrow. Climate change therefore represents the tragedy of the horizon: by the time it is clear that climate change is creating risks that we want to reduce, it may already be too late to act. That need to act most obviously includes government through climate policy. But since the financial risks that climate change creates are to be managed in all future states of the world, it is incumbent upon financial firms, and central banks and supervisors, to act too.[2]

One executive said, *"This is too important, as banks we need to act now and get smarter on this topic. We need to start asking smarter questions, even if we don't have the answers yet."*

Pressure for action is growing

While activist groups have increasingly targeted banks, the pressure on banks to address sustainability comes from a variety of direct stakeholders:

- **Internal stakeholders.** Several participants stressed that employees are pushing banks to act. One director said, *"Yes, the regulators have put this on board agendas in some ways, but honestly it's our employees that are* *driving a lot of this. This issue is very important to them. You cannot hire and retain top talent unless you take this seriously."* Another participant said, *"It's no longer just the younger people who are invested in this, there is interest among many of our employees and clients to focus on this area more, and we are trying to respond."*

"You cannot discount BlackRock's influence in this. It is reflective of a societal change, but they have a lot of actual influence in the business world."

– Director

- **External stakeholders.** Investors are also paying more attention to these issues, in many cases pushing for corporations and financial institutions to be more proactive on climate risks. A group of Barclays shareholders recently filed a landmark climate change resolution calling on the bank to publish a plan to phase out financing companies in the energy sector and gas and electric utilities that are not aligned with the Paris climate agreement.[3] And in his annual letter to CEOs, BlackRock Chief Executive Larry Fink wrote that environmental sustainability will become a core goal of the investment giant's decisions, adding that the firm will now assess ESG governance "with the same rigor that it analyzes traditional measures such as credit risk and liquidity risk,"[4] including voting against directors of companies who are not doing enough to disclose how they address climate change. A director said, *"You cannot discount BlackRock's influence in this. It is reflective of a societal change, but they have a lot of actual influence in the business world."*

Focus on climate risk is expanding

Several participants indicated that they have recently witnessed a sea-change in attitudes toward sustainability across the sector, pushing climate risk rapidly up the risk hierarchy. An EY report found that 52% of banks view environmental and climate change as a key emerging risk over the next five years, up from 37% one year ago.[5] Huw van Steenis, chair of the sustainable finance committee at UBS and a former senior adviser to Mark Carney at the Bank of England, recently stated, "2020 may be the year when climate-risk analysis of portfolios moves out of a niche into the mainstream. Investors and boards have begun to realize that it can be more costly to ignore these issues than to try to grapple with them."[6] As banks adapt risk management frameworks to properly oversee this area, they face ongoing challenges due to the novel and complex nature of the risks, the lack of historical data, and the lack of clarity as to how these risks could develop going forward.

Climate risk can take a variety of forms

Participants discussed the ways that climate risk could manifest:

- **Physical risk.** Physical risks arise from increased destruction of property, loss of asset value, loss of economic activity, and declining global incomes. These risks could result in destabilizing losses for financial institutions with direct and indirect exposure to affected industries and assets. Participants see potential systemic risks from the physical risk of climate change. As a result, many said their banks are trying to determine their direct exposure to physical risks through things like mortgages and other real estate investments that might be particularly vulnerable to climate events.

"The question right now is still whether you view this primarily through a reputational risk lens or a financial risk lens."

– Director

- **Transition risk.** Transition risk stems from efforts to mitigate climate change and transition to a low-carbon economy, spurred by policy, technological developments, or public opinion. The realization of a low-carbon economy could result in stranded assets in carbon-intense sectors. Material and large-scale devaluation of assets could, in turn, have significant impact on financial institutions' balance sheets and broader implications for the financial system. The scope is potentially vast; a study by the Network for the Greening of the Financial System, a group of central banks, estimated the losses associated with the devaluation of assets as a result of transitioning to a low-carbon economy could be as much as $20 trillion.[7] Policy changes could result in rapid and unexpected changes to the risk profile: *"You could make something that seems like a sound credit decision right now, but if a new rule comes out next year you could be in trouble …The thing is that economies are hyperconnected organisms and it's not clear how the second or third order effects of decisions could play out."*
- **Reputational risk.** Given public sentiment and attention to climate issues, reputational concerns could be as significant in the near term as the direct risks of climate transitions. As one director said, *"The question right now is still whether you view this primarily through a reputational risk lens or a financial risk lens."* Another said, *"At the moment a lot of the decision-making is based mostly on reputational concerns, that's the biggest risk right now."*

