“State of the Art” ESG in Financial Services

AIBE
29th March 2023

In today's session...

What is Sustainable Finance

Shift toward a more holistic approach whereby environmental and social considerations are systematically integrated into financial decision making including risk management, and lending and investment decision making processes

Environmental

Investments with **environmental impact** are often called green investments. Examples include investments in climate change mitigation, investments in adaption to the physical impacts of climate change, and investment in biodiversity conservation.

Social

Investments with positive **social impact** are those that positively impact individuals, communities and societies as a whole. Examples include investments in companies and projects that focus on gender equality or that focus on better work conditions.

Governance

Governance, which refers to the systems, processes and oversight in place to ensure an organization and its products deliver on their financial, social and environmental goals, and to provide reassurance to stakeholders that these goals will be delivered.

Why is Sustainable Finance important

Incentives for Sustainable Finance Products

Short Term	Medium and Long Term	
Marketing & sales	**Lower cost of funds**	**Macro Factors**
Widen client base by attracting new ESG oriented clientele **Improve ESG lending understanding** Meet rising **investor expectations** and **access to capital** Tap an **emerging and growing market**	(Re)finance **with lower costs** through green, social, and sustainable bonds **Mitigate** balance sheet **issues** or achieve **greater capital leverage**	Elimination of **risks caused by emerging regulations** Meet **reporting and disclosure** expectations **Grow revenues** by aligning balance sheet with future net zero economy **Enhance reputation** as responsible lender

Reduced risk exposure

- The share of your portfolio in low risk sectors would increase
- A better understanding of sustainability risks allows companies to convert them into opportunities

Organisations and their stakeholders recognize the need to act now

1.5°C

51%

of global CEOs say they've made a **Net Zero commitment** — or are working towards one

86%

of **employees** want to work for companies that care about ESG issues

80%

Consumers are more likely to buy from companies that support ESG initiatives

79%

Global **investors** say managing ESG risks is an important factor in investment decisions

Sources: PwC's 25th Annual Global CEO Survey, PwC's 2021 Global investor survey, PwC 2021 Consumer Intelligence Series survey on ESG

IPCC Synthesis Report 2023

- Climate change is a threat to human well-being and planetary health. **There is a rapidly closing window of opportunity** to secure a liveable and sustainable future for all
- Keeping warming to 1.5°C above pre-industrial levels requires **deep, rapid and sustained greenhouse gas emissions reductions in all sectors**

- Emissions must be **halved by the mid-2030s** if the world is to have any chance of limiting temperature rise to 1.5 degrees Celsius
- There is **sufficient global capital** to close the global investment gaps but there are barriers to redirect capital to climate action
- The **choices and actions implemented in this decade** will have impacts now and for thousands of years

“*This is a ticking time bomb. (The IPCC report) is a survival guide for humanity….the 1.5ºc limit is achievable. But it will take a quantum leap in climate action”*

Antonio Guterres, UN Secretary General, March 2023

Global carbon intensity must fall by 77% by 2030 to keep 1.5°C on track

"We're headed for a global catastrophe... We must close the emissions gap before climate catastrophe closes in on us all"

