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Sustainable Banking: Embedding ESG in Financial Institutions' Investment Decisions

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List of Acronyms:

Acronym	In Full
IR	Environmental Impact Ratio
BCG	Boston Consulting Group
ESG	Environmental, Social and Governance
AuM	Assets under management
EIA	Environmental Impact Assessment
ICMA	International Capital Market Association
ASEAN	Association of Southeast Asian Nations
SFDR	Sustainable Finance Disclosure Regulation
TMA	Total Managed Assets
TSR	Total Shareholder Return

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EXECUTIVE SUMMARY

This paper is about embedding ESG in the investment decisions of financial institutions. It defines sustainability in the lenses of European Central Bank (2020), as the process of developing financial value of a bank while adhering to pertinent ideals such as social values and environmental conservation. The methodology to data collection is purely secondary data. The paper acknowledges the importance of ESG and their benefits to the financial sector, then discusses how ESG can be integrated into financial institutions' investment decisions. Three strategy categories are leveraged to embed ESG.

1. **Sustainable financing:** including green bonds, social bonds, sustainability, and linked bonds.
2. **Sustainable investing:** including norms-based screening, negative/positive screening, ESG integration, impact/community investing, thematic investing, and corporate engagement and
3. **Operational efficiency:** The paper anchors on the BCG (2023) survey to provide guidance for integrating the social pillar. The paper **concludes** that financial institutions need to remain profitable to be sustainable. That said, it recommends financial institutions to find the nexus between profitability and sustainability for sustainable investment to become the mainstream.

Keywords: Environment, Social, Governance, Sustainability, Financial institutions

1.0 BACKGROUND

ESG issues have become a strategic priority for corporate boards. That said, investment performance is being analysed according to sustainability criteria based on corporate ESG scores. At Global level, Sustainable Investment Alliance put ESG Assets under Management (AuM) at \$30.6 trillion in 2020, with ESG assets projected to be at \$50 trillion by close of 2023 which is over 25% of projected \$ 140 trillion assets under management (AuM) (World, bank, 2021). AuM is defined as the market value of the investments managed by a person or an entity (e.g. bank) on behalf of clients. Investors often consider higher investment inflows and higher AuM of a financial institution as positive indicators of management performance and experience when evaluating a bank.

According to Climate bond initiative, the financial services industry has an average growth in global ESG activity at 400% where sustainable bond issuance increased from \$107 billion to \$570 billion, and assets held in investment funds considered ESG, increased fourfold from \$475 billion to \$1.8 trillion between 2016 and 2020. Similarly, according to S&P Global markets intelligence (2022), the world's large financial institutions announced Individual sustainable finance targets in \$ billion for year 2030 including JPMorgan targeting \$2,500, Bank of America \$1,500, Citi \$1000, HSBC \$875, Wells Fargo \$500, among others. These targets suggest a growing level of commitment to ESG initiatives across the financial services industry thus a growing focus on sustainability in the banking sector.

The paper **inspiration** is multifaceted: first, as providers of capital, financial institutions have a critical role in promoting the transition from a fossil fuel dominated economy to one supported by renewable energy. Further, there is growing

awareness and demand for sustainability among stakeholders which should prompt financial institutions to become sustainable (AfDB, 2021). Financial institutions are also major players in driving towards SDGs. The SDGs that receive the greatest bank focus are those related to; Economic Growth and Decent work (SDG8), Climate Action (SDG13), Clean Energy (SDG 7), Sustainable Cities and Communities (SDG 11), Gender Equality (SDG 5) and Responsible Consumption and Production (SDG 12). To drive towards SDGs, banks must shift from traditional to sustainable banking (World Bank, 2021). Financial institutions for example can show alignment to SDG 11 through financing of projects in low-income urban areas. Lastly, some financial institutions merely follow the regulatory norms and do not lie under the higher level of the model in the sustainable typology. That said, the paper attempts to address the following topic.

Sustainable Banking: "Embedding ESG into Financial institutions' Investment Decisions" and proceeds as follows:

2.0 UNDERSTANDING SUSTAINABLE BANKING AND ESGs

Sustainable banking and ESGs are top boardroom matters that need to be conceptualised if financial institutions should work towards their goals.

2.1 Sustainable Banking:

For the purposes of this paper, sustainable banking is defined in the lenses of European Central Bank criteria. It is the process of developing the financial value of a bank while taking ESG considerations into account when making investment decisions. This definition disguises the economic approach of measuring GDP, entirely based on economic growth, leaving out ESG yet, ESGs' are pertinent ideals (EY, 2022).

2.2 The Concept of ESG in Investment

ESG Investing is the consideration of ESG factors alongside financial factors in the investment decisions (EY, 2022).

