

# **Sustainable Finance**

The Contribution of  
Private Banks



# Climate protection and sustainable economies: challenges for our society

Combatting climate change is one the most pressing tasks of our time. If humanity does not take action now, it is facing an average global temperature increase of around 3.2°C by 2100.<sup>1</sup> A temperature rise of this magnitude would have disastrous consequences for the environment, the economy and the whole of society.

Persistent periods of drought in Central Europe, more frequent and increasingly powerful storms in the Caribbean, widespread fires in the Siberian tundra – these and other recent phenomena provide a vivid illustration of how climate change is already impacting the environment today. And this has consequences for the economy and society: rising sea levels, for example, threaten our innovative and burgeoning coastal regions. Thanks to the changing climate, the distribution of important resources such as water are already becoming a source of conflict; social tensions are only likely to increase in future. This means that if we want to continue living as we have done, we must achieve the aims of the Paris Climate Agreement, but also make a tangible contribution to meeting the UN’s Sustainable Development Goals (SDGs).

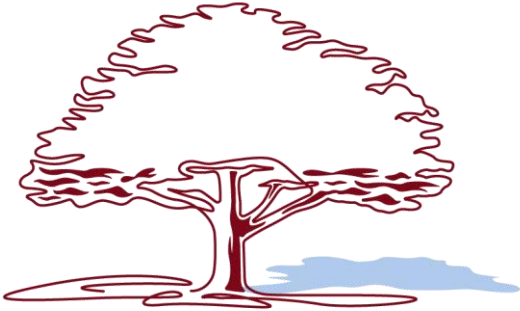
---

*The aims of the Paris Climate Agreement must be achieved.*

---

But we must not stop with climate protection, we must also keep an eye on other aspects of environmental protection, such as biodiversity or waste prevention, as outlined in the SDGs. There is also an increasing focus on aspects of social equality, protecting human rights and sustainable corporate governance.

This position paper shines a light on the role of private banks in sustainable finance and, more specifically, in climate protection. It aims to show where the industry currently stands, what major challenges it faces and what private banks are planning for the future.



This summer, the Association of German Banks conducted an extensive survey of its members. The main thrust of the questionnaire was to discover how important this topic is for individual banks, where they stand in terms of implementation, what risks they see and how they are dealing with those risks. This paper highlights some of the key findings from the survey.

---

<sup>1</sup> Climate Action Tracker, December 2019.

## The role of private banks in Germany

The Association of German Banks has 170 institutions among its members, ranging from small specialist banks to global universal banks. It also counts among its members other companies, including several fintechs, whose specialist knowledge and experience provide valuable insights for our committee meeting discussions. This structure, which has grown and established itself over the years, provides an ideal platform for embedding such an important and all-encompassing topic as sustainable finance<sup>2</sup> in companies' business strategies and processes across the board, and establishing it as a banking industry standard.

# 50%

of those surveyed are anticipating a tangible impact from climate change on their institution in the next 10 years. 39% are even expecting serious consequences.

One key area of sustainable finance is climate protection. Germany's private banks believe it is vital that the economy achieves greenhouse gas neutrality by 2050. The aim must be to sustainably limit global warming to below 2°C, in accordance with the Paris Climate Agreement.

The financial industry and private banks have a key role to play in achieving this aim because they have control over an important tool. They are financing the economic transformation, thus making an essential contribution to achieving global and national climate goals. Apart from the Paris Climate Agreement, they are also guided by the Sustainable Development Goals of the UN's 2030 Agenda and by the aims of the Principles for Responsible Banking.

---

*The financial industry has an important role to play in the social and economic transformation.*

---

In order for private banks to fulfil this key role properly and achieve the desired objectives, the following steps should be taken.



---

<sup>2</sup> Sustainable Finance means establishing a financial economy based on sustainability.

**The Association of German Banks intends to sensitise all its member banks to sustainability and especially climate protection. Both aspects should play an even greater role in business strategy, corporate governance and business processes than it has done to date.**

The landscape of private banking in Germany features a wide variety of business models, regional focuses and ownership structures. Alongside globally operating banks, there are also many medium-sized institutions that are firmly established in their regions, often with a long company tradition, who see themselves as having a particular responsibility for their business regions. Internationally positioned banks offer a different range of services – but all banks are affected by the issues of sustainability and climate change in one way or another.

