

BENCHMARKING ESG IN BANKING & FINANCE

ANALYSIS OF THE SIZE, GROWTH & PENETRATION OF
SUSTAINABLE FINANCE ACTIVITY IN GLOBAL MARKETS

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By Maximilian Bierbaum, Christopher Breen, and Seethal Kumar

In partnership with:



> This is our second report that measures the penetration of ESG in different sectors of banking and finance around the world and highlights the challenges ahead for the industry. While there has been significant growth in ESG activity in the past years, in most sectors and regions it is still a small fraction of the total. Europe is a long way ahead in most areas of activity, but the US and APAC are catching up.

INTRODUCTION

The penetration of ESG in banking and finance

ESG has risen to the top of the agenda of policymakers and the global financial services industry in the past few years. When taking a look at a few websites of asset managers or pension funds, some may think they have landed on the website of a climate NGO instead. ESG seems to be everywhere - so it is surprising that it is still relatively difficult to find consistent and comparable data to measure the level of penetration of ESG in banking, finance, and the capital markets.

This is why in 2021 New Financial and Luxembourg for Finance set out to provide the first clear and consistent benchmark of the progress so far in sustainable finance, and we are pleased to publish a refined second edition of the report now.

There have been a few welcome developments in the last two years. First, the value of labelled ESG finance has significantly increased: from 2020 to 2021, ESG activity in all markets virtually exploded, and in 2022 penetration remained relatively stable. Second, more firms from all sectors have committed to applying ESG principles. And third, we are now able to better measure the implementation of ESG in different parts of the banking and finance industry.

But there are also a few things that have not changed: Europe remains the heartland of ESG with other regions catching up at different speeds, the majority of capital markets activity remains non-ESG, and it is still difficult - if not impossible - to find clear data on ESG activity in a lot of important areas of banking and finance.

We think this report captures the penetration of ESG in banking and finance in an even clearer, more consistent, and more accessible way than our 2021 report. But it is still not perfect: for example, the fact that many sectors are missing indicates that the overall level of ESG penetration is probably still overstated. We are planning to further revise and improve this benchmark, and any feedback would be most welcome.

The report's first section looks at the public commitment to ESG by market participants around the world in different sectors. The second section measures the value, growth, and penetration of ESG labelled finance across bond, loan, and fund markets, and we also provide analysis of the different types of ESG bonds. The final section analyses the implementation of ESG. Throughout the report, we discuss the current challenges of ESG and pose a few questions about its future.

We hope this research provides relevant insights and we are always interested in your thoughts and questions. I would like to thank Christopher Breen, Seethal Kumar, and Katharina Ritter for collecting and analysing much of the data that underpins this report, William Wright for his support and feedback, Dealogic, The Banker, S&P Global Market Intelligence, and Morningstar Direct for providing access to their data, and Luxembourg for Finance for once again partnering with New Financial on this fascinating project.

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NEW FINANCIAL

Rethinking capital markets

New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive growth and prosperity.

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We are a social enterprise funded by institutional membership from different sectors of the capital markets industry.

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EXECUTIVE SUMMARY

Here is a short summary of the report:

- 1. Measuring penetration:** in this report, we measure the penetration of ESG in banking, finance, and capital markets by looking at the industry's commitment, the levels of labelled ESG financial activity, and the implementation of ESG across the industry. In some areas of the industry, there are welcome levels of activity, while in some others there is virtually no activity at all. For all the noise around ESG, there are still relatively few areas of capital markets activity where there is clear, measurable, and comparable data.
- 2. A growing pledge:** the commitment to ESG in the finance industry is growing. Almost half of 2,000 of the world's largest banking and finance firms have signed up to at least one ESG initiative. But there is a wide range of public commitment between sectors - from 84% of all asset managers to just 24% of global insurers.
- 3. Serious money:** in those areas of the capital markets where we can clearly measure ESG labelled finance, activity is growing. In 2022, the value of global ESG bond issuance reached \$900bn (+46% since 2020), the value of ESG loan issuance reached \$500bn (+255% since 2020), and the value of sustainable investment funds was a remarkable \$2.5tn (+85% since 2020).
- 4. A breakout year:** 2021 was the breakthrough year for ESG labelled activity. Activity in all markets virtually doubled in value and the penetration doubled or tripled in virtually every sector and every region: in Europe, between a fifth and a third of all measurable capital markets activity is now 'ESG'. Despite 2022's wider market downturn, penetration levels of ESG labelled issuance remained stable.
- 5. More than just the 'E':** green bonds remain the primary type of ESG labelled bond issuance - accounting for more than two thirds of activity - but other types of ESG bonds are increasing in popularity. More and more corporate issuers worldwide are making use of sustainability-linked bonds, and the Asia-Pacific region is the leading market for corporate social bond issuance.
- 6. All eyes on Europe:** other markets are playing catch-up, but Europe remains the heartland of ESG - likely due to a combination of the European industry having had a headstart in ESG matters and stronger regulation. Europe continues to capture the majority of global ESG activity across all areas of activity, more than one-third of all corporate bonds issued in Europe in 2022 were ESG labelled, and European sustainable investment funds account for more than 70% of the global ESG investment fund value.
- 7. The good and the bad:** not all ESG activity in the capital markets is labelled. When analysing the share of capital markets activity by 'good' (a solar panel manufacturer) and 'bad' (an oil refinery) companies, we see that capital markets as a whole are still directing large amounts of funding to 'bad' companies. The good news is that things are getting better: the ratio between 'good' and 'bad' activity has improved in recent years.
- 8. Walking the walk?** The uptick in firms that are signing up to ESG initiatives is a welcome development. They now need to walk the walk. Early implementation data by the Transition Pathway Initiative, the Science-based Targets Initiative, the Net-Zero Banking Alliance, and the Net-Zero Asset Owner Alliance indicates that firms are starting to do what they set out to do, but that there is still a lot of room for further progress.
- 9. Data challenges:** while in some areas of banking and finance, such as investment funds or bond issuance, ESG finance is clearly labelled, in many others there is no clear distinction between ESG and non-ESG activity, and data is not comparable, does not exist, or is only limited to anecdotal examples. This could indicate a relative lack of activity, but it could also mean that data is just not recorded well.
- 10. Much work ahead:** ESG has risen to the top of the agenda in the past few years, but there are questions on whether the current framework is still fit for purpose. There will need to be an honest discussion about whether ESG is adaptable and flexible enough to respond to a changing world, and whether it really is the best framework for the banking and finance industry to play its important role in supporting and driving this change.

KEY TAKEAWAYS

The size and penetration of ESG in banking and finance

There is a lot of data in this report, and it would be pretty exhausting to read it all in one go. This section provides ten key takeaways on the size, growth, and penetration of ESG in banking and finance.

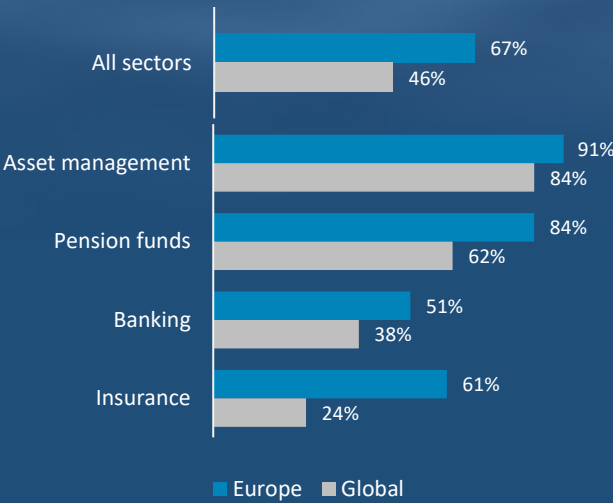
1. THE PUBLIC COMMITMENT TO ESG

2/3

Two-thirds of all large European banking and finance firms are committed to ESG

Overall commitment to ESG in the finance industry is growing, and European firms continue to be a leader in ESG, but there is a wide range in public commitment between sectors: from 84% of the largest asset managers worldwide to just 24% of global insurers.

The proportion of large firms in each sector that have signed up to one or more ESG initiatives in Europe and worldwide:



2. THE LEADING MARKET

50%

Half of global ESG labelled bonds and loans issuance is issued in Europe

Labelled ESG activity has increased worldwide, but Europe remains the heartland for ESG, and Europe's capital markets are seeing deeper levels of ESG penetration.

3. NOT ENOUGH 'GOOD'

5:1

The ratio between 'bad' and 'good' capital markets activity

For every dollar raised in the capital markets by a wind power company in 2022, roughly five dollars were raised by 'bad' companies that are causing the problem in the first place. The good news is that this ratio has improved.

4. MEASURING THE RIGHT THINGS

95%

The share of Net-Zero Banking Alliance members that are measuring their financed emissions

More and more financial institutions are signing up to various ESG initiatives, and these initiatives are ramping up pressure on firms to measure and disclose their impact on the environment.

5. REAL WORLD OUTCOMES

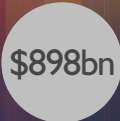
77%

The proportion of companies from all sectors that have approved emission targets aligned with 1.5°C

Companies from across the real economy are starting to show some seriousness about their transition goals and how they will help the world achieve net zero by 2050.

KEY TAKEAWAYS

6. IMPRESSIVE NUMBERS



The value of ESG labelled bonds

In 2022, the value of global ESG labelled bond issuance came close to one trillion dollars. ESG bond issuance accounted for 14% of total global bond issuance.



The value of ESG labelled loans

The value of global ESG labelled loan issuance in 2022 reached nearly half a trillion dollars, accounting for 11% of total global loan issuance.



The value of ESG investment funds

The value of sustainable investment funds in 2022 accounted for 6% of the total value of global investment funds.

7. NEARLY MAINSTREAM



The proportion of corporate bonds issued in Europe in 2022 that were ESG

More than one-third of all corporate bonds issued in Europe in 2022 were ESG labelled. This is a significant uptick compared to 2020, when ESG labelled corporate bonds accounted for only 10% of European corporate bond issuance.

9. THE 'E' IN 'ESG'



Two-thirds of global ESG bonds are 'green' bonds

A frequent criticism of ESG is that it is too dominated by the 'E'. The distribution of ESG labelled bond issuance by type of bond evidences the focus on the 'E': in 2022, nearly two-thirds of ESG labelled bond issuance was 'green', with the other third being a mix of social, sustainability, transition, and sustainability-linked.

8. A FAST GROWING MARKET



The growth rate of global ESG labelled bond issuance from 2020 to 2021

From 2020 to 2021, the value of ESG labelled bond issuance nearly doubled. Much of that growth was driven by European issuance, but US and APAC issuers played an important role, too. 2021 was a breakout year for ESG labelled issuance across the bond, loan, and fund markets.

10. WHAT ABOUT THE 'S'?



The share of global ESG bonds that are 'social' bonds

The 'S' continues to struggle to find its place in the ESG capital markets. In 2022, less than a fifth of labelled ESG bonds were used to finance social projects and causes. If ESG is to be a broad church, it needs to not just be about climate issues.

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FOREWORD BY LUXEMBOURG FOR FINANCE



Growing pains

We are proud to once again partner with New Financial for this report, which shows that sustainable finance has made progress across the board in the various verticals of the financial industry. Critically, however, the data collected also highlights that the speed of progress differs per vertical and there are growing pains across all of them.

As I like to see the glass as half full, I rejoice in the progress that has been made within the asset management industry, where assets in sustainable funds reached \$2.5 trillion. We should also celebrate the advances seen in the capital markets where ESG labelled bond issuance in 2022 reached \$900 billion. There is also good progress with respect to ESG loans, even though volumes are more modest compared to the overall market.

Europe continues to lead, playing out its pioneering role in setting out a comprehensive, continent-wide regulatory framework. The ongoing refining of this framework, with regulatory technical standards still being defined, certainly explains much of the shakeup seen as funds shift from Article 9 back to Article 8.

Achieving the goals set in the Paris agreement or the 17 UNSDGs can however not be done by Europe alone. Celebrating our leading market share is thus beside the point and we need to help bring others on board as well. In this sense, the fact that sustainable finance is making progress in other geographies is another important fact.

The maturing of ESG investing that is documented by the report lies also in the broadening of the scope of such investing from environmental finance to other areas such as social finance. The pandemic has brought home the importance of putting people at the centre of our focus.

Sustainable finance still has a long way to go. We are only at the beginning of a long process of transitioning towards a carbon-free economy and to get there measurable data is a vital ingredient to track progress. Finding granular and relevant data is the most important challenge ahead with regards to further embedding sustainable finance.

In this regard, high quality reports like the ones produced by New Financial help already in measuring whether we are on the right track and whether we are progressing fast enough or need to accelerate. I wish to thank William Wright, Maximilian Bierbaum and their team for the excellent work done.

Nicolas Mackel

Chief Executive Officer
Luxembourg for Finance

AT A GLANCE: COMMITMENT

A growing pledge

A starting point for measuring the penetration of ESG in banking and finance is to measure the public commitment to ESG by market participants around the world. We measure this by analysing how many large firms in different sectors have signed up to one or more of 28 key ESG initiatives.

There are three main takeaways: first, overall commitment to ESG in the finance industry is growing. This is a welcome development. Fig. I i) shows that almost half of the more than 2,000 largest firms worldwide have signed up to at least one ESG initiative.

Second, European firms continue to be a leader in ESG. Two-thirds of all large European finance firms are publicly committed to ESG. This is likely due to a combination of the European industry having had a headstart in ESG matters compared to global peers, and stronger regulation. But Fig. I ii) shows that other regions are catching up, with commitment rates on average growing faster than in Europe.

