8 November 2021 Financial Institutions

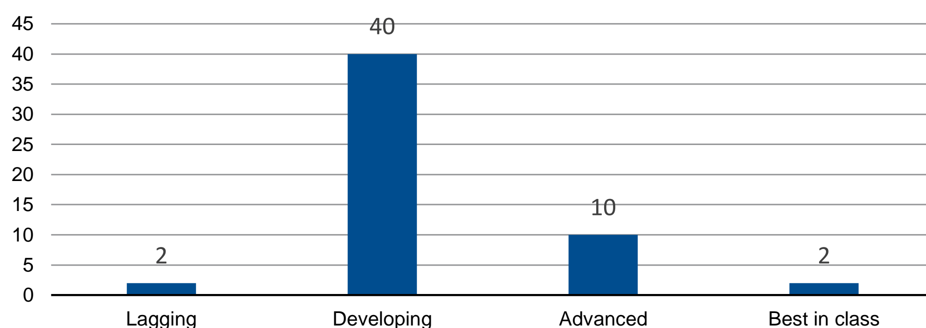
ESG and digital transition as measures of long-term sustainability for banks

Given the rising importance of ESG, we explicitly take environmental, social and governance risk factors into account in our credit ratings via a long-term sustainability modifier. We also include digital transition risk (D) because we see this as the most pressing issue for banks' sustainability. This report provides colour on the main drivers of our long-term sustainability assessments for a selection of large European banks and an overview of our ESG research.

Our long-term sustainability assessments are qualitative and not based on pre-defined questionnaires, scorecards, or pre-set weights. Rather, our rating analysis focuses on the most material ESG-D issues and includes informed opinion about how proactively issuers are tackling them.

We assign a positive long-term sustainability factor when banks are either best-in-class or advanced relative to their peers. Currently, long-term sustainability has a positive impact on only 24% of our ratings (Figure 1), reflecting our view that, despite significant efforts, the full extent of ESG-D risks is, on average, still not well understood, measured, or managed by banks.

Figure 1: Long-term sustainability assessments of European Banks



Source: Scope Ratings

Our assessments are often driven by governance (G) and preparedness for digital transition (D). For large institutions, governance concerns are the exception rather than the rule – largely a result of the closely regulated nature of the industry. Digital transition risk, which is perhaps the most pressing risk banks face, also tends to be lower at large institutions, as they have been investing heavily in digitalisation for several years.

Environmental (E) and social (S) risks are seldom the main drivers of our long-term sustainability assessment, but this could soon change. Increasing regulatory focus on both areas will make it more relevant, as will convergence of disclosure standards in coming years.

In the following pages of this report, we provide some colour on elements that can drive banks' long-term sustainability assessments in our rating process. After a short overview of the relevant methodological aspects, we cover the team's recent ESG-focused research and provide case studies highlighting the main drivers of the long-term sustainability assessment for 20 large European banks. All of them are rated on a subscription basis, with ratings disseminated on ScopeOne, our investor platform. For these names, we also include in this report a more systematic attempt at mapping materiality, exposure to and management of the different ESG-D risk dimensions. This is not part of our rating process, but rather a tool to stimulate analytical discussions.

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Main findings from our long-term sustainability assessments

Over 50 rating committees with explicit ESG-D assessments in 2021

Since the beginning of 2021, we have held 54 rating committees[1] where we have assigned long-term sustainability qualifiers to banks in our coverage universe. Our overall assessment is that while European banks are gradually embracing changes, they are mostly doing so too slowly to grant any positive credit differentiation. Most of the banks are classed as developing, acknowledging some degree of awareness of emerging ESG-D risks but not to an extent that provides a rating uplift.

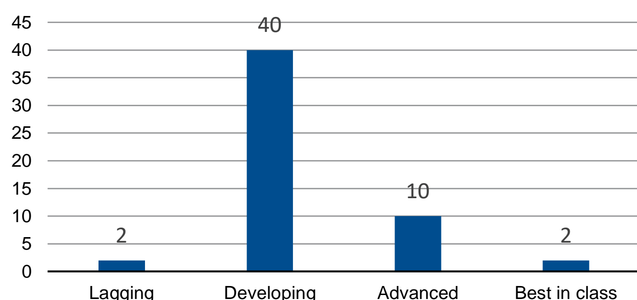
	Sector materiality		
	Low	Medium	High
E-risks		x	
S-risks	x		
G-risks			x
D-risks			x

We have established a clear pecking order for the materiality of factors potentially affecting the long-term sustainability of business models. Governance (G) and preparedness for digital transition (D) are most likely to drive credit risk differentiation. Environmental (E) factors come next while social (S) factors are least likely to drive credit risk. However, the importance of both E and S factors are clearly increasing due to the increasing focus by investors and regulators. Therefore, we expect that our research on the materiality of long-term sustainability and our related ratings assessments will evolve in response to investors' needs.

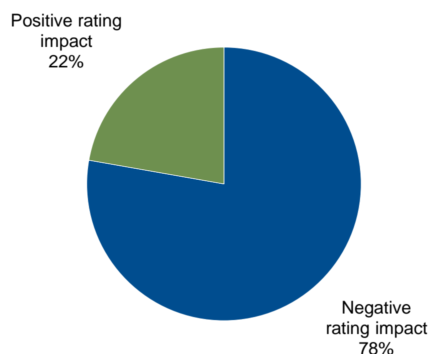
Under our weak-link approach, negative credit differentiation through 'lagging' or 'developing' qualifiers is more common than positive credit differentiation through 'advanced' or 'best-in-class' qualifiers. If a bank does not adequately manage a single material ESG-D risk, we will likely limit the assessment to 'developing' or 'lagging'. The same applies if an issuer is making progress but is not demonstrably better or faster than the sector average.

Positive credit differentiation with 'advanced' or 'best-in-class' qualifiers typically results from an issuer's comprehensive management of all ESG-D risks or from lower-than-average exposure to ESG-D risks.

Figure 2: Distribution of ESG-D assessment for 55 banks



Source: Scope Ratings



Source: Scope Ratings

G-risks more likely to drive negative differentiation

With respect to governance, negative differentiation often arises for banks that have been investigated and/or are frequently in the news for corruption, AML failings, sanctions violations or other instances of misconduct, litigation or regulatory investigations. An unstable management team or lack of a consistent strategic approach are also G-related drivers of negative credit differentiation. Positive differentiation related to governance is less likely for large banks because they generally display strong governance structures due to their supervisory oversight, listing rules, and high investor expectations. Governance failures will, however, likely drive credit differentiation.

[1] Including public ratings and ratings available on subscription.

D risks (and opportunities) are more symmetric in nature

Digital risks can result in positive differentiation for banks with business models that are inherently less likely to suffer from competitive disruption (corporate and investment banking vs retail) or because the bank is particularly well equipped to deal with digital disruption, to the extent that we consider it to be an opportunity and a competitive advantage.

Negative differentiation linked to digital risk typically arises when a bank is not keeping up with its competitors in its digital offering and back-end processes, leading to high investment needs and poor cost efficiency. The inability to adequately invest in digitalisation can be a negative risk driver for smaller and less profitable banks.

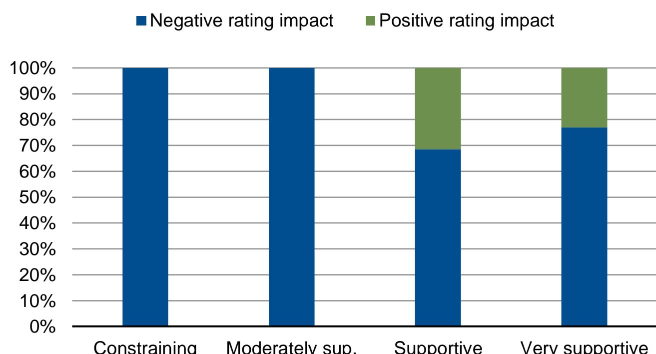
E-risks and S-risks less likely to be main drivers of assessments

Environmental and social risks have not so far emerged as main drivers of our long-term sustainability assessments, either positively or negatively. However, strong management of climate risk or the ability to tap sustainable financing has in some cases contributed to more favourable ESG-D assessments.

