Environmental, Social, and Governance (ESG) Principles in the Banking Sector: Development, Integration, and Risk Management Strategies

A case study of a Finnish banks’ approach to ESG framework

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Abstract:

This thesis investigates how banks develop, integrate, and manage Environmental, Social, and Governance (ESG) principles to address sustainability challenges and regulatory requirements. The study begins by exploring the development of ESG principles within the banking sector, examining how these principles have evolved and been defined over time. It continues with integration of ESG principles, focusing on practical strategies and methods that banks employ to incorporate ESG into their operations. Finally, the research addresses ESG risk management and compliance, highlighting the importance of adhering to regulatory frameworks. Through a combination of interviews with industry professionals and an extensive literature review, the study provides a comprehensive view of ESG practices in banking. The findings emphasize the necessity for banks to add ESG considerations into their governance structures and decision-making processes to foster sustainable change and societal impact. Additionally, the research reveals the significance of developing clear and consistent ESG standards to facilitate better implementation and compliance. The thesis concludes by explaining the study's limitations and recommending further research to broaden the understanding of ESG in the banking sector. It suggests incorporating quantitative methods and examining the long-term effects on financial performance and stakeholder perceptions to help banks in navigating sustainability challenges and regulatory requirements.

Keywords:

ESG Integration, Banking sector, Sustainability, ESG development, ESG integration, ESG Risk Management, Regulatory landscape

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List of Abbreviations

AIFMD	Alternative Investment Fund Managers Directives
BTAR	Banking Book Taxonomy Alignment Ratio
BIL	Banque Internationale à Luxembourg
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CRS	Corporate Social Responsibility
CSV	Creating Shared Value
EBA	European Banking Authority
ECB	European Central Bank
ESG	Environmental, Social and Governance
ESGT	Environmental, Social, Governance, Technology
GAR	Green Asset Ratio
IFC	International Finance Corporation
KPI	Key Performance Indicator
KRI	Key Risk Indicator
NFRD	Non-Financial Reporting Directive
MI	Management Information
QDA	Qualitative Data Analysis
RCSA	Risk Control and Self-Assessment
SRI	Socially Responsible Investing
SFDR	Sustainable Finance Disclosures Regulation
TEG	Technical Expert Group
UCITS	Collective Investment in Transferable Securities

1 Introduction

1.1 Background

This thesis focuses on the topic of implementing Sustainable Banking principles using the Environmental, Social and Governance (ESG) framework. The ESG framework helps understanding an organization's approach to handling risks and opportunities associated with environmental, social, and governance considerations, also referred to as ESG factors. The European Banking Authority (EBA) defines ESG factors as follows: “ESG factors are environmental, social and governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual” (EBA, 2020, p.1).

In recent years, mainstream banking has undergone significant changes, incorporating environmental and social considerations into its regular operations. This shift towards ‘sustainable banking’ has been prompted by increased investment in projects that benefit the environment and society in the long term. The International Finance Corporation suggests that sustainable banking may include environmental and social risk management, green lending, and reducing banks' own environmental footprint. While the emphasis on these components may vary, sustainable banking is seen as a broader concept than green banking, which primarily focuses on environmental concerns. While there is no formal definition of sustainable banking, international authorities generally agree that it involves directing financial resources towards economic sectors while also considering ESG issues. Banks have various motivations for adopting sustainable practices, including attracting customers, managing ESG risks, avoiding reputational damage, and aligning with ethical principles. Regulatory frameworks and action plans at the European and international levels are also driving banks towards sustainable practices (Ziolo, 2020).

Shastry (2023), describes that governments play a crucial role in leading climate change initiatives, as seen in the United Kingdom's ambitious policies like the net-zero carbon target by 2050, increased offshore wind capacity, and the phase-out of petrol and diesel cars by 2030. These efforts are significant given the political and economic challenges of Brexit and the COVID-19 pandemic, highlighting the UK's resilience and commitment to climate action.

Even though renewable energy is growing, the pace is insufficient for an early transition, and natural gas, considered a ‘bridge fuel’, has its own environmental drawbacks. The global climate discourse often races ahead of actual commitments, with countries like China still heavily reliant on coal. A viable energy transition requires substantial financing, technological shifts, and a focus on people-centered approaches, as highlighted by the World Economic Forum and the International Energy Agency. Just as governments need to contribute to climate change, corporate leaders must integrate non-financial metrics, such as environmental and social impacts, into their strategies to make significant progress. The role of business in reducing carbon intensity is critical, as maintaining the status quo will not suffice for meaningful climate action (Shastry, 2023).

The European Commission has outlined the environmental, social, and governance aspects that banks should consider, including climate change mitigation, social issues like gender equality and labour relations, and governance structures within banks. The European Banking Authority emphasizes the integration of ESG criteria into financial services, supporting sustainable economic growth, and managing ESG risks. The International Monetary Fund also advocates for the incorporation of ESG principles into banking strategies to promote economic development (Ziolo, 2020).

In a period of commercial lending that is focusing on ESG issues, banks are taking on a critical role by financing projects that aim to incorporate these concerns. Similarly, companies as they disclose their strategies to investors, must decide which projects to pursue and seek financing based on their materiality (i.e. principles which leaders apply to understand which ESG issues to prioritise in their organization's strategy) and other factors. Additionally, companies seeking capital from banks for ESG-related projects need to understand the factors that can influence lending terms and raise funds effectively. As pressure grows on companies to undergo transformation, banks have introduced new lending products to support sustainability, net-zero initiatives, and social goals. Over the past few years, three main types of loans have emerged, aligning more closely with values based or ESG principles than in traditional lending. These include Green Loans, which support environmental objectives like carbon reduction and renewable energy projects; Social Loans that address social issues such as affordable housing or employment generation; and Sustainability-linked Loans that aim at meeting sustainability goals in exchange for favourable lending terms, although they may not directly contribute to ESG improvements or innovations. While Green and Social Loans focus on specific objectives,

Sustainability-Linked Loans are tied to agreed-upon ESG metrics. Companies are increasingly leveraging these types of loans; however, it can be challenging to determine whether ESG projects are receiving funding through Sustainability-Linked Loans or if the focus is solely on meeting metrics to improve loan terms. Overall, the evolving landscape of ESG-focused commercial lending presents opportunities for companies to finance projects that align with their sustainability goals and contribute to positive social and environmental outcomes (Sekol, 2024).

Ziolo (2020) indicates that, to transition towards sustainable banking, banks must adjust their governance, business models, and services. A sustainable business model involves financial viability, positive economic contributions, environmental stewardship, and social welfare. A step-by-step approach is recommended for banks to integrate sustainability into their strategies, including assessing current capabilities, identifying priority areas, and designing new financial products. Once committed to sustainability, banks need to establish internal ethical policies and standards for customers, ensuring transparency and accountability. By adhering to these principles, banks can achieve success in their sustainable mission while contributing to positive societal and environmental outcomes.

When talking about Finnish banks specifically, they contribute to sustainability through various measures, including investing in renewable energy projects, promoting socially responsible financing, and integrating sustainable practices into their business strategies. Finnish banks also actively report their progress and commitments towards sustainability in their Sustainability Reports. These reports provide transparency to stakeholders about bank’s commitment to sustainable practices and cover areas such as carbon footprint reduction, responsible lending and investment, community engagement and efforts to promote diversity and inclusion within the organisation. These efforts collectively contribute to Finnish banks’ commitment to sustainable development and environmental governance within the banking sector. By incorporating sustainability considerations into their strategies, Finnish banks contribute to the transition towards a greener economy. That way their actions align with the environmental preservation and responsible resource management, thus facilitating the shift towards a more sustainable and environmentally friendly economic model (Bank of Finland, 2023).

Despite the growing emphasis on sustainability, a significant gap remains in the comprehensive understanding and implementation of the ESG framework within the banking sector. According to Shastry (2023), banks are struggling to effectively define, develop, integrate, and manage ESG principles, which is crucial for addressing pressing sustainability challenges and meeting regulatory requirements. The lack of a holistic ESG approach slows the ability to align with global sustainability goals, respond to stakeholder expectations, and mitigate financial and reputational risks associated with inadequate ESG practices. The need for a robust and integrated ESG framework is further emphasized by the increasing regulatory pressures and the complex nature of sustainability issues that banks must navigate. Therefore, a detailed examination of ESG integration strategies is essential to guide banks in enhancing their sustainability performance and regulatory compliance (Shastry, 2023).

1.2 Motivation for choice of research topic

According to the EBA (2021), the internal structures, policies, and practices of banks, as well as their general ways of working, can have a significant effect on the various players in the financial industry. Strong governance is essential for ensuring ethical conduct, risk management, and accountability. By incorporating good governance practices, banks can enhance transparency, align with regulatory requirements, and minimize legal and compliance risks. Overall, through the application of the ESG framework, banks can achieve long-term sustainability, mitigate risks, enhance stakeholder trust, and contribute to a more sustainable and inclusive society.

Sustainability also becomes increasingly important in the face of environmental challenges where banking sector is an important player with the potential to drive positive change. The choice of research topic is influenced by my work within the banking sector, where I have developed an interest in the advancements in ESG practices. Despite not being directly involved in ESG initiatives, I intend to explore this subject further. Thus, my decision to investigate the development of sustainable banking strategies, specifically focusing on the ESG framework, is driven by a profound curiosity about the future landscape of the financial industry. Furthermore, my personal commitment to sustainability and inclusivity motivates me to understand how the implementation of the ESG framework can guide banks toward long-term sustainability objectives while also fostering trust among stakeholders.

1.3 Aim of the study

The topic of integrating sustainable banking principles through ESG framework provides an opportunity to explore practical solutions for the banking industry to drive positive change and create a sustainable future. The study seeks to identify the evolving role of banks in addressing societal issues, integrating sustainability factors into risk management and financing strategies, and promoting collective action and stakeholder engagement. The study aims to provide insights that can guide banks in effectively navigating the complexities of ESG integration and management. By understanding the development, integration, and management of ESG principles, banks can address sustainability challenges and regulatory requirements while also enhancing their long-term resilience and value creation. Through this study, the aspiration is to contribute to the creation of a more transparent, responsible, and inclusive financial system that benefits society.

1.4 Research Question

This study aims to answer the following research question: "How can banks effectively develop, integrate, and manage Environmental, Social, and Governance principles to address sustainability challenges and regulatory requirements?" - this research question aims to examine the ESG principles within the banking sector and investigate the ESG development, integration, and risk management, particularly considering regulatory changes and the need for standardized framework. This study aims to provide several key insights when addressing the research question:

Development of ESG Principles: The study seeks to understand how banks can evolve their ESG principles over time, considering changing societal expectations, regulatory landscapes, and industry best practices. Insights into this aspect could include identifying the foundational components of ESG principles, tracking their historical development within the banking sector, and analyzing emerging trends and challenges.

Integration of ESG Principles: By examining how banks integrate ESG principles into their operations and strategic agendas, the study aims to uncover effective strategies and practical approaches. This involves exploring how banks align ESG considerations with their core business activities, risk management frameworks, and decision-making processes. Insights

may include case studies of successful ESG integration initiatives, identification of common barriers and challenges, and recommendations for overcoming integration obstacles.

Management of ESG Principles: Understanding how banks manage ESG principles involves examining their approaches to risk management, regulatory compliance, and governance structures. Insights in this area may encompass effective risk assessment methodologies, regulatory compliance strategies, and governance mechanisms for ensuring accountability and transparency. Additionally, the study may explore how banks monitor and report on their ESG performance to stakeholders.

1.5 Research Methodology

A case study is being conducted on a selected Finnish bank, focusing on its ESG principles. A case study approach typically involves a detailed examination of a single social unit, in this instance, the chosen Finnish bank, to understand its ESG practices. The data collection process consists of seven one-hour semi-structured interviews with representatives in different business areas that work with ESG related issues. Interviews are chosen due to their effectiveness in gaining insights into people's motivations and rationales. The use of semi-structured interviews allows for flexibility and spontaneity while maintaining some consistency across discussions. This approach ensures a comprehensive overview of ESG processes by involving representatives from different areas of a bank (Myers, 2019).

Through the qualitative case study approach and semi-structured interviews, the research aims to provide first-hand insights into the principles employed by the Finnish bank in integrating the ESG framework. The findings are expected to identify key ESG integration practices, provide a brief overview of the bank's sustainability goals, and assess the effectiveness of their processes.

To facilitate data analysis, the interviews are transcribed, and a bottom-up analysis is conducted and is aligned with an inductive method. Myers (2019) describes that bottom-up analysis evolves from the basic level of knowledge and works upwards to form a comprehensive picture. Inductive method involves moving from specific observations to general principles or theories, providing a deeper understanding of the responses and identifying key themes and patterns.

To organize the data, a coding system is used to categorize and label data segments based on their meaning, employing Qualitative Data Analysis (QDA) software for efficiency. The analysis involves the use of Gioia Methodology that aims at exploring relationships between themes, identifying connections to existing literature, and generating insights for reporting. The goal is to present clear, organized findings supported by interview quotes, contributing to the literature on ESG integration in the banking sector (Gioia, 2013).

Adhering to ethical principles, the preservation of anonymity for both the company and interviewees is carefully maintained, ensuring confidentiality throughout the research process.

1.6 Limitations

This study comes with several limitations that should be considered when interpreting the findings. Firstly, the decision to focus on a single Finnish bank for the case study may compromise the generalizability of the results. A specific bank may also not be representative of the broader banking industry, limiting the external validity of the study. Additionally, the regional specificity of the research could include factors unique to Finland that may not be applicable to banks in other countries or regions.

The qualitative nature of the research, especially relying on semi-structured interviews, also introduces potential subjectivity. Participants' responses may be influenced by their perspectives or organizational roles, impacting the objectivity of the findings. Moreover, the use of inductive reasoning, does not guarantee the absolute truth of conclusions. The interpretations drawn from the data may be subject to revision based on new evidence.

Personal bias is another potential limitation that can influence data interpretation and analysis. Although efforts will be made to mitigate bias, acknowledging its potential impact on the study is essential. The study's timeframe, constrained by the duration of seven one-hour interviews, may limit the depth of my research, potentially missing some long-term impacts of the bank's ESG strategies. Furthermore, the accuracy of information related to the bank's ESG practices relies on the transparency and precision of the bank's reporting, introducing a potential source of error. Qualitative data analysis, involving subjective coding and interpretation, may introduce variations among researchers, potentially influencing the study's outcomes. The reliance on Microsoft Teams for recording and transcribing interviews introduces a

technological dependency. Technical issues or limitations in the platform may affect the quality and accessibility of interview data.

Finally, the study's exclusive reliance on semi-structured interviews as the primary data source exclude other essential aspects of the bank's ESG practices, such as internal documents or external audits, limiting the data collection. Acknowledging these limitations is crucial for maintaining transparency and ensuring that the study's findings are appropriately interpreted within the scope of the research design.

1.7 Structure of the thesis

The thesis is structured in a following way: it starts with an introduction that offers a comprehensive understanding of the study's context and its significance. Within this section, the foundational framework for the entire thesis is established. Various elements such as the motivation behind the chosen topic, background information, the aim of the study, research questions, limitations, theoretical framework, selected research methods, and an overview of the thesis structure are covered.

The introduction is followed by a literature review section, that dives into the existing knowledge on ESG principles in the banking sector. This section provides a comprehensive overview of the development, trends, and challenges associated with ESG integration and implementation. Key themes explored include ESG principles, ESG Development and Integration, ESG Reporting and Compliance. By looking at different research studies, the literature review section helps to understand ESG principles better in the context of banking.

The method section elaborates on the rationale behind the chosen research methodology. This description is crucial to understanding the subsequent results and discussion. The methodology, data collection, data analysis, and result evaluation are explained within this section.
The results section aims to present the study's outcomes, following the Gioia Methodology. The goal of this section is to present the outcome of the study in a clear and accessible format, avoiding personal interpretations. Following the results, a critical examination and interpretation of the findings occur in the discussion section, aligning them with established theory and literature. This discussion leads to the conclusions, where the broader implications of the research and evaluates its strengths and limitations are highlighted.