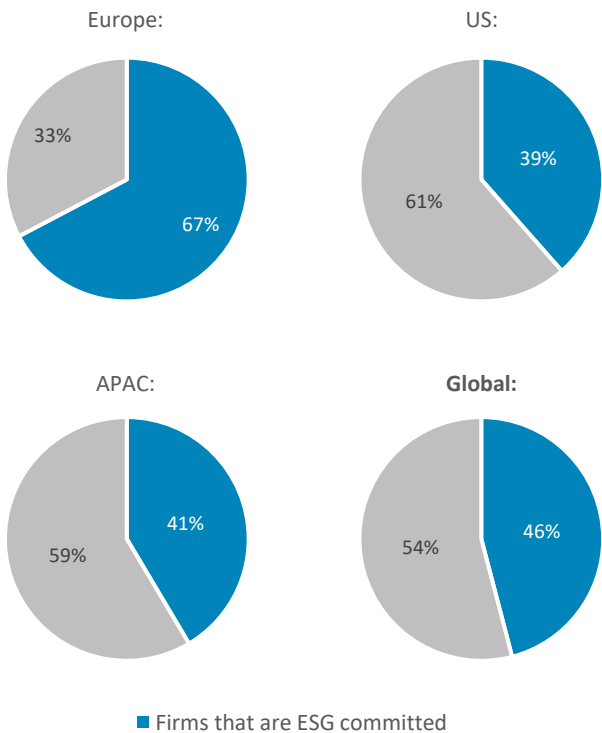
Third, Fig. I ii) shows that there is a wide range of public commitment between sectors: from 84% of the largest asset managers worldwide to just 24% of global insurers. One of the reasons could be that ESG standards in some sectors are better developed than in others.

Since this report's first edition in 2021, we made two key changes to this analysis: we are now including further ESG initiatives to cover a wider range of ESG issues such as nature and biodiversity; and we are not analysing the commitment of private equity firms (PE) and stock exchanges in detail this time.

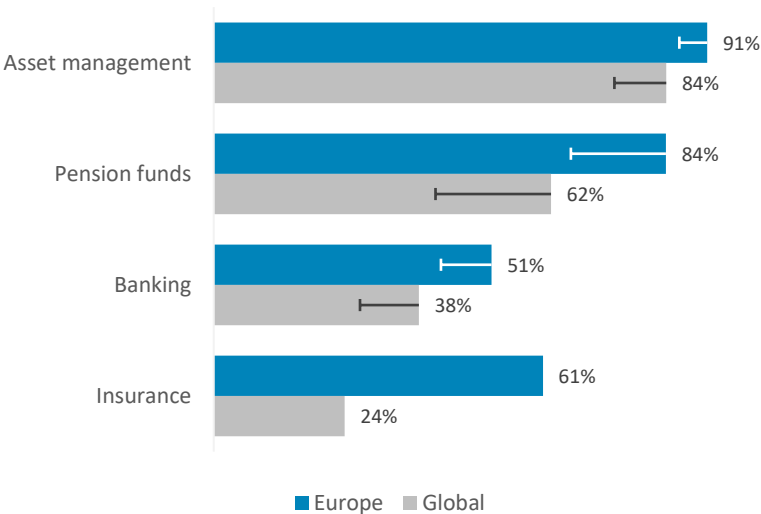
There is no major initiative specifically targeting PE firms. This makes comparisons difficult and can be a sign of a lack of commitment in the sector. For stock exchanges, 'Sustainable Stock Exchanges' (SSE) is the only major initiative, and there is almost universal take-up with 19 of the world's 20 largest stock exchanges being SSE partners. Stock exchanges now need to deliver on their commitments.

Fig. I What is the public commitment to ESG?

i) The share of the world's largest banking and finance firms that were signed up to one or more ESG initiatives in 2022 in selected markets and worldwide
Note: our definition of Europe in this report includes the EU, UK, and all EFTA countries



ii) The share of large firms in each sector that were signed up to one or more ESG initiatives in 2021 (error bars) and 2022 in Europe and worldwide
Note: 2021 sample of insurance companies not comparable with 2022



Source: New Financial analysis

AT A GLANCE: HARD VALUE

The right direction

A second way to measure the penetration of ESG in banking and finance is to analyse those areas of the industry that have clearly designated ESG activity. We call this the 'hard value' of ESG activity and we measure growth and penetration of ESG across bonds, loans, and funds within Europe and worldwide.

In terms of market activity, 2021 and 2022 were impressive years for ESG and reflect how ESG has become an important part of the capital markets. Fig.2 i) shows that ESG activity has accelerated not just in Europe but worldwide: the penetration level in every market and every region has doubled or tripled since 2020. The penetration in the corporate bond market is particularly impressive: in Europe, penetration went up from a tenth to more than a third of activity in only two years.

While Europe remains the leading market across all areas of activity, other regions are catching up. APAC issuers are raising more and more finance via transition and social bonds. The US has improved its standing in ESG, but the current political environment is threatening this development, and ESG activity in the US is still not reflecting the importance of the US in conventional areas of the capital markets.

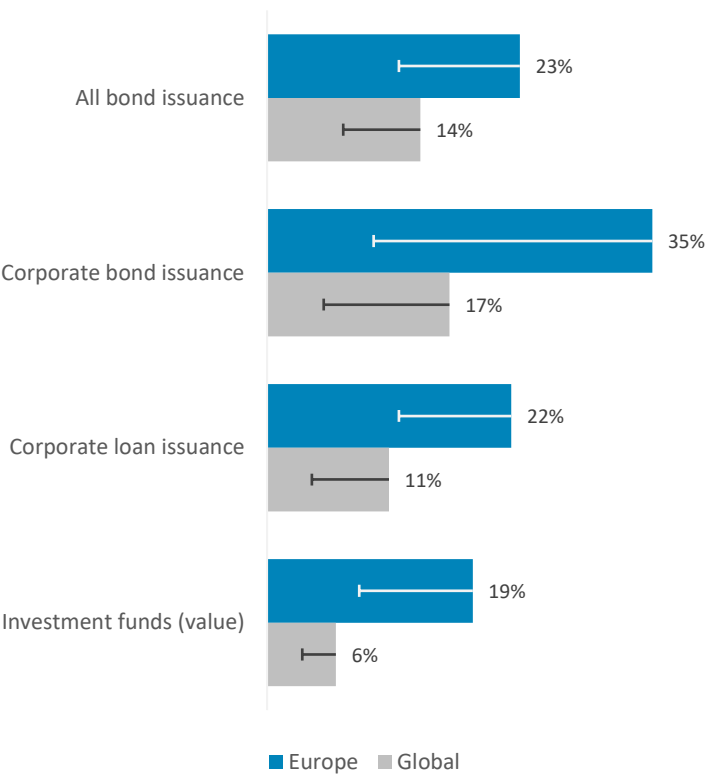
We made two updates to this section: we provide additional insight into the different types of ESG bonds, and we remove detailed analysis of asset management and PE activity.

The success of green bonds has been the trademark of ESG, with two-thirds of ESG labelled corporate bonds being 'green' (Fig.2 ii), but other types of ESG bonds are playing a vital role, too - especially outside of Europe.

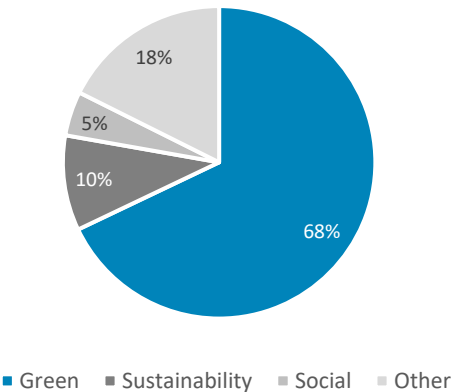
Asset management is one of the most ESG-committed sectors, but data availability on ESG or sustainable assets under management is limited and not entirely comparable with labelled activity in other areas of the capital markets. The problem exists for PE activity, too, and we discuss this in more detail in this report's challenges section.

Fig.2 What is the hard value of ESG activity?

i) The share of ESG labelled capital markets activity in Europe and worldwide in different areas of activity in 2020 (error bars) and 2022



ii) The distribution of corporate bonds in 2022 by type of ESG label (with 'other' including transition and sustainability-linked bonds)



Source: New Financial analysis

AT A GLANCE: IMPLEMENTATION

Walking the walk?

The third step to measure the penetration of ESG in banking and finance is to analyse whether firms are walking the walk and not just talking the talk. We do this by analysing the climate engagement strategies of finance firms, measuring capital markets activity by 'good' and 'bad' companies, and checking how banking and finance are implementing the commitments they have made across various ESG initiatives.

Fig.3 i) shows an example of the sort of data we analyse in this section. The Transition Pathway Initiative's 2022 pilot framework and analysis assesses the preparedness of banks for the low-carbon transition. The highest share of bank alignment with the Paris Agreement is in climate governance, but even here alignment is not very high. Climate policy engagement (also known as lobbying) is an area where almost no bank is 'walking the walk'.

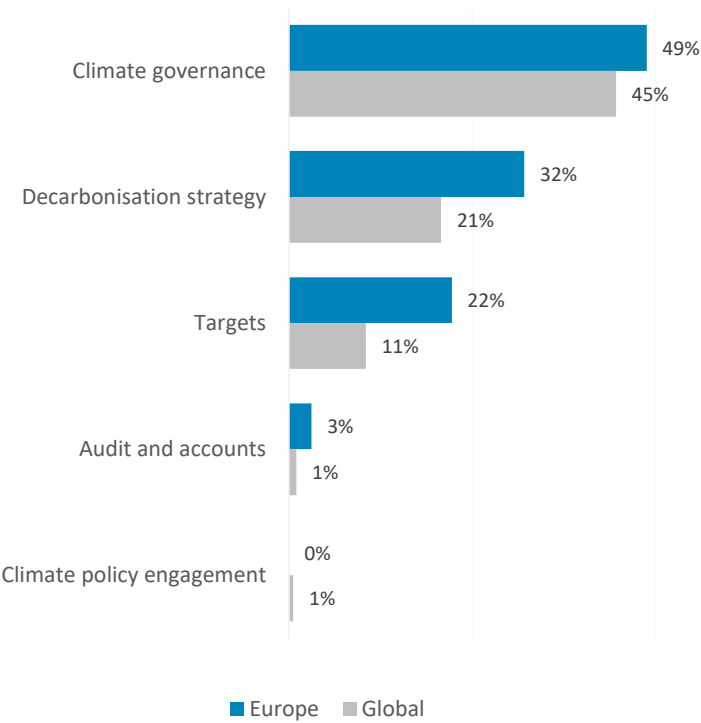
Our analysis of climate engagement strategies shows a more welcome development. Across banking and finance, there is increased engagement with portfolio companies around climate issues, and some financial institutions have begun requiring their portfolio companies to set science-based targets.

To provide another perspective on ESG implementation, we measure capital markets activity for two groups of companies. We call these 'good' (a solar panel manufacturer; a social housing developer) and 'bad' (an oil refinery) ESG companies. Fig.3 ii) shows how the capital markets as a whole are still directing large amounts of funding to companies that we consider 'bad' for ESG.

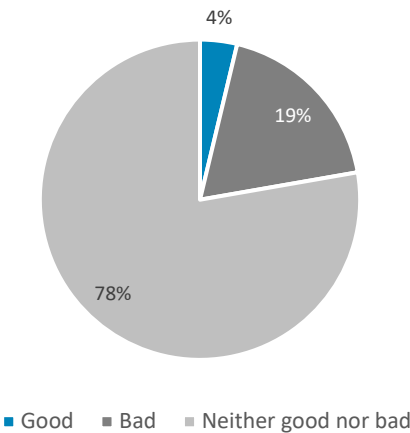
One challenge around the analysis of ESG implementation is that many of the data points that are currently available give a good idea of what the banking and finance industry does (or does not do) in terms of meeting climate and net zero targets. But there is not a lot of information on implementation around the 'S' and the 'G', and this is disappointing given the idea of ESG being a broad church.

Fig.3 How are ESG commitments being implemented?

i) The average share of bank alignment with the goals of the Paris Agreement across five of the six areas assessed by the Transition Pathway Initiative



ii) The distribution of capital raising across global corporate bond, loan, and equity markets by 'good' and 'bad' companies in 2022



Source: New Financial analysis

THE CHALLENGES AROUND ESG

The main challenges of ESG in banking and finance

ESG has risen to the top of the political and business agenda in the past few years, but there are questions whether the current framework is still fit for purpose. It has become complex, fragmented, and confused, and risks delaying the vital role that capital markets and private investment can and should play in providing the huge amount of financing needed to ensure a just transition to net zero and to achieve the world's sustainable development goals.

This section presents and discusses the main challenges around ESG in the banking and finance industry. Addressing these will enable growth in ESG activity and lead to a more sustainable global economy and future for citizens across the world and help achieve the targets set by governments and international bodies on climate change and social issues.

1. **Commitment without implementation:** signing up to the latest ESG initiative, rewriting marketing material, and launching some new ESG products is one thing, but embedding ESG into day-to-day business is a different and more challenging proposition. A growing number of firms have committed to reaching 'net zero' by 2050, but far fewer have published detailed plans on what they are going to do in the next few years to achieve it.