There are also other, less discussed risks that may eventually become significant. One participant predicted, *"A big part of this is litigation risk. We've seen them go after fossil fuel companies already, it could happen to banks next. This changes all of what you do, and it's something people don't think about and then it just comes and hits you on the nose. As you look at things coming down the pike, that's something to be very aware of."*

> *"It is a classic systemic risk. It is far-reaching in breadth and scope; it will reach across all sectors and across all geographies. The impacts are likely to be interconnected across the system."*
>
> – Regulator

Regulatory and policy pressures are growing

Regulators increasingly see potentially systemic impacts for the financial system stemming from climate change. A regulator said, *"It is a classic systemic risk. It is far-reaching in breadth and scope; it will reach across all sectors and across all geographies. The impacts are likely to be interconnected across the system. It is nonlinear."* Another participant added, *"When evaluating exposure as a bank, the answer you might get is that it's not a major risk because it's not projected to significantly impact the balance sheet in the near term. I don't agree, I think it is a systemic risk."*

Most central banks have taken steps to indicate that climate risks represent a threat to the global financial system. The Network of Central Banks and Supervisors for Greening the Financial System, a group consisting of 54 members representing most of the central banks from the largest markets, aims to "green the financial system and strengthen efforts of the financial sector in achieving the Paris climate agreement goals." Meanwhile, European Central Bank President Christine Lagarde has referred to the fight against climate change as "mission critical" for the central bank.[8] Under Mark Carney's leadership, the Bank of England announced plans to incorporate climate-based stress testing beginning in 2021, though those plans are now under review and may be delayed due to the novel coronavirus pandemic.[9, 10] Although the tests have been delayed, a participant explained that the tests have three main goals: size the risk, explore business scenarios and how banks will adapt models, and understand how risk management will be carried out.

> *"The risk of regulatory fragmentation is very real. We need alignment around how we do this, what metrics we use, and how we disclose."*
>
> – Participant

Regulators are moving at different speeds

As policymakers, regulators, and central bankers move at different speeds, the lack of global regulatory and policy cohesion could increase. A participant observed, *"Different countries are on different paths, which is creating inequalities in the system we're all operating in, and that's not good for anyone."* Another stated, *"The risk of regulatory fragmentation is very real. We need alignment around how we do this, what metrics we use, and how we disclose. The regulators need to take us there."* Some participants shared hope that more regulatory cohesion could be achieved as American policymakers and regulators become more focused on the issues. However, another participant expressed skepticism: *"Unless the outcome is completely different from everything else, the US will do what is best for its economy full stop, and it will not be harmonized with other approaches."*

As with many emerging risks, regulators, like bankers, are learning as they go. One regulator compared climate risk to cybersecurity or cloud computing, where regulators are trying to catch up with the pace of adoption in the market and identify potential risks and mitigants. *"Sometimes there are these things we have to react to as supervisors before there is full clarity of how policy will evolve,"* the regulator said. As regulators move forward, one acknowledged that some regulatory actions taken today may not be fully mature: *"We cannot let perfection be the enemy of good when it comes to this risk. I think we'll learn a lot, even though in five years we'll likely look back and say this is all very primitive. But the fact is we need to move forward and get on with it."*

"We've got the crew, we know where we want to go, but we haven't got a bloody map to get there."

– Participant

Grappling with response challenges

As banks contemplate their responses to risks related to climate change and other sustainability issues, they are hampered by a lack of good industry standards and practices to guide them. As one participant said, *"We've got the crew, we know where we want to go, but we haven't got a bloody map to get there."*

Banks may be asked to play an expanding role. As governments look to transition their economies to be carbon neutral, participants noted that some may view banks as the best transition mechanism for achieving that goal. A director said, *"I'm very loathe that the banking industry should be seen as the leader of government policy. Ultimately, the people elected by society will have to do something related to policy. Sure, a lot can be done by the regulator, but ultimately it's government that needs to lead."* Yet banks may be positioned to play a leadership role. A regulator said, *"Let's be clear, it's the real economy that emits carbon, not the folks here,"* but added, *"Yet, it is the decisions you make about how to provide finance that can impact this."* Firms are increasingly facing a fundamental decision as to how they want to respond to climate risks as an institution, which would require implementing a cohesive strategic approach.

Determining institutional exposure is difficult

Firms are in the early stages of determining their direct exposure to aspects of climate change. The balance sheets of many large banks retain significant exposure to "brown assets," or those considered to be high carbon or climate-risk inducing. Those with the greatest exposure are typically the

"One of the biggest challenges right now is just simple benchmarking and trying to figure out if we're doing enough."