2 Literature review

2.1 Sustainable Business Practices

There are various approaches and ideologies that aim at sustainable and ethical business practices. Concepts such as Corporate Social Responsibility (CSR), the Triple Bottom Line, the Circular Economy, Socially Responsible Investing (SRI), and Environmental, Social, and Governance (ESG) criteria serve as the base for those approaches and ideologies. Each concept offers a unique perspective on how businesses can navigate their societal and environmental impact while pursuing financial success (Dolan & Zalles, 2021).

According to Dolan and Zalles (2021), CSR, often regarded as a foundation of responsible business conduct, indicates a company's accountability for the broader implications of its operations. It includes a fundamental shift towards socially accountable business practices because businesses increasingly recognize the analogy between their operations and societal well-being. CSR has evolved to become part of corporate culture and strategy. Building upon the principles of CSR, the concept of Creating Shared Value (CSV) emphasizes the integration of responsible practices into core business strategies. This approach seeks to transform CSR initiatives from mere cost centers to sources of innovation and competitive advantage, aligning financial success with societal benefit.

Some researchers believe that a company's main obligation is to its shareholders, suggesting that CSR initiatives can increase costs and reduce both profitability and competitiveness. They argue that environmental practices might divert resources from essential business operations, leading to higher production costs and weaker economic performance. Supporting this perspective, a study on Canadian firms found a negative correlation between environmental disclosure and performance, with high ESG disclosure levels linked to lower corporate efficiency and reputational damage due to the revelation of unfavorable information. On the other hand, some researchers argue that well-crafted environmental regulations can foster innovation, such as the development of cleaner technologies, which can counterbalance compliance costs and improve competitiveness. Evidence indicates that companies committed to environmental management practices often see enhanced financial performance. Effective environmental disclosure is crucial for environmental management, necessitating a framework that controls and prevents environmental impacts across the supply chain by analyzing both

input and output indicators. Effective environmental performance, typically measured by reductions in pollution and CO2 emissions and improvements in air and water quality, reflects a company's ability to address environmental challenges, contributing to resource efficiency, waste reduction, and better economic performance (Alsayegh et al., 2020).

Similarly, the Triple Bottom Line framework supports overall assessment of corporate performance, considering not only financial profitability but also environmental and social factors. This concept highlights the importance of balancing economic prosperity with environmental stewardship and social equity. The concept of Circular Economy represents a shift in resource utilization, promoting sustainable practices that minimize waste and pollution. By promoting the reuse and regeneration of materials, this model aims to design out waste and create a more environmentally sustainable industrial system (Dolan & Zalles, 2021).

In the field of finance, SRI offers investors the means to align their financial goals with social and environmental impact. Originating from ethical considerations and negative screening of harmful industries (i.e. the process of finding and excluding companies that score poorly on ESG factors relative to their peers), SRI has evolved to encompass proactive investment strategies aimed at promoting positive societal change. Finally, ESG criteria have emerged as a standardized framework for evaluating companies based on their environmental, social, and governance principles. Unlike traditional financial metrics, ESG criteria provides with a comprehensive understanding of a company's sustainability performance, influencing investment decisions and corporate behavior. And, while each concept offers valuable insights into responsible business practices, ESG principles stand out as a unifying framework that encompasses environmental, social, and governance considerations (Dolan & Zalles, 2021).

Social sustainability performance measures a company's success in achieving social objectives, including working conditions, health and safety, employee relations, diversity, human rights, fair labor practices, community involvement, and philanthropy. The connection between ESG factors and social sustainability performance is examined through the lenses of stakeholder theory, legitimacy theory, and signaling theory. Some researchers argue that socially responsible policies misallocate company resources, incurring high costs without sufficient tangible benefits, which harms shareholders. They also found a negative or weak relationship between ESG practices and social sustainability performance.

Other studies show a positive link between ESG practices and corporate performance, suggesting that these practices improve efficiency and competitiveness, lower operating costs, and financial risks, and enhance corporate reputation and consumer trust. According to stakeholder and legitimacy theories, companies implement ESG policies to gain legitimacy and fulfill stakeholder expectations, thereby improving access to resources. Strong relationships with stakeholders can create valuable intangible assets that contribute to long-term social sustainability. Additionally, better internal health and safety conditions can increase employee motivation, morale, commitment, and loyalty, resulting in higher productivity and lower recruitment and training costs. Externally, ESG practices enhance corporate reputation and consumer trust, providing a sustainable competitive advantage. Companies integrating ESG practices, such as favorable working conditions, attract productive employees, enhancing competitiveness and economic and social performance. Thus, high compliance with social norms is expected to improve organizational legitimacy and social sustainability performance (Alsayegh et al., 2020).

2.2 ESG Principles

ESG principles (Figure 1) play an important role in assessing a company's approach to managing **Environmental** risks, including greenhouse gas emissions, toxic waste management, and compliance with environmental regulations. Some examples of environmental issues that companies need to address include climate policies, energy consumption, waste management, pollution control, natural resource conservation, and animal welfare. In terms of **Social** aspect, the focus is on how a company interacts with its internal and external stakeholders, including suppliers, employees, customers, and the local community. This involves assessing whether the company adheres to its own ESG standards, contributes to the community through donations or volunteer programs, maintains safe and healthy workplace conditions for employees, and avoids unethical practices towards customers. Lastly, ESG **Governance** aims to ensure that companies adopt accurate and transparent accounting practices, prioritize integrity and diversity in leadership selection, and remain accountable to shareholders. Furthermore, it recommends that companies follow specific rules, such as avoiding conflicts of interest or using political donations for special favours and staying away from engaging in illegal activities (Investopedia, 2024).

Dimension	Factors	Definition
Environmental (E)	• GHG emissions (=greenhouse gas emissions) • Energy consumption and efficiency • Air pollutants • Water usage and recycling • Waste production and management (water, solid, hazardous) • Impact and dependence on biodiversity • Impact and dependence on ecosystems • Innovation in environmentally friendly products and services	Environmental matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Social (S)	• Workforce freedom of association • Child labor • Forced and compulsory labor • Workplace health and safety • Customer health and safety • Discrimination, diversity, and equal • Opportunity • Poverty and community impact • Supply chain management • Training and education • Customer privacy • Community impacts	Social matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Governance (G)	• Codes of conduct and business principles • Accountability • Transparency and disclosure • Executive pay • Board diversity and structure • Bribery and corruption • Stakeholder engagement • Shareholder rights	Governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.

Figure 1: ESG Framework (Li et al., 2021)

In essence, ESG principles, cover a corporate strategy that prioritizes three key areas: environmental impact, social responsibility, and governance practices. This strategy involves actions such as reducing pollution, fostering diversity in the workforce, and ensuring ethical decision-making at all levels. For this reason, by embracing ESG principles, companies can enhance their resilience, reputation, and long-term value creation while contributing positively to society and the environment (Investopedia, 2024).

2.3 ESG Definition

Understanding why a company should care about ESG also requires defining what ESG is, its origins, and the various beliefs surrounding it. As was discussed in the previous section, ESG consists of Environmental, Social, and Governance pillars, representing a wide array of ideas and topics. Environmental pillar includes the ecological footprint of companies, encompassing climate risks, sustainable practices, and product differentiation strategies. Social dimensions extend to inclusivity, diversity, and stakeholder engagement, addressing issues such as labor practices and cultural norms. Governance, meanwhile, centers on principles of ethical conduct,

board accountability, and corporate transparency. While the ESG acronym captures the broad and interconnected nature of these three pillars, it does not encompass everything. The concept of ESG originated from initiatives like the UN's Global Compact and efforts within the financial markets to incorporate sustainability into investment practices. However, the focus was initially on investment analysis rather than on the companies themselves. Consequently, ESG has become a loosely defined corporate practice with multiple interpretations, lacking a clear and unified framework. In essence, understanding why companies should prioritize ESG involves struggling with its multifaceted nature, navigating its inconsistent definitions, and recognizing its evolution from an investment perspective to a broader corporate practice. For this reason, establishing a consistent understanding of ESG within the context of a company's operations is crucial for effective implementation and development in this area. Currently, there are no global standards defining and regulating ESG, leading to inconsistency in its interpretation. Different entities, such as regulators, companies, and financial firms, define ESG based on their specific objectives and contexts. This variability in interpretation results in a flexible definition that can be stretched to fit various purposes (Sekol, 2024).

As stated above, there are various definitions and interpretations ESG principles within the business landscape. Some examples of these definitions are presented below, first example is taken from the Cambridge dictionary:

> ESG - short for Environmental, Social and Governance - is a set of standards for measuring a business's impact on society and the environment, as well as its transparency and accountability (Cambridge dictionary, 2024).

Dollan and Zalles in their book “Transparency in ESG and the Circular Economy” provide the following definition of ESG:

> ESG, although very important, is a broad concept that comes in many forms because different situations and contexts may be applicable for certain components of ESG rather than its entirety. ESG is often used interchangeably with other terms like sustainability, sustainable investing, responsible investing, impact investing, and socially responsible investing, and yet there are many facets to the various terms that have evolved in this space (Dolan & Zalles, 2021, p. 27).

Last example is taken from the article published by Deloitte on the topic of ESG:

> ESG stands for environmental, social and governance. These are called pillars in ESG frameworks and represent the 3 main topic areas that companies are expected to report in. The goal of ESG is to capture the non-financial risks and opportunities inherent to a company's day to day activities (Deloitte, 2019).

These brief definitions do not provide a comprehensive understanding of ESG, which is pivotal for companies seeking to navigate the complexities of modern business landscapes, because central to understanding ESG is the concept of a company's long-term viability and stakeholder expectations. ESG risks, such as climate-related hazards, pose significant threats to physical assets and operational continuity. By addressing ESG risks and opportunities, companies can enhance their long-term value and resilience. While unforeseen ESG crises may still arise, companies that prioritize ESG can gain insights into emerging trends and prepare more effectively. Developing a strategic approach based on these insights can support a company in the face of such challenges. For instance, a company that adopts sustainable practices in its products may experience increased customer satisfaction and reduce long-term transition costs as unsustainable materials become less popular. This strategic shift not only aligns with customer values but also enhances the company's overall value proposition. Essentially, a company that proactively manages risks and opportunities over the long-term would naturally recognize and take advantage of such opportunities, irrespective of its specific focus on ESG. And although ESG may not be essential for immediate success, it holds value in mitigating governance risks and driving long-term sustainability. ESG issues are also interconnected and require a comprehensive approach that goes beyond risk management. By internalizing a consistent definition of ESG and recognizing its value to corporates, companies can effectively deliver value and prioritize meaningful impact aligned with their own values and goals (Sekol, 2024).

2.4 ESG Development

When talking about the development of ESG, its emergence traces back to January 2004 when former UN Secretary General Kofi Annan extended invitations to over 50 CEOs of major financial institutions. This invitation marked the establishment of a collaborative initiative under the UN Global Compact, supported by the International Finance Corporation (IFC) and the Swiss Government. The primary objective was to explore paths for integrating ESG considerations into capital markets. A pivotal outcome of this initiative was the publication of the report titled ‘Who Cares Wins’ in the subsequent year, authored by Ivo Knoepfel. This

report presented a strong argument for the incorporation of ESG factors within capital markets. It emphasized the idea that integrating environmental, social, and governance considerations into investment decisions not only aligns with business interests but also fosters the development of more sustainable markets and contributes to positive societal outcomes. The report covered the shift in investment practices, highlighting the potential benefits of ESG integration for both investors and society at large. By recognizing the relevance of ESG factors in investment decision-making processes, the initiative aimed to promote responsible and sustainable investing practices. In essence, the ESG investing represents a joint effort by global financial institutions and policymakers to promote sustainability within capital markets, where the 'Who Cares Wins', report served as a foundational document in articulating the rationale and benefits of ESG integration (Kell, 2018).

Since its formal proposal in 2004, ESG has gained traction globally, particularly in Europe and America. Achievements such as the establishment of evaluation systems, disclosure standards, and index systems have started the development of ESG practices. As ESG gains mainstream acceptance, scholars worldwide have shown increasing interest in its study, although existing literature primarily focuses on specific aspects like ESG investment, metrics in socially responsible investment, and the influence of ESG scores on corporate sustainability. Recent research highlights the interconnected nature of environmental, social, and governance factors within the ESG framework, emphasizing their impact on enterprise sustainability and financial performance. Understanding how these factors interact is essential for using ESG to promote sustainable development. Enterprises must prioritize ESG integration within their internal governance structures to strengthen its positive impact on economic outcomes. This involves refining how the organization is set up and providing training to employees to create strong risk management processes. For financial institutions, understanding ESG governance principles can help them offer detailed investment insights beyond traditional data metrics. Moreover, they can improve the assessment of ESG factors by working together with industry partners (Li et al., 2021).

When it comes to successful ESG development and implementation - companies prioritizing responsibility towards people, customers, and the environment are likely to excel compared to those that do not As stated, ESG is more than just attracting capital, rather, it is a bounded to societal expectations regarding ethical conduct. ESG principles encompass all types of organizations. Ultimately, embracing ESG is a commitment to doing what is morally right,

with implications for organizational success and societal impact. Over the past two decades, three influential streams came together to shape the ESG movement. Firstly, driven by scientific evidence and activism, environmentalism was boosted by figures like former Vice President of the United States Al Gore and environmental activist Greta Thunberg, who urge action to address climate change and environmental degradation. Secondly, SRI gained traction and was pushed forward by individual and institutional investors seeking ethical investment options and advocating for corporate responsibility. Lastly, prompted by corporate failures, governance reform initiatives aimed to enhance corporate governance practices, enforcing greater accountability and transparency. Together, these streams have joined forces, forming the foundation of the ESG movement, advocating for sustainable, responsible, and fair business practices (Brown, 2021).

It is getting more and more obvious that ESG is not a passing trend but rather a fundamental aspect that businesses cannot afford to overlook. In fact, there's speculation that ESG may evolve into ESGT, with the "T" representing technology. This expansion would entail stakeholders, including investors, customers, employees, and suppliers, evaluating companies based on their governance of technology-related issues. ESGT would encompass various technological concerns, such as cybersecurity, data protection, data mining, the Internet of Things (IoT), robotics, surveillance, and the handling of fake news. As technology becomes increasingly integrated into every aspect of business operations, stakeholders also become more attentive to how companies manage these issues. They expect companies to demonstrate responsibility and ethical conduct in handling technological advancements, especially concerning data privacy and security. This shift suggests that companies will be judged not only on their traditional ESG practices but also on their governance of technology-related risks and opportunities. Failure to address these concerns may lead to reputational damage, loss of trust, and potential disengagement from stakeholders. Therefore, businesses must proactively incorporate technology governance into their ESG strategies to remain competitive and resilient in an evolving business landscape (Brown, 2021).

2.5 ESG Integration

There is an evolving landscape of social responsibility, environmental sustainability, and governance strategy within the banking sector, followed by various implications and emerging trends. Social responsibility in banks is rapidly growing, since there is an increased focus on

financial institutions' role in societal well-being and ethical conduct, particularly considering large-scale projects' potential social and human rights implications (Brown, 2021).

Increased importance of environmental sustainability in banking also resulted from the wake of the COVID-19 pandemic. The pandemic accentuated global environmental vulnerabilities, prompting banks to re-evaluate their carbon footprint and energy efficiency. For example, the UN's Sustainable Development Goals and the Paris Agreement (i.e. international treaty on climate change), underscore the urgency of addressing climate change, with banking supervisory authorities advocating for improved risk disclosure and mitigation strategies. The integration of environmental sustainability into banking governance is another critical area of interest, aligning with regulatory expectations and stakeholder demands. Banks' Governance strategy on climate change covers such areas as governance composition, stakeholder engagement, and risk management processes, emphasizing the need for transparent decision-making and robust risk assessment techniques. Overall, there is an evolving role of banks in promoting social responsibility, environmental sustainability, and governance strategy to navigate regulatory pressure and address stakeholder expectations. For this reason, it is important for banks to integrate these considerations into their governance structures and decision-making processes to mitigate risks, enhance transparency, and drive long-term value creation (Galletta et al., 2021).