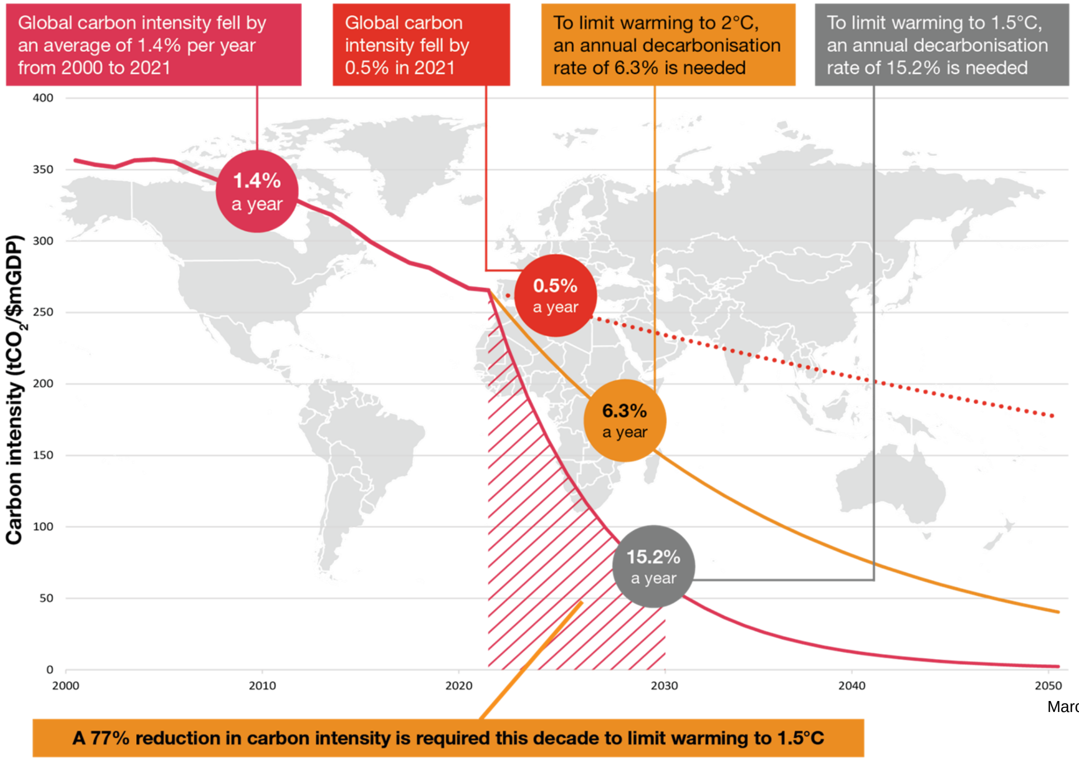
Antonio Guterres, UN Secretary-General

27 October 2022

Collective action is needed in an era of uncertainty

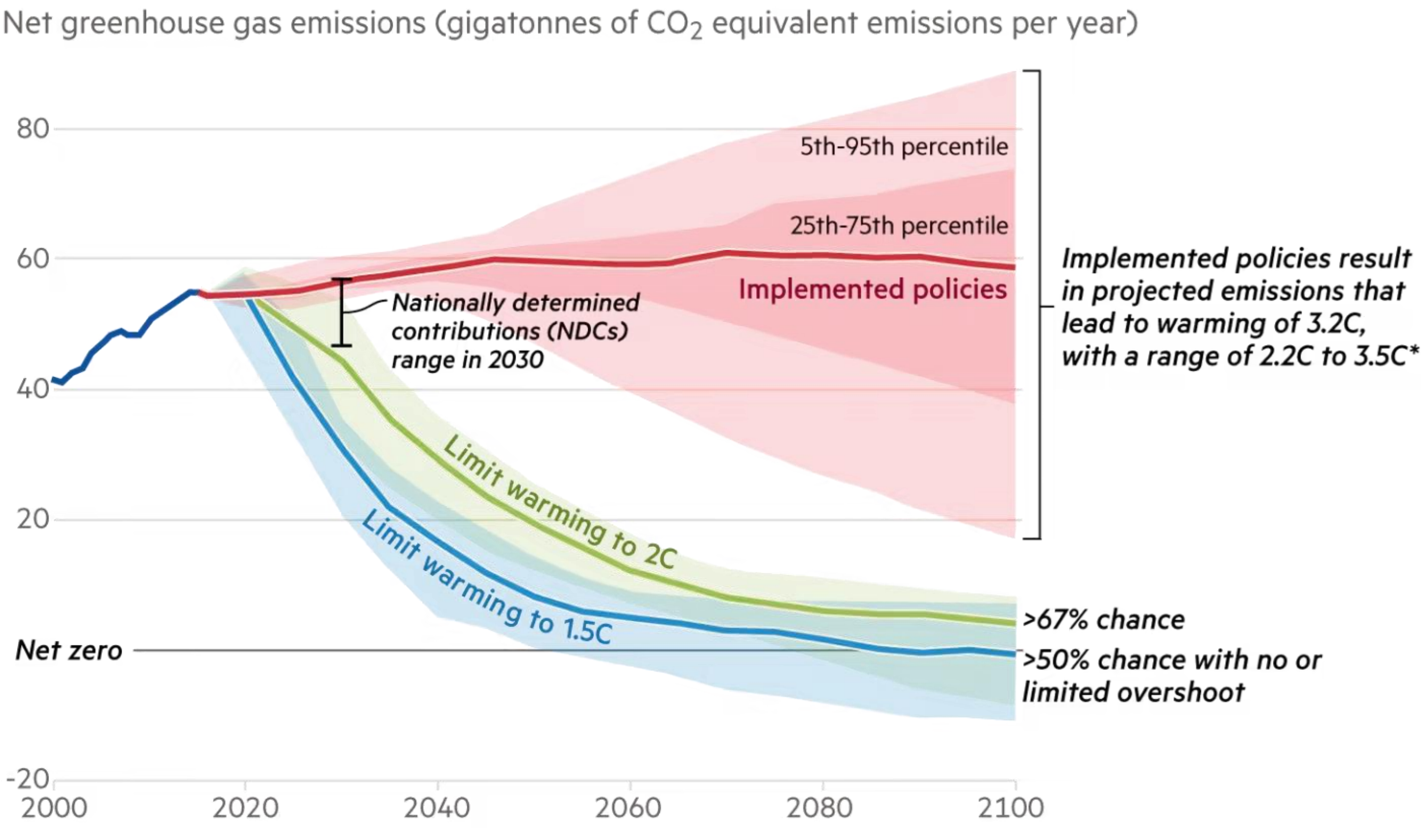
PwC's Net Zero Economy Index 2022
Global findings:
Economy-wide net zero ambitions continue to scale up, but progress on decarbonisation over the past 12 months has declined

Figure 1: Net Zero Economy Index 2022



Source: [PwC Net Zero Economy Index]()

Net Zero can be achieved through strong reductions across all sectors



Source: Synthesis Report 2 of the IPCC Sixth Assessment Report

* medium confidence

GFANZ aims to accelerate the transition to a net zero economy

About Glasgow Financial Alliance for Net Zero (GFANZ)

GFANZ is a global coalition of financial institutions committed to accelerating the transition to a Net Zero economy, launched in April 2021 by Mark Carney.