Exhibit 2.1: ESG Issues for Consideration

ENVIRONMENTAL ISSUES (Conservation of the natural world)	SOCIAL ISSUES (Consideration of people & relationships)	GOVERNANCE ISSUES (Standards for running a company)
CARBON EMISSIONS	Customer satisfaction	Board composition
POLLUTION	Data protection and privacy	Audit committee structure
BIODIVERSITY	Gender, diversity & Inclusion	Bribery and corruption
DEFORESTATION	Employee engagement	Executive compensation
ENERGY EFFICIENCY	Community relations	Lobbying
WASTE MANAGEMENT	Human rights	Political contributions
Water scarcity	Labor standards	Whistleblower schemes

Source: (IFC, 2022).

Exhibit 2.1 provides an example of issues an investor might consider under each ESG pillar.

However, there is no standard criteria that investors can look to, in each of the E, S, and G subcategories (AfDB, 2021).

This is because values, technologies, regulations, and policies differ across regions.

3.0 IMPORTANCE OF EMBEDDING ESG' INTO INVESTMENT DECISIONS

The AuM that incorporates elements of ESG review and decision making have globally grown AfDB, (2021) due to the following risks:

3.1 Credit risk

Credit risk is defined as the potential financial loss arising from a financial institution's borrower failing to meet its obligations in accordance with the agreed terms (BCG 2023). One can argue that embedding ESG in investment decisions is a credit risk management strategy to mitigate financial losses. Similarly, ESG considerations help in assessing the creditworthiness and performance of borrowers. This is because financial institutions can be affected if the value of property they took as security is impaired by pollution costs. Examples of pollution costs include legal fees and court fines brought against the borrower and attached to the collateral due to environmental damage. These fines have the potential to adversely affect the value of security and the borrower's ability to pay back the loan. It is thus important for financial institutions to evaluate and monitor the borrower's environmental record. Also some businesses that financial institutions finance (e.g., agriculture) are directly adversely impacted by climate change hence risking incidences of credit default (NPL).

3.2 Legal risk

Legal risk arises from failure to comply with statutory or regulatory obligations. Litigation is the most common legal risk financial institutions may face for non-compliance with ESG requirements

(AfDB 2023). Legal risk through litigations thus, risks a financial institution's finances and reputation. It thus implies that managing a bank's legal considerations partly means appropriately embracing ESG issues.

Financial institutions face the potential for legal risk since government policies require them to measure and disclose ESG risks in their loan portfolios. For example, in India the Companies Act, 2013 requires certain profitable companies to spend a minimum of 2% of their three-year annual average net profit towards CSR initiatives in a financial year. Also, Indian financial institutions must finance micro, small, and medium enterprises at discount rates.

Similarly, in the US, the Community Re-investment Act requires financial institutions to report on how they meet the credit and banking services needs of the entire market, including low- and moderate-income communities. Compared to Europe, EU, financial institutions are required under SFDR to disclose their spending on ESG, or else could face penalties and limited access to capital (EY, 2022). The above views are in sharp agreement with BCG, (2023). BCG surveyed what most motivates financial institutions to address climate change. The findings are reflected in exhibit 3.1 below.

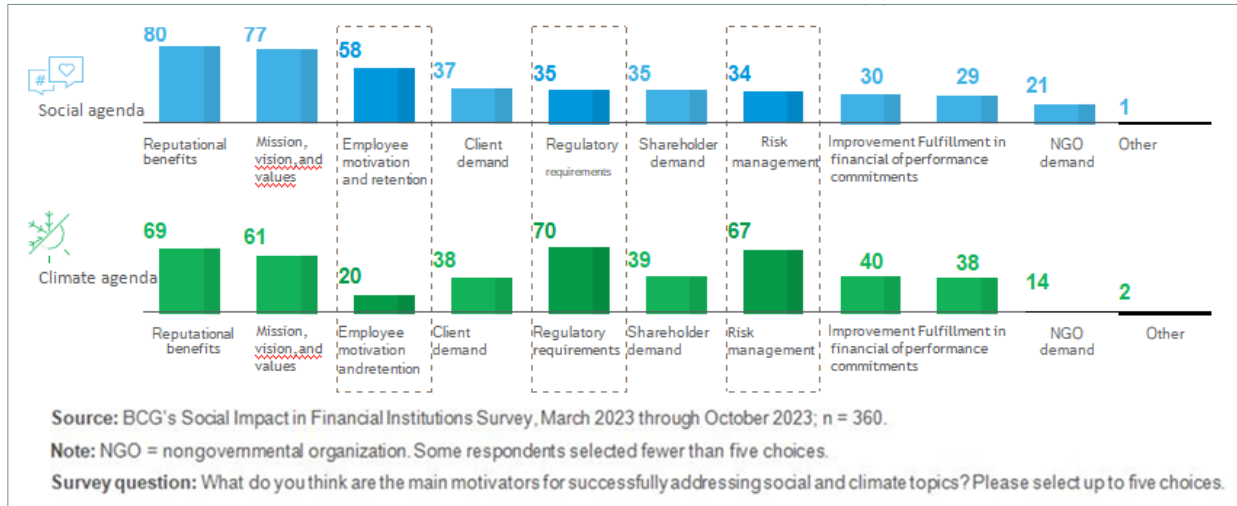
Exhibit 3.1: Motivators for tackling Climate Change and Social Issues.**Respondents who ranked these motivators among the top five (%)**

Exhibit 3.1 shows that regulation and risk are much bigger motivators for addressing climate change than they are for tackling Social Issues.