Integrating ESG considerations into business practices, has a particular impact on a company. Firstly, there's a significant financial advantage to strong ESG practices. Investors increasingly prioritize companies with robust ESG profiles, leading to better access to capital and potentially lower costs. Companies with weak ESG practices may face difficulties in securing financing and may incur higher capital costs. Consumers are also increasingly drawn to sustainable products and environmentally conscious brands. Failing to align with this trend can result in loss of market share and damage to reputation. Additionally, implementing environmentally friendly processes not only reduces expenses related to energy, water, and waste but also drives down packaging and waste disposal costs, further enhancing profitability (Brown, 2021).

Furthermore, companies with higher ESG ratings are better equipped to attract and retain top talent.

> Environmental, social and governance (ESG) ratings provide an opinion on a company or financial instrument's sustainability profile or characteristics, exposure to sustainability risks or impact on society and/or the environment (European Commission, 2022).

Aligning with social and environmental values enhances employee motivation and engagement. Conversely, a negative perception of a company's ESG practices can diminish its attractiveness leading to talent shortages.

> KPMG UK surveyed around 6,000 UK adult office workers, students, apprentices and those who have left higher education in the past six months on their attitudes to work. The findings highlight that almost one in two (46 per cent) want the company they work for to demonstrate a commitment to ESG, while one in five (20 per cent) have turned down a job offer when the company's ESG commitments were not in line with their values. Those aged 25-34 are the most likely (55 per cent) to value ESG commitments from their employer, but 18-24 years olds (51 per cent) and 35-44 years old (48 per cent) are not far behind. And when it comes to looking for a new role, one in five respondents (20 per cent) said they had turned down a job because the company's ESG commitments were not in line with their values, rising to one in three for 18–24-year-olds (McCalla-Leacy, 2023)

ESG initiatives can also have significant implications for regulatory compliance. While environmental regulations are becoming stricter, governments increasingly offer subsidies and support for sustainable initiatives. Conversely, non-compliance may result in penalties, fines, and loss of favour with regulatory bodies. Integrating ESG considerations into business operations not only aligns with societal and environmental goals but also offers tangible financial benefits, including improved access to capital, enhanced sales growth, cost savings, talent attraction, and regulatory compliance. Utilizing existing frameworks like the balanced scorecard (i.e. measure that provides a balanced view of an organization's performance by considering both financial and non-financial factors, enabling managers to monitor progress and make informed decisions aligned with the overall strategy) can streamline reporting on ESG initiatives, providing stakeholders with clear and accessible information (Brown, 2021).

For example, Banque Internationale à Luxembourg (BIL's) Executive Committee and Board of Directors recognized the pivotal role that the banks play as a financial actor in facilitating the transition to a sustainable world. For that reason, they established an ESG integration framework, where ESG factors were integrated into the bank's evaluation framework to assess its broader impact beyond financial returns. This involved the identification and evaluation of

ESG risks that could potentially affect the bank's performance and reputation, including climate change, labour practices, diversity, data security, and ethical governance. Overall, the approach to ESG encompassed two primary dimensions: addressing ESG impacts within its own operations and fulfilling its role as a financial intermediary. Internally, the bank conducted assessments to determine the incorporation of ESG factors across various aspects such as product creation, human resource management, procurement processes, risk management, and environmental sustainability. And externally the bank played a crucial role in driving the transition to sustainable corporate models through the integration of ESG considerations in its products and services offerings (BIL, 2023).

Dolan & Zalles (2021) describe that, in terms of ESG related issues that can be faced during the integration of ESG principles, one is that in the complex landscape of ESG, where businesses navigate various global challenges and interdisciplinary themes, standardizing metrics and definitions presents a significant challenge. ESG initiatives show diversity across different contexts and stakeholders, resulting in an abundance of approaches to reporting and measuring ESG performance. This diversity complicates the comparability of ESG data and weakens efforts to draw meaningful insights. As noted by experts, "ESG initiatives can take a wide range of forms across different contexts, needs, and stakeholders," (Dolan & Zalles, 2021, p. 59) reflecting the multifaceted nature of sustainability efforts. This diversity gives rise to inconsistencies in reporting frameworks, making it challenging for stakeholders to interpret and utilize ESG metrics effectively. Without a common format to organize and analyze data, stakeholders face difficulties in extracting actionable insights.

Due to this uncertainty in standardizing metrics and definitions, companies are compelled to define their own ESG strategies and reporting practices, often without clear guidance on best practices. Consequently, ESG initiatives risk being downgraded to mere compliance measures rather than strategic requirements. Without a strategic approach to ESG integration, companies may miss opportunities to leverage responsible practices for innovation and market differentiation. The lack of transparency and accountability in ESG reporting further exacerbates challenges in evaluating companies' sustainability performance. Greenwashing, or the spreading of misleading information about a company's environmental practices, weakens the credibility of ESG reporting and influences stakeholder trust. Without clear guidelines and oversight mechanisms, companies may engage in misleading practices, such as overstating their ESG impact or misrepresenting their sustainability efforts. Additionally, the reliance on

self-reported ESG metrics introduces biases and inaccuracies into sustainability reporting. In the absence of standardized reporting frameworks, companies may inflate their ESG performance to project a favorable image to stakeholders. This dependence on self-reported data compromises the reliability and integrity of ESG disclosures, hindering stakeholders' ability to make informed decisions (Dolan & Zalles, 2021).

And while ESG has gained significant attention, the evidence supporting its benefits is more nuanced than often portrayed. There is a potential in ESG to enhance profitability and growth for companies while lowering risk and delivering positive returns for investors. However, there’s some evidence suggesting that socially responsible firms may enjoy lower discount rates, translating to lower expected returns for investors. The link between ESG practices and higher profits or growth is less clear. While some companies indeed thrive by prioritizing ESG initiatives, others suffer from high costs without getting the corresponding benefits. Moreover, situations where the connection between ESG and operating performance is doubtful, raises questions about the effectiveness of promoting ESG to corporate leaders. When it comes to ESG-focused investing, the evidence for generating positive returns is weak. Both active and passive strategies fail to consistently outperform the market, and the underlying problem remains unresolved. It's unclear whether adopting ESG practices leads to success or if successful companies are simply more inclined to embrace ESG principles. Despite the interest surrounding ESG, there's skepticism about its transformative potential. While it may benefit certain individuals and industries, the broader impact on corporate social responsibility remains uncertain. Instead, there's a need for a more comprehensive dialogue on ESG-related policies, particularly those addressing climate change. Ultimately, the goal is to establish a regulatory framework that enables corporations to prioritize shareholder wealth while also addressing societal and environmental concerns. In doing so, companies can navigate the complexities of ESG in a way that aligns with both their financial objectives and broader societal interests (Cornell & Damodaran, 2020).

When talking about ESG and investment practices specifically and evidence for generating positive returns, there are some examples of such practices. The research on ESG and Financial Performance by Tensie Whelan, Ulrich Atz, and Casey Clark, indicates that incorporating ESG factors into investment strategies can lead to improved financial performance, especially over an extended period. Studies have revealed that focusing on long-term sustainability tends to result in more positive or neutral outcomes compared to short-term approaches. For instance,

a meta-analysis involving 142 studies found that corporate investments in environmental sustainability might not immediately impact financial performance in the short term but could lead to positive effects over the longer term. Similarly, recent studies have shown optimism regarding how markets value long-term commitments, such as CEOs communicating "long-term plans," resulting in positive reactions from the stock market. Moreover, research suggests that adopting ESG integration strategies tends to be more effective than employing negative screening methods (e.g. finding companies that score poorly on ESG and excluding them from certain investments). Comparative analyses of different investment approaches have indicated that ESG integration often outperforms other strategies, such as socially responsible investing or ethical funds. Furthermore, emphasizing material ESG issues and identifying firms that demonstrate improvement in their ESG practices can lead to even better financial outcomes. For example, studies have highlighted the outperforming potential of firms focusing on material ESG issues and showing improvement in their ESG performance (Whelan et al., 2020).

Assessing a company's performance for ESG investment also involves various complexities and considerations: "wanting to build an ESG portfolio might be a relatively easy decision but working through the details of constructing such a portfolio can require much more effort" (Hill, 2020, p. 167). Investors face challenges in navigating the multitude of ESG factors and indicators, especially with the increase of AI-driven analysis. "Some choose instead to follow other investors with similar professed ESG goals" (Hill, 2020, p. 168). This strategy offers simplicity but may not align perfectly with the investor's objectives. Alternatively, investors can go for ready-made ESG investment products, which provide ease of execution but require understanding the differences among funds. To evaluate ESG funds effectively, investors must analyze their risk-return profiles and sustainability approaches. However, assessing ESG performance can be complex due to the multidimensional nature of ESG considerations (Hill, 2020).

In conclusion, the challenges of inconsistent definitions, standards, and metrics in ESG integration highlight the need for a concentrated effort to standardize and harmonize sustainability practices to provide better ESG processes. By establishing clear guidelines and frameworks for ESG reporting, stakeholders can enhance transparency, accountability, and comparability, fostering more effective sustainability initiatives and investment decisions (Dolan & Zalles, 2021).

2.6 ESG Reporting

The European ESG regulatory landscape is witnessing a significant increase in interest and requirements regarding ESG issues. Europe stands out with its comprehensive ESG disclosure obligations imposed on firms through initiatives like the EU Taxonomy (i.e. a classification system that establishes a common framework for determining which economic activities can be considered environmentally sustainable), and Sustainable Finance Disclosures Regulation (SFDR) as part of the EU Action Plan. European banks are also subject to sustainable finance legislation, such as the Capital Requirements Directive (CRD) IV and the Capital Requirements Regulation (CRR), which form the legal framework for their regulation and supervision. Within this framework, the EBA has established Pillar III Disclosures, which mandate banks and financial institutions to disclose information about their capital and risk exposures. These disclosures are part of the EBA's broader regulatory framework aimed at introducing comparable disclosures and Key Performance Indicators (KPIs) to illustrate how European banks are integrating sustainability considerations into their risk management, strategy, and business models, aligning with the goals of the Paris Agreement (i.e. international treaty on climate change). The primary objective of these disclosures is to enhance transparency and enable market participants to better evaluate the overall risk profile of a bank (Sustainalytics, 2024).

According to Sustainalytics (2024), Pillar III Disclosures primarily affect banks and large institutions established in the EU under the supervision of the European Central Bank (ECB) or those with securities traded on regulated markets of any EU member state. Large institutions are defined as banks with assets of €30 billion or more, encompassing a significant portion of European banks, as outlined in a comprehensive list published by the ECB in July 2022, which included 110 significant supervised entities. Additionally, the EBA has identified Global Systemically Important Institutions and Other Systemically Important Institutions, explicitly referencing them in the regulation to determine banking entities required to comply with the disclosures. Smaller institutions may be exempt from some requirements based on their size, complexity, and the regulations of specific EU member states.

There are several reporting obligations and timelines concerning ESG factors (Table 1). These obligations encompass:

1. **Climate risks**: identifying potential impacts of climate change and transition risks on a bank's balance sheet, such as stranded carbon-intensive assets or exposure to properties in flood-prone areas.
2. **Mitigating actions**: describing the measures taken by banks to address physical and transition climate-related risks, including adaptation strategies and investments in resilience.
3. **Green Asset Ratio (GAR)** and **Banking Book Taxonomy Alignment Ratio (BTAR)**: explaining how banks finance activities aligned with the climate goals of the Paris Agreement using the EU's Taxonomy of green activities.
4. **Strategies, governance, and risk management of ESG Risks**: discussing banks' approaches to managing ESG risks, including their strategies, governance frameworks, and risk management practices (Sustainalytics, 2024).

Table 1: ESG reporting obligations and timelines (Sustainalytics, 2024)

WHAT TO DISCLOSE		EXAMPLES OF DISCLOSURE	FIRST REFERENCE DATE*
Tables 1-3: Qualitative Disclosures	Qualitative information on environmental, social and governance risks	• Governance arrangements • Business model and strategy • Risk Management	31 December 2022
Templates 1-5: Risk Disclosures	**Climate Change Transition Risk:** Information on exposures to sectors or assets that may highly contribute to climate change	• Exposure to fossil fuel companies excluded from sustainable climate, benchmarks, and to other carbon-related sectors	31 December 2022 (phase in period until June 2024 for scope 3 emissions)
	Climate Change Physical Risk: Risk exposures subject to extreme weather events	• Assets subject to impact from chronic climate change events by sector and geography	31 December 2022 (phase in period until June 2024 for scope 3 emissions)
Templates 6-8: Green Asset Ratio	Information on **exposures towards NFRD Corporates and Retail financing** taxonomy-aligned activities consistent with Paris Agreement goals that contribute substantially to climate change mitigation and adaptation, including information on transitional and enabling activities	• **Contributing to Climate Change Mitigation:** Generation of renewable energy • **Enabling Climate Change Mitigation:** Manufacture of renewable energy technologies • **Contributing to Climate Change Adaptation:** Afforestation • **Enabling Climate Change Adaptation:** Engineering activities for adaptation to climate change	31 December 2023
Template 9: Banking Book Taxonomy Alignment Ratio (BTAR)	Information on **exposures towards non-NFRD corporates not assessed in the GAR** financing taxonomy-aligned activities consistent with Paris Agreement goals, contributing substantially to climate change mitigation and adaptation.		From 30 June 2024 Disclosure of this information is to be provided on a voluntary basis
Template 10: Mitigating Actions	Actions that support counterparties in the **transition** to a carbon neutral economy but that do not meet taxonomy criteria	• Building renovation loans that improve the energy efficiency of the building but do not meet the taxonomy screening criteria	31 December 2022
	Actions that support counterparties in the **adaptation** to climate change but that do not meet taxonomy criteria	• Loans to build barriers against flooding, or water management mechanisms against droughts but do not meet taxonomy screening criteria	31 December 2022

The GAR and the BTAR, have a special significance. These ratios serve as metrics aimed at assessing whether banks are financing sustainable activities that are aligned with the goals of the Paris Agreement. The GAR and BTAR indicate the proportion of a bank's assets that are environmentally sustainable and contribute to either mitigating or adapting to climate change, as defined by the EU Taxonomy. These ratios are designed to align with disclosure requirements outlined in the taxonomy, ensuring consistency with the data and timelines mandated for large corporates under the Non-Financial Reporting Directive (NFRD). These metrics play a crucial role in shaping strategies for banks, as they provide insights into the extent to which a bank's financing activities support the objectives of the Paris Agreement. Even banks with relatively low values of these ratios can use them to formulate strategies aimed at gradually transitioning their financing activities to align more closely with the Paris Agreement goals. Moreover, these ratios enable banks to measure and monitor the effectiveness of their sustainability strategies over time (Sustainalytics, 2024).

Hill (2020) indicates that understanding corporate ESG reporting and the services available for assessing ESG performance is crucial for investors as well. A 2017 survey examined corporate responsibility and sustainability reporting across 4900 companies globally. The findings revealed that most of the largest companies in various countries report on corporate responsibility and sustainability, integrating financial and nonfinancial data in their annual reports. While many companies disclose targets for reducing carbon emissions, few acknowledge climate risk or attempt to quantify it. It's important to consider that these findings are self-reported, raising questions about data consistency and usefulness. External verification services are utilized by some companies to ensure the quality and accuracy of their reports, but this practice is less common among larger companies.