550+ financial institutions

Over $130 trillion in assets

Commitments

- Use science-based guidelines to reach net-zero emissions across all emission scopes by 2050.
- Set 2030 interim targets that represent a fair share of the 50% of decarbonisation required this decade.
- Set and publish a Net Zero transition strategy.
- Commit to transparent reporting and accounting on progress against those targets.
- Adhere to strict restrictions on the use of offsets.

Seven areas of focus

- **Sectoral pathways**
- **Real economy transition plans**
- **Financial institution transition plans**
- **Portfolio alignment measurement**
- **Mobilising**
- **Policy**
- **Build commitment**

Source: Glasgow Financial Alliance for Net Zero

Net Zero Banking Alliance (NZBA)

The **Net Zero Banking Alliance** brings together a global group of banks committed to aligning their lending and investment portfolios with Net Zero emissions by 2050.

Membership

126
Banks

41
Countries

USD73trn
Total Assets

41%
of global Banking assets

Signatories include:

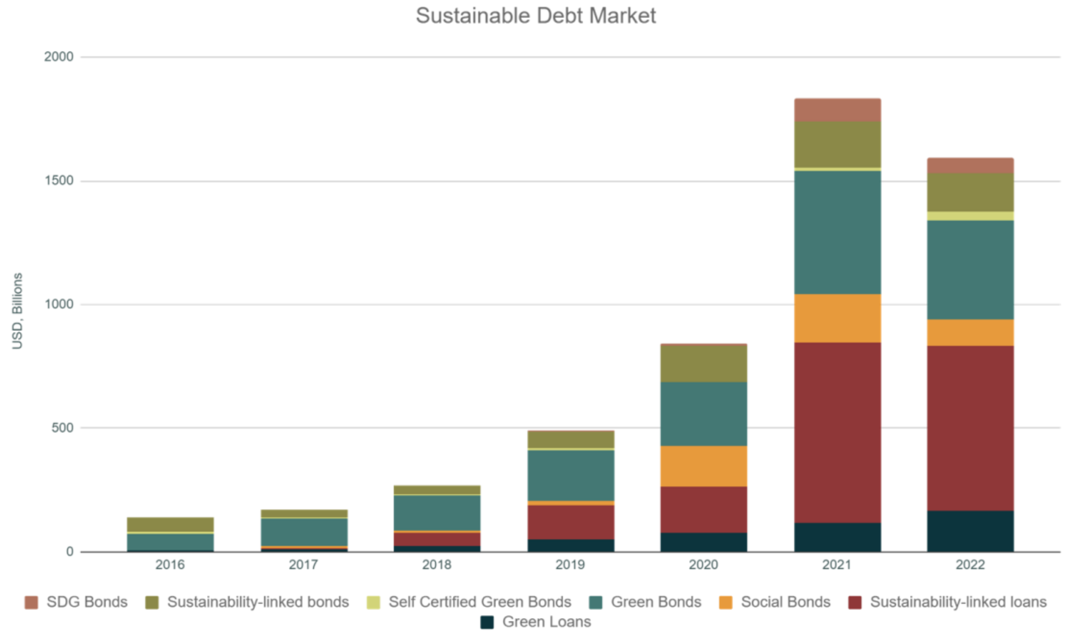
All banks that have signed the commitments will:

- Set 2030 and 2050 emission reduction targets within 18 months of joining including financed emissions
- Focus on priority high-emitting sectors when setting targets to have the most significant impact in line with Paris Agreement
- Disclose annually climate impact and progress against targets (absolute and intensity metrics)

Source: UN Environment programme NZBA

What’s happening globally in Sustainable Finance

The importance of sustainable finance is apparent in global financial markets



Green, social, sustainable and sustainability-linked bonds, loans and other financial products continue to represent, year-on-year, ever-larger slices of the overall market in both volume

Source: PwC/Refinitiv, [Climate bonds initiative]

There is a focus on green finance

- By September 2022, cumulative green, social, sustainability, sustainability linked and transition bonds (GSS+) had topped USD3.5tn
- 52% of cumulative GSS+ volumes were green followed by 22% which were sustainability bonds in 2022
- Cumulative green bond issuance passed the USD2tn milestone at the end of September 2022

