DECEMBER 2022

Bank Director® INTELLIGENCE REPORT

CHOOSE YOUR PATH:

A PRACTICAL GUIDE TO ESG

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CHOOSE YOUR PATH:

A PRACTICAL GUIDE TO ESG

Information on:

Aligning strategy with environmental, social and governance (ESG) objectives, evolving expectations from regulators and investors, different approaches to the risks and opportunities associated with ESG, and the board's oversight responsibilities.

Bank Director

Dear Reader,

By their very nature, banks tend to be stronger than most corporations when it comes to environmental, social and governance matters.

ESG already covers a number of areas pertinent to a bank's day-to-day operations. It's a language of sorts that helps investors understand the nonfinancial factors that could affect a company's future operations, including cybersecurity and data privacy, employee development, community engagement and diversity, equity and inclusion. ESG also can help communicate a company's strategic values to employees, customers and communities.

Much of the industry's built-in ESG compliance comes via regulatory decree. Laws like the Community Reinvestment Act encourage banks to meet the needs of all borrowers in their communities, including low- and moderate-income customers, through loans, investments and financial education programs. And of course, boards have an important governance obligation to their shareholders, along with ensuring the safety and soundness of their institutions.

Some aspects of ESG prove controversial. Bankers want to focus on lending to their communities and growing deposits, and stay out of areas they deem political. Environmental issues have proved most contentious, with already-taxed bankers fearing that regulators will simply add on to their existing compliance burden. "ESG is purely a political item," wrote one respondent earlier this year in response to a Bank Director survey. "[It] could distract resources from more important bank concerns such as safety and soundness." Big banks and asset managers are receiving blowback from some corners. Lawmakers from conservative states seek to pull business from banks that have, in their view, discriminated against industries such as fossil fuels and gun manufacturing.

But ESG could also represent new opportunities for banks, from expanding business lines to building efficiencies in their operations. In this report, sponsored by Crowe LLP, we'll take a pragmatic view, offering information for bank boards and leadership teams to help them evaluate their approach to this hot-button issue.

If every bank has a different strategy, then every bank will have a slightly different approach to ESG. This report isn't intended to dictate how banks should act, but we hope it cuts through some of the noise as you hone your bank's strategy.

Sincerely,

Emily McCormick
Vice President of Research
Bank Director

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SPEAKING THE LANGUAGE OF ESG

By: **Emily McCormick**

On the heels of exponential growth in environmental, social and governance (ESG) investing, a contingent of conservative politicians have started pushing back.

In August, Republican attorneys general in 19 states claimed that the asset manager BlackRock "appears to use the hard-earned money of our states' citizens to circumvent the best possible return on investment, as well as their vote." And in October, conservative AGs demanded that six big financial firms — JPMorgan Chase & Co., Goldman Sachs, Bank of America Corp., Citigroup, Wells Fargo & Co. and Morgan Stanley — share documents around their institutions' net-zero commitments, including involvement in global climate organizations and how their company would honor its pledges to them.

Conservative lawmakers say they're worried about the impact on the energy sector, and they're fighting back with the most effective tool at their disposal: money. In August 2022, Texas Comptroller Glenn Hegar wrapped a probe into whether large financial firms have unfairly restricted lending and other services to energy companies. The state created a list of 10 financial firms, including BlackRock, that it says actively "boycott" energy companies. State pension funds could be forced to divest their holdings.

Hegar points to a "systemic lack of transparency" that includes "the use of double-speak by some financial institutions as they engage in anti-oil and gas rhetoric publicly

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> “Sustainability plus corporate responsibility, now plus financial reporting, equals ESG. ... as disclosures grow, [investors] have more information to make comparable decisions, and that will just continue to grow because of the regulatory environment.”
>
> **Chris McClure,** partner, Crowe LLP

yet present a much different story behind closed doors." The state's list, he says, provides clarity to Texas taxpayers.

For their part, investors have also been seeking clarity and transparency from public companies around ESG criteria. That interest has driven a rapid growth in ESG investment products, ratings and disclosures. In response, each of the 20 largest retail and commercial banks released an ESG or similar report in 2021 or 2022, according to Bank Director research, with plenty of smaller banks following suit.

ESG covers a wide array of risks, opportunities and practices that can affect a company's future performance, including employee engagement and development, corporate citizenship, cybersecurity, governance and the risks posed by climate change. Banks do a lot of those things well, especially in comparison to other industries. "They have great HR processes," says Chris McClure, a partner at Crowe LLP who leads the firm's ESG services team. "They're investing in their community; they're lending in certain ways to disadvantaged or underserved populations." But given this vastness, it's tough for bank leadership teams and boards to make sense of what investors expect, what's coming down the pike from regulators, and what areas they may choose to incorporate as part of their long-term strategy to grow and strengthen their business. The inclusion of areas deemed political, particularly climate change, makes ESG a controversial topic in bank boardrooms. Further, bank leaders worry that regulators could drive up compliance costs and distract banks from the business of banking. And it's hard to parse out what matters and what doesn't.

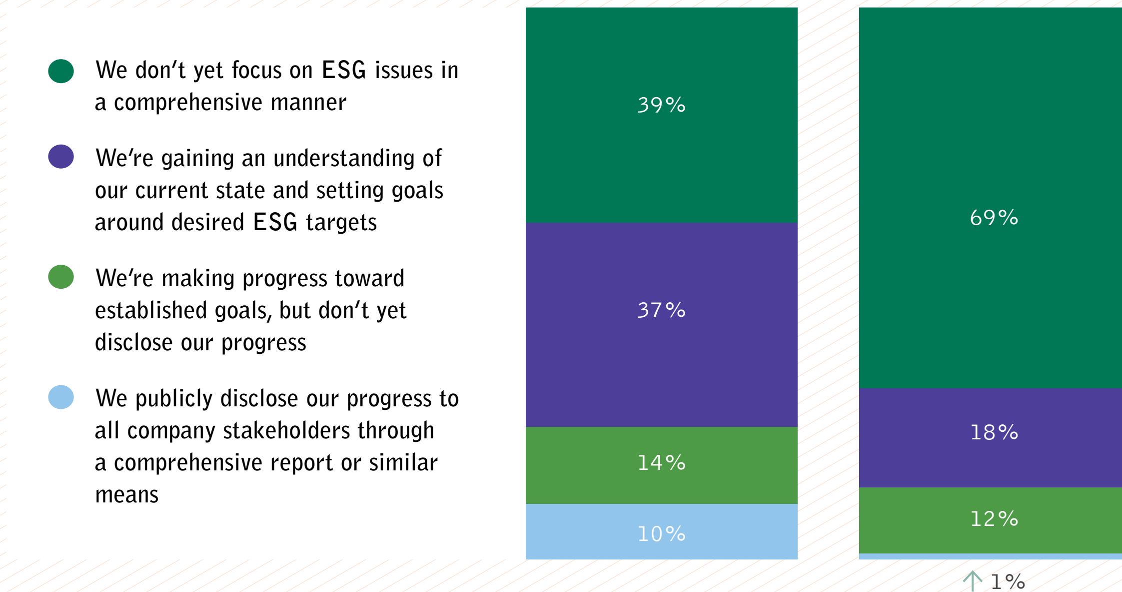
With that in mind, Bank Director has put together this practical guide, sponsored by Crowe, to help bank executives and board members respond to an increasingly divisive issue.