The challenge for the industry will be to take meaningful action to back up commitments, and avoid ESG becoming an administrative 'box-ticking' exercise. To do this, ESG must not only be implemented at the 'Davos level' but all the way through an organisation and its everyday operations. It will also require every part of the industry to play their part: investment banks need to ensure that designated ESG finance serves its purpose, especially when raised by the worst polluters, whereas asset managers and investors need to ask the right questions and be specific as to what they want and need when they engage with portfolio companies.

2. **Not enough disclosure, not enough data, not enough clarity:** one of the biggest challenges remains around the existence and availability of data on ESG-related activity. It is often difficult to get sufficient data on a company's activities relevant to environmental and social issues, data availability varies across sectors, and it also varies within different sectors. This is a problem for a report like this one, where it is virtually impossible to find consistent and comparable data across multiple sectors; and it has an even bigger impact on investors who are trying to use ESG data to inform their investment decisions.

While labelled financial products exist, for example in the debt capital markets, labels are not always clear and they change over time; and labelled products do not capture the entirety of ESG-related financing. In the bond market, green bonds may have different levels of 'green' based on the use of proceeds of the bond: one green bond may direct funding towards a wind farm, while another would direct funding towards more 'transitional' projects such as shifting an energy company's fuel base from oil to gas. In asset management or private equity, even if data exists, it is often not comparable due to differences in methodologies and labelling across jurisdictions. This has implications on the usefulness and accuracy of the data. And in other important sectors of the banking and finance industry such as public equity markets, bank lending, retail banking, and derivatives, there is no clear distinction at all between ESG and non-ESG-related activity.

3. **A demanding exercise:** as the ESG market develops, smaller companies should not be denied access because they do not have the same resources to apply to ESG reporting, disclosure, and marketing compared to their larger peers. Large firms usually are better resourced to produce the data and metrics that conform to the needs of ratings providers, regulators, and investor demands.

This creates an imbalance in the financial benefits that can come from ESG activity: for example, when companies are included in ESG indices, their stock often experiences an increase in demand because of the nature of ESG-related passive investment strategies. ESG activity in the industry should be accessible based on the nature of economic activity rather than compliance and reporting resources of a company. It is a welcome development that the EU's corporate sustainability reporting directive (CSRD) is trying to address this.

THE CHALLENGES AROUND ESG

4. **Taxonomical confusion:** the EU has moved faster on sustainability than many other jurisdictions, but others are catching up, and a number of markets have introduced (or are about to introduce) their own sustainability disclosure frameworks. While proposed legislative definitions for sustainability ('taxonomies') can provide greater certainty and prevent greenwashing, divergent approaches could be a barrier to global ESG activity.

The EU and other markets are facing challenges in encouraging global cooperation with different regions moving at different speeds (sometimes in different directions) and developing different standards. In the US, while the industry and regulators seem committed, the febrile political environment means that progress could be held back. And strained geopolitical relations with China, an important potential ally in addressing climate change, are making cooperation on sustainability harder. The new International Sustainability Standards Board (ISSB) based in Frankfurt will have a vital role to play in encouraging more consistency and interoperability.

5. **Regulatory side effects:** the good thing is that regulators and industry-led organisations are trying to improve matters. Recent work by bodies such as the ISSB, the UK's Transition Plan Taskforce, TCFD, and others show that regulators, governments, and industry bodies are committed to improving the data that is being reported, how it is being reported, and where it is being reported. Disclosure frameworks are getting more serious.

The problem with it is that the increasing levels of regulation and standards can lead to investors and issuers shying away from using the ESG label due to the difficulty of achieving it in the first place. The recent 'Article 9' discussion in the EU is a good example for this: it is well meant when EU guidance indicates that 100% of assets in an Article 9 fund must be sustainable. But it is still unclear what exactly qualifies as a sustainable asset, and so many managers have downgraded their funds to 'Article 8' funds, or ditched the ESG label altogether.

6. **Inconsistent scoring systems:** a number of ESG rating providers produce data that underpins much of the ESG activity in markets today, but the methodology applied by different providers varies considerably, and ratings across providers are not consistent.

For example, one way of thinking about ESG is as an input into an investment process; another way of thinking about it is as an output to maximise. Each approach can lead to wildly diverging ESG scores for the same company. This makes comparisons between companies difficult, can lead to confusion around investment decisions, and can create an 'everyone is a winner' environment where every company can claim they have an excellent ESG rating - they just need to find the right provider with the right methodology to back it up.

ESG assessments are understandably complex and users may have different priorities that are catered for by different methodologies used by different providers, but there might have to be some form of supervision as the ESG industry grows. This may include encouraging rating agencies to take a double materiality approach, a concept that has gained traction in the EU. Through a double materiality framework, rating agencies would not just look at a company's ability to manage financial risks in relation to ESG-related issues (and regulatory standards), but also how the company's own operations impact the environment and society.

7. **The focus on the 'E':** a frequent (and reasonable) criticism of ESG is that it is too dominated by the 'E' and that this happens at the expense of social and governance issues. The number of ESG initiatives that focus on climate-related commitments shows this: there are only a few that capture wider nature and biodiversity-related issues, and even fewer that focus on the 'S' or the 'G'.

There is a particular challenge around the 'S' in ESG, which is often considered to be the least well understood and captured of the three. There is some coverage of companies' internal social factors (such as employment practices or health and safety), but less so of external social factors (such as human rights, supply chain ethics, or community impacts), and it does not help that scoring systems cannot agree on which social factors to include in their frameworks, and how to measure them. There is increasing investor interest in diversity and inclusion, for example, but a [lack of consistent data](#) is the biggest barrier to its development.

THE CHALLENGES AROUND ESG

8. **A (too) broad church:** the often observed focus on the 'E' highlights another problem of ESG - the problem of reconciling 'E', 'S', and 'G' in a unified way. Many rightly argue that environmental, social, and governance factors are inextricably linked. But coming from a more technical ratings perspective, this does not necessarily have to be the case. A Russian renewable energy company, for example, would currently probably not be seen as an ethical investment due to Russia's invasion of Ukraine, whereas a French arms manufacturer that is supplying defence weapons to Ukraine could receive much more favourable views than prior to 2022.

The challenge with the current 'broad church' ESG approach is that it can lead to companies trying to game the system. A heavily polluting company, for example, could increase its ESG rating by focusing on improving social and governance issues without even caring about its carbon footprint. Likewise, an electric car maker might have such a high 'E' score that it stops caring altogether about the 'S' and the 'G'. This shows the occasional disconnect between ESG principles and their real-world outcomes.

9. **Anti-ESG backlash:** efforts to integrate ESG into corporate and investment decisions are increasingly facing diverging pressures. On the one hand, consumer groups and political activists are worried about inadequate action, criticise 'greenwashing', and claim the banking and finance industry is not doing enough. On the other hand, there is growing political opposition particularly in the US to integrating ESG standards into investment processes, and some US states have started barring their fund managers from applying ESG principles.

What both developments have in common is that they can have a direct commercial impact on finance firms, for example through lost business or the risk of litigation related to sustainability inactions. It is worrying but unsurprising that some banking and finance firms are now thinking about dialling down their tone on ESG and sustainability-related matters, or abandoning their commitments altogether.

One way to tackle this challenge would be to have more clarity on what it is that ESG is supposed to do. Is ESG meant to be a guide rail for investor behaviour, or is it meant to 'do good'? There sometimes seems to be a clash between expectation and reality, between how corporate leaders and investors think about ESG and what the public and (some) politicians expect ESG to achieve.

10. **ESG... or what?** All the challenges discussed in this section show that the current shape and form of ESG is a fragile concept. Responsible investing and business is not likely to disappear any time soon, but the ESG acronym might. It will certainly evolve: recent developments such as Covid or the Russian invasion of Ukraine show that something that is considered 'green' or 'social' today may not be considered 'green' or 'social' anymore tomorrow. A company that is treating their employees well during good times but announces lay-offs during a pandemic cannot keep its high 'S' rating. And while the green transition remains one of the world's biggest challenges, energy security and poverty reduction have become just as important since February 2022.

A famous investor recently said, "I think it's time for RIP ESG". This may sound drastic, but one of the key questions will be whether ESG is adaptable and flexible enough to respond to a changing world, and whether it really is the best framework for the banking and finance industry to play its important role in supporting and, at times, driving this change. It will be no mean feat to update (or completely redevelop) a framework that some expect to save the world.

THE CHALLENGES AROUND ESG

Sectors with limited data (or limited ESG activity)

One of the main challenges in analysing the penetration of ESG in banking and finance is the availability and consistency of data. While in some areas of activity, such as investment funds or bond issuance, ESG finance is clearly labelled, in many others there is no clear distinction between ESG and non-ESG activity, and data is not comparable, does not exist, or is only limited to anecdotal examples. This could indicate a relative lack of activity, but it could also mean that data is just not recorded well. (We found, for example, that in many instances 'good' ESG companies such as solar panel producers do not label the finance they raise as 'ESG'.) Here are some banking and finance sectors where these limitations exist:

Banking: despite widespread concern among the public about environmental and social issues, we still find that comprehensive data on ESG-linked retail products by banks is almost non-existent in the public domain. There are some anecdotal references to product innovations such as green home improvement loans and green mortgages, but there is no clear and consistent data on the proportion of overall activity represented by or ESG products. In a similar fashion, it remains both surprising and frustrating that there is limited visibility on ESG activity in bank lending to companies - particularly given the importance of bank lending as a source of funding for companies in Europe.

Asset management: perhaps one of the most surprising data limitations we encountered is around the activity of asset managers. Asset management is one of the most ESG-committed sectors, but we could not locate clear or up-to-date data on the value of ESG or sustainable assets under management outside of investment funds. Data does exist on the value of assets managed under an ESG framework, but this is not comparable with ESG labelled activity in other areas: assets managed under such a framework do not have to be sustainable assets.

Insurance: there is very limited information available to measure ESG-related insurance products insurers provide to either retail or corporate customers. Recent anecdotal evidence suggests that insurance products are being developed that offer lower premiums for certain 'green' behaviour (such as driving electric cars or having solar panels on a house), and a number of insurance firms have said they will reduce or cease providing services to companies that do not have a credible net zero plan. At the same time, we are also seeing evidence of a 'climate protection gap': the more climate data becomes available, the more insurers exclude climate-related issues.

Equity markets: while in bond markets a bond issued by a company or government might be labelled clearly as 'green', 'social' or 'sustainable', such a distinction does not exist in equity markets. Although this report shows that ESG-related activity exists in equity markets in the form of issuance by 'good ESG' and 'bad ESG' companies, there is no such thing yet as a clearly labelled 'ESG' stock or a 'green' IPO. ESG ratings and sustainable segments on stock exchanges help, and stock exchanges in Europe have started to verify 'green' activity by listed companies, but overall it is difficult to measure accurately ESG-related activity in this important industry segment. The World Federation of Exchanges recently announced an initiative to define and measure green activity.

Private equity: private equity funds are by nature not subject to the same regulations and disclosure requirements their public counterparts are. While regulators are looking into addressing this, there is even less disclosure around ESG-related activity by private equity firms, and there is no comprehensive data available on how much private equity activity can be considered 'ESG'. Anecdotal evidence suggests that private equity could even serve as a 'safe haven' for companies with low ESG ratings which go private to avoid further scrutiny. Given the shrinking of public markets, particularly in Europe, this is disappointing, and more transparency and commitment is needed.

Derivatives: data on ESG-related activity in the important derivatives markets remains either non-existent or very limited. There has been progress on labelling in derivatives listed and traded on exchanges, but the problem remains pronounced in over-the-counter derivatives. There are a few sustainability-linked derivatives products recorded by the International Swaps and Derivatives Association (ISDA), a number of ESG-related listed derivative products created by exchanges, and more bespoke over-the-counter derivatives in certain areas, but overall activity in this important market remains opaque.

The commitment to ESG

The starting point for measuring the penetration of ESG in banking and finance is to measure the public commitment to ESG by market participants around the world in different sectors. This section analyses the public commitment to ESG in selected sectors of the industry by looking at the number of initiatives and signatories in each sector and the distribution of signatories by region.

Later in this report, we also analyse how firms are implementing the commitments they made when they signed up to the various ESG initiatives.

Asset management and pensions	16
Banking and insurance	17

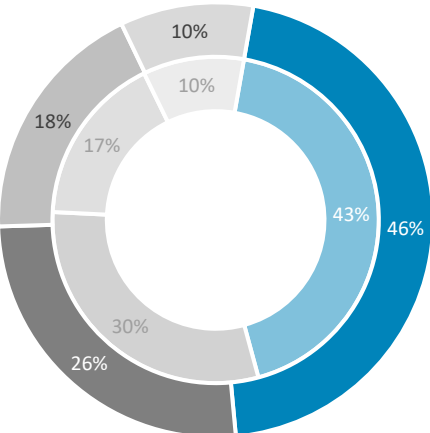
Fig.4 Where are signatories to ESG initiatives located and how has the distribution changed?

The regional distribution of signatories to sector-relevant ESG initiatives in 2022

Note: inside values show the regional distribution of signatories in 2021

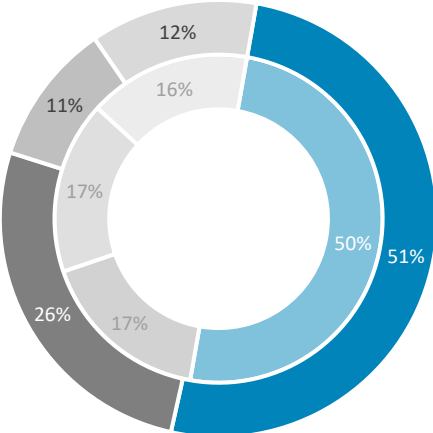
i) Asset management

Sample: Thinking Ahead Institute / P&I
500 largest asset managers



ii) Pension funds

Sample: Thinking Ahead Institute / P&I
300 largest pension funds



- Europe
- US
- APAC
- Rest of world

Source: New Financial analysis of initiatives signatory lists & lists of largest firms in the world. Data as of 12/2022

To measure the commitment to ESG by market participants, we look at 28 different ESG initiatives around the world related to banking and finance. Signing up to a particular initiative is almost cost-free, so it is the least you might expect of a large firm. Not signing up to one or more initiatives can be seen as evidence that a firm may not be committed to ESG.