Several services also offer research on corporate ESG performance, such as Sustainalytics, which provides data on over 70 indicators weighted by industry importance. MSCI (Figure 2), also offers ESG ratings for thousands of companies and securities, with a focus on governance, environmental, and social issues. RepRisk monitors companies for ethical issues like human rights violations and environmental concerns. Ceres, a nonprofit organization, has developed core principles for corporate environmental behavior and provides resources for investors and companies to address environmental and social risks. JUST Capital ranks companies based on factors determined through polling, creating an investible index. However, it's important to

note that all these ESG ratings are based on historical data and may not accurately reflect future performance. The wide range of issues encapsulated in sustainability ratings can make interpretation challenging for investors (Hill, 2020).

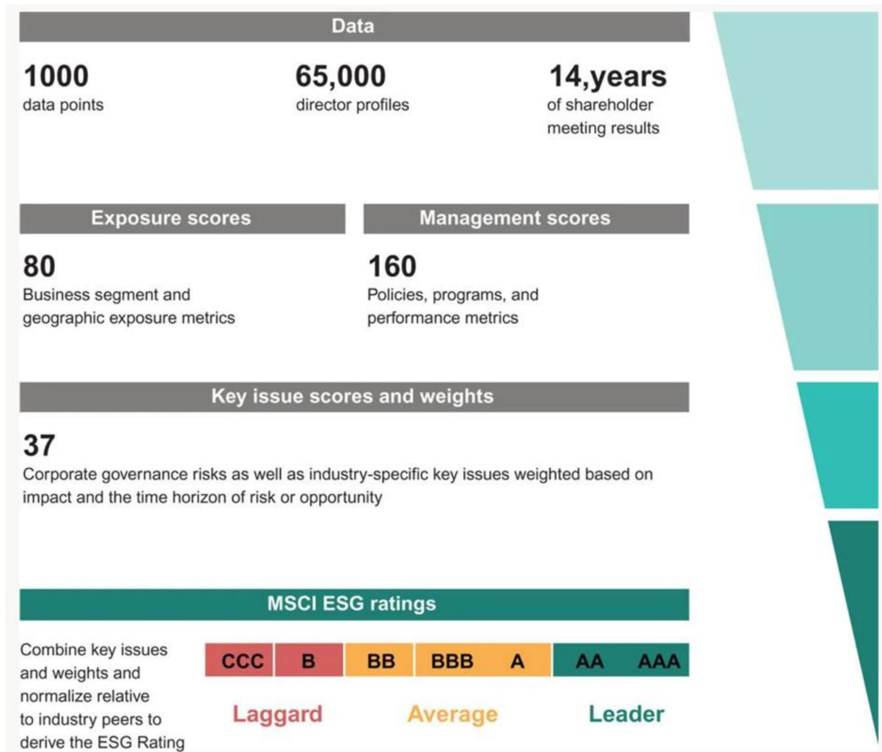

Figure 2: The making of an MSCI ESG rating (Hill, 2020)

Overall, the lack of standardized metrics prevents investors' ability to evaluate ESG investment opportunities accurately. As companies fight with different reporting standards and frameworks, investors face challenges in comparing ESG performance across firms. This variability underscores the need for a unified approach to ESG reporting that facilitates transparent and comparable assessments. The absence of agreement on reporting methodologies leaves companies uncertain about which metrics to prioritize and how to align them with their strategic objectives. With various reporting standards and frameworks available, firms face difficulties in selecting the most relevant and impactful metrics for their operations. This issue is particularly visible among financial institutions, where diverse stakeholders and regulatory requirements further complicate ESG reporting (Dolan & Zalles, 2021).

2.7 ESG Compliance

The European Commission introduced a sustainable finance package in May 2018, comprising measures such as a unified EU Classification system for sustainable economic activities, improved ESG disclosure requirements, and new benchmarks for comparing carbon footprints (Cheasty, 2019). In July 2018, the European Commission established the Technical Expert Group on sustainable finance (TEG), composed of diverse participants from academia, business, and the finance sector, as well as representatives from EU and international public bodies. One of the TEG's main tasks was to develop a comprehensive EU classification system for sustainable economic activities. Due to the complexity of this task, the TEG's activities were extended until 2020. The final version of the Taxonomy Technical Report, known as the EU Taxonomy, was released in March 2020, following an initial release in June 2019 (Lucarelli et al.,2020).

Lucarelli et al. (2020) describes that, the EU Taxonomy focuses on six environmental objectives: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. These objectives serve as the basis for determining when economic activities can be deemed environmentally sustainable within the EU Taxonomy framework. The EU Taxonomy assessment also determines the extent to which a company's performance can be considered environmentally sustainable. This assessment considers the individual contribution of each eligible economic activity to the company's performance, including factors such as turnover, revenues, capital expenditure, and operational expenditure. An economic activity is classified as environmentally sustainable if it substantially contributes to at least one of the six environmental objectives outlined in the EU Taxonomy. Additionally, it must adhere to the principle of ‘Do No Significant Harm’ to any other environmental objectives and comply with minimal social safeguards. Once an economic activity meets these performance thresholds, it is certified as ‘EU Taxonomy-aligned’ (Lucarelli et al., 2020).

Companies involved in eligible economic activities and meeting the EU Taxonomy criteria can classify a corresponding percentage of their performance (e.g., turnover, capital expenditure) as environmentally sustainable. Investment firms, such as investment funds and pension funds, can disclose the nature and extent to which their financial products are EU Taxonomy-aligned,

providing a competitive advantage. Companies are required to disclose their EU Taxonomy-aligned turnover and capital expenditure in their annual reports as per the Non-Financial Reporting Directive. Failure to align with the EU Taxonomy requirements would result in the financial intermediary declaring that a product does not align (Lucarelli et al., 2020).

In parallel with EU Taxonomy release, the European Securities and Markets Authority (ESMA) published technical guidance in April 2019, proposing amendments to the Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Fund Managers Directives (AIFMD) to integrate sustainability risk factors. The proposed amendments cover organizational and operating requirements, including due diligence, conflicts of interest, and risk management policies. Key components of the risk framework include incorporating sustainability risk into the risk appetite statement and ensuring compliance with regulatory requirements related to sustainability risk. Risk management principles outlined in the guidance impact governance structures, risk ownership, Risk Control and Self-Assessment principles (RCSA), compliance, and reporting (Cheasty, 2019).

Cheasty (2019) defines sustainability risk as "environmental, social, or governance events that could negatively impact investment value, spans various risk domains, including operational, regulatory, and conduct risks." Companies are advised to develop relevant components for managing sustainability risk, including policies, procedures, risk registers, and Key Risk Indicators (KRIs)/Management Information (MI), aligned with their risk appetite. Future regulatory developments, increased industry expertise in ESG, and enhanced data availability are expected to further mature ESG risk management capabilities.

There are also ways in which banks' business models can influence their risk mitigation capabilities through investments in ESG pillars: for example, environmental improvements are linked to decreased default probability in wholesale banks, with regulatory responses to environmental challenges amplifying default risks. Similarly, retail banks, due to their customer-centric nature, experience slight improvements in risk profiles surrounded by increasing environmental consciousness and regulatory focus on consumer protection. In the social dimension, investment banks initially show a positive association with social factors, transitioning to a negative one over time. The complex nature of investment banking activities, tied to stakeholder interactions and financial ventures, makes them sensitive to social considerations, influencing risk assessments. Retail banking, rooted in direct consumer

interactions, is highly responsive to social factors influenced by societal norms and individual preferences, shaping default risk profiles. Regarding governance, investment banks consistently exhibit a negative association with governance scores, possibly due to their high-risk activities. Wholesale and retail banks, on the other hand, show positive associations, with robust governance practices enhancing reliability and trust-building in their operations. In terms of managing environmental risks in banking, it is important to incorporate ESG dimensions into risk management frameworks and to embrace ESG practices for sustainability and resilience. Policymakers and regulatory authorities are encouraged to adopt a holistic approach to assess banks' default probability through comprehensive business model analysis and incorporate ESG performance into risk assessment procedures (Palmieri et al., 2024).

In general, ESG risks, particularly those related to climate change and shifts in client behaviour, present significant areas of concern for the bank's business activities. These risks are broadly categorized into physical risks, associated with climate change impacts, and transition risks, linked to the shift towards a low-carbon economy. Physical risks encompass hazards such as facility damage, supply chain disruptions, and water scarcity, while transition risks involve challenges associated with policy, legal, technological, and market changes. Integrating ESG considerations into the bank's operations and decision-making processes is essential for identifying, assessing, and managing these risks effectively to ensure resilience and long-term stability. This involves adjusting the bank's processes for providing finance and investments to account for environmental, social, and ethical factors. Ultimately, ESG integration is not only about addressing financial materiality but also about recognizing and managing the bank's impacts on people and the environment, thereby fostering sustainability and responsible practices (BIL, 2023).

3 Method

In this thesis, the research is based on a case study of a selected Finnish bank. Case study is considered a detailed study of a single social unit:

> The social unit is usually located in one physical place, the people making up the unit being differentiated from others who are not part of it. In short, the unit has clear boundaries which make it easy to identify. A case study can be of a social process, an organization, or any collective social unit (Myers, 2019, p. 91).

Generally, case study research in the business discipline involves using empirical evidence derived from real people and organizations in contemporary settings. Researchers conducting case studies aim to comprehend the reasons behind specific business decisions or the mechanisms driving certain business processes. This method allows for an in-depth examination of the bank, providing a detailed understanding of its ESG strategies, practices, and outcomes. Consequently, it enables a comprehensive analysis of the bank's approach to ESG development, integration, risk management and its alignment with overall sustainability goals. The research method for this thesis involves conducting a qualitative case study to explore the key strategies and approaches adopted by a Finnish bank in integrating ESG principles into its operations, products, and services. The qualitative research method was selected for its ability to understand the context behind decisions and actions within an organization through conversations with the people involved. It is also preferred for gaining an in-depth understanding of people's thoughts, motivations, and actions (Myers, 2019).

This research is an inductive study, where data moves from specific observations to more general principles or theories. Data and existing theory were considered in tandem, creating a balance between prior knowledge and openness to new discoveries (Dudovskiy, 2023).

The initial stage of the research considered the following statement from Gioia, Corley, and Hamilton's article, ‘Seeking Qualitative Rigor in Inductive Research: Notes on the Gioia Methodology’:

> There is value in semi-ignorance or enforced ignorance of the literature if you will. Up to this stage in the research, we make a point of not knowing the literature in great detail, because knowing the literature intimately too early puts blinders on and leads to prior hypothesis bias /confirmation bias (Gioia, 2013, p. 21).

3.1 Data Collection

The data collection process involved conducting seven one-hour semi-structured interviews with representatives from different business areas within the bank. Selection criteria for interviewees was based on their expertise and involvement in the topic of ESG in banking. The aim was to ensure a diverse range of perspectives by interviewing individuals with various roles across different business areas within the bank (Table 2).

Table 2: Role of Informants and Interview numbers

Interview number	Level	Role of the Informants
1	Head of the Unit	ESG Representative
2	Head of Business Area	Financial Leadership
3	Functional Lead	Group Sustainability Strategy Implementation
4	Strategic Analyst	ESG Performance Management
5	Risk Expert	ESG Framework and Coordination
6	Functional Lead	Sustainable Procurement
7	Subject Matter Expert	Capital Management & Regulations

Priority was given to upholding ethical standards, especially in safeguarding the anonymity of participants throughout every stage of the research process. The reason for choosing interview as a method of data gathering was because it is highly valued technique in qualitative research within the field of business and management.

> Interviews are an excellent 'window' into an organization and can help you to find out what people are thinking. They are particularly useful for finding out people's motivations and their rationale as to why they did certain things (Myers, 2019, p. 96).

Semi-structured interviews also provided a framework using pre-formulated questions (see Appendices) as a starting point while allowing for spontaneous insights and the emergence of new questions during the conversation. This approach encouraged improvisation and ensured some consistency across interviews (Myers, 2019). The selection of representatives from different business areas within the bank as interviewees ensured that information from various business areas of the bank was captured, providing a comprehensive overview.

The qualitative case study approach, through semi-structured interviews, provided first-hand information about the strategies and approaches used by a Finnish bank to integrate ESG considerations. Semi-structured interviews allowed to explore the bank's specific initiatives, the rationale behind their adoption, and the outcomes achieved. The insights gained from this study helped identify the key ESG integration practices, understand the bank's overall sustainability goals, and assess the effectiveness of banks' strategies in achieving ESG goals. The qualitative approach provided with a necessary data and allowed for a detailed analysis of the research question. Generated insights may further contribute to the implementation and integration of sustainable banking principles. By focusing on a real-world case of a Finnish bank, the research findings offered practical implications for other banks and financial institutions seeking to develop sustainable banking principles and effectively integrate ESG considerations.

All interviews have been recorded and transcribed via Microsoft Teams. Detailed notes were made after every interview to help organize and structure further analysis as well as to ensure an accurate representation of the data from the interviews.

3.2 Data Analysis

The ultimate objective of the data analysis was to construct a model that captures the dynamic relationships, patterns, and interactions among the identified concepts and themes to help answering the research question. The purpose of this analysis was to offer a theoretical perspective and to contribute to the advancement of knowledge on the topic of ESG integration in the banking sector in Finland.

The thesis adopts a qualitative approach and is focusing on the Gioia methodology, where emergent themes and concepts arise from the data itself rather than being imposed by existing theories (Gioia, 2013).

During the data analysis phase notes and transcribed data were reviewed to gain a deeper understanding of the responses, identify key themes, and observe any interesting patterns or observations. Special focus was on what interviewees said, what kind of terms they used, what experiences they had in relation to ESG. It was important to understand how they articulate their thoughts, intentions, and actions within the organization:

> … the people constructing their organizational realities are ‘‘knowledgeable agents,’’ namely, that people in organizations know what they are trying to do and can explain their thoughts, intentions, and actions. … If we had designed our interview protocol around existing theory and terminology, we would have missed a key aspect of their sensemaking by imposing our preordained understandings on their experience (Gioia, 2013, p.20).

Even though a lot of focus was put into the concepts and experiences of the interviewees, a conscious effort was also made to refrain from adopting their perspectives. This was done to maintain a higher-level perspective that supports informed theorizing, where theories or conceptual frameworks are based on well-founded knowledge, evidence, or information rather than speculation (Dudovskiy, 2023).

Data analysis process was initiated with open coding (process of analysing textual content), involving the systematic labelling and categorization of raw data. The aim of this phase was to extract concepts, themes, and categories directly from the collected data without imposing any predetermined theoretical framework. In the initial phase of analysis (1st order analysis), the data was handled in its raw form, which led to a vast number of categories. This stage allowed for immersion in the data to explore without predefined constraints, acknowledging the need to feel lost before finding direction. Subsequently, as research progressed, similarities and differences among these categories were identified, reducing the number to a more manageable quantity. These refined categories were labelled, retaining interviewees terms where possible, to analyse if a deeper structure or connection exists. First-order concepts emerged organically from the perspectives and terms used by the interviewees and are thus informant-centric, reflecting the perspectives and experiences of the individuals involved in the study. The goal of this phase was to immerse oneself in the data, exploring it comprehensively before identifying patterns or themes. In the second phase of analysis (2nd order analysis) understanding the broader narrative emerging from the data was necessary to create a set of themes. The analysis progressed into a more theoretical study, aiming to develop concepts that explain observed phenomena, especially those not adequately addressed in existing literature or those particularly relevant to new domains. “Thus, second-order themes are researcher-centric, as they are shaped by the researcher's interpretation and synthesis of the data” (Gioia, 2013, p.18). These themes go beyond the specific perspectives of individual informants and seek to create a coherent framework or theory that explains the data. Additionally, in second-order analysis, there is a focus on refining emergent themes into higher-level 'aggregate

dimensions', which provide a more abstract and comprehensive understanding of the data (Gioia, 2013).