3.3 Reputational risk

Reputational risk, for the purposes of this paper describes the risk of damage to image or negative perception of an entity's brand due to inaction or inappropriate action related to ESG issues or concerns (AfDB, 2023). The risks can result from various sources such as media exposure, stakeholder activism, legal action, or regulatory changes. One can thus say ESG reputational risks can result in loss of stakeholder trust, legal and regulatory scrutiny and ultimately, damage to the financial institution's finances. Where financial institutions do not measure up to their ESG pledges, they can be accused of green washing.

Greenwashing is making ESG green claims that an entity does not live up to KPMG (2020). Greenwashing can lead financial institutions to

be accused through litigations which risk a bank's financial sustainability and reputation (BNP, 2018). In 2021 in the US for example, an NGO filed a legal complaint against Deutsche Bank, Barclays, Axis Bank, DBS Bank and Emirates NBD Bank. They were accused of green washing related to Sustainability-Linked bonds (SLB). The bonds had inadequate incentives to meet sustainability goals and had weak targets GCF (2022). Additionally, the Royal Bank of Canada's (RBC) was investigated by the Canadian Competition Bureau on grounds of false and misleading statements about its environmental policy and net zero pledges GCF (2022). The VW automobile was accused of cheating on pollution tests by modifying engine software. Greenwashing cost the German carmaker more than 32 billion euros (\$34.8 billion) in fines, refts, and legal costs. Greenwashing thus may be more damaging to a brand than technical non-compliance with ESG standards.

4.0 ESG EMBEDDING - THE FINANCIAL BENEFITS

4.1 Integrating ESG-(E) controls the IR:

According to S&P Global Trucost "Environmental Register database, 6,842 financial institutions were studied globally between 2006-2022. For each bank during a certain financial year the aggregate environmental "impact ratio" (IR) was computed as, the ratio of environmental damage costs, to total revenues. This metric-IR (%) on exhibit 4.1 quantifies the percentage of a bank's annual earnings at risk should the Bank be held accountable for environmental impacts.

Exhibit 4.1: Average IR and DISCL across Regions, (2022)

Region	% of Sample	IR (%)	DISCL (%)
Africa	3.52	0.3788	33.5712
Asia Pacific	38.54	0.2767	20.1934
Europe	18.02	0.3636	54.4767
Latin America & Caribbean	4.72	0.5181	30.7679
Middle East	5.89	0.2916	21.2821
U.S & Canada	29.30	0.2610	11.6176
Total	100		
Source: S&P Global Trucost, (2022)			

Exhibit 4.1 reports that financial institutions from the Latin America and Caribbean have the highest environmental impact (IR close to 0.52%) followed by African (IR close to 0.38%) and European financial institutions (IR close to 0.36%). It is argued that environment impact ratios (IR) are high so can severally affect annual total revenues of financial institutions, thus the need for embedding ESGs.

4.2 Integrating ESG-(S) Improves Financial Performance and Cost of Capital:

There is a proven correlation between performance on social metrics and improved total shareholder return (TSR) and reduced cost of capital (BCG, 2022)

4.2.1 Integrating ESG-(S), improves Shareholder Return:

BCG assessed financial institutions' performance in the three ESG pillars, identifying the 20% leaders and 20% laggards in each Pillar. BCG then looked at Total Shareholder Return (TSR) performance for each group.

Exhibit 4.2: Difference in Annualized TSR btn Leaders and Laggards



Source: Monthly Refinitiv TSR data and monthly MSCI ESG Pillar scores from Jan 2017 to March 2022, BCG Analysis

Note: Sustainability leaders defined as top quintile (20%) MSCI E,S&G Pillar scores. Laggards defined as bottom quintile (20%) MSCI E, S&G Pillar scores.

N= 2485 (varies based on monthly data available), All Financial sector players.

The analysis on exhibit 4.2 reveals improved TSR for leaders on all the three pillars but the greatest difference in TSR was observed between the leaders and laggards in the social metric-a difference of more than 4 percentage points.