The private banking industry as a whole has been the source of many important incentives for climate protection in recent years. Member banks have been quick to get involved in international initiatives, for example, in helping draft the UN Principles for Responsible Banking, thus assuming a pioneering role. The association benefits from this expertise and the international positioning of its member institutions and, as a result, can draw on their experiences in other countries. Our aim is to coordinate and interlink these activities more closely, with a greater focus on climate protection implementing sustainability criteria.

**65%**

**of surveyed banks thought that sustainability would become a very important topic in the next 5 years. 19% thought it already was.**

The association has already taken important steps in recent years to emphasise the importance of sustainability to its members. By setting up specialist internal committees and working groups at European level within the framework of the European Banking Federation (EBF) and the International Banking Federation (IBFed), the association has ensured that banks have been able to relate to and factor in the most important developments in sustainability generally and in climate protection specifically.

As a consequence, all our member banks now place a greater focus on sustainability. The implementation of the Corporate Social Responsibility (CSR) Directive in German law has undoubtedly contributed to this. The law obliges financial institutions with 500 or more employees to provide non-financial statements giving information about their policy on, among other things, environmental matters. This has made banks even more aware of the importance of this topic.

The Association of German Banks is acutely aware that this is only the first step of many.

---

*We want all our member institutions to be enthusiastic about sustainable finance.*

---

In order to further raise awareness of this issue and ultimately convince all member institutions of its relevance, sustainable finance will feature far more frequently on the agendas of the association's main committees. The same applies to the information platforms which are aimed at medium-sized and foreign members of the association.

Given the broad consensus across society on the need for climate protection measures and an accompanying pressure to act quickly, the financial industry cannot afford to wait for further regulatory steps. The Association of German Banks therefore calls on its members to act now. Any regulation in this area should be viewed not as a threat, but as an incentive to be among the first movers and come up with good ideas.

**The challenges surrounding sustainable finance need to be addressed efficiently. Together with its members, the Association of German Banks is developing a standard understanding of sustainability and is working on practical solutions.**

Sustainable finance and thus the financing of climate protection measures is to a large extent relatively uncharted territory with a number of open and often urgent questions for policymakers, regulators, non-governmental organisations and, of course, banks. We should respond by all pulling together despite the competition in the industry in order to ensure that the emerging framework conditions can be put into operation in a timely manner and to establish a common, industry-wide understanding of the market. The planned typology for sustainable financial instruments that is being developed jointly by the German Banking Industry Committee (GBIC), the German Investment Funds Association (BVI) and the German Derivatives Association (DDV) is a first step towards achieving this.

In addition, Germany's private banks will step up their submission to regulators of proposed solutions to certain aspects of financing climate protection and seek dialogue. It is important to involve as many private banks as possible in this process and to make sure small and medium-sized institutions receive particular support.

---

*The Association of German Banks can deliver added value by acting as a platform for the exchange of ideas.*

---

The Association of German Banks is therefore expanding its sources of information for members. In addition to tried and tested formats such as the Communication Forum for SME Banks and the Dialogue for Small and Medium-sized Banks, the association's training and education arm, the Banking Academy, is planning to offer a new range of seminars.

On top of that, the association and its members are preparing additional implementation and interpretation guidance for the area of climate protection/sustainable finance. This actively supports the development of good practice.



**Many private banks are sensitising their staff to sustainable finance issues – especially with respect to climate protection. This enables them to provide customers with appropriate and targeted advice. Customers are then able to make investment decisions which are good both for themselves and for the environment while paying due regard to climate aspects.**

Customers are extremely interested in the issue of climate protection, as a large number of surveys have shown. Despite this interest, there is a great deal of uncertainty about how customers can best invest their money in projects aimed at protecting the climate and about where potential risks may lie. Private banks therefore lay great importance on providing their clients with suitable information on the subject of climate protection, be it in the context of investing in shares, financing businesses or buying real estate.

Bank advisers are available to clients so that they are in a position to consider long-term climate protection trends and make the right decisions in future. This is particularly true in the area of corporate finance, where the viability of many business models will be put to the test by changing customer demand and wide-ranging legislation on environmental and climate protection.

**70%**  
of surveyed banks want sustainability to become part of their professional training programme in the next 5 years. 33% already include it.

To ensure banks are able to discharge their advisory responsibilities appropriately, the Association of German Banks is planning to expand its training programme for the staff of private banks. In cooperation with the Banking Academy, the association is developing special formats for this purpose.

---

*Education is key. This applies both to society as a whole and to customer advisers in banks.*

---

Transparency and the promotion of basic knowledge among the general public are also major concerns. The Association of German Banks has for many years been committed to improving school students' knowledge of economics. The association's activities in this area are to focus even more on the issue of climate protection and sustainability.

