Shaping Banking's Next with ESG

Banks worldwide are increasingly gearing up for the pivotal role they will play in fostering the Environmental, Social, and Governance imperative in the industry, for their client community and for the society at large. In 2025 and beyond, four key ESG trends are set to reshape banking strategies. First, global developments on climate finance—including evolving pledges from international conferences—are driving a shift toward climate-resilient projects, green lending, and renewable energy investments. Second, the growth in ESG regulations and reporting is prompting banks to measure and disclose a broader range of sustainability metrics, particularly around carbon emissions and responsible governance. Third, the emergence of ESG ecosystems highlights the importance of partnerships among banks, fintechs, NGOs, and industry consortia for data sharing, innovative product development, and scaling sustainable finance solutions. Finally, the effective, responsible, and sustainable use of AI will enable banks to streamline operations and improve decision-making, but it also demands careful consideration of environmental footprint, social impact, and governance standards. Together, these trends underscore the increasingly central role ESG will play in the future of banking.

Industry Trendline

The parties in COP29 conference held in Baku Nov 2024, collectively committed to USD 300 billion annually towards climate finance

ESG standards demand banks report Scope 1, 2, and 3 emissions for transparent benchmarks

Embedding ESG into AI strategies unlocks value across business, experience, and efficiency

With Sustainability as a Core Strategy in 2025, Banks will

Prioritize scaling their climate finance portfolios to address mitigation and adaptation goals

Enhance their ESG reporting frameworks to meet evolving regulatory requirements and stakeholder expectations

Build a robust ESG Ecosystem to access reliable data, enhance measurement frameworks, and scale ESG initiatives

Ensure that AI is deployed responsibly and sustainably at their bank

Global Developments on Climate Finance

From the recently concluded COP29 conference held in Baku in Nov 2024, one of the biggest takeaways was the parties' collective commitment of USD 300 billion annually towards climate finance. This pledge by developed nations is substantial, despite falling short of the demand figure of USD 1 trillion annually towards the same. It is an indicator of a significant directional trend. Let's put this into context.

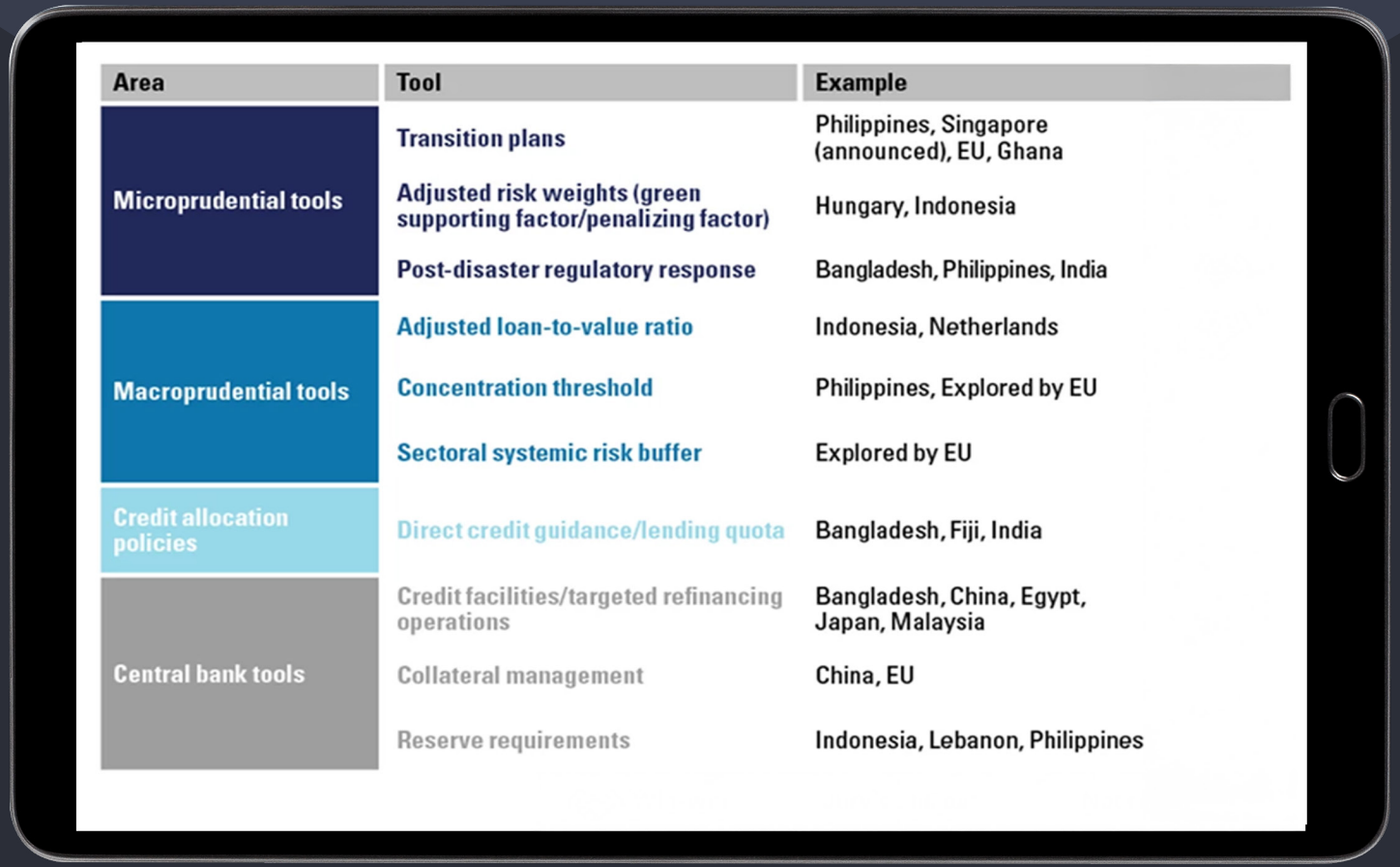
The World Meterological Organization has already published that the year 2024 has been the hottest year on record, with global warming temporarily hitting +1.5 deg Celsius. What has been the effect of this? A study done by the International Chamber of Commerce reports that increasing climate change over the past decade has resulted in over 4000 extreme-weather related events globally, and estimates that the economic loss due to these events is USD 2 trillion. This is only based on acute climate related events and doesn't include chronic and gradual impacts of climate change.

