Sustainability practices stocktake

How banks and insurers have progressed

mazars

Contents

4 Foreword
6 Key findings

Survey results
10 Governance
18 Strategy
27 Risk management
46 Disclosures

57 Conclusion
60 Methodology

Foreword

Financial institutions, as a core component of the economy, bear the responsibility to uphold rigour and resilience of their risk management. Equally significant is their social responsibility to offer vital financial support to sustain global economies. However, with the strong recognition that the financial industry needs to reboot and shift to a more responsible finance model, what sustainability progress have banks and insurers made?

While banks and insurers have indeed made progress since the publication of our Responsible banking practices: Benchmark study 2021, our latest 'Sustainability practices stocktake: how banks and insurers have progressed?' report reveals that substantial sustainability-related knowledge gaps still exist. Despite environmental and societal matters such as climate change, employee well-being, and human rights increasingly in the spotlight, banks and insurers still struggle to fully comprehend how these factors might affect them and establish reliable metrics to set targets and monitor progress.

Addressing environmental and societal questions should now be an integral part of the operational framework for banks and insurers. The main reason is that these factors translate into drivers impacting the conventional credit and underwriting risks banking and insurance activities are exposed to.

The need to manage multiple datasets to address sustainability issues

Banks and insurers continue to grapple with the significant challenge of integrating global data mainly related to climate change, and social data that requires a regional approach due to variations based on cultural and socio-economic factors. The extent of the challenge varies depending on whether an institution is an international bank or a specialised underwriter operating in a limited number of locations. However, building a comprehensive understanding of the data necessary for identifying, assessing, addressing and monitoring exposure to environmental, social and governance (ESG) issues is key to ensure effective management.

Boards and senior management must establish clarity and precision regarding the impacts to be measured. Only then it becomes possible to identify the relevant data needed and use it to define measurable targets. Increasingly, banks and insurers will need to adopt a best practice approach that supplements third-party data with the deep vaults of customised information they already collect. This approach enables them to construct a more comprehensive and accurate data ecosystem to underpin their shift towards a resilient and responsible business model.

A strategic focus on innovation and research

Banks and insurers have a strong history of adapting to a demanding and evolving regulatory landscape. Their experience in this regard has matured, allowing them to shift their attention toward developing new products and services. As market demand and stakeholders' interest in sustainable finance solutions continue to rise, banks and insurers find themselves in a prime position to facilitate their clients' sustainable objectives.

However, our report highlights an inequality in research and development efforts among institutions. The larger ones possess greater ease in mobilising capital and can invest more substantially, while smaller players encounter challenges in keeping pace with these developments. Nonetheless, smaller firms can leverage their agility and responsiveness to market trends, enabling them to identify niche sustainability opportunities that offer significant financial rewards.

Foreword

The importance of clear roles and responsibilities for sustainability disclosures

It is encouraging to observe that over half of institutions provide disclosures related to their sustainable and ESG-related financial products. When facing challenges in disclosure, these are primarily associated with insufficiently defined roles and responsibilities.

While nearly all banks and insurers have allocated responsibility for sustainability-related matters to senior management members, it is crucial to ensure that these roles are effectively integrated and communicated across all levels of the organisation. Additionally, it is important that responsibilities are thoroughly understood and supported at Board level.

The transformation challenge posed by the size of the institutions

For small and medium-sized players, transitioning to a more responsible business model presents the specific challenges of cost and access to solutions. To optimise their budgets, they need to place extra focus on identifying and addressing material sustainability-related matters. Seeking support from peers, engaging in dedicated forums and working groups, and seeking tailored solutions can help them make the most of their available time and resources.

This year's sustainability practices survey was the most comprehensive and information-rich report to date. We hope the results help inform the debate and provide an invaluable benchmark for banks and insurers looking to progress in their journey to a more sustainable business model.

Phuong Gomard
Sustainable Finance
Practice Leader, Mazars

Key findings

Responsibility for sustainability

Over the past two years, financial institutions have achieved notable progress in allocating individuals with specific responsibility for sustainability matters. Almost all banks and insurers (99%) reported they have allocated responsibility for sustainability-related matters to members of their senior management.

Nearly half of these institutions (48%) have designated one individual to hold ultimate responsibility for sustainability issues, while a small majority (51%) have apportioned responsibility amongst multiple executives. A very small number of respondents (1%) reported that the role of responsibility for sustainability had not been allocated.

Chief Financial Officers (CFOs) and Chief Executive Officers (CEOs) are most frequently identified by organisations as the bearers of accountability for sustainability issues (50% and 41% respectively).

More than a third (36%) now have a Chief Sustainability Officer (CSO) dedicated to this role – Asia Pacific is the most advanced region globally, with 57% allocating responsibility to a dedicated CSO.

The allocation and assignment of responsibility for sustainability matters is influenced by several factors, including jurisdiction and the size and type of the firm. Indeed, the geography of respondents greatly impacted who firms allocated responsibility for sustainability to. For example, 73% of African respondents allocated responsibility to their CFO, but only 40% of North American respondents followed suit. Similar differences can be seen across these metrics and are expanded upon within this report.

Key findings

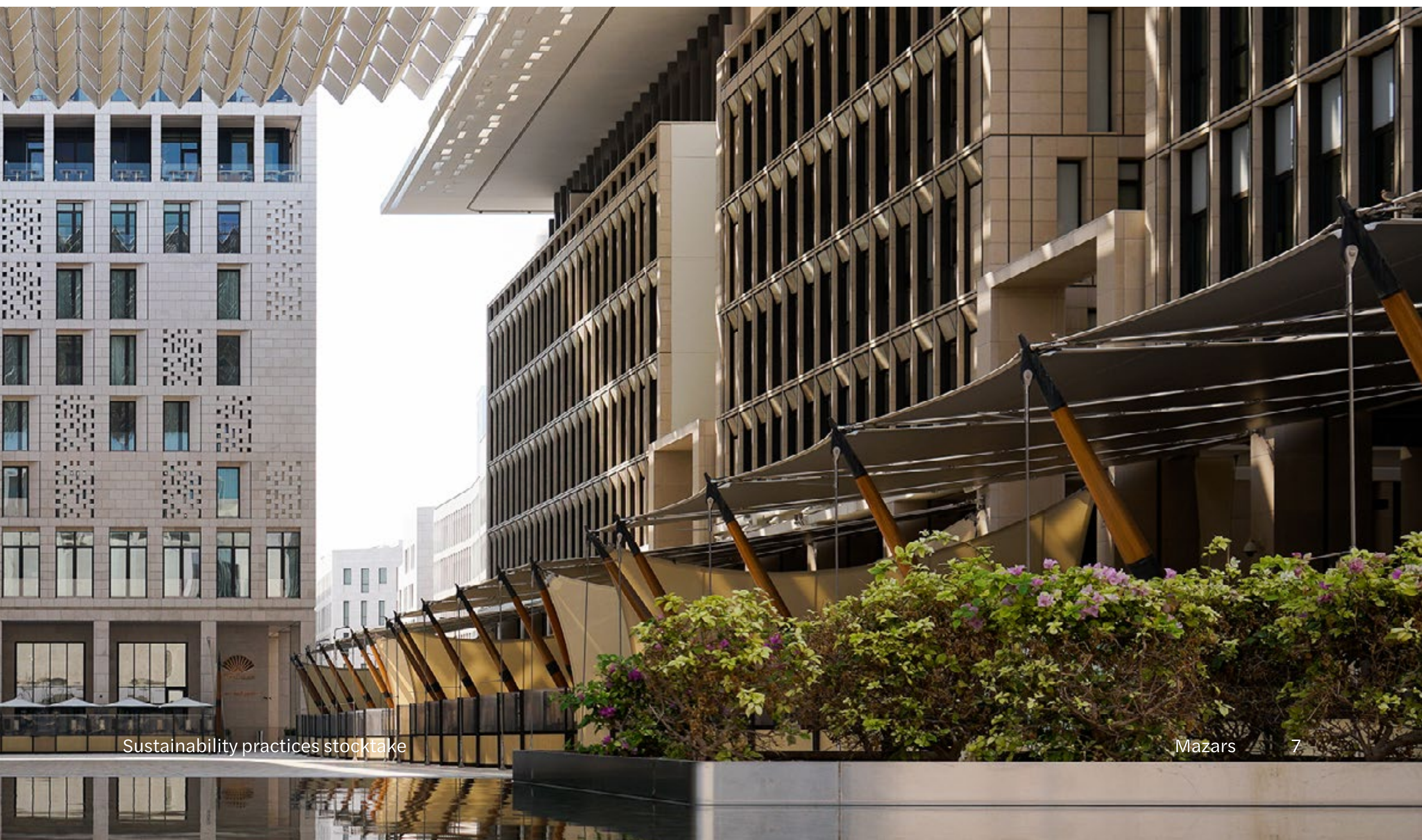
Knowledge gaps that persist

Financial institutions have acknowledged the existence of substantial knowledge gaps in various areas of sustainability. Firms identify their most significant gaps in knowledge are in socially-related sustainability issues such as employee and human rights matters (62%), and in assessing climate risk drivers (60%). Firms' confidence in their understanding of sustainability issues was generally found to be low, with more than half (55%) identifying significant knowledge gaps across all identified sustainability-related matters.

Knowledge gaps vary between different types of financial institution. A greater number of banks (64%) report a significant knowledge gap in identifying and assessing socially-related sustainability concerns compared to insurance companies (56%). On the other hand, insurers recognise a greater knowledge gap (64%) than banks (58%) in their ability to assess drivers of climate risk.

Notable differences are also apparent depending on the size of the institution. Large banks are more confident than medium-sized banks in their internal knowledge regarding disclosures, with 52% of large banks reporting knowledge gaps in this area, compared to 59% of medium-sized banks. Gaps in knowledge around socially-related sustainability issues are also greater in medium-sized banks, with 67% reporting significant gaps compared to 60% in large banks.

From a regional standpoint, Africa and the Middle East, Europe and Latin America all noted significant knowledge gaps in socially-related sustainability issues (76%, 55% and 67% respectively). Respondents in the Asia-Pacific region reported the highest knowledge gap globally in clients' credit quality (73%). North America stood out for its lack of ability to assess climate risk drivers (65%).



Key findings

Strategising sustainability

Many financial institutions incorporate sustainability-related matters in their strategic planning. For banks, this is most common when deciding on new activities, products and services (51%), and for insurers when investing in research and development (53%). The biggest disparities in approach were found to be in strategic planning regarding the supply and value chains, where 44% of banks would consider sustainability-related matters, compared to 31% of insurers. In potential acquisitions and divestitures, again, banks are more likely to consider sustainability (41%) compared to insurers (35%).

For both banks and insurers, the primary areas of strategic planning for considering sustainability-related matters are in developing new activities, products and services (51%), and when investing in research and development (50%). This aligns with the expectations established by regulators worldwide, with nearly half (46%) of respondents affirming that they incorporate sustainability considerations when reassessing their business models, and during the formulation of business plans and forecasts (47%).

The prevalence of sustainability considerations within strategic planning varies considerably across regions. A large majority (72%) in Africa and the Middle East consider sustainability in their investments in research and development. In Latin America, sustainability is considered when reviewing business plans and forecasts (53%). In the Asia-Pacific region and Europe, sustainability guides decisions on new activities, products and services (57% and 45% respectively). Whereas firms in North America are particularly mindful of sustainability when working on their people strategy and resource planning (58%).

Evaluating risk

External credit rating information on counterparties is evolving as an essential tool for evaluating climate-related and environmental (C&E) and energy-related risks, with 90% of respondents seeing this as an important data source. A large majority of financial institutions regard energy consumption (88%) and energy performance (also 88%) as other crucial data sources, along with greenhouse gas (GHG) emissions for financed assets (87%).

Our data indicates that half of respondents (50%) believe the establishment of governance frameworks and oversight committees, coupled with the implementation of data integrity measures and the introduction of internal quality control checks and frameworks, are optimal strategies for managing data related to C&E risks.

Climate Risk Scenario Analysis continues to be integral in evaluating the comprehensive risks financial institutions face due to climate change, with a large majority (88%) saying this is important for informing business planning and strategy. While this is a pivotal tool for risk assessment, the development and refinement of internal climate risk tools and methodologies are imperative for evaluating green investments, lending and assets within an institution's investment portfolio – nearly two thirds of financial institutions (65%) have used Climate Risk Mapping financial metrics.

Key findings

Disclosure trends and challenges

Over half of institutions (53%) reveal sustainability-related information through disclosures that accompany sustainable and environmental, social and governance (ESG) financial products. It is noteworthy that insurers are less inclined than banks to disclose sustainability-related information, whether within Pillar 3 disclosures (19% compared to 24%) or in conjunction with sustainability-related financial products (48% compared to 54%).

Consistent with expectations, financial institutions generally allocate ownership of these sustainability disclosures to their finance business area (45%), particularly in North America (58%). Large banks are considerably more inclined to consider double materiality during the declaration of climate-related disclosures (72%) compared to their medium-sized counterparts (64%).

Over half of banks (59%) and insurers (50%) currently secure verification or assurance from external parties for their sustainability-related disclosures. Notably, financial institutions in the Asia-Pacific region are nearly twice as likely to seek such verification (71%) compared to their counterparts in Europe (49%) and North America (49%).

Across different types of financial institution, the main challenges identified in producing sustainability-related disclosures are primarily associated with the inadequate definition and delineation of roles and responsibilities (77%), and the alignment of financial statements with climate-related disclosures (75%). Additionally, four out of five insurers (81%) encounter challenges in integrating ESG data into their firm's systems, compared to just under three quarters (74%) of banks.

Governance

Governance

Who has responsibility for sustainability matters?

In order to guarantee the successful incorporation and proficient management of sustainability throughout a financial institution, it is imperative to establish well-defined, allocated, and formal roles and responsibilities. Financial institutions should identify the most suitable senior-level executive(s) who will bear responsibility for spearheading and advocating for sustainability initiatives within the company.

Key findings

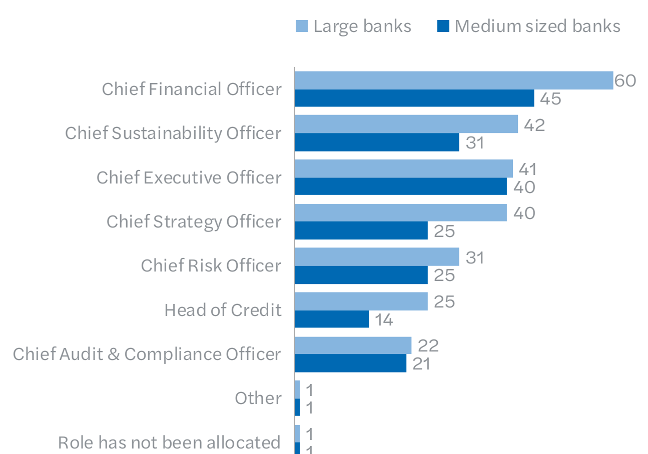
- **Sustainability responsibility assignment** | Just under half of respondents (48%) had assigned responsibility for sustainability matters to a single position.
- **Primary responsibility in senior management** | The primary responsibilities pertaining to sustainability-related matters within senior management are apportioned to CFOs (50%) and CEOs (41%).
- **Variations in responsibility allocation by institution size** | A significant proportion of large banking institutions (42%) have entrusted the responsibility to a CSO, whereas a majority of smaller to medium-sized counterparts (60%) have assigned this responsibility to their CFOs.
- **Regional variation in responsibility assignment** |
  - The regional distribution of responsibilities indicates that a majority of respondents from the African region (73%) have delegated sustainability responsibilities to CFOs.
  - In contrast, a majority of respondents in North America (55%) and the Asia-Pacific (67%) regions have identified the CEO as the designated individual responsible for sustainability matters.

Allocation of responsibility for sustainability matters within senior management

Percent of respondents, by institution type

Allocation of responsibility for sustainability matters within senior management

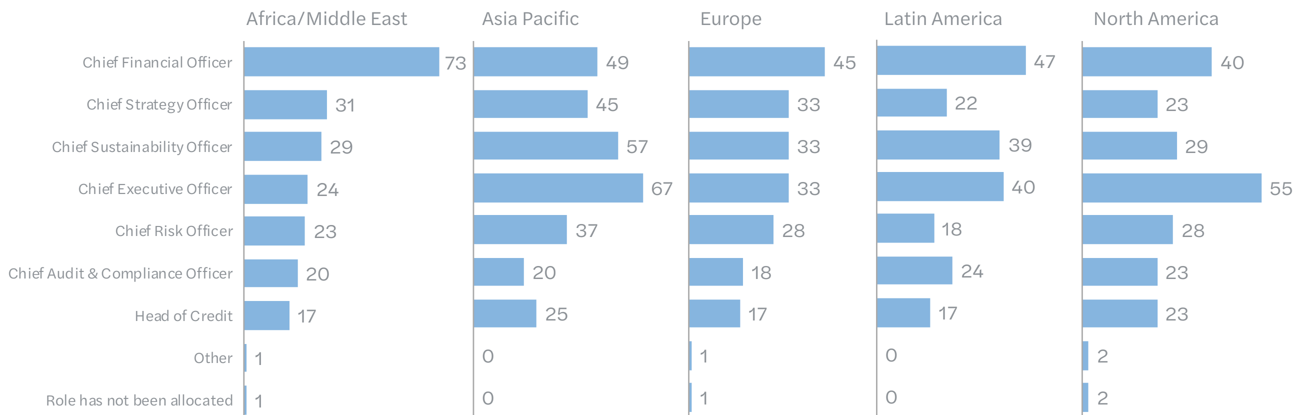
Percent of respondents, by bank size



Governance

Allocation of responsibility by region

Percent of respondents, by region



Further insights

The majority of respondents identified CFOs as the individuals responsible for sustainability-related matters. This underscores the significant role that the finance function is anticipated to assume in the context of sustainability, particularly considering the increasing global trend towards mandatory sustainability disclosure frameworks.

The finance function will be expected to fulfil several key responsibilities:

- Ensure the integration of sustainability initiatives into broader financial planning and the optimal allocation of resources toward these initiatives.
- Expand their role as "storytellers" of business performance reported in financial statements to encompass sustainability practices, progress and outcomes.
- Oversee the integration of the financial impact that sustainability has on business performance into the financial reporting process.
- Leverage the rigour and internal controls governing financial information to compute and report on sustainability-related performance metrics.
- Collaborate closely with other functions, such as risk and sustainability, to highlight the influence of sustainability-related risks and opportunities on business strategy.

CFOs should therefore prioritise upskilling staff, updating existing processes and deploying appropriate technologies to effectively address the growing demands and expectations associated with sustainability matters.

Which governance structure and management information are institutions adopting?

There are increasing regulatory expectations globally for financial institutions to disclose and demonstrate how sustainability-related responsibilities are allocated to Board members, across organisational structures and to relevant internal functions. Accountability procedures should be in place to monitor that these responsibilities are being effectively carried out. To this effect, management information (MI) received and reviewed across governance structures are being updated to ensure effective oversight over sustainability matters.