**Private banks are developing products that will make an active contribution to sustainability and especially to climate protection.**

Given the European and national climate protection legislation that has already been passed or is underway, we will continue to see strong growth in the demand for tailored products to finance transformation processes in companies, in particular. Private banks already offer a wide range of products, from sustainability-linked loans, green bonds and green promissory notes to sustainably managed funds.

The private banks are constantly refining their existing range of products and designing new ones that will enable customers not only to survive transformation processes but to emerge from them stronger.

---

*The range of products is broad and includes green promissory notes, green bonds, ESG funds, development loans and sustainability-linked loans.*

---

**Private banks segment their loan and investment portfolios to identify the customers with the highest CO<sub>2</sub> emissions. They consider sustainability criteria that go beyond climate protection. Methods for managing the portfolios are developed and integrated into business processes. This enables banks to gear their business to achieving the two-degree target in 2050 and support customers in the transformation process.**

In the past, CO<sub>2</sub> emissions did not play much of a role when granting loans so there is little relevant data available, especially when it comes to small and medium-sized enterprises. For this reason, private banks are now working hard to better understand the climate impact of their customers' businesses.

The first step is to break down loan and trading portfolios by industry. This enables banks to focus on the sectors that emit the most CO<sub>2</sub> (e.g. energy producers, manufacturing industries, transport and mobility, the construction industry). Some private banks are already able to use models to determine the carbon footprint of their customers. Others are still in the process of selecting suitable models. Our aim is to ensure that it is standard practice for all our member banks to measure the CO<sub>2</sub> emissions associated with an activity financed by a loan. The fundamental principles of materiality and proportionality should figure prominently in the process.

---

*Banks want to reduce the CO<sub>2</sub> burden of their portfolios. The proportion of environmentally sustainable economic activities will significantly increase.*

---

On the basis of these results, banks can then define criteria for new business which will help them gear their portfolios to meeting the 2°C target of the Paris Climate Agreement. These criteria should be an integral part of a bank's business and risk strategy.

Banks are already implementing various measures to support this process. Some have stopped lending to certain industries, while others set fixed and possibly phased-in caps on lending to certain sectors. There is no one-size-fits-all solution here: lending to a climate-damaging cement plant to enable it to increase its efficiency may be more effective than refusing to provide finance.

Private banks believe it is important to talk to their customers about sustainability. It is now standard practice at some banks to discuss the client's ESG rating,<sup>3</sup> if it has one.

**23%**  
of surveyed banks already use ESG ratings when processing loan applications.

Sustainability must become an integral part of discussions with customers and banks should be able to offer concrete support and advice. This applies both to lending and to investment advice.

Private banks offer a wide range of investment products that are geared towards sustainability. They firmly believe that clients want to make investment decisions in all

---

*Banks are currently seeing a moderate rise in demand for sustainable products in the securities segment.*

---

good conscience and based on sound knowledge, as evidenced by the steadily growing demand for sustainable investment products. For this reason, the Association of German Banks encourages its members to actively offer sustainable investment products and to sensitise customers to the issue and advise them accordingly.

The standards to which banks hold their customers should also apply to the banks themselves: many already follow the Principles for Responsible Investment (PRI) when investing in shares and bonds.

---

<sup>3</sup> ESG: environmental, social and governance



**Risk management is at the heart of banking. Climate change and the associated transformation of the economy will be a significant risk driver for many banks. Private banks are working to identify, measure and manage these risks. It will be a major challenge to integrate these medium and long-term risks with all their associated uncertainty into the existing risk management world.**

Private banks have high standards when it comes to managing risk: risks must be correctly measured, a distinction made between material and immaterial risk and a robust basis for management decisions ensured. This means that all the risks relevant to a bank have to be adequately taken into account. Climate risk acts as a risk driver of the major types of risk (e.g. credit risk, market risk, operational risk).



Compared with risks that can be easily modelled, such as credit risk, climate risk poses a special challenge to the financial industry: while there is broad consensus in the scientific community about the serious consequences that global warming will have for the ecosystem as a whole, the precise economic consequences for companies and consumers are currently very difficult to predict. What is more, the period over which the risk will materialise is extremely long by risk management standards.

---

*Physical and transition risks need to be correctly mapped. The length of the period to be considered and the paucity of available data represent challenges.*

---

The German Federal Financial Supervisory Authority (BaFin) and the European Central Bank (ECB) have already issued guidelines which provide valuable impetus for dealing with climate risk and raise the right questions. They do not yet offer concrete solutions, however. And it is precisely these solutions that the private banks are currently working on and will continue to work on in the future.