Banks with stronger business models or which operate in more supportive operating environments tend to fare better in our assessments of ESG-D risks. We attribute this to better governance codes, greater stakeholder sophistication with respect to ESG themes, greater resources allocated to ESG risk management and digital transformation. However, we are conscious of the limited sample size to draw firm conclusions and we therefore will be adding more banks to our sample.

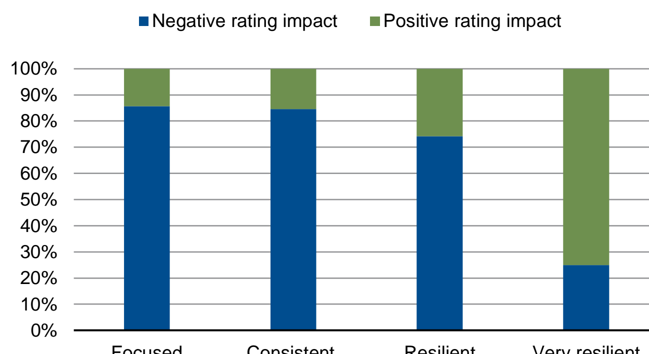
Figure 3: Correlation of ESG-D assessment with other rating drivers

Correlation with Operating environment



Source: Scope Ratings

Correlation with business model assessment



Source: Scope Ratings

Scope's approach to sustainability risks of banks

ESG risks do not yet have a measurable direct impact on bank fundamentals, but we believe they increasingly will. In our most recent methodology update in January 2021, we introduced a “long-term sustainability” assessment to refine a bank's anchor rating. This assessment looks at relevant ESG risk factors with a specific focus on an issuer's preparedness for digital transition risk (D).

While our analysis overlaps with traditional ESG impact scores, the end goal is different because we do not take normative views or actively try to influence banks' behaviour. Rather, we focus how ESG-D risks might impact an issuer's creditworthiness and ability to repay debt.

ESG analysis is still in its infancy insofar as the credit risk aspect is concerned because risk factors are difficult to measure since disclosure is insufficient and inconsistent. As such, ESG-D risks do not easily lend themselves to quantitative analysis and scoring models. But that is not a good reason to ignore them.

Our approach is therefore qualitative and takes into account the level of sophistication of an issuer relative to peers in a respective region or business segment.

We expect ESG information to improve due to increasing demand from investors, supervisors and other stakeholders. Financial institutions that cannot meet rising expectations face potentially higher funding costs or regulatory consequences. In our assessments, we look for signs that management is anticipating these rising expectations and taking steps to meet them in a timely manner.

We summarise our assessment of an issuer's position by assigning an ESG-D ratings qualifier (best in class, advanced, developing, lagging). The assessment can result in a small uplift or lowering of our anchor rating.

Scope's Financial institutions research on ESG risks

Environmental risk factors

All banks are exposed to climate-change risk, but this is not an immediate concern

For banks, exposure to climate-change risk is unavoidable because their lending portfolios reflect the economies they operate in. See our report Assessing ESG as a component of bank credit risk Part 1: Environmental factors – 25 February 2021. To the extent that extreme weather events can affect bank borrowers and/or collateral values, physical risks are something banks manage through setting appropriate underwriting criteria and risk limits.

Transition risk affects banks directly by affecting their ability to underwrite new business and indirectly via asset-quality channels when loan books are highly exposed to polluting industries, which may become stranded assets and face difficulties refinancing their debt as economies transition.

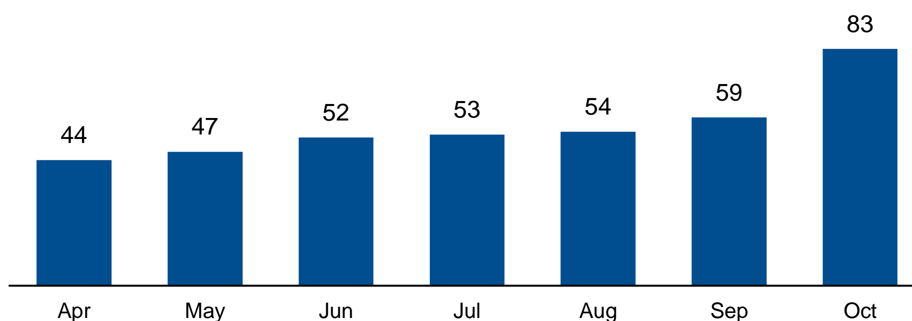
There is an obvious, though not complete, interplay between physical and transition risks. At the industry level, physical risks are bound to increase over time – as average global temperatures continue to increase. By how much will largely depend on how successful we are collectively at cutting emissions early on. At the same time, the stricter the approach to emissions reduction, the greater the risk of disruption to the current economic set-up – with potential unintended consequences for banks.

While some early manifestations of climate change are already visible, they have so far had contained impacts on bank's financial performance and there is a risk that banks will delay necessary adjustments to their strategies as they deal with more urgent matters such as cost management and digital transition.

2050 emission targets longer than investors' time horizons

Large banks' climate-risk commitments are converging towards the goal of net zero emissions in their lending and investment portfolios by 2050. In other words, banks will have to completely divest themselves of carbon-emitting sectors over the next 30 years unless they can help their clients restructure or fund enough investment in carbon offsets. At present, 84 banks globally have joined the UN-convened Net-Zero Banking Alliance by signing a commitment to do so, as well as publish intermediate targets for 2030.

Figure 4: Banks that have joined the Net-Zero Banking Alliance since inception



Source: UNEPFI, Scope Ratings

Aside from the obvious risks, it is important to highlight that green transition comes with opportunities in the areas of green finance and some banks may in fact benefit from the need to finance customers' transition to greener business models.

Poor disclosure limits the analysis of banks' climate risks

Slow-moving disclosure standards for climate-risk exposures are a problem in particular when assessing banks' indirect emissions i.e. those arising from their lending and investing activities. The amount of available information has skyrocketed in recent years, yet it remains largely un-audited, self-declaratory and often selective.

The confusing landscape of ESG standard setters, scoring tools, industry initiatives and climate activists increases the risk of greenwashing (Loose ESG disclosure for banks: good for on-boarding not trust, 17 Sep 2021). At the same time, the ever-increasing public focus on climate change is raising headline and reputational risk for banks with links to highly-polluting industries and for banks that make inflated claims about their green credentials.

Thankfully, there seems to be a greater drive towards convergence. In April 2021. the European Commission adopted a proposal to amend the Non-Financial Reporting Directive (NFRD) and introduce the Corporate Sustainability Reporting Directive (CSRD). In our view, the main benefit of the CSRD is to outline a clear roadmap to determine a more detailed and prescriptive framework, including a requirement for an assurance check of sustainability reporting. As well, the IFRS Foundation has started work on setting IFRS sustainability standards.

Growing regulatory focus will raise the bar for banks to manage climate risk

Like other ESG risks, it is easy for climate-change risk to fall to the bottom of the agendas of busy management teams. ESG risk manifestation may be perceived as too rare or too distant compared to other KPIs that are measurable and looked at quarterly. But, as our research activity has highlighted on several occasions, regulators are sharpening their tools and it is clear that E-risks increasingly feature on regulatory and supervisory agendas (European banks: mind the GAR (Green Asset Ratio), 09 Mar 2021; UK banks making progress on capturing climate-related financial risks, 26 May 2021; French banks: supervisory pilot test reveals moderate exposure to climate risks 10 May 2021).