Key findings

Updated Board committee responsibilities | 69% of respondents reported that responsibilities of all Board committees have been revised within the last two years to include sustainability-related matters, while 53% of respondents indicated that only some Board committees have undergone such updates.

Governance

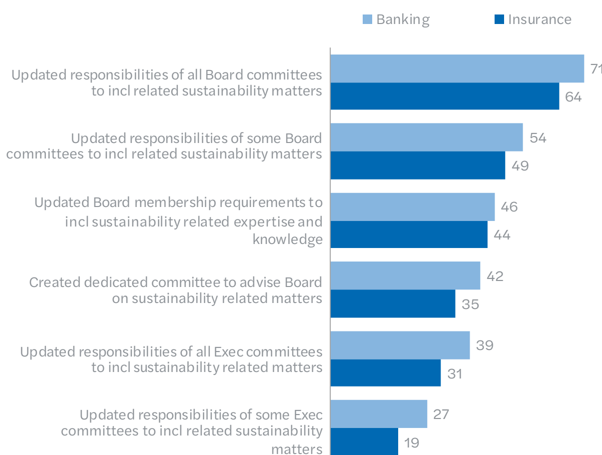
Quarterly Board engagement on sustainability matters | A significant proportion of respondents (39%) indicated that the Board reviews and deliberates sustainability-related management information on a quarterly basis. Specifically, 38% of respondents in the banking sector and 44% in the insurance sector follow this practice.

Metrics focus in Board reviews | In the banking sector, 51% of respondents noted that the Board reviews metrics pertaining to green finance and climate-related risks and opportunities impact underwriting. Conversely, within the insurance sector, a majority (51%) of respondents indicated that the Board reviews metrics related to the impact of ESG-related risks on investing activities.

Regional variations | In all regions, with the exception of Africa/Middle East where Board discussion of MI most commonly occurs on an annual basis, Boards are most likely to discuss MI on a quarterly basis.

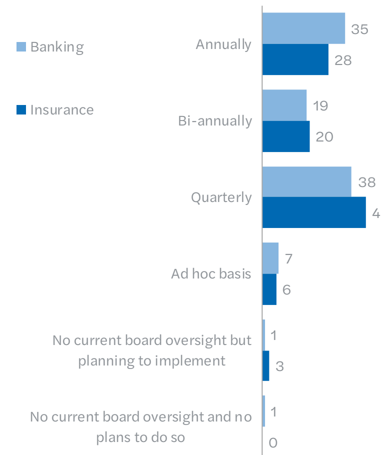
Has governance structure been updated within last two years to include sustainability?

Percent of respondents



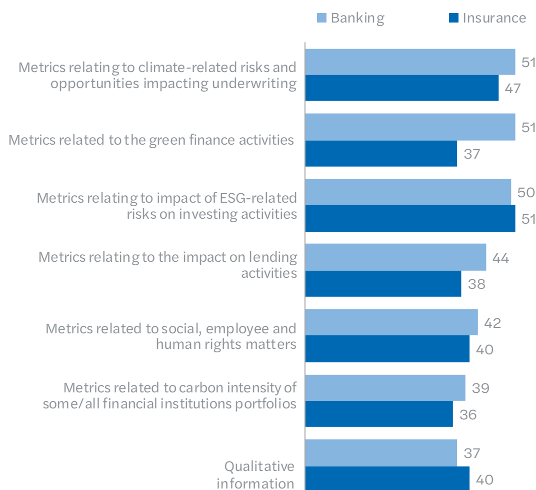
How often boards discuss sustainability matters

Percent of respondents, by institution type



Type of management information reviewed by board: Banks vs Insurance

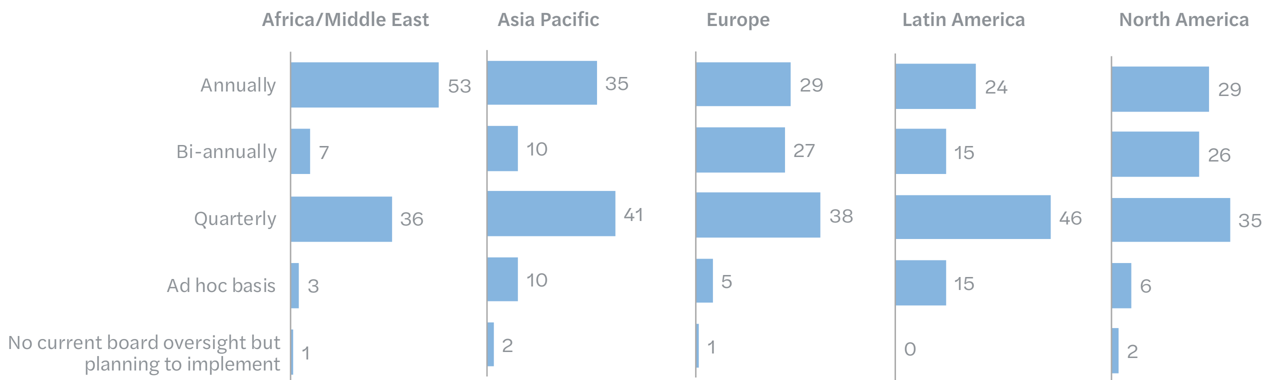
Percent of respondents



Governance

How often boards discuss sustainability matters

Percent of respondents, by region



Further insights

Board committee integration | Over the past two years, 69% of financial institutions have expanded the role of sustainability across all their Board committees. This aligns with increasing expectations for financial institutions to incorporate sustainability in areas like responsibilities, terms of reference, meeting agendas and MI reporting.

Board competency and oversight | It's crucial for financial institutions to ensure that Board members have the necessary understanding and skills to fulfil their sustainability-related responsibilities effectively.

Executive committee alignment | Only 35% of respondents have updated responsibilities for all Executive committees, revealing a potential misalignment between Board and Executive-level oversight. This underscores the need for a more holistic approach to sustainability initiatives involving different departments within organisations.

Quarterly Board focus | A majority of respondents indicated that their Boards discuss sustainability and MI quarterly. Discussions centre on climate-related risk metrics and their impact on investment and financing activities.

Challenges in carbon intensity metrics | Metrics related to the carbon intensity of portfolios received a low response rate (38%). This may be attributed to challenges related to data completeness and reliability for computing Scope 3-financed emissions. Financial institutions should exercise vigilant oversight over data assumptions and proxies, and have a clear strategy to address data gaps with regular progress reporting to the Board.

Gaps in knowledge remain. Which specific areas are significantly impacted?

As financial institutions work on integrating sustainability considerations into decision making and strategic planning, they need to ensure staff across all levels have sufficient skills and expertise. Internal knowledge gaps should be uncovered and clear plans put in place to support upskilling and increase awareness around sustainability across the organisation.

Key findings

Respondents have highlighted specific areas where significant knowledge gaps exist:

Major knowledge gap: social factors | Identification and assessment of social-related factors (36%) - representing the "S" in ESG - were identified as a major knowledge gap.

Gap in technical knowledge for C&E factors | Technical knowledge and internal capabilities for effectively integrating C&E factors into portfolio concentration analysis and assessing their impact on credit quality were cited as lacking by 32% of respondents.

Insurers' primary knowledge gap: climate risk drivers | Among insurers, the primary knowledge gap identified was related to the assessment of climate risk drivers, as reported by 64% of respondents.

Regional variations |

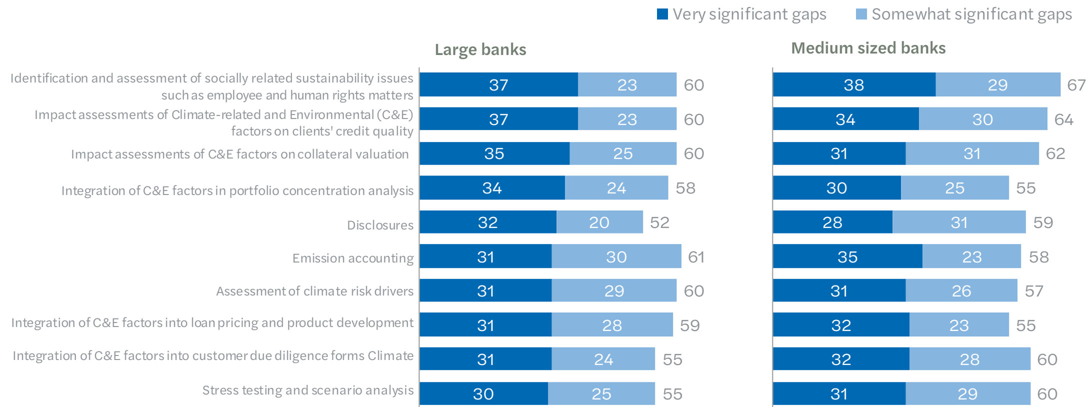
- In Europe, Latin America, and Africa/Middle East, social-related sustainability was deemed the most significant knowledge gap (67%, 67% and 76% respectively).
- In Asia Pacific, the assessment of impacts on clients' credit quality emerged as the top knowledge gap, with 73% of respondents indicating this.
- In North America, the primary knowledge gap was related to the assessment of climate risk drivers, with 65% of respondents expressing this concern.

These findings underscore the need for enhanced knowledge and expertise in various aspects of ESG and sustainability, depending on the specific focus areas and regions within the financial sector.

Governance

Gaps in knowledge

Percent of respondents, by bank size

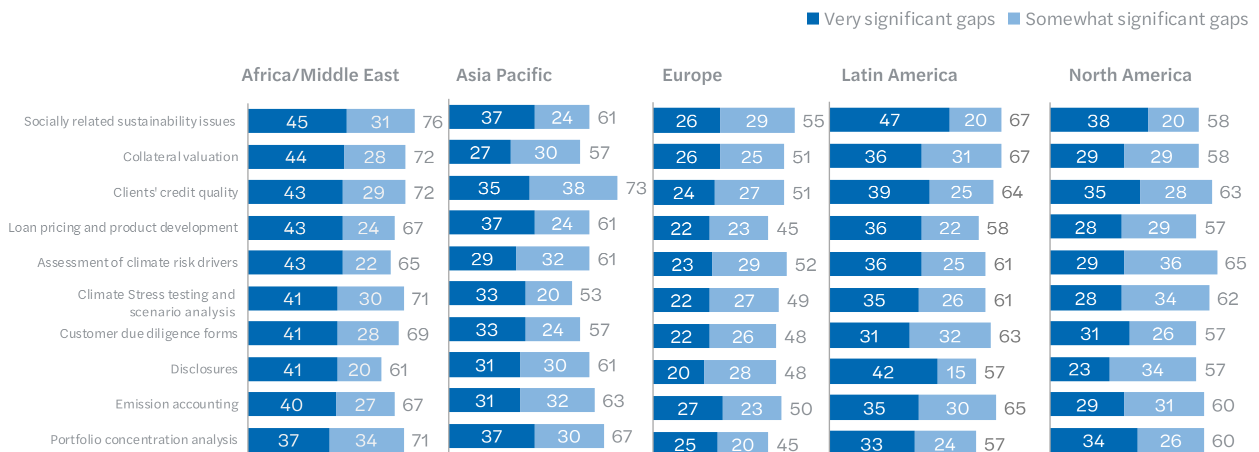


Gaps in knowledge

Percent of respondents, by institution type

Gaps in knowledge

Percent of respondents, by region



Governance

Further insights

Emerging focus on social sustainability | As a relatively new focus compared to environmental or governance aspects, social sustainability lacks globally recognised measurement methodologies and consistent data collection. Ongoing initiatives aim to address these challenges, such as the EU's proposal for a Social Taxonomy and the ISSB's consultations on human capital and human rights standards.

Social sustainability knowledge gap | Respondents identified a significant knowledge gap in understanding and assessing social-related risks, including human rights, labour rights and employee well-being. Social sustainability can profoundly impact a financial institution's stakeholder interactions.

Localised understanding of social sustainability | Social sustainability encompasses diverse context-specific issues varying across cultures, regions and socio-economic conditions. Financial institutions should prioritise adopting a localised understanding of stakeholder needs in each jurisdiction they operate to effectively address evolving social considerations.

Climate risk knowledge gap | Assessing climate risks, including understanding transmission channels, materiality and impact on business strategies presents significant challenges.

Coordinated approach for climate risk up-skilling | To address these knowledge gaps and enhance climate risk integration, financial institutions should promote internal collaboration and knowledge sharing across different teams, fostering a holistic understanding of climate risks and their implications for effective navigation and adaptation.

Strategy

To what extent is ESG and sustainability integrated into the strategic planning process?

The integration of ESG considerations into strategic planning is increasingly becoming a common practice among financial services firms. However, there is a notable variation in how organisations from different geographic regions choose to implement these considerations.

Key findings

Differences between banks and insurers | Significant disparities were observed between banks and insurers in terms of the areas within strategic planning where sustainability matters are considered. In comparison to their insurance counterparts, banks tend to give more attention to aspects related to supply and value chains (44% compared to 31%), as well as potential acquisitions and divestitures (41% vs 35%).

Common ESG focus areas | Among both banks and insurers, ESG considerations are most prominently incorporated into new activities, products and services (51% and 50%), as well as research and development (49% and 53%).

Regulatory alignment | Most financial institutions align with regulatory expectations globally by considering ESG factors when reviewing their business models and developing business plans and forecasts.

Medium-sized banks | Medium-sized banks appear to be less inclined to consider sustainability-related matters across various business activities compared to other sectors within the financial services industry. Across all but two survey options, medium-sized firms were less likely to consider sustainability metrics within areas of strategic planning. For example, they are 25% less likely to consider sustainability factors when deciding on new activities, products and services.

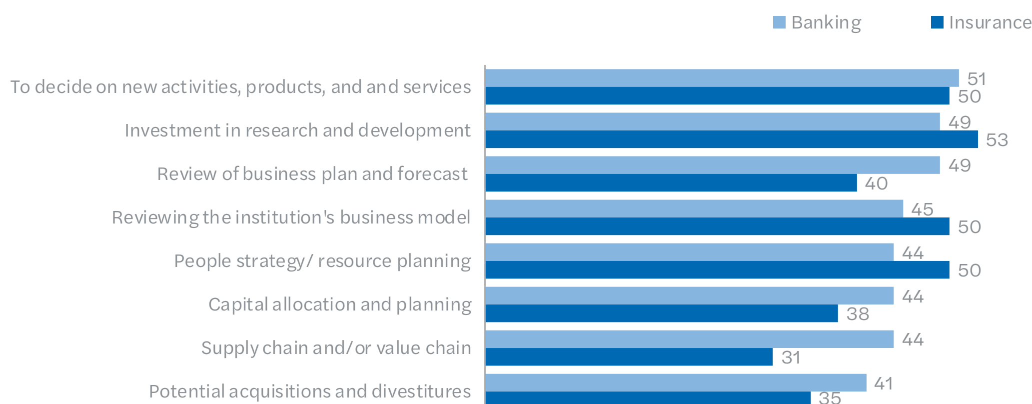
Regional variations | There are distinct regional variations in how ESG considerations are integrated into strategic planning:

- In Asia Pacific and Europe, sustainability-related matters play a significant role in designing and deciding new services and products (57% and 45% respectively).
- In Latin America, ESG factors are particularly influential when reviewing business plans (53%).
- In Africa/Middle East, emphasis is placed on ESG considerations for investment in research and development (72%).
- In North America, ESG factors are notably incorporated into people strategy decisions (58%).

These findings underscore the evolving landscape of ESG integration within the financial services sector, highlighting both commonalities and regional distinctions in how organisations approach sustainability matters in their strategic planning processes.

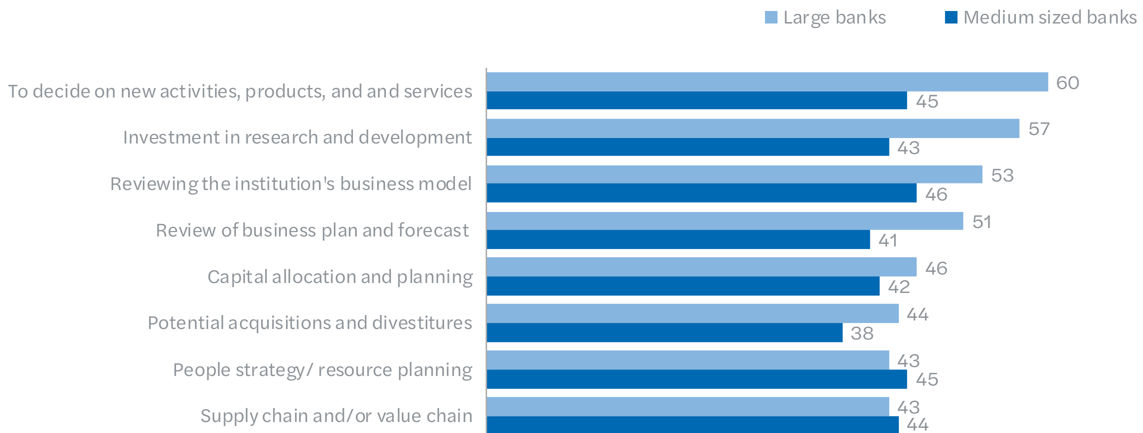
Areas sustainability is considered within strategic planning

Percent of respondents, by institution type

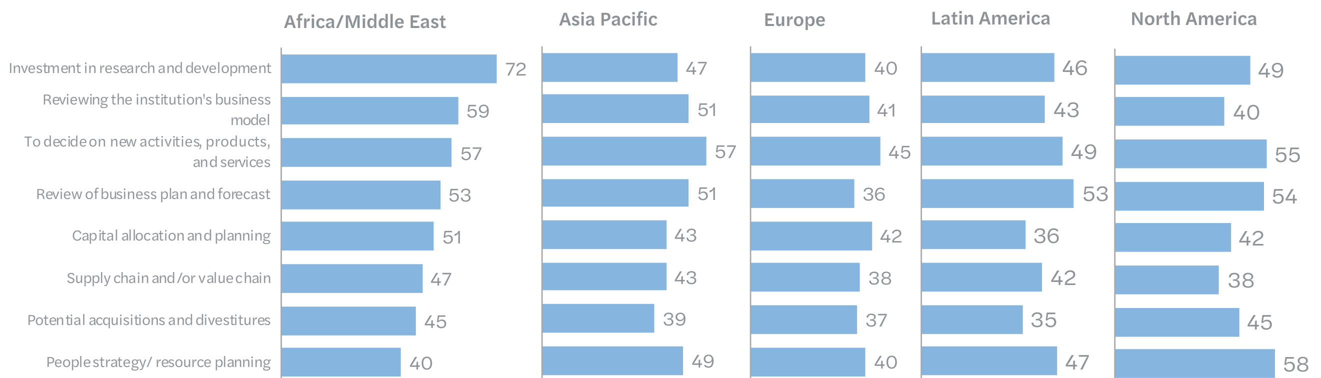


Strategy

Areas sustainability is considered within strategic planning
Percent of respondents, by bank size



Areas sustainability is considered within strategic planning
Percent of respondents, by region



Further insights

The analysis of this data subset has revealed a substantial area of discrepancy between respondents, particularly when comparing large and medium-sized organisations. This discrepancy is most pronounced in two key areas.

