ESG Research

ESG Materiality Map
Banks

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This report does not constitute a rating action

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In line with the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, S&P Global Ratings is publishing research on the ESG materiality map of the banking sector. We provide an illustration of our current view of the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. The materiality map does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis.

Banking Sector

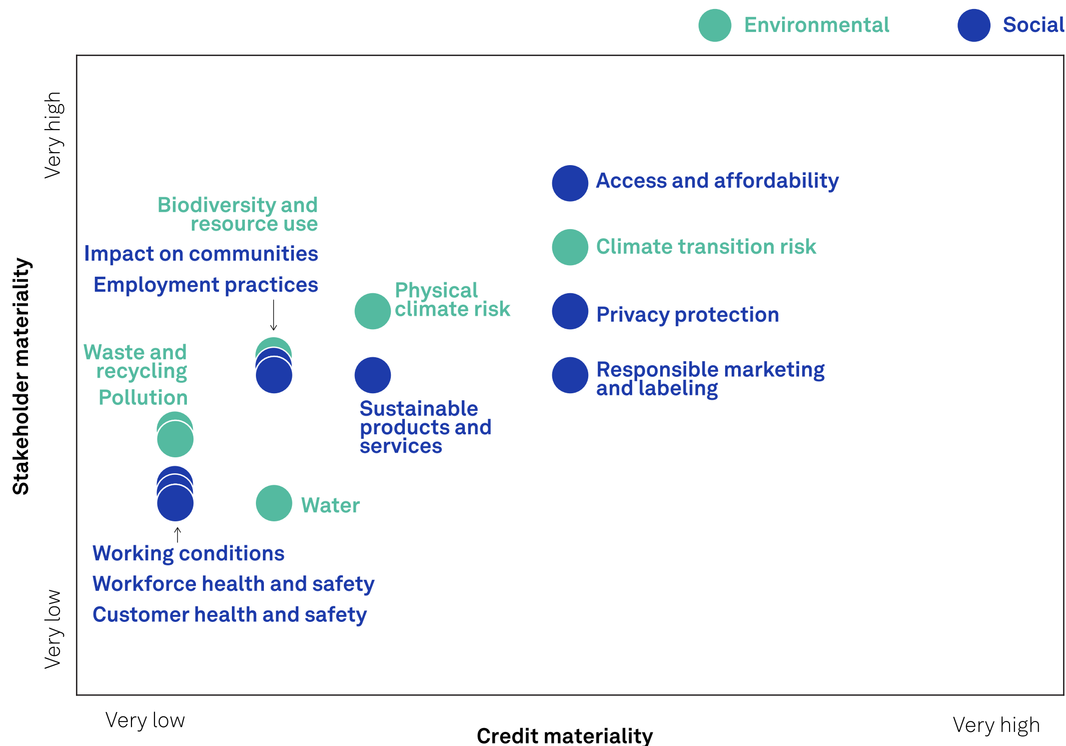
Banks are financial institutions licensed and regulated to receive deposits and provide loans. They typically also provide financial services targeting different client segments and needs, including retail and commercial banking to serve individuals, small and medium-sized enterprises, and middle-market companies; private banking to serve high-net-worth clients; and corporate and investment banking to provide large corporates and governments with advisory and other wholesale banking and transactional services.

Key Takeaways

- Environmental and social factors are material from both the stakeholder and credit perspectives, but less than most industrial sectors. The banking business model is diversified and has strong regulation and supervision by key stakeholders, including regulators, central banks, and customer protection agencies, per the industry's central role in the economy.
- Access and affordability is the most material social factor for banks, especially for stakeholders, as the industry can ensure broad access to financial services for the population and economic agents. The rise of new players and technologies could challenge this role over time and disrupt the sector.
- Banks are largely exposed to climate transition risk as they finance the economy. We anticipate those risks to be proportional to the impact of climate change on the economy. While already highly material for stakeholders, we anticipate this factor will likely become increasingly impactful for credit.

See materiality map on the following page.

ESG Materiality Map For The Banking Sector



The materiality map provides an illustration at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. It does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG Criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis. Source: S&P Global Ratings.

How To Read The ESG Materiality Map

The stakeholder materiality (Y axis) reflects our assessment of the relative level of impacts and dependencies of the sector on the environment, society, and economy.

The credit materiality (X axis) reflects our assessment of the relative level of potential and actual credit impact for the sector. The credit implications for the factors positioned on the left side to the middle of the X-axis would be more limited and absorbable. On the right side, there is higher potential for these implications to be more disruptive. We assess credit implications for an entity based on its individual characteristics.

Assessing E&S factors' materiality: We consider both the likelihood of the impact from a given factor, as well as the magnitude of the impact. The materiality of the factors varies depending on the perspective (stakeholder or credit) as well as the evolving and dynamic interactions between these two dimensions.

The main areas of the map:

- The upper-right quadrant displays the most material, on a relative basis, E&S factors identified for the sector from both a stakeholder and credit perspective.
- The upper-left quadrant presents factors that are more material from a stakeholder than credit perspective. These factors have the potential to become more material from a credit perspective.
- The bottom-left quadrant shows factors that are less material for both stakeholders and credit. Their materiality may evolve over time and this dynamic may not be linear.

Examples Of Material Factors

Below we provide the rationale of some of the material factors to illustrate the above findings.