The recent ECB economy wide stress test report[2] illustrates how a belated and disorderly transition will eventually result in higher bank losses, leading to a greater probability of bank failures. The discussion about the long-term assumptions used in climate stress test will stimulate the regulatory debate and support the introduction of firmer regulatory metrics over time. In turn, this could help current management teams focus on more tangible shorter-term ambitions.

[2] The wide angle – The ECB's climate stress test for banks: five caveats

Social risk factors

The importance of public trust for banks

Despite improvements in public perceptions over the past decade, banks continue to suffer from a lack of public trust when compared to most large corporate sectors. We have highlighted how the gap to large technology companies may increasingly translate into a business challenge as digitalisation continues to transform the industry and as new business models emerge (Assessing ESG as a component of bank credit risk Part 2: Social factors, 25 March 2021).

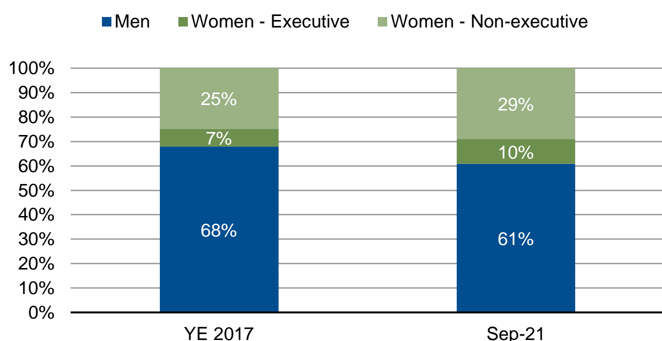
In our research, we have often highlighted the pressure on banks to shrink their cost base, and to reduce the number of branches. But branch closures and M&A can be painful for stakeholders such as clients, local communities and, in the case of costly workforce reductions, for staff and shareholders.

Mis-managing the social repercussions of transition can be a costly mistake

Financial inclusion, in the context of shrinking physical networks, will likely be a point of political, regulatory and media tension. In developed markets, any step back in financial inclusion is unlikely to be met kindly by any stakeholder groups. Managing data privacy, including cyber security, is also a critical challenge for the industry.

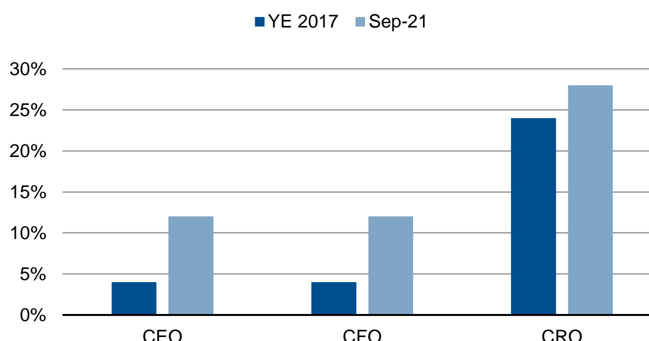
Diversity and inclusion is perhaps one of the areas where progress is more easily quantified and tracked. We believe the breadth of experience and views provided by a diverse management team supports a robust risk culture and ensures that a bank is better prepared to adapt to rapidly changing operating dynamics.

Figure 5: Board composition by gender



Source: 25 European banks, Scope Ratings

Figure 6: Proportion of women in senior executive roles in European banks



Source: 25 European banks, Scope Ratings

There is some scepticism about the relevance of social considerations to credit risk. However, we argue that once regulators take a stance on these matters, their relevance for investors increases. Our research (European banks: social factors material for credit analysis as regulatory pressure mounts, 30 September 2021) highlights several key regulatory initiatives in Europe, including a recent discussion paper from the Bank of England and the UK Financial Conduct Authority, highlighting the willingness to use regulatory powers to enforce greater diversity and inclusion in bank workplaces and management teams. The European Central Bank is also looking to become more forceful in ensuring diversity. For example, the latest revision to the guide for fit and proper assessment includes considerations about gender diversity.

Governance risk factors

We have highlighted governance as the key ESG risk driver for banks – and the most likely to be a material driver of credit risk (Assessing ESG as a component of bank credit risk Part 3: Governance factors, 4 August 2021). Certain governance failures are ESG factors with a proven link to punitive regulatory intervention that have even contributed to the default of some smaller banks. Even for large banks, where major governance

failures are less likely on paper due to the highly regulated nature of the institutions, fraudulent behaviour can still go undetected and eventually cause significant reputational damage and severely disrupt liquidity and funding spreads, thus negatively affecting all stakeholders.

In our rating and research activity, we have identified several aspects of governance that may lead to higher credit risk. These include:

- The complexity of a group's structure
- A lack of independence among its board of directors
- Lack of relevant board expertise in key areas
- Excessive power of a key executive
- Key-man risk and absence of succession planning for key executives
- Poor management oversight of material risk-takers
- Material related-party transactions, or aggressive optimisation of intra-group resources, from tax optimisation to fungibility of resources
- Poor track record on business conduct such as incidents of product mis-selling, benchmark manipulation or money laundering
- Excessive remuneration or risk-taking reward policies

Incorporating ESG risks into sovereign ratings

Since October 2020, our sovereign ratings include a quantitative and qualitative assessment of the ESG risks that affect the credit profiles of sovereigns. These ESG assessments are of relevance because many retail and commercial banks operate at the national level and their portfolios are therefore correlated with the ESG risks of that economy.

While we publicly rate 36 sovereigns, our model includes 132 countries, enabling us to draw a few stylised conclusions for our ESG risk factors across and within regions.

Environmental risks are likely to have long-term demand and supply-side implications and could even disrupt economic and financial systems. Examples include the rise in costs from increased incidence and severity of extreme weather conditions and the structural change economies must undergo as policymakers and regulators adopt and expand carbon-pricing mechanisms.

Social risks arising from labour-market developments and ageing populations have a fundamental impact on growth trends and the outlook for public finances.

Lastly, the strength, soundness and stability of a country's political institutions inform the sovereign's ability to implement structural reforms, including those addressing environmental and social challenges.

We use the following quantitative variables to capture ESG risks in our sovereign ratings. Details of this framework and the rationale for individual variables can be found in our Sovereign Ratings methodology.

Rating category	Indicator
Environment	CO_2 emissions per USD 1,000 of GDP
	World Risk Index which measures the risk of disaster in consequence of extreme natural events
	Resource risk: a country's ecological footprint of consumption relative to its biocapacity
Social	Old-age-dependency ratio: ratio of population aged 65+ per 100 population 15-64
	Income inequality: income share held by highest 20% / income share held by lowest 20%
	Labour force participation rate, ages 15-64
Governance	Worldwide Governance Indicators

Source: Scope Ratings

While some of these variables explicitly incorporate long-term forecasts, such as 'the old-age dependency ratio' (up to 2035), others reflect the most recently available data, including 'CO_2 emissions', 'natural disaster risks' or 'governance indicators.' As such, these variables capture the underlying structural and societal features of an economy, informing factors that may drive long-term economic growth and the sustainability of public finances.

--------ESG-D risk profiles--------

1. DACH countries
2. France and Benelux
3. Italy
4. Nordic countries
5. Spain
6. UK

ESG and digital transition as measures of long-term sustainability for banks

Commerzbank AG	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment reflects the evolving nature of sustainability initiatives in line with the bank's current strategy refinement. Environmental and social risks are adequately managed. It has to be noted, however, that the bank is a late comer in implementing ESG-related practices compared to European peers.

