

## The Public Sector Deposit Fund Advisory Board

### ESG Integration into the CCLA PSDF, COIF and CBF Deposit Funds

As an asset manager our aim is to meet our clients' financial objectives in a way that aligns with their values and furthers their mission. We believe we have a duty to go beyond the boundaries of traditional investor engagement and work with the industry to address systemic risks that threaten communities, the environment and ultimately investment markets. We achieve this through the following three principles.

#### Act

We act as an agent for 'change' because we believe investment markets can only ever be as healthy as the environment and communities that support them.

#### Assess

We assess environmental, social and governance (ESG) standards because we believe that a combination of legislation, regulation and changing societal preferences will negatively impact the most unsustainable business models.

#### Align

As we are the guardians and not the owners of the assets we manage, we aim to invest in a way that aligns with our clients.

As part of this commitment, we seek to integrate the Good Investment principles above into the Deposit funds managed by CCLA.

We explain our current approach, why it is no longer fit for purpose and how we propose improving the integration of the above Good Investment principles in the way CCLA selects banks for and manages the deposit funds.

### **1. Current approach**

The Deposit funds managed by CCLA currently only integrate the 'Assess' principle.

CCLA's current approach to integrating ESG factors into the deposit fund investment process is based on the assessment of bank governance through CCLA's proprietary governance rating. Where banks receive a 'high risk rating', investment committee approval is required prior to new or continued investment. Currently the only counterparty requiring continued approval is ABN AMRO Bank.

The current approach to climate change is based on Task Force on Climate-related Financial Disclosures (TCFD) reporting. TCFD is currently developing a voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.

A similar approach is taken to Equator Principles supporters. The Equator Principles (EP) are intended to serve as a common baseline and risk management framework for financial institutions to identify, assess and manage environmental and social risks when financing projects.

The Social and Environmental section of the review draws on our sustainability assessment based on the Sustainability Accounting Standards Board financial materiality matrix, incorporating data from MSCI.

Unlisted counterparties are reviewed on a number of criteria mirroring the quantitative and qualitative indicators for listed counterparties.

Client values are not integrated into the selection of counterparties and engagement with banks has been sporadic, mostly focused on pertinent governance issues.

## **2. Why a new approach?**

With ever evolving best practice and regulation, client feedback and to better align with CCLA's good investment principles a new enhanced approach is necessary.

The current approach is in line with CCLA's Assess principle, however it currently does not integrate the Act and Align principles.

Since the previous approach was created a number of assessment benchmark and best practice tools have been developed to assess banks' performance on environmental and social indicators by important stakeholders such as the Transition pathway Initiative of the London School of Economics and the World Benchmarking Alliance.

The Institutional Investors Group on Climate Change (IIGCC), Ceres and the Interfaith Centre for Corporate Responsibility (ICCR) created a banks engagement group to engage with the largest banks on environmental issues.

Clients have increasingly questioned our inclusion of some counterparties based on climate change issues.

Finally, the FCA is due to release its final draft of the UK Sustainable Disclosure Regulation (SDR). This new regulation would enable funds to qualify for one of the three sustainability labels, one of which is the 'Improver' label. 'Improver' funds are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the asset management firm. In line with CCLA's Good Investment principles, the improver label is likely going to become the label CCLA funds will seek to qualify for. An enhancement of the current approach will set the foundation for potential future qualification into the Improver label.

## **3. Proposed future approach**

### Assess.

The proposed future approach involves an expansion of indicators. It includes an assessment of material financial sustainability factors based on the Sustainability Accounting Standard's Board (SASB) sector financial materiality matrix and CCLA's governance rating as before.

The SASB matrix identifies ESG factors that are most relevant (material) to a given sector. In this case this would be commercial banks. Commercial banks' main financially material risk areas are:

- Data security. Ensuring the privacy and data security of personal financial data is an essential responsibility of the Commercial Banks industry.
- Financial Inclusion & Capacity Building. Commercial banks, as their primary business activity, have to continuously balance their capacity building efforts with the risks and opportunities associated with lending to unbanked, underbanked, or underserved customers.
- Incorporation of Environmental, Social, and Governance Factors in Credit Analysis including financed emissions. As financial intermediaries, commercial banks contribute to significant positive and negative environmental and social externalities through their lending practices.
- Business Ethics. Commercial banks must adhere to a complex and inconsistent set of rules relating to performance and conduct as well as disclosure on issues including insider trading, anti-trust, price fixing, and market manipulation.
- Systemic Risk Management. In an effort to demonstrate how the risks associated with banks' size, complexity, interconnectedness, substitutability, and cross-jurisdictional activity are being managed, commercial banks should enhance disclosure on quantitative and qualitative metrics measuring how well they are positioned to absorb shocks arising from financial and economic stress and meet stricter regulatory requirements.