- **Development of new products and services |** Large organisations place a significantly greater emphasis on, and allocate more resources to, the development of new products and services with ESG considerations compared to medium-sized organisations. This suggests that larger institutions are more proactive in leveraging sustainability factors to drive innovation in their offerings.
- **Investment in Research and Development (R&D) |** Similarly, large organisations show a notable commitment to investment in R&D with a focus on ESG factors. They tend to mobilise more resources in this regard compared to their medium-sized counterparts. This underscores the dedication of larger institutions to advancing sustainability through R&D initiatives.

These findings highlight the disparity in the level of ESG integration and resource allocation between large and medium-sized financial organisations, particularly in areas that involve innovation and research.

Why such a difference?

- **Mobilisation of capital |** The observed difference in ESG integration between large and medium-sized financial services firms can be attributed, in part, to the availability and mobilisation of capital. While there are numerous opportunities for green investments and sustainable offerings in the financial sector, many of these require substantial capital investments. For instance, green or sustainable bonds, renewable energy investments and carbon market-related products often demand a significant financial commitment to initiate.
- **Access to capital |** Larger banks, given their greater access to capital, find it more feasible to explore and expand their ESG and sustainable offerings by pursuing opportunities that necessitate substantial investments. On the other hand, smaller banks and insurers may have limited access to such capital, making it challenging to engage in these types of initiatives to the same extent.
- **Opportunities for smaller firms |** However, it is essential to note that there are still sustainable opportunities available for smaller financial firms. These organisations can focus on targeted sustainability R&D and tailor service offerings to align with their capabilities and relevant market segments. Smaller firms have the advantage of being more agile and responsive to market trends, which can be leveraged to identify niche sustainability opportunities that are financially rewarding.

Looking ahead | It is expected that the gap between large and medium-sized financial services firms in the context of ESG integration will narrow. Smaller firms, recognising their agility, will likely become more adept at adopting emerging sustainability trends and, in the process, make them more competitive with their larger counterparts.

What are the primary priorities concerning sustainability strategies, and what methods do firms employ to track and assess their progress toward sustainability goals and targets?

To adapt to the swiftly evolving regulatory landscape and meet the expectations of stakeholders, financial firms are increasingly formulating sustainable goals and strategies to address a diverse range of targets. These endeavours are aimed at meeting national and international disclosure requirements, as well as meeting stakeholder expectations.

Key findings

Priority areas in sustainability strategies | Banking respondents most commonly emphasised the importance of sustainability strategies in promoting biodiversity and the natural environment (57% very important, 34% somewhat important). In contrast, insurance respondents often highlighted the significance of promoting diversity and inclusion within their sustainability strategies (54% very important, 37% somewhat important).

Time horizons for monitoring metrics | A significant proportion of both banks (60%) and insurance respondents (50%) indicated that they monitor metrics across short, medium, and long-term time horizons. This suggests a comprehensive approach to sustainability performance measurement.

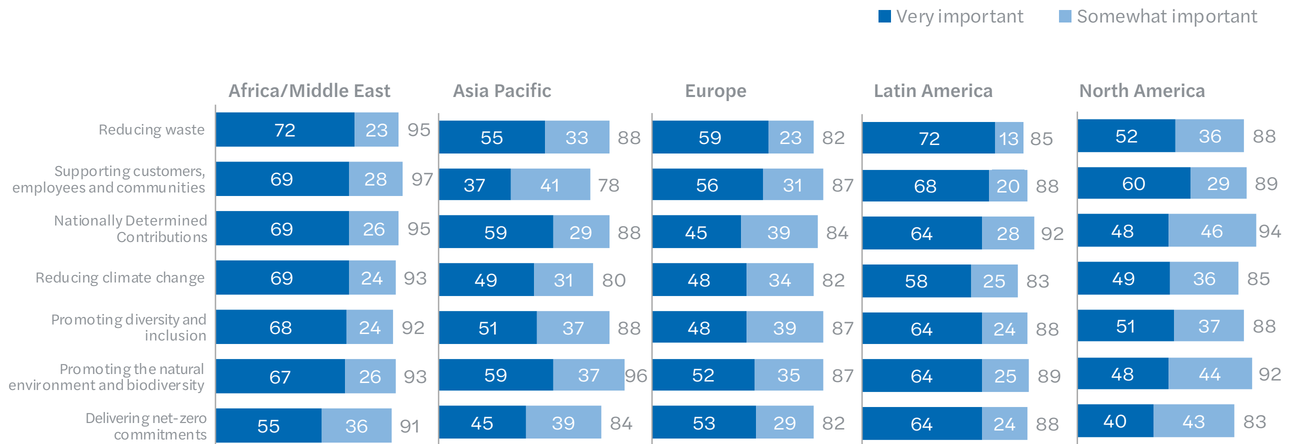
Scope of metric monitoring | Only 51% of banks and 45% of insurers reported monitoring metrics and targets across different business lines and geographic regions. This indicates that there may be room for expanding the scope of sustainability metric monitoring in these organisations.

Regional focus on reducing waste | Institutions in Africa/Middle East and Latin America exhibited a stronger focus on reducing waste compared to other regions (72% considered very important for both regions). Conversely, Asia Pacific-based respondents were notably less likely to identify supporting customers, employees and communities as key elements of their sustainability strategies (37% considered very important).

Strategy

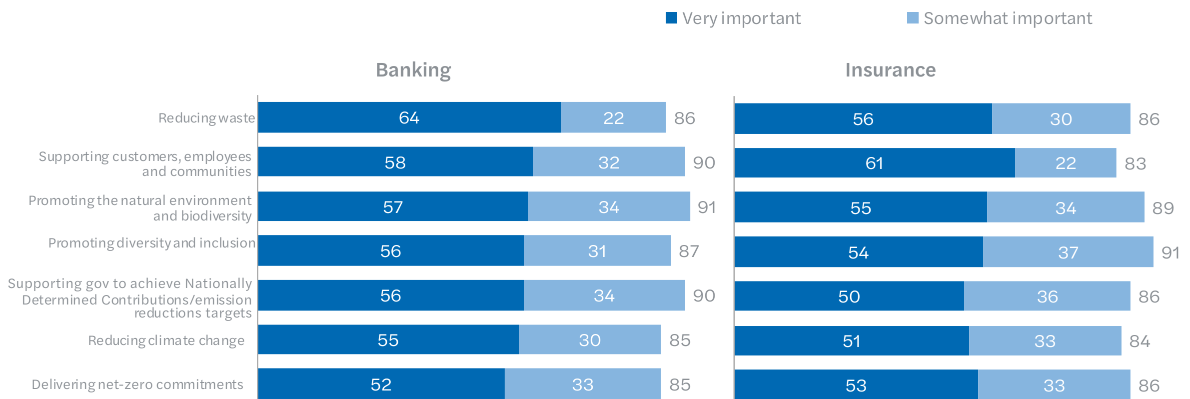
Importance of sustainability strategies

Percent of respondents, by region



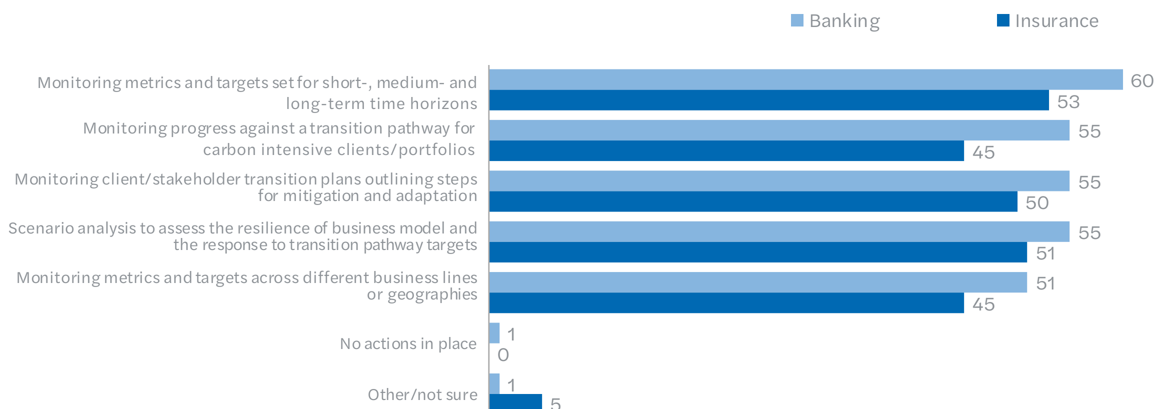
Importance of sustainability strategies

Percent of respondents, by institution type



Monitoring of target emissions

Percent of respondents, by institution type



Further insights

The process of target setting and formulating sustainability strategies presents a significant challenge for many financial services firms. Emissions reduction targets and the pursuit of net-zero strategies have become central elements of ESG strategies for a substantial portion of these firms. This trend is driven by several factors, including:

- **Consumer demand for carbon neutrality |** There is a growing consumer demand for products and services that are carbon neutral, reflecting a heightened awareness and concern about climate change among the public.
- **International and regulatory initiatives |** International bodies and domestic regulators have introduced net-zero goals and emissions reduction targets, compelling financial institutions to align with these objectives as part of their regulatory compliance.
- **Globally recognised greenhouse gas (GHG) reduction methodologies |** The presence of established and globally recognised methodologies for GHG reductions provides a framework for financial firms to structure their sustainability initiatives and reporting.

Prominent methodologies maturing | The rapid adoption and growth of net-zero target setting methodologies such as the Science Based Targets initiative (SBTi) have significantly streamlined and made achievable the process of setting emissions reduction targets for financial services firms. With over 1,045 companies representing over $23tr in market capitalisation - larger than the US gross domestic product (GDP) - adhering to these methodologies, the promotion of emissions reduction targets has gained substantial traction. This development has made it easier for financial institutions to align with sustainability goals.

However, calculating and reporting financed emissions, as opposed to direct emissions, presents a more complex challenge. Over the past two years, significant process has been made in addressing this barrier to effective sustainable target setting. The Glasgow Financial Alliance for Net Zero (GFANZ), the world's largest coalition of financial institutions committed to achieving net-zero emissions by 2050, has played a pivotal role in this transition.

One surprising insight from the data is that reducing climate change was not viewed as the most common consideration of importance within respondents' sustainability strategies. Several potential reasons for this observation exist.

- **Complexity of climate strategy |** Developing a climate strategy can be more challenging for financial services firms compared to other industries due to the lack of direct emissions in their operations.
- **Evolving sustainability focus |** The topic of sustainability is evolving among financial services firms. As the ESG landscape continues to evolve, firms are expanding the scope of their sustainability strategies to encompass areas like biodiversity and social causes.
- **Regulatory and stakeholder pressure |** The threat of future regulatory developments, growing stakeholder interest and increasing consumer demand for ethical and sustainable practices are pushing financial institutions to their strategic activities to include sustainability considerations to a greater degree.

For instance, the formation of the United Nations (UN) Conference on Biodiversity has elevated the importance of biodiversity in future regulatory developments, guiding financial services firms to incorporate biodiversity considerations into their strategic planning.

Overall, the data suggests that financial services firms are expanding the ethical scope of their sustainability practices. In the future, we may see sustainability reporting from these firms becoming more holistic and encompassing a wider range of ESG factors. This reflects the evolving landscape of sustainability in the financial industry and the growing recognition of the interconnectedness of various sustainability issues.

What recent developments are taking place in the field of sustainable finance products and services?

As financial services firms aim to harness the opportunities arising from climate change and other sustainability issues, the field of sustainable finance products and services has expanded significantly in terms of both size and scope. However, the constantly evolving and relatively immature nature of the sustainable finance market can pose challenges for these firms as they seek to navigate the complex landscape.

Strategy

Key findings

Key findings regarding the adoption of sustainable finance products and services among financial services firms include:

Size matters | Large banks are notably more inclined to engage in sustainable finance activities such as issuing green loans (48% of large banks vs 37% of smaller banks), sustainability bonds (46% vs 38%)and providing advice on sustainable investments (46% vs 39%) compared to their medium-sized counterparts. This suggests that larger institutions have greater capacity and resources to participate in a broader range of sustainable finance offerings.

Consistency between banking and insurance | The adoption rates of various sustainable finance offerings are relatively consistent between banking and insurance respondents, with similar response rates. However, notable gaps exist in areas like social bonds (39% adoption rate for banks vs 31% for insurers) and transition planning advisory services (34% banks vs 26% insurers).

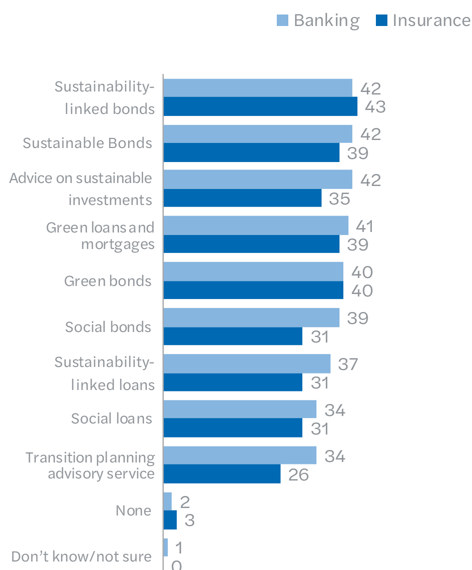
Portfolio sensitivity | Large banks, in particular, place significant emphasis on portfolio sensitivity when developing sustainable products and services (65% of large banks vs 52% of medium banks). This suggests a keen focus on aligning these offerings with their overall investment portfolios to ensure sustainability goals are integrated holistically.

Regional variations | The popularity of different types of sustainable finance products and services varies significantly by region. For instance, firms in Asia/ Pacific demonstrate a strong preference for offering sustainable bonds (57%), while European firms are generally less likely to provide a variety of sustainable finance products, with the exception of green loans and mortgages (43%).

These findings underscore the influence of factors such as institution size, regional context, and portfolio alignment on the adoption and popularity of sustainable finance products and services within the financial services industry. It also highlights the diverse strategies employed by financial institutions to engage with sustainability in various regions and sectors.

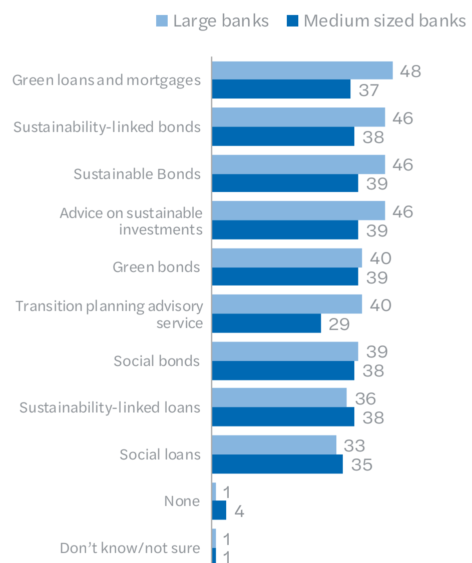
Issued sustainable finance products and services

Percent of respondents, by institution type



Issued sustainable finance products and services

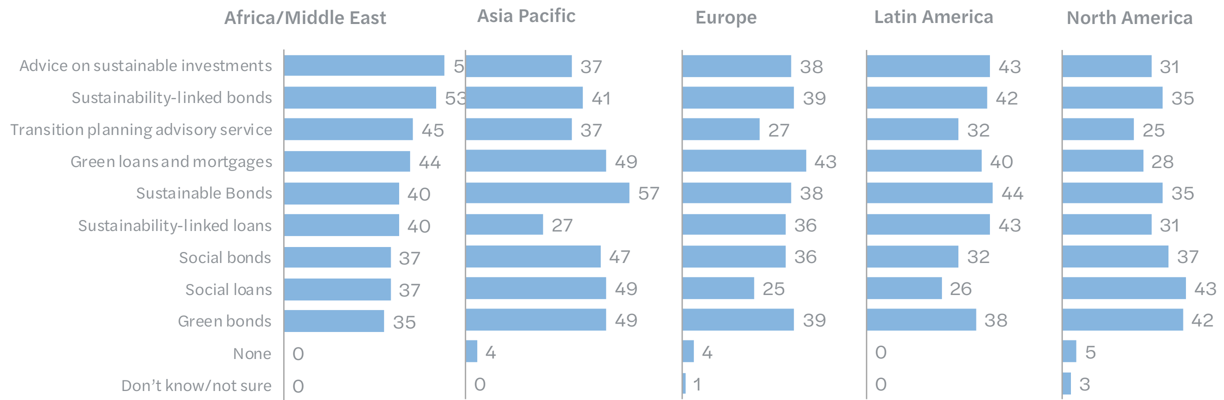
Percent of respondents, by bank size



Strategy

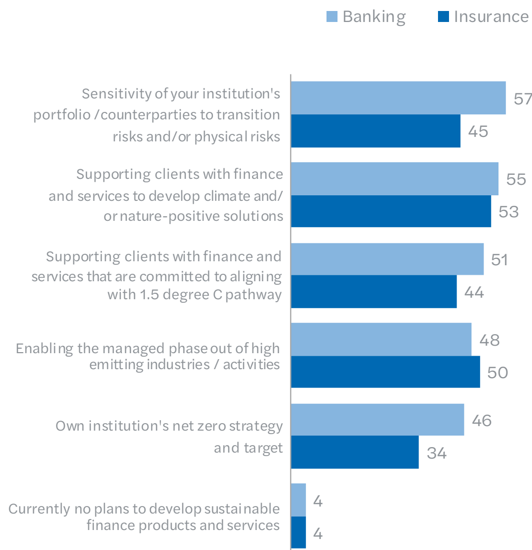
Issued sustainable finance products and services

Percent of respondents, by region



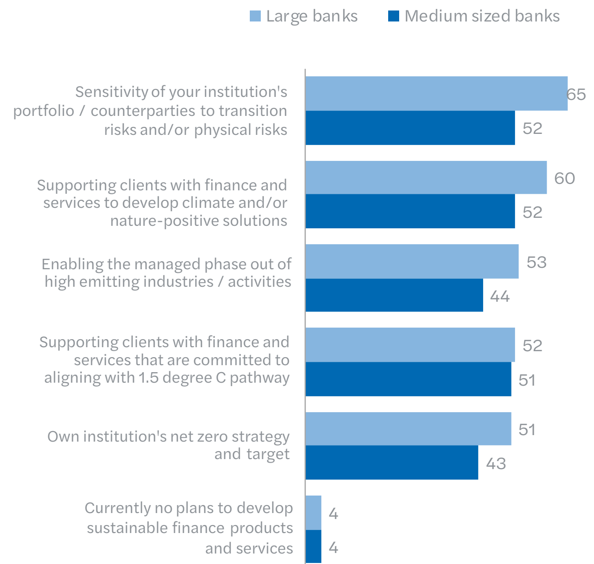
Considerations when developing sustainable finance products/services

Percent of respondents, by institution type



Considerations when developing sustainable finance products/services

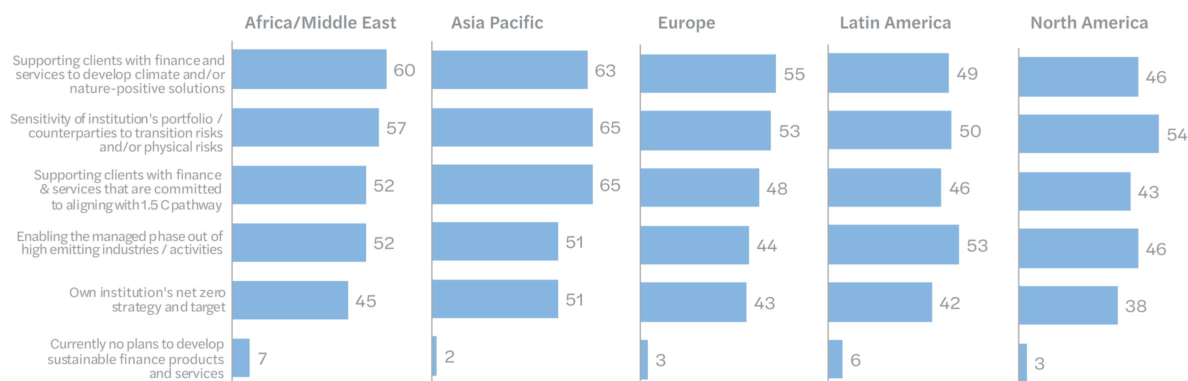
Percent of respondents, by bank size



Strategy

Considerations when developing sustainable finance products/services

Percent of respondents, by region



Further insights

In recent years, there has been a remarkable expansion in the variety of sustainable finance products available, accompanied by a substantial increase in their issuance and global trading volumes. This trend underscores two critical aspects:

- **Market relevance |** The growing diversity of sustainable finance products reflects the increasing relevance of sustainability in the financial sector. This expansion signifies the market's response to the pressing need to address ESG concerns and align financial activities with sustainability goals.
- **Increased demand |** The surge in sustainable finance products is a direct response to heightened demand from customers, investors and businesses. More stakeholders are seeking opportunities to invest in projects and initiatives that promote sustainability, align with ESG principles and address global challenges such as climate change and social inequality.