Asset managers

Of the 500 largest asset managers in the world, 418 are signed up to at least one of 11 sector-relevant ESG initiatives. This increase from 370 ESG-committed asset managers in 2021 is a welcome development. Of the 418, more than two-thirds are signed up to two or more initiatives, indicating that asset managers are increasingly taking a broader approach to ESG.

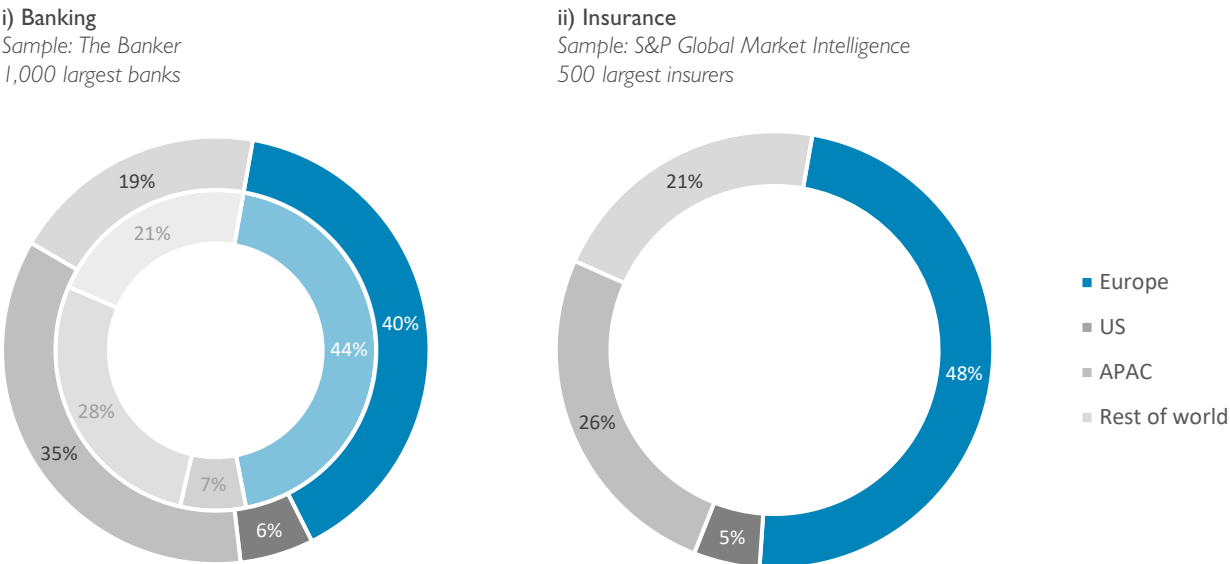
Fig.4 i) shows the regional distribution of signatories to asset management-relevant ESG initiatives. Of those that are signed up to initiatives, 46% are located in Europe, an increase from 43% in 2021. This high level of representation continues to be disproportionate to the size of the European industry and the level of representation in the lists of the largest worldwide, and it reflects the status of the EU in particular as a global leader in ESG and sustainability matters. For reference, European asset managers account for only a third of the largest asset managers in the world.

Pension funds

Nearly two-thirds of the world's 300 largest pension funds are signed up to at least one of 12 pensions-relevant ESG initiatives. Fig.4 ii) shows that this increase from 41% in 2021 was particularly driven by US-based pensions funds who newly joined to initiatives last year. While this is good news, almost half of the 300 largest pension funds are located in the US, suggesting that US firms are still a way off where they could be. Changes proposed by the Biden administration to make it easier for US pension funds to consider ESG factors when making investments could further drive their commitment.

Fig.5 Where are signatories to ESG initiatives located and how has the distribution changed?

The regional distribution of signatories to sector-relevant ESG initiatives in 2022
Note: inside values show the regional distribution of signatories in 2021. 2021 sample of insurance companies not comparable with 2022



Source: New Financial analysis of initiatives signatory lists & lists of largest firms in the world. Data as of 12/2022

Banking

Of the 1,000 largest banks in the world, 379 are signed up to at least one of 15 sector-relevant ESG initiatives. This is a welcome increase from the 271 banks that were signed up in 2021. Of the 379, however, more than half are signed up to only one initiative. This indicates that while banks overall are increasing their commitment to ESG, the majority who publicly show their commitment are still only doing the bare minimum. Later in this report we discuss how part of the reason for the relatively low commitment rates of banks could be that banks are still having difficulties to quantify climate-related matters.

Fig.5 i) shows the regional distribution of signatories to banking-relevant ESG initiatives. 40% of ESG-committed banks are located in Europe. The share of banks that are committed to ESG and located in APAC increased from 28% in 2021 to 35% in 2022. Only 6% of ESG-committed banks are located in the US, even though US banks make up 14% of global asset value.

Insurance

The insurance sector is less committed to the principles of ESG than other sectors. Only around a quarter of the world's 500 largest insurers are signed up to one or more of 10 relevant ESG initiatives. Insurance has an important role to play in ESG. Insurers have trillions of long-term savings under their belt that they can funnel towards ESG-aligned assets, and their policies and products are crucial in mitigating and adapting to matters such as climate change. Not signing up to an ESG initiative does not mean an insurer is not following ESG principles, but the low commitment figure makes for a bleak picture.

Fig.5 ii) shows that of those insurance companies that have joined one or more ESG initiatives, almost half are located in Europe, with another quarter located in the APAC region. US-based insurers make up only 5% of ESG-committed insurance companies, even though nearly a fifth of the world's 500 largest insurers are located in the US.

THE HARD VALUE OF ESG ACTIVITY

The hard value of ESG activity

The second step for measuring the penetration of ESG in banking and finance is to analyse those areas of the banking and finance industry that have clearly designated ESG activity. In this section we measure the growth in designated ESG activity, the share of ESG out of total capital markets activity within Europe and worldwide, and the distribution of ESG activity by region.

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A deeper part of the market

The most likely place to find clearly defined and high levels of sustainable and ESG activity is the debt capital markets. We measure the growth and penetration of ESG labelled bond issuance throughout the world in the last five years and analyse green, social, and sustainable as well as transition and sustainability-linked bond issues.

2021 was a breakout year for ESG-labelled activity in the debt capital markets. Fig.6 i) shows that after already remarkable growth between 2019 and 2020, the combined value of European and non-European issuance almost doubled from 2020 to 2021.

The dip in value in 2022 reflects the wider downturn in activity, but the encouraging news is that the penetration of ESG labelled activity in the debt capital markets held up. Fig.6 ii) shows how in both 2021 and 2022, ESG labelled bond issuance made up more than a tenth of global bond issuance and almost a quarter of bond issuance in Europe.

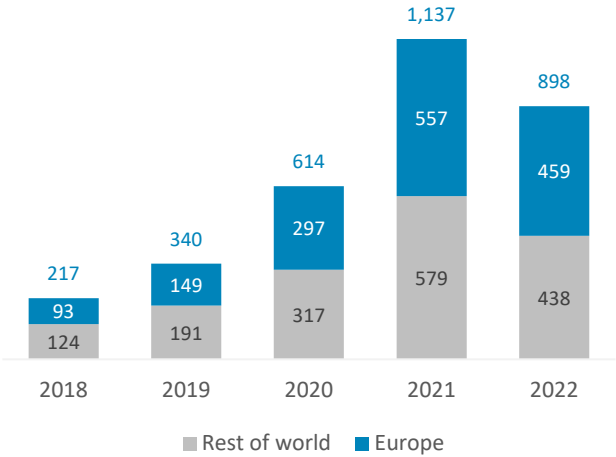
While developments seem to be going in the right direction, there is need for caution. The troubles in the bond markets in 2022, alongside increasing interest rates and a crackdown on greenwashing, could have a sustained impact on the future growth of ESG labelled bond issuance. Another reason for caution is that this is still a heavily European market, with other regions not pulling their weight in terms of value and penetration.

Fig.6 iii) shows how the EU is still an overperformer relative to its overall market share in the debt capital markets. While the EU made up nearly half of global ESG labelled bond issuance in terms of value in 2022, it only made up around a quarter of overall issuance. The US, on the other hand, is underperforming: it is making up nearly a third of overall issuance, but less than a fifth of ESG activity. ESG activity in all other markets is broadly in line with their overall market share.

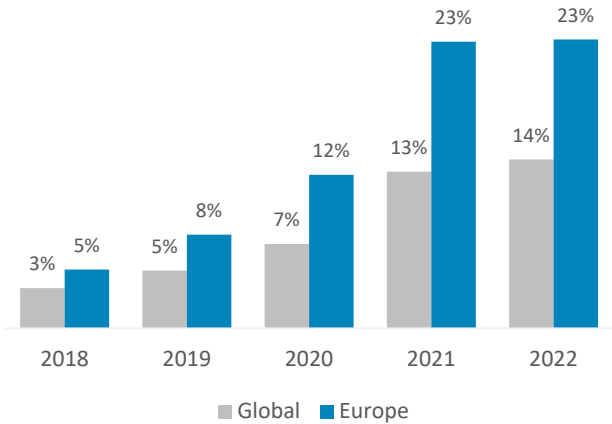
The developments we are seeing in the debt capital markets, particularly since 2020, are promising, but investors and issuers alike need to be wary of complacency and ensure that we keep the ‘good times’ going - or else we might see continued stagnation in penetration and perhaps further decreases in value.

Fig.6 How has ESG bond issuance changed?

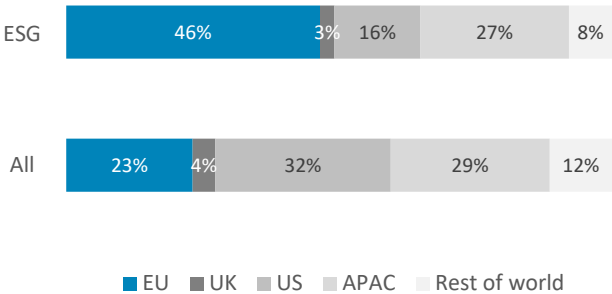
i) The growth in ESG debt capital markets issuance in Europe and the rest of the world, \$bn



ii) The penetration of ESG debt issuance in global and European debt capital markets



iii) The distribution of ESG debt capital markets issuance and all debt capital markets issuance across regions in 2022

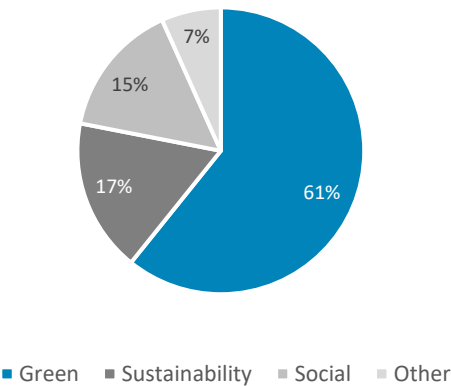


Source: New Financial analysis of Dealogic data
Note: DCM issuance includes medium-term notes, asset-backed securities, all bonds, covered bonds, preferred shares, and mortgage-backed securities

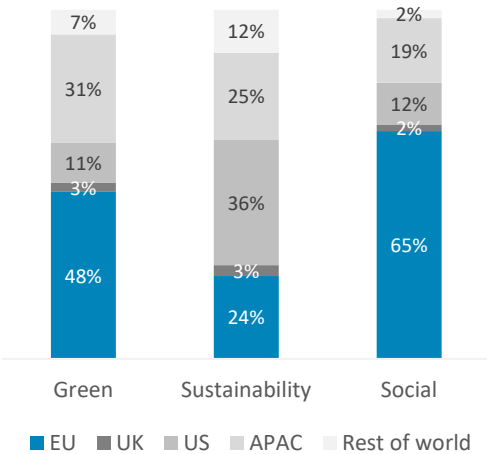
Fig.7 What types of ESG labelled bonds are being issued and what is their regional distribution?

The distribution of ESG labelled debt issuance by type and region of issuance in 2022

i) Distribution of global ESG labelled debt issuance by type of bond, 2022



ii) Regional distribution of green, sustainability, and social bonds by region, 2022



Source: New Financial analysis of Dealogic data

Green takes the lead

ESG is a broad church, and there are a lot of areas that issuers and the banking and finance industry are trying to address with it. Taking a look at labelled bond issuance by the type of label (green, social, and sustainability as well as transition and sustainability-linked bonds) allows for a more nuanced understanding of ESG activity in the debt capital markets.

Perhaps unsurprisingly, we see that 'green' bonds remain the primary type of ESG labelled bond issuance. A frequent (and reasonable) criticism of ESG is that it is too dominated by the 'E', that it is too focused on issues such as climate change and net zero, and that this might happen at the expense of social and governance issues. The distribution of ESG labelled bond issuance by type of bond evidences the focus on the 'E'.

Fig.7 i) shows that in 2022 nearly two-thirds of ESG labelled bond issuance was 'green'. Sustainability and social bonds made up less than a fifth each. The remaining amount went towards other types of bonds such as 'sustainability-linked' bonds. Unlike other labelled bonds, sustainability-linked bonds do not finance sustainable or social projects but rather the general operations of an issuer and have their financing terms attached to corporate performance based on sustainability metrics.