- **Environmental.** Commerzbank's public commitment to environmental protection is solid and stipulated by a comprehensive set of policies. Sustainability aspects are increasingly taken into account in the bank's loan and investment portfolios. The bank is systematically examining products, transactions and business relationships for potential environmental risks, paying special attention to reducing carbon-intensive sectors within its portfolio.
- **Social.** We do not believe S factors will drive credit quality materially in the near term. However, we note the significant headcount and branch network reduction over the past few years.
- **Governance**. Corporate governance showed weaknesses in establishing a consistent strategy following the financial crisis. This also resulted in a material rebuild of the Management and Supervisory Boards. The desire of the government to divest the 15% stake puts pressure on management.
- **Digital transition.** The group has set a clear focus with respect to digitalisation, including successful initiatives with the fintech hub MainIncubator. Yet the bank needs larger-scale investments in IT structure as measures taken so far are unlikely to set new industry standards.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x			x	
S-risks	x			x				x	
G-risks			x			x			x
D-risks			x		x			x	

Country of domicile: GERMANY		
Sovereign rating ESG scores	Environmental risks	**Weak**
	Social risks	**Neutral**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Credit Suisse AG	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment is driven by concerns about Credit Suisse's risk governance following several high-profile incidents.

- **Environmental.** The group has a relatively small loan book as a proportion of assets compared to peers, with more exposure through investment activities. Responsibility for managing climate risks starts at the board level. Credit Suisse is developing climate-related metrics for risk management purposes and has been using scenario analysis since 2018. In 2020, the group announced initiatives to strengthen its sustainability strategy to capture growth opportunities.
- **Social.** For Credit Suisse, the assessment of sustainability risk considers both environmental and social risks. There may be fallout from recent events on the group's reputation and employee recruitment and retention.
- **Governance**. Following large losses from dealings with US-based hedge fund Archegos, and events related to supply chain finance funds linked to Greensill Capital, Credit Suisse has taken several actions including replacing board members and senior executives, refocusing business activities, and performing internal reviews. Further changes may be forthcoming as a new chairman has been in place since May 2021.
- **Digital transition.** Shifts in customer behaviour and digital capabilities have allowed the group to reduce its branch network by 25% in Switzerland. Digitalisation was a theme of the December 2020 strategic update, with the group seeing opportunities for further digitalisation in all business areas, including risk and compliance. We see the group's wealth management business as being less exposed to digital transition risks.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x		x			x		
S-risks	x					x		x	
G-risks			x			x			x
D-risks			x	x				x	

Country of domicile: SWITZERLAND		
Sovereign rating ESG scores	Environmental risks	Neutral
	Social risks	Strong
	Institutional and political risks	Neutral

Source: Scope Ratings
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ESG and digital transition as measures of long-term sustainability for banks

Deutsche Bank AG	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment reflects the integration of sustainability factors into strategic targets and initiatives as well as the progress the bank has made in regard to sustainable financing and further adoption of digital practices. Yet, Deutsche Bank has a weak track record due to ongoing litigation and investigations, particularly in Germany and the US.

- **Environmental.** The bank's green bond programme launched in 2020, adoption of the Equator Principles and Fossil Fuel Policy, among many initiatives, demonstrate solid management of environmental risks. Recent measures point to the increased importance of environmental risk management in the group. The bank has set a target to achieve EUR 200bn in sustainable financing and ESG investment by year-end 2025 and exceeded its first interim target in 2020.
- **Social.** We do not believe S factors are likely to drive credit quality materially in the near term. However we note the significant headcount and branch network reduction over the past few years.
- **Governance**. Reputational risks continue to present a burden for internal capital generation as litigation and other regulatory disputes constrain the bank's strategic transformation efforts. In addition, management of ESG assets is very important for DWS, the group's asset management business and for Deutsche Bank and therefore we see the recent media reports of greenwashing as a potentially material reputational risk.
- **Digital transition.** The expansion of digital capabilities remains a strong focus across all businesses. Yet, fintechs pose a challenge for the bank when it comes to transaction payments and consumer finance. Deutsche Bank is therefore taking opportunities to co-operate with fintech companies.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x			x	
S-risks	x			x				x	
G-risks			x			x			x
D-risks			x		x			x	

Country of domicile: GERMANY		
Sovereign rating ESG scores	Environmental risks	**Weak**
	Social risks	**Neutral**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

BNP Paribas SA	LT Sustainability modifier: Best in Class	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Best in Class' long-term sustainability assessment reflects our view that the bank has developed a comprehensive digital and sustainability strategy. We see BNP Paribas as an early adopter of the most advanced industry standards in these two areas. We believe this approach has enhanced its credit standing. Internal controls and risk management, including business conduct across the group, have been reinforced in recent years.

- **Environmental.** Environmental risk is material given the diversity of operations by geography and sector-wise, from insurance, asset management and corporate lending. The group is exposed to reputation risk in this area. Disclosures explain how the group intends to transition. Priorities were already well embedded in the 2017-2020 medium term plan and the strategic focus keeps increasing.
- **Social.** Social factors are less of a differentiating factor for BNP Paribas. The bank operates a large retail franchise across France and Belgium, and to a lesser extent in Italy and the US. The active optimisation of branch networks has been well managed from a reputation perspective.
- **Governance**. Legacy issues include implementation of a remediation plan following the 2014 USD 9bn settlement with the US authorities for violating sanctions. The bank agreed with the need to review its compliance function. It has not been a source of reputation risk in recent years. The group continues to communicate on initiatives in place to strengthen the compliance function.
- **Digital transition.** We view the group as a frontrunner in digital banking. BNPP has developed various digital tools to target different large-scale customer segments using the full range of available digital solutions, while optimising its physical presence. Solutions like Hello Bank or Nickel have contributed to expand the group's geographical presence beyond traditional retail markets. Streamlining IT infrastructure is also a strategic focus.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x	x		
S-risks	x				x			x	
G-risks			x			x		x	
D-risks			x		x		x		

Country of domicile: France		
Sovereign rating ESG scores	Environmental risks	Strong
	Social risks	Neutral
	Institutional and political risks	Neutral

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Coöperatieve Rabobank UA	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects Rabobank's strategic focus on the financing of sustainable energy transition and the sustainable food industry globally. It underpins the long-term relevance of the business model and contributes to enhance the bank's credit standing. Like domestic peers, Rabobank is also working on improving 'Know Your Customers' capabilities, as required by Dutch authorities.

- **Environmental.** Rabobank's ambition is to be positioned as a global leader in the financing of the food and agriculture sector. Exposure is high as a result but managing this risk is a strategic priority. This focus requires the bank to manage its exposure to climate change proactively. The bank describes this as 'a huge risk and a great opportunity'.
- **Social.** Rabobank's second strategic pillar is to protect its leading retail position in the Netherlands. Rabobank is a leading bank for the domestic agriculture sector, an important contributor the economy. Rabobank has gone through a massive workforce optimisation programme to adapt to evolving operating conditions, properly managed to limit reputation risk.
- **Governance**. Rabobank has been exposed to governance issues, such as a deficient anti-money laundering program in the US and has taken remediation actions. Improving KYC remains a priority. The governance structure is much less complex than other co-operative banking groups in Europe thanks to efforts made to improve centralisation over the years (also as part of efforts to improve resolvability). New initiatives are in place to further strengthen centralisation of operations.
- **Digital transition.** Rabobank's efforts to develop digital capabilities are less well documented than those of its peers but its strategic initiatives are standard for the industry (especially given the importance of digital capabilities in retail banking in the Netherlands). Modernising IT infrastructure is part of the group strategy to improve central operations.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x	x		
S-risks	x					x	x		
G-risks			x			x		x	
D-risks			x		x			x	

Country of domicile: The NETHERLANDS		
Sovereign rating ESG scores	Environmental risks	Neutral
	Social risks	Neutral
	Institutional and political risks	Neutral

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Crédit Agricole SA	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects the variety of the group's initiatives across its business lines, participation in major industry initiatives and the absence of major governance issues despite the relatively complex group structure. CAG faces the challenge of optimising its retail operations while preserving its co-operative DNA grounded in a dense physical network.