Regional disparities in sustainable finance products | An intriguing insight from this research is the significant variation in the popularity of sustainable finance products across different regions. Several factors contribute to this variation, including disparities in the development of regional frameworks on a global scale.

Evolution of sustainable bond types | While green bonds remain the most prevalent type of sustainable bond, other forms of sustainable products are gaining prominence. For example, social bonds have emerged as a means to fund social goals rather than focusing exclusively environmental objectives. Additionally, there is a broader category of sustainable bonds that support both environmental and social issues.

Challenges in sustainable bond classification | The challenge arises in the classification of what qualifies as a sustainable bond, which can vary regionally. The absence of a global standard and the complexity of bond classifications across different jurisdictions have contributed to hesitancy in the adoption of sustainable, green and social bonds in various regions.

Role of regulators and national bodies | To address this hesitancy and promote clarity and consistency in sustainable finance, regulators and national bodies can play a crucial role by endorsing and promoting guidance frameworks. Frameworks such as the Green Bond Principles (GBP) can provide clear definitions, criteria and standards for different types of sustainable bonds, helping to create a common understanding and facilitate greater adoption of these instruments across regions. This harmonisation can enhance transparency, build investor confidence and encourage the broader integration of sustainability principles in financial markets worldwide.

Challenges in achieving a global approach | The introduction of the GBP in 2021 aimed to provide guidance for green bond issuers and enhance transparency. Despite these guidelines, variation in responses across jurisdictions persists, highlighting the challenges in achieving a consistent global approach to sustainable finance.

Risk management

Risk management

How do institutions treat and analyse climate-related and environmental risks in their risk management framework?

There is growing pressure for banks and insurers to incorporate C&E factors in their risk management frameworks (RMF). These pressures are driven by changing regulatory expectations with regard to C&E risk management, industry standards, practices and initiatives, investor expectations and demands, and from national and regional policies and transition strategies. The way C&E risks are incorporated vary depending on an institutions' size, business model, strategy and whether certain regulatory expectations apply.

Key findings

Incorporation of C&E drivers in traditional risks | The study shows that most institutions now incorporate C&E risks within their risk framework, and four in five institutions say C&E risks are fully incorporated as a driver of all or certain existing risk types.

Difference of maturity between banks and insurers | Banks exhibit a higher degree of focus on the integration of C&E risks within all or part of their existing risk types compared to insurers. Indeed, 20% of insurers still consider C&E risks as a stand-alone risk.

Variations in responsibility allocation by institution size | Larger banks predominantly opt for full integration of C&E risks across all existing risk categories. In contrast, two in every five medium-sized banks incorporate C&E risks as drivers for certain existing risk types.

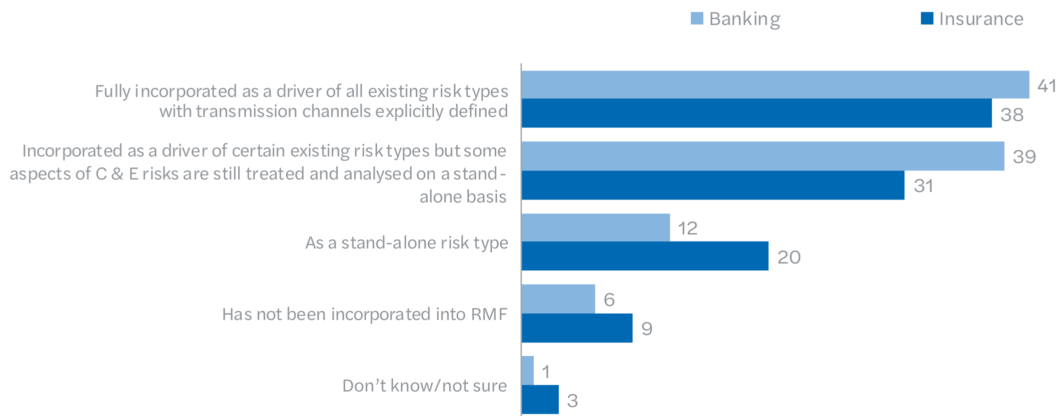
Across geographic regions

- Overall, there is a prevailing inclination to fully incorporate C&E risks across all existing risk categories. Nonetheless, in Latin America, 58% of institutions are still incorporating C&E considerations for specific, rather than all, existing risk types.
- With the exception of Latin America, approximately 15 to 18% of respondents in most regions are still treating C&E risks as a stand-alone risk, rather than a risk driver across existing risks.

Risk management

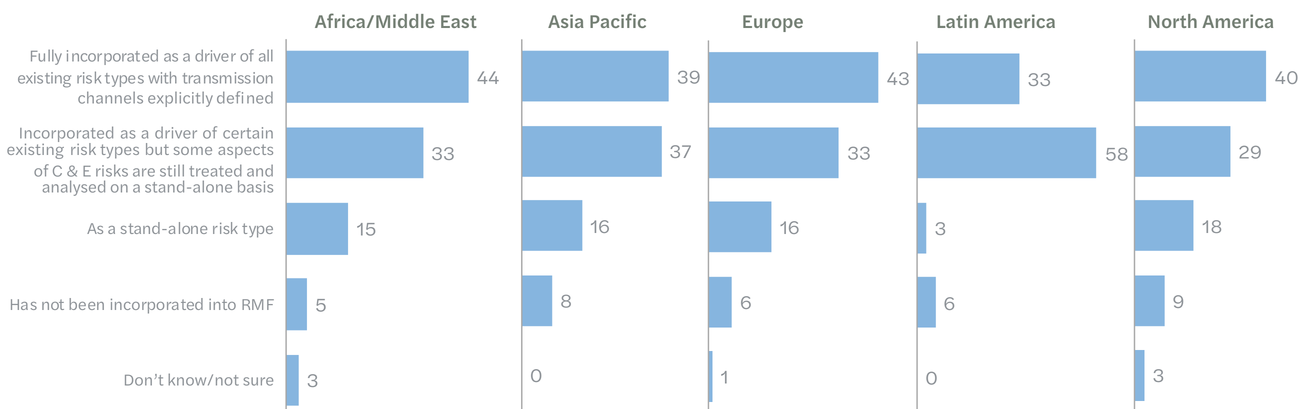
C & R risks treatment within institutions' RMF: Insurance vs Banks

Percent of respondents, by institution type



How C & R risks are incorporated within RMFs

Percent of respondents, by region



Risk management

Further insights

Financial institutions have the flexibility to address C&E risks in one of two ways: either by integrating them within existing risk categories or by treating them as separate, stand-alone risks. Each approach carries its own set of advantages and disadvantages.

Cross-geographic framework for climate risk management | Regulators are increasingly pushing banks and insurers to incorporate C&E factors into their risk frameworks and decision-making processes. Furthermore, they can mandate the inclusion of the identification, assessment and management of these risks within standard financial disclosures. Many of these disclosure requirements are aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This reflects a growing emphasis on climate and environmental risk management within the financial industry, driven by regulatory authorities.

Time horizon: the key challenge | Incorporating climate considerations into risk appetite statements presents a significant challenge, primarily related to the time horizons over which these considerations will materialise. These horizons encompass the short, medium, and long term. Notably, the most substantial physical impacts of climate change are expected to manifest beyond the typical timeframes covered by traditional business planning. However, it is imperative to take immediate action to mitigate these long-term risks, even though the full extent of their impact may not become evident for many years. This creates a complex dynamic in which the urgency of action is mismatched with the longer-term nature of the climate risks involved.

Climate risk exposure | To effectively manage climate exposures, it is advisable for banks and insurers to conduct measurements at various levels within their organisations. This comprehensive approach allows for the creation of heat maps and detailed reports that are specific to different business activities or units. By doing so, financial institutions can gain a more granular understanding of their exposure to climate-related risks and opportunities. With this information, banks and insurers can make informed decisions about allocating specific risk limits to manage and mitigate these exposures effectively.

How C&E risks are incorporated into risk appetite framework?

Incorporating C&E considerations into risk appetite statements is essential for organisations. This practice allows them to set clear thresholds for the climate impacts they are willing and able to absorb. By establishing these thresholds, organisations can effectively monitor their exposure to C&E risks, guided by defined guidelines and exposure limits. They can use the results from macro financial and climate stress testing to gain insights into their risk exposure and make informed decisions that promote the long-term financial well-being of the firm.

Key findings

Over half of financial institutions have incorporated C&E risks | Quantitative risk indicators are commonly used by financial institutions to assess their exposure to transition risks, with approximately half of them relying on these indicators. However, when it comes to physical risks, a smaller percentage of institutions use quantitative indicators. Specifically, 42% of banks and 30% of insurers employ quantitative indicators to evaluate their exposure to physical risks.

Difference of risks coverage between insurance and banking | On average, risk appetite statements for banks typically encompass all key existing risks. In contrast, insurance risk appetite statements tend to cover only certain key existing risks, indicating a difference in the scope and focus between these two types of financial institutions.

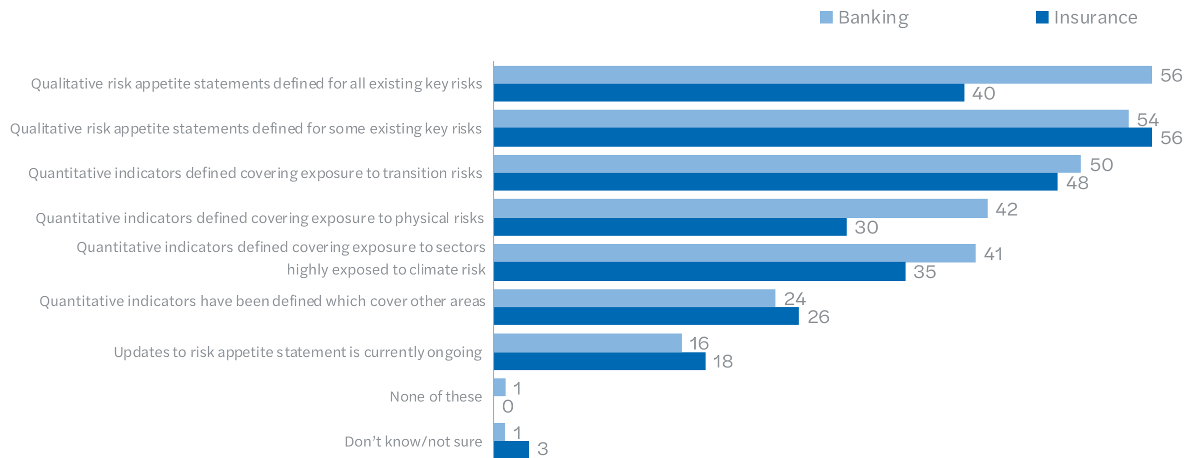
Variations due to size | Larger banks are more inclined to develop both quantitative and qualitative risk appetite statements for their key risks when compared to medium-sized banks. This suggests that larger banks are more comprehensive in defining and communicating their risk appetite across different dimensions, aligning with their size and complexity.

Regional variations | In Asia Pacific and Europe, over half of banks (51%) have risk appetite statements defined for all risks, showcasing a strong commitment to comprehensively addressing risk across various dimensions. On the other hand, regions like Africa, Latin America, the Middle East, and North America primarily have risk appetite statements available for only some key risks, suggesting a more selective approach to defining risk appetite in these areas.

Risk management

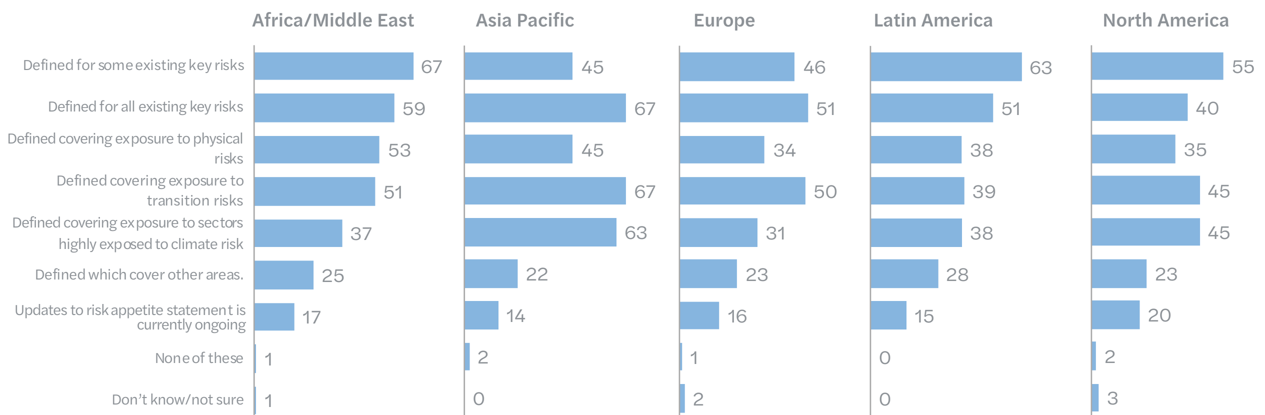
C&E risks within risk appetite framework

Percent of respondents, by institution type



C&E risks within risk appetite framework

Percent of respondents, by region



Risk management

Further insights

Financial institutions must be thorough in their understanding of the unique aspects of financial risks stemming from climate change and consider a long-term perspective that extends beyond conventional business practices. Their risk appetite statements should reflect this by accounting for climate-related risks that may arise in the long term.

Consideration of C&E risks within risk appetite statements | Financial institutions should assess their overall business strategies, existing portfolios, and the nature of their climate risk exposure to determine their tolerance for climate risks. They should also define relevant metrics, associated thresholds, and limits, which can encompass results from scenario analysis and be applied across the institution.

Transition risk appetite metrics | For transition risks, institutions can consider implementing transition risk scores for customers in high transition risk sectors, setting a percentage limit on exposures or investments in high transition risk industries, and developing specific credit, concentration and sectorial policies to monitor and manage transition risks.

Physical risk appetite metrics | Metrics for physical risks may include assessing the percentage of the portfolio exposed to high-risk locations under different scenarios or determining the probability of impact from physical hazards. These metrics can be integrated into the risk appetite framework.

Other considerations | Additional factors to consider in climate risk appetite statements include the percentage of the portfolio aligned with green taxonomy, alignment with net-zero targets, and results of stress and scenario testing for various time horizons. These measures help institutions monitor climate risks effectively.

Depending on the jurisdiction, regulatory requirements for climate risk appetite statements vary. A brief overview of these requirements in the UK, EU, and Hong Kong is provided below.

Prudential Regulatory Authority (PRA) | The firms' boards are required to understand and assess the financial risks resulting from climate change that impact the firm. They must also be capable of addressing and overseeing these risks within the firm's overall business strategy and risk appetite.

European Central Bank (ECB) | Institutions are expected to establish a climate-related risk appetite framework (RAF) that encompasses all material risks to which the institution is exposed. The RAF should be forward-looking, aligned with the strategic planning horizon defined in the business strategy, and subject to regular review.

Hong Kong Monetary Authority (HKMA) | Firms must provide evidence of how they monitor and manage financial risks related to climate change in accordance with their risk appetite statement. HKMA places emphasis on ensuring that institutions actively manage and report on climate risks within their risk framework.

Have risk identification processes been revised to incorporate climate risk drivers?

The process of identifying and assessing physical and transition risks in financial institutions is intricate and continually evolving. It necessitates the utilisation of data, models and frameworks to evaluate the potential impacts of climate change on the financial system. This complex undertaking involves multifaceted analyses, and a comprehensive understanding of how climate-related factors can affect various aspects of an institution's operations and portfolio. It's a critical area of focus as financial institutions aim to proactively manage climate-related risks and align their strategies with sustainability goals.

Key findings

Incorporation of risk identification mechanisms | Among surveyed banks, approximately three-quarters have established risk identification mechanisms to detect transition risks, while around 60% have implemented such mechanisms for recognising physical risks.

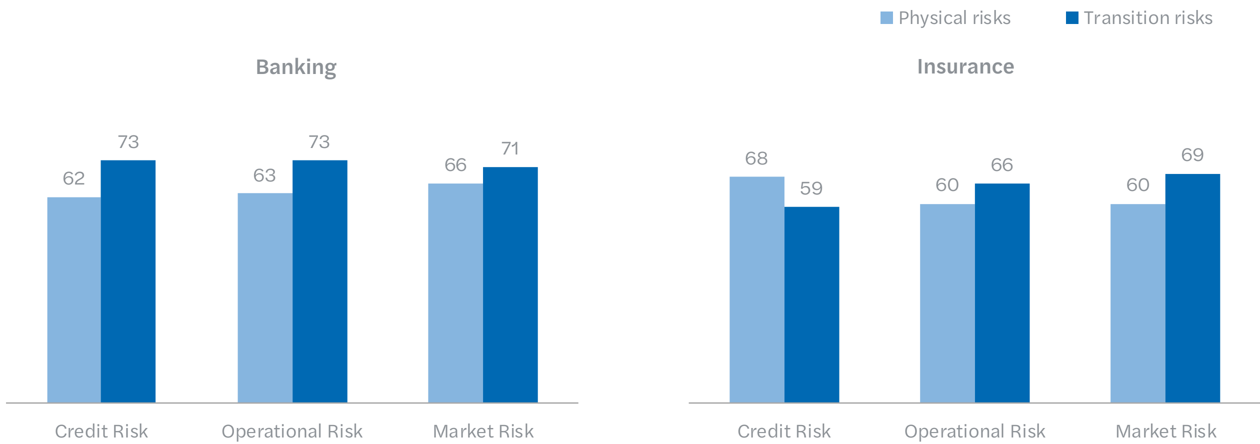
Incorporation of risk identification mechanisms in insurance | Within the insurance sector, 68% of respondents prioritise the consideration of physical risks over transition risks in their credit risk evaluations. Additionally, 65% of surveyed participants emphasised the importance of including transition risks in their risk identification processes.