4.2.2 Reduced Cost of Capital.

In addition, when looking at performance in social, (exhibit 4.3) the leaders had a weighted average cost of capital (WACC) that was 77 basis points lower than the laggards, BCG (2022) (3.2)

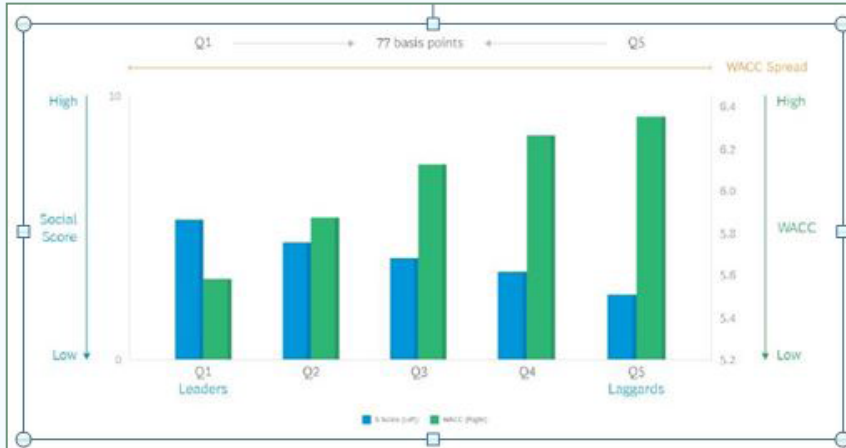


Exhibit 4.3: Lower WACC for Financial institutions that lead on Social.

Not surprisingly, most of the market capitalization (the total value of a company's shares of stock) in ESG scoring companies is in ESG related investments as shown on exhibit 4.4.

Source: MSCI Social score; Refinitiv Eikon WACC; BCG (2022) Analysis

Note: Leaders, defined as top 20% & Laggards as bottom 20% in each category

N 1,168

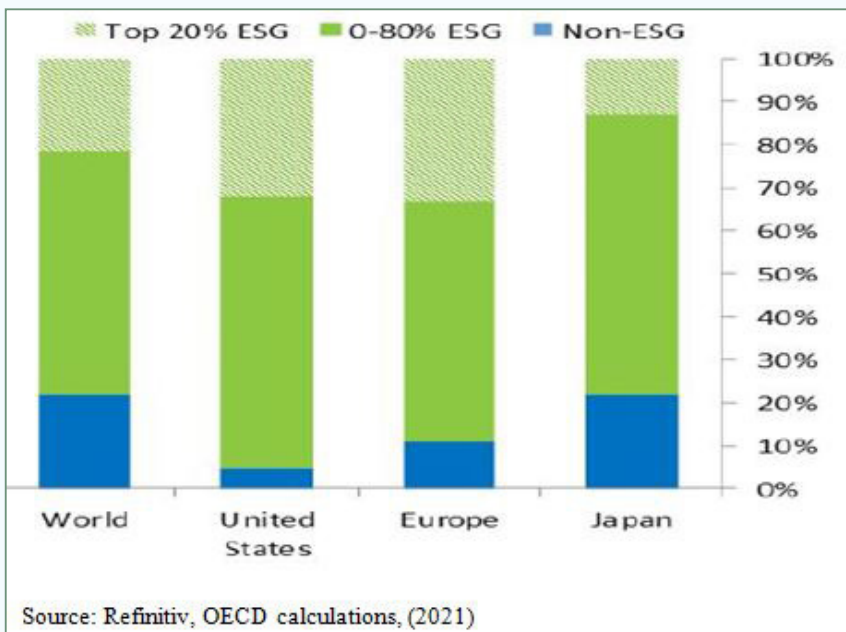


Exhibit 4.4: Market capitalization as share of ESG by region, 2021.

The market capitalization of all ESG scoring companies represents 78% of the total market capitalisation in the world, 95% in the US, 89% in the EU, and 78% in Japan (OECD, 2021).

This implies that integrating ESG into investment decisions is the new normal. A high market capitalization in ESG is crucial since it gives investors an idea of the company's size and impacts companies' ability to raise funds (Refinitiv (2021)).

Source: Refinitiv, OECD calculations, (2021)

5.0 HOW TO EMBED ESG-(E) PILLAR INTO FINANCIAL INSTITUTIONS' INVESTMENT DECISIONS

Embedding ESG' involves three broad strategies, commonly used for integrating the Environmental pillar, but which also apply for S and G pillars (S&P Global Trucost, 2022).

5.1. Leverage Sustainable financing.

This means prioritizing loans and other lending instruments for companies with sustainability and ESG as a strategic commitment. Responsible lending sends a strong message to businesses looking for capital access. A comparative analysis below offers valuable insights of best practices to foster sustainability.

Exhibit 5.1: Sustainable Financing strategy- Selected Entities in Africa, 2022

Country	Bank/ Entity	Sustainable Finance Initiative	Investment	ESG project
S.Africa	Nebbank	Corporate Green bond	1.7 billion Rand (approx. \$12m)	Renewable energy & energy efficient projects
Rwanda	Rwanda Government	Rwanda Green Fund (FONERWA)	\$ 130m	Renewable energy Sustainable agriculture & waste management
Kenya, Uganda & Tanzania	M-KOPA Solar Company	Sustainability-Linked debt Financing	\$ 120m	Access to clean energy for: lighting, charging phones & powering small appliances Now, testing electric motorcycle.