Fig.7 ii) highlights the regional distribution of green, sustainability, and social bond issuance in 2022. European issuance made up the majority of green and social bond issuance. In the case of social bonds, more than two-thirds of global volume was issued by European issuers.

An interesting finding is that the US was the biggest market for sustainability bond issuance. Sustainability bonds are issues where proceeds can be used to finance a combination of green and social projects. Given the recent Anti-ESG backlash in the US, sustainability bonds covering a wider area of issues might be a less controversial way for issuers to raise ESG finance.

Not just a European story

To understand ESG activity in the corporate bond market, we measure the value and penetration of green, social, sustainability, transition, and sustainability-linked bonds issued by corporates. As with the overall ESG bond market, we find that 2021 was a breakout year. More interestingly, while Europe was the dominant issuer in all bonds, the rest of the world plays a more important role in the corporate bond market.

From 2020 to 2021, the value and penetration of ESG corporate bond issuance dramatically increased, with much of that growth coming from outside of Europe. Fig.8 i) shows that the value of ESG corporate bond issuance increased almost threefold, and nearly two-thirds of that increase was driven by corporate bond issuance outside of Europe.

Fig.8 ii) highlights how the penetration of ESG in corporate bond issuance in Europe and worldwide increased nearly tenfold from 2018 to 2022. The standout figure here is that in Europe, more than one-third of all corporate bonds issuance in 2022 was ESG labelled. In European corporate bonds, ESG is becoming part of the mainstream.

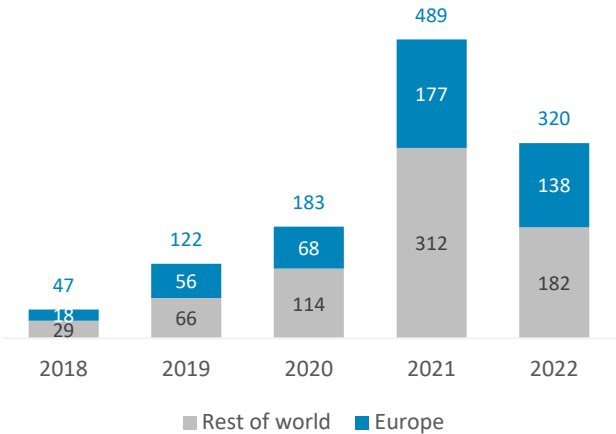
Across the corporate bond market, ESG labelled issuance is rising fast in terms of value and penetration. This is a welcome development. And while Europe's ESG corporate bond market is deeper than it is worldwide, ESG corporate bond issue is less a European story than it is for all bonds.

Fig.8 iii) shows that the EU once again punches above its weight, and that the US' share of the ESG corporate bond market is lower than its overall corporate bond issuance market share would suggest. But the difference is a little less pronounced than it is for all bonds. The UK, APAC, and the rest of the world capture about as much of the ESG corporate bond market as they do of the overall corporate bond market.

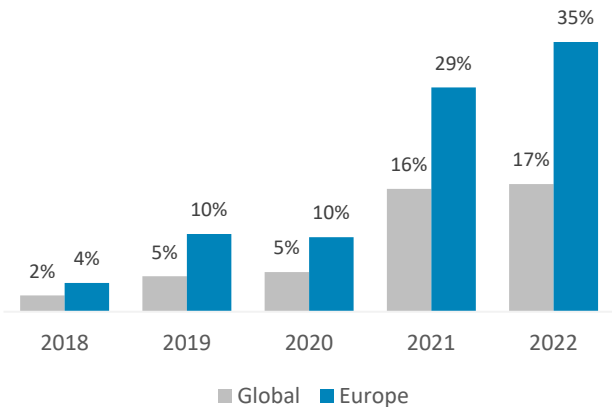
Many of the issues that ESG touches are global, rather than regional, and addressing the regional imbalance in ESG issuance will be a critical step moving forward. Corporate issuers in the US in particular need to step up their game, but the difficult political environment is making this challenging for them.

Fig.8 How has ESG corporate bond issuance changed?

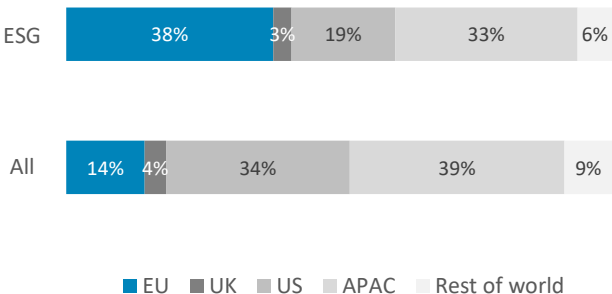
i) The growth in ESG corporate debt issuance in Europe and the rest of the world, \$bn



ii) The penetration of ESG corporate debt issuance in global and European corporate debt capital markets



iii) The distribution of ESG corporate debt capital markets issuance and all corporate debt capital markets issuance across regions in 2022



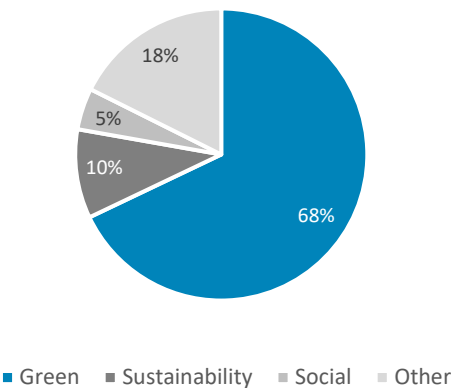
Source: New Financial analysis of Dealogic data

ESG CORPORATE BONDS: BY TYPE

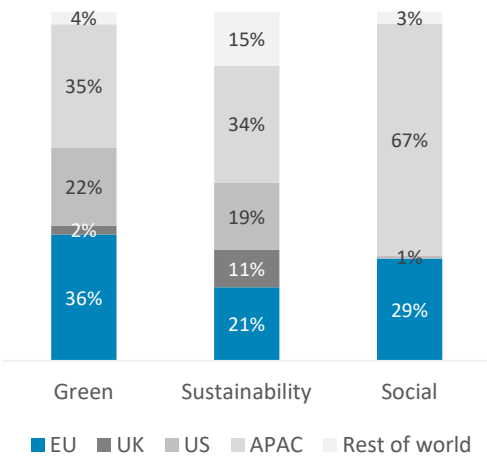
Fig.9 What types of ESG labelled corporate bonds are being issued and what is their regional distribution?

The distribution of ESG labelled corporate debt issuance by type and region of issuance in 2022

i) Distribution of global ESG labelled corporate debt issuance by type of bond, 2022



ii) Regional distribution of green, sustainability, and social corporate bonds by region, 2022



Source: New Financial analysis of Dealogic data

A more diverse picture

Our analysis of the types of ESG labelled corporate bonds shows that the increasing levels of ESG penetration in this market are driven by high levels of green issuance. Fig.9 i) highlights that green bonds accounted for two-thirds of global ESG corporate bond issuance in 2022. Again, given the focus on the ‘E’ in ESG, this is unsurprising.

A perhaps more striking finding is that ‘other’ bonds such as transition and sustainability-linked bonds made up nearly a fifth of issuance. The overall global volume of transition bonds is low, which suggests that sustainability-linked finance is a popular way for corporate issuers around the world to raise ESG finance.

With their focus on a firm’s overall sustainability performance, sustainability-linked bonds can be a bit more flexible as other ESG labelled bonds and allow firms to use proceeds for more general corporate purposes. On the other hand, critics argue that sustainability-linked bonds can open the door to greenwashing: there are no defined projects, and if firms do not meet sustainability targets, they simply pay a fine in form of less favourable financing terms to absolve themselves.

Fig.9 ii) shows that in 2022 corporate social bonds were predominantly issued by issuers located in the APAC region - more than two-thirds of global social bond issuance was issued here. This is in stark contrast to the more European picture for all bonds and suggests that European social bond issuance is primarily coming from non-corporate issuers. In the US and UK, social bonds did not play a role at all.

There is a lot of room for growth for ESG corporate bond issuance of all types: in the EU, the more firms make use of the capital markets, the more ESG corporate bonds they will likely issue. And in other regions, the focus will need to be on making the high volume of overall corporate bond issuance more ‘ESG’.

The missing label

Using analysis of loans following the sustainability linked-loan principle (SLLP) as the main way to measure the value and penetration of ESG activity in the corporate loan market, we again see that there was significant growth from 2020 to 2021.

Fig.10 i) shows that after some stagnation between 2019 and 2020, the value of SLLP loans increased nearly fivefold between 2020 and 2021. Fig.10 ii) highlights how the penetration of SLLP loans in global and European loan markets increased alongside their value. In 2020, SLLP loans made up only little more than a tenth of corporate loan issuance in Europe, but by 2021 they accounted for more than a quarter. Globally, SLLP loan penetration went from 1% in 2018 to more than a tenth of all corporate loan issuance in 2021 and 2022.

An interesting finding is that in contrast to the bond markets, where penetration of ESG activity in Europe either increased or remained stable in the last two years, the penetration of SLLP loans in Europe decreased between 2021 and 2022. While this decrease was not large, it is still noteworthy, particularly given Europe's position as being the most important market for SLLP loans (and ESG activity more widely).

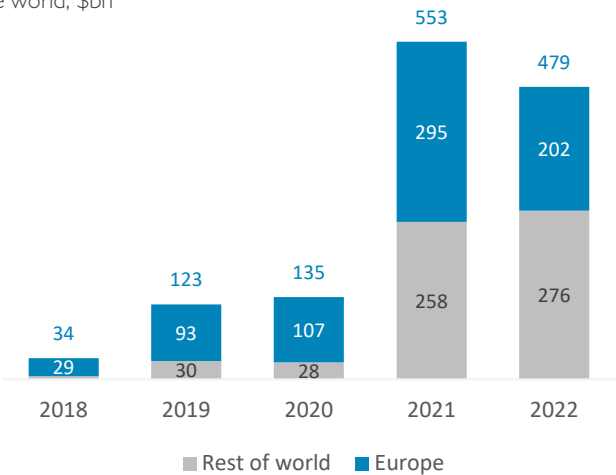
Fig.10 iii) shows another striking example of Europe's leading position in ESG activity: although the EU and UK combined made up less than a fifth of overall loan issuance in 2022, they accounted for 40% of global SLLP loan issuance. US borrowers on the other hand were responsible for more than half of all loan issuance, but just under a third of SLLP loan issuance.

It is more difficult to measure clearly defined ESG activity in the corporate loan market than it is in the corporate bond market. The only distinctively ESG labelled loans are SLLP loans, and the problem with these loans is that they are very similar to sustainability-linked bonds and more about financing terms and metrics than about directing money towards sustainable projects.

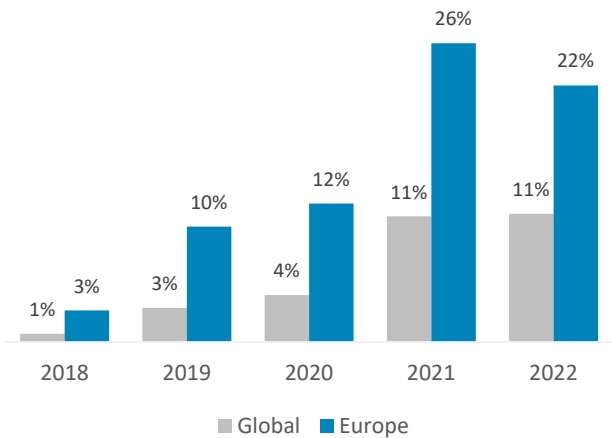
Uncertainty around ESG principles in the loan markets could be one of the reasons why penetration has not seen further growth recently, and there is a lot of room in the corporate loan market for evolution around ESG and ESG-related activity.

Fig.10 How has ESG loan issuance changed?

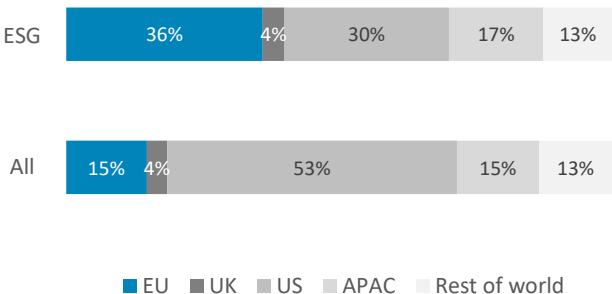
i) The growth in ESG corporate loan issuance in Europe and the rest of the world, \$bn



ii) The penetration of ESG corporate loan issuance in global and European corporate loan markets



iii) The distribution of ESG corporate loan capital markets issuance and all corporate loan capital markets issuance across regions in 2022



Source: New Financial analysis of Dealogic data

Investing in the future

Another area of capital markets that has clearly designated sustainable or ESG activity is investment funds. We analyse the growth in the value of assets of sustainable investment funds, their penetration relative to all investment fund assets globally and within Europe, and the regional distribution of sustainable funds.

The good news is that the sustainable investment fund market has grown significantly in recent years. Europe is behind much of that growth. Like in other areas of activity, 2021 was a breakout year for sustainable investment funds both in terms of value and penetration.

Fig. I I i) shows that from 2020 to 2021 the value of sustainable investment funds almost doubled to more than \$2.5 trillion. Almost all of that growth was a result of a vast expansion in European sustainable investment funds, which more than doubled in value.