Sustainable finance products

Debt Instruments

“Use of proceeds” products

- Green/Social/Sustainability bonds
- Green/Social/Sustainability sukuk
- Transition bonds
- Climate bonds
- Green/Social loans

“Sustainability linked” products

- Sustainability linked loan
- Sustainability linked bond

Transaction Banking*

“Use of proceeds” products

- Buyer’s credit
- Factoring
- Guarantees
- Letter of credit
- Renting and leasing
- Trade loan
- Supplier’s credit
- Sustainable Supply Chain Finance

Sustainability linked products

- Trade Finance
- Bill of Exchange and Promissory Note Discounting

Retail Banking

Lending

- Green personal loans
- Green car loans
- Credit cards
- Green mortgage

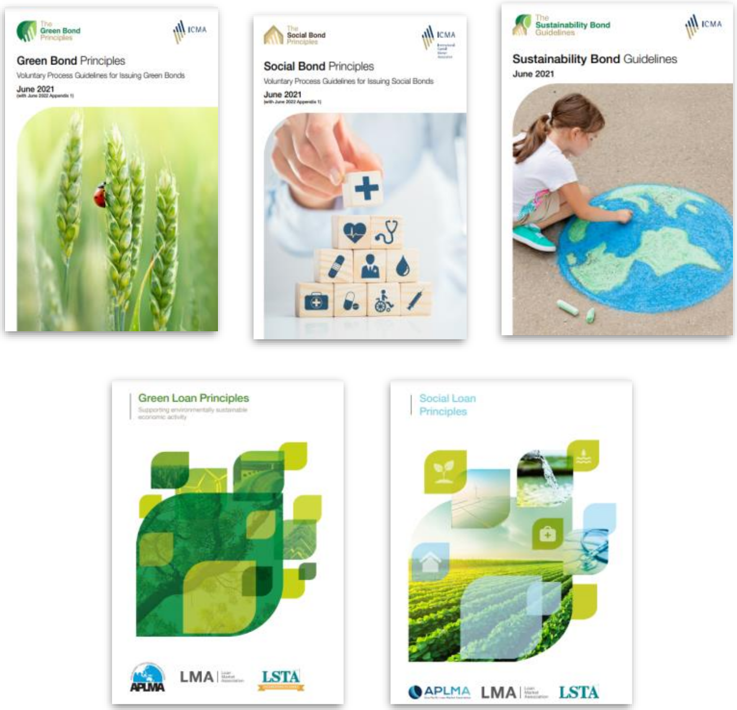
Investing

- Sustainability-enhanced funds
- Sustainability-enhanced pensions
- Green deposits

*There is no commonly accepted standard on transaction banking yet, but early movers have developed frameworks based on ICMA’s and LMA’s guidance principles.

Sustainable debt instruments - “use of proceeds” products

Guidelines for use of proceeds products



1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

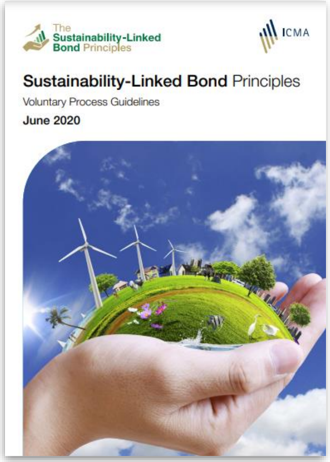
Relevant Products

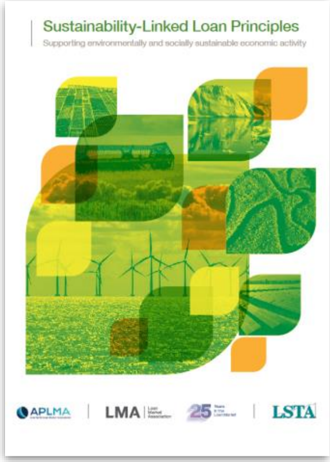
- Green/Social/Sustainability Bonds
- Green/Social/Sustainability Sukuk
- Transition Bonds
- Climate Bonds
- Green/Social Loans

Source: ICMA green bond, social bond, sustainability bond, LMA green loan, social loan

Sustainable debt instruments - “sustainability-linked” products

Guidelines for sustainability linked products





1. Selection of KPIs
2. Calibration of Sustainability Performance Targets (SPTs)
3. Loan/bond characteristics
4. Reporting
5. Verification

Relevant Products

- Sustainability Linked Bonds
- Sustainability Linked Loans

Source: ICMA, LMA

Challenges related to sustainable debt instruments

Use of proceeds products

Project evaluation and selection

- Alignment of the eligibility criteria with relevant taxonomies is necessary due to upcoming regulatory requirements
- Knowledge and expertise is required to understand and interpret the eligibility criteria
- Dedicated internal process/working group