Source: Sustainable Finance Initiative, 2022

Exhibit 5.1 exemplifies successful sustainable finance models in Africa.

Exhibit 5.2 gives us lessons from the most sustainable bank in Europe (**BBVA**) for the 4th consecutive year in 2023, according to Dow

Jones sustainability Index (DJSI) and the second worldwide (Andrea, 2023)

Exhibit 5.2: BBVA Bank Sustainability Strategy

Region/ Country	BBVA Bank's Sustainability Strategy	
	Current	Planned
Europe -Spain- (Madrid)	-Financing sustainable infrastructure; agribusiness, financial inclusion	-Reduce emissions in oil & gas, by 30% by 2030.
	-Green lending portfolios by setting targets for carbon intensive industries. e.g. oil & gas	-No financing coal driven Companies by 2030
	Reduced emissions in power generation by 4% by supporting renewable energy	-Invest EU550 million in social initiatives to support inclusive growth.
	-Focus on electric and hybrid vehicle manufacturers -Prestigious LEED certification -Green building (ISO 14001 Standard) e.g. recycled material, use of rain water etc -Uses artificial Intelligence (AI) to improve energy efficiency	-Greening all corporate buildings leveraging on artificial Intelligence (AI)

Source: Kate Birch, (2023)

One can infer that, sustainability is a competitive advantage for BBVA that enables it to capture incremental business and improve risk management.

Compared to African financial institutions

Andrea, (2023) reflects the following practices for the most sustainable financial institutions in Africa in 2023, from which other financial institutions can pick a leaf.

Societe Generale (SocGen) bank is on the forefront of Micro finance solutions for financial inclusion and sustainable infrastructure financing (e.g., wind & solar plants). **Absa Group** participated in sustainable infrastructure projects e.g., the \$558 million renewable energy project for Eskom and offered Sustainability-linked, debt package e.g., for mining specialist Harmony (AfDB, 2023). **TDB BANK** pioneered the use of blockchain technology to facilitate trade finance and finances sustainable infrastructure projects.

The **Rand Merchant Bank** pioneered issuance of a gender-linked bond in Africa and participated in structuring gold-producer, Pan African Resources 800 million rand in SLB in local currency and green bond issuance of 1.5 billion rand (for certified green building in S.A), AfDB (2023). Finally, **Standard Bank** delivers Sustainability finance bonds and Sustainability-linked loan (SLL) in the auto industry, with 6.8 billion rands in issuance to Motus Holdings. The KPI is linked to use of road fuel (Andrea, 2023). Thus, African financial institutions like ABBVA in Europe, do offer sustainable financing solutions and other African Financial institutions can leverage similar sustainable practices including:

5.1.1 Green Loans or Sustainability linked loans.

Financial institutions can provide loans to entities investing in sustainable technologies, such as energy-efficient buildings and electric vehicles

(e.g., Kiira Motors Corporation) at lower interest rates, which enables investors to align their investment portfolios with the bank's values and sustainability goals, for example, investing in renewable energy, solar, wind, and hydroelectric power projects (UNECA, 2021).

5.1.2 Innovation into new products and Services

Financial institutions can develop the following sustainable finance instruments

(a) **Green bonds:** - are financial instruments used to fund projects that are eco- friendly (green business) and thus offer climate benefit (Sustainable Finance Initiative, 2022). An example of green bonds is the World Bank green bonds that raise funds from fixed income investors to lend to eligible projects such as renewable energy projects, pollution prevention, waste management and green building projects that seek to mitigate climate change. Green bond issuance offers financial institutions the benefit of accessing a growing pool of socially responsible investors. **However**, there is a risk of a higher ratio of NPL, since it is relatively a new field (Jaggi, 2019).

(b) **Social bonds:-** these are bonds whose proceeds are earmarked to fund a new or existing project that addresses a social issue (Social Investment Forum, 2022). Unlike normal bonds, they are not affected by interest rate risk. However, they are subject to default and inflation risk. Inflationary risk is the risk that inflation will undermine an investment's return through a decline in purchasing power (S&P Global Trucost (2022).

Social bonds face inflationary risk when their pay outs are generally based on fixed interest

rates. For **example**, if an investor buys a 30-year bond that pays a four percent interest rate, if inflation skyrockets to 12%, the bond holder loses more purchasing power with each passing year. However, an inflationary risk can be counteracted by building an inflation premium into the interest rate for an investment. For example, if a bank (lender) expects that the value of money will decline by 4% in the course of one year, they can add 4% to the rate of interest that they charge, to compensate.

(c) **Sustainability-Linked Bond (SLB):-** SLB are bonds that fund any project provided certain sustainability improvements are met, such as reducing emissions by a set amount within a predetermined deadline (Global Trucost, 2022). This implies that the use of funds or proceeds is not restricted to green businesses alone. That said, SLB has the potential to drive market actors in all sectors towards transition (sustainability) goals. SLB for example can be issued to an oil company to improve its emissions. Thus, SLB does not come with a loss of control over budget expenditure, unlike green bonds (UNECA, 2021). **However**, KPI tend to be inconsistent since are determined by the issuer. But in all, SLBs attract investors to raise ESG standards.