Geographical variation | Across the surveyed markets, a majority (65%) displayed a similar level of commitment to implementing mechanisms for addressing physical and transition risks. However, both Latin America and North America appear to have room for improvement in fully integrating physical risks into their traditional risk assessment practices.

Risk management

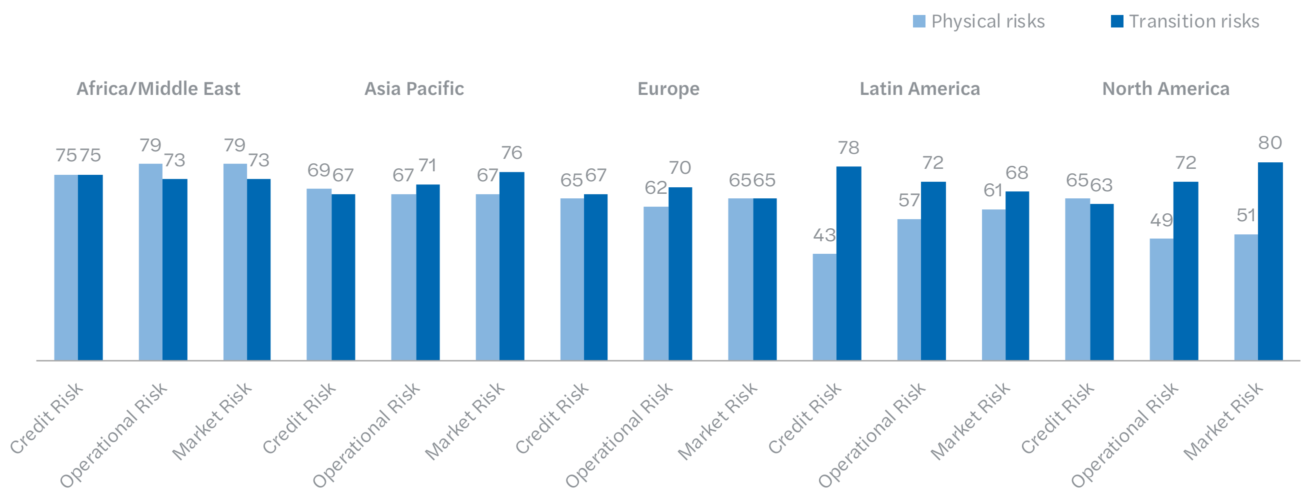
Incorporation of climate risk drivers within risk identification process

Percent of respondents, by institution type



Incorporation of climate risk drivers within risk identification process

Percent of respondents, by region



Risk management

Further insights

Banks often have significant exposure to sectors with high emissions, making them vulnerable to potential losses during the transition to a low-carbon economy. Moreover, exposure to physical risks can pose a more severe threat if climate change isn't adequately addressed and economies fail to adapt. Transition and physical risks, as previously defined, can become concentrated in specific sectors, regions and individual banks. Hence, it is crucial to pinpoint the precise climate risks within bank portfolios, especially given growing regulatory expectations for banks to develop robust climate risk management frameworks and conduct scenario analyses to assess how both physical and transition risks might impact their operations.

In what manner are C&E risk drivers integrated into the management of conventional risk categories?

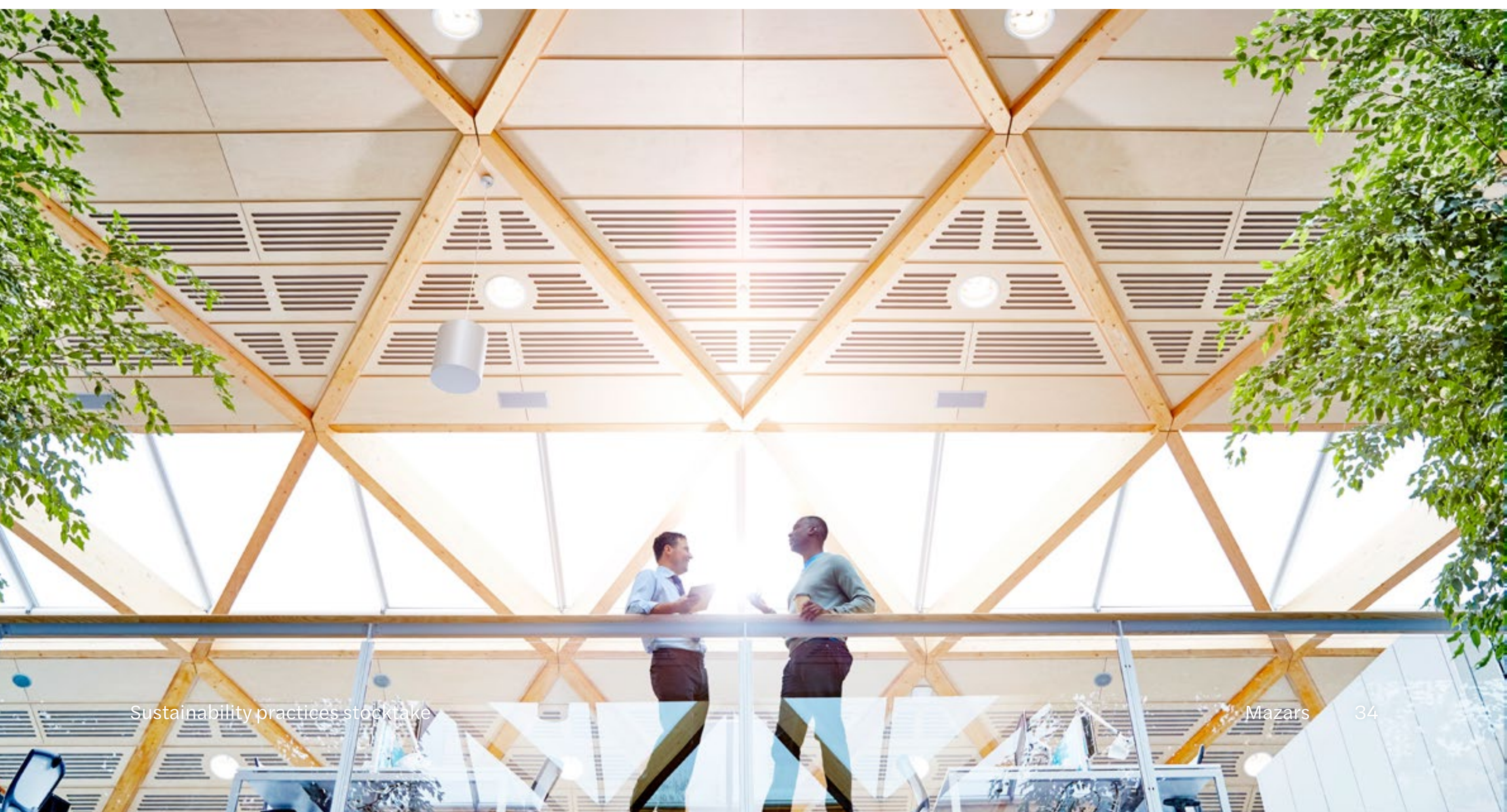
Climate-related risks can serve as drivers of financial risks for institutions. These risks can manifest through various transmission channels, translating climate and environmental risks into more conventional categories such as operational, credit or market risk. Financial institutions have the responsibility to manage these risk drivers by incorporating them into their risk management frameworks and strategies. This proactive approach enables institutions to identify, assess and mitigate the potential financial impacts associated with climate-related risks.

Key findings

Inclusion of C&E risk drivers into traditional risk management | The inclusion of C&E risk drivers into traditional risk management practices is gaining traction. Specifically, over 60% of banks have started incorporating C&E risk drivers into business continuity planning and market risk metrics.

Regional variations | There are variations in the adoption of these practices based on the geographical location of financial institutions:

- For credit risk, the use of C&E risk drivers varies across regions.
- For operational risk, most regions are including C&E considerations in their business continuity planning.
- When it comes to market risk, financial institutions in Africa, the Middle East, Latin America, North America and the Asia-Pacific region are incorporating C&E drivers into their market risk metrics.

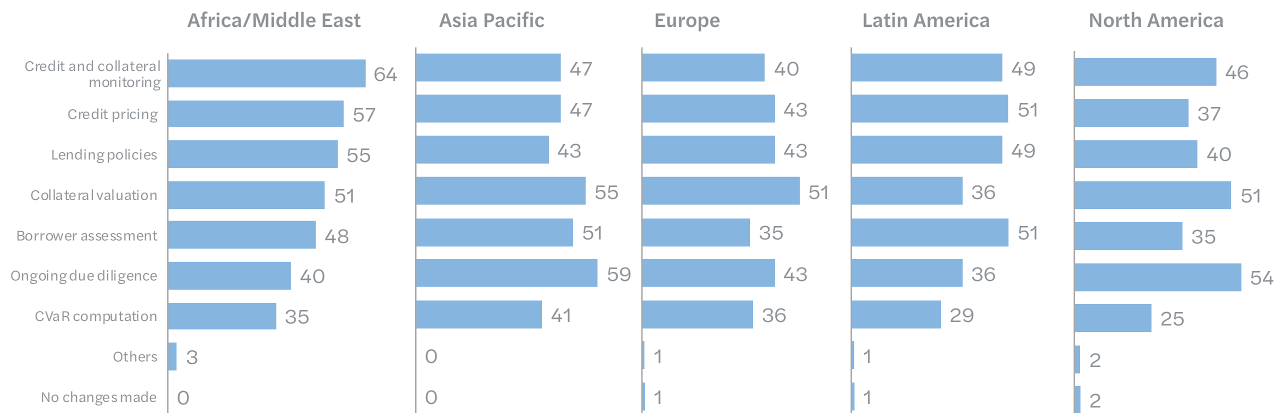


Risk management

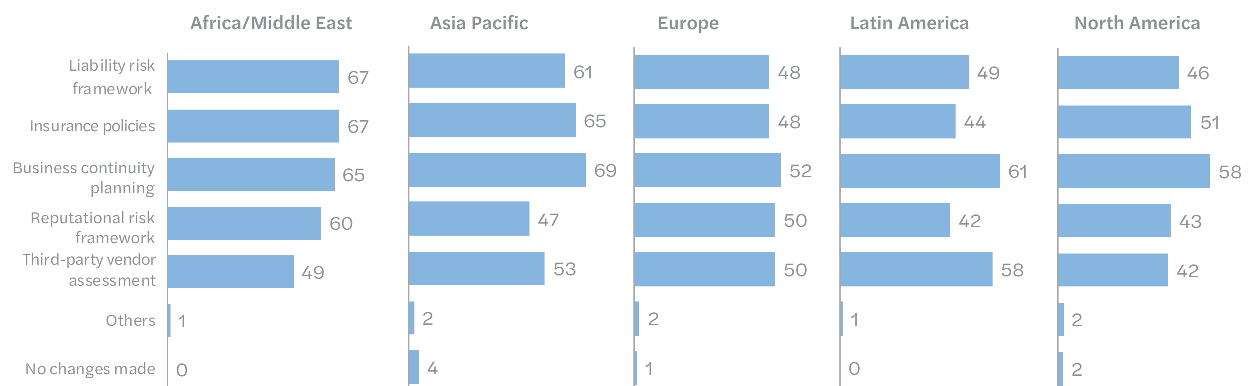
Incorporation of C & E risk drivers into the management of traditional risk types

Percent of respondents, by region

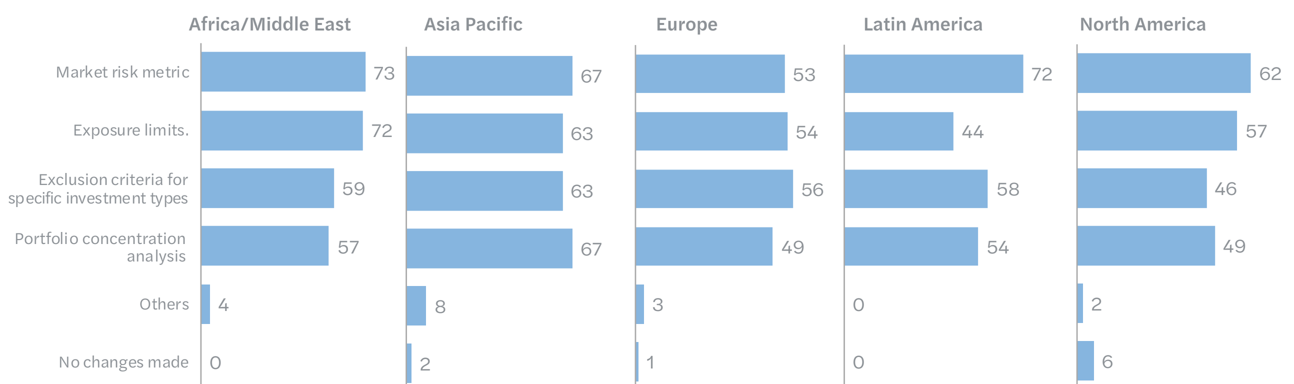
Credit risk



Operational risk



Market risk



Further insights

Physical and transition risk drivers | Financial institutions must systematically identify and understand the relevant risk drivers associated with climate-related physical and transition risks. This identification is crucial for effective risk management and involves developing a process to determine which risk drivers could potentially have a material impact on their risk profile and operations.

Transmission channels | The impacts of physical and transition risk drivers can affect economic activities, which in turn influence the financial system. These causal chains that explain how climate risk drivers give rise to financial risks are known as transmission channels. Such channels can operate directly through microeconomic impacts, such as lower corporate profitability or asset devaluation, and indirectly through macro-financial changes. As a result, climate risk drivers can impact various financial risk categories through these transmission channels, including credit, operational, market and liquidity risks.

Collateral valuation | One specific area where the impact of climate risks is becoming increasingly important is in collateral valuation. Inclusion of climate risks in the valuation report for immovable property collateral may become a minimum requirement. This is because climate risks can affect the loss given default (LGD) and expected credit losses. These changes in collateral valuation can subsequently impact the way credit risks associated with lenders are computed.

How important are the following data sources in quantifying C&E risks?

Key findings

Energy consumption dominates | Energy consumption is the top data source for both banks and insurers, with approximately 61% of surveyed financial institutions considering it the most vital data source for assessing C&E-related risks. This indicates the significance of energy-related data in understanding climate and environmental impacts.

Balanced approach in insurance | Insurers tend to give equal weight to multiple data sources, with approximately 55% considering energy consumption, energy performance, current GHG emissions for financial assets and external credit rating information on counterparties as important data points. This balanced approach reflects insurers' comprehensive assessment of C&E risks.

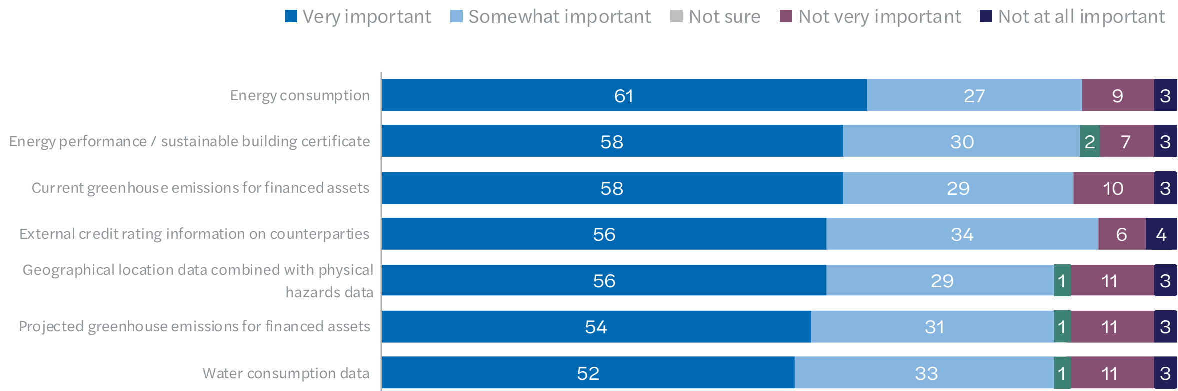
Regional differences | There are notable regional variations in the importance placed on specific data sources. For instance, in Africa/Middle East and Latin American markets, energy consumption and energy performance receive the highest emphasis, with 80% and 76% of surveyed institutions considering them vital. This heightened focus can be attributed to the growing momentum of sustainability reporting in these regions. In European markets, GHG emissions are a prominent dataset, with 55% of surveyed institutions considering them essential for assessing C&E-related risks. Europe has been at the forefront of building climate policies and awareness, contributing to the significance of GHG emissions data.

Geographical variations | Geographical variations in responses highlight the differing levels of climate awareness and policies in various regions. While Africa/Middle East and Latin America demonstrate elevated emphasis on climate-related datasets, Europe, with more mature climate policies, places slightly less emphasis on energy consumption.

Risk management

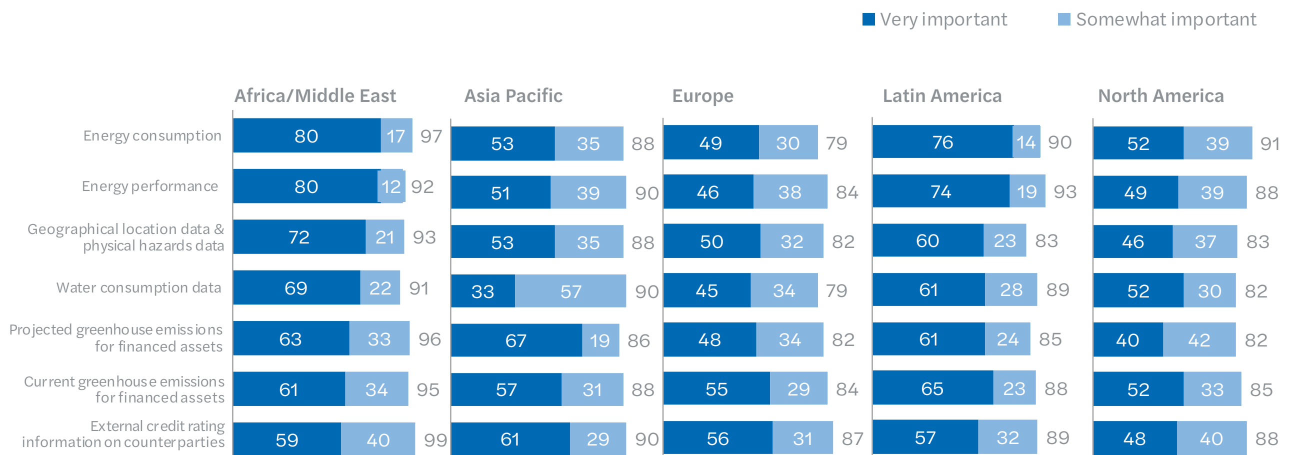
Importance of data sources in quantifying C & E risks

Percent of respondents, total sample



Importance of data sources in quantifying C & E risks

Percent of respondents, by region



Risk management

Further insights

The banking and insurance sectors hold significant influence over the transition to a low carbon economy. However, measuring the indirect emissions' impact of their operations remains challenging due to data limitations. Access to robust data is crucial for achieving global net-zero targets and fulfilling climate disclosure requirements from various global standards.