- **Environmental.** We view positively initiatives implemented across the group to develop a competitive edge. Awareness of ESG issues is generally higher in asset management than in banking. The group benefits from the expertise and strategic focus developed by some of its specialised subsidiaries, such as Amundi, Crédit Agricole Assurances, and Crédit Agricole CIB e.g. in ESG bonds. Exposure to climate risk is material. CAG manages a large and diversified corporate loan book and operates as a leading bank for the financing of the agriculture sector in France. CAG has a detailed and well-articulated ESG governance framework for ESG risk.
- **Social.** The social factor is a strength for a large co-operative group like Crédit Agricole, maintaining close links with local communities, a large clientele (52 million clients) and a large workforce (130,000 employees). Managing the development and re-skilling of such a large workforce is a challenge.
- **Governance**. The group's overall governance structure is well managed but complex, stemming from its wide business diversification and co-operative nature. It does not weigh on the rating in comparison to large, listed banking groups, however. Monitoring of risk appetite is adequate. Geographic expansion in Italy has been implemented in an orderly manner. CIB activities have not impacted reputation risk in recent years.
- **Digital transition.** CAG has ambitions to be an omni-channel bank, combining digital channels with an extensive physical network. We expect the group to increase its digital capabilities to accompany changing customer behaviour. Competition from fintech companies in the payment business is medium-term challenge so developing the payment business is a strategic pillar. The group claims to be the market leader in payments in France (20% market share). Investment to improve back-end solutions is material. In 2019 and 2020, CAG allocated EUR 8bn to IT transformation, including about 40% for improving systems and data management.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x	x		
S-risks	x					x	x		
G-risks			x		x			x	
D-risks			x		x			x	

Country of domicile: France		
Sovereign rating ESG scores	Environmental risks	Strong
	Social risks	Neutral
	Institutional and political risks	Neutral

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

ING Groep NV	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment balances ING's well-articulated digital and sustainability strategies against the need to continue improving customer due diligence monitoring as required by Dutch authorities, which is weighing on costs. Beyond these governance issues, which are being addressed, we believe the industry leading digital approach and active sustainability strategy have contributed to enhance ING's credit standing.

- **Environmental.** We value ING's 'best in class' approach in this specific area, with comprehensive initiatives (internally and externally), an early start and a well-articulated strategic roadmap. ING started disclosing its carbon footprint in 2005 and launched its sustainability strategy in 2014. Materiality analysis has been performed since 2011. The bank issued its first Green bond in 2015.
- **Social.** The social dimension is less of a differentiating factor for the group given its digital-first strategy. Nonetheless, ING is primarily a commercial lender with a leading retail banking position in the Netherlands, Belgium and Germany (with a digital set-up) hence exposed to misconduct and reputation risks. ING operates in over 40 countries with 55,000 employees serving over 39 million retail customers, of which 13.7m are considered primary customers.
- **Governance**. Legacy governance issues relating to insufficient customer due diligence and transaction monitoring constrain our overall assessment. These resulted in a EUR 775m penalty and the dismissal of the CFO in September 2018. ING has mobilised resources to implement an enhancement programme to ensure compliance with 'know your customer' (KYC) and 'client activity monitoring' requirements. ING has around 4,000 people working on KYC-related activities. These issues have attracted particular attention in the Netherlands, at system level.
- **Digital transition.** With over 20 years of experience as a direct banking pioneer, ING is a frontrunner in digital operations in Europe. Maintaining this competitive advantage, however, is a challenge. ING is working on large-scale digital projects to improve cross-border scalability, which is also a challenge given country-specific characteristics (from IT infrastructures to customer preferences). There are various transformation programmes in place based on digital transition and linked to targeted efficiency gains.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x			x		x	
D-risks			x			x	x		

Country of domicile: The NETHERLANDS		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Neutral**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

KBC Groep NV	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment primarily reflects our view that the group's well-articulated digital and sustainability strategy contributes to enhancing its credit standing and competitive position.

- **Environmental.** We view the dedicated governance structure as part of the group sustainability strategy, communications around achievements and defining refined metrics and targets as positive. Given its diversified geographic base, the group needs to accommodate some country-specific characteristics, which may impact overall performance indicators and require proper communication. The importance of insurance activities to the group is driving awareness of environmental risk. This also applies to asset management activities.
- **Social.** The group's strategy is to operate as a leader in bancassurance in each market where it operates. The retail focus exposes the group to the risk of misconduct and mis-selling. KBC was exposed to the mortgage tracker issue in Ireland, an industry-wide issue. Risks are otherwise adequately managed.
- **Governance**. KBC has a stable base of core shareholders. The group has not been exposed to major litigation risk.
- **Digital transition.** The roll-out of the digital strategy is aimed at improving the customer experience, cross selling and internal processes. The objective is also to transition from an omni-channel distribution model to a digital-first distribution model under which digital interactions with customer will form the initial basis of the relationship. KBC plans to invest an additional EUR 1.4 bn in digitalisation in 2021-2023.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x		x			x	
D-risks			x		x		x		

Country of domicile: BELGIUM		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Neutral**
	Institutional and political risks	**Weak**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Société Générale SA	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects the group's proactive sustainability strategy and tangible initiatives to transition into a more digital bank. These initiatives provide a competitive edge even if the full benefit in terms of financial performance is not yet visible because of the continuing investment phase. Legacy governance issues are neutral given the progress made.

- **Environmental.** The bank established a clear sustainability strategy some years ago. This is critical for a group materially exposed to rising stakeholder demand in relation to its asset management, insurance and corporate lending activities. SG participates in major industry initiatives and the quality of disclosure is higher than the industry average.
- **Social.** Social factors are less of a differentiating factor for SG. However, the merger of the Société Générale and Crédit du Nord branch networks in France is a sensitive project. Communication around the transition plan is regularly updated. We also note a more refined disclosures on social indicators.
- **Governance**. Standards are in line with the industry. Two governance issues, now settled, have had a major impact on the bank's reputation in the past: the Kerviel case (trader involved in an illegal trading scheme resulting in a EUR 4.9bn loss); and litigation settled with US authorities in 2018 *(*penalties amounted to USD 2.7bn). There has been no additional large provisioning efforts or disbursements since then.
- **Digital transition.** SG is a front-runner in the French digital retail banking segment with Boursorama Banque (c. 2.9 million clients) but also with the project to merge its dual retail networks in France (SG and Crédit du Nord). SG has committed to invest EUR 4bn in IT every year (half recognised as investments). Communication around the cybersecurity strategy is better articulated than that of peers.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x			x		x	
D-risks			x		x		x		

Country of domicile: France		
Sovereign rating ESG scores	Environmental risks	Strong
	Social risks	Neutral
	Institutional and political risks	Neutral

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Intesa Sanpaolo SpA	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment reflects the bank's continuous initiatives and progress in the area of long-term sustainability. The ISP Group has the highest market share in Italy of ethical and ESG fund management. Special lending guidelines adopted by the bank attempt to limit or exclude loans with high ESG risk. Digitalisation of front and back-end processes has developed convincingly in the context of the transformation of the bank's distribution model.

- **Environmental.** The management of climate-related transition risk is evolving. The ISP Group dedicates a solid portion of new loans to green and circular economy projects. Consideration of environmental risks in the credit evaluation process and the adoption of various policies to reduce the carbon footprint contribute to the sound management of environmental risks. The group has announced an exit from coal by 2025 and from unconventional oil and gas activities by 2030.
- **Social.** The group has quite a high turnover rate due to the branch network reduction and the rejuvenation of the workforce. Overall, we believe S factors are unlikely to drive credit quality in the near term.
- **Governance**. The Group has not been involved in any major governance or legal issues with large financial consequences. The governance arrangements are standard for a listed bank.
- **Digital transition.** The Group has been able to develop its digital capabilities, not only at the front-end, with most retail products available online, but also through digital processing and data management. In 2020, several digital metrics strongly improved. There is no evidence of potential market share erosion due to new challengers.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x		x	
S-risks	x			x				x	
G-risks			x		x		x		
D-risks			x		x			x	

Country of domicile: ITALY		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Weak**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

UniCredit SpA	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment reflects the adoption of a clear business plan highlighting targets for climate risk management and sustainable financing. Governance risks are adequately managed, while strategic awareness and investments are supporting the digital transition of the bank.