(d) **Transition Bonds:-** These are bonds which aim to fund shifts by companies to have a lesser impact on the environment (UN, 2023). Unlike green bonds where the focus is on the direct use of the debt proceeds for environmentally friendly projects, transitional bonds focus on an Issuer's commitment to becoming green(er). For example, a coal-mining firm may issue a transition bond to finance efforts to capture and store carbon. Transition bonds, thus focus on helping a company progress towards its decarbonisation goals. However, funders of

transition bonds risk transition washing. Transition washing is when sustainable finance is used to fund carbon-intensive companies that do not use the capital to pivot their businesses away from fossil fuels.

Exhibit: 5.3 Global Bond Issuance, in billion \$

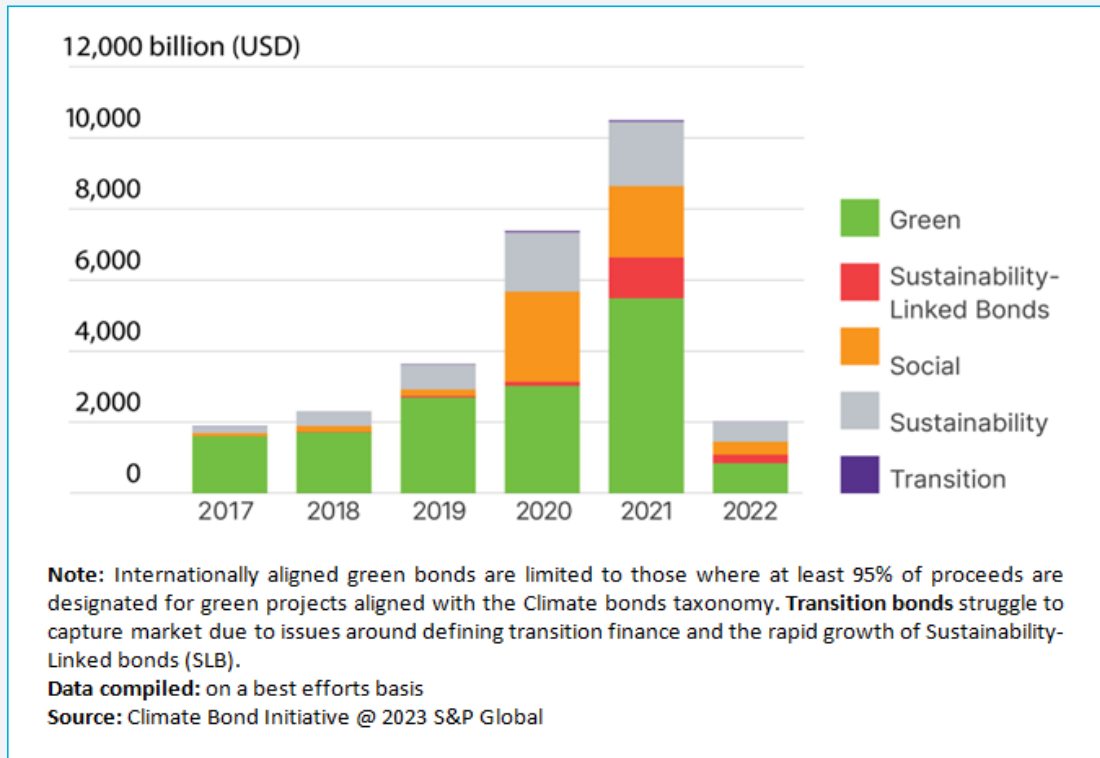


Exhibit 5.3 shows green bonds lead sustainable debt market issuances, but growth in SLB should not be ignored.

5.2 Operational Efficiency

Financial institutions can pursue operational efficiency ESG strategies. For example, Wells Fargo Bank in the US entered into a 20-year renewable energy purchase agreement with Florida-based NextEra Energy Resources. Under the agreement, Wells Fargo Bank will consume 100% of the solar energy produced (Climate Bonds Initiatives, 2023).

Similarly, Jaggi (2019) analysed the most adopted operational efficient practices in Green Indian financial institutions and indicates the following:

Exhibit 5.4: Green Operational Efficiency in Indian Financial institutions.