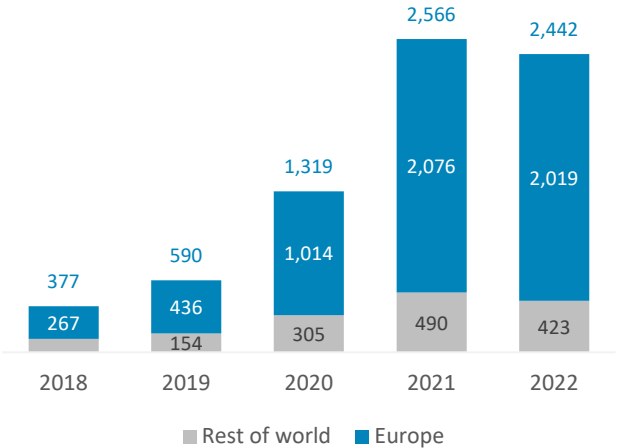
The wider market downturn of 2022 had a lesser impact on the value of sustainable investment funds than it had on ESG bond issuance. Fig. I I ii) shows that the penetration of ESG in the fund market continued to grow between 2021 and 2022. This suggests that the value of ESG investment funds likely would have further increased had there not been the turmoil in the financial markets in 2022. But the overall penetration of ESG in European and global investment fund markets remains lower than in the debt capital markets.

Fig. I I iii) highlights Europe's lead in the sustainable fund market. More than two-thirds of the value of global sustainable investment fund assets is concentrated in EU sustainable investment funds. This is a much larger proportion than the share the EU is capturing of the overall fund market, where US based funds account for nearly 60% of asset value.

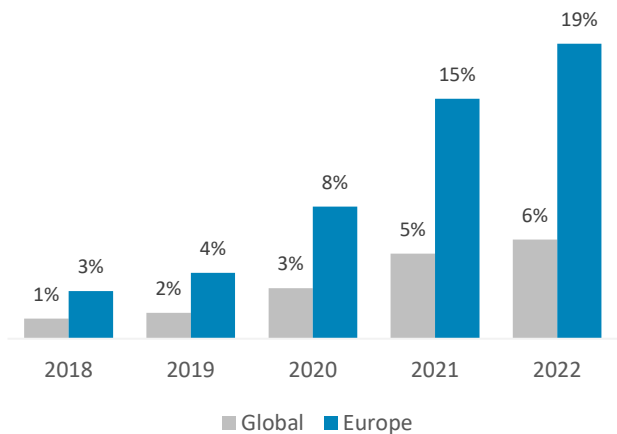
In Europe, sustainable investment funds have come under scrutiny. Recent EU guidance has made it more difficult to achieve the often desirable 'Article 9' label that indicates that 100% of assets in a fund are sustainable. Such fund reclassifications and further data methodology changes have had an impact on our analysis of the value of sustainable fund assets, and we discuss these changes in more detail on the next page.

Fig. I I How have ESG investment funds changed?

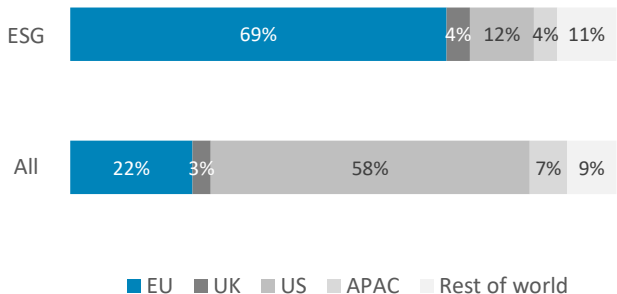
i) The growth in the value of ESG investment funds in Europe and the rest of the world, \$bn



ii) The penetration of ESG investment funds in global and European investment fund markets



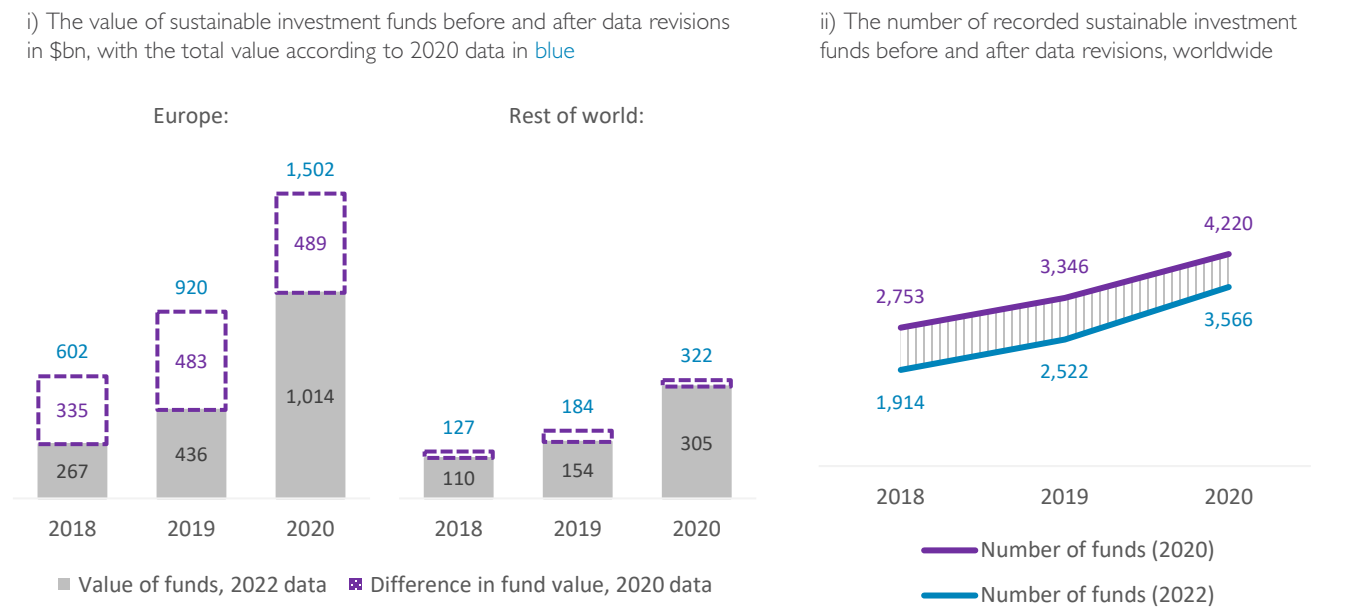
iii) The distribution of ESG investment funds and all investment funds across regions in 2022



Source: New Financial analysis of Morningstar Direct data

Fig.12 How has data on sustainable investment funds changed?

The change in the value and number of sustainable investment funds after data revisions between 2020 and 2022



Source: New Financial analysis of Morningstar Direct data

Difficult reclassifications?

When we first benchmarked the penetration of ESG in finance in 2021 (using a 2020 dataset), the data we analysed showed a significantly higher value of ESG investment funds in 2018, 2019, and 2020 than the revised data we use now.

Fig.12 i) shows that the numbers we were using in 2021 indicated that the global sustainable investment fund value in 2020 was in excess of \$1.8 trillion - around \$1.5 trillion in Europe, and a little more than \$300 billion in the rest of the world. Our revised figures show the global value of sustainable investment funds in 2020 dropping to little more than \$1.3 trillion. Fig.12 ii) shows that there were 654 fewer sustainable investment funds in 2020 after the data was revised - about 15% of ESG investment funds from our 2020 dataset got 'lost' in the process.

There is no detailed explanation by the data provider of the methodology changes that caused this, but European sustainable investment funds were particularly affected by the data revisions: of the \$505 billion that 'went missing' for 2020, an astonishing 97% used to be allocated to European funds. This indicates that fund reclassifications in Europe could be one of the reasons for the drop in value. For example, new EU guidance indicates that 100% of assets in an 'Article 9' fund must be sustainable, but it is still unclear what exactly qualifies as a sustainable asset, and many managers subsequently downgraded their funds or ditched the ESG label altogether. An investment fund that was recorded as 'sustainable' in the 2020 dataset may not be recorded as 'sustainable' or 'ESG' anymore in the revised dataset that we are using now.

This does not necessarily mean that the overall value of sustainable investment fund assets has dropped: it could simply mean that data providers have stopped counting a number of funds that they previously counted. But it does expose the challenge that exists around availability and comparability of data on ESG activity, and it shows that that with Europe being by far the number one market for sustainable investment funds, any changes here have a big impact on global fund volumes.

The implementation of ESG

The third step to measure the penetration of ESG in banking and finance is to analyse whether firms are walking the walk and not just talking the talk. This section looks at the climate engagement strategies of finance firms and measures capital markets activity by 'good' and 'bad' companies.

We also analyse whether banking and finance companies are implementing the commitments they made when they signed up to various ESG initiatives. Implementation can take many forms: for example, an investee committing to set a science-based target after engagement by an investor is the investor implementing its own commitments.

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The ripple effect

One of the ways to measure how and whether the banking and finance industry is doing what it set out to do when firms made commitments to ESG is to look at how the largest firms in each sector are engaging with their clients and portfolio companies on matters such as climate reporting or setting climate targets.

Fig.I3 shows the share of the largest 50 companies in each region and sector that have published an engagement strategy on climate reporting, or set targets for portfolio companies and clients in different sectors of the industry, or do both.

The good news is that the share of firms that engage with their clients and portfolio companies in this way has increased across the board. When we first ran this analysis in 2021, less than half of the world's largest companies in each sector had publicly disclosed such an engagement strategy. Now, 40% of the largest insurers, half of the largest pension funds, and more than three-quarters of the largest asset managers do.

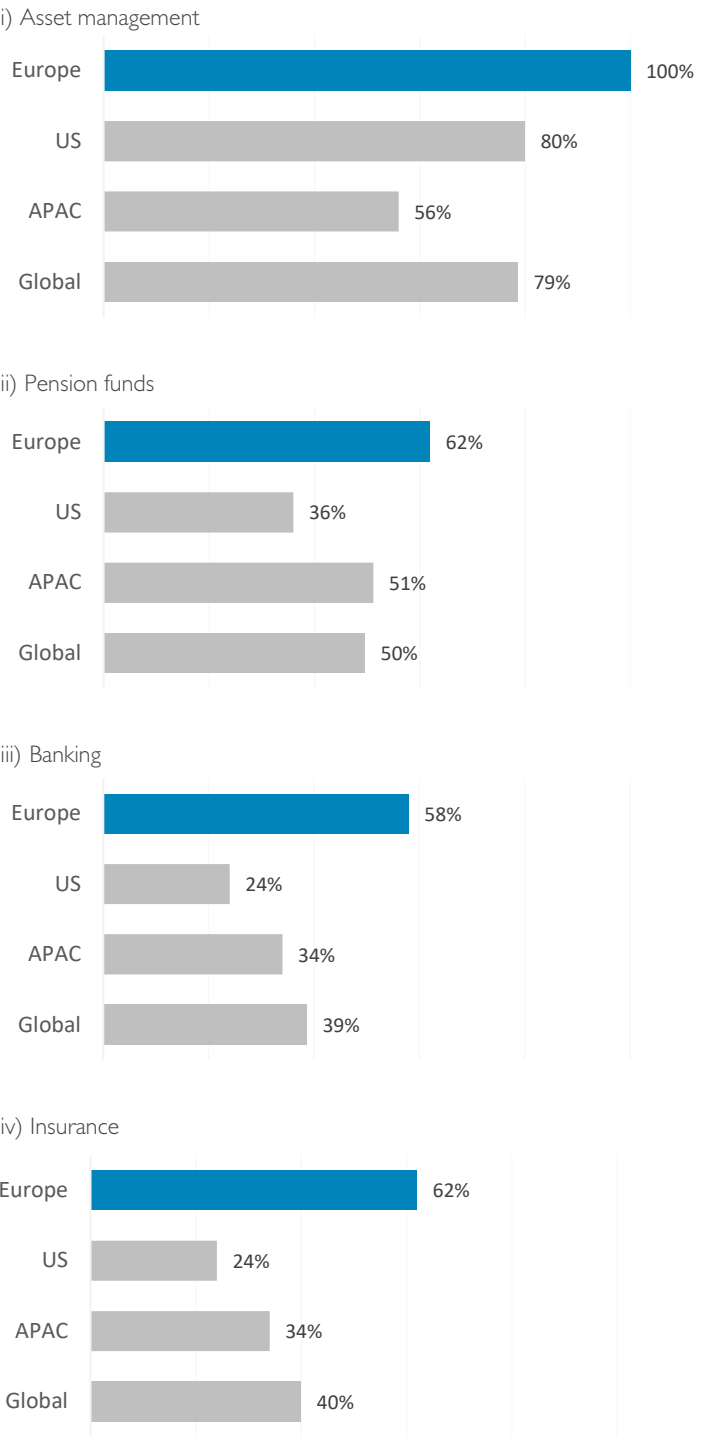
Perhaps unsurprisingly, European firms take the lead in every sector. The standout figure is under asset management: all of Europe's largest 50 asset managers publish a climate engagement strategy. This reflects the strong commitment figures we are seeing for the sector, and it makes it even more surprising that there is no credible and comparable data on the value of sustainable assets under management.

Insurers, pension funds, and banks located in the US are trailing their peers in other markets when it comes to publishing climate engagement strategies. This is a pattern we see in our commitment and 'hard value' analysis as well. The challenging political environment in the US might encourage firms to avoid publicly disclosing their climate engagement strategies, or it means they do not have one at all.

This form of engagement is a perfect example of how the banking and finance industry can drive change. Every company in the real economy, particularly the largest and most polluting firms, need to make use of the capital markets and raise finance in some form at some point. A strong engagement strategy by asset managers, pension funds, banks, and insurers can ensure that these moments are used to put companies on the right track.