Not surprisingly, over the past few years, there has been notable progress in the areas of climate services, early warning systems, understanding climate variability, renewable energy generation, energy system resilience, analysis of energy demand patterns, and several initiatives on protecting the environment, harnessing sustainable energy, and driving investments towards sustainability. The climate finance funding from the developed nations to the developing nations are likely to flow into such initiatives, seeking climate change mitigation actions, reducing GHG emissions and climate resilient nation building, with a process for transparency and assessing the progress.

The UNFCCC (United Nations Framework Convention on Climate Change) website includes a climate finance data portal that provides details on the climate finance process, fund movements, climate action initiatives undertaken by various countries with the help of the climate funding.

According to a World Bank Group survey, climate financing is five percent or less of the lending portfolio for nearly 60 percent of EMDE banks (Emerging Market and Developing Economies) – with 28 percent providing no climate financing at all. Consequently, there is growing interest among central banks in using so-called targeted refinancing operations—providing more favorable financing terms for climate friendly lending by banks—to encourage green finance.

Banks should prioritize scaling their climate finance portfolios to address both mitigation and adaptation goals. Leveraging technology will be crucial—banks should invest in advanced data analytics, AI, and blockchain to track, manage, and report climate finance flows transparently. They should also develop innovative green financing instruments, such as green bonds and sustainability-linked loans, to mobilize capital for renewable energy, climate-resilient infrastructure, and emission reduction initiatives. By integrating climate risk into decision-making and fostering collaborations, banks can accelerate progress toward a sustainable future.



Area	Tool	Example
Microprudential tools	Transition plans	Philippines, Singapore (announced), EU, Ghana
	Adjusted risk weights (green supporting factor/penalizing factor)	Hungary, Indonesia
	Post-disaster regulatory response	Bangladesh, Philippines, India
Macroprudential tools	Adjusted loan-to-value ratio	Indonesia, Netherlands
	Concentration threshold	Philippines, Explored by EU
	Sectoral systemic risk buffer	Explored by EU
Credit allocation policies	Direct credit guidance/lending quota	Bangladesh, Fiji, India
Central bank tools	Credit facilities/targeted refinancing operations	Bangladesh, China, Egypt, Japan, Malaysia
	Collateral management	China, EU
	Reserve requirements	Indonesia, Lebanon, Philippines

Growth in ESG Regulations and Reporting

As a fallout of increasing global interest and focus on ESG, today it is no longer sufficient to claim that an organization embraces ESG considerations. There are increasing interest from many parties, including customers, partners, investors and employees to know more about how and how much the organization is ESG conscious. Another global development that is unfolding is that ESG compliance and reporting is being mandated and regulated by increasing number of countries.