– Participant

biggest North American banks.[11] In China, the largest banks continue to lend to companies engaged in coal mining and production. Across the UK banking sector, loan exposure amounts to approximately 70% of banks' common equity Tier One capital.[12] While banks may be able to calculate their direct credit exposure to key players in the fossil fuels industry, many have discovered it is far more complicated to estimate exposures to climate change more broadly. As of the end of 2019, Crédit Agricole SA was the only bank to assess carbon emissions for its entire lending portfolio.[13] Further, if the risk is truly systemic, exposure likely extends beyond any potential impact on the balance sheet of a single bank, some participants noted.

Coordination is needed across the sector

As institutions move forward in this changing environment, the sector may benefit from more collaboration between banks. A director said, *"I'd like the industry to share more best practices. I think some banks 'see competitively' which means we're not sharing as much as we should be. If we worked together more, we could impact policy."*

Several participants see an opportunity for regulators to take a lead when it comes to improved coordination and information sharing. One director suggested: *"If I were a regulator, I'd probably do a horizontal review. We're all sitting here with the same questions and you can do the review on those key issues to get an idea [of] what the range of practice is out there. That's something banks often welcome and the sector could benefit from it."* Banks are looking for better defined, more standardized ways to track risks and progress in mitigating them. Another participant observed, *"It's similar to what cybersecurity was like a couple of years ago. One of the biggest challenges right now is just simple benchmarking and trying to figure out if we're doing enough. Regulators are uniquely positioned to collect information from the banks and share good practices."*

"We need to stretch our horizons and think about the decisions we're making today even though the consequences of them may not be felt for some time."

– Regulator

Strategic questions persist

Whether we truly face a "climate emergency," how long we have to respond, and what form that response should take remains a heavily debated and politicized issue across countries and stakeholders. Banks' business models and direct and indirect exposure to climate risks also vary significantly. Some bank leaders have noted that the long-term risk of climate change is mitigated by the fact that loan books turnover on a much shorter timeline, enabling them to adjust as the risk evolves. But one regulator urged banks to address the risk more immediately, saying, *"This may feel like a distant risk but to manage it well we need to act today, we need to stretch our horizons* *and think about the decisions we're making today even though the consequences of them may not be felt for some time."*

Determining how proactive to be

Banks will ultimately need to decide how far out in front of policymakers and their peers they want to be in proactively taking steps to address climate risk. For some, the answer may be to very publicly lead the charge: Ana Botín, Santander's executive chair, recently called for the mobilization of the bank's customers and employees and "the trillions of euros and dollars required to finance the transition to the green economy … in order to deliver for our people, our customers, our shareholders and our communities on our purpose."[14] Some, like Citigroup's CEO Michael Corbat, shared a different perspective regarding the banks' role in driving change: "I say to our clients, 'I don't want to be the sharp end of the spear …You should set those [standards], you get proper buy-in and we will be here to support you.'"[15]

"Oil and gas is an enormous industry and it is still the foundation of many economies. You can't just turn off that tap overnight."

– Director

The decision to lead or follow is complicated. Ms. Botín acknowledged the complexities of even seemingly straightforward steps banks could take. Asked in an interview why Santander does not just stop funding fossil fuel companies, she replied, "That wouldn't be responsible. We cannot just cut the energy off in Poland, where a lot of the economy is still powered by coal. But we did announce … that we are not going to finance any new coal projects. You have to find a sensible balance between transforming and supporting our customers."[16]

One executive said, *"It's really complex once you start to dig into this. It's not just a simple decision, like just supporting electric energy and that solves it, because there are bad environmental practices in that industry as well, like the use of rare earth minerals. It's not a binary thing. You have to think about how far down the supply chain you need or want to go when making these decisions."* Another director went further, noting, *"I'm struggling with how regulatory bodies and [the] general public is coming down on the financial sector and pushing them to the edge of what is to be done or not be done or what industries should or should not be financed. For instance, we could easily say airlines shouldn't be funded. Where do we stop? What are the lines?"*

Navigating client relationships

A director said, *"Oil and gas is an enormous industry and it is still the foundation of many economies. You can't just turn off that tap overnight. So as banks the question is how do you help them to transition?"* Several participants advocated for actively evaluating and engaging clients in a range of industries about the sustainability of their business models and transition strategy. As one director noted, *"You lend to institutions; you don't lend to industries."* Another asserted, *"We don't tell our clients what to do; they tell us what they want to do, and we tell them whether we'll finance it."* And several clarified that while boards need to help set the strategic direction of the bank's response to climate risk, they should not be getting involved in specific credit decisions: *"It's a bad day for banks when boards start making loans; that's not the board's role,"* stated one director.