- **Environmental.** The bank has made tangible efforts in trying to address climate-change risks. Policies and principles are in place to manage and reduce exposure to selected industries. The latest business plan outlines targets including exit from the coal industry altogether by 2028, among other initiatives. The group is committed to green financing, selling its inaugural green bond in June 2021.
- **Social.** Agreement with unions on tangible layoffs should limit reputational risk. Despite progress made in the area, the representation of women in senior positions is still comparably weak. We do not expect the S factor to drive rating differentiation in the short-term, however.
- **Governance**. Governance risk is material but standards are high compared to Italian average and continuously improving. The bank's management of legal matters related to past misconduct is adequate.
- **Digital transition.** The group acknowledges the need to increase digitalisation to retain and grow its customer base, especially in retail and commercial banking, as well as to cut costs. The new CEO has instigated a renewed focus on digital through a substantial overhaul of the bank's infrastructure.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x		x	
S-risks	x				x			x	
G-risks			x		x		x		
D-risks			x		x			x	

Country of domicile: ITALY		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Weak**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

DNB Bank ASA	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects DNB's comprehensive approach to sustainability which the group, defines as long-term value creation in line with the expectations of key stakeholders. Further, management has been aware of the challenges from digital transition for some time and has been actively addressing them.

- **Environmental.** Considering its importance to the Norwegian economy and its own credit exposures, the group has a strategic approach to the oil and gas sector. To enable better climate risk assessments, work is being done to enhance quantification and scenario analysis. DNB has set relatively detailed targets for achieving net-zero emissions from financing and investment activities.
- **Social.** Two of DNB's three sustainability focus areas are promoting diversity and inclusion within the group and externally and combatting financial crime and contributing to a secure digital economy. In 2015, the group set an internal goal of 40% female representation in management levels 1-4; this has been met in management levels 1-3. The group recognises the need to continuously re-skill employees to meet future needs and invests in enhancing skills and facilitating mobility between business areas. Greater group expertise is being developed in critical areas such software engineering, data analysis, security, and compliance.
- **Governance**. Governance arrangements are in line with large European banks. In our view, however, DNB's connection to the Norwegian government (which holds a 34% stake) reinforces the group's commitment to long-term sustainability.
- **Digital transition.** DNB has significantly reduced its branch network and transitioned to digital distribution channels. Since 2015, the group has reduced the number of branches by more than half and has been operating with fewer than 60 for several years. Less than 1% of retail customer interactions are physical. Operating in a digitally advanced market (Norway), the group invests to remain at the forefront of digitalisation. Having developed Vipps into a national payment app in 2015, it is being merged with the Danish company MobilePay and the Finnish company Pivo to create a cross-border digital wallet. During the Covid-19 pandemic, DNB rapidly developed a national technology platform for distributing government support to businesses.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x		x	
S-risks	x			x			x		
G-risks			x		x		x		
D-risks			x		x		x		

Country of domicile: NORWAY		
Sovereign rating ESG scores	Environmental risks	Neutral
	Social risks	Strong
	Institutional and political risks	Strong

Source: Scope Ratings
Scope's LT Sustainability rating modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope's bank analysts and are not part of Scope's Bank Rating Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Skandinaviska Enskilda Banken AB	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects the high degree of awareness throughout the organisation about the sustainability of the business, strong governance arrangements, and the focus on corporate lending, which we deem less vulnerable to technological disruption in the near term, due to its capital intensive and relationship-based nature.

- **Environmental.** In 2019, SEB adopted a framework model to classify its lending portfolio and measure (and hence manage) climate impacts, aiming to transform its credit and investment portfolios to increasingly support a low-carbon economy. Detailed environmental policies, including sector policies e.g. mandating the exclusion of lending to certain sectors, have been adopted at group level. E-risk governance looks robust, involving the chief risk officer in a control function and mandatory reporting at board level of deviations from these policies.
- **Social.** We do not believe S factors are likely to drive credit quality in the near term. The bank has a public diversity and inclusion policy and commitments, and the numbers of male and female top managers are rapidly converging. The percentage of women on the Group's executive committee has more than doubled from 17% in 2017 to 36% in 2020. The staff turnover rate (8.6% in 2020) is slightly higher than at other Swedish banks.
- **Governance**. We have not identified areas of particular concern. SEB's governance arrangements are in line with other large European banks.
- **Digital transition.** Digitalisation is at the core of the group's long-term strategy, Vision 2025, which is reviewed periodically. The 2019-2021 plan envisages investments of SEK 2-2.5bn in IT, IT security and automation. We believe the group is less exposed than peers to the risk of digital disruption. In particular, the CIB business is, by its own nature, more capital and relationship-intensive than retail and commercial banking, and as such less prone to commoditisation.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x		x			x	
D-risks			x	x			x		

Country of domicile: SWEDEN		
Sovereign rating ESG scores	Environmental risks	**Strong**
	Social risks	**Neutral**
	Institutional and political risks	**Strong**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Nordea Bank Abp	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's **'**Developing' long-term sustainability assessment reflects the fact that while the Nordea group is well advanced in its transition to digital, this is not a differentiating factor relative to peers in the Nordic region. ESG is looked at from a risk-management perspective and is being integrated into credit and other risk management processes.

- **Environmental.** Similar to other banks in the Nordic region, the level of strategic awareness of the E challenge is high at Nordea. The bank is part of several international initiatives with respect to disclosures and has set explicit targets for net-zero emissions in its lending and investment portfolios by 2050 and of a 40%-50% reduction by 2030. Large customers are screened for ESG risks and opportunities and relevant decisions are escalated at board level. In 2020, Nordea classified sectors most vulnerable to physical risk in all of its four home markets, an exercise that will drive risk mitigation in the loan book. Similarly, it has mapped its lending exposures according to their climate impact ad identified exposures to transition risk with a view to integrating the resulting information in its credit risk management framework in 2021. Nordea asset management's public exclusion list includes several companies involved in coal mining and oil sands.
- **Social.** Nordea has a public commitment to equality, diversity and inclusion and regularly publishes updates on the gender distribution of its workforce (roughly 50/50 in 2020), board (40/60) and global leadership team (36/64). We do not believe S factors are likely to drive credit quality in the near term.
- **Governance**. Nordea is a large organisation with multiple listings. The governance arrangements are in line with large European banks.
- **Digital transition.** Falling behind competitors could lead to rapid market-share losses in retail, as customer expectations with respect to digital banking solutions in the Nordic region are higher than average. The group is investing heavily in IT development to manage this risk, as well as to improve and streamline back-end processes. We believe the CIB business is less vulnerable to digital disruption in the near term.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x		x			x	
D-risks			x		x			x	

Country of domicile: FINLAND		
Sovereign rating ESG scores	Environmental risks	**Strong**
	Social risks	**Neutral**
	Institutional and political risks	**Strong**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Svenska Handelsbanken AB	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's **'**Developing' long-term sustainability assessment is primarily driven by the challenges arising from Handelsbanken ongoing business-model transformation, including the material downsizing of the branch network, which in our view carries some execution risk.