Access and affordability

Access and affordability is the most material social factor for banks from a stakeholder point of view and one of the four most important from a credit perspective. Supporting stakeholder materiality is banks' large impact (through its financing activities) on individuals and businesses' access to financial services. Banks also enable the correct functioning of payment systems, which are cornerstones of economic development and stability. Therefore, allowing access to financial services, and at fair market conditions, has strong impact on society. Currently, the coverage gap is significant in some countries, with large segments of the population lacking access to affordable banking services. This means that the banking sector could face growing pressure to develop products and solutions with lower margins to serve these segments. While structural issues such as poverty, informality and lack of financial literacy partly limit the access to financial services, banks have large opportunities to support economic development through financial inclusion. In addition, banks can leverage new technologies, including blockchain and artificial intelligence (AI), to provide access to banking products and services to a wider population. Those that fail to successfully navigate this fast-moving technological environment may lose market share, hence why this is material for credit.

Climate transition risk

Climate transition is the most material environmental factor for banks for both stakeholders and credit. Our analysis focuses on the environmental impact financed (i.e., funded or invested in) by banks, because the direct impact from their own operations is limited. As funding providers, banks are highly exposed to climate transition risk from a stakeholder point of view. As policymakers implement rules to reduce greenhouse gas (GHG) emissions, they will ultimately affect the banking sector and could raise credit and legal risks for banks with large exposures to sectors with significant GHG emissions such as oil and gas, metals and mining, or transportation. These medium- to long-term risks are significant and will be proportional to the impact of climate change on the economy. Positively, financing the climate transition also offers a growth avenue for banks through direct lending and market activities.

Physical climate risk

Physical climate risks will affect many economic activities as climate change will increase the frequency and severity of extreme weather events. This factor is currently more material for stakeholders than credit. Supporting this is banks' exposure, through financing, to a wide number of business sectors in different geographies, themselves subject to physical climate risks. However, while climate change is a global issue, the impact of climate hazards is typically localized, so the aggregated exposure can be lower. Credit materiality is comparatively lower, and there is a high correlation between the geographical location of the assets a bank is financing and the materiality of physical climate risk. For instance, some countries, such as small islands in the Caribbean, are regularly hit by climate hazards that significantly damage critical infrastructure and disrupt economic activity. At global level, credit materiality is therefore more limited, but this may evolve over time as severe weather events proliferate.

Privacy protection

Banks rely heavily on IT systems, using digitization (or computer processing of information) extensively. Growing use of client data collection, data mining, and artificial intelligence (AI) have brought significant efficiency gains and facilitated financial access. However, this has increased banks' exposure to the risk of IT infrastructure failures, cyberattacks, and other quickly evolving risks. The resulting disruptions (such as client data leakage, data theft, or AI-related unintended or biased use of private personal data) could subject banks to higher and unpredictable risks given their large number of customers and business partners. In addition, stolen data may be used by criminals to commit various types of frauds. This may ultimately trigger financial losses and dent client confidence in banks and tarnish their reputations. We see privacy protection risks rising and evolving as cyber hackers become more sophisticated--but for now, the credit impact remains moderate because most banks have strong risk governance and controls in place to prepare for these risks.

Responsible marketing and labeling

This factor is equally material from stakeholder and credit perspectives. Our view on stakeholder materiality balances the recurrent risk of misconduct in marketing and labeling with banks' generally advanced supervisory frameworks. Banks serve a large number and various categories of customers. Therefore, they depend greatly on customer satisfaction and trust. Historically, opaque pricing and mis-selling in retail operations have challenged customer trust on some banks. In addition, investors, regulators, and the broader public are exercising greater scrutiny on banks' sustainable products, calling out what they perceive as greenwashing. Much of this skepticism is founded on concerns that firms may use disclosures and sustainability-related labels on products and services as a marketing tool to appear more proactive on those issues than they truly are. However, regulation, supervision, and consumer protection mechanisms have evolved in the past decade and should continue to help limit these risks in the banking sector. This supports our view of a medium credit materiality. Although controversies will continue, they most often cause only relatively short-term harm to an individual bank's or banking sector’s reputation.

Employment practices

Employment practices is more material for banks from a stakeholder standpoint than for credit. The stakeholder materiality is supported by the heavy dependence of banks on skilled labor resources which continues to test their human capital management skills. Many factors challenge banks’ abilities to attract, upskill, retain talent, and treat employees fairly, especially in cases of downsizing or reorganization. These factors include fierce competition, increasing use of automation, digitalization and artificial intelligence, demographic changes, and goals to achieve gender pay parity among others. As they also outsource and offshore a growing number of functions to reduce costs, oversight of the workforce of their supply chains is becoming more important. However, banks usually have stronger employment practices than most other sectors and therefore have been so far well positioned to compete for skilled professionals. We expect the credit impact will remain low for the sector due to the relatively proactive employment practices to adapt to these new trends.

What is our approach to research on the ESG materiality map?

Referring to the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, this research is built on the ESG materiality concept that considers ESG issues as material when they could affect stakeholders, potentially leading to material direct or indirect credit impact on entities. It considers that all businesses, through their activities and interactions, impact and depend, directly or indirectly, on stakeholders such as the environment (natural capital), society (human and social capital), and economy (financial capital). Using this ESG materiality concept, S&P Global Ratings has worked toward identifying a common, global, cross-sector set of E&S factors that we believe are material to stakeholders, and either are already, or have the potential to become, credit material for entities. The materiality map we propose provides an illustration at a point in time, of our findings on the relative materiality of those factors, from both the stakeholder and credit perspectives.

How does the sector ESG materiality map relate to credit ratings or ESG evaluations?

The sector materiality map is a visual representation of the factors that we consider impactful to the sector from a stakeholder and credit perspective for the purposes of this research. It does not represent any new analytical approach to the E&S factors in our credit ratings.

The relative materiality of the factors indicated on the materiality maps may inform the E&S Risk Atlas scores and the weights of the E&S factors used in ESG evaluations.

They may also inform our discussions with issuers on those factors' existing or potential credit materiality.

Related Research

- Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors, May 18, 2022
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- ESG Evaluation Analytical Approach, Dec. 15, 2020

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