**1/3**  
of those surveyed currently  
monitor and manage climate  
risk.

Private banks have already started to determine the carbon footprint of their client portfolios (see above). The next step is to assess how climate change will affect individual sectors. To this end, sound and plausible scenarios need to be developed that allow conclusions to be drawn about changes to a customer's creditworthiness and thus risk of default. It is anything but easy, however, to describe a possible correlation between CO<sub>2</sub> emissions and the probability of default in such a way that useful results can be generated for risk management purposes.

---

*The default risk of a customer with high CO<sub>2</sub> emissions may, but does not necessarily have to, be high. The link between risk and greenhouse gas emissions is a question urgently needing to be addressed.*

---

The Association of German Banks, in constant dialogue with rule-makers and supervisory authorities, is committed to ensuring that risk management continues to meet the highest standards while at the same time adequately reflecting new developments in the area of climate risk. The aim is to find practicable solutions, not knee-jerk reactions.

In addition, the association has established a platform for its members to exchange views on the many methodological issues and on how the expectations of the ECB and BaFin can best be implemented.

**The Association of German Banks encourages all its members to address the United Nations' Sustainable Development Goals (SDGs) and reflect them in their actions. In future, as many of the association's members as possible should report publicly on their progress.**

The Sustainable Development Goals of the UN's 2030 Agenda<sup>4</sup> set the private banks an important standard for actively and efficiently supporting the development of a sustainable economy. Though the focus is currently on curbing climate change and its associated impacts, the concept of sustainability is not limited to overcoming the consequences of global warming and other ecological problems.

Aspects of social equality, the protection of human rights and sustainable corporate governance are playing an increasingly important role in the work of our members. The 17 SDGs and their 169 sub-targets help to underpin this approach with concrete figures which can be fact-checked by the public.

---

***The 17 sustainable development goals***  
*No poverty; zero hunger; good health and well-being; quality education; gender equality; clean water and sanitation; affordable and clean energy; decent work and economic growth; industry, innovation and infrastructure; reduced inequalities; sustainable cities and communities; responsible consumption and production; climate action; life below water; life on land; peace, justice and strong institutions; partnerships*

---

For this reason, the association's member banks should take the SDGs and their sub-targets on board and integrate them into their activities. We are aware that this process is in its infancy. Given the diverse business models, sizes and regional focuses of our members, long-term success can only be achieved by a step-by-step approach that takes account of the differences between individual banks and their internal capabilities.

---

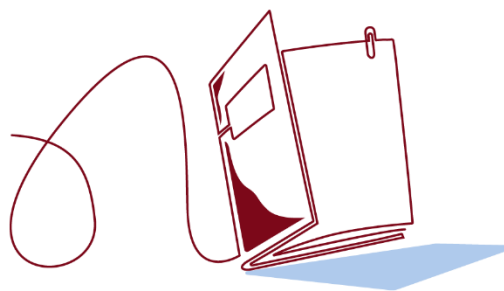
<sup>4</sup> For more information, go to <https://sdgs.un.org/goals>

**Private banks take their responsibilities seriously and are putting the necessary change processes in place to lay the foundations for a greenhouse gas-neutral economy. They want to be judged by how they measure up to their own targets. To this end, the Association of German Banks will publish regular joint reports on the progress made and obstacles encountered in this process.**

The aim of the private banks is to identify, on the basis of extensive analysis, which activities in their core business will enable them to make the greatest progress in the transition towards an economy which is greenhouse gas neutral.

In addition, the Association of German Banks will report on the regulatory steps it believes lawmakers and supervisors need to take to ensure the effectiveness of existing measures or enable the introduction of new ones. The report is intended to highlight the contribution of private banks in the field of sustainable finance and offer a basis for dialogue with relevant stakeholders. The report will also facilitate a transfer of experience and expertise between private banks and the further development of the association's sustainable finance activities.

It is important to note that the report will be prepared and published in addition to the existing reporting formats of our members. It is not intended to replace the reports of individual banks. The first report will be published for the year 2021 and will then be updated annually.



## Necessary political steps

To enable sufficient financial resources to flow into climate protection and the transformation of businesses, political framework conditions need be continuously improved. The following measures are especially important.