Exploring opportunities in green finance

> *"The risk side is what the climate is going to do to your institution and the financial system. The opportunity side is what you can do to drive the economy in the right direction."*
>
> – Participant

Despite the risks posed by climate change, the opportunities to expand investment in green and sustainable finance could be significant. One executive said, *"There's so much focus on the risk agenda that I don't think we are paying nearly enough attention to the opportunity side."* Massive investment will be required for economies to transition to cleaner energy and production and achieve internationally agreed upon goals. According to the Global Commission on Economy and Climate, the transition to a low-carbon, sustainable economy could lead to an economic boost of $26 trillion by 2030, creating more than 65 million new jobs.[17] A participant said, *"The risk side is what the climate is going to do to your institution and the financial system more broadly. The opportunity side is what you can do to drive the economy in the right direction."* Sustainable finance has been a particular area of growth, as corporate lending tied to some measurable sustainability metric—such as reducing emissions or waste—increased by 800% in 2018 to $36.4 billion.[18] In response to growing investor demand for sustainable options, the green bond market, which emerged in 2007, has grown to reach a global total of $521 billion.[19]

Banks are beginning to scale sustainable finance

As banks determine how proactively they want to manage climate risk, they will also have to decide how aggressively they want to pursue opportunities in this space. One executive urged firms to avoid complacency regarding the chance to generate new business: *"We can all choose how you want to respond to the alarm raising. We can use all our energy saying it is too complicated and pushing back, or we can really prioritize embedding science in banking and starting to find these opportunities."* An EY SMA added, *"I'm really interested to see how banks can be at the center of the solution here. They are well-positioned to help the transition and that could be a major business opportunity."*

> *"What we are seeing, particularly with our younger customers, is that they are crying out for green products."*
>
> – Executive

In the face of external pressures, banks may see some traditional sources of revenue become unsustainable from a reputational risk standpoint. An executive explained, *"Banks have to find a way of replacing fossil revenues. Any organization with any consumer facing business needs to be running analysis on what it is going to take to continue to generate revenue from something that is seen as unacceptable by customers in another part of your business. The money we're making from old fossil fuel economies cannot continue."* Further, demand for green banking products is expected to increase rapidly in the coming years, particularly as younger generations become more active banking customers and investors: *"What we are seeing, particularly with our younger customers, is that they are crying out for green products, green credit cards, whatever we can come up with. We have just started to dip our toes in the water and are totally overwhelmed by the response so far."*

Participants highlighted some additional challenges as the growth of green finance continues:

> *"Perhaps the biggest challenge on the opportunity side is not knowing how to measure the opportunities, or how to price them."*
>
> – Participant

- **Banks may lack historical expertise to take advantage of some opportunities.** Some participants noted that large banks are not suited to investing in small-scale initiatives and start-ups, areas where the greatest investment may be needed today. One observed, *"When you talk about the opportunities, the trillions of financing needed, a lot of that is going to be in emerging economies or in small scale businesses and sectors, and that's tricky for banks."* Where banks can be most helpful is in financing larger-scale projects, such as major infrastructure projects. That, however, will require additional coordination with political leaders to identify opportunities. A director said, *"When it comes to opportunities, my concern is that many of them are things banks are not very good at funding right now. I think a lot of the opportunities that could arise will be under-secured or unsecured cash flow lending, early stage companies, etc."*
- **The green finance market is still maturing.** Participants shared concerns about a lack of agreement on basic aspects of the nascent sustainable finance business. As one participant said, *"Perhaps the biggest challenge on the opportunity side is not knowing how to measure the opportunities, or how to price them."* "Greenwashing," or conveying a false impression or providing misleading information about how a company's products are more environmentally sound, was also cited as a potential issue of concern. A participant said, *"There is such a demand for green products, but you've got hundreds and hundreds of terms out there*

that are all supposed to mean the same thing—sustainable investment, ethical investment, green, etc. ... If we don't get some standardization on that it will be really difficult to ever scale these opportunities."

"If we don't get some standardization it will be really difficult to ever scale these opportunities."

– Participant

- **North American banks may be positioned to invest and scale quickly.** Though some North American financial institutions may appear to be less aggressively addressing climate risk, that does not mean they will not pursue opportunities. Competition is likely to increase as more investment shifts to green and sustainable finance. One participant cautioned, *"I think it would be very foolish for anyone to think that the big American banks are behind on this. They have the capital to be fast followers and scale their efforts very rapidly, and we're already seeing huge investments on their part."*

Sustainability initiatives are linked to broader corporate purpose efforts

Businesses are increasingly responding to stakeholder demands and attempting to articulate their corporate purpose while also demonstrating how that purpose drives decision making across the institution. An executive said, *"Having a statement of purpose that resonates with employees is absolutely a necessity if you want to be a relevant company for the future."* For banks, the approach to address climate change and sustainability issues ultimately comes back to a core question of purpose: will these types of issues be treated as a corporate social responsibility exercise, or are issues around sustainability central to the long-term strategy of the financial institution?