- **Importance of climate data**: Climate-related data is vital for financial institutions to measure C&E risks, although obtaining robust data is challenging.
- **Bridging data gaps**: To bridge climate data gaps, institutions should develop internal capabilities, establish process frameworks, and utilise data from external sources and industry initiatives like the Partnership for Carbon Accounting Financials (PCAF) for measuring emissions.
- **Transition plans**: Efforts to reduce carbon content, decrease coal's share in the financed energy mix and set GHG reduction objectives are notable in many banks and insurers. Transition plans emphasise the need for climate data from counterparties.
- **Sector-specific initiatives**: Leading banks participate in sector-specific initiatives to reduce financed emissions. Examples include the Poseidon Principles for international shipping decarbonisation and the Sustainable STEEL Principles for measuring emissions from steel loan portfolios.
- **Future expansion**: The focus on climate data is expanding to encompass wider sustainability metrics, including natural capital, biodiversity, human capital and social aspects. Institutions are encouraged to develop capabilities in these areas with guidance from organisations like the Task Force on Nature-related Financial Disclosures (TNFD).

Which of the following practices are in place to manage C&E data?

Key findings

Governance committee and data integrity: Half (50%) of surveyed institutions consider establishing a governance committee, implementing data integrity and internal quality control measures as the best ways to manage C&E risks.

IT applications and tools: Nearly half (47%) opt for developing IT applications or internal tools and 46% undertake gap analysis exercises.

Banks vs. insurers:

- More than half (51%) of banks prioritise developing IT applications and internal tools to manage C&E risks.
- On the other hand, insurance companies (51%) emphasise building data integrity and quality controls as the preferred approach.

Differences by bank size:

- **Large banks**: The majority (57%) of large banks have established governance committees, while 51% have developed IT applications or tools.
- **Medium-sized banks**: Over half (51%) of medium-sized banks focus on IT applications and tools, while 46% have governance committees in place.

These differences highlight the diverse landscape of climate risk management practices within the industry. Institutions that invest in areas like IT, governance, and internal controls are likely to meet regulatory obligations and climate-related disclosure requirements effectively, ensuring alignment with evolving sustainability practices.

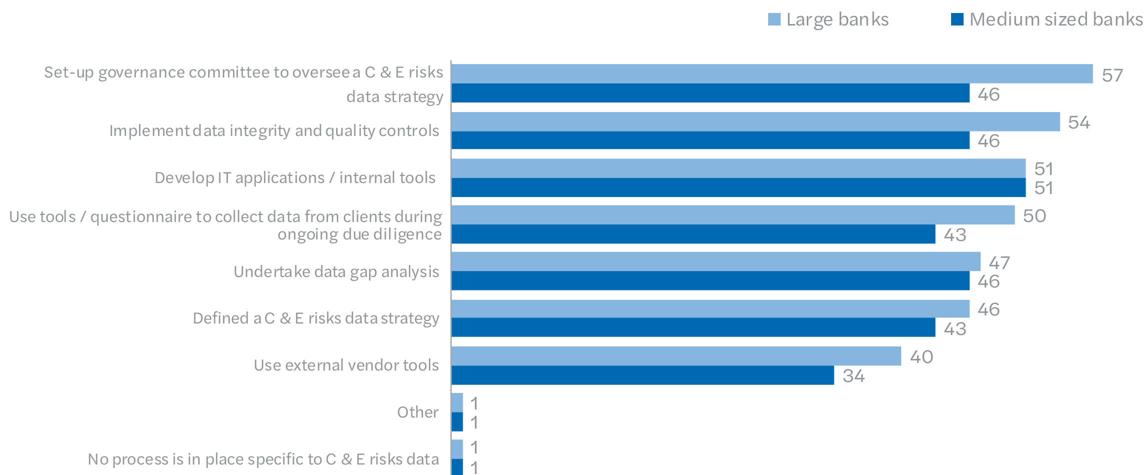
Risk management

Practices in place for managing C & E risk data

Percent of respondents, total sample

Practices in place for managing C & E risk data

Percent of respondents, by bank size



Further insights

Financial institutions are actively building internal expertise and tools to track the emissions they finance, demonstrating their commitment to sustainability. This entails the development of proprietary methodologies and internal systems to monitor emissions and align with the Paris Agreement targets.

Internal tools and scorecards: Many leading banks have created their own methodologies and internal systems to track financed emissions within their portfolios, aligning with global sustainability goals.

Client engagements: Financial institutions engage with clients to gather data and insights related to sustainability. These engagements are crucial for obtaining a reliable set of data from counterparties and measuring risks associated with climate and environmental factors.

ESG scorecards: Internal ESG scorecards are becoming common practice. These scorecards link covenants with sustainability-linked targets (SLTs), aligning SLTs with credit risk scores, including probability of default (PD) and LGD.

These efforts underscore financial institutions' proactive approach to obtaining accurate data and managing risks associated with climate and environmental factors. By developing internal expertise and implementing tools, they are better positioned to contribute to sustainability goals and align with global initiatives.

What's considered most important for developing and performing scenario analysis?

Key findings

Business planning and strategy is key | 60% of surveyed financial institutions believe that business planning and strategy are the most vital factors for building and performing scenario analysis.

Industry best practices | For banks, following industry best practice (60%) is considered the most crucial aspect of scenario analysis. In contrast, insurance companies place slightly more emphasis (56%) on having clear business planning goals and strategies.

Regulatory obligations | Regulatory obligations are also highly significant, with 58% of banks and 55% of insurance companies recognising their importance in the context of scenario analysis.

Internal capability improvements | Many institutions (57% of banks and 50% of insurance companies) place a high value on improving their internal capabilities to build robust risk frameworks.

Stakeholder pressure | The pressure from stakeholders to estimate the impacts of climate and environmental risks on their businesses is acknowledged by 55% of banks and 43% of insurance companies.

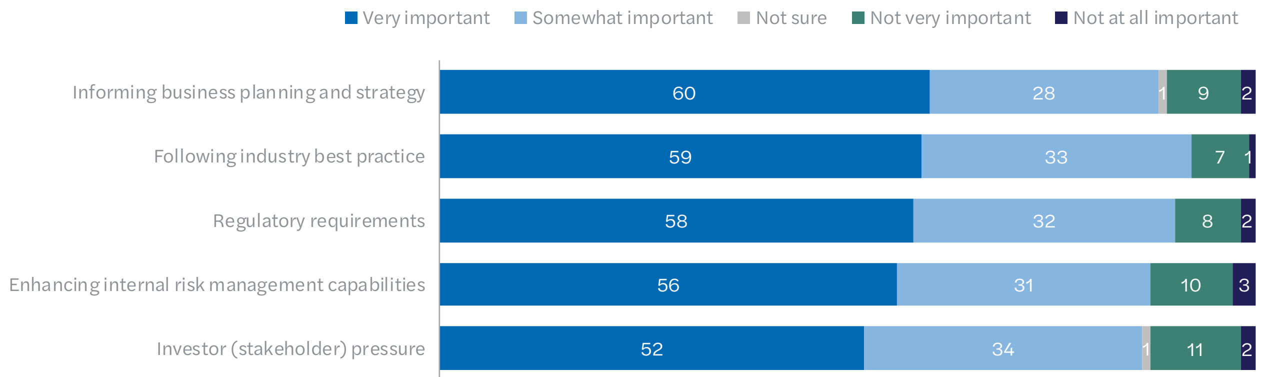
Net-zero commitment | Many financial institutions are committed to achieving net-zero GHG emissions - often by 2050 - which is a driving force behind their scenario analysis efforts.

Reference to regulatory efforts | Financial institutions often use regulatory efforts and guidelines, such as climate stress tests conducted by central banks and regulators like the Bank of England (BoE), French Prudential Supervision and Resolution Authority (ACPR), HKMA and ECB, as reference points for building the required capabilities in their scenario analysis models.

Risk management

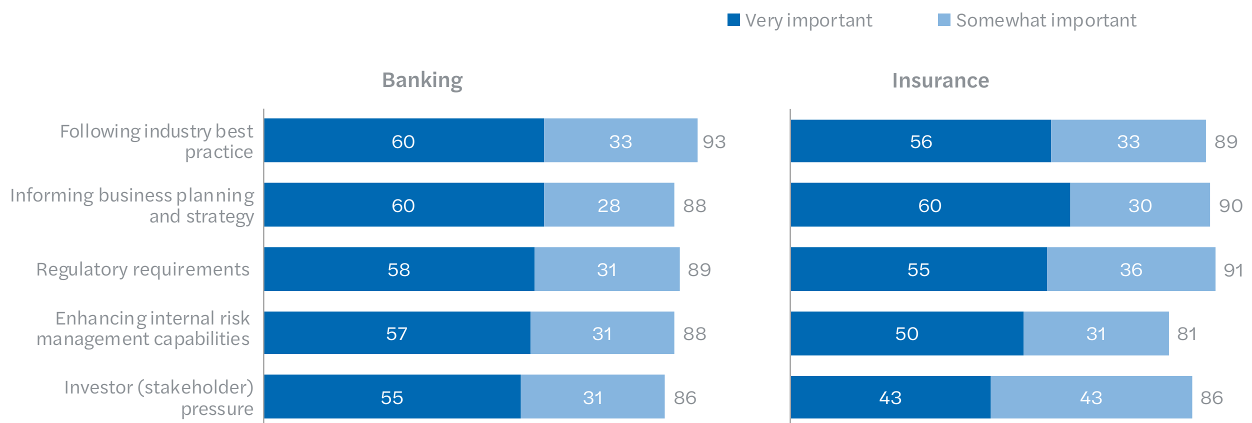
Driving factors for developing and performing scenario analysis

Percent of respondents, total sample



Driving factors for developing and performing scenario analysis

Percent of respondents, by institution type



Risk management

Further insights

Credible climate scenarios | A credible climate scenario requires consistency among its components, such as macroeconomic, energy and climate variables. Integrated Assessment Models (IAMs) are commonly used to model the interactions of these variables in different transition pathways. Notably, significant climate scenarios, including those by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), the International Energy Agency (IEA) and the Intergovernmental Panel on Climate Change (IPCC), adopt this approach.

According to the recent NGFS Survey conducted in June 2023, over 70% of respondents from various financial institutions, central banks and consulting firms indicated their familiarity with NGFS scenarios. Most banks have incorporated NGFS scenarios into their climate analysis, aligning them with UNEP FI pilot projects. These scenarios are tailored to individual banks' portfolios and home markets, with the assistance of tools like the Paris Agreement Capital Transition Assessment (PACTA) for managing investments and identifying future strategic goals.

Climate and insurance specific risks | In contrast to banking, the insurance sector faces a broader range of risks, including life, non-life and health-related risks, in addition to financial, market, credit and operational risks. The Own Risk and Solvency Assessment (ORSA) process in the insurance sector places considerable emphasis on stress testing and scenario analysis. These ORSA guidelines have gained global influence, with countries like Canada, the US, Europe, and South Africa starting to implement them.

Looking ahead | Scenario planning is a multifaceted process that requires careful preparation, execution and follow-through. It's essential to involve a diverse, cross-functional team of participants and stakeholders to provide varied viewpoints and expertise. Collecting and analysing data from multiple sources and using a range of methodologies is crucial. Balancing scenarios to find a middle ground between feasibility and challenge is key to avoid extremes or excessive similarities. It's important to use scenarios as a tool to enrich and challenge strategies and goals, rather than replacing them outright.

Risk management

What climate risk financial metrics are being used?

Key findings

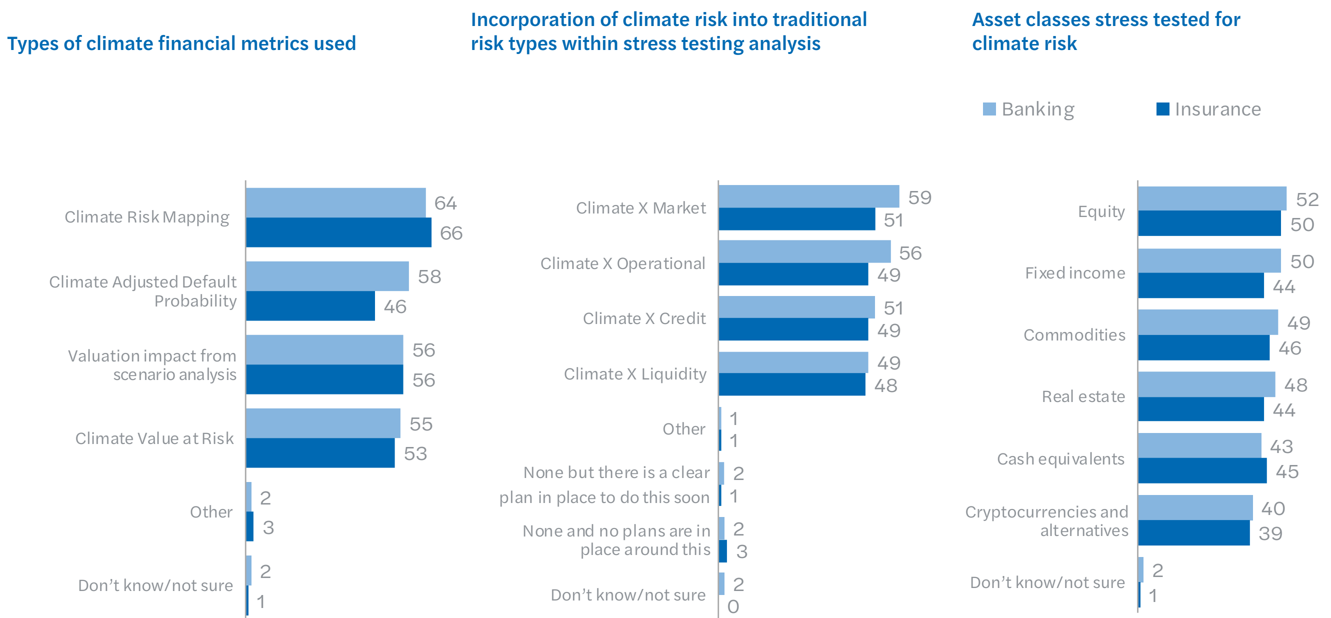
Climate risk metric usage | Climate risk metric usage is prevalent, with over 60% of surveyed financial institutions utilising climate risk mapping financial metrics. Following closely are the integration of climate scores with internal PD models and conducting scenario analysis, both of which are primary practices for assessing climate change-related risks.

Traditional risks stress tested for climate risks | In terms of traditional risks subjected to stress testing for climate risks, approximately 50% of banks and insurers in the study have incorporated Climate X Market, Climate X Operational and Climate X Credit risks into their analyses.

Regional insights | Regional variations in stress testing are observed. Three in five institutions in Africa/Middle East have stress tested real estate and commodities. Over half have tested equity in Europe, fixed income in Latin America and cash equivalents in North America. This underscores the diversity in the application of climate risk stress testing across different regions.

Risk metrics

Percent of respondents, by institution type



Risk management

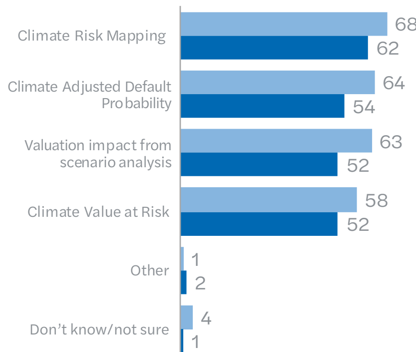
Risk metrics

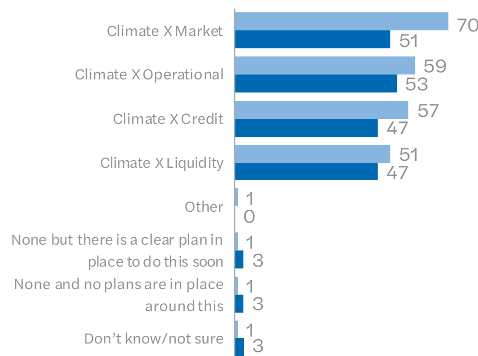
Percent of respondents, by bank size

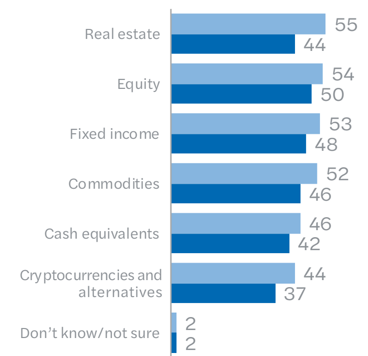
Types of climate financial metrics used

Input title "Incorporation of climate risk into traditional risk types within stress testing analysis

Asset classes stress tested for climate risk

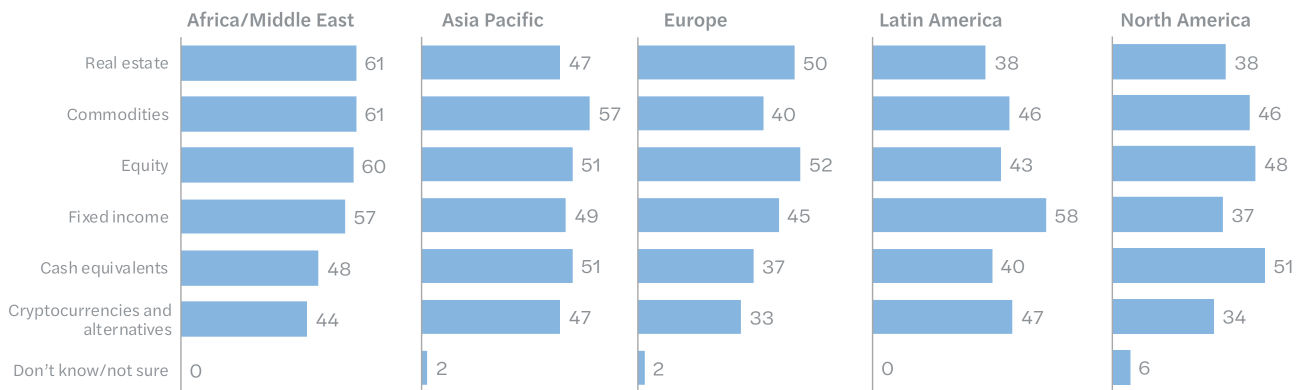






Portfolio asset classes stress tested for climate risks

Percent of respondents, by region



Risk management

Further insights

Risk metrics | Financial institutions employ location-based physical risk scores, covering various physical risk drivers like heat stress, wildfires, floods and sea-level rises. They have also started to use geospatial mapping to assess the potential impact of physical risks on their exposures.