Fig. I3 Requesting climate reporting and targets

The share of the largest 50 companies that have an engagement strategy on climate reporting and targets for portfolio companies



Source: New Financial analysis of disclosures by the largest firms in the world

'GOOD' AND 'BAD' CAPITAL MARKETS ACTIVITY

More than just a label

One of the problems we find when measuring ESG activity in capital markets is that not all of it is labelled. In order to measure unlabelled activity, we create a (somewhat simplistic) binary distinction between 'good' and 'bad' companies based on whether a company's operations advance ESG goals or not. For example, a 'good' company for 'E' might be one that builds and distributes solar panels, while a 'bad' company might be one that works in oil exploration and extraction.

To carry out our 'good' and 'bad' analysis, we classify issuers as one or the other based on words in their business descriptions that reflect either 'good' or 'bad' operations. In addition, we include a company in the 'bad' category if it is part of the Climate Action 100+ (a group of the highest polluters in the world) or an oil, gas, or mining company. We then analyse the share of capital markets activity by both types of companies.

Capital markets as a whole are still directing large amounts of funding to 'bad' companies. Fig.14 i) shows that from 2018 to 2022, the ratio between 'bad' and 'good' capital markets activity was 7:1. For every dollar raised in the capital markets by a wind power company, roughly seven dollars were raised by 'bad' companies that are causing the problem in the first place.

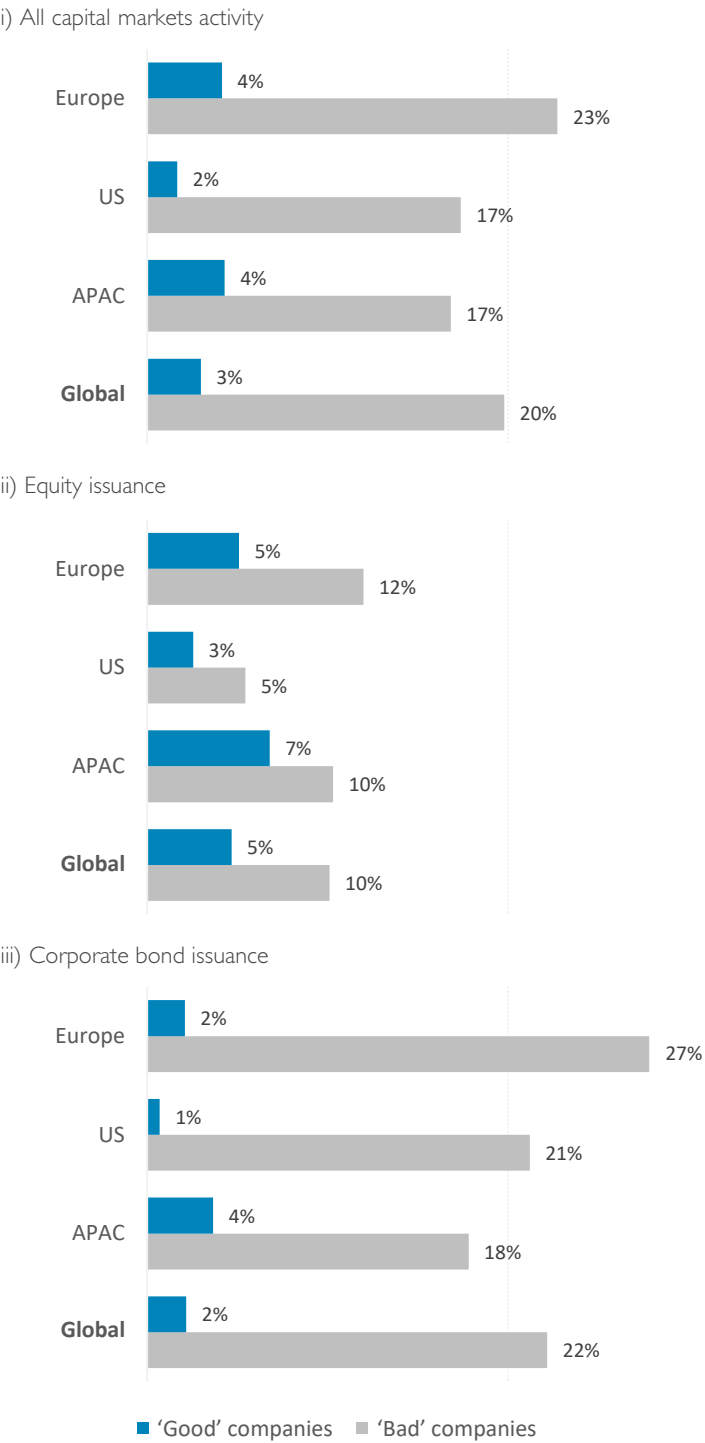
The good news is that this ratio is improving. If we only look at data from 2022, the ratio improves to 5:1. And not all capital raised by 'bad' companies is bad: the worst polluters need a lot of money to finance their transition.

Given Europe's leading position in ESG, it is perhaps surprising that the share of 'bad' capital markets activity is the highest of all markets. There are two possible explanations for this: first, the biggest economies in Europe have a large industrial base that tends to be 'bad' by our definition; and second, capital markets activity in the EU is still dominated by large firms that - again - are more likely to fall under our 'bad' label than issuers in the US, for example, where a much more diverse range of issuers makes use of the capital markets to raise finance.

Despite its simplicity, our analysis of 'good' and 'bad' capital markets activity adds an additional layer of nuance to the analysis of headline ESG activity. Moving forward, having labels for companies themselves and their activities could be a helpful way to understand how much of finance flows can actually be considered to be 'ESG'.

Fig.14 The penetration of ESG in capital markets

The share of capital markets activity by 'good' and 'bad' companies in each region from 2018 to 2022



Source: New Financial analysis of Dealogic data

Aligned with Paris?

The uptick in finance firms that are signing up to ESG initiatives is a welcome development: it shows that more and more organisations are committed to deliver on various ESG goals. Some of these initiatives have been around for a while now and are starting to track progress.

The Transition Pathway Initiative's (TPI) 2022 pilot framework and analysis assesses the preparedness of banks for the low-carbon transition. While the pilot framework only analyses 27 of the world's largest banks, it provides valuable insight into whether banks are doing what they set out to do.

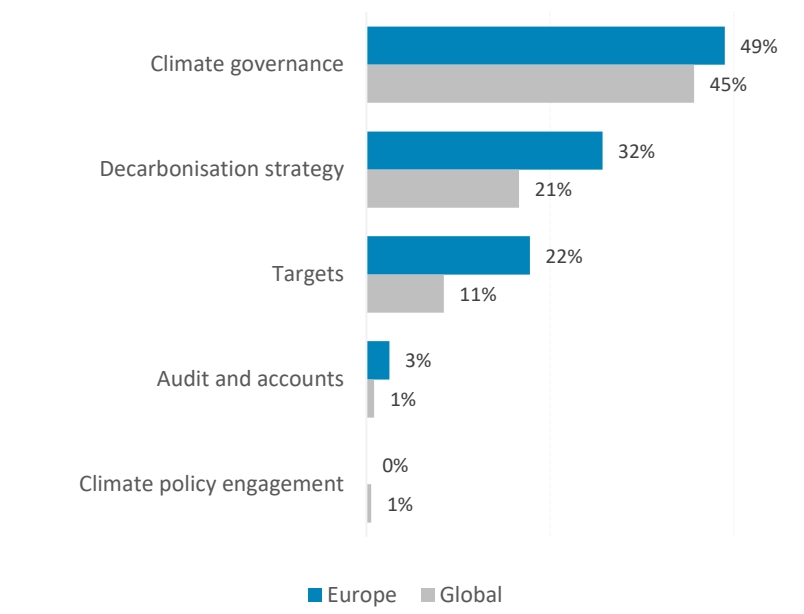
Fig.15 shows the share of bank alignment across five of the six areas assessed by TPI. The highest share of bank alignment is in climate governance which covers issues such as board or executive committee responsibility for oversight of banks' climate change policies. In four of the five areas, European banks are - on average - more aligned than banks worldwide. Climate policy engagement (also known as lobbying) is the one area where almost no bank is 'walking the walk'.

Another initiative that is tracking the alignment of the banking and finance industry (and of companies in other sectors) with Paris is the Science-Based Targets initiative (SBTi). Unlike some of the other ESG initiatives we discuss in this report, it is less a voluntary initiative and more a global body and standard setter that independently assesses and approves companies' emission reduction targets.

Fig.16 shows that, on average, banking and finance firms are having more ambitious validated targets than firms from all sectors. Of the 53 finance firms with validated targets, 94% have targets that are aligned with the 1.5°C temperature goal, and no finance firm has a 2°C-aligned target. Across the economy, nearly a quarter of companies have targets that are not aligned with 1.5°C. Having a climate target that is verified by an independent body is a crucial step in implementing ESG commitments.

Fig.15 How are banks' financing activities aligned with Paris?

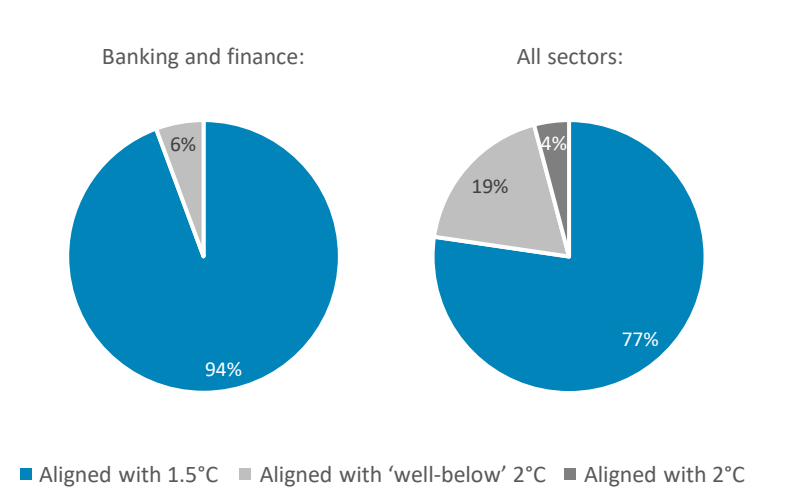
i) The average share of bank alignment with the goals of the Paris Agreement across five of the six areas assessed by the Transition Pathway Initiative
Note: figures indicate the percentage share of sub-indicators aligned with (see ii)



Source: New Financial analysis of TPI data. Data as of 12/2022

Fig.16 How are financial institutions setting science-based targets?

The share of banking and finance firms with approved targets that are aligned with 1.5°C and other temperature goals compared to companies of all sectors



Source: New Financial analysis of SBTi data. Data as of 12/2022

A lot of targets, a lot of metrics

The Net-Zero Banking Alliance is another initiative that reported on their members' progress for the first time in 2022. Around 10% of the world's largest 1,000 banks are a member of the alliance. The alliance's first progress report is based on the submissions of 62 banks and shows how these banks are implementing their commitments.

Of the 62 banks, 95% report that they have measured their financed emissions (Fig.17 i), though baseline disclosure levels vary by sector (Fig.17 ii). Two-thirds of respondents have set a 2050 portfolio target and one-third have set portfolio-wide intermediate targets for 2030. On average, member banks have set intermediate targets for three of the nine key sectors the alliance identified.

Banks use a mix of absolute and emissions intensity metrics to measure financed emissions. For example, in the commercial real estate sector, just under a third of reporting banks set their reduction target on an absolute basis in terms of all greenhouse gases emitted; a quarter on an absolute basis in terms of carbon emissions only; and another quarter on an intensity basis in terms of carbon emissions per m² of their commercial real estate portfolio.

In addition, targets and measured emissions cover different asset classes: in the commercial real estate sector, 56% of targets cover lending only and exclude banks' investment and other capital markets activities.

While the alliance acknowledges that the different ways of setting metrics and measuring financed emissions have 'pros and cons', the alliance is asking banks to provide a full explanation of emissions trends members are seeing. It is also asking members to measure all greenhouse gas emissions - not just carbon.

