

# Growing importance of environmental, social and governance priorities



**The banking sector plays an essential role in supporting the global transition to greener, low carbon and resilient industries by enabling the movement of capital to these new trends. Banks are increasingly choosing to finance companies with strong ESG performance, advancing their agendas beyond their own doors.**

Banks are increasingly recognizing ESG the importance and relevance of risk assessments in establishing their policies and products. They have become key drivers for discussions with their customers and investors that are sustainability driven. New ESG-tied products and models are being developed, tested and commercialized. The bottom line is that banks can no longer afford to overlook ESG and must embrace it to align with the global growth of the sustainable finance market and meet the increased demand from regulators and stakeholders on the integration of sustainability into financial products.

## ESG in Jordan

In our KPMG Jordan CEO Outlook 2021, 76% of CEOs in Jordan stated that their focus has shifted towards the social component of their ESG program. A key area of focus for Jordanian banks' ESG programs is gender diversity—helping tackle the 'S', or social, aspect of ESG. A healthy competition has developed among many banks to boost female employment. Several banks

have made significant efforts in female employment and are being spurred to push higher by their competitors. The next step for banks is to increase female employment at the middle- and senior-management level.

The banking sector as a whole is changing to make both its operations more sustainable and its financing more directed towards sustainability-related projects. The findings of our CEO Outlook reflect that business leaders in Jordan are looking to devote significant capital to becoming more sustainable, with 56% planning to invest more than 10% of their revenues towards their efforts of becoming more sustainable. Banks will play a critical role in the financing of such ambitions, while banks have also formulated wide-ranging commitments to renewable energy usage within their organization.<sup>1</sup>

## Pressure for change

Pressure from regulators, investors and the public for greater adoption of ESG is on the rise. Prudential and conduct

risks are on the rise — both in terms of the direct risks (i.e., the physical impact of climate change on assets) and the transition risks (i.e., the challenges inherent in a wholesale move towards a low-carbon economy).

Governments will prioritize the effectiveness of ESG-related regulations in reaching climate change goals over the difficulties faced by banks. Jordan has launched a 10-year national energy sector strategy to improve its energy mix and reduce carbon emissions by 10% in 2030.<sup>2</sup> Banks play an important role in supporting the global transition to greener, low carbon and resilient industries.

Investors are ramping up pressure on banks to promote ESG but want to ensure they can continue to earn a return on their investment. Those two goals are achievable together. An analysis by S&P Global of 26 large ESG exchange-traded funds and mutual funds showed that 19 of those funds performed better than the S&P 500 from March 2020 – March 2021. Those outperformers rose

between 27.3% and 55% over that period. In comparison, the S&P 500 increased 27.1%.<sup>3</sup> Stock exchanges' focus on sustainability and ESG disclosures is increasing aligning with investors demands. The Amman Stock Exchange has joined the Sustainable Stock Exchange Initiative and has voluntarily committed to promote the integration of sustainability. The stock exchange has published a voluntary guidance on sustainability reporting for its listed issuers.

At the same time, banks are also starting to feel pressure from their customers and from the public at large. Customers want to bank with a firm that reflects their views and beliefs; younger people, in particular Generation Z, are said to be choosing their bank based on their ESG credentials.

## Measuring ESG

Traditionally, investors have used companies' annual reports to judge their ESG agendas. Having few reliable reporting or rating

mechanisms for ESG programs, there has been little incentive for companies to be overly forthright about the impact – or lack thereof – of their ESG programs.

The introduction of ESG ratings systems and stock indexes of companies with leading sustainability programs have changed the ESG investment paradigm. ESG ratings support investors gain a broader view of a company's ability to manage current and future ESG risks and opportunities, and guides them in their decision making process.

In the ratings field, Morningstar's Sustainalytics is driving innovation through its 'ESG Risk ratings,' which takes a quantitative approach to gauging a company's effort allocated to ESG initiatives. Dow Jones, MSCI, and other rating agencies have introduced sustainability indexes, which have boosted appeal for the stocks of companies with strong ESG programs.

Several banks in Jordan use Global Reporting Initiative (GRI) standards to report their ESG activities. The GRI standards represent the global best practice for reporting publicly on a range of economic, environmental, and social impacts. Sustainability reporting based on the standards provides information about an organization's positive or negative contributions to sustainable development.

There is some variation in the rigor reporting using GRI standards used by banks—the 'core' option being less rigorous than the 'comprehensive' option. Jordanian banks are increasingly using the comprehensive option, which places pressure on core option users to join them, thus enhancing the overall ESG reporting environment in the country. Although several banks have issued sustainability reports, they are currently not assessed by international rating agencies.



<sup>1</sup> <https://www.arabbank.com/docs/default-source/sustainability-reports/susreport2020en>

<sup>2</sup> <https://www.worldbank.org/en/news/feature/2022/05/24/countries-on-the-cusp-of-carbon-markets>

<sup>3</sup> <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/esg-funds-beat-out-s-p-500-in-1st-year-of-covid-19-how-1-fund-shot-to-the-top-63224550>



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#### Embedding an ESG strategy

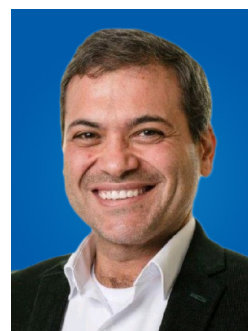
So, what could banks be doing to embed ESG into their strategy? KPMG member firms' work with banks and other organizations across the financial services ecosystem suggest there are four key actions that bank executives should be addressing today.

**1) Understand your current baseline.** More than simply quantifying the financial risks and probabilities, banks should create an understanding of common ESG expectations of key stakeholders and build awareness of leading ESG practices, in particular amongst senior management and board members. This includes taking time to understand their current practices and exposures, including whether they have the right data, the right capabilities and the right processes to monitor and manage ESG appropriately going forward.

**2) Explore ESG global trends.** Looking towards international and regional peers and their performance provides an overview for the banks position and enables them to identify enhancement opportunities. This should not be limited to ESG disclosures, but includes products such as green bonds, sustainable bonds and green loans.

**3) Know what's expected.** While regulatory and supervisory authorities are exploring approaches as to how they might provide specific targets or expectations, bank executives should be talking to their regulatory authorities to understand what is expected of them and how those expectations may change over the short to medium-term. They should also be working proactively with their regulators and authorities to seek out facts, develop standards and identify solutions.

**4) Put it on your risk radar.** For many banks, ESG factors remain a reputational risk. But they need to be more than that. Bank executives (and particularly boards) should be ensuring that ESG risks are a lens through which all decisions are made, especially in relation to credit and valuation risks in their portfolios, reflecting the strategic nature of these risks. Develop a strategy. ESG risks cannot be managed off the side of a desk. It requires banks to develop a robust strategy that is integrated into the overall business strategy for the organization. While the strategy must retain a level of flexibility, it must also be actionable and measurable.



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