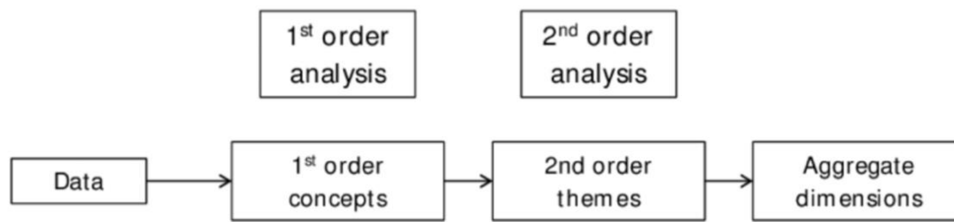

Figure 3: The Gioia methodology (Gioia, 2013)

According to Gioia (2013), after having a full set of 1st order concepts, 2nd order themes and aggregate dimensions, analysis proceeded with a data structuring, which was a pivotal stage of the research. Data structuring helped to illustrate progression from raw data to analytical terms and themes. To understand the results, a methodical approach was applied to categorize and create aggregate dimensions. Circulating between emergent data, themes, concepts, and dimensions and the relevant literature allowed to see whether the findings have some pattern or whether new concepts have been discovered. In the final stages of data analysis, discrepancies in interpreting interviewees terms and passages were reviewed. If there was a disagreement in certain coding, unified decision rules were created to guide the coding of various terms or phases, ensuring a harmonized approach to interpretation.

3.3 Data Interpretation

The raw data obtained from the transcribed semi-structured interviews was uploaded to a qualitative research software. A coding system was used to categorize and label data segments based on their meaning, employing QDA software for efficiency. In the QDA software, the collected data was categorized into distinct tags or 2nd order themes. These tags represented key concepts or topics identified during the analysis process. Subsequently, the categorized data was exported from the QDA software into an Excel file for further analysis. Within the Excel file, a Pivot table was utilized to analyse the data, providing a concise summary of the frequency of each tag or 2nd order theme. This analysis facilitated a deeper understanding of the significance of various themes within the dataset, allowing for meaningful insights. Based on the frequency of each tag, data was grouped into high-, medium-, and low frequency tags that were later considered in creating relevant aggregate dimensions (Table 3).

Table 3: 2nd order themes based on the frequency or count of each tag

High-Frequency Tags (Count > 50)	Medium-Frequency Tags (Count between 25-50)	Low-Frequency Tags (Count < 25)
ESG In Banking	ESG Legal Requirement	ESG Factors
ESG Development	ESG Framework	ESG Targets
Environmental Aspect	Social Aspect	EU Taxonomy Regulation
Sustainability Promotion	Governance Aspect	
ESG Reporting	ESG Definition	
	ESG Issues	
	ESG Strategy	
	ESG Ratings	
	Future Recommendations	
	Procurement and ESG	
	ESG Risk Management	

High-frequency tags, defined as those with counts exceeding 50, served as the foundation for the first dimension, which included essential topics such as ESG in Banking, ESG Development, and Sustainability Promotion. Following this, medium-frequency tags were identified, with counts ranging between 25 and 50, consolidating topics like ESG Framework, ESG Strategy, and ESG Issues. Low-frequency tags, characterized by counts below 25, were associated with 2nd order themes related to Compliance, Risk Management, and EU Taxonomy Regulations. The next step after identifying frequency, patterns, trends, and correlations within the dataset, was creating aggregate dimensions from identified 2nd order themes (Figure 4).

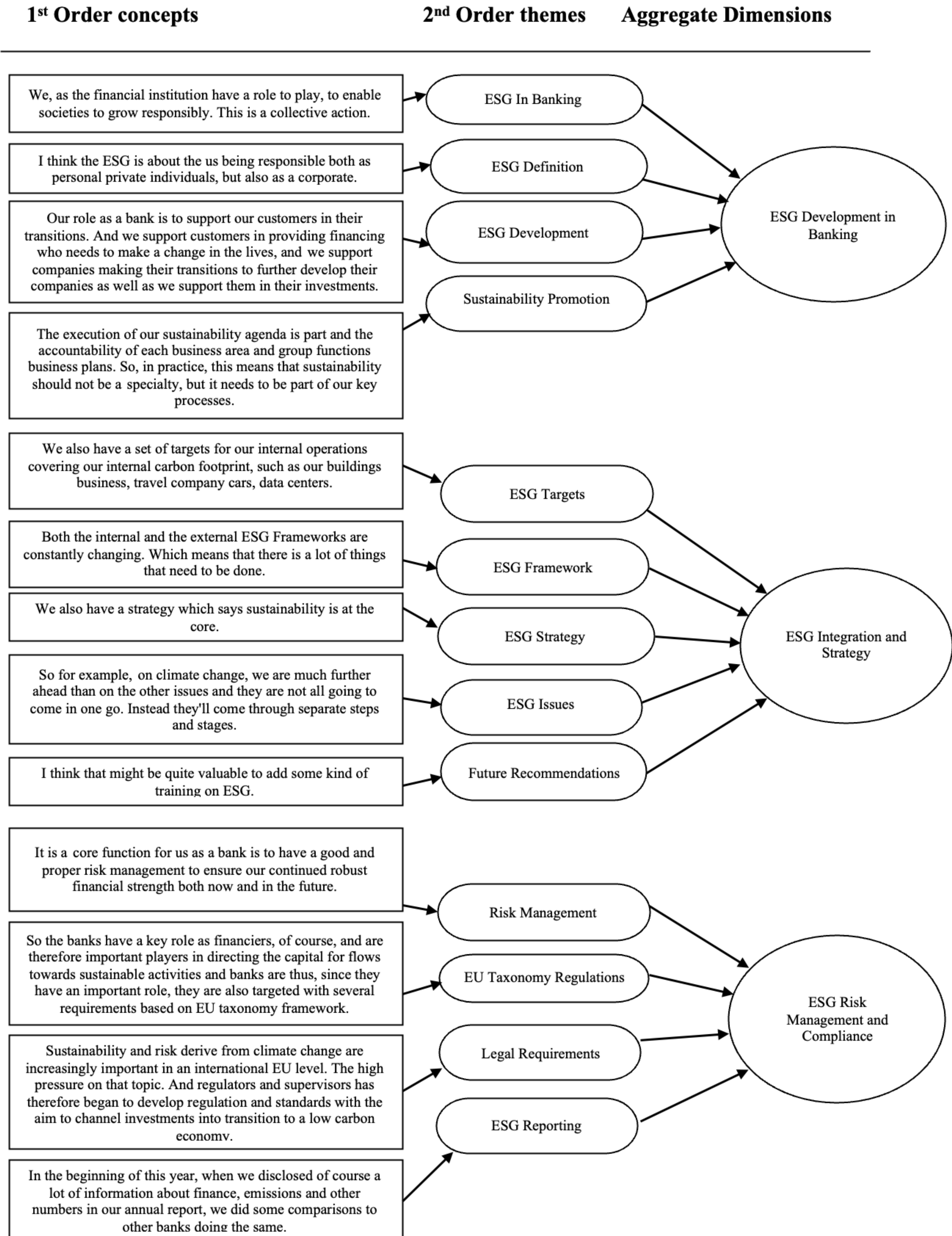

Figure 4: Code-Aggregation Diagram

The first core aggregate dimension that was identified is "ESG Development in Banking," includes essential components like ESG in Banking, ESG Definition and Development. This dimension reflects the evolution of ESG practices within banking. The second dimension is

"ESG Integration and Strategy" revolves around the practical implementation and the strategic planning of ESG initiatives within the banking industry. Topics such as ESG strategy formulation, sustainability promotion, future recommendations, ratings, and targets highlight the proactive approach of banks in shaping their ESG agendas. The third dimension, "ESG Risk Management and Compliance," encompasses topics related and regulatory compliance of ESG principles within the banking sector. With a focus on reporting, legal requirements, risk management, governance, and regulatory frameworks such as the EU Taxonomy Regulation, this dimension highlights the crucial aspects of ensuring that banks adhere to ESG standards and guidelines.

The resulting aggregate dimensions were designed to capture specificity of each theme, providing a structured framework for understanding the key ESG topics based on their frequency of occurrence. These three aggregate dimensions group the topics based on their thematic similarities and the number of highlights associated with them. It provides a structured way to interpret the data and understand the relevance of each topic within the broader context of ESG in banking.

It is important to note, that in the literature review section, several similar ESG topics were identified that resemble the results of the study. These topics include themes such as ESG integration, ESG development, and ESG reporting. As the analysis progressed and aggregate dimensions were developed, it became apparent that many of these topics from the literature review correlate with the emergent themes or areas of focus in the study. By aligning the topics identified in the literature review with the aggregate dimensions developed in the study, connections between existing theoretical frameworks and empirical findings can be established. This correlation helps validate the study's findings within the broader context of existing knowledge and provides a foundation for further analysis and interpretation.

4 Results

This section aims to present the outcome of the study and contains three sections that represent aggregate dimensions that were identified and represented in code-aggregation diagram (*Figure 4*). Each dimension contributes to a comprehensive understanding of the research findings and their implications within the context of the study.

4.1 ESG Development in Banking

In the world of finance, the concept of ESG holds a diverse range of meanings and implications. For example, Interviewee 3, sees ESG as not just a corporate buzzword but a personal responsibility and emphasizes the importance of both individual and corporate accountability, linking together climate impact and human rights within the concept of ESG, where "Responsibility is at the core."

Meanwhile, Interviewee 2 offers a broader perspective, going beyond the traditional concepts of sustainability and climate change. Interviewee 2 highlights the pivotal role banks play in addressing societal issues, emphasizing the multifaceted nature of ESG and the importance of social and governance aspects. Some level of scepticism is reflected by Interviewee 4, that acknowledges the cynicism surrounding ESG, where some see it merely as “something we need to do to look good”. However, Interviewee 4 also challenges this perception, suggestion that this is a genuine action: "This is about doing something that we have to do," recognizing the societal obligation for change.

During the discussion, Interviewee 1 shares an interesting idea and sees ESG as a hope for a brighter future and wants personally to leave good world for the next generation. Even though Interviewee 1 knows that one person can't do everything, there is a hope that if many people work together, they can make a big difference. Interviewee 1 encourages everyone to join in protecting the environment:

> So, when I think of the ESG, I suppose I think of this in terms of apparent where I don't want to leave the world a worse place. So, to me it it's about that legacy and trying to limit the damage that we do if we think about the epoch to the environment as much as possible.

While navigating discussions on the definition of the ESG, it becomes clear that ESG is not just a corporate initiative but a moral aspect guiding individuals and institutions towards a more sustainable and equitable future. Discussions continue within the topic of ESG development and offer varied perspectives on this topic: Interviewee 7 for example, reflects on the evolution of ESG metrics, noting an increased emphasis on environmental factors. Interviewee 7 expresses a desire to broaden this focus to encompass social and governance dimensions, acknowledging their importance:

> Currently, the set of numbers and metrics we follow mainly focuses on the E part of the ESG. But of course, we're hoping to expand that scope also to cover more of the S and G in the future.

Interviewee 2 discusses the advisory role of banks, especially in assisting smaller customers with ESG initiatives. Interviewee 2 highlights ongoing dialogues within sustainability and ethics committees, because "There's a strong advisory role". The aim is to broaden understanding and action to include social and governance considerations. Moreover, Interviewee 2 mentions the importance of dialogue and risk-taking in financing the transition to sustainability. Interviewee 2 emphasizes the need for collective action and engagement with stakeholders to navigate the complexities of the transition process effectively: "We need to find a way to have the dialogue".

Interviewee 4 underlines the integration of sustainability factors into risk management and steering processes. Interviewee 4 identifies growth opportunities in transitioning to a greener economy and emphasizes the collective responsibility of financial institutions in facilitating responsible growth and transition: "It is essential for us to integrate relevant sustainability factors not only into our risk management but also our steering processes". These insights allow to understand the complex nature of ESG development within the banking sector, emphasizing collaboration, dialogue, and proactive engagement as essential elements of driving sustainable change.

During the discussions around the topic of ESG in banking, Interviewee 7 explains the pivotal role of financial institutions in driving climate change and transition: "As a financial institution, it's critical that we are drivers for climate change and transition". In here, responsibility of banks in allocating capital and assisting customers in transitioning to a Net Zero economy is emphasised. Moreover, Interviewee 7 highlights the crucial function of financial institutions in

reallocating capital and financing the transition towards decarbonization across various sectors. There is a significant role that banks play in facilitating this transition. Interviewee 4 supports this idea and explains the importance for banks to support customers in the transition to a greener and more sustainable future and the role of financial institutions in providing financing, investments, and products to meet the demands of customers during this transition.

Interviewee 2 also describes the evolving landscape of banking, particularly in terms of sustainability and elaborates on the approach banks take in assessing sustainability impacts, integrating ESG targets into credit assessments: "We start to assess the risk of them not meeting their ESG targets," where the dual role banks play as enforcers and promoters of ESG, and sustainability initiatives are emphasized. Expanding on this theme, Interviewee 2 explains the importance of consumer-driven change and recommends banks to encourage customers to consider their supply chains and business footprints, emphasizing the power of informed consumer choices in driving corporate sustainability efforts.

Interviewee 4 further elaborates on the key areas of impact for banks and stress the importance of increasing positive impact by channeling capital into sustainable solutions and reducing negative impact through stringent sustainability requirements. Lastly, Interviewee 6 reflects on the shifting pattern within banking, with ESG considerations transitioning from the side to the core of banking operations: "ESG is moving from being a sort of an issue on the side, now it's being moved into the heart of banking." This shows the increasing centrality of sustainability considerations in shaping banking practices.

In summary, these insights from discussions around the topic of ESG in banking illustrate the evolving role of banks in integrating ESG considerations into their operations and their pivotal role in driving sustainable change within the banking sector.

In the context of promoting sustainability within the banking sector, Interviewee 2 suggests a proactive approach in encouraging customers to consider sustainability in their supply chains and business practices:

> There's nothing like consumer led enthusiasm or commitment to certain things that will cause companies to wake up and listen. And so, you know, I'm alongside the things that we might do to support and encourage industry in Nordic countries to make the necessary changes.

Interviewee 2 highlights the importance of informed consumer choices in influencing corporate behaviour. Interviewee 5 also highlights efforts banks undertake to promote sustainability, particularly through green mortgages and explains how banks issue green bonds based on the number of green retail mortgages:

> More than half of our green assets are in banks mortgage subsidiaries, and they are mainly green mortgages where we use energy performance certificates to measure how much energy and a building or property use. And the less energy they use, the more energy efficient the house is, the greener it is. So, we can quantify how many green retail mortgages we have. And from there we can issue green bonds on the back of that.

This shows the significant role of financial institutions in fostering sustainable investment. Furthermore, Interviewee 1 discusses the integration of sustainability considerations into business practices, particularly in the context of travel strategies and explains the shift towards virtual meetings to reduce carbon emissions and promote sustainable ways of working: "We can utilize virtual meetings more to reduce carbon emissions". This way Interviewee 1 emphasizes the importance of adapting traditional business practices to align with sustainability goals.

In summary, these perspectives illustrate the multifaceted approach banks take in promoting sustainability, encompassing consumer engagement, financial products, and operational strategies. Through these proactive measures and innovative initiatives, banks are driving sustainable change within the banking sector and beyond.

Interviewee 6 also touched upon the comprehensive approach adopted by a bank in the realm of procurement and ESG integration: “Sustainability is not an isolated concern within the procurement process but rather ingrained at every step”. Interviewee 6 highlights the integration of sustainability requirements into overarching directives and supporting guidelines, emphasizing the complex nature of sustainable procurement practices:

> Moreover, the bank conducts annual sustainability reviews for high-risk suppliers, delving deep into their policies and practices alongside external auditors. This hands-on approach ensures alignment with sustainability principles and values across all levels of supplier operations.