Exhibit 5.4 indicates leveraging renewable energy, Solar ATM and Green bonds. According to Jaggi (2019), Solar ATM are efficient than conventional ATMs that use more energy. Green bonds are issued at lower interest rates, so tend to have better yields than conventional types of debt, Andrea (2023). Thus, **financial institutions in Africa** can borrow a leaf from the Indian sustainability approach in addition to the following:

Region	Bank	Efficient Green Banking	Purpose
India	SBI Public sector	Green building standards:-e.g. use of renewable energy (Solar) Energy efficient lighting (LEED) Public transportation system	Efficiency & Environmental sustainability
	HDFC	Eco –Vehicles and green communication (online)	Efficiency & Environmental sustainability
	ICICI Private Sector	Mobile and Online-banking Green Channel Counters (e.g. internet-banking)	Efficiency & paperless banking. Paper-based banking to card-based green banking.
	IndusInd	Solar ATM Green Credit Cards	Biodegradable credit card materials. Efficiency & paperless banking
	EXIM Bank	Green Bonds	Support to renewable energy projects

Source: Jaggi (2019)

(a) Adopting the Principles of LEED-certified green buildings:-

This involves using renewable energy-efficient lighting, motion sensors, sewage treatment facilities for recycling wastewater, rainwater collection systems and recycling of dry waste.

(b) Adopting Green Savings Accounts:-

Financial institutions can make green donations (e.g., energy-saving technology- fluorescent lighting), based on the amount saved by customers.

(c) Leveraging Digital Transformation:-

Such as blockchain, artificial intelligence, and data analytics can enhance efficiency in sustainable finance practices (Brainy Insights, 2022). Digital transformation also supports the use of Green Credit Cards, ATMs with Special Touch Screens and Paperless transactions.

5.3 Sustainable/Responsible Investing

It is investing in companies based on their ESG integration rate. The following strategies may be leveraged (HSBC Global Research, 2022).

Exhibit 5.5: Globally applied Sustainable Investment Strategies

Sustainable Finance Strategy	Description	Example
Norms-based Screening	Screening of investments against minimum standards issued by UN, ILO, OECD, and NGOs (e.g., Transparency International).	ISO-14001
Negative/ Exclusionary Screening	Exclusion from a fund, based on activities considered harmful or not investable	No weapons and or tobacco
Positive Screening	Investment in entity selected for positive ESG performance relative to industry peers.	The 10% best regarding ESG criteria
ESG integration	Integration of ESG aspects into traditional financial analysis	In-house research by institutional investors
Impact/community investing	Impact comes first	Investing in marginalised communities
Corporate engagement & Shareholder action	The use of investor rights and influence to protect and enhance overall long-term value for clients and beneficiaries.	Shareholder resolution
Thematic investing	Specific sustainability-themed investment	Clean tech Fund

Source: HSBC Global Research, (2022)

The performance of sustainable investing strategies across regions is shown on Exhibit 5.6

Exhibit 5.6: Proportion of sustainable investing assets by strategy & region 2022



Source: HSBC Global Research, (2022)

2022 BILLIONS

	EUROPE (EUR)	UNITED STATES (USD)	CANADA (CAD)	AUSTRALIA & NEW ZEALAND (AUD)	JAPAN (YEN)	GLOBAL (USD)
Impact/community investing		\$19	\$9	\$34	¥499	\$55
Positive/best-in-class-screening		\$264	\$43	\$104	¥23,108	\$574
Sustainability themed investing		\$136	\$99	\$199	¥27,643	\$598
Norms-based screening		\$0	\$284	\$138	¥170,903	\$1,807
Corporate engagement and shareholder action		\$2,977	\$880	\$883	¥431,194	\$8,053
Negative/exclusionary screening		\$724	\$623	\$712	¥243,050	\$3,840
ESG integration		\$693	\$980	\$879	¥401,686	\$5,588
Total (net)*	€12,410	\$8,400	\$3,014	\$1,680	¥493,598	\$30,320

Exhibit 5.6 shows that the largest sustainable investment strategy globally is corporate engagement and shareholder action, with a combined USD8.06 trillion in AuM. Community investing is still low. The figure suggests that diversifying sustainable strategies is the new normal and there is potential to leverage on them. Exhibit 5.7 reinforces the idea that sustainable investment can be leveraged to improve a financial institution's asset base.

Exhibit 5.7: Proportion of Sustainable Investing Assets relative to Total Managed Asset, 2014-2022.

On exhibit 5.7 the proportion of sustainable investing relative to total managed assets continued to grow strongly in Japan, increasing from 24% to 34%.

In contrast, the United States and Canada reported a lower proportion of sustainable investing assets relative to total managed assets for 2020 to 2022.

This reflects significant changes in the research methodology in these regions (UN, 2023).

The decline in Europe, from 42% to 38%, is explained by increased regulations and a subsequent move to more conservative fund labeling and reporting.