- **Even "trite" statements can be impactful.** Some participants admitted to initial skepticism regarding the value of what can seem like trite purpose statements, yet when they see how these statements can resonate in day-to-day business discussions and are reflected in employee and customer engagement survey results, they recognize the importance in driving home a simple message about the purpose of their work. One director said, *"It can actually sound cornier in the boardroom than it does to employees and customers."*

Sustainability initiatives are linked to broader corporate purpose efforts

- Purpose statements need to be backed by actions. While most bank leaders appear to agree that a strong sense of corporate purpose is critical, implementing it across a complex organization can be a challenge. It is important for boards and management to ensure their institutions are following through on purpose statements with concrete actions. One executive offered concrete examples of how they did so: *"When we started on our journey management made two really brave decisions. We removed any targets from branches and centers, [and] results drastically improved. We also changed the rewards system to be fully based on customer feedback, and we saw a huge increase in financial results from that."*

- Purpose and profitability need not be at odds. While these decisions are often presented as a choice between being purpose-driven or returns-driven, a director said, *"There seems to be this supposed dichotomy between purpose statements and generating profitability. I don't think that's the case. I think some of this can generate value faster than you might think."* An executive cautioned, *"Purpose is seen as this talisman, the magical elixir that restores credibility of big business. There's a lot of junk out there, frankly,"* but also emphasized that there are real benefits to getting it right, *"A strong sense of purpose in any job will improve performance, deliver more loyalty among customers—the most valuable commodity there is—and will deliver profits and get loyalty from shareholders."*

- Tone and attention at the top are essential. To be successful, participants agreed that purpose needs to be embraced and led at the highest levels of the institution. One participant said, *"Purpose has to have governance around it, you can't discuss it once per year. It needs time, it needs the right people, it needs cultural buy-in, it needs senior people to keep pushing."*

Several participants noted that banks still have work to do convincing people that they are driven by a socially beneficial purpose. A director said, *"A lot of people still self-select out of banking. As an industry, we lead with paycheck, not with purpose ... A lot of us have the great tone from the*

Sustainability initiatives are linked to broader corporate purpose efforts

top, but when you get down into the organization the type of people we attract are the type that think The Wolf of Wall Street is a recruiting video, and that's not what we want."

Articulating and operationalizing sustainability approaches

Despite some progress, it remains early days for many banks when it comes to implementing sustainability efforts across an entire organization and explaining that approach to stakeholders. A 2019 study found that two-thirds of banks have adopted a group-wide climate strategy, versus 58% a year prior.[20] An executive said, *"This agenda is new. To be successful, we will all need to be combining things like ensuring tone at the top, bringing in new opportunities, collaborating with each other and with regulators, and really bringing all [of] the organization together and trying to get not just your bank but the sector at large to a place we all want to be."* Appealing to customers and investors may speed up banks' efforts. An executive noted, *"Consumers are starting to understand that choosing how they use their money is the only power they have. We are seeing a lot of customers concluding that they don't want their money going into an organization that is failing to understand this issue on a fundamental strategic level."*

Management roles

To effectively carry out a firm-wide sustainability strategy, banks have been rethinking management roles and responsibilities. Many banks have tasked a senior member of management with responsibility for oversight of sustainability. In late 2018, the Bank of England's Prudential Regulation Authority mandated that boards of insurers and banks must identify a senior executive to take charge of managing climate change risks and report to the board.[21] Several of the largest banks have now named a chief sustainability officer, but the role's definition and responsibilities vary significantly. Yet, some say that having a single executive with primary responsibility for sustainability is insufficient. One participant said, *"Ultimately, for sustainability to be center of the plate, it needs to be part of everyone's jobs and not siloed off."* Another agreed, suggesting more banks should *"have ESG task forces educating all their bankers across the board to understand what ESG is and*

"Ultimately, for sustainability to be center of the plate, it needs to be part of everyone's jobs and not siloed off."

– Participant

what sustainable finance products are out there, so that it can just be integrated into regular conversations with clients. It's about making this a part of your everyday discussions with your clients and integrating it into the fabric of what you do."

Ultimately, participants widely agreed that sustainability must be increasingly integral to strategy, which requires buy-in from leadership. An executive said, *"Tone at the top is vital. Yes, everyone says that, and that is because it's true. Once you have your CEO pushing this, that enables you to get the best people in the organization involved. To be successful, you need to get a dedicated percentage of people's time to look at this."* A director agreed, *"You need to have leaders who are really believers and drivers of actual activity, not just words or policies but driving actual measurable benefits."*

Board oversight

"It's important to get the balance right between creating new structures and using existing ones … The thought process here is not that different from other risks."