In addition to regular reviews, sustainability assessments are conducted for specific cases triggered by external sources or internal monitoring systems. This proactive approach enables the bank to address sustainability issues on a case-by-case basis, ensuring accountability and transparency in supplier relationships. Interviewee 6 reflects on the evolution of procurement practices, noting significant maturity and structure in integrating sustainability elements. The bank's commitment to sustainability as a fundamental principle rather than a mere regulatory requirement is also emphasized. During this discussion it becomes evident that the bank's procurement initiatives align with key sustainability priorities, particularly in climate action. Interviewee 6 also highlights efforts made to reduce air travel emissions through revised travel guidelines, promoting alternatives like train travel whenever feasible. This initiative underscores the bank's commitment to reducing its carbon footprint and contributing to broader sustainability goals.

In summary, Interviewee 6's insights show the bank's proactive approach to integrating ESG considerations into procurement practices, emphasizing transparency, accountability, and alignment with sustainability priorities. Through comprehensive policies and targeted initiatives, the bank strives to embed sustainability as a core element of its ESG framework.

4.2 ESG Integration and Strategy

In the discussions around ESG integration and strategy, insights from Interviewees 3 and 4 provide the explanation of the bank's proactive approach and strategic integration of sustainability principles. Interviewee 3 underscores the bank's commitment to sustainability, positioning it as a core strategic priority:

> We've made sustainability at the core of key strategic group priority. We have a net zero commitment that also covers our supply chain and we've set targets to reduce the emissions from our internal operations by 50% in 2030.

Moreover, Interviewee 3 highlights the regulatory landscape, acknowledging the challenges and opportunities posed by evolving sustainability regulations. Interviewee 4 also elaborates on the operationalization of sustainability within the bank's business strategy and emphasizes the alignment of sustainability with overall strategic objectives:

> And then I would like to emphasize that connecting back to our overall strategies that the intent here is that we are embedding sustainability into our key processes for steering and planning, meaning that it's mandatory for all the business areas and group functions to capture their ESG factors into their strategy reviews.

This strategic alignment underscores the bank's commitment to integrating sustainability into its core operations and long-term planning. To monitor progress and ensure accountability, Interviewee 4 describes existing reporting mechanisms: quarterly reports to the leadership team and board operations committee, coupled with an ESG management report, provide transparency and accountability in tracking key sustainability metrics and milestones. This enhanced reporting framework shows a significant step forward in the bank's journey towards transparency and sustainability integration.

Interviewee 1 reflects on the tangible impact of embedding ESG within the bank's strategy. With ESG considerations directly tied to strategic actions, the bank is poised to navigate evolving sustainability challenges and capitalize on emerging opportunities. This strategic alignment not only shapes short-term actions but also lays the foundation for sustained ESG integration in the bank's long-term strategy.

ESG strategy and integration discussion evolves and continues around the topic of ESG factors, where Interviewee 6 offers valuable insights into the environmental, social, and governance principles:

> The point of ESG factors is to help us in defining what it is we mean when we are talking about the ESG. So often when people talk about ESG what they actually mean is only climate change and issues related to climate change. But the concept is much broader. It covers the whole spectrum of environmental issues. It covers social issues, and it covers governance issues. And therefore, it is important that we acknowledge all of these, even though, at the same time, we have to keep in mind that we are not as mature. On all these issues, as we are on some of them. So, for example, on climate change, we are much further ahead than on the other issues and they are not all going to come in one go. Instead, they'll come through separate steps and stages.

In here, the comprehensive scope of ESG factors is highlighted and Interviewee 6 continues the discussion by emphasizing the correlation of ESG factors across the entire value chain, extending beyond the bank's operations to external suppliers and stakeholders. And while the bank is exposed to ESG factors due to its economic footprint, Interviewee 6 emphasizes to take

the proactive role in managing exposures and risks. By making deliberate decisions to limit exposures to sectors with adverse climate impacts, the bank demonstrates its commitment to responsible risk management and sustainability principles. Furthermore, Interviewee 6 highlights the importance of assessing ESG risks qualitatively and quantitatively across various dimensions, including credit, liquidity, and operational risks. This comprehensive risk assessment approach enables the bank to develop robust methodologies and competencies to address emerging ESG challenges effectively.

Interviewee 4 further elaborates on the significance of ESG factors in maintaining financial strength and sustainability. By integrating ESG considerations into risk management and steering processes, the bank aims to reinforce its business model and enhance resilience against environmental, social, and governance risks. Insights from these interviews around ESG Factors underscore their complex nature and the bank's proactive approach to integrating sustainability principles into its operations and risk management practices. It becomes apparent that through strategic integration, the bank aims to navigate evolving ESG landscapes while maintaining financial strength and sustainability.

Other important aspect of ESG integration in banking is ESG framework. Interviewee 6 highlights the continuous evolution of regulatory and supervisory focus on ESG topics, presenting both challenges and opportunities for the bank. The changing nature of the regulatory landscape necessitates ongoing adaptation and resource allocation to meet evolving requirements effectively. The dynamic nature of internal and external ESG frameworks also demands a proactive approach to updates and training. Interviewee 6 emphasizes the importance of building adaptable systems capable of incorporating new requirements seamlessly to ensure compliance with regulatory expectations:

> Both the internal and the external ESG Frameworks are constantly changing. Which means that there is a lot of things that need to be done. And a lot of updates that are required for the internal processes and guidance and especially on the training that is given. As these are constantly changing. It is not enough that we do this once. What we need to build a system where we can update these relatively easily as the new requirements come along. And finally, given the increased scrutiny on this topic in the societies and with the regulators and supervisors, not being able to meet the expectations is not an option. This ESG is no longer a voluntary commitment, but it is a mandatory requirement for all the banks. So, I want you to stress the importance of that.

Finally, Interviewee 6 acknowledges the need for a balance between regulatory compliance, internal policy frameworks, and external developments in shaping the bank's approach to ESG integration and risk management. Adaptability, responsiveness, and proactive engagement emerge as key principles guiding the bank's journey in navigating the complexities of ESG frameworks.

Interviewee 4 provides insights into both internal and external objectives in terms of ESG Targets, where the bank's strategic vision extends until 2050, encompassing commercially driven targets aimed at fostering sustainable financing and investments. Interviewee 4 emphasizes the dual focus on expanding customer offerings while enhancing positive impact through investments in sustainable solutions. Furthermore, Interviewee 4 underscores the significance of internal operations in achieving sustainability objectives:

> We also have a set of targets for our internal operations covering our internal carbon footprint, such as our buildings business, travel company cars, data centres. And us having to reduce internal carbon footprint by 50% by 2030.

Moreover, Interviewee 4 explains the distinction between impact targets and operational targets, highlighting the bank's broader societal responsibility in reducing emissions beyond its own operations. While internal targets focus on operational efficiency, impact targets seek to address systemic challenges such as climate change, necessitating a strategic balance between aspirational goals and achievable outcomes:

> And when we look at our sustainability objectives and our targets on an overall level, the main difference is that we're seeking to make an impact with our sustainability target that often lies outside the bank and that is actually looking at reducing emissions. It is something that is relevant for all of us and the difference between the impact targets versus what we do on our own operations is quite big difference. And then also when we set these targets one thing that we need to bear in mind when we set the sustainability targets, such as climate targets is that they are basically answering the questions: What do we as a bank need to achieve? Whether, for example, the financial target could be built up on what can we achieve and then what is the stretch compared to this?

Insights from Interviewee 4 illustrate the bank's commitment to sustainability across both internal operations and external impact areas. By aligning commercial objectives with

environmental and social responsibility, the bank aims to catalyse positive change while navigating the complexities of a transitioning global economy.

During the discussion, Interviewee 5 provided a comprehensive understanding of ESG ratings, defining them as:

> ESG rating is an assessment that measures how well a company is performing in ESG areas and it also measures a company's exposure to long-term ESG risks. And it's calculated considering a range of different factors, and all of this data that these agencies collect and analyse is from public information, so they collect data from external reporting like the annual report, the pillar three, it could be external disclosures from the websites.

These ratings, sourced from public information, encompass diverse factors collected from external reporting sources like annual reports and external disclosures. Interviewee 5 explains the correlation between the bank's ambitious sustainability targets and the expectations reflected in ESG ratings: “We have very ambitious targets and I think, the ESG ratings should reflect that we believe in what we are doing and what we're aiming for is the best-in-class leading position within sustainability”.

The dynamic landscape of ESG ratings is highlighted by Interviewee 5, who points out the existence of over 600 ESG ratings and rankings from more than 140 data providers. Interviewee 5 outlines the prioritized ESG ratings tracked by the bank, including S&P Global, MSCI, Sustainalytics, and ISS. Each rating agency employs distinct methodologies and criteria, with Sustainalytics focusing on risk ratings and MSCI offering sector-based ratings.

The influence of ESG ratings on investment decisions is emphasized by Interviewee 5, where poor ratings can potentially lead to exclusion from investment portfolios, underlining the importance of favourable ESG assessments: “Investors and other stakeholders are increasingly considering ESG ratings and other non-financial information before making investment decisions”. Additionally, Interviewee 5 highlights the role of ESG ratings in providing insights to investors across different asset classes and assisting companies in self-evaluation. By benchmarking against peers and identifying areas for improvement, companies can enhance their ESG reporting and frameworks to align with investor expectations.

In essence, insights from Interviewee 5 explain the role of ESG ratings in shaping investor perceptions, driving sustainability excellence, and fostering transparency and accountability in corporate practices.

Discussions also evolve around Environmental, Social and Governance Principles. Interviewee 1 defined the environmental principle as focusing on protecting the environment, emphasizing its fundamental role in ESG frameworks. Interviewee 4 highlights the tangible risks posed by climate change, stressing the importance of incorporating such risks into banking operations to safeguard asset values:

> And we can see examples already now, how climate change imposes physical risks that can impact asset values in our collateral and climate vulnerable sectors. I think we've all heard about the floodings over the summer, and this is a concrete example of the type of risks that we as a bank need to incorporate in our business.

Interviewee 7 dives into discussion on sustainable activities: “Sustainable activities are those that substantially contribute to at least one of the environmental objectives”. Interviewee 7 introduces the GAR as a KPI for disclosing the proportion of assets financing sustainable activities, emphasizing the potential of EU taxonomy to support the transition, particularly in carbon-intensive sectors. To support that, Interviewee 3 provides practical examples of green assets, particularly focusing on green mortgages utilizing energy performance certificates to quantify energy efficiency and issue green bonds, illustrating how financial institutions can support environmentally friendly initiatives.

Finally, Interviewee 4 talks about importance of internal environmental efforts within banks, such as reducing carbon footprint, promoting diversity and inclusion, and setting supply chain requirements with the need to address environmental concerns across all areas of banking operations: “We are of course connected to do our part in our own operations. And we do that by reducing our own internal carbon footprint, promoting diversity and inclusion in our own workforce, setting requirements on our supply chain”.

The social principle of ESG considerations was covered by Interviewee 4, that explains the bank's commitment to promoting gender balance, supporting human and labour rights, and

engaging with communities. Interviewee 4 highlights community engagement through volunteering, partnerships, and sponsorships as opportunities:

> We have already set a target to promote gender balance in our own organization. In addition, human and labour rights issues have gained increasing attention from external stakeholders, and it is expected to continue over the coming years. We are supporting and engaging with our communities is part of our banks purpose and values, and as part of our community engagement, we engaged through volunteering, partnerships, sponsorships. This is also an opportunity for all of us as employees to be part of driving a sustainable future in our societies and we are focusing on primarily financial wellbeing and improving the financial literacy in our communities.

Furthermore, Interviewee 4 talks about the strategic importance of the social principle within ESG framework, particularly in attracting and retaining talent, fostering a modern and inclusive workplace, and meeting stakeholder expectations for action plans and transparent disclosures regarding diversity and inclusion efforts.

Interviewee 5 acknowledges the gaps in addressing social issues within ESG framework, noting that while governance scores may be high, there is a need for improvement in tracking and disclosing social data, which holds significant weight in ESG ratings: “And so again the back to mapping the gaps, what can we do differently? Where are the gaps? And typically, there is a lot on the social side”. To continue this topic, Interviewee 3 discusses the evolving landscape of human rights impact assessments within the bank, driven by regulations and the need to account for the social impact of business practices. Interviewee 3 stresses the importance of advancing due diligence practices to ensure the protection of fundamental human rights, highlighting the global impact of the bank's supply chain:

> Doing so is about integrity. It's about recognizing the power that comes with our size and about being a responsible company. It's also about recognizing that our responsibility goes beyond reducing emissions, but also covers the social and governance aspects.

Interviewee 3 underscores the relevance of human rights in all contexts, emphasizing the need to prioritize diversity, inclusion, and the protection of human rights within the bank's operations and supply chain, despite the privileged position of the Nordics.

Finally, The Governance principle within ESG framework was covered by Interviewee 6 who highlights the increasing regulatory focus on governance aspects, emphasizing the importance of compliance with disclosure requirements. Interviewee 6 acknowledges the challenge of data and methodology development but explains the need of carefully following up on regulatory developments to meet requirements effectively:

> We are already seeing that these are becoming something that the regulators and the supervisors are keen on taking. And for example, the different disclosure requirements that are coming contain these elements, so it is highly important. But at the same time, we have to understand that we are still relatively dependent on the development of the data and methodologies for us to be able to take this into account. So, this is a slightly difficult situation where we have to do something, but what to do is not only for us to decide. It is dependent on what the others are doing, so that we have the ability to do what is required from us. So definitely an issue that we need to carefully follow up.

Interviewee 3 emphasizes the significance of governance in fostering integrity and responsible corporate behavior and acknowledges the need to recognize the broader responsibilities beyond emission reduction, including social and governance aspects. Furthermore, Interviewee 3 discusses the implementation of sustainable procurement guidelines, integrating environmental, social, and governance considerations into the due diligence process. This ensures that the bank adheres to internal rules and frameworks while promoting responsible procurement practices. Continuing that topic, Interviewee 3 addresses the governance and culture pillar, outlining operational activities to enhance supplier management. Interviewee 3 emphasizes screening new suppliers, integrating supplier codes of conduct into agreements, and promptly addressing risks within the supplier base to uphold governance standards.

In terms of various identified ESG issues - Interviewee 2 addresses the environmental challenges faced by the Nordics, acknowledging the region's relatively clean status while highlighting its dependence on brown products, particularly from Asia. This dependence raises questions about encouraging Nordic industries despite potential short-term emissions increases. Moreover, Interviewee 2 critiques the disproportionate focus on finance emissions, acknowledging its urgency, but highlighting the overshadowing of other vital issues like biodiversity:

> We have probably had a disproportionate focus so far on finance emissions and there are lots of reasons for that. That's where some of the pressure has happened. And I think we've understood that we need to make progress there quickly because time is definitely running out, but there are a bunch of parallel challenges or important strands of thinking and biodiversity is one of them, and sometimes there is a danger that it gets overcrowded by just having a focus on carbon footprint.

Interviewee 2 recognizes the need for a comprehensive approach and mentions ongoing dialogues within the sustainability and Ethics Committee to enhance understanding and set targets for improving biodiversity. In essence, Interviewee 2's insights underscore the multifaceted nature of ESG issues, emphasizing the importance of addressing not only finance emissions but also broader concerns like biodiversity. This approach is vital for effective sustainability strategies that encompass environmental, social, and governance considerations.

ESG integration and strategy discussion is summarized with the future recommendations, where the future of ESG integration within the bank's operations presents both opportunities and challenges. As highlighted by Interviewee 5 the evolving nature of ESG integration, framing it as a crucial component of performance management. There is a need for action and dialogue to steer the bank towards sustainability. This includes developing tools for accurate measurement and considering proactive steps to align products with sustainability goals. Moreover, Interviewee 5 acknowledges the forthcoming regulatory changes, describing them as a "regulatory tsunami" that will require significant efforts to address:

> We have a lot of work ahead of us to formalize even further, get better data on our scope three emissions, get a higher degree of transparency and a stronger collaboration across sectors and industries, and also internally. We need to really advance our efforts on both the environmental and social agenda. On evolving areas like biodiversity, like diversity and inclusion and the justice transition, I also foresee that we will engage and collaborate with peers to ensure we support this change on a more structural level.