ESG as a concept traces its roots back to the 1960s, according to the research firm MSCI. Back then, socially responsible investing emerged as a way to avoid specific industries, like tobacco, or companies doing business with the apartheid regime in South Africa. The first socially responsible index launched in 1990, containing 400 of the largest 3,000 U.S. companies. Thirty years later, demand from investors for those types of investments has only grown. Thousands of indices incorporate ESG criteria. A May 2022 survey by the Index Industry Association forecasts further growth, with respondents expecting ESG factors to comprise 40% of their funds within the year, and 57% within five years.

It's a growing industry, and investors are hungry for more information. The same Index Industry Association survey

How would you describe the maturity of your bank's ESG initiatives?

Public vs. Private Banks



Source: Bank Director's 2022 Risk Survey

cited disclosure and data standardization as key gaps for asset managers.

Gregg Anderson, a managing director in the risk consulting group at Crowe, thinks of ESG as a language that allows companies to talk about their performance from a nonfinancial perspective — a language that's continuing to mature. "What [investors are] attempting to do is standardize data that's non-financial in nature, that they can gather and use for analysis and create new products to sell to their customers," says Anderson. The upside of all of this, he says, is that companies will be able to benchmark their ESG performance and disclosure against peers. You can read more about what investors expect later in this report, on pg. 8.

Every institution has goals and objectives that touch on some aspect of ESG, whether it's something as ordinary as risk management or supporting communities, or opportunities as progressive as green lending. In the past, reporting about these initiatives has worn different hats under labels like corporate social responsibility; for public banks, these disclosures may have appeared within annual filings.

Many banks don't comprehensively measure or broadly share their ESG efforts. In Bank Director's 2022 Risk Survey, conducted in January, just 10% of executives and board members representing publicly traded banks said their institution disclosed its progress on ESG to stakeholders.

"Climate, the environment, and diversity and inclusion, responsible supply chains, governance, cyber protection, data protection — there are so many issues that are included now in ESG," says McClure. "I always think of it as sustainability plus corporate responsibility, now plus financial reporting, equals ESG. ... as disclosures grow, [investors] have more information to make comparable decisions, and that will just continue to grow because of the regulatory environment."

Bank regulators have long focused on consumer protections, through the Consumer Financial Protection Bureau, compliance with fair lending laws and the Community Reinvestment Act. Lately, the prudential regulators — the

Office of the Comptroller of the Currency, the Federal Reserve and the Federal Deposit Insurance Corp. — have turned their focus to climate-related risks for the largest banks. In March 2022, the Securities and Exchange Commission — the federal agency charged with protecting investors — proposed that public companies disclose more about how climate-related risks are managed and governed, along with the impacts of these risks.

The SEC has received thousands of comments in response to its proposed climate disclosure rule. Many respondents were supportive but still expressed concerns around disclosure of greenhouse gas emissions, according to Anderson; opponents have complained about regulatory overreach and implementation costs. The SEC had hoped to issue a final rule in October, but technical glitches forced the agency to re-open the rule to comments, according to Bloomberg. Reviewing that feedback will be onerous, likely pushing a final rule into early 2023.

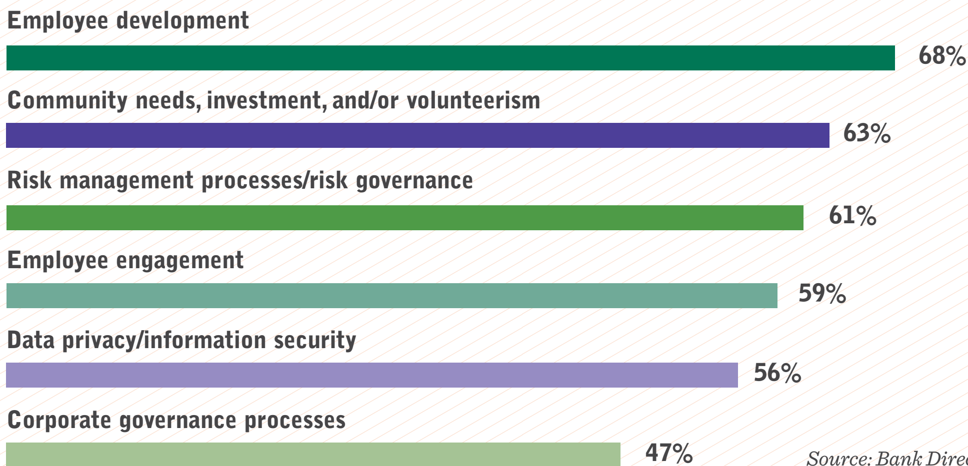
Bank leaders largely find themselves stymied at the concept of applying environmental measurements to their own institutions, which on their own aren't heavy emitters of the greenhouse gas emissions that contribute to climate change. Yet, they may finance businesses that emit large amounts of greenhouse gasses.

But overall, financial leaders can effectively choose their own destiny when it comes to ESG, based in part on an assessment of their major stakeholders, including shareholders that may steer them in a certain direction.

"You have to define what ESG is and isn't" when it comes to your bank and its stakeholders, says McClure. These stakeholders include, but aren't limited to, regulators and investors. What other stakeholders matter to your bank — and how should your bank respond in a way that's strategically true for your organization?

In ESG parlance, companies often talk about the concept of materiality — what's significant to a company's stakeholders and its overall strategy. For banks in general, board composition, risk management, cybersecurity and regulatory compliance are some of the areas that fall under the governance category. Community involvement, personnel and diversity, equity and inclusion count as social criteria; green business initiatives and climate-related risks fall under the environmental umbrella. Some areas may require a certain regulatory response, but each bank could emphasize those in their own way.

Direct and indirect pressures from investors, regulators and other stakeholders have some banks, particularly larger, publicly traded ones, formalizing their approach to ESG. That could include assembling internal, cross-functional teams to drive the organization's strategy forward. For public companies particularly, the bank's auditors would be involved in ESG-focused reports or SEC filings. While few ESG standards have been codified into law, the language of ESG is rapidly changing. In May 2022, the SEC fined BNY Mellon Corp. due to state-



Source: Bank Director's 2022 Risk Survey

ments made by its investment unit that ESG-tied mutual funds underwent a quality review, a practice the agency said wasn't consistently applied. And in June, the SEC was examining whether Goldman Sachs made false claims around ESG metrics applied to its mutual funds. With greater scrutiny on corporate greenwashing, ESG may no longer serve simply as a way to promote the bank and share its good works in the community. Increasingly, it's an important document for the bank's various stakeholders, and there could be real consequences — regulatory and reputational — for banks that get it wrong.

Smaller, privately held banks are less likely to take a comprehensive view of ESG. That's not to say that small banks will ignore ESG entirely. But they may prefer to focus on individual slices of the ESG pie, particularly employee development, community engagement, risk management, cybersecurity and governance, as Bank Director's 2022 Risk Survey found.

Whatever the approach, bank executives and boards would be wise to evaluate who their stakeholders are and what they value. "[ESG is] an evolving concept," says McClure. "It changes based on what's happening with your stakeholders, it changes if your bank or your organization changes, if you're doing acquisitions, if you're moving in geographies, getting into new territories, offering new products — materiality can change."