### Support for ESG projects

The public sector should give ESG projects more support by assuming some of the associated risk, for example. Governments could, for instance, use state guarantees in a targeted manner to assume part or all of the counterparty credit risk of loans with a focus on sustainability. Loans guaranteed in this way would not be subject to the capital requirements of the solvency regime. Guarantees would also reduce potential losses so that from an economic point of view, too, less internal capital would have to be set aside under Pillar II of the capital framework.



### Reduce capital requirements for banks

Recent years have seen a significant rise in capital requirements for European banks in terms of both quality and quantity with the aim of making the financial sector as a whole more stable and resistant to crises. On the one hand, this is right and proper because it increases the stability of the banking system. On the other hand, it means the capital thus tied up is not available for lending. Yet financing the energy transition is a mammoth task requiring an enormous amount of resources.

The private banks believe lawmakers should send a clear political signal about the importance of financing sustainable investment and sustainable consumption. We therefore recommend an across-the-board reduction of capital requirements for such loans. Sustainable loans are not low-risk per se. So there should be no link to the underlying risk of a loan of this kind. But low capital costs would increase the economic viability of sustainable investments and thus make such loans more attractive both to banks themselves and to society as a whole. It would also make it possible to mitigate the huge impact of Basel IV in a targeted manner.

## **CO<sub>2</sub> pricing**

The German government's climate protection package envisages a steady fall in greenhouse gas emissions towards a 2030 target of a reduction of at least 55 per cent compared to 1990 levels. The German Fuel Emission Trading Act lays the foundations for trading in emissions allowances and thus ensures that fuel emissions are priced in if they are not covered by the EU Emissions Trading Scheme (EU ETS). In the medium term, however, this basically correct approach to CO<sub>2</sub> reduction should be applied at European level and be integrated into an EU-wide trading system for transport and heat which is separate from the EU ETS. A fair CO<sub>2</sub> price is crucial: it will set in motion an effective steering mechanism that encourages both companies and consumers to adjust their CO<sub>2</sub> emissions.

## **Availability of data**

It is becoming clearer than ever that, when assessing sustainability aspects, the banking industry is dependent on reliable and robust data from the real economy – especially CO<sub>2</sub>-intensive sectors. This is the only way that banks can properly evaluate not only the contribution of loans to reducing CO<sub>2</sub> emissions but also the risk associated with these loans. It is vitally important to improve transparency on CO<sub>2</sub> emissions.

It is also essential to ensure that smaller companies are not unable to meet data collection requirements because of the level of detail involved. Graduated reporting requirements according to the size of a company and the amount of its emissions should be ensured. It is better to start with simple, clearly defined and standardised key indicators. This increases acceptance, speeds up the transformation and allows sustainability to become an integral part of the decision-making process.

One area with considerable potential for CO<sub>2</sub> savings is energy usage in the real estate sector. Unfortunately, however, the necessary data are not yet collected and made available in an efficient manner. As a result, banks engaged in real estate financing have no systematic way of accessing the energy performance certificates which properties have to obtain. A central online database for energy certificates along the lines of those already available in some EU member states would be a good solution. Overall, the most efficient method would be to make sustainability information that is relevant to a large number of addressees centrally available in a data register at EU level.

Accurate maps showing individual natural hazards are needed if physical risks are to be assessed. Maps of this kind are available in a geo information system financed by the German government showing the potential risks to property emanating from natural hazards (*GIS-ImmoRisk Naturgefahren*). The banking industry and business undertakings should be able to access this tool free of charge.

## Defining sustainability

The aim of the taxonomy is to allow investors and companies make well-founded investment decisions about ecologically sustainable activities. To be considered sustainable, economic activities must contribute significantly to at least one of the six environmental goals. The taxonomy was developed primarily for use by the capital markets. It cannot therefore be easily applied to bank lending.

Nevertheless, the banking industry needs clear and reliable guidelines as to what should be considered sustainable. The taxonomy must therefore be lean and practicable. It must be easy to recognise what data and information is required to meet sustainability criteria.

We should abandon the idea of introducing a system of only classifying non-ecologically sustainable activities, or so-called 'brown taxonomy'. The idea of establishing and applying a 'green taxonomy' is ambitious enough. A brown taxonomy would significantly increase the complexity of the task and send out all the wrong signals in the transformation process.

## Digitalisation

Policymakers must do more to advance digitalisation. Innovations in the area of sustainability will only succeed in the presence of a robust IT infrastructure and a practicable regulatory framework. Existing funding schemes in the field of digital infrastructure aimed at supporting the expansion of fibre optic networks throughout Germany should therefore be made even more attractive, possibly by partially exempting the financing parties involved from liability.