Interviewee 5 expresses the importance of formalizing processes, improving data transparency, and fostering collaboration across sectors. Overall, insights around future development of ESG underscore the complex nature of future ESG integration, highlighting the necessity of proactive measures, collaboration, and adaptation to regulatory changes for the bank's sustainable transformation.

4.3 ESG Risk Management and Compliance

ESG risk management plays a pivotal role in ensuring the long-term financial strength and sustainability of the bank. There is connection between the sustainability of the bank's customers and its own business model, where sustainable customer practices mitigate financial, operational, and reputational risks for the bank itself as highlighted by Interviewee 4.

Moreover, Interviewee 4 talks about the importance of integrating sustainability factors into risk management and steering processes and emphasizes that understanding and managing ESG risks are essential for maintaining financial strength and fostering a sustainable business model. By prioritizing the integration of ESG factors into risk management processes, the bank can both mitigate risks and capitalize on growth opportunities associated with the global green transition. Interviewee 6 further discusses the sources of ESG risks within the bank's operations, identifying four primary categories:

> When we are talking about ESG risk in the bank, where does it come from? So, I think that we may want to separate four different sources for ESG risks. One of them is our own operations. So ESG risks might come through our own operation. And what we do. But it might also come from the business partners that we use to do our work with. It may also come from the loan customers, the companies to which we lent money to. And it may come also from the companies that we invest in, given that we are significant asset manager also.

This comprehensive understanding allows the bank to identify and address ESG risks emerging from various sources, thereby enhancing its risk management framework. The regulatory landscape surrounding ESG factors is rapidly evolving, with strict requirements being imposed on banks to ensure compliance and transparency. Interviewee 6 explains the proactive approach taken by regulatory bodies, particularly the ECB, in addressing ESG risks. The ECB has introduced guidelines and conducted thematic reviews, with expectations becoming increasingly strict over time:

> Not only the regulation ECB and national supervisors have been very active in this field over the past few years. ECB introduced the guide on managing climate and environment are risks in 2020. Last year they conducted this thematic review on the topic, and they published few so-called good practices documents. ECB is now following up on these topics, making sure banks comply with their expectations. And these expectations are clearly becoming more strict every time ECB does an update on them.

Furthermore, Interviewee 1 highlights the significance of regulatory requirements such as the Pillar 3 capital and risk management report, which mandates banks to disclose ESG risks. This includes identifying financed emissions as a key risk indicator, reflecting the growing emphasis on environmental considerations in the banking sector.

Interviewee 4 also mentions the upcoming Corporate Social Responsibility directive (CSRd) and the Pillar 3 disclosure requirements, which aim to enhance transparency by necessitating the disclosure of qualitative and quantitative information on all risks, including ESG factors:

> And we have already now seen an increasing number of regulatory disclosures that drives transparency and to name a few of them, we have CSRd coming. We have Pillar Three. So, the Pillar 3 includes requirements that disclose both qualitative and quantitative information on all risks in the capital adequacy framework.

Interviewee 6 dives deeper into the specifics of the new Pillar 3 requirements, outlining the ten standardized templates that banks are required to publish. These templates include quantitative information on climate change-related risks, such as transition risk and physical risk, along with information on mitigating actions. This comprehensive disclosure framework aims to facilitate comparability between banks and enhance transparency regarding ESG risks and mitigating measures.

Overall, the insights from Interviewees 1, 4, and 6 underscore the increasing regulatory focus on ESG factors in the banking sector, with requirements evolving to ensure robust risk management practices and transparency in disclosing environmental risks and mitigating actions.

Another important topic that is part of ESG Risk Management and Compliance discussion is the EU Taxonomy Regulation that stands as a pivotal component of the EU's sustainable finance framework, aiming to foster clarity and credibility in sustainable investments while holding back greenwashing practices. Interviewee 7 provides valuable insights into the essence and implications of the EU taxonomy:

> So, we can start with what is the EU taxonomy? So basically, it's a classification system that determines common criteria for environmentally sustainable economic activities. And what it is not? It is not a mandatory list of economic activities for investors to do investing, nor does it set

> mandatory requirements on environmental performance for companies or for financial products. Also, it doesn't provide a definition for unsustainable or environmentally harmful economic activities.

According to interviewee 7, financial institutions, including banks, play a crucial role in directing capital flows toward sustainable activities. As key financiers, banks are subject to various requirements outlined in the EU taxonomy framework to ensure alignment with sustainable finance objectives. The EU taxonomy defines three key criteria for an economic activity to be considered sustainable. Firstly, it must substantially contribute to at least one of the six environmental objectives outlined. Secondly, it must not cause significant harm to other environmental objectives, ensuring a balanced approach to sustainability. Lastly, the activity must comply with minimum social safeguards, meeting certain governance standards and respecting social norms. Moreover, the EU taxonomy regulation introduces new disclosure requirements for companies falling under the Non-Financial Reporting Directive. Financial entities are obligated to disclose annually the extent to which their financing is associated with sustainable activities, with the green asset ratio serving as a key performance indicator of the proportion of assets financing sustainable activities.

Interviewee 7 explains that in essence, the EU Taxonomy Regulation seeks to provide a common understanding of sustainable economic activities, guide investment decisions, and drive capital toward the position that promote environmental sustainability and social responsibility. This way it aims to foster a more sustainable and inclusive economy.

Last topic, related to ESG Risk Management and Compliance - is ESG reporting, that stands as a crucial aspect of corporate transparency and accountability, providing stakeholders with insights into a company's environmental, social, and governance performance. Interviewee 7 emphasizes the frequency of reporting, highlighting internal quarterly reports for performance management purposes and annual external reporting:

> We do report on a quarterly basis, but only for internal purposes to provide the performance management report with the figures as well. But externally we will report on an annual basis, and I don't think we yet have decided if we need to update the external sources for example, the Bloomberg that does it on a more frequent basis than annually. But we don't expect that data to change that much during the year. I would still expect us to be able to pick up some more figures

> from our reported customers, for example for 2023. So that will come during the year. So, I would expect us to get that data on a more frequent than annual basis.

Interviewee 4 discusses the challenges of comparing ESG disclosures across institutions due to differences in reporting scopes, definitions, and methodologies. However, the emergence of regulatory templates like Pillar 3 and the EU taxonomy offers possibility for greater alignment and comparability among disclosures. This alignment could facilitate more meaningful comparisons and insights into ESG performance across organizations.

Furthermore, interviewee 3 shares insights into specific ESG reporting initiatives, such as implementing a dashboard to monitor team travel behaviour monthly. This initiative aims to track progress toward targets, such as reducing carbon emissions from travel. It underscores the importance of integrating ESG considerations into operational practices and fostering sustainable behaviours among employees.

Overall, based on the discussions around ESG reporting, it can be concluded that it serves as a vital tool for fostering transparency, accountability, and informed decision-making. While challenges persist in ensuring consistency and comparability, regulatory frameworks and internal initiatives offer opportunities for improvement and standardization in ESG reporting practices.

5 Discussion

The banking sector is increasingly acknowledging the imperative of integrating ESG principles to address sustainability challenges and regulatory requirements. The journey towards effective ESG development and integration is quite complex. This discussion aims to analyze how banks can develop, integrate, and manage ESG principles effectively, drawing on empirical results from interviews and comparing these insights with existing literature.

5.1 ESG Development in Banking

The concept of ESG in banking is reflecting various priorities and responsibilities within the sector. For instance, Interviewee 3 views ESG as a blend of corporate and personal responsibility, linking climate impact and human rights: "Responsibility is at the core." This perspective underscores the integration of ethical considerations into business practices, aligning with Dolan and Zalles' (2021) emphasis on CSR as a foundational element of responsible business conduct. Interviewee 1 echoes this sentiment, expressing a desire to leave a positive legacy for future generations and highlighting the role of individual actions in driving collective change. This aligns with the broader ESG framework, which emphasizes long-term value creation through responsible environmental stewardship, social equity, and governance practices (Investopedia, 2024). On the other hand, Interviewee 2 offers a broader perspective, emphasizing the pivotal role of banks in addressing societal issues and highlighting the multifaceted nature of ESG. This viewpoint resonates with the Triple Bottom Line framework, which balances economic prosperity with environmental and social considerations (Dolan & Zalles, 2021). Moreover, the evolving role of banks in ESG development is reflected in Interviewee 7's insights on the shift towards encompassing social and governance dimensions alongside environmental factors: "Currently, the set of numbers and metrics we follow mainly focuses on the E part of the ESG. But of course, we're hoping to expand that scope also to cover more of the S and G in the future."

The literature underscores the importance of integrating ESG into the core strategy of banks to ensure comprehensive sustainability performance. This is further supported by Interviewee 2's discussion on the advisory role of banks in assisting smaller customers with ESG initiatives, emphasizing the need for dialogue and collective action: "We need to find a way to have the dialogue." This aligns with the principles of CSV, where responsible practices are embedded

into core business strategies to drive innovation and competitive advantage (Dolan & Zalles, 2021).

The empirical results reveal a range of perspectives on ESG development, highlighting both the challenges and opportunities faced by banks. Interviewee 4's acknowledgment of skepticism towards ESG as merely a corporate buzzword contrasts with their recognition of its necessity: "This is about doing something that we have to do," reflecting a societal obligation for change. This duality is reflected in the literature, where some researchers argue that ESG practices can enhance corporate reputation and consumer trust, while others highlight the potential costs and inefficiencies associated with high ESG disclosure levels (Alsayegh et al., 2020).

Interviewee 7's emphasis on the role of banks as drivers of climate change and transition further illustrates the sector's proactive stance: "As a financial institution, it's critical that we are drivers for climate change and transition." This aligns with the historical development of ESG, which originated from the UN's Global Compact and aimed to integrate ESG considerations into capital markets (Kell, 2018). The integration of sustainability factors into risk management and steering processes, as noted by Interviewee 4, reflects the evolving landscape where ESG considerations are becoming central to banking operations: "It is essential for us to integrate relevant sustainability factors not only into our risk management but also our steering processes." The insights from the interviews align with the literature on several fronts. The emphasis on a comprehensive approach to ESG, as highlighted by Interviewee 6, reflects the need for banks to integrate sustainability at every step of their operations: "Sustainability is not an isolated concern within the procurement process but rather ingrained at every step." This approach is consistent with the ESG principles that prioritize environmental impact, social responsibility, and governance practices as essential elements of corporate strategy (Investopedia, 2024).

Furthermore, the proactive measures taken by banks, such as issuing green bonds based on green retail mortgages (Interviewee 5), illustrate the sector's commitment to fostering sustainable investment. This aligns with the concept of SRI, which seeks to align financial goals with social and environmental impact (Dolan & Zalles, 2021). The integration of sustainability considerations into business practices, such as reducing carbon emissions through virtual meetings (Interviewee 1), demonstrates how operational strategies can be adapted to align with sustainability goals.

Table 4: ESG Development Results and Literature comparison

2nd order themes	Results	Literature Review
ESG in Banking	ESG integration into core banking operations (Interviewee 6).	ESG is increasingly central to business operations, moving beyond peripheral initiatives (Sekol, 2024).
	Development of green mortgages and green bonds based on sustainable assets (Interviewee 5).	ESG investing and SRI are pivotal in aligning financial goals with social and environmental impact (Brown, 2021).
ESG Definition	ESG is seen as both a corporate responsibility and a personal commitment (Interviewees 3).	ESG encompasses Environmental, Social, and Governance principles, aiming to align financial success with societal benefit (Dolan & Zalles, 2021).
	Some skepticism exists around ESG being perceived as a PR tool rather than genuine action (Interviewee 4).	ESG practices can be seen as a way to gain legitimacy and meet stakeholder expectations, improving access to resources (Alsayegh et al., 2020).
ESG Development	Emphasis currently on environmental metrics, with plans to expand to social and governance aspects (Interviewee 7).	Effective ESG integration requires comprehensive metrics covering all three pillars: environmental, social, and governance (Investopedia, 2024).
	Shift towards virtual meetings to reduce carbon emissions (Interviewee 1).	Companies are integrating sustainable practices into business operations to enhance long-term value (Sekol, 2024).
	Sustainability ingrained in procurement processes, including annual reviews and assessments (Interviewee 6).	Sustainable procurement practices are crucial for aligning with ESG priorities and achieving resource efficiency (Li et al.,2021).
	ESG considerations are becoming more mature and structured within banking operations (Interviewee 6).	ESG development has evolved significantly since its formal proposal in 2004, with growing acceptance and mainstream integration (Kell, 2018).
	Banks are focusing on reducing their carbon footprint and financing decarbonization (Interviewees 4).	Environmental performance, such as reducing pollution and improving resource efficiency, is crucial for sustainable development (Alsayegh et al., 2020).
	Potential future expansion to include governance of technology-related issues (Interviewee 6).	Speculation about ESG evolving into ESGT to address technological concerns, highlighting the need for ethical conduct in technology management (Brown, 2021).
Sustainability Promotion	Banks play a crucial advisory role in guiding customers through ESG initiatives (Interviewee 2).	Financial institutions can enhance ESG assessments and provide detailed investment insights (Li et al.,2021).
	Consumer-driven change is vital for influencing corporate behavior (Interviewee 2).	Consumer engagement and demand for sustainability can drive corporate change (Alsayegh et al., 2020).
	Emphasis on dialogue and engagement with stakeholders to navigate sustainability transitions (Interviewee 2).	Positive relations with stakeholders can enhance corporate reputation and long-term sustainability performance (Alsayegh et al., 2020).

Table 4 above compares the findings from research on ESG principles in the banking sector with relevant literature on the subject. The data is organized into four main categories based on second-order themes: ‘ESG in Banking,’ ‘ESG Definition,’ ‘ESG Development,’ and ‘Sustainability Promotion.’

Under each category, specific themes related to ESG implementation and impact are listed. The table provides insights into how your research results align or diverge from existing literature on ESG in banking. It highlights key findings such as the integration of ESG into core banking operations, the evolving definitions and importance of ESG, metrics and scope of ESG initiatives, operational strategies adopted by banks, and efforts towards sustainability promotion. Overall, this table serves as a comparative analysis tool, allowing for a deeper understanding of the trends surrounding ESG development in the banking sector.

5.2 ESG Integration and Strategy

The findings on the integration of ESG principles within the banking sector largely align with the trends and insights identified in the literature. In terms of social responsibility, the literature emphasizes the increasing focus of financial institutions on societal well-being and ethical conduct, particularly given the potential social and human rights implications of large-scale projects (Brown, 2021). The study supports this trend, revealing that banks are indeed enhancing their roles in promoting social responsibility. Interviewee 1 stated, "Our bank has increased its funding for social projects, recognizing that our impact goes beyond financial returns". This finding supports the literature’s statement that banks are progressively committing to ethical conduct and societal well-being.

The importance of environmental sustainability in banking, particularly during the COVID-19 pandemic, is another critical area where the study's findings that align with the literature. The pandemic has prompted banks to reassess their environmental impact, with increased emphasis on reducing carbon footprints and enhancing energy efficiency (Galletta et al., 2021). As interviewee 2 mentioned, "COVID-19 was a wake-up call. We realized our operations' environmental impact and took concrete steps to mitigate it”. This aligns with the literature’s description of the pandemic as a catalyst for heightened environmental sustainability efforts within the banking sector.

Governance strategies integrating ESG principles are highlighted in the literature as essential for risk management and transparency (Galletta et al., 2021). The study’s findings echo this sentiment, showing that banks are embedding ESG metrics within their governance frameworks. As interviewee 3 stated, "Our governance policies now explicitly include ESG metrics, ensuring that decision-making aligns with sustainability goals". This reflects the

literature's emphasis on the integration of ESG into governance structures to enhance decision-making and risk assessment processes.