While regulators have focused on risk and compliance, banks may also find opportunity. Through June 30, 2021, $4.3 billion First Internet Bancorp, a digital bank based in Fishers, Indiana, originated $136.3 million in financing to municipalities to fund energy efficient and renewable energy projects. St. Paul, Minnesota-based Sunrise Banks, a $2 billion community development financial institution, partners with fintechs focused on financial inclusion. Community banks like $6.4 billion Forbright Bank in Chevy Chase, Maryland, are issuing green bonds to fund sustainable projects.

For some banks — particularly smaller, private ones — their approach to ESG may not change significantly from what they're doing today. But John Epperson, managing principal of financial services at Crowe, recommends that banks consider how ESG-aligned objectives can drive other strategic goals, from finding new opportunities for growth, to attracting talent, to meeting the expectations of investors. "[Take] a step back from a strategic perspective and [ask], 'What are the outcomes that I would like to engineer through my ESG program?'" he suggests. "'Who are the stakeholders, whether it be internal, whether it be external, whether it be regulatory, that I'm trying to influence with those outcomes, to build and operationalize a program that fits my desired outcomes?'"

The Prudential Regulators

Banking's primary federal regulators — the Office of the Comptroller of the Currency, the Federal Reserve and the Federal Deposit Insurance Corp. — have been working on draft principles focused on climate-related financial risk management for large banks above $100 billion in assets.

Banks are also anticipating the long-awaited joint effort to modernize the Community Reinvestment Act. In May 2022, the three agencies invited public comment, noting their goals to improve access to financial services to low- and moderate-income communities and adapt to a digital economy. The regulators promise a unified approach, along with better clarity, consistency and transparency; CRA evaluations will also be tailored by bank size and type.

Consumer Financial Protection Bureau

Under Rohit Chopra, who began leading the agency in October 2021, the CFPB has ramped up inquiries into matters relative to consumer protection. This includes enhanced scrutiny of overdraft and similar punitive fees levied by banks, with many financial institutions dropping or adjusting those fees in response. The CFPB has also promised more scrutiny around fair lending, use and protection of personal financial data, and buy now, pay later practices. Banks fined by the CFPB in 2022 include Birmingham, Alabama-based Regions Financial Corp., which was ordered to pay $191 million due to "surprise" overdraft fees, and U.S. Bancorp, which was fined $37.5 million for opening accounts without customers' permission. The CFPB also sued New York-based MoneyLion Technologies, charging the online lender with violating the Military Lending Act.

Where Washington Stands on ESG

Banking's prudential regulators are coordinating their approach, while the SEC's request for climate disclosure promises to impact public companies.

The Securities and Exchange Commission

In March 2022, the SEC issued a controversial draft proposal for climate-related disclosure requirements, clocking in at almost 500 pages. The disclosure could include how the company manages and governs climate-related risks, the material impacts of these risks on the company's strategy and operations, and quantitative measurement of greenhouse gas emissions, including direct emissions from the company and indirect emissions through its vendors and clients. Additionally, companies could be asked to include climate-related scenarios, targets and goals, along with plans to transition to a low-carbon economy. Smaller companies would be exempt from some aspects of the rule, which remains pending as this report goes to press. SEC Chair Gary Gensler said in a release that the proposed rule will provide investors with better information to inform their decisions. "[I]nvestors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies," he said, "and investors need reliable information about climate risks to make informed investment decisions." But industry advocates and conservative lawmakers called foul, pointing to increased climate costs and concerns about regulatory overreach. "The SEC is wading into controversial public policy debates that are far outside its mission and its expertise and without the legal authority to do so," said Sen. Pat Toomey in a September statement. "In doing so, the SEC risks politicizing the agency, slowing economic growth, increasing inflation, and even undermining national security."

INVESTORS VALUE RISK AND REWARD

By: **Laura Alix**

In his 2022 letter to CEOs, Larry Fink, chairman and CEO of the asset management firm BlackRock, made the case that attention to environmental and social issues is a matter of long-term staying power for companies. Firms that ignore developments in renewable energy or evolving labor issues, for instance, risk losing out on business opportunities or experiencing higher turnover in their workforce.

"It is through effective stakeholder capitalism that capital is efficiently allocated, companies achieve durable profitability, and value is created and sustained over the long term," Fink wrote. "Our conviction at BlackRock is that companies perform better when they are deliberate about their role in society and act in the interests of their employees, customers, communities, and their shareholders."

The rising focus on environmental, social and governance factors in banking has been led in large part by increasing expectations on the part of investors. In recent years, large institutional investors and pension funds have called for greater detail on a variety of ESG factors, from publicly traded companies' workforce diversity to the greenhouse gas emissions generated by their business activities.

At a high level, investors want to understand how an organization might respond to nonfinancial changes in its environment. These include climate-related issues and other broad changes, like shifting demographics, workforce and labor trends, and rising housing costs. In essence, investors want to know that the companies they invest in are paying attention to these issues, and thinking about how they might respond to the risks and opportunities therein.

While ESG has generated a fair amount of backlash, proponents contend that environmental and social issues have very real implications for companies' profitability and their ability to adapt to broader social changes. The Covid-19 pandemic could be one especially prominent example of a "nature-based crisis" that ultimately had a tremendous impact on businesses and supply chains, says Steven Rothstein, managing director of the Ceres Accelerator for Sustainable Capital Markets.

"What does a pandemic have to do with your institution? What does inflation have to do with your institution? What does cryptocurrency have to do with your institution? All of these are macro factors," Rothstein says. "We're not suggesting every [public] bank should take the exact same cookie-cutter approach to solve the issue. But every bank needs to do an assessment."

To date, the very largest U.S. banks have begun to publish ESG disclosures, detailing their environmental impact and steps they are taking to address a host of environmental and social issues.

> "Investors want to ensure that both the stewards of the company, the board, and also the products and services that the bank is standing for, are in lockstep with the market that they're serving, to ensure that they will be viable and competitive for many years to come."
>
> **Marija Kramer,** head of ISS Corporate Solutions, Institutional Shareholder Services

Bank of America Corp., for example, recently quantified the greenhouse gas emissions generated by its financing activities in a report following guidelines issued by the Financial Stability Board's Task Force on Climate-related Financial Disclosures. The Charlotte, North Carolina-based bank estimated that its financing in auto manufacturing, energy and power generation had produced roughly 47.3 million metric tons of carbon dioxide in 2020, representing a 4.3%

> "[Investors] want to see data, and they want to see verifiable disclosure. We're moving away from selective narratives and toward comparable data. Comparable meaning year-over-year data that shows improvement, and also comparable in that they can compare to other investment opportunities."
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> **Chris McClure,** partner, Crowe

decrease from the prior year. The company also set forth goals for reducing emissions from each of those sectors by the year 2030, in line with its overall goal to achieve net-zero emissions before 2050.

Some publicly traded bank leaders may be surprised to find that institutional investors and bond ratings agencies are already evaluating their institutions on environmental and social criteria. In guidance outlining its approach to these issues, Kroll Bond Ratings Agency advises that ESG principles are best viewed through an active risk management lens. That means the agency wants to understand which ESG issues companies are studying, and how they are thinking about addressing risk or capitalizing on the opportunities those factors present.

While the agency does not use subjective ESG scoring rubrics, it does want to get a better sense for the particular issues that could ultimately impact a firm's finances or creditworthiness. KBRA gives the example of an e-cigarette company deciding to stop selling flavored e-cigarettes in order to get ahead of regulation and signal that it's attuned to public opinion. Or in another example, a company might decide to disclose proactive emergency preparedness plans that specifically prioritize employees' health and safety.