The governance rating includes an assessment of is based on the following good governance indicators which, when combined, produce a governance risk rating for each company. the percentages show the weighting given to each score:

- 15 % capital stewardship assesses the quality of management and its ability to generate cash and manage growth
- 15 % accounting assesses the quality of the company's financial statements and its accounting
- 35 % board composition assesses the quality of individuals, independence and track record
- 35 % shareholder rights assesses the ownership structure of the company

The environmental and social indicators have been expanded. In particular, the environmental and climate change section now considers banks':

- Financed emissions targets in line with a 1.5°C trajectory
- The strength of their net zero target disclosures
- Lending policies in key sectors
- Approach to fossil fuel financing
- Absolute fossil fuel financing
- Fossil fuel financing trend

The social indicators have been expanded to include:

- The financial institution's commitment to paying its workers a living wage
- Financing for underserved populations
- CCLA mental health benchmark score

We also include MSCI's controversy flag indicator (green = no controversies, yellow = moderate, orange = severe, red = most severe controversy). Each section score is weighted and added to an overall score (total points). The governance and environmental sections both receive 40% of the weight in line with the importance of governance factors and client feedback and interested in environmental performance of banks. The SASB and social section both receive 10% of the weighting each.

Data is taken from multiple sources including MSCI, CDP (formerly known as the Carbon Disclosure Project), The World Benchmarking Alliance's Financial System Benchmark, the Rain Forest Alliance's 'Banking on Climate Chaos' report.

For unlisted banks we have narrowed down the approach to understand whether the right policies are in place in each ESG dimension. No weighting is applied and research is undertaken by reviewing company disclosures manually.

#### Align.

If a bank scores less than 30% of the points we propose that it will be excluded and no deposits should be made with the bank.

#### Act.

For banks scoring between 30% and 45% of the points we propose to engage with them on issues identified through the ESG indicators outlined above under 'Assess'.

### **4. Review**

Due to the breadth of different data sources, we plan to review certain areas of this matrix at different times.

Controversies, SASB indicators and the CCLA Governance rating will be monitored quarterly.

All other data, aside from those data points taken from the World Benchmarking Alliance (WBA) will be monitored on an annual basis.

A full re-assessment will be undertaken every two years including the WBA data points.

We will monitor evolving best practice and consider further enhancement at full re-assessment.

### **5. Worked example**

Barclays.

SASB Score: Barclays receives 10.3 out of 30 points due to higher risk of ethics issues based on the assessment of their policies and controversies, good practices on data protection and lacking behind peers on the management of social and ethical risks related to their products and services.

Governance (10.19/20 points): Barclays received a medium risk score on the CCLA Governance Rating and has some evidence of consistent public policy engagement policies.

Environment (30.91/60 points): Barclays has some evidence of financed emissions targets alignment with 1.5 degrees and further strong target setting disclosure, lending policies to high emitting sectors and declining fossil fuel financing trend.

Social (18.75/40 points): Barclays is a Living Wage Employer, with limited evidence of financing programmes for underserved populations and a good CCLA Mental health Benchmark score.

Controversies (3/10): Barclays is involved in controversies related to its Customers, Governance, Human Rights and Labor Rights impacts. It faces significant concerns related to Bribery & Fraud.

Overall Barclays receives 46.44% of the available points or 17<sup>th</sup> out of a sample of 65 banks.

Barclays would not be excluded and would not fall within our scope of engagement.

## **6. Scoring Matrix**

The scoring matrix below shows an excerpt of the full assessment. Where banks are marked approved, they are currently being used or able to be used for deposits by the cash investment team.

Listed MSCI Name	Investment STATUS	Score (max30)	SASB RANK	Score (max 20)	GOV RANK	Score (max 60)	ENV RANK	Score (max 40)	SOC RANK	Controversy Flag	Controversy Point Deduction	Total Points	Rank Total	Percentage
LLOYDS BANKING GROUP PLC	APPROVED	11.50	48	8.92	13	36.29	2	18.61	3	Yellow	7	27.76	1.00	56.66
Nordea Bank Abp	APPROVED	14.40	22	4.79	58	33.44	5	3.64	40	Green	10	27.10	2.00	55.30
KBC GROEP NV	APPROVED	19.10	2	9.16	9	25.70	23	5.93	19	Green	10	26.45	3.00	53.97
STANDARD CHARTERED PLC	APPROVED	12.00	40	9.94	7	30.03	11	17.20	4	Yellow	7	25.57	4.00	52.19
DNB BANK ASA	APPROVED	17.00	4	7.08	38	26.04	21	2.80	45	Green	10	25.23	5.00	51.48
Commerzbank Aktiengesellschaft		15.30	15	7.12	37	33.59	4	2.80	45	Yellow	7	24.76	6.00	50.53
THE BANK OF NOVA SCOTIA	APPROVED	16.20	9	9.13	10	22.34	29	2.80	45	Green	10	24.49	7.00	49.97
UNITED OVERSEAS BANK LIMITED	