The below figure from compliance and risks (https://www.complianceandrisks.com/) depicts the growth in global ESG regulations over the past 8 years.

Below is a list of key ESG regulations that will be impacting your business over the next 12-18 months:

- **EU:** CSRD – Corporate Sustainability Reporting Directive, 2022
- **EU:** ESRS – European Sustainability Reporting Standards, Commission Delegated Regulation 2023
- **EU:** CSDDD – Corporate Sustainability Due Diligence Directive, July 2024
- **EU:** SFDR – Sustainable Finance Disclosure Regulation, 2021
- **USA:** Enhancement and Standardization of Climate-Related Disclosures for Investors, Final Rule, March 2024
- **UK:** Sustainability Reporting Standards, Guidance Document, Revised, May 2024
- **UK:** Non-financial Reporting Review: Simpler Corporate Reporting, Consultation Document, May 2024
- **Canada:** Sustainability Disclosure Standard CSDS 1 – General Requirements for Disclosure of Sustainability-related Financial Information, Exposure Draft Standard, March 2024
- **Latvia:** Sustainability Disclosure, Draft Law, Jan 2024
- **Singapore:** Sustainability Reporting: Enhancing Consistency and Comparability, Consultation Document, March 2024
- **China:** Sustainability Reporting for Major Listed Companies, Guidelines, April 2024
- **South Korea:** Sustainability Disclosure Standards, Draft Standard, April 2024
- **India:** BRSR – Business Responsibility and Sustainability Reporting, May 2021, amended June 2024, phased mandatory from April 2023 onwards

References
https://www.complianceandrisks.com/
https://commission.europa.eu/
https://www.sebi.gov.in/ (BRSR reporting)
https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/

Most ESG standards also recommend or mandate measuring the environmental impact of a business organization through an industry-neutral metric like CO2e (tonnes of CO2 equivalent), which helps in an apples-to-apples comparative benchmarking. Banks specifically would need to also report on not only their Scope 1 & 2 emissions, but also Scope 3, which are emissions directly influenced by the bank's lending portfolio.

Some examples of the banking specific metrics sought include the below.

- The ISSB and SASB reporting asks for several metrics, including
  - Description of approach to incorporation of environmental, social and governance (ESG) factors in credit analysis
  - Description of significant concentrations of credit exposure to ESG factors, which may include carbon related assets, water-stressed regions and cybersecurity risks
  - Number of data breaches, percentage that are personal data breaches, number of account holders affected
  - The India BRSR regulation also asks for a break-up of the Total Scope 3 emissions (Break-up of the GHG into CO2, CH4, N2O, HFCs, PFCs, SF6, NF3, if available).

In 2025 and beyond, banks should prioritize enhancing their ESG reporting frameworks to meet evolving regulatory requirements and stakeholder expectations. This includes implementing robust systems for measuring and disclosing comprehensive ESG metrics, such as Scope 1, 2, and 3 emissions, alongside integrating environmental, social, and governance factors into credit analysis and risk management practices. Emphasizing transparency and accountability in sustainability disclosures will be essential for maintaining regulatory compliance and fostering trust among investors, customers, and other stakeholders.

Emergence of ESG Ecosystems

Banks are increasingly recognizing that achieving meaningful ESG impact is not a solo endeavour – it requires collaboration with a broader ecosystem of partners, including fintechs, technology providers, non-governmental organizations (NGOs), regulatory bodies, and industry consortia. Such ecosystems enable banks to access reliable data to measure emissions and evaluate lending opportunities, enhance measurement frameworks, and scale ESG initiatives effectively.

What are ESG ecosystems enabling for banks?

1. Access to Reliable Data: ESG ecosystems are helping banks overcome data gaps by sourcing diverse, high-quality ESG data from specialized providers and NGOs.

2. Effective Measurement and Better Disclosures: Partnerships with technology firms and data analytics providers are allowing banks to evolve ESG measurement, reporting, and compliance.