"Companies that are responsive to mitigating and managing ESG-related risks and capitalizing on ESG opportunities will be better positioned to boost their performance and profitability in the changing competitive business landscape," the firm says in its guidance.

Institutional investors, ratings agencies and regulators also want to generally understand how a firm is overseeing ESG at the board level. The proxy advisory firm Glass Lewis, for instance, has recommended shareholders vote against governance chairs at S&P 500 companies that fail to provide explicit disclosures around their firm's ESG oversight.

A proposed rule issued in March 2022 by the Securities and Exchange Commission would require publicly traded companies to report on climate-related risks, relevant risk management processes and greenhouse gas emissions. It would also require those companies to disclose information about board oversight of climate risks, including which directors or committees oversee those matters, how frequently the board discusses climate risk and how those are factored into the company's overall strategy. Companies would also be required to disclose any climate-related goals, including timelines and metrics used to measure those outcomes.

"In this way, the proposed disclosure requirement could help investors assess the degree to which a board's consideration of climate-related risks has been integrated into a registrant's strategic business and financial planning and its overall level of preparation to maintain its shareholder value," the SEC said in its proposal. A final rule remains pending.

In addition to environmental risk factors and opportunities,

investors are asking for more information about social issues that could impact the way publicly traded companies do business. Some activist investment firms in particular have pushed for more information about the racial and gender makeup of companies' workforces, as well as pay gap data.

For example, Citigroup revealed early in 2020 that it had calculated a 27% pay gap between men and women across the organization in the U.S. the prior year. In that exercise, Citi looked at raw data, rather than adjusting for pay by location or job description, because activist investors argued that metric would more meaningfully show whether women were concentrated in lower-paying roles. The megabank shrank that pay gap slightly the following year, to 26%.

A study by the nonprofit JUST Capital, published early in 2022, found that just under a quarter of the largest companies in the U.S. disclose that they have performed a gender pay equity analysis. More than half of those companies share the results publicly, but 47% do not tell investors how they're faring on gender pay equity.

But those kinds of hard numbers are exactly what investors and ratings agencies want to see in companies' ESG disclosures.

"[Investors] want to see data, and they want to see verifiable disclosure. We're moving away from selective narratives and toward comparable data. Comparable meaning year-over-year data that shows improvement, and also comparable in that they can compare to other investment opportunities," Chris McClure, a partner at Crowe and leader of the firm's ESG team, says. "They'd like to see as many critical topics expressed as possible."

At a baseline, institutional investors want to better understand public companies' practices and protocols related to business ethics, says Marija Kramer, head of ISS Corporate Solutions, a subsidiary of Institutional Shareholder Services. For a human capital-intensive industry like banking, they also want to understand workforce issues, including employee relations, work environments, and diversity and inclusion.

"Investors want to ensure that both the stewards of the company, the board, and also the products and services that the bank is standing for, are in lockstep with the market that they're serving, to ensure that they will be viable and competitive for many years to come," she says.

Banks that are still early in their own ESG journeys can start by designating board oversight for ESG matters, including any individual directors or committees with responsibility for that area. They can look at what their competitors are doing in terms of workforce and human capital management, and think about where they can improve their own processes, Kramer adds. They can also identify the environmental and social matters that are the most relevant for their customers and markets, and think about how those could be affected under a variety of scenarios, she says.

"If you're in a community that has a high concentration in the oil business or people selling to the oil companies, what is the risk there? What if the government puts a price on carbon?" Ceres' Rothstein says. "It's not overnight, but over time." He adds that any plans a bank may make to reduce its environmental impact should be time-limited and include specific, measurable data points.

Banks could also show investors that they are thinking about the potential opportunities in relevant environmental and social issues. The Inflation Reduction Act, passed in August 2022, earmarks $369 billion for climate solutions and technologies, and that represents an area where banks might be able to find new financing opportunities. Other examples of opportunities could include lending to condo associations for retrofits for storm resiliency or offering so-called green deposit products for commercial clients with their own ESG mandates.

"It's not all just costs and risks," McClure says. "It's opportunities for outdoing your peers, opportunities for capitalizing in new markets, opportunities for making new headway and developing new products, and doing things in a way that's really going to capture value and capture the attention of consumers, and put you in an advantageous position."

Focus Areas for Investors

Investors and bond ratings agencies generally look for the same basic frameworks when evaluating a firm's approach to ESG.

ESG Oversight

Institutional investors and bond ratings agencies want to understand how companies are assigning responsibility for environmental, social and governance matters. That will look different for every organization, depending upon its size and the range of expertise already available among its workforce and board. At a minimum, these entities expect companies to identify directors and committees, if applicable, that oversee ESG at the board level, as well as members of management responsible for ESG. Disclosures would identify relevant expertise on the board and outline how often ESG discussions take place between management and the board.

In its 2022 proxy review, Glass Lewis says that it generally recommends voting against a governance chair at an S&P 500 company that fails to provide explicit disclosures around the board's oversight of environmental and social issues.

Relevant Data

One overriding theme among institutional investors and ratings agencies is a desire for greater transparency, including the data and metrics companies are using to benchmark their progress against various ESG goals. Social metrics, for example, might include demographic breakdowns of a company's workforce, including its C-suite and its board, as well as any information about pay gaps and what steps the company may be taking to address those.

"There is no one-size-fits-all approach, but at BlackRock we see it as being about making research, data and insights available to our portfolio managers and working with them to identify potential process enhancements across investment activities," the asset manager says of its own approach to ESG integration.

Climate Plans

Investors and ratings agencies increasingly want to know whether publicly traded companies are setting firmwide goals around climate risk and opportunities. For banks, this information could include greenhouse gas emissions tied to its business activities, and timelines by which the firm intends to accomplish any environmental goals it may set, such as reducing its carbon footprint. Smaller reporting companies would be exempt from some of those requirements, such as reporting greenhouse gas emissions that derive from lending and investments.

A proposed rule by the Securities and Exchange Commission would require publicly traded firms to disclose all of those details, a move that Kroll Bond Ratings Agency praised for increasing transparency more broadly for investors. Currently, voluntary disclosures are inconsistent and difficult for investors to compare between companies. Standardized guidance will make it easier for investors to make more meaningful comparisons between publicly traded firms.

"Companies that are not prepared for these disclosures could eventually experience strained relationships with investors and other key stakeholders," the bond ratings firm said in a statement.

UNCOVERING OPPORTUNITY

By: **Kiah Lau Haslett**

More and more banks are strategically leveraging ESG to identify opportunities to grow and improve their business.

Creating Trust

"When you think about the trust our clients place in us every day to safeguard their finances and help them achieve their dreams, you can see why integrity matters," writes CEO Jim Ryan in the first line of Old National Bancorp's Code of Business Conduct and Ethics.

The Evansville, Indiana-based bank has a long-running commitment to ethics and corporate governance, including having a chief ethics officer since 2008 and a board-level corporate responsibility committee that reviews the bank's ethics policies and programs. The bank's chief ethics officer, Joan Kissel, is also the bank's chief auditing officer; she leads the internal audit team and reports directly to the bank's audit committee chair — meaning the internal audit team functions independently from the bank's other business segments and risk management team.