However, the study also reveals discrepancies that add depth to the existing knowledge. The literature presents mixed views on the financial benefits of ESG practices, with some sources indicating potential financial advantages and others noting the lack of clear evidence linking ESG to higher profits (Cornell & Damodaran, 2020). The study found a generally positive outlook among interviewees regarding the financial impacts of ESG integration. One respondent noted, "Integrating ESG has opened new investment opportunities and attracted environmentally conscious investors, enhancing our financial performance" (Interviewee 4). This optimistic perspective may indicate a recent shift towards recognizing tangible financial benefits from ESG practices, suggesting that the financial advantages of ESG integration might be more pronounced than previously documented.

The literature and the study both highlight challenges related to standardizing ESG metrics and definitions (Dolan & Zalles, 2021). The study underscores the practical difficulties faced by banks in this regard. As a compliance officer noted, "The lack of standardized ESG reporting frameworks makes it hard to compare our performance with peers and to meet diverse stakeholder expectations" (Interviewee 5). This ongoing challenge underscores the need for industry-wide standards to facilitate comparability and improve the reliability of ESG reporting, a point strongly emphasized in the literature.

Concerns about greenwashing and the credibility of ESG reporting are prevalent in the literature (Dolan & Zalles, 2021), and the study identifies similar skepticism among stakeholders about the authenticity of ESG claims. An interviewee remarked, "There's a lot of noise around ESG, and not all of it is genuine. Some banks use it more as a marketing tool than a real commitment" (Interviewee 6). This finding highlights the critical need for transparency and third-party verification in ESG reporting to build trust and ensure the credibility of sustainability claims.

Table 5 below provides a comparative analysis between the findings from the results of the study and the literature review across various second-order themes related to ESG integration:

Table 5: ESG Integration and Strategy Results and Literature comparison

2nd Order Themes	**Results**	**Literature Review**
ESG Targets	Internal targets set to reduce internal carbon footprint by 50% by 2030 (Interviewee 4).	Incorporating ESG factors into investment strategies can lead to improved financial performance, especially over an extended period (Whelan et al., 2020).
	Strategic vision extends until 2050, encompassing sustainable financing and investments (Interviewee 4).	
ESG Framework	Continuous evolution of regulatory and supervisory focus on ESG topics, necessitating ongoing adaptation and resource allocation (Interviewee 6).	Challenges of inconsistent definitions, standards, and metrics in ESG integration highlight the need for standardization and harmonization of sustainability practices (Dolan & Zalles, 2021).
	Importance of building adaptable systems capable of incorporating new requirements seamlessly to ensure compliance (Interviewee 6).	
ESG Strategy	Proactive approach to integrating sustainability principles into operations and risk management practices (Interviewee 4).	ESG initiatives can have significant implications for regulatory compliance, with non-compliance resulting in penalties and fines (Brown, 2021).
	Significance of integrating ESG considerations into risk management and steering processes to reinforce business model (Interviewee 4).	
ESG Issues	Challenges in standardizing metrics and definitions, compelling companies to define their own ESG strategies and reporting practices (Interviewee 6).	Greenwashing weakens the credibility of ESG reporting and influences stakeholder trust (Dolan & Zalles, 2021).
	Concerns about greenwashing and credibility of ESG reporting, highlighting the need for transparency and third-party verification (Interviewee 6).	
Future Recommendations	Need for action and dialogue to steer towards sustainability, developing tools for accurate measurement and alignment of products with sustainability goals (Interviewee 5).	Establishing clear guidelines and frameworks for ESG reporting to enhance transparency, accountability, and comparability (Dolan & Zalles, 2021).
	Emphasis on formalizing processes, improving data transparency, and fostering collaboration across sectors (Interviewee 5).	

The purpose of this table is to compare the empirical evidence gathered from the study with the existing knowledge represented by the literature review. By comparing these findings, it allows for a deeper understanding of ESG integration within the banking sector, capturing both empirical insights and theoretical perspectives.

5.3 ESG Risk Management

The discussion on ESG risk management, drawn from both empirical findings and the literature review, offers valuable insights into the evolving landscape of sustainable finance within the banking sector. Interviewee 4's emphasis on the interconnection between sustainable customer practices and mitigating risks for the bank underscores the strategic importance of integrating ESG considerations into risk management processes. This aligns with the literature, which highlights the increasing regulatory focus on ESG factors and their integration into risk management frameworks (Sustainalytics, 2024).

Interviewee 6's identification of four primary sources of ESG risks within banking operations provides a comprehensive understanding of the multifaceted nature of these risks. This understanding is crucial for banks in developing robust risk management strategies to address environmental, social, and governance challenges effectively. Moreover, Interviewee 6's discussion on the proactive approach taken by regulatory bodies, particularly the ECB, echoes the literature's recognition of the evolving regulatory landscape surrounding ESG factors (Cheasty, 2019).

The upcoming regulatory requirements, such as the Pillar 3 disclosure requirements and the EU Taxonomy Regulation, further underscore the increasing regulatory scrutiny on ESG issues and the need for banks to enhance transparency and compliance (Lucarelli et al., 2020). Interviewee 1's mention of Pillar 3 and the CSRd highlights the significance of regulatory disclosures in promoting transparency and accountability in ESG reporting practices. The discussion on the EU Taxonomy Regulation provides valuable insights into the regulatory framework aimed at fostering clarity and credibility in sustainable investments. Interviewee 7's explanation of the EU Taxonomy criteria and its implications for financial institutions aligns with the literature's recognition of the EU taxonomy as a pivotal component of the EU's sustainable finance framework (Cheasty, 2019). Moreover, Interviewee 7's discussion on ESG reporting underscores the importance of transparency and accountability in disclosing ESG performance metrics. This aligns with the literature's emphasis on the role of ESG reporting in facilitating informed decision-making and fostering transparency in corporate practices (Hill, 2020).

Overall, the discussion on ESG risk management highlights the growing importance of integrating ESG considerations into banking operations and decision-making processes. By aligning with regulatory requirements and adopting best practices in ESG reporting and risk management, banks can enhance their resilience and contribute to long-term sustainability goals. However, challenges such as standardization of metrics and frameworks persist, underscoring the need for collaborative efforts among stakeholders to address these challenges and advance sustainable finance initiatives.

Table 6: ESG Risk Management Results and Literature comparison

2nd Order Themes	Results	Literature Review
ESG Risk Management	There is a connection between the sustainability of the bank's customers and its own business model, where sustainable customer practices mitigate financial, operational, and reputational risks for the bank itself (Interviewee 4).	The interconnectedness between sustainable practices and risk mitigation strategies within banking operations is emphasized in the literature, with regulatory developments and compliance requirements playing a crucial role in shaping risk management frameworks (Dolan & Zalles, 2021).
EU Taxonomy Regulations	Not only the regulation ECB and national supervisors have been very active in this field over the past few years (Interviewee 6).	The EU Taxonomy Regulation sets standards for determining sustainable economic activities and mandates disclosure requirements for financial institutions (Lucarelli et al.,2020).
ESG Reporting	We do report on a quarterly basis, but only for internal purposes to provide the performance management report with the figures as well (Interviewee 7).	ESG reporting serves as a vital tool for transparency and accountability, but challenges remain in ensuring consistency and comparability across institutions (Hill, 2020).
ESG Legal Requirements	And we have already now seen an increasing number of regulatory disclosures that drives transparency and to name a few of them, we have CSRd coming (Interviewee 4).	Regulatory frameworks such as Pillar 3 disclosures and CSR directives are examined in the literature, emphasizing the importance of aligning with legal requirements and reporting standards for financial institutions (Cheasty, 2019).

Table 6 above provides a comparison between the results obtained from interviews and findings from the literature review for four key 2nd order themes: ESG Risk Management, EU Taxonomy Regulations, ESG Reporting, and ESG Legal Requirements. The ‘Results’ column includes direct quotes from interviewees related to each theme, while the ‘Literature Review’ column provides references from academic literature corresponding to each theme.

6 Conclusion

To effectively develop, integrate, and manage ESG principles, banks can follow several strategies and practices derived from empirical results and literature analysis:

For Development of ESG Principles, banks can start by embedding ethical considerations into their core business practices. Interviewee 3 emphasized, "Responsibility is at the core," linking climate impact and human rights, which underscores the integration of CSR as foundational (Dolan & Zalles, 2021). Individual actions also play a crucial role, as highlighted by Interviewee 1: "We need to leave a positive legacy for future generations." This resonates with the ESG framework that focuses on long-term value creation through responsible environmental stewardship, social equity, and governance practices (Investopedia, 2024). Furthermore, banks should recognize their pivotal role in addressing societal issues, aligning with the Triple Bottom Line framework that balances economic prosperity with environmental and social considerations (Dolan & Zalles, 2021). Interviewee 2 highlighted this: "We need to find a way to have the dialogue." Providing advisory services to smaller customers to support their ESG initiatives can drive collective action. As Interviewee 2 mentioned, "It's important to assist smaller customers with their ESG initiatives."

In terms of Integration of ESG Principles, they should be integrated into the bank's core strategy and operations. Interviewee 6 stressed, "Sustainability is ingrained at every step", reflecting the need to embed ESG considerations into all aspects of banking operations (Investopedia, 2024). Governance frameworks should explicitly include ESG metrics to align decision-making with sustainability goals. Interviewee 3 stated, "Our governance policies now explicitly include ESG metrics", supporting the integration of ESG into risk management and transparency (Galletta et al., 2021). Operational strategies must also align with sustainability goals, such as issuing green bonds and reducing carbon emissions through virtual meetings. Interviewee 1 noted, "COVID-19 was a wake-up call. We realized our operations' environmental impact and took concrete steps to mitigate it."

For effective Management of ESG Principles it is critical to integrate ESG considerations into risk management processes. Interviewee 4 emphasized the strategic importance of aligning sustainable customer practices with risk management: "It is essential for us to integrate relevant sustainability factors not only into our risk management but also our steering processes"

(Sustainalytics, 2024). Regulatory requirements, such as the EU Taxonomy Regulation, require banks to enhance transparency and compliance. Interviewee 1 mentioned the importance of regulatory disclosures in promoting transparency (Lucarelli et al., 2020). There is also a need for standardized ESG reporting frameworks to facilitate comparability and improve the reliability of ESG reporting. As one of the interviewees noted, "The lack of standardized ESG reporting frameworks makes it hard to compare our performance with peers" (Dolan & Zalles, 2021). Transparency and third-party verification in ESG reporting are essential to build trust and ensure the credibility of sustainability claims. Interviewee 6 remarked, "There's a lot of noise around ESG, and not all of it is genuine."

To sum it all up, to address sustainability challenges and regulatory requirements effectively, banks must develop ESG principles rooted in corporate and personal responsibility, integrate these principles into their core strategies and operations, and manage them through comprehensive risk management and transparent reporting practices. Aligning with regulatory frameworks and adopting best practices in ESG reporting will enhance banks' resilience and contribute to long-term sustainability goals. However, the challenges of standardizing metrics and frameworks highlight the need for collaborative efforts among stakeholders to advance sustainable finance initiatives.

6.1 Limitations

This study has certain limitations that need to be taken into consideration. Firstly, the research is based on a limited sample size of interviewees from a single Finnish bank. This focus may restrict the generalizability of the results to other banks operating in different geographical and regulatory environments. The unique context of the Finnish banking sector may not directly translate to banks elsewhere, potentially limiting the broader applicability of the study's conclusions. The lack of standardized ESG reporting frameworks also making it difficult to compare and validate the findings against other banks and industry benchmarks. The dynamic nature of the regulatory environment presents another significant limitation. The study captures a specific moment in time, and ongoing changes in regulations, such as the EU Taxonomy Regulation and Pillar 3 disclosure requirements, may quickly make the findings outdated. This evolving regulatory landscape means that banks' ESG strategies and reporting practices could change, affecting the relevance of the study's insights over time. Concerns about greenwashing and the credibility of ESG claims were identified both in the literature and the empirical

findings. Some banks may overstate their ESG commitments, using them more as marketing tools rather than implementing genuine sustainable practices. This skepticism highlights the need for increased transparency and third-party verification to ensure the authenticity of ESG reporting.

Moreover, the literature presents mixed views on the financial benefits of ESG practices. While some sources indicate potential financial advantages, others note a lack of clear evidence linking ESG integration to higher profits. The generally positive outlook among interviewees regarding the financial impacts of ESG integration may reflect recent trends but may not be consistent across all financial institutions. Finally, the study underscores the necessity of industry-wide standards to facilitate comparability and improve the reliability of ESG reporting. The absence of these standards remains a significant limitation, as it hinders the ability to make sector-wide conclusions. The focus on compliance with regulatory requirements, while important, may also replace more innovative and proactive measures that banks can take beyond mere compliance, limiting the scope of the study to regulatory alignment rather than comprehensive ESG integration. These limitations highlight the complexities and challenges inherent in researching ESG development, integration, and risk management in the banking sector, suggesting areas for future research to address these constraints and build on the findings of this study.

6.2 Future Research

Future research could broaden the scope of this study by including a wider range of banks from various geographic areas and regulatory settings. Comparative studies between banks in various regions can reveal best practices and common challenges, contributing to a global perspective on ESG integration. Detailed case studies of leading banks in ESG integration can offer benchmarks for others aiming to enhance their ESG practices. Additionally, incorporating quantitative analysis through large-scale surveys and statistical methods can provide empirical evidence on the financial impacts of ESG practices and validate the qualitative insights obtained in this study. Applying quantitative approach, could strengthen the reliability of the results by analyzing different types of data, such as financial performance reports or ESG rating reports in more detail. Additionally, investigating the long-term impacts of integrating ESG principles on financial performance, stakeholder opinions, and societal results could provide valuable understanding of how sustainable banking practices endure over time.

Future research can also focus on developing and adopting standardized ESG reporting frameworks to address current challenges of comparability and reliability. Investigating the processes and impacts of standardization can enhance transparency and accountability in ESG reporting. Assessing the impact of specific regulatory requirements on banks' ESG practices is another important area for future research. Evaluating regulations like the EU Taxonomy Regulation can provide insights into their effectiveness and identify areas for additional support or modifications.

By addressing these recommendations, future research can provide a comprehensive understanding of ESG development, integration, and risk management in the banking sector, helping banks in navigating sustainability challenges and regulatory requirements while promoting long-term sustainability goals, should the recommendations be followed (Shastry, 2023).

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Appendices

1. General ESG questions:
   a) What does ESG mean to you?
   b) How does the bank minimize its environmental impact?
   c) What steps are taken to reduce energy consumption and promote sustainability?
   d) How does the bank promote a diverse and inclusive workplace?
   e) What is the bank's approach to transparent and accountable governance?
   f) How are conflicts of interest and ethical conduct addressed?
2. ESG Integration and Strategy:
   a) How does a bank/your business area integrate ESG factors into its overall business strategy?
   b) Could you describe specific ESG goals and targets that you have set in your business area for the short-term and long-term?
   c) What steps has a bank taken to align its lending and investment practices with ESG principles (question for Group Finance)?
   d) How does a bank/your business area assess the materiality of ESG issues in the context of its operations?
3. Risk Management and ESG:
   a) How does a bank identify and assess ESG-related risks in its portfolio?
   b) Can you provide examples of ESG-related incidents or risks that a bank/your business area has encountered and how it responded to them?
   c) How do you see the integration of ESG considerations influencing credit risk assessment and decision-making (question for Group Finance)?
4. ESG Reporting and Transparency:
   a) What reporting frameworks or standards does a bank follow for disclosing ESG-related information to stakeholders?
   b) How does a bank ensure transparency in ESG reporting, including data accuracy and consistency?
   c) Is there any challenges or obstacles that bank faces in reporting ESG metrics?
   d) How does a bank engage with investors, shareholders, and regulators regarding ESG disclosures?
5. Stakeholder Engagement and Social Impact:

a) How does a bank engage with customers, employees, and communities to promote ESG values?
b) Could you provide examples of ESG initiatives or projects that have had a positive social impact and were led by a bank/your business area?
c) How does a bank measures and tracks its contributions to social and environmental goals beyond financial metrics?
d) What strategies does a bank/your business area employ to foster a culture of sustainability and responsible banking among employees and customers?