- **Environmental.** Disclosure around the group's efforts to tackle climate risks are good. Handelsbanken publishes a detailed asset management climate report, describing its policies to actively steer investments, decarbonise portfolios, and support the transition to renewable energies. Handelsbanken signed the UN Principles for Responsible Banking in late 2019 and endorses the Task Force on Climate-related Financial Disclosures.
- **Social.** The average turnover of employees of Handelsbanken in Sweden was c. 5% 2020, which is low both by Nordic and international standards. We see this as a strong pointer to inclusive workforce management. The bank has a public commitment to workforce diversity and inclusion. Gender diversity targets (minimum 40% women) are in line with peers in the Nordic region and there is strong representation of both genders at board and top management level.
- **Governance**. Handelsbanken applies the Swedish Code of Corporate Governance with no deviations. One peculiarity of Handelsbanken's governance relative to peers is its long-term profit-sharing system that revolves around the Oktogonen foundation and to which each employee of the bank participates. Instead of receiving a cash bonus payment, employees receive an allocation in shares of the Oktogonen foundation, which are only cashed out when the employee turns 60. In the interim, Oktogonen invests the cash in Handelsbanken shares, thus ensuring that each employee has "skin in the game" for the bank's long-term value creation. Oktogonen is the second largest shareholder of Handelsbanken, controlling approximately 10% of the bank's equity capital.
- **Digital transition.** Handelsbanken's new strategy under CEO Akerstrom includes a material reduction in the number of branches and increased investment in digital banking channels. We see this as a courageous and epic shift for Handelsbanken, whose corporate culture has always put proximity at the very centre of the customer relationship.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x		x		
G-risks			x		x		x		
D-risks			x			x		x	

Country of domicile: SWEDEN		
Sovereign rating ESG scores	Environmental risks	**Strong**
	Social risks	**Neutral**
	Institutional and political risks	**Strong**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Swedbank AB	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability modifier reflects the view that while Swedbank is well positioned regarding the digitalisation trend and in the management of climate-change risk, the recent hiccups with respect to money laundering risk management weigh more negatively on the assessment.

- **Environmental.** We acknowledge the group's advanced efforts to integrate environmental sustainability into its operations. This includes its commitment to several global initiatives for greenhouse gas emission reductions, especially in the asset management business, where it launched a number of Paris-aligned funds in 2020. The group has explicit GHG emission reduction targets for its loan portfolio (-60% from 2019 to 2030) and has had a working framework for categorising green financing since 2017, when it issued its first green bond. From a risk-management perspective, the group identifies and discloses lending that presents material climate-related risk exposures, grouped in accordance with the Task Force on Climate-related Financial Disclosures.
- **Social.** We do not believe S factors will drive credit quality in the near term. Swedbank has a strategy for diversity and inclusion to ensure that they are integrated in all HR processes and all relevant parts of the bank. The bank regularly conducts gender analyses and takes the necessary measures to ensure parity.
- **Governance**. The announcement by the Swedish FSA in 2020 that it had found deficiencies in money-laundering risk management still weighs negatively on our assessment of the group's longer-term sustainability. The group has undergone significant management changes since and has implemented the remedial actions requested by Swedish and Estonian supervisors. Nevertheless, it could still be hit by one-off costs related to anti-money laundering investigations.
- **Digital transition.** Swedbank is well aware of the strategic challenges (and opportunities) arising from the ongoing seismic shift in banking technology and customer preferences in favour of digital banking interactions. It defines itself as a digital bank with physical meeting points and, over the course of recent years, it has rapidly shrunk its physical branch network and invested in digital capacity, to the point where a large majority of its customers are considered digitally active. Swedbank also regularly co-operates with financial technology companies, and in some cases integrates them into the group. We view positively the bank's significant efforts to digitise both its customer interface and back-end processes, which we consider crucial to fend off competition in a digitally advanced market such as Sweden.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x		x				x
D-risks			x			x	x		

Country of domicile: SWEDEN		
Sovereign rating ESG scores	Environmental risks	**Strong**
	Social risks	**Neutral**
	Institutional and political risks	**Strong**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Banco Santander SA	LT Sustainability modifier: Best in class	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Best in class' long-term sustainability assessment reflects the bank's commitment in this area, in particular its consistent and focused communication with respect to ESG initiatives and its frontrunning digital strategy, of late increasingly focused on global payments solutions.

- **Environmental.** The group achieved carbon neutrality in 2021 and targets net zero by 2050. It is committed to the preservation of the environment, refraining from certain types of financing via energy, metal-mining and soft commodities policies. The bank has made a commitment to triple green finance volumes mobilised by 2025 from EUR 42bn since 2019 to EUR 120bn.
- **Social.** Santander participates in numerous social initiatives promoting financial inclusion and prioritises gender equality through public targets for senior positions. Sizeable layoffs in its home market highlight the need to strike a balance between efficiency gains and social considerations.
- **Governance**. The Group is involved in several pending legal and litigation cases. Yet, litigation provisions are at an adequate level, with a continuous downward trend experienced in recent years.
- **Digital transition.** Digital transformation is among the key strategic priorities and the Group's specific approach combines a global vision with regional and business-specific solutions to achieve optimal operational efficiency. Significant investments are earmarked for digital transformation as part of a two-pronged strategy, relying on core banks as "supertankers", with a view to improve customer experience, and speedboats, joint-ventures to develop new solutions. Execution includes the creation of the Digital Consumer Bank as a merger of Santander Consumer Finance and the Openbanking platform, and the acceleration in the global payments business via PagoNxt, for merchant and trade solutions.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x		x	
S-risks	x				x			x	
G-risks			x			x	x		
D-risks			x		x		x		

Country of domicile: SPAIN		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Weak**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

ESG and digital transition as measures of long-term sustainability for banks

Banco Bilbao Vizcaya Argentaria SA	Scope has not yet assigned a LT sustainability modifier	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's highlights BBVA's high strategic awareness of sustainability which has so far translated to the bank being at the forefront of industry-wide initiatives. A pioneer of the digital journey, BBVA is now a globally recognised case study for a successful strategy.

- **Environmental.** In 2002, BBVA joined the United Nations Global Compact and in 2004 adopted the Equator Principles. In 2018, the bank presented its 2018-2025 pledge to help fulfil the United Nations Sustainable Development Goals and the Paris Agreement on Climate Change, by increasing its sustainable financing target to EUR 200bn by 2025 (EUR 67bn by June 2021). The governance model reflects the sustainability effort, with mandatory training for employees and the variable remuneration of executive board members based on meeting objectives with respect to sustainable financing. Risk management encompasses physical and transition risk classification: the latest TCFD report highlights how 17% of the wholesale portfolio's Exposure at Default has been identified as transition risk-sensitive; thresholds having been established at the Group and geographical level for maximum risk taking. The mortgage portfolio is analysed for transition and physical risk, auto lending for transition risk. The bank has been carbon neutral since 2020 and is committed to achieving net zero by 2050. It will cease coal financing activities by 2030 in developed countries and by 2040 elsewhere.
- **Social.** BBVA has a number of ongoing social initiatives, including via foundations. Women represent more than 50% of total employees and the group is targeting at least 40% of female directors by 2022 (33% of the Board were women in 2020). Turnover is in line with the industry average (6.6% in 2020). In 2021 an agreement regarding redundancies of 10% of the Spanish workforce was reached, prioritising voluntary termination and including an outplacement programme.
- **Governance**. BBVA has a one-tier board system with 67% of independent directors. Governance arrangements are in line with other large European banks. The Grupo Cenyt spying case led to the resignation of honorary president and former chairman Francisco González. Investigations into the case are ongoing.
- **Digital transition.** BBVA has a global development platform where products are developed once, and then rolled out across different countries. Digital channels are driving new customer acquisition and sales: one-third of retail customers came through the digital channel in the first half of 2021, and digital sales account for 64% of the total. In Spain, the bank's mobile banking application has evolved continuously in the past 10 years, front-running most peers in embedding functionalities. BBVA recently announced the creation of a digital retail bank in Italy. Acquisitions of fintech companies accelerated the transformation. Elsewhere, the bank pioneered VC investment, initially in 2009 through BBVA Ventures and later through Propel, a VC fund, and Sinovation, an AI focused Chinese venture.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x	x		
S-risks	x				x			x	
G-risks			x			x		x	
D-risks			x		x		x		

Country of domicile: SPAIN		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Weak**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability ratings modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope bank analysts and are not part of Scope's Bank Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

Barclays plc	LT Sustainability modifier: Advanced	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Advanced' long-term sustainability assessment reflects the group's comprehensive approach to ESG issues. Barclays has identified ESG-related factors considered material for its business success and external stakeholders, accompanied by key performance metrics, and reporting in line with global standards. As well, ongoing digital investments continue to support business growth.