– Director

Sustainability oversight has become a board-level issue, but boards are still in the early stages of developing more comprehensive approaches to overseeing sustainability risks and opportunities. A regulator said, *"The level of engagement at the board level is increasing. I do think the board has a role to play here and at most of the institutions we supervise, I would say they are taking a leading role asking about what management is doing, what commitments they are making, and how they are incorporating new risks."* However, a director stressed that most conversations are focused on business sustainability: *"We're not trying to figure out what's happening with the ice caps, we're talking about whether clients can pay us back in two years."*

Another director observed, *"There are still a lot of questions about what governance should look like from an internal standpoint. Where does this reside? What is the reporting both internally and to the board? How does it fit into your board structure and processes?"* Just as they have done with other risks that became board-level issues, such as cybersecurity, banks must determine if it is necessary to significantly alter board governance to oversee sustainability, or if current structures can be adapted. One director said, *"It's important to get the balance right between specialists and generalists, between creating new structures and using existing ones. I tend to push for the latter. We have a lot of frameworks in place and a lot of the time has gone into those, and the thought process here is not that different from other risks. Our board is leery of creating separate structures for this."* Another director agreed but stressed the importance of ensuring existing structures have clearly allocated responsibilities: *"We had a similar thought; we didn't want to* *create a whole new bureaucracy to interact with the rest of the bureaucracy. The function of the board is not to duplicate and replace what's going on in the other functioning areas, it's to ensure we don't have gaps and all the chairs of the committees know what the others are doing so we can identify gaps."* Ultimately, the selected approach is not the point: as an EY SMA said, *"It really doesn't matter where you put it on the board, what matters is that you are being thoughtful about how you're addressing all the issues."*

Public commitments

"It really doesn't matter where you put it on the board, what matters is that you are being thoughtful about how you're addressing all the issues."

– EY Partner

More financial institutions are making public sustainability commitments to reduce their own carbon footprints and shift investment from fossil fuels to sustainable and green finance. According to the World Resources Institute, 25 of the world's largest 50 banks have made public sustainable finance commitments totaling more than $2.5 trillion.[22] More than 100 financial institutions have adopted coal restrictions and there are coal phase-out plans in 31 countries. Five banks—ING, BBVA, BNP Paribas, Société Générale and Standard Chartered—have committed to "progressively align" their corporate loan books with the goals of the Paris Agreement.[23] In 2019, the United Nations introduced its Principles for Responsible Banking, which include the goal of positioning the sector to contribute to climate change mitigation and adaptation. As of 2019, 130 banks representing $47 trillion in assets have adopted the principles.[24]

Yet, some industry commentators, as well as some participants, have noted that many of these commitments may be more about rhetoric than action, and the effectiveness of such commitments remains opaque.[25] An executive said, *"It's not just activists or young people, the skepticism of this is really broad and it includes regulators and policymakers. It's really important that we commit thoughtfully and speak clearly on this."* One study found that 57% of banks that have made commitments do not publicly disclose their accounting methodology, and a third do not have plans to report on the progress of keeping their commitments.[26]

One director spoke of the board's role in banks' public commitments: *"I think you need to be really careful to make sure these commitments actually have some meat to them and can be tracked over time, because increasingly, you're going to get a lot of questions: 'How are you measuring this? Is this something you were already going to do anyway?'"* Another said, *"It's really important not to over-promise and under-deliver. You have to look at what you can actually do as an institution, and what your peers are doing."*

Metrics and communication

> *"All the banks I talk to have different perspectives on how they see the climate risks and opportunities, but they all agree on one thing: they don't have the toolkit to do it properly."*
>
> – Participant

Stakeholders want to hear what banks are doing about sustainability and are keen to hold them accountable for executing against their commitments. As senior bank leaders try to explain their efforts to the public, they cite the current lack of standardized metrics and frameworks across the industry as a barrier. As one participant put it, *"All the banks I talk to have different perspectives on how they see the climate risks and opportunities, but they all agree on one thing: they don't have the toolkit to do it properly. They don't have the data, they don't have the common language in sustainable finance, [and] they don't know how to disclose."*

Standardizing metrics

An executive stressed that effective metrics are necessary for banks to establish credibility regarding sustainability efforts: *"When you have the aspiration to be responsible, you have to be as direct and clear as you can be in linking goals to metrics and tracking, to be clear you're walking the walk and not just doing marketing."* Not everyone, however, has figured out how to do this effectively. A participant explained, *"There are a lot of different standards and taxonomies globally, plenty of acronyms. We're trying to create frameworks and measurements, but for now it's creating some confusion and a lack of comparability."*