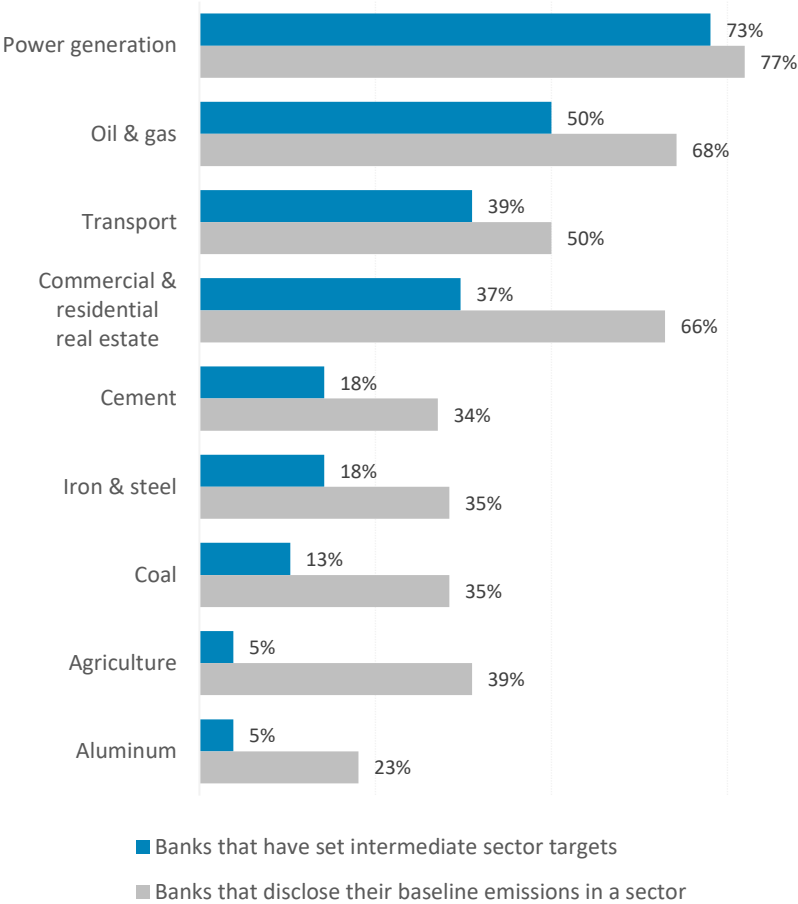
Measuring financed emissions is another important step in implementing commitments, but the many different ways of measuring them shows that banks are still having difficulties to quantify climate-related matters

Fig.17 What steps are banks taking to achieve net zero?

i) The share of Net-Zero Banking Alliance members that have measured their financed emissions



ii) The share of Net-Zero Banking Alliance members that disclose their baseline emissions for one of the nine key sectors the alliance identified and/or have set intermediate sector targets for 2030 or earlier



Source: New Financial analysis of Net-Zero Banking Alliance data

Good progress in need of scale

Asset owners play a unique role in the financial system: they can engage portfolio companies to set strategies aligned with net zero, and asset managers to align stewardship practices with the long-term interests of the asset owners.

One of the key tracks of the Net-Zero Asset Owner Alliance is its engagement track. The alliance believes that engagement with companies will be more successful in the long run than divestment.

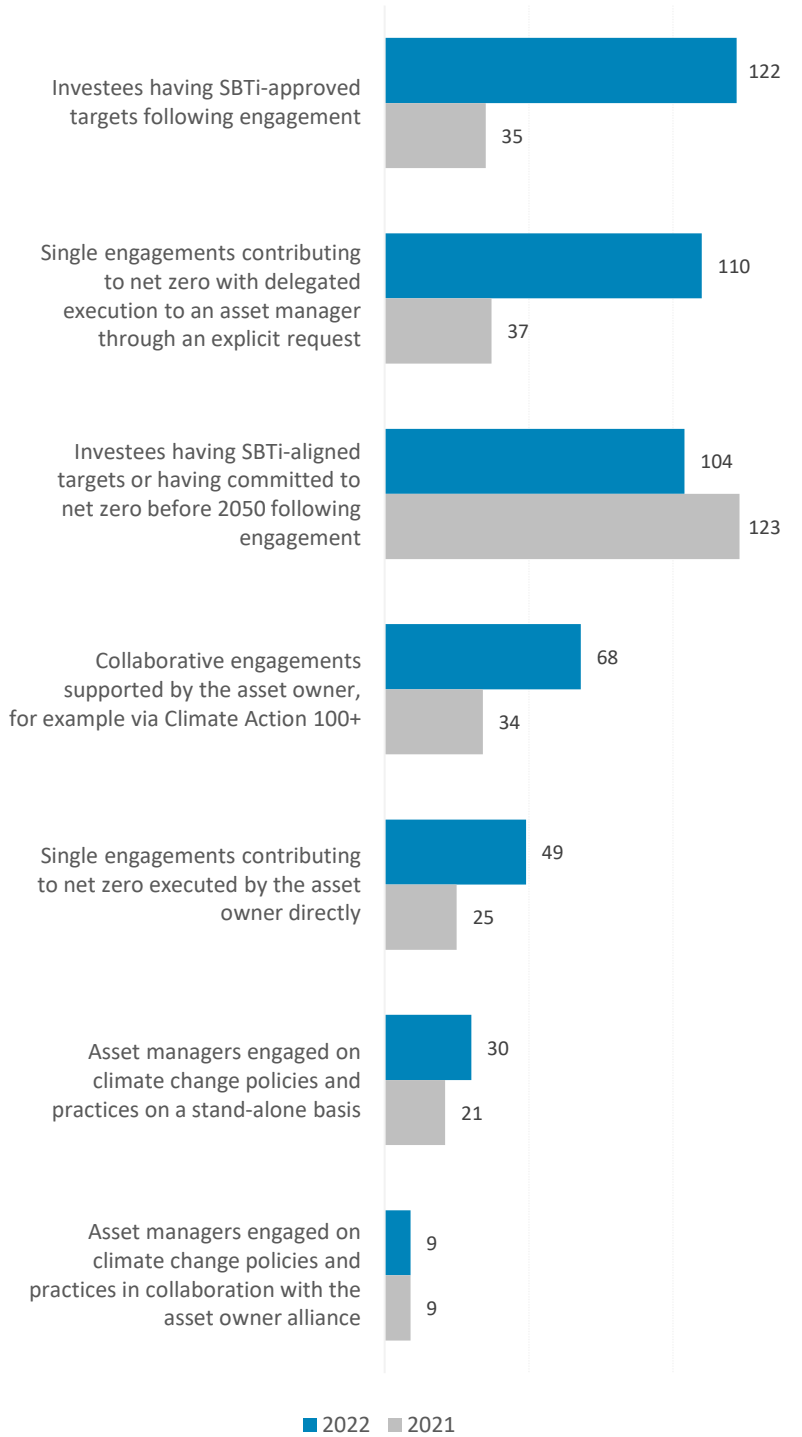
Fig.18 shows how alliance members are using engagement to achieve progress. From 2021 to 2022, nearly all of the alliance's KPIs for engagement have increased. This is a positive development. For example, an average alliance member is now working towards having 122 portfolio companies with SBTi-approved targets following engagement - up from 35 in 2021. The alliance's implementation report indicates growing investor support for collaborative and bilateral corporate engagement, increased engagement of asset managers, and more direct delegation to asset managers for engagement.

While more direct corporate engagement is welcome, the alliance highlights its limits in addressing systematic problems like climate change when implemented in isolation from other engagement approaches. Corporate engagement needs to be based on a systemic understanding of the transition barriers and opportunities across sectors and value chains. It also needs to go hand in hand with asset manager engagement (to get asset managers to factor in climate strategies when bidding for asset owners' business) and policy engagement (to create a wider business environment that is supportive and on track to net zero).

Only 21 of the world's 500 largest insurers and 16 of the world's 300 largest pensions funds are members of the Net-Zero Asset Owner Alliance. While those firms that are members are making good progress in implementing their commitments, engagement needs to happen at a larger scale to achieve impact.

Fig.18 How do asset owners engage on net zero?

The average number of targets for each engagement key performance indicator by Net-Zero Asset Owner Alliance members



Source: New Financial analysis of Net-Zero Asset Owner Alliance data

What next?

There has been a lot of progress around ESG in the last two years, but there have also been some more concerning developments, and ESG is still far from becoming mainstream in most sectors and regions.

The following two pages discuss some of the reasons for why 2021 was such a significant year for ESG and list a selection of questions for policymakers, regulators, and market participants to encourage debate about how the future of ESG in banking and finance could look like.

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WHY 2021 WAS A BREAKOUT YEAR FOR ESG

Significant progress

The breakthrough year for ESG labelled activity was 2021. From 2020 to 2021, activity in all markets virtually exploded, and it was the first time that penetration of ESG labelled activity across the bond and loan markets in Europe reached levels of between a quarter and a third of all capital markets activity. Here are some of the drivers and reasons for why there were such significant levels of ESG activity in 2021, what this meant for 2022, and what it might mean going forward:

1. **A focus on the environment:** carbon emissions dropped during worldwide Covid-related lockdowns in 2020, but at the end of that year, greenhouse gases reached record levels again. In addition, 2021 saw many extreme weather events across the world that were connected to climate change: a deadly winter storm in the US that left millions in Texas without electricity when the power grid failed, severe floods in Germany and Belgium during the summer that killed hundreds, and a heatwave and widespread wildfires in Canada.

Against this backdrop, COP26 took place in Glasgow in November 2021. The conference was the first since the Paris Agreement on climate change that expected parties to step up their commitments. Climate finance was one of the main topics of the conference, the COP26 Private Finance Hub was established to mobilise private finance to support the transition of the economy, and many firms committed to achieving net zero via frameworks such as the UNFCCC's Race to Zero and the Glasgow Financial Alliance for Net Zero (GFANZ).

2. **A focus on social issues:** businesses and investors continued to focus on social issues in 2021. The death of George Floyd in Minneapolis in 2020 triggered a wave of diversity and inclusion efforts in organisations and put a spotlight on the 'S' in ESG. After the Covid pandemic drastically changed working patterns and work-life balance, firms spent time and resource on redeveloping employment policies and practices. And businesses also looked at increasing their resilience, particularly around supply chains - partly due to the pressures caused by the pandemic and geopolitical tensions, but also due to a spotlight on working conditions and human rights.
3. **Increased shareholder pressure:** these developments led to increased shareholder activism around ESG issues. In the US, support for ESG proposals at shareholder meetings rose to 32% in 2021 from 27% in 2020, according to the Sustainable Investments Institute. ShareAction reported that, on average, European asset managers supported 69% of environmental and social resolutions in 2021.
4. **Regulatory action:** shareholder pressure was not only driven by increasing scrutiny by the public, but also by regulatory action. 2021 was the year when more and more ESG disclosure that was voluntary previously became mandatory for issuers and financial services, and many firms tried to get ahead of the curve.

In the EU, initial elements of the sustainable finance disclosure regulation (SFDR) came into force, and the EU continued to publish technical guidance on its sustainability taxonomy. A growing number of countries, including the UK, the US, Brazil, and New Zealand announced or started considering how they would incorporate mandatory climate-related risk reporting in their respective regulatory frameworks in the coming years. The US also announced that it would make it easier for pension funds to use ESG in decision making.

5. **Beyond 2021:** the good news is that our data indicates that the relatively high ESG penetration levels of 2021 remained stable in 2022. This suggests that 2021 served as a form of wake-up call to the banking and finance industry. The problem is that the current global economic and geopolitical turmoil presents a complex and challenging backdrop to the financial services industry, and ESG could slip down the agenda when it is most needed. Policymakers, regulators, and market participants now need to think about what the future of ESG in banking and finance could look like.

The future of ESG in banking and finance

The main takeaway from this report is that while ESG has moved to the top of the political and business agenda, questions remain about whether it is helping the world achieve its ambitious sustainable development goals. ESG can mean many different things to many different people. Here is a selection of questions for policymakers, regulators, and market participants to encourage debate about the future of ESG in banking and finance:

1. **Keeping up the pace:** how can we maintain the positive developments in ESG (the rise in labelled ESG activity, increasing attention towards climate and social issues, increasing corporate commitment) while leaving the negative or overly complex elements (fragmentation of regulatory standards, lack of implementation) behind? How can we ensure that companies are walking the walk and not just talking the talk?
2. **Beware of the backlash:** with ESG being criticised for being 'too woke', a cover-up for corporate misbehaviour, or both, it will be necessary for issuers and investors to clarify what they mean by 'sustainable finance' and 'ESG'. How can we prevent ESG from becoming ever more politicised and from spooking issuers and investors rather than helping them achieve their sustainability goals?
3. **What about the 'S'?** What can companies, investors, and governments do to make sure the 'S' in ESG is not forgotten and taken over by environmental and climate issues? It might be worth asking an even more difficult question - is the 'S' not being approached because it is much more challenging to define than 'green' and 'not-green'? Is there a way to approach the 'E' with the 'S' in mind, and vice versa?
4. **How do we measure 'G'?** Given that governance is central to every company's day-to-day operations, how can we provide a reliable metric for 'G'? Is there a way to develop a labelled 'governance' bond? Can we distinguish which companies are 'good' or 'bad' when it comes to governance, and what do we do when a company with great scores in 'E' and 'S' is not very good in 'G'? How can we develop our understanding of the interconnection between the 'E', the 'S', and the 'G'?
5. **From 'bad' to 'good':** ESG emerged from the corporate responsibility movement which intended to make corporations good citizens after decades of alleged misbehaviour. What role can ESG play in turning a 'bad' company into a 'good' one? How can ESG transform companies (or even whole economies)? Is it even the right framework and principle for this task?
6. **Do we always need a label?** Is a label always necessary to mobilise financing for sustainable or social undertakings? Can an issuer get the same ESG credentials without issuing a 'green' or 'social' bond?
7. **How much regulation is too much?** When does government and regulatory policy go from being helpful to being in the way? How many definitions and taxonomies do we need for issuers and investors to raise more amounts of sustainable finance? Is global harmonisation of ESG and sustainable finance frameworks the only way, or is there merit in having taxonomies that are tailored to regional circumstances?
8. **More or better disclosure?** Is the main problem that we need more data, better data, or a bit of both? How can investors pressure issuers to provide greater disclosure, and what role do governments and regulators have to play in mandating disclosure without having a deterring impact on profits and innovation?
9. **The proof is in the pudding:** when (and how) can we know that ESG has succeeded? Will ESG have succeeded if there is a cleaner atmosphere, a more diverse and inclusive workforce, and better governed companies? Or is ESG more about the journey rather than the destination?
10. **Sustainable finance is finance:** how do we turn ESG - or whichever term will be used in the future to refer to 'sustainable' finance - into the main form of finance?

NEW FINANCIAL

Rethinking capital markets

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[*Benchmarking ESG in banking & finance \(2021\)*](#)