3. Greater ESG Impact: Collaborative ecosystems are enhancing banks' reach across the ESG value chain through co-developed solutions, such as green finance tools and sustainable investment platforms, amplifying their ESG impact.

HSBC:

- HSBC collaborates with organizations like the World Resources Institute (WRI) and CDP to enhance climate risk data and improve ESG disclosures. They have also launched partnerships to support global carbon markets and green financing initiatives.

Standard Chartered:

- Standard Chartered has created partnerships with fintechs and industry bodies to advance ESG-aligned trade finance and supply chain financing. They also work with NGOs to ensure their ESG products have measurable social and environmental benefits.

BNP Paribas:

- BNP Paribas works closely with global organizations like UNEP FI (United Nations Environment Programme Finance Initiative) and other industry players to align its ESG practices with global frameworks. It actively co-develops ESG impact tools and green finance solutions.

How can your bank build a robust ESG Ecosystem in 2025 and beyond?

- Data Partnerships: Collaborations with ESG data providers (e.g., MSCI, Refinitiv, Sustainalytics) and open data platforms.

- Technology Integration: Working with tech firms for blockchain-based transparency, carbon accounting tools, and AI-powered ESG analytics.

- Cross-Sector Alliances: Partnering with market-specific NGOs, government bodies, and industry groups to align with international and local ESG standards and best practices.

The Effective, Responsible, and Sustainable use of AI

While Artificial Intelligence (AI) is set to revolutionize the banking sector by improving decision-making, efficiency, and speed of innovations, there are several environmental, socio-ethical and compliance-driven considerations that banks must address at a strategic level, to ensure that AI is deployed responsibly and sustainably at their bank.

ESG considerations being integrated into the AI adoption journey

Environmental Considerations

AI systems, particularly large-scale machine learning models, require significant computational power, leading to high energy consumption and carbon emissions. Optimizing AI operations and using renewable energy-powered data centers are critical to minimizing the environmental footprint of AI.

Socio-ethical Considerations

As AI is increasingly used for decision-making (e.g., credit scoring, risk analysis), it raises concerns about algorithmic bias, transparency, and fairness across customers from diverse backgrounds and walks of life. Banks must ensure that AI-driven decisions are equitable, non-discriminatory, and aligned with ethical principles.

Governance Considerations

AI deployment is often accompanied with concerns around data privacy, security, regulatory compliance, performance monitoring and accountability. Having a well-defined AI compliance charter that is adherent to global standards, is a crucial foundational block to ensure long-term compliance, even as regulation evolves in this field.

What are banks doing to drive ESG-conscious AI adoption?

ESG-consious AI actions	Examples
Environmentally-conscious AI	
Energy-Efficient AI Models: Shift to models that require less computational power.	Microsoft Sustainability Cloud, used by several banks, offers AI-powered tools optimized for energy efficiency.
Cloud-Based AI: Use cloud platforms optimized for low-energy consumption.	Deutsche Bank partnered with Google Cloud to enhance AI systems while reducing energy usage.
Renewable Energy Use: Power data centers with clean energy to offset emissions from AI operations.	Standard Chartered shifted its data centers to renewable energy sources to support sustainable AI operations.
Socio-Ethically-conscious AI	
Transparent Algorithms: Banks must use explainable AI to ensure stakeholders understand AI-driven decisions.	ING developed a governance framework for AI to ensure transparency in credit scoring models.
Stakeholder Inclusivity: Engage diverse groups to develop AI systems that consider varied perspectives.	Citi has actively worked towards stakeholder inclusivity in its AI systems by engaging diverse teams and external experts (such as DEI advocacy groups) to ensure their AI models reflect varied perspectives and minimize bias, particularly in areas like credit risk assessment and customer engagement.
Governance-conscious AI	
Governance Frameworks: Robust frameworks to monitor, audit, and rectify biases in AI models.	BNP Paribas conducts regular bias audits on its AI models to ensure equitable decision-making.

The responsible and sustainable use of AI is a critical trend for 2025. By incorporating environmental, socio-ethical and governance considerations into your bank's AI strategy, you can can unlock tremendous value in business, customer experience and efficiency, while remaining ESG conscious.

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Our solutions and people help banks to engage, innovate, operate and transform better, so that they can improve their customers' financial lives, better.

What we offer

A comprehensive suite of industry-leading digital banking solutions and SaaS services that help banks engage, innovate, operate and transform better.

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