> *"Right now, there are so many efforts to harmonize metrics that there are almost more harmonization efforts than actual frameworks."*
>
> – Participant

Not everyone is convinced that standardization is a panacea. One director said, *"The questions of data and metrics are enormous. It's different for every sector. You would need to have a sector-by-sector approach to a lot of these things. But I worry about standardization because there's a risk of standardizing to the wrong thing. There needs to be a kind of constant recalibration."* A participant added, *"Right now, there are so many efforts to harmonize metrics that there are almost more harmonization efforts than actual frameworks, which is frustrating."*

Improving disclosures and communication

Investors and regulators are increasingly looking for improved disclosures about sustainability efforts to provide insight and demonstrate progress. A 2019 study found that 81% of banks are disclosing information on progressive climate-related public policy engagement.[27] The Sustainability Accounting Standards Board (SASB) created sector-specific standards to disclose the financial impacts of sustainability. The Task Force on Climate-related Financial Disclosures (TCFD), launched by the Financial Stability Board and chaired by Michael Bloomberg and Mark Carney, released its initial recommendation in 2017. It identified four areas of disclosure for climate-related risks:

governance, strategy, risk management, and metrics and targets.[28] By 2019, 785 organizations had become supporters of the task force, including many of the world's largest banks, asset managers, and pension funds, which together manage assets of $118 trillion.[29]

An executive said, *"There will continue to be a lot of talk about disclosures and frameworks. It's costly and it takes time. Ultimately, it's the financial material risks that you're looking for exposure on and how those impact returns. Most banks will have some sort of TCFD alignment, but making it easily digestible for investors is key."* To provide guidance, a participant said, "*TCFD and SASB frameworks are complementary in achieving the goal of disclosing more financially material information, particularly as it relates to industry-specific metrics and target setting. [Investors] will be expecting companies to align their disclosures to both of these."*

Metrics and data may be insufficient. An executive said, *"Communication is key, this must be translated effectively and properly. You need to go beyond just numbers and build a narrative for your institution."* A participant added, *"You have to tell personal stories. I can give you a bunch of numbers, but you have to tell these stories and have real belief, because as banks we will never return to the earning models of the past and if we really believe this matters we need to do this very quickly."* Yet, this is a challenging area to navigate, as banks serve a broad variety of stakeholders who could be affected differently by their decisions. One director noted, *"We believe in taking action, we believe in measuring what we're doing, but we're somewhat skittish about communicating what we're doing due to the different impacts those actions have on the various communities we serve."*

"The transition is the great opportunity for banks. You are not trusted by society; you are not trusted by investors. You need to find a narrative on transition before it is imposed upon you."

– Participant

One participant urged bankers to develop their narratives sooner rather than later: *"The transition is the great opportunity for banks. You are not trusted by society; you are not trusted by investors. You need to find a place to differentiate yourselves at the individual and institutional levels … You need to find a narrative on transition before it is imposed upon you."* For those who fail to communicate progress, the same participant cautioned, *"Investors will hold the most senior non-executive director accountable if, within an agreed timeframe, the company has not provided adequate disclosures and made progress on the business practices underlying them."*

★★★

Upon announcing Goldman Sachs's commitment to sustainable finance, CEO David Solomon wrote: "Companies have traditionally treated sustainability as a peripheral issue, focusing narrowly on the way they manage their impact on the environment. We don't have the luxury of that limited perspective anymore. The evidence of climate change is clear. And, people in both developed and developing countries are questioning the ability of their economies to reward their hard work. There is not only an urgent need to act, but also a powerful business and investing case to do so."[30] Banks are faced with pressures to be a mechanism to influence the transition to a carbon-neutral economy. They are in the early stages of integrating climate change and sustainability into their purpose and strategies, improving the way they articulate and communicate about them, and working with clients to translate statements into action. One director said, *"This industry has seen massive change over the past fifty years, and banks have responded time and time again. They will adjust, they will use different instruments and models, they will change how they look after clients. But this industry, going back to the middle ages, has displayed high levels of adaptability, and we should be positive about that."*

About the Bank Governance Leadership Network (BGLN)

The BGLN addresses key issues facing complex global banks. Its primary focus is the non-executive director, but it also engages members of senior management, regulators, and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring, and trustworthy banking institutions. The BGLN is organized and led by Tapestry Networks, with the support of EY. *ViewPoints* is produced by Tapestry Networks and aims to capture the essence of the BGLN discussion and associated research. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of senior management, advisers, and stakeholders who become engaged in this leading-edge dialogue, the more value will be created for all.