The $46.2 billion bank has been recognized as "one of the World's Most Ethical Companies" for 11 consecutive years by the Ethisphere Institute, a global firm that works with companies to examine, define and advance ethical business practices and standards. Old National was one of five global banks to receive the 2022 honor.

Increasing Access

Valley National Bancorp has launched a lending platform that helps streamline access to commercial products for businesses owned by women and individuals in ethnic minority groups.

Valley National, based in Wayne, New Jersey, has a community lending team that specializes in servicing women and minority-owned small businesses with relevant financial products, resources and connections. The bank made more than 6,100 small business loans in low-to-moderate-income census tracts and to businesses with a gross annual revenue of $1 million or less in 2021, according to a company release.

As part of that effort, Valley National designed a platform to organize this initiative across the $55.9 billion bank's four-state footprint. The new platform reduces the paperwork that would normally take the bank weeks to process, and streamlines the application and lending process for business owners. It's now easier for women and minority-owned businesses to access traditional products such as payroll, commercial mortgages and merchant services, according to the company. It also will incorporate personal and business credit scores in loan decisioning, in addition to traditional lending requirements such as cash flow and three years of business history.

Green is the New Green

Green bonds are nothing new: They have been around since 2007, and issuances passed $1 trillion in December 2020. But the issuers tended to be international financing or development organizations, megabanks or municipalities. In the United States, Bank of America Corp. has issued $11.85 billion in ESG-themed bonds between 2013 and 2021.

Now, several community banks have tapped the debt markets to finance sustainability-focused or environmentally beneficial projects. In 2021, Chevy Chase, Maryland-based Forbright Bank, with $6.4 billion in assets, issued a $125 million green bond focused on decarbonization or similar projects. And this year, $11.3 billion Berkshire Hills Bancorp in Boston sold a $100 million sustainability bond to fund social and environmental projects that align with its sustainable financing framework.

Funding Employee Giving

Bell Bank wants its more than 2,000 employees to give to causes and communities that are meaningful to them.

Every year since 2007, it has given full-time employees $1,000 for their own personal donations; part-time employees receive $500. In 2020, the Fargo, North Dakota-based bank unit of $11.3 billion State Bankshares doubled those amounts in response to the pandemic. Employees can choose to pool their money with coworkers or contribute to broader causes in the community.

Over the past 14 years, the bank has given away $22 million through its employees. To celebrate this generosity, the bank collects stories about the impact these funds have on recipients and shares them at the company holiday party.

Greening Businesses

Climate First Bank is helping create a greener economy through commercial transition loans.

The idea resulted from an opportunity to provide financing to build and operate a gas station in Florida. Executives at the $250 million, mission-based bank, a unit of Climate First Bancorp in St. Petersburg, Florida, submitted a proposal that included installing a solar power system and electric vehicle charging stations.

Climate First thinks transitional commercial loans could help business customers operate today while setting themselves up for the future. "[W]e relish the opportunity to be a partner in helping local businesses become more green," the bank said in its 2021 Impact Report. The client will save around $2,200 in energy costs annually, as well as 1,595 tons of carbon dioxide emissions, according to the bank.

FOCUS ON: ENVIRONMENT

By: **Laura Alix**

Key Material Matters for Environmental

Green Lending & Business Opportunities	Climate Impacts on Customers & Communities	Greenhouse Gas Emissions

Of the three letters in the ESG acronym, it's the 'E' — for environmental — that gets bankers' hackles up most. Regulators, lawmakers and investors have promised to turn up their scrutiny of the environmental impact of banks' lending and investing activities. Acting Comptroller of the Currency Michael Hsu says he's concerned about risks that impact the safety and soundness of the banking system, including those tied to climate. But bankers like William Demchak, CEO and chairman of PNC Financial Services Group, believe it's nothing more than "political football."

"We're in the risk business," Demchak said at a June 2022 conference. "We stress test this stuff all the time. This isn't a stress loss issue for the banking system. It's a real climate change issue for the country that we need to transition in, but [U.S.] policies to do that are terrible."

PNC was not among the six largest banks that agreed to participate in a pilot climate scenario analysis exercise with the Federal Reserve. The program is designed to understand climate-related financial risk, and doesn't carry the capital or supervisory implications of a stress test, according to the Fed.

> "The idea behind the environmental lending policy was to set guidelines and make very clear guardrails for our team, since we are in various lines of businesses, that we need to be mindful of these things"
>
> **Nicole Lorch,** president and chief operating officer, First Internet Bancorp

In a rule proposed by the Securities and Exchange Commission in March 2022, publicly traded companies would be required to report climate-related risks. These would include Scope 1 and Scope 2 emissions, referencing direct and indirect greenhouse gas emissions generated by a bank's business activities and vendors, and Scope 3 emissions, or those emissions generated by a bank's loans and investments. Scope 3 emissions are trickier to calculate because doing so relies on gathering large amounts of data from commercial clients.

Industry groups such as the Independent Community Bankers of America argue that too much regulation could have a chilling effect on community banks' ability to extend credit and that banks are already masters at managing risk, pointing to banks' long history with natural disasters. As such, according to the organization in a September 2021 report, "community banks do not need additional supervision or regulation to manage their potential climate risks."

Some banks have taken steps to consider environmental factors in lending criteria and corporate strategy more broadly. One example of this is $4.3 billion First Internet Bancorp. The bank considers whether a borrower is in an environmentally sensitive industry or could have a negative impact on its surroundings — say by contaminating soil or groundwater. It has chosen not to work with oil and gas refineries or coal mining companies, saying that other institutions are better able to price those risks, but it does lend to convenience stores with fuel pumps. Lenders also consider fairly mundane criteria, including prior uses of a property, its history of ownership and possible contamination from neighboring properties.

"The idea behind the environmental lending policy was to set guidelines and make very clear guardrails for our team, since we are in various lines of business, that we need to be mindful of these things," says President and Chief Operating Officer Nicole Lorch.

> "It seems like basic blocking and tackling, understanding the value of the collateral on the loan, and recognizing the impact of climate change or regulations on the value of property."
>
> **Gregg Anderson,** managing director, Crowe LLP

$136.3M

financing by First Internet to governmental entities to fund energy efficiency and renewable energy projects through June 30, 2021

Source: First Internet Bancorp 2021 ESG report

33K

plastic water bottles First Internet saved by offering refill stations in its offices

Source: First Internet Bancorp 2021 ESG report

The bank has considered environmental factors since its founding in 1999 but formalized the policy last year.

Environmental criteria aren't there for the purpose of rejecting potential borrowers, but rather so the Fishers, Indiana-based bank can better understand the risk profile of the loans it makes and price accordingly, Lorch says. In doing so, the policy protects shareholders' interests. If the bank has to take possession of a piece of property, executives want to know whether toxic chemicals could have leached into the ground at some point, or if it's uninsurable for some reason.

"It seems like basic blocking and tackling, understanding the value of the collateral on the loan, and recognizing the impact of climate change or regulations on the value of property," observes Gregg Anderson, managing director at Crowe LLP.

Lorch illustrates this impact with a real-life example drawn upon a credit officer's experience working at another bank. During his time there, the financial institution dealt with a workout on a loan to a gas station. Because electricity to the property had been cut off, a sensor in the gas pumps stopped functioning, and gas began leaking into the ground. That's a risk a bank would want to account for, because it can affect the property's value or future uses, Lorch says. Therefore, First Internet Bank wants to make sure that its borrowers have the financial means to remediate any potential contamination.