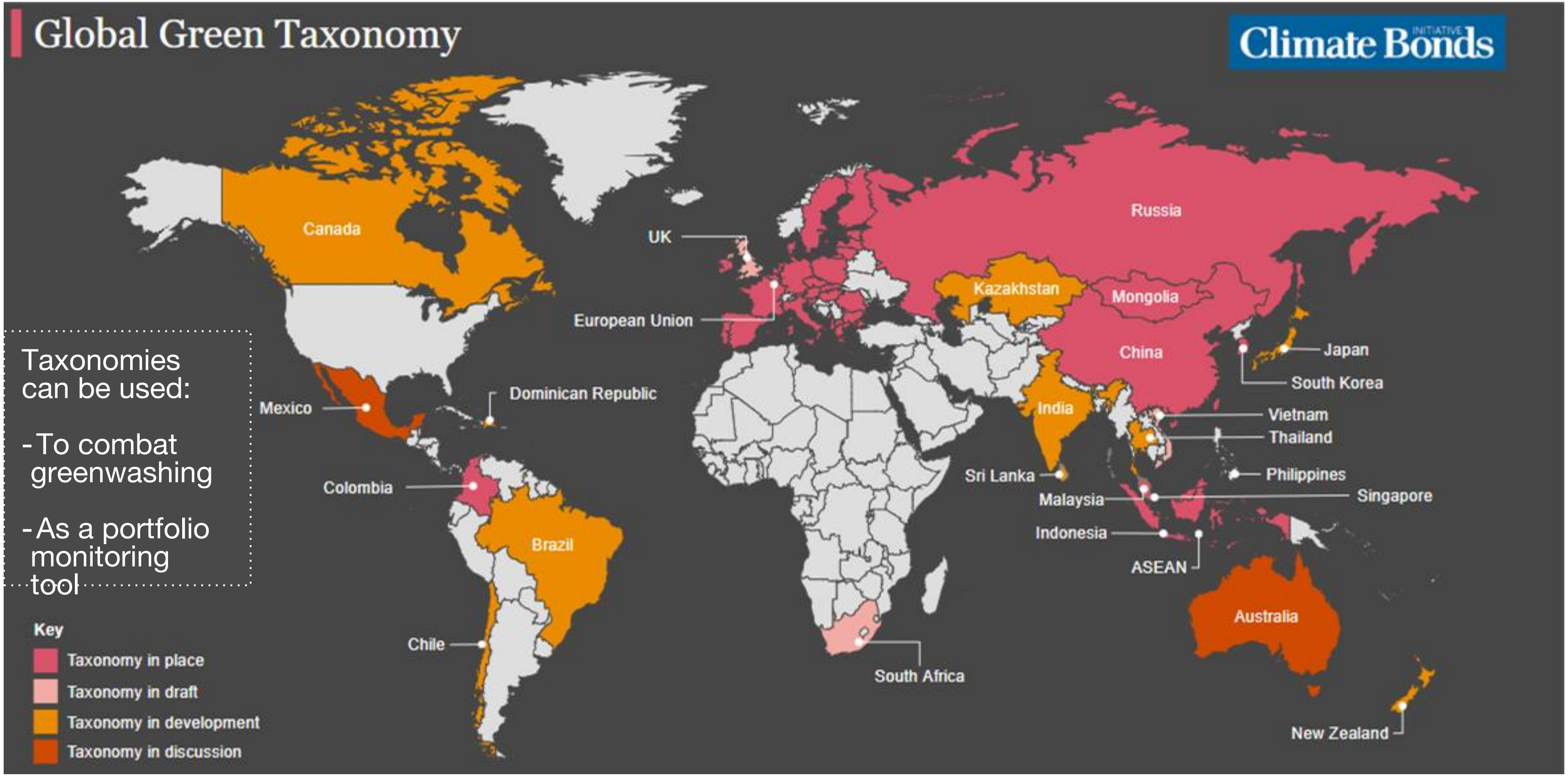
Evolving eligibility criteria

- Requires continuous attention to monitor the most up to date criteria
- Need for regular updates of the frameworks

Sustainability linked products

- SLL principles do not specify how a pricing adjustment should be applied, e.g.:
  - One way - margin reduction when SPTs are met
  - Two way - margin reduction or increase if SPTs are met or not met
- There is no regulatory body that approves what qualifies as SLL
- Risk of greenwashing due to inappropriate KPIs and SPTs leading to litigation risk and/or regulatory scrutiny
- Takes longer to execute compared to plain vanilla debt instruments - discussion and agreement on appropriate KPIs, targets and terms
- Additional costs for borrowers related to external verification

Global regulatory developments



Taxonomies can be used:

- To combat greenwashing
- As a portfolio monitoring tool

Spotlight: HSBC

> We're mobilising finance and unlocking innovation, in line with the science, to help limit the temperature rises to 1.5C. With our help, carbon-intensive industries and regions can invest and create the green business models of the future