About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multistakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the banking industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients, and for its communities. EY supports the BGLN as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

Appendix

In February and March of this year, Tapestry and EY hosted two BGLN meetings on sustainability and purpose in banking. These meetings included over 40 conversations with directors, executives, regulators, supervisors, and other thought leaders. Insights from these discussions informed this *ViewPoints*, and unattributed quotes from these discussions appear throughout.

The following individuals participated in these discussions:

BGLN Participants

- Hilary Ackermann, Risk Committee Chair, Credit Suisse USA
- Homaira Akbari, Non-Executive Director, Santander
- Mike Ashley, Audit Committee Chair, Barclays
- Nora Aufreiter, Corporate Governance Committee Chair, Scotiabank
- Antoni Ballabriga, Global Head of Responsible Business, BBVA
- Colin Bell, Group Chief Compliance Officer, HSBC
- Win Bischoff, Chair of the Board, JPMorgan Securities
- Norman Blackwell, Chair of the Board, Nominations & Governance Committee Chair, Lloyds Banking Group
- Sarah Breeden, Executive Director, UK Deposit Takers Supervision, Bank of England
- George Bridges, Senior Adviser to the Group Executive Chair, Santander
- Agnes Bundy Scanlan, Non-Executive Director, Truist Financial
- Celeste Clark, Non-Executive Director, Wells Fargo
- Martha Cummings, Head, Compliance Strategy & Operations, Wells Fargo
- John Cummins, Managing Director, Future Cities, Legal & General
- Lara de Mesa, Group Executive Vice President, Head of Responsible Banking, Executive Chair’s Office, Santander
- Terri Duhon, Risk Committee Chair, Morgan Stanley International
- Julia Dunn, Chief Risk Officer, Nationwide Building Society
- Eliza Eubank, Managing Director and Global Head, Environmental and Social Risk Management, Citi
- Maria Ghazal, Senior Vice President & Counsel, Business Roundtable

- Sonja Gibbs, Managing Director and Head of Sustainable Finance, Institute of International Finance
- David Godfrey, Non-Executive Chair, Nomura Europe Holdings and Nomura International
- Andy Griffiths, Executive Director, The Investor Forum
- Petri Hofsté, Audit Committee Chair, Rabobank
- Brad Hu, Chief Risk Officer, Citi
- Nick Le Pan, Audit Committee Chair, CIBC
- Brian Levitt, Chair of the Board, TD Bank Financial Group
- Morgan Lewis, Board of Governors of the Federal Reserve System
- Amanda Mackenzie, Non-Executive Director, Lloyds Banking Group
- Richard Meddings, Chair, TSB Banking Group
- Tom Mildenhall, Global Head, Technology Business Development, Bank of America
- Scott Moeller, Risk Committee Chair, JPMorgan Securities
- Elsa Palanza, Global Head of Sustainability and Citizenship, Barclays
- Mary Phibbs, Chair, Virgin Money Unit Trust Managers, Remuneration Committee Chair, Morgan Stanley International
- Martin Pfinsgraff, Risk Committee Chair, PNC Financial
- Sarah Russell, Audit Committee Chair, Nordea
- Sabahat Salahuddin, Director BlackRock Investment Stewardship, BlackRock
- Vandana Sharma, Senior Vice President, Federal Reserve Bank of New York
- Alan Smith, Global Head of Risk Strategy, HSBC
- Elisabeth Stheeman, Member, Financial Policy Committee, Bank of England
- Dr. Rhian-Mari Thomas, Chief Executive Officer, Green Finance Institute
- Tim Tookey, Risk Committee Chair, Nationwide Building Society
- Kevin Walsh, Deputy Comptroller for Market Risk, OCC
- Tom Woods, Non-Executive Director, Bank of America

EY

- Omar Ali, Managing Partner, UK Financial Services
- Jan Bellens, Global Banking & Capital Markets Sector Leader
- Peter Davis, Americas FSO Advisory Managing Partner
- Chris Hagler, Americas Climate Change and Sustainability Services Managing Director
- John Liver, Partner, EMEIA Financial Services
- Gillian Lofts, UK Wealth and Asset Management Leader, EMEIA Sustainable Finance Leader
- Brandon Sutcliffe, Principal, Sustainability, Climate Change, Risk Management
- Mark Watson, Managing Director and Americas FSO Board Matters Deputy Leader
- Marcel van Loo, EMEIA Financial Services, Regional Managing Partner

Tapestry Networks

- Dennis Andrade, Partner
- Brennan Kerrigan, Senior Associate
- Tucker Nielsen, Principal

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