"Having that experience and having those guidelines are very helpful, especially as we continue to grow as an organization and bring on people from different experiences," Lorch says. "It really helps our underwriting and lending teams learn from those who have been to that particular rodeo before. We don't want to make those mistakes."

Beyond its underwriting criteria, First Internet has a number of environmentally-minded policies, many of which were initially undertaken for other reasons. Founded as a digital bank, First Internet has never offered paper banking statements, a move that cuts down on waste and costs. A 2017 study by Javelin Strategy & Research estimated that the industry spent $594 million annually issuing paper statements to digital customers.

annual industry spend on paper statements to digital customers

Source: 2017 Javelin Strategy & Research study

The bank also offers water bottle filling stations and a soda fountain primarily as perks for its employees, but it's also saved roughly 33,000 plastic bottles from hitting landfills. First Internet Bancorp has also installed energy efficient lighting in its headquarters and large rainwater cisterns for irrigating the green spaces it provides as worker amenities, Lorch adds.

When it put together its first ESG report, the bank enlisted an outside consulting firm, Third Economy, which identified these kinds of efforts as counting toward the bank's environmental goals, Lorch says.

"There was some added expense in putting the report together on that first go round," Lorch acknowledges. "But the lessons we have learned from that, and the knowledge that was transferred through that process, has been very worthwhile to us."

The bank's eight-member board reviews its ESG policy on a yearly basis and discusses aspects of the policy regularly, says Aasif Bade, a director with First Internet who's also the CEO of an industrial development company. A clear environmental policy can capitalize on increasing demand in the marketplace, he says. Similar dynamics are playing out in the commercial real estate world: Companies increasingly build new construction to LEED green-building certification standards because buyers and tenants see long-term value in more energy efficient buildings, he adds.

First Internet has found new business opportunities as it has formalized its environmental policies. Lorch says the company has begun to carve out a niche lending to municipalities interested in energy efficient upgrades. First Internet made $136 million of such loans as of mid-2021, according to its ESG report.

For public banks, the regulatory environment could become more prescriptive, requiring institutions to disclose their energy use in their buildings and tied to business travel, along with those tied to business activities like lending. However, "[it's] not all just risks and costs, but potentially opportunities if the economy shifts to renewable energy," says Chris McClure, a partner at Crowe and leader of its ESG team. "Maybe you have loans with solar companies or other evolving technologies that create a lot of opportunity for you."

FOCUS ON: SOCIAL

By: **Kiah Lau Haslett**

Key Material Matters for Social

Access to Financial Products & Services	Employee Engagement, Development & Pay	Community Involvement

Sauywanna Davis and her son didn't set out to become entrepreneurs.

A decade ago, Davis was teaching math to kids in high school when she and her 8-year-old son stumbled upon a business idea: beaded keychain crafts that teach kids math concepts.

Together, they created Keychain Karnival, a business that pairs craft kits with educational programming. Today, Davis is the company's COO and operations manager; her son, Kaionta Dabney, is the CEO and founder. Even though Davis has degrees in business, she says she needed to learn the language of entrepreneurship and how to navigate the challenges of owning a business with her young son. That included founding the business, identifying suppliers and sales opportunities, and then calculating growth and revenue.

In summer 2022, Davis was one of the participants in Midwest BankCentre's Small Business Academy program, where she connected with other small business owners as well as mentors. She found out about the academy through a Midwest BankCentre banker who spoke to a youth entrepreneurship program her son

> “[We] think about the optimization of a relationship, not the maximization. I believe that to maximize anything, to anyone, is a zero-sum situation ... For us, it’s about optimization and creating environments where there’s shared prosperity.”
>
> **Orvin Kimbrough,** CEO and chairman, Midwest BankCentre

was enrolled in. Now, Davis has a community she can reach out to for questions or guidance. Additionally, she and her son now have accounts at Midwest BankCentre.

"To me, community banking means the banks are working with the people, sharing information so they can grow their businesses, provid[ing] them opportunities for networking, contact and resources," Davis says. "To say, 'Hey, we want to help you grow, because if you grow, the community grows.'"

Growing a community through the individuals and businesses that live and work there is at the core of St. Louis-based Midwest BankCentre's mission. The bank runs a variety of initiatives aimed at closing the creditworthiness gap of prospective clients and works with partner organizations to jump-start community development through financing.

"If we say that we're going to serve every part of the region, then we have to make sure that we're looking at our products within that lens. ... What works for a high-income person is different from what works for a low-to-moderate-income person," says Orvin Kimbrough, CEO and chairman of the $2.4 billion bank. That includes designing systems and policies that can accommodate potential customers who are looking to rebuild or reestablish banking relationships.

"We recognize that life happens, and we intend to be inclusive to those who are rebuilding their credit and their personal finances," he says. "Everyone deserves a meaningful banking relationship."

To help local small businesses strengthen their financial position and grow, Midwest BankCentre launched its Small Business Academy in March 2021. The program provides practical education over the course of eight weeks to small business owners interested in accessing growth capital in the future. The first cohort was in partnership with the region's energy utility company and worked with 19 of its small business suppliers. The bank has also worked with another 14 small

business owners in partnership with the Hispanic Chamber of Commerce of Metropolitan St. Louis.

The academy aims to help these business owners "think like a banker." Midwest BankCentre's employees, including members of the bank's community economic development team, developed the curriculum and teach classes that cover subjects like understanding financial statements, key ratios and other crucial items of information a banker needs to extend credit and capital.

Working with other civic groups and companies helps the bank make connections with small businesses in the area, while creating buy-in from businesses in the community about shared prosperity and success.

"Everything that we do, we try to do in partnership. When you think about the really big businesses in St. Louis, they do business with really small businesses," Kimbrough says. "They have a captive audience of vendors who could be potential participants in a Small Business Academy and ultimately, potential customers for the bank. Our goal was to create this educational tool that exposed these individuals to the ins and outs of banking."

The Small Business Academy is one example of how Midwest BankCentre promotes financial inclusion across all of its communities. St. Louis is a metropolitan area with pockets of prosperity and poverty. Midwest BankCentre believes financial institutions play a key role in providing capital and financing to businesses and residents — so closing the bankability gap becomes crucial to reversing the plight of less prosperous communities. To that end, the bank is almost two years into a five-year commitment to fund around $200 million in capital loans to individuals, faith-based organizations, community development projects and small businesses working in distressed communities in St. Louis.

"Community and economic development is really a strategy that's embedded within our culture at the bank. It's not a job that one person or one team has," says Wes Burns, executive vice president of community and economic development at Midwest BankCentre.

He says it can take up to 18 months to help an underbanked small business owner get their credit in order, standardize their financial reporting and work through their cash flow issues. At many banks, this isn't a risk they would want to take or time they could spend — leaving the business owner underserved, with no adviser to assist them on becoming bankable.

But 18 months pales in comparison to eight years, which was the amount of time it took the bank to work on a project with a nonprofit that wanted to build a community center. Midwest served as the advisor and banker to the nonprofit, researching how they could work together to build a capital stack for the project that incorporated different tax incentives and partnerships. At the end, Midwest BankCentre was able to make a loan to the nonprofit as part of the capital project.