- **Environmental.** Like other large UK banks, Barclays is held to relatively high supervisory expectations for managing climate-related financial risks. Since 2019, the group has been strengthening the integration of environmental issues into its business, starting at the board and executive management level. Last year, Barclays performed its second internal climate stress test to better understand its climate risks and to prepare for the Bank of England's 2021 biennial exploratory scenario on financial risks from climate change. Addressing the concerns of external stakeholders, a climate resolution was passed at the May 2020 annual general meeting. As a leading capital markets player, Barclays also actively facilitates sustainable financing.
- **Social.** Barclays identifies human capital and diversity and inclusion as well as colleague engagement and development as being highly significant for its business success. Various initiatives to develop future talent, create an inclusive and supportive culture, and foster continuous dialogue with employees to support this. The group's employee turnover rate compares well to the industry average. In 2020, the rate was 9%, with the voluntary employee turnover rate at 6%.
- **Governance**. As a large UK-listed bank with operations also in the US, Barclays is closely regulated and supervised. Governance arrangements are in line with other large European banks. Historical conduct issues appear to have been largely dealt with.
- **Digital transition.** Ongoing digitalisation is one of the group's four strategic pillars, and initiatives are being pursued throughout the business. Barclays typically ranks well against other large UK banks when it comes to customer satisfaction with its online and mobile banking services. The group's strong franchises in payments and capital markets are underpinned by digital capabilities. Having invested more than GBP 500m in its payments capabilities, the group is aiming to increase income from this business by more than 50% by 2023.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x			x		x		
S-risks	x				x			x	
G-risks			x		x			x	
D-risks			x			x	x		

Country of domicile: UK		
Sovereign rating ESG scores	Environmental risks	Neutral
	Social risks	Neutral
	Institutional and political risks	Neutral

Source: Scope Ratings
Scope's LT Sustainability rating modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope's bank analysts and are not part of Scope's Bank Rating Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology..

ESG and digital transition as measures of long-term sustainability for banks

HSBC Holdings plc	LT Sustainability modifier: Developing	The credit rating and its rationale, including the key rating drivers are available to ScopeOne subscribers.

Highlights

Scope's 'Developing' long-term sustainability assessment reflects HSBC's vulnerability to geopolitical risks due to the size and geographical breadth of its operations. The group continues with efforts to better leverage digital capabilities across the span of its activities.

- **Environmental.** Like other large UK banks, HSBC is held to relatively high supervisory expectations for managing climate-related financial risks. Since 2020, the group has been integrating climate risk into its group-wide risk management framework. After performing its own stress tests, HSBC has determined that its UK and HK mortgage exposures face limited climate risks. Due to the nature of its business, HSBC has greater exposure to clients facing transition risks.
- **Social.** We do not believe that S factors are likely to drive credit quality in the near term although we note that the UK regulator is increasingly focused on improving diversity and inclusion within financial services.
- **Governance**. With key operations in the UK and Hong Kong, the group is vulnerable to geopolitical risks and changing social perceptions which may negatively impact its business franchise. That said, HSBC has taken a consistently prudent approach to managing risks.
- **Digital transition.** Digitalising at scale is one of four key tenets of the group's strategy. HSBC is shifting its approach from building bespoke local technology platforms to building once and deploying globally. Technology spend is expected to be allocated increasingly for investments rather than business-as-usual activities.

Overview of materiality, exposure and management of relevant ESG-D risks

	Sector materiality			Exposure			Management		
	Low	Medium	High	Lower	In line	Higher	Strong	Adequate	Weak
E-risks		x				x	x		
S-risks	x				x			x	
G-risks			x			x		x	
D-risks			x			x		x	

Country of domicile: UK		
Sovereign rating ESG scores	Environmental risks	**Neutral**
	Social risks	**Neutral**
	Institutional and political risks	**Neutral**

Source: Scope Ratings
Scope's LT Sustainability rating modifier refers to Scope's Bank Ratings Methodology. Rankings of materiality, exposure and management of ESG-D risks represent the research view of Scope's bank analysts and are not part of Scope's Bank Rating Methodology. Sovereign ESG scores are based on Scope's sovereign ratings methodology.

Appendix: long-term sustainability assessments: rated banks (public and subscription)

Bank	LT sustainability	Bank	LT sustainability
BANCO SANTANDER SA	Best in class	DEUTSCHE BANK AG	Developing
BNP PARIBAS SA	Best in class	**ERSTE GROUP BANK AG**	Developing
BANKINTER SA	Advanced	**FCA BANK SPA**	Developing
BARCLAYS PLC	Advanced	**HSBC HOLDINGS PLC**	Developing
BRAGE FINANS AS	Advanced	**IBERCAJA BANCO SA**	Developing
COÖPERATIEVE RABOBANK U.A.	Advanced	**IBL ISTITUTO BANCARIO DEL LAVORO SPA**	Developing
CREDIT AGRICOLE SA	Advanced	**INTESA SANPAOLO SPA**	Developing
DNB BANK ASA	Advanced	**JSC MFO MICRO BUSINESS CAPITAL**	Developing
ING GROEP NV	Advanced	**KUTXABANK SA**	Developing
KBC GROEP NV	Advanced	**LANDESBANK BADEN WUERTTEMBERG**	Developing
SKANDINAVISKA ENSKILDA BANKEN AB	Advanced	**LANDKREDITT BANK AS**	Developing
SOCIETE GENERALE SA	Advanced	**MBANK SA**	Developing
ACHMEA BANK NV	Developing	**MEDIOBANCA BANCA DI CREDITO FINANZIARIO SPA**	Developing
ALLIED IRISH BANKS PLC	Developing	**NATIONWIDE BUILDING SOCIETY**	Developing
BANCO BPM SPA	Developing	**NORDEA BANK ABP**	Developing
BANCO DI DESIO E DELLA BRIANZA SPA	Developing	**OP YRITYSPANKKI OYJ**	Developing
BANK OF IRELAND GROUP PLC	Developing	**POWSZECHNA KASA OSZCZEDNOCSI BANK POLSKI SA**	Developing
BANQUE FEDERATIVE DU CREDIT MUTUEL SA	Developing	**SANDNES SPAREBANK**	Developing
BELFIUS BANK	Developing	**SANTANDER CONSUMER FINANCE SA**	Developing
BN BANK ASA	Developing	**SANTANDER UK PLC**	Developing
BPCE SA	Developing	**SPAREBANK 1 NORDMORE**	Developing
CAIXA GERAL DE DEPOSITOS SA	Developing	**STANDARD CHARTERED BANK**	Developing
COMMERZBANK AG	Developing	**SVENSKA HANDELSBANKEN AB**	Developing
CREDIT SUISSE AG	Developing	**SWEDBANK AB**	Developing
CREDITO EMILIANO SPA	Developing	**UNICREDIT SPA**	Developing
DANSKE BANK A/S	Developing	**BANCA POPOLARE DI SONDRIO SCPA**	Lagging
DE VOLKSBANK NV	Developing	**JSC MFO SWISS CAPITAL**	Lagging

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