Integration of climate-related financial risks | Progress is underway in comprehensively integrating climate-related financial risks into existing risk management processes, including banks' risk appetite and the impact on financial risk parameters such as PD, LGD and risk-weighted assets.

Insurance sector vulnerability to climate risks and stress testing | The insurance sector, like the banking sector, faces climate-related risks and is susceptible to climate stress testing. Studies indicate that insurance companies could experience significant losses during disorderly transitions. For example, EU insurers' equity holdings in climate policy-vulnerable industries could decline up to 15% under a disorderly scenario. On the liability side, climate-related risks are also expected to have a notable impact, with the loss ratio for property insurance firms reaching 30% of previously collected gross written premiums.

Stress testing by banks | Banks conduct various scenarios and stress tests to assess the impact of climate change on their portfolios, covering credit risk, market risk and operational risk. For instance, in the ECB's 2022 climate scenario testing, banks projected that overall credit losses in the non-financial corporation (NFC) loan and mortgage portfolio would be 10% higher under a disorderly transition by 2050. In a "hot house world" scenario, the increase would be 13%.

Infusing climate risk in the operational and credit risk | Climate risk processes are being incorporated into operational and credit risk frameworks, with stress testing focusing on the percentage of assets or collateral impacted by physical risks.

Looking ahead | Climate stress testing should consider climate, macroeconomic, sector and company-specific factors, differing from traditional stress testing tools and credit risk models. It is an ongoing process and as numerous climate stress tests are established, they are expected to play a significant role in refining methodologies, developing comparable exercises and addressing data gaps. NGFS's recent release of its conceptual note on short-term climate scenarios in October 2023 is a significant step for central banks and supervisors in understanding the near-term macro-financial impact of transitioning to a net-zero economy, including the consequences of severe natural disasters.

Disclosures

Disclosures

How do firms address ESG disclosure requirements and who has the responsibility for producing the reports?

ESG disclosures are pivotal for understanding how firms address sustainability and climate-related risks and opportunities. The expectations for transparency are high, with various considerations for facilitating comparisons among peers and sectors. These disclosures encompass governance, strategy, risk management and key performance indicators, but there's a significant challenge in effectively disclosing information across different sustainability areas. Over 70% of respondents find this challenge substantial. This complexity arises from interconnected sustainability reporting frameworks with distinct requirements and jurisdictional scopes. We analyse prevalent practices and emerging trends in the banking and insurance sectors regarding sustainability and climate-related disclosures.

Key findings

Sustainability-related information disclosure | 53% of banking and insurance institutions have reported the disclosure of sustainability-related information in connection with sustainability and ESG financial products.

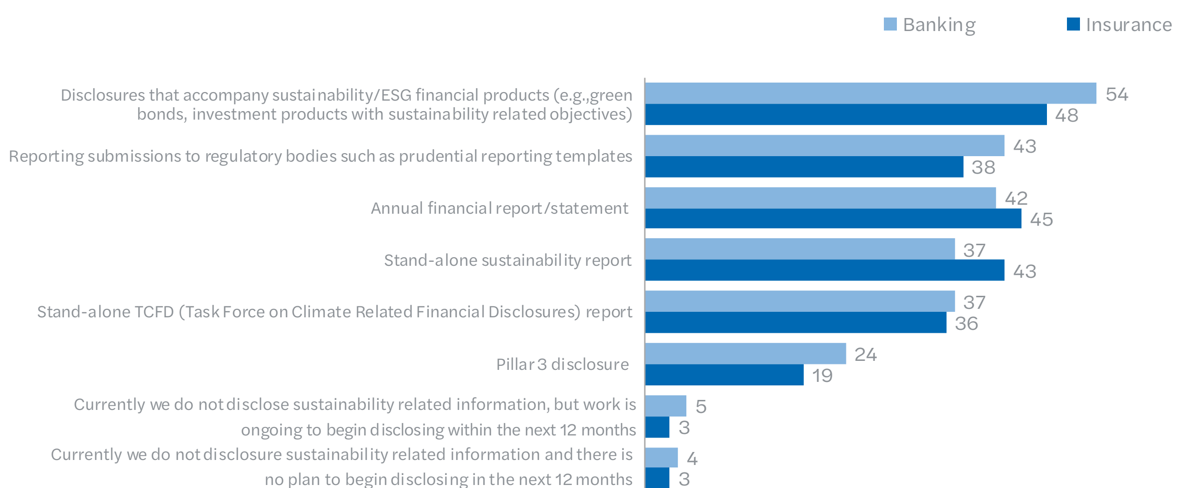
Disclosure method choices by bank size | Almost two-thirds of large banks (61%) and 49% of medium-sized banks have chosen to disclose sustainability-related information through accompanying disclosures linked to sustainability and ESG financial products.

Responsibility for public disclosures | Across all banking and insurance respondents, the responsibility for overseeing sustainability-related public disclosures is typically vested in the finance team (45%). The second most common option (29%) was a dedicated sustainability team.

Regional variation in disclosure approaches | With the exception of North America (35%), all other regions primarily utilise accompanying disclosures related to sustainability and ESG financial products for sustainability-related information dissemination (average of 58% across all other jurisdictions). North America predominantly relies on reporting submissions and annual financial reports for this purpose (both 38%).

Location of sustainability disclosures

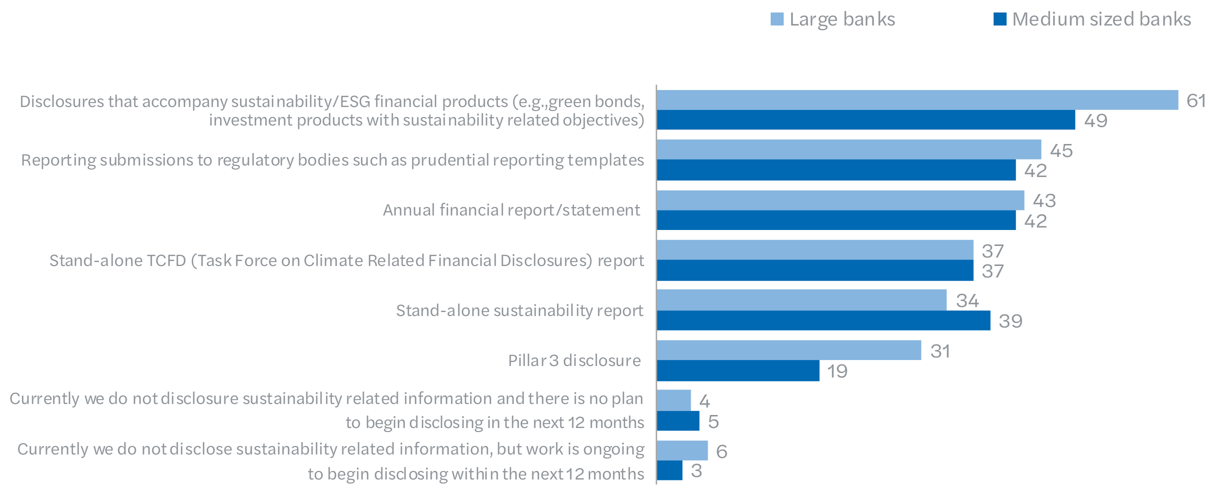
Percent of respondents, by institution type



Disclosures

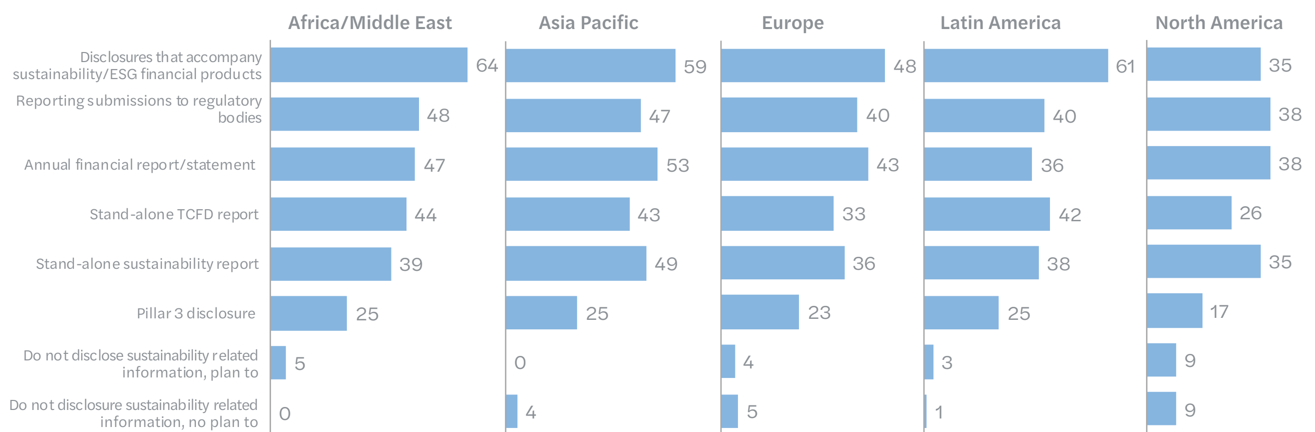
Location of sustainability disclosures

Percent of respondents, by bank size



Location of sustainability disclosures

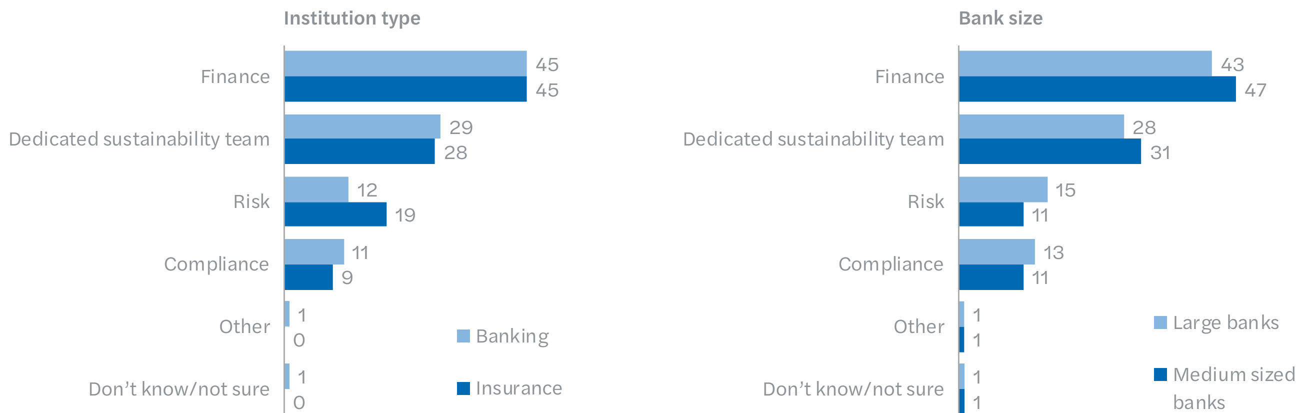
Percent of respondents, by region



Disclosures

Ownership of process for consolidating sustainability disclosures

Percent of respondents, by institution type and bank size



Further insights

The majority of banks and insurance companies opt to disclose the sustainability profile of their financial products. These disclosures are typically included as part of their regulatory submissions and are also publicly disclosed in their annual financial reports. The inclusion of sustainability information in the annual financial reports carries an expectation that banks and insurance companies apply the same level of rigour and internal controls as they do when preparing their traditional financial statements. This approach underscores the importance of treating sustainability disclosures with the same level of diligence and scrutiny as their financial reporting obligations.

In the past two years, there has been substantial progress in simplifying and aligning the landscape of reporting frameworks, both voluntary and mandatory, for companies. A pivotal development in this regard is the introduction of the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards (IFRS S1 and S2) by the ISSB in June 2023, which establishes a global foundation for reporting. These standards were formulated by incorporating insights from existing sustainability standards and frameworks, many of which companies have adopted, either mandatorily or voluntarily.

IFRS S1 and S2 standards are designed to compel companies to disclose information related to sustainability and climate-related risks and opportunities in a manner that serves the interests of investors, lenders and other creditors. While disclosing sustainability-related information remains intricate, there has been significant headway in harmonising these disclosure frameworks and standards. This aims to simplify the reporting process and enhance consistency and comparability in how companies communicate their sustainability and climate-related performance to stakeholders.

In the area of climate-related disclosures, the TCFD framework has become a widely adopted standard. It laid the foundation for the core elements of IFRS S1 and S2, covering aspects like governance, strategy, risk management, metrics and targets. In some regions, the TCFD framework is mandated, resulting in a need for rigorous reporting akin to traditional financial reporting. This explains why many banks and insurers in our sample place the responsibility for sustainability reporting within their finance teams.

The alignment of sustainability reporting with financial reporting cycles is paramount. It ensures a more efficient and integrated approach to disclosures and underscores the growing recognition of the interconnectedness between financial and sustainability performance in the banking and insurance sectors.

Disclosures

What is ESG materiality and why is it important for reporting?

In ESG reporting, materiality is crucial for enhancing transparency and accountability in sustainability and climate-related disclosures. It helps companies identify significant reporting issues relevant to stakeholders. Materiality comes in various forms: financial materiality, impact materiality and double materiality.

- Financial materiality focuses on sustainability issues impacting financial performance, aligning with annual financial reporting criteria.
- Impact materiality considers a company's effects on stakeholders and broader society, encompassing social and environmental impacts.
- Double materiality involves both financial and impact considerations.

Most banks and insurers in our survey adopt the double materiality approach for sustainability reporting, but challenges persist. This approach offers a comprehensive view of sustainability performance but requires a nuanced understanding of both financial and impact-related material issues.

Key findings

Double materiality consideration | A significant proportion of banks and insurers, approximately two-thirds (67% for banking, 66% for insurance), take into account the concept of double materiality, which involves considering both "outside-in" and "inside-out" impacts when making sustainability disclosures.

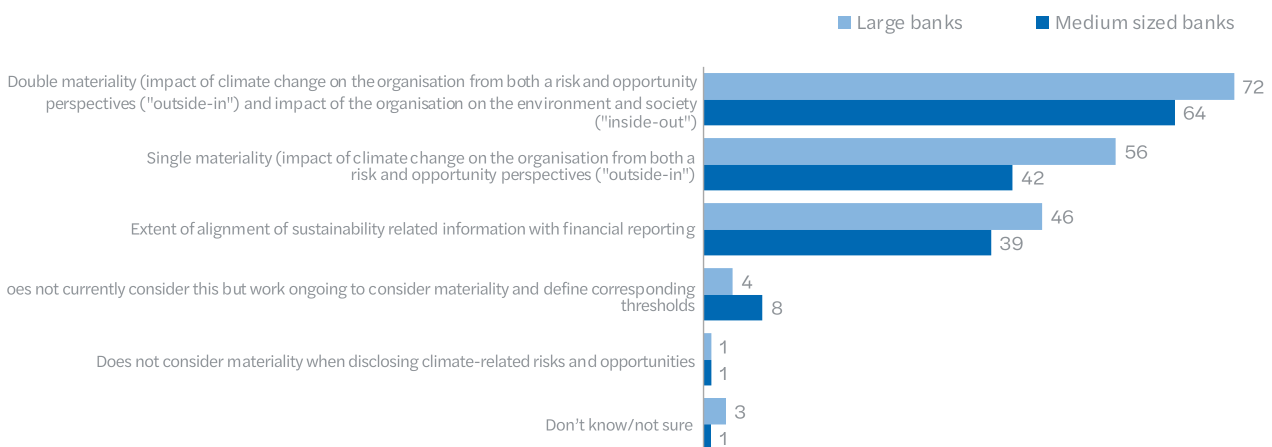
Double materiality in large banks | Among large banks, 75% incorporate the double materiality perspective into their climate-related disclosures. In the case of medium-sized banks, 64% follow the same practice.

Global adoption of double materiality | Across all regions, the majority of firms factor in the concept of double materiality when making climate-related disclosures (lowest = 63% in North America). This demonstrates a global trend in recognising the importance of assessing the interplay between financial and impact-related materiality in sustainability reporting.

Regional variation in double materiality | African and Middle Eastern respondents exhibited a notably higher likelihood of having considered double materiality in their sustainability reporting (75%).

Materiality considerations within climate disclosures

Percent of respondents, by bank size

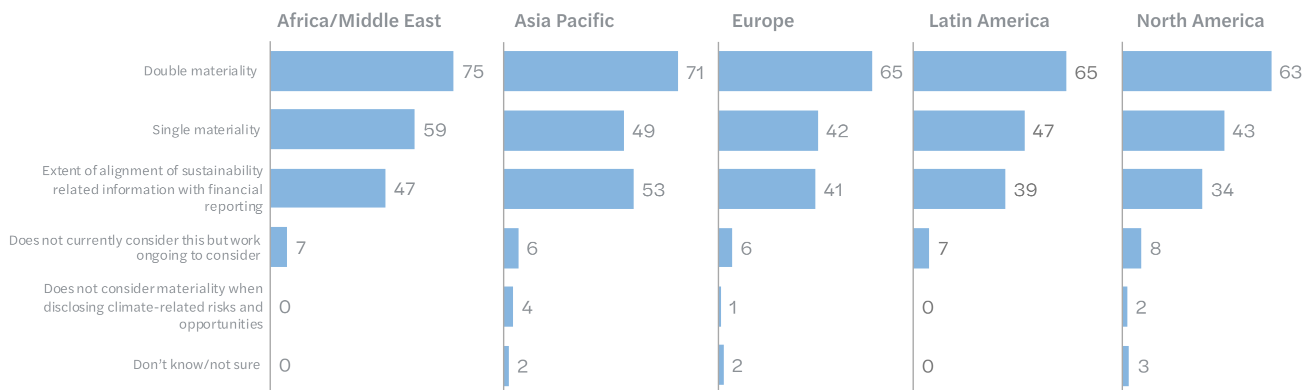


Disclosures

Banks and insurers across the regions, Africa/Middle East, Asia Pacific, Europe, Latin America and North America, use both double and financial (single) materiality. When comparing banks and insurers, there are no differences noted.

Materiality considerations within climate disclosures

Percent of respondents, by region



Materiality considerations within climate disclosures

Percent of respondents, by institution type

Disclosures

Further insights

Double materiality has garnered strong support from European Union (EU) regulators and is considered a best practice for non-financial information disclosure. The EU Corporate Sustainability Reporting Directive (CSRD) has introduced an extra-territoriality principle, expanding the scope to include non-EU groups or companies within the population of entities subject to EU sustainability reporting requirements.

Furthermore, the upcoming European Sustainability Reporting Standards (ESRS), which will be phased in for reporting periods commencing on or after 1 January 2024, mandate the adoption of double materiality. This signifies a significant shift towards harmonising sustainability reporting practices and aligning them with the double materiality approach, particularly within the EU and its associated regulatory framework.

Despite the EU and subsequent industry push for double materiality to become the norm within sustainability reporting, there is still a way to go in terms of establishing global standardisation and adoption of the concept.

