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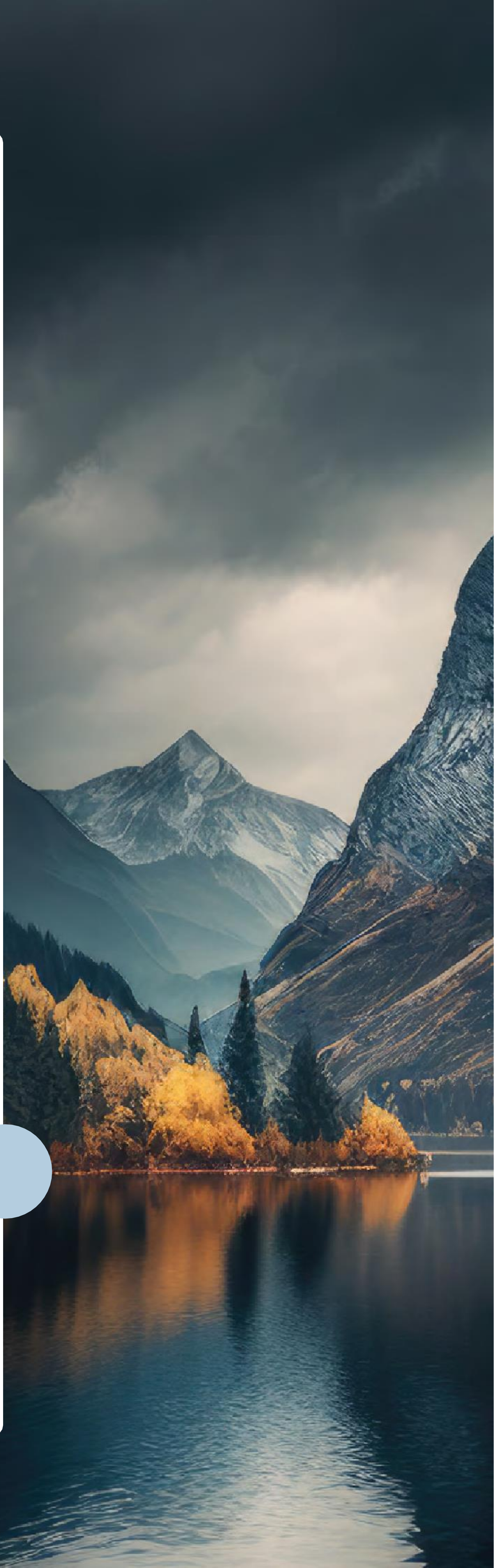
Candriam's view on ESG in the banking industry.



MARCH 2023

Marketing communication

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The long view.

As the March drama unfolds, it might help us to remember the long road that banks have travelled, and the path ahead. Those paths are very different on either side of the Atlantic.

In Europe, recent events should not cause us to lose sight of the regulatory issues which were already rolling out (who could forget Basel III?), and importantly, those which are soon to arrive.

Banking regulation in the EU puts the spotlight on **disclosure of climate risks**, including risks to their loan books which can arise from climate change. The European Banking Authority will ask banks to disclose both data on these risks, and their strategies to address these risks, beginning in December 2023. With loan exposure industries from real estate to energy, banks could face write-downs from extreme weather events, or from changes in climate policy and regulation.

In the US, the situation is different. Most importantly, corporate governance norms in the US lag those of Europe. The idea of corporate governance came to the US later than it did in Europe. Cultural attitudes towards risk differ in the US, relative to Europe. The US banking regulators also take a less-focused approach to climate risks at banks. If anything, in the broader sense, deregulation may be a better description of the US banking landscape. From the repeal of Glass-Steagall two decades ago, and the re-introduction of trading risks into bank solvency, to the rollbacks of Dodd-Frank over the last five years, US regulatory responses to banking crises are being rolled back, with only moral suasion on the horizon.

How can banks better address ESG considerations?

Governance

Corporate governance remains the key material issue for the banking sector, despite the strengthening of internal governance and improvement of 'sound and prudent' management since the Global Financial Crisis.

To return to basic principles, the first role of corporate governance is the protection of the interests of minority shareholders. This is the rationale behind corporate governance rules such as the composition of the board of directors. Minority shareholders must be represented on the Board for their interests to be defended. The Board should include expertise in the company's areas of activity as well as a diversity of skills, knowledge, background, age and gender. This is necessary to ensure that decisions are made in the corporate interest of the company, including the legitimate interests and expectations of shareholders and all other stakeholders.

Banks should follow the principles set out by corporate governance codes. For example, the Board of Directors should include a *minimum* of 50% independent directors overall, while best practice for committees would be full independence for the audit, remuneration and nomination sub-committees.

Consider the example of remuneration. Compensation packages for the CEO and senior management need to be structured to offer incentives for the creation of long-term value, and include meaningful goals for performance-based compensation which support the company's long-term value creation strategy.

Companies displaying poor corporate governance, including a non-independent Board with a lack of oversight, have a higher probability of fraudulent practices, misalignment of executive pay with performance, and subordination of minority shareholders. All these factors negatively affect company valuation and increase the cost of capital. Proper and sound governance practices are crucial to the financial sector.

Good information is a pre-condition for well-informed decision-making. Too many banks in the banking union still do not possess sufficiently agile IT systems to adequately aggregate data on risk appetite, risk limits and risk profiles. Weakness in this area just feeds into the governance issues the banks are facing. ***Bank management bodies set the bank's risk appetite.*** They are responsible for communicating the bank's strategic objectives and values. A strong governance framework provides Board members with proper information and data in a timely manner.

Environment

In recent years, regulators worldwide have declared climate change to be a material risk in maintaining financial stability. As capital allocators, the financial sector has a crucial role to play in advancing the transition towards a low-carbon economy and meeting the objectives set by the Paris Agreement. Consequently, financial institutions are under pressure to enhance transparency and disclosures regarding climate risks. Enhanced disclosures of bank balance sheets help stakeholders to understanding the banks' exposures to long-term environmental risks. Green bonds and sustainability-linked loan products act as a way to finance general corporate purposes while still encouraging sustainability improvements.

Human Capital

It is crucial for financial firms to have career management programs in place to enhance productivity levels and limit turnover, which can prove to be very costly. Effective human management practices have material implications for financials.

Customers

Financial institutions routinely possess highly confidential client information, due to the nature of their activities. Analyzing company data protection polices and compliance with regulations has become an important issue for the banks, especially in the EU under its General Data Protection Regulation (GDPR). Customer product safety and transparency is a key responsibility for financial institutions as there is often a knowledge gap between the bank and the customer.

€139 B

AUM at end December 2022*

600

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* As of 31/12/2022, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 31/12/2022.

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