6.0 HOW TO EMBED ESG - (S,PILLAR) INTO FINANCIAL INSTITUTIONS' INVESTMENT DECISIONS

According to BCG (2023), the objective of the bank should guide which social topics should be advanced for sustainability. A bank may aim to manage risk, drive commercial benefits, or create positive impact. In its survey, BCG asked respondents to select the top 5 out of 20 social topics financial institutions should address for each objective. (See exhibit 6.1)

Exhibit 6.1- Financial institutions Should Address Different Social Topics Depending on Their Objective

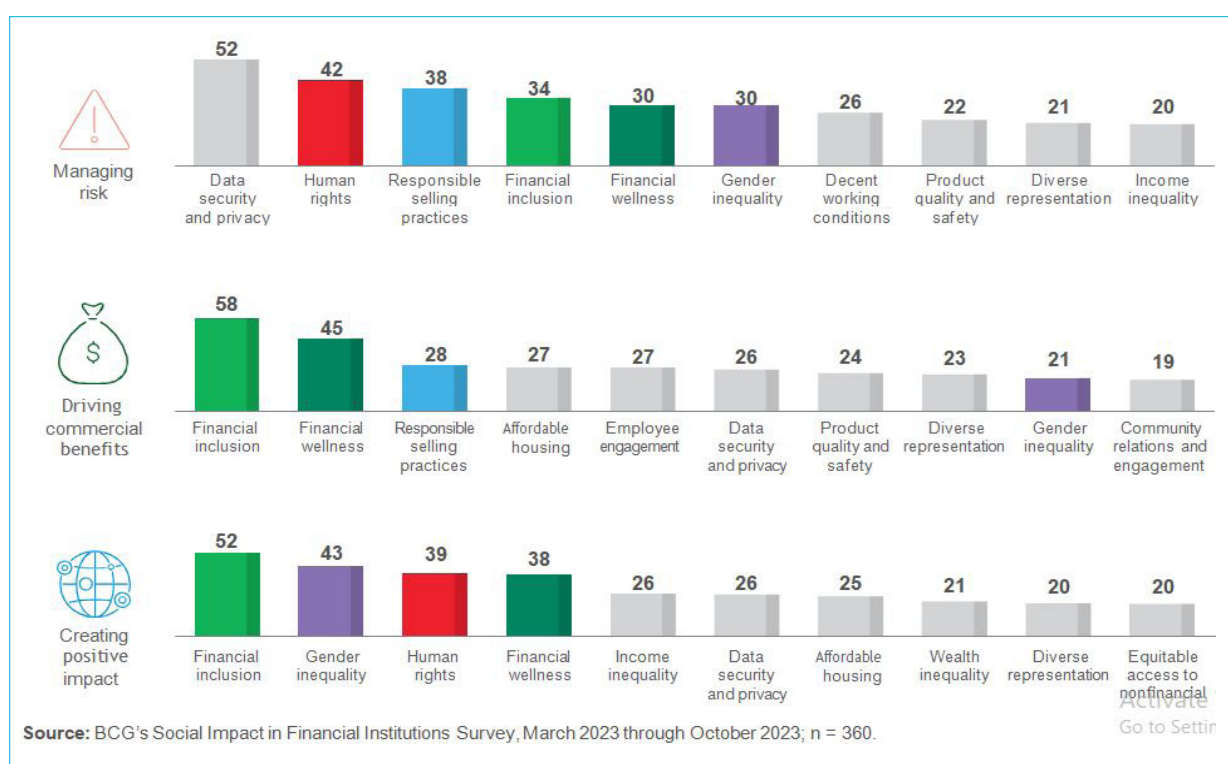


Exhibit 6.1 shows that financial inclusion and financial wellness are high priorities for each objective. **Anchoring on BCG (2023)**, financial institutions can embed ESG- 'Social' by focusing on financial inclusion among other social topics. Financial inclusion can be advanced by **expanding access to credit for small businesses and offering other financial services to marginalised communities.**

However other than the **environmental goals that are clear**, (e.g., net zero carbon), and set out by regulators, it is difficult for investors to know what exactly falls within the remit of the "S" indicators (Brainy Insights, 2022). For example, in the USA, provision of healthcare benefits and diversity are particularly important issues, whilst in other countries, forced labour and corruption issues receive more attention (Brainy Insights, 2022).

7.0 HOW TO EMBED THE GOVERNANCE PILLAR IN FINANCIAL INSTITUTIONS' INVESTMENT DECISIONS

Clear control mechanisms must be anchored in the lending process: ESG factors have to be checked and assessed in the course of lending. This means that assessments must not only be implemented initially when granting loans, but also recurring regularly (UNECA, 2021). Bank management may also increase disclosure of ESG information.

8.0 CONCLUSION

Despite existing challenges, sustainable finance initiatives offer tremendous potential for fostering sustainable banking. The issuance of green bonds and the development of sustainable investment products offer avenues to mobilize capital for green projects. However, financial institutions need to remain profitable to be sustainable, and finding the nexus between profitability and sustainability is vital for sustainable banking. The paper has **practical implications**. First, policymakers should develop clear regulatory frameworks that guide sustainable finance practices on reporting standards, disclosure requirements, and risk assessments related to ESG factors. Second, financial institutions should request investors to produce an **EIA report**, before financing projects. Third, capacity building programs should be implemented by financial institutions to foster innovation in sustainable finance. Lastly, educational institutions should integrate sustainable finance principles into curricula, to prepare future generations for sustainability.

BIOGRAPHY:

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