"It's a 'one person at a time' approach. It is time intensive. But if banks continue to do what we've done as an industry for the last several decades, you'll continue to have these large pockets of marginalized, disinvested communities that have no banks on Main Street," Burns says,

$200M

five-year lending commitment to nonprofits, small businesses, community development projects and others in underserved communities in St. Louis

Source: Midwest BankCentre 2021 Community Impact report

52

small business owners have participated in Midwest BankCentre's Small Business Academy since it launched in 2021.

Source: Midwest BankCentre

adding that a long-term lack of capital creates a ripple of detrimental impacts on these communities.

Midwest BankCentre's approach to ESG is to position the bank for long-term, sustainable profitability. It's a future orientation, Kimbrough says.

"[We] think about the optimization of a relationship, not the maximization. I believe that to maximize anything, to anyone, is a zero-sum situation," he says. "For us, it's about optimization and creating environments where there's shared prosperity."

Burns admits he never really says the phrase "ESG," even though by his own admission, "the S component is what I do day in and day out." The bank doesn't necessarily think of its actions as part of an ESG framework, but instead, thinks about how it can optimize its workforce, policies and practices, and relationships with customers for long-term mutual success. Fostering an ecosystem of financial inclusion and working with potential clients to become financially stable and prosperous is how the bank sets itself up for future relevancy and success within its communities.

"Sometimes, I think the industry thinks about inclusiveness in terms of diversity and having a bunch of people who look really different from each other. But inclusion can also mean the work you do to bring people into the financial system, to be prepared to be in the financial system; it's the idea that prosperity is shared," Burns says. "Sometimes I think that banks forget the role that they play in the perpetuation of shared prosperity or of inequality."

"Community and economic development is really a strategy that's embedded within our culture at the bank. It's not a job that one person or one team has."

Wes Burns, executive vice president of community and economic development, Midwest BankCentre

FOCUS ON: GOVERNANCE

By: **Emily McCormick**

Key Material Matters for Governance

Board Structure, Independence & Composition	Risk Management	Cybersecurity & Data Privacy	Regulatory Compliance

David Reiling, the CEO and chairman of Sunrise Banks in St. Paul, Minnesota, recently took the bank's board on a bus tour around the Twin Cities to witness its work building up businesses in the low- and moderate-income communities it serves.

"There's nothing like … seeing and meeting the people who are working [on] the projects, the transformational real estate that's taken place, the business owner that now has five employees," says Reiling. "It's that impact that just sparks everything else." That level of direct connection and transparency engages board members; it's likely that the tour won't be a one-time occurrence.

Sunrise Banks, with $2 billion in assets, is a community development financial institution, or CDFI — one of just 175 banks and thrifts with the designation, which focuses on providing financial services to low-income communities. Sunrise Banks is also one of a handful of banks that have opted to become B corporations. More than 5,600 companies worldwide and around 2,200 in the U.S. — including big brands like King Arthur Baking Co., Ben and Jerry's, and Patagonia — have earned the B corporation designation from the nonprofit B Lab, which assesses each company across five areas that align with ESG: governance, workers, community, environment and customers.

The assessment is free, and the 200 questions posed by the organization could help a company better measure its performance across the examined areas. To be certified as a B corporation, however, B Lab charges an annual fee that's based on the company's revenue. Companies must score at least an 80 across the assessed areas to receive the certification. Further, all B corporations must change their legal structure to become a public benefit corporation, which is available in most states. Those companies are still for-profit, but their charter includes one or two social or environmental benefits within their statement of purpose.

Within the ESG acronym, banks might be best at governance, says John Epperson, managing principal of financial services at Crowe LLP. "There [are] a lot of laws and regulations that really put [governance] front and center," he says. Key governance considerations include board competency and structure, as well as cybersecurity and risk mitigation, adds Chris McClure, a Crowe partner who leads the firm's ESG services team. Of the 11 B corp banks identified by Bank Director, five scored in the top 5% of all B corp companies globally for their governance practices. That number includes Sunrise.

In the governance portion of its assessment, B Lab emphasizes accountability and transparency, which Reiling likens to "walking the talk." Put simply: Does what you say you value align with what you actually do as an organization? "You do measure what you treasure," explains Reiling. "What did we improve? Where did we fall short?" A member of the executive team hosts a monthly all-staff call that provides an update on what's going on at the bank, including its performance. The show, "Sunny Scoop," started during the early stages of the pandemic to keep employees filled in on the changes impacting the company. It continues as a way to keep staff engaged. "We're hitting areas of the bank that are important, whether it's the financial metrics or impact metrics," he says.

As a CDFI, Reiling says, 60% of the bank's loans have to serve low- and moderate-income customers. Some of the achievements touted in the bank's 2021 Impact Report include partnering with a local marketing firm to offer financial literacy programs to 3,000 low- and moderate-income students, originating 1,945 Paycheck Protection Program loans and providing mortgages to 132 families, almost half of those via an alternative lending program tailored for customers who don't qualify for a traditional mortgage.

Focusing on financial performance and mission-specific goals — and holding management accountable to them — necessitates a different mindset in the boardroom, Reiling says. That requires bringing on engaged board members with the right values and expertise. It can also mean letting directors go when they can no longer effectively contribute to the mission.

To encourage new points of view, directors serve one-year terms, and the board undergoes an annual assessment. "This provides a baseline performance rating," says Reiling. "In addition, the survey asks how each individual board member perceives the health and

> "As a bank, you've got to meet certain safety and soundness [requirements]. At the same time, what risks are you willing to accept? ... We want to choose the risk we take."
>
> **David Reiling,** CEO and chairman, Sunrise Banks

performance of the board and their participation." One-on-one conversations with Reiling follow the evaluation, to discuss how each individual feels about their contributions and determine if the board member should continue to serve. "A mature board member [may say], 'I've been on the board for so long; I've really enjoyed it, but it's time to bring in someone new,'" says Reiling. "It's easy to get lazy and say, 'Things are fine. Let's keep going.' But that doesn't help you in the long run."

The proxy advisory firms Glass Lewis and Institutional Shareholder Services (ISS) both note board composition and independence from management within their voting guidelines for 2022; they also emphasize refreshment via regular director evaluations and other means. "In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face," according to Glass Lewis. "[A] lack of refreshment can contribute to a lack of board responsiveness to poor company performance."

Board-level diversity has been a particular area of focus for stakeholders. Nasdaq requires listed companies to annually disclose statistics about the board's composition, including gender and race. Boards that don't have at least two diverse directors must explain why. Glass Lewis and ISS make harsh recommendations for boards that don't have women. As of 2022 for Russell 3000 companies, Glass Lewis will recommend a vote against a nominating chair if the company's board has fewer than two gender-diverse members and against the entire nominating committee if there are none represented. Companies outside that index are expected to have at least one gender-diverse director. For its part, ISS will recommend voting against or withholding a vote from the chair of nominating committees of Russell 3000 or S&P 1500 companies that lack a woman or racially or ethnically diverse director on the board. ISS's gender diversity policy will expand to companies not on the two indices effective for annual meetings held on or after February 1, 2023.

47%

say their board conducts an annual performance assessment.

56%

believe that greater diversity improves the performance of a corporate board.

Source: Bank Director's 2022 Governance Best Practices Survey

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> “[A] director’s experience can be a valuable asset to shareholders because of the complex, critical issues that boards face ... [A] lack of refreshment can contribute to a lack of board responsiveness to poor company performance.”
>
> Glass Lewis, 2022 Policy Guidelines

Reiling believes that Sunrise Banks has been successful in recruiting skilled directors who represent diverse backgrounds. Right now, the bank seeks to improve its digital competency on the board and across the organization. It isn’t just seeking technologists but wants to attract digitally savvy individuals in areas like compliance.