Launched in 2021 **Green SME Fund**	Supporting businesses of all sizes invest in sustainable solutions and transition and thrive in a low carbon economy.
Green Term Loans	Available to Large Corporates, Mid-Market Enterprises and SMEs looking to secure funding for environmentally beneficial activities. The minimum loan value is £300,000.
Green Revolving Credit Facilities	Enables companies to fund cash flow needs for environmentally beneficial projects. Minimum loan value of £1,000,000.
Green Asset Finance	Facilitates the financing of green assets through hire purchase, commercial loan, finance lease and operating lease.
Sustainability Linked Loans	Available to customers who are looking to set meaningful and ambitious targets based off their pre-existing sustainability strategies. This loan doesn't need to be for green purposes but must meet the specific criteria aligned to the Sustainability-Linked Loan Principals (SLLP).
Green, Social and Sustainable Bonds	For larger clients they provide access to their Debt Capital Markets team who provide their expertise on bonds which are to be used for green and/ or social or purposes or bonds which are linked to meaningful and ambitious sustainability targets.

Key statistics and targets

HSBC aim to provide and facilitate $750bn to $1tn of sustainable finance and investments by 2030

In H1 2022 HSBC provided and facilitated $44.1bn of cumulative sustainable finance and investments bringing their cumulative amount since 1 Jan 2020 to $170.8bn.

Focus on green technology: In Jan 2022 HSBC announced a $100m investment as an anchor partner in Breakthrough Energy Catalyst, a programme that uses private-public capital to accelerate the development of clean technology.

Source: [HSBC interim 2022 report](#)
[Sustainability hub](#)

Spotlight: ING

> We make our biggest contribution to a sustainable future through our financing. We are committed to better understanding the impact of our lending activities and working with our clients to drive progress on climate action and financial health. We have ambitious targets to guide us.

Sustainability-linked Loans	• Launched the first ever SLL to Phillips in 2017 • Partnered with EcoVadis to develop a standardised SLL offering to mid-market clients
ESG M&A Advisory	• Provide advisory services on Net Zero and ESG value creation
Supply Chain Financing	• Link supply chain finance discount rates to suppliers' sustainability scores
Sustainable Equity Team	• Provide equity stakes and subordinate loans to scale up technology companies and make strategic links with M&A advisory clients
Other products include green/social loans, green/social/sustainability bonds, sustainable structured finance transactions and sustainable improvement derivatives	

Key statistics and targets

In wholesale banking, ING are committing to mobilise EUR 125bn of sustainable finance per year by 2025

In H1 2022 ING supported 205 sustainable transactions of which 85 were Sustainability Linked Loans, followed by 54 bonds with a sustainable component and 21 green/social loans

In 2021 ING had their first sustainable supply chain financing, circular product-as-a-service financing, green asset-backed security and first green bond where circularity was the main theme

'We're aiming to steer the most carbon-intensive parts of our portfolio towards reaching net zero by 2050. We call this the Terra approach.'

Source: ING Terra approach
ING 2022 Climate report

Sustainable transaction banking

Expectations

- In the early stages, but there is significant growth potential
- The demand for sustainable Global Transaction Banking (GTB) products far exceeds supply[1] (at present, only 10% of demand is met)

Opportunities

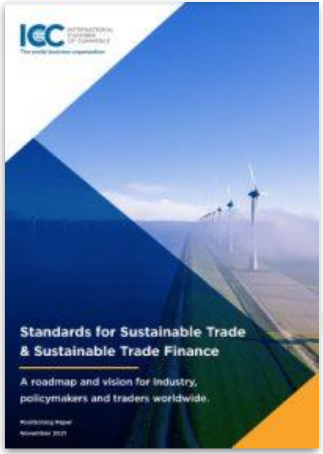
- Opportunity for early movers to capture a high market share
- Banks should act now to build a sustainable GTB value proposition that enables them to:
  - Defend existing relationships
  - Expand their market share while staying ahead of customer demands
  - Meet the expectations of employees, investors, and the public

Estimations

- Revenue from sustainable trade finance and cash management products is expected to grow by 15 to 20% annually to total combined revenues of $28 billion to $35 billion in 2025[1]

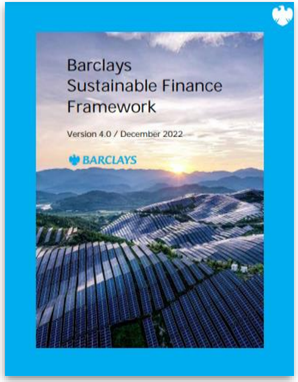
Many organizations work collaboratively around establishment of standards.

ICC published the first draft set of Standards for Sustainable Trade Finance.



[1]World Supply Chain Finance Report, ICC Standards

Examples of sustainable trade finance



Early movers have started to shape their products based on the existing principles regarding “use of proceeds” and “sustainability linked” debt instruments.