The IFRS Sustainability Disclosure Standards requires companies to disclose information about sustainability-related risks and opportunities that could reasonably be expected to impact the company's prospects i.e., cashflows, access to finance or capital. This is therefore different to the ESRS which requires a double materiality perspective.

In the context of reporting requirements, financial services companies must carefully assess the challenges associated with adopting a particular materiality concept. While double materiality has gained widespread acceptance, it is perceived by some as open to interpretation, which can impact its effectiveness as a universally applicable conceptual tool.

What are the main challenges in producing ESG disclosures?

Financial services firms are facing growing expectations for sustainability-related disclosures from both regulators and various stakeholders. Striking a balance between meeting these disclosure expectations and managing the associated challenges is a critical endeavour.

The survey results revealed that a substantial number of respondents have identified significant challenges, particularly in areas related to governance structures, data management and processes. Effectively addressing these challenges is paramount for financial institutions as they work to enhance their sustainability reporting and align with evolving regulatory and stakeholder demands.

Key findings

The survey results highlight several key challenges faced by financial services companies in the context of sustainability reporting:

Inadequate definition and allocation of roles and responsibilities | A significant number of respondents identified this challenge as a major issue (42% very significant, 35 % somewhat significant). Notably, this challenge appears to be more pronounced in banks compared to insurers, underscoring the need for well-defined roles and responsibilities in sustainability-related matters.

Alignment between financial statements and climate-related disclosures | This challenge is particularly prominent for insurance companies in comparison to banks (78% of banks vs 73% of insurers). Ensuring that climate-related disclosures align seamlessly with financial statements poses a significant concern for insurers (43% report very significant challenges).

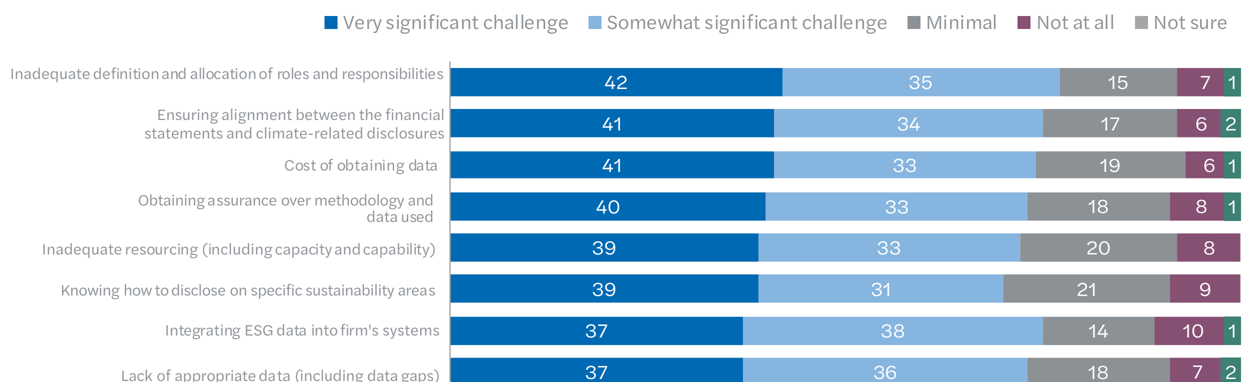
Obtaining assurance for methodology and data | The challenge of obtaining assurance for the methodology and data used in sustainability reporting is notably more pronounced for insurance companies (43% very significant challenge) as opposed to banks (39% very significant challenge). This highlights the importance of data accuracy and methodology validation in the insurance sector's sustainability reporting efforts.

Regional variations | North American respondents reported significant gaps related to inadequate definition (88%). Africa and the Middle East reported more gaps in the cost of obtaining data (83%) than any other region and Asia-Pacific respondents had high response rates reporting significant gaps within inadequate resourcing (80%)

These findings indicate that both banks and insurers face distinct challenges in sustainability reporting, emphasising the need for tailored strategies to address these specific issues effectively.

Challenges producing sustainability disclosures

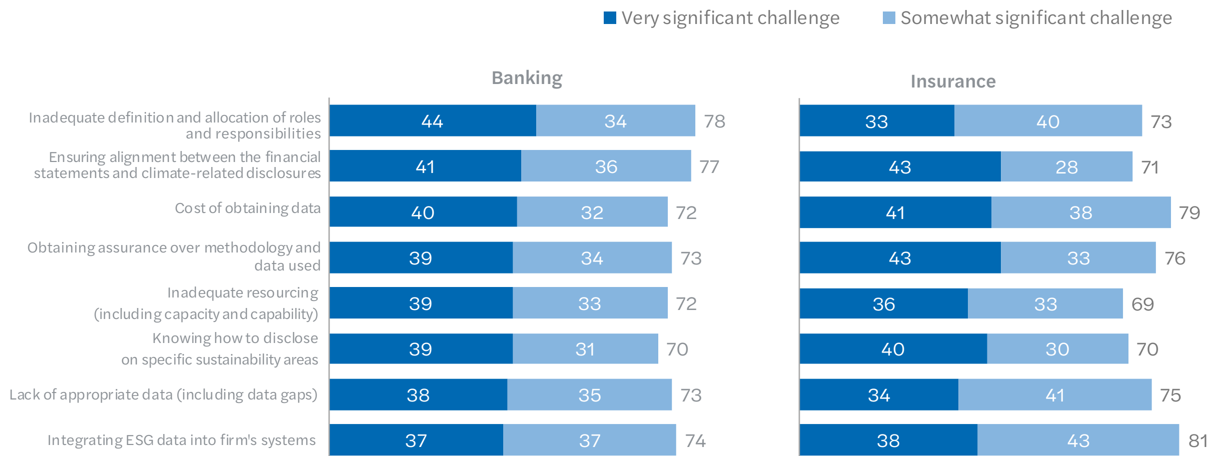
Percent of respondents, total sample



Disclosures

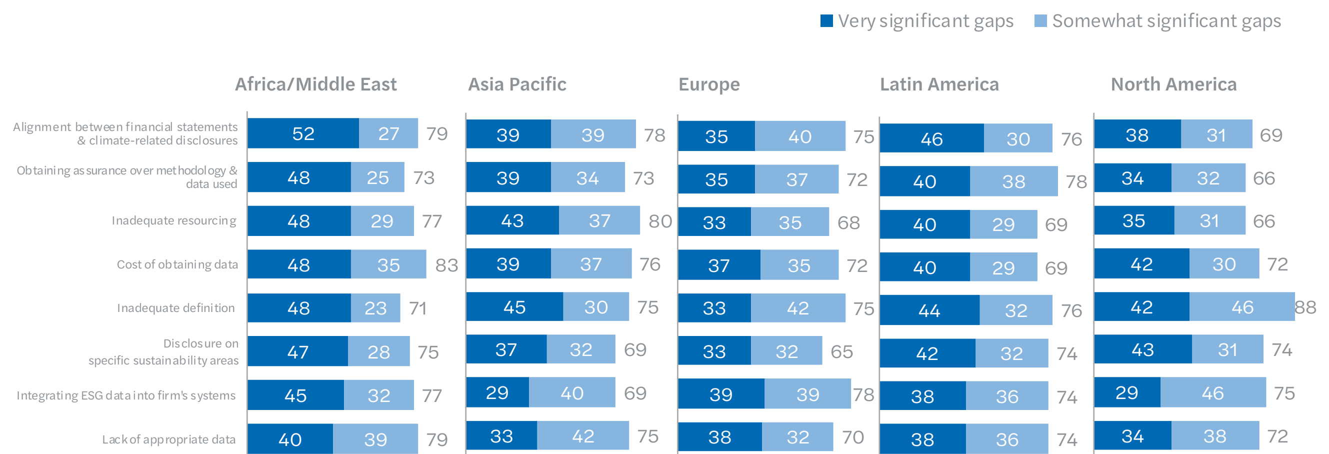
Challenges producing sustainability disclosures

Percent of respondents, by institution type



Challenges producing sustainability disclosures

Percent of respondents, by region



Further insights

The ability to produce sustainability-related disclosures and financial statements simultaneously pose challenges, especially regarding data availability and verification. New regulations exacerbate these issues for banks and insurers.

To address these challenges:

- **Embrace an integrated approach |** Implement a holistic sustainability approach across departments to establish robust governance structures and ensure consistent reporting.
- **Leverage financial reporting cycles |** Utilise established financial reporting processes and controls. Assess data quality, identify partners for data verification and integrate sustainability into existing reporting frameworks.
- This strategy enables financial institutions to manage the complexities of concurrent sustainability and financial reporting while meeting regulatory and stakeholder expectations.

What are the ESG verification approaches being considered?

The verification of sustainability disclosures is a crucial element of the reporting process. It is an area that exhibits a significant degree of variation in terms of the approaches and methodologies employed by different organisations.

Key findings

The verification of sustainability disclosures shows notable variations in approach, with some key findings:

Internal audit vs. third-party specialists | Regarding the most popular methods of disclosure verification, 59% of banks opt for internal audit reviews, while 53% of insurers choose independent verification by third-party specialists.

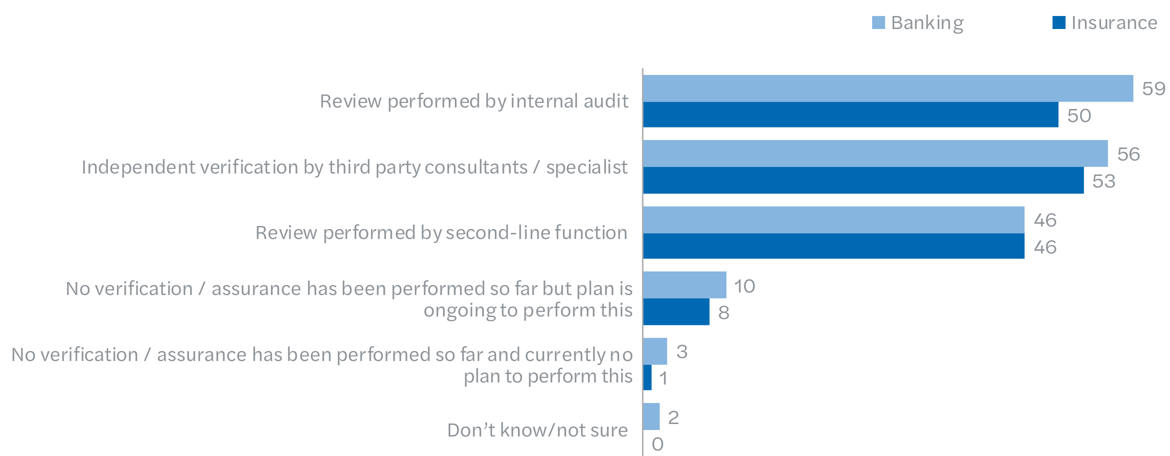
Verification by bank size | Among large banks, 66% use independent verification by third-party specialists, while 60% of medium-sized banks have their sustainability disclosures reviewed by internal audit.

Regional differences | The choice of verification method varies by region. Institutions in Africa/ Middle East, Europe, and North America tend to favour internal audit reviews (average of 60%), while those in Asia Pacific (71%) and Latin America (58%) opt for independent verification by third-party specialists.

These findings illustrate that there is no one-size-fits-all approach to the verification of sustainability disclosures. Financial institutions employ various methods, including internal audit and independent third-party specialists depending on their size and regional preferences, highlighting the diverse landscape of sustainability verification in the industry.

Disclosure verification

Percent of respondents, by institution type



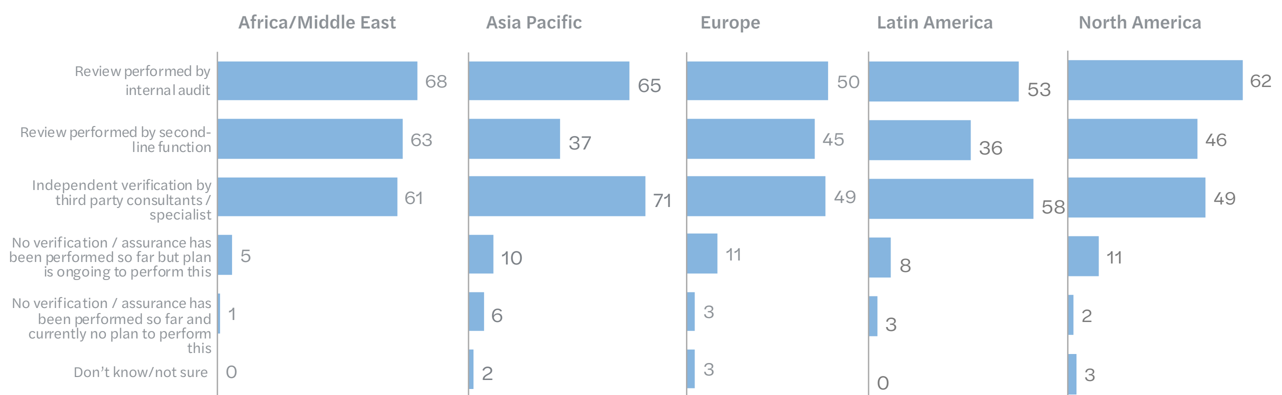
Disclosures

Disclosure verification

Percent of respondents, by bank size

Disclosure verification

Percent of respondents, by region



Further insights

The data reveals that the verification of sustainability disclosures is distributed relatively evenly between external parties and internal audit departments within banks and insurers. Each approach, whether internal or external verification, offers valid and tangible benefits.

For financial institutions that have not yet initiated the verification process, several considerations come into play:

- **Readiness for verification |** Before choosing between internal and external verification, companies must assess their readiness. For external verification, it is crucial to evaluate the robustness of reporting processes to ensure they can withstand external scrutiny.
- **Effective internal verification** | Internal verification requires effective collaboration across relevant parties responsible for sustainability-related disclosures. The responsible individuals or committees must be comfortable with the information produced and published. Additionally, the risk department, compliance teams and internal audit can contribute by assessing risks, process mapping and designing effective controls.

These considerations underscore the importance of careful planning and collaboration when it comes to verifying sustainability disclosures, whether through internal or external means. Making the right choice depends on the institution's specific circumstances and its preparedness for the verification process.

Conclusion

Conclusion

What's next?

Having conducted the first rounds of sustainability disclosure reports, the largest banks and insurers now await comprehensive feedback on what regulators think of initial efforts made, as well as reactions from their various stakeholders. It will be interesting to see how different disclosure approaches highlighted in our latest report are viewed by regulators and whether regional differences will inform future disclosure requirements.

We are at an early stage in the regulatory timetable, which allows time for disclosure improvements to be made, particularly in relation to how governance and risk disclosures inform and impact a credible sustainability strategy. Feedback from regulators should, however, not be underestimated. A report viewed negatively by regulators will no doubt be given initial pointers that should help improve future disclosure iterations.

Importantly, banks and insurers receiving positive feedback from regulators can use this to their competitive advantage.

Client demand more likely to drive change

While mobilisation of capital and sector-specifics remain a challenge for small to medium-sized banking and insurance players looking to progress their sustainability journey, there are signs that client demand may be the primary driver of change. We are currently seeing best practice approaches from specialised and niche banking and insurance players who have had to step up and respond to sustainability preferences expressed by clients.

This focus on client demand can provide the right business drivers that push small banking and insurance players into innovating and providing sustainable finance solutions in a more cost-effective and less resource-intensive way. While this approach is more suitable for players offering a narrow range of products, it provides a template for smaller players to adapt and reach their sustainable goals and ambitions.

Conclusion

Are nature and biodiversity the new focus?

While a focus on nature and biodiversity is increasingly discussed in terms of achieving a more sustainable business model, it has yet to reach the action stage. However, this may be about to change with the recent publication of the Taskforce on Nature-related Financial Disclosures (TNFD). The TNFD follows in the footsteps of the Taskforce on Climate-related Financial Disclosures (TCFD) and is similarly based on four pillars. The TNFD's recommendations and guidance will enable business and finance to integrate nature into decision-making, ultimately supporting a shift in global financial flows away from nature-negative outcomes.

While TNFD will need to be finely-tuned over time, it already offers a starting point for banks and insurers to think about how economic sectors are impacted by nature degradation; specifically, how activities lead to the destruction of natural habitats, resource overuse, chemical pollution and land degradation. These actions, in turn, affect households and businesses by driving up the costs of goods and services.

While we are at these early stages, what we do know is that the industry does not have the luxury of time to achieve a shift toward nature-positive outcomes. Banks and insurers who begin to look at sustainability strategies more holistically can be at the forefront of the shift to a truly responsible finance model.

Methodology

Methodology

The survey deployed for this report undertook an assessment of banks and insurers across Europe, North America, Latin America, Asia Pacific, Africa and the Middle East. To be included in this study, the selected banks and insurers were required to have a minimum of 500 employees.

This research effort represents an evolution of prior sustainability benchmarking studies, with the most recent edition, "Responsible banking practices: Benchmark study 2021", published in 2022. For this current edition, we expanded the scope of the study to include insurers in addition to banks, and introduced a survey to delve deeper into the existing sustainability practices within these financial institutions.

A total of 404 senior executives participated in the survey, and they were chosen based on their roles and responsibilities concerning their financial institution's ESG policies, operations and reporting.

The fieldwork for this study was carried out via online panels, between May and June 2023.

Respondents were asked to provide a self-assessment of existing sustainability practices in their institution across the following areas:

- Governance
- Strategy
- Risk management
- Disclosures

The survey questions were formulated in alignment with the expectations outlined by financial regulatory bodies and international organisations like the United Nations Environment Programme Finance Initiative (UNEP FI) and the International Sustainability Standards Board (ISSB). The questions sought to gauge how financial institutions are incorporating sustainability and addressing climate-related financial risks in their practices.

Methodology

The tables below provide a breakdown of the 404 survey responses received and analysed for this study.

Sector	Sample
Insurance	80
Banking	324

Seniority Level of Respondent	Sample
CEO, Chair, Board	189
President or other C-suite executive	64
Senior/VP, MD, Director	151

Company Size (no. of employees)	Sample
Up to 1,000	101
1,001 to 10,000	143
10,001 to 50,000	93
+50,000	67

Region	Sample
Africa/Middle East	75
Asia Pacific	51
Europe	141
Latin America	72
North America	65

Methodology

Our respondent sample can be broken down as follows:

Global region	Country	Sample
Africa/Middle East (n=75)	Egypt	20
	Nigeria	26
	South Africa	29
Asia Pacific (n=51)	Japan	26
	Singapore	12
	India	13
Europe (n=141)	France	35
	Germany	26
	Italy	25
	Spain	25
	United Kingdom	30
Latin America (n=72)	Argentina	15
	Brazil	30
	Mexico	27
North America (n=65)	Canada	25
	United States of America	40
Total sample		**404**

Contacts

Phuong Gomard
Global Sustainable Finance Leader
New York, United States
+1 929 631 8702
Phuong.Gomard@mazarsusa.com

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax and legal services*. Operating in over 95 countries and territories around the world, we draw on the expertise of more than 47,000 professionals – 30,000+ in Mazars' integrated partnership and 17,000+ via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.

*Where permitted under applicable country laws

© Mazars 2023

www.mazars.com

mazars