An important element of governance is risk; boards must oversee reputational, climate, credit and other risks that are also inherent in ESG. “As a bank, you’ve got to meet certain safety and soundness [requirements]. At the same time, what risks are you willing to accept?” says Reiling. “We want to choose the risk we take.”

As the risks facing community banks evolve, the governance structure and composition of the board should evolve as well. Policies and procedures should support the bank’s strategy, along with new compliance and reporting requirements, says Annette Michelle “Shelli” Willis, a partner at the law firm Troutman Sanders. “[The board’s] role should be strategy and oversight,” so directors need to keep risks — and opportunities — front and center.

Responding to those risks and opportunities requires continual improvement — and that means Reiling’s board needs to be comfortable with change. And bank leaders can’t make perfect the enemy of good. Sunrise Banks recently began disclosing its carbon emissions, including those financed by the bank’s lending activities. Like a number of financial institutions, it has struggled with data quality around greenhouse gas emissions. “We want to be in compliance with the Paris Agreement,” says Reiling, referencing the 2015 treaty that seeks to halt global warming to 1.5°C above pre-industrial levels, a feat that will require entities like Sunrise to achieve “net zero” emissions by 2050. “This process is challenging [because] our data quality is only so good at the moment; we’re using a lot of proxies.”

Years ago, Reiling met Jerry Greenfield, the co-founder of Ben and Jerry’s, at an event. “I always wanted to talk to him,” recalls Reiling. The ice cream purveyor emphasized the importance of being true to the company’s mission. “[Greenfield] was just so adamant [in] saying, ‘You have to believe in something; you’re not going to serve everybody,’” he says. “Those who believe what you do ... are going to come because you share values. It’s beyond price; it’s just a deeper relationship, and that’s where you want to be with your customers.”

That starts in the boardroom. “Given Sunrise’s mission and entrepreneurial operating system, the board’s governance skills need to keep pace,” says Reiling. “We strive to have the right values-aligned people in the right seats throughout the organization, including the board.”

THE BOARD'S ROLE IN ESG OVERSIGHT

By: **Emily McCormick**

Introducing controversial environmental, social and governance topics — particularly hot-button issues like climate change — can quickly turn a board meeting into a shouting match, says John Epperson, managing principal of financial services at Crowe LLP. Boards frequently question what these issues have to do with the business of banking, but ESG themes touch multiple areas that affect the day-to-day operations of the bank, from fair lending compliance to concentrations in the loan portfolio to cybersecurity to the composition of the board. Starting with the bank's unique strategy, and incorporating ESG goals within it, can help boards dial down that noise. "How do [directors] define success?" he says. Coming from the same place, in a strategic sense, can help foster healthy discussion and dialogue.

Every financial institution's approach to ESG will be different, based on its mission, values and objectives. And every board will have a role to play, and it starts with oversight and governance, says Chris McClure, a Crowe partner and leader of the firm's ESG services team.

16%

say their board annually discusses climate change.

Source: Bank Director's 2022 Risk Survey

Directors will need to heed regulatory ebbs and flows, along with shifts in stakeholder expectations. That may require new perspectives in the boardroom, as well as education and training so members can provide credible challenge, a critical part of their fiduciary responsibility that requires asking shrewd questions of management to protect investors' interest in the institution. "Does management have the tools that it needs to manage growing goals and obligations around ESG?" says McClure. That includes resource allocation, reporting and governance structure, supporting leadership and setting appropriate goals, along with setting the right tone at the top.

The board's job boils down to three important areas: strategic planning, risk management and talent, says Heather Eastep, a partner at the law firm Hunton Andrews Kurth. "In those three big directives, for every board, [there] are ESG components," she says. "And it's the board telling management, 'This is how we want you to start thinking about [issues like] diversity, [or] climate change when it comes to our credit risk or our investment portfolio.'"

Boards have a fiduciary responsibility to shareholders, including institutional investors that are increasingly interested in ESG. Customers and employees matter as well, to drive the bank's financial performance. The expectations of these groups will continue to evolve, as will the bank's risks and opportunities. The bank will need to adapt in response, says Eastep. "Not only do we have the right people on the board, but do we have the right people in management?"

Banks tend to be strong on governance compared to other industries, but boards with institutional shareholders or public banks may need to adapt their risk management frameworks to address ESG. That could include issues like climate risk, which was hardly top of mind for boards and management teams earlier this year, prior to increased attention from regulators around disclosure and stress testing for larger, public banks. Just 16% of directors and executives responding to Bank Director's 2022 Risk Survey in January said their board annually discussed climate change as part of its analysis and understanding of the risks facing their institution.

Banks may not need to establish an exhaustive ESG program, per se. In fact, many don't: According to Bank Director's Risk Survey, just 6% indicated that their bank publicly disclosed its ESG progress through a comprehensive report. Many banks break ESG into discrete components, such as employee development and engagement or community investment.

And most elements of ESG are far from controversial, notes Gregg Anderson, a managing director in Crowe's risk consulting group. Take cybersecurity. "Some people forget that [ESG] includes cybersecurity and data privacy, and I've yet to find anybody [who] says, 'I don't want my bank to keep my stuff private.'"

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QUESTIONS FOR BANK BOARDS

1. What goals are material to our stakeholders — shareholders, employees, customers, regulators and other groups that are important to our institution?

"You can't chase everything," says Crowe Partner Chris McClure. It's easy to get caught up in fads and political controversies, and miss the risks and opportunities that stakeholders value. "Have a process for listening to the voices that matter the most" to your organization.

2. Who's accountable for ESG?

Putting responsibility for ESG within the senior leadership team sets a strong tone at the top. In addition, McClure recommends a cross-functional team that includes the head of ESG, chief financial officer, head of internal audit and chief risk officer, as well as senior legal, compliance and human resources personnel.

3. What committees should address ESG as part of their duties and responsibilities?

The nominating and governance committee often plays a significant role, but other committees could have slices of the ESG pie. The compensation committee typically oversees diversity and inclusion. Cybersecurity could be housed in the audit, risk or technology committee, depending on the bank.

4. What data should be disclosed?

Disclosed information should be auditable, so quality is better than quantity. "If that means disclosing less information, but it's transparent and you have greater confidence in it, that's better than disclosing [bad data]," says Gregg Anderson, a managing director at Crowe. Data can be a particular challenge for banks seeking to assess climate-related risks in their loan portfolios. Look at what other banks measure and align that with your institution's goals.

5. What are our next steps?

Building your bank's ESG program will take time. "When you have topics like a warming planet or changing demographics, those require thinking longer term," says Anderson. "To have an effective program [necessitates] deliberate decisions." New opportunities and risks will emerge as the bank continues to fine-tune and strengthen its approach.

CONCLUSION

Each of the more than 4,000 banks across the U.S. has their own unique way of doing business, from focusing on niche sectors of the economy to offering plain-vanilla banking. Environmental, social and governance matters touch every area of a bank — but for many, what topics are emphasized and what information is disclosed will be the decision of the management team and the board, in response to what matters to stakeholders. You have the power to control your bank's destiny when it comes to ESG. Find your path and the opportunities that await.

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CHOOSE YOUR PATH:

A PRACTICAL GUIDE TO ESG

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