Use of proceeds: Proceeds are allocated to green, social or sustainable activities

Sustainability linked: Transactions are eligible based on overall sustainability performance of the counterparty (relevant KPIs and ambitious SPTs)

Green/Social Trade Finance

- Support to green/social trade activities adhering to the Green/Social Loan Principles
- A trade finance facility is made available to exclusively fund green/social trade activities

Sustainable Supply Chain Financing

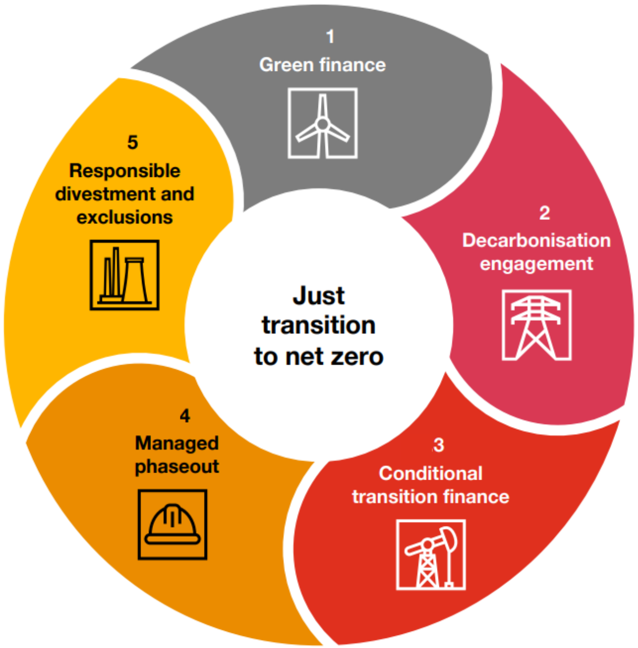
Early payments to customers’ suppliers on terms that take into account the suppliers’ sustainability performance.

Objectives:

- Service the client needs of ensuring sustainable sourcing
- Reduce the carbon footprint within the client’s supply chain

Source: HSBC, BBVA, Barclays

Just transition to Net Zero



Green finance
- Finance for low or zero carbon activities
- Investments facilitating a reduction in greenhouse gas emissions (GHGs) or the carbon intensity of an activity.

Decarbonisation engagement
- Engaging with businesses of high-emitting activities, that need to decarbonise, and where financial institutions have a significant influence to support the changes required.

Conditional transition finance
- Limited new investments in high-carbon activities which may require some continued investment as part of a net zero energy transition, with qualifying conditions in place

Managed phaseout
- Retiring high emitting assets earlier than planned
- Clear commitments and careful planning with stakeholders to avoid social harm

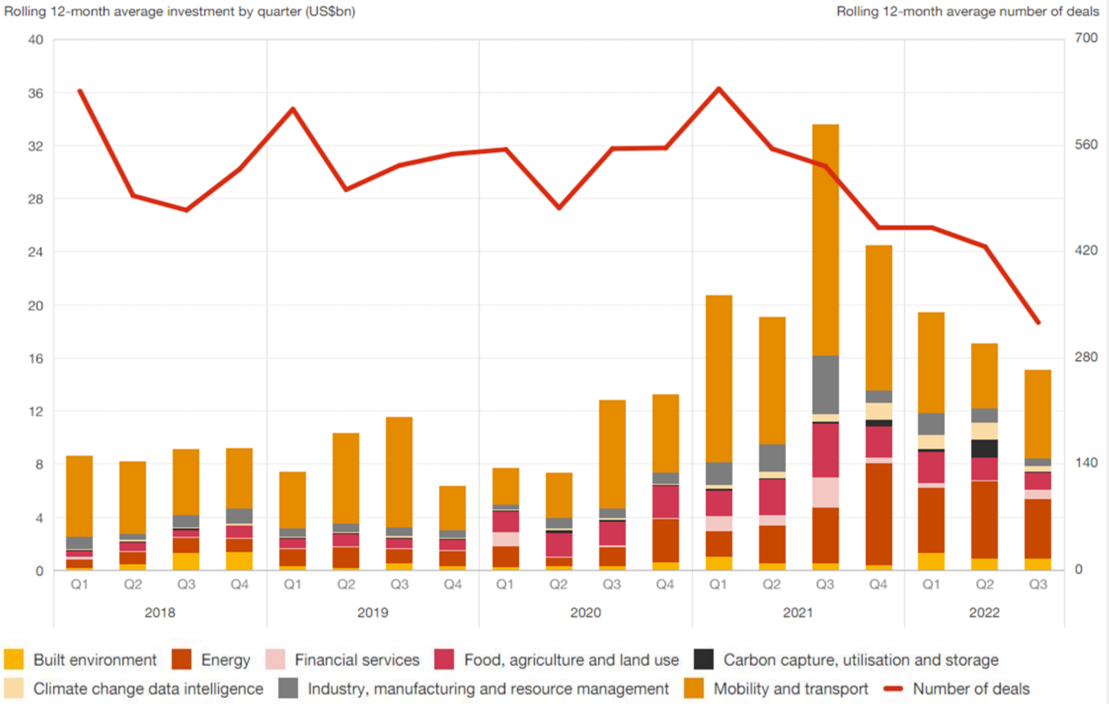
Responsible divestment and exclusions
- Divesting or excluding assets or activities which do not align with an institution's decarbonisation pathway
- Restrictions on new lending and investment
- Careful handling of divestments to minimise social harm and achieve real world emissions reductions.

Source: PwC Navigating a just transition to Net Zero

Future trends: Climate technology

Climate tech investment has slowed in 2022, but is still above pre-2021 levels. Wider macro trends from the public and private sectors suggest a positive outlook and increasing demand for climate technology.

Figure 2: State of Climate Tech 2022



Source: PwC State of Climate Tech 2022

Climate tech funding in 2022 represented more than a quarter of every venture dollar invested in 2022, in the upper half of the 20-30% range observed since the start of 2018.

Investment in climate tech has been in the US$15-20 billion range per quarter, in line with the first half of 2021. This represents aggregate funds raised for climate tech since the start of 2018 of US$260 billion, over which more than US$50 billion has come in 2022.

Deals in 2022 are increasingly later-stage venture deals, and with larger average deal sizes than in 2021.

Future trends: Climate technology

All eight challenge sectors have attracted growing investment

Estimated investment in the last 5 years† and the subsector with the most funding

Mobility & Transport	Energy	Food, Agriculture and Land Use	Industry, Manufacturing + Resources	Built Environment
Low GHG Light and Heavy Vehicles	Renewable Energy Generation	Alternative foods and low-GHG proteins	Transformative circularity	High efficiency fixtures and fittings
$138B	$49B	$30B	$21B	$11B

Climate change management + reporting	Emissions data monitoring, management and reporting	**$7.1B**
Financial Services	Funds, portfolios, and investment banking	**$7.7B**
GHG Capture, Removal + Storage	Carbon capture, utilisation, and storage (CCUS)	**$3.4B**

Source: PwC State of Climate Tech 2022

Future trends: Nature Finance

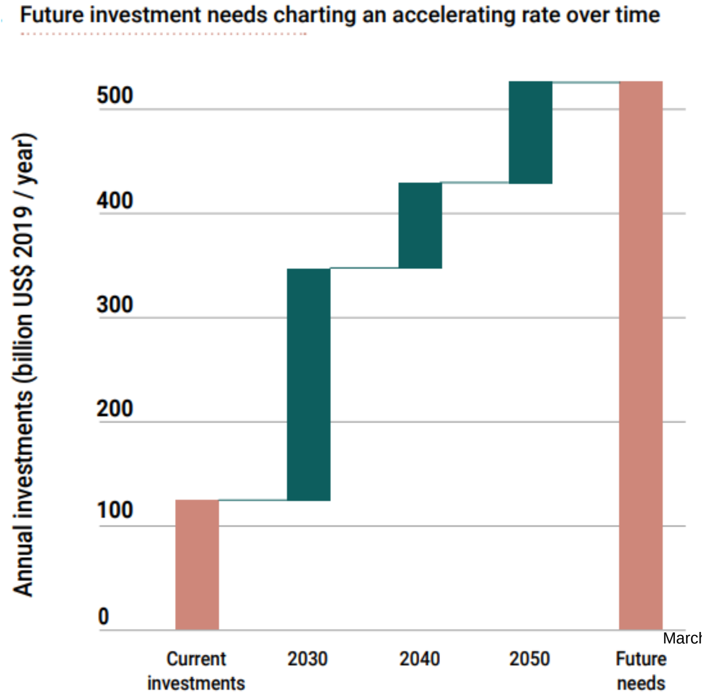
"Developing and tapping solutions for a net zero, nature positive, resilient food system that could generate up to USD$4.5 trillion of new business opportunities annually by 2030" while "*those who fail to act could shortly see billions of dollars of value permanently lost*", with individual firms at the centre of the global food supply system potentially losing up to 26% of their value by 2030.

UN Climate Change High Level Champions report

- If the world is to meet climate change, biodiversity, and land degradation targets, it needs to close a USD 4.1 trillion financing gap in nature by 2050.
- The current investments in Nature-based solutions amount to USD 133 billion – most of which comes from public sources.
- There's increased interest in direct investment into Nature-based solutions (i.e. for a financial return, not just as a buyer of ecosystem services, or conservation philanthropy)

Products:

- Blue Bonds and Blue Loans
- Green Bonds and Green Loans



Source: UNEP State of Finance for Nature

“The lynchpin to progress across all climate pillars is finance”

Dr Sultan Ahmed Al Jaber, COP28 President-Designate, UAE Special Envoy for Climate Change and Minister of Industry & Advanced Technology

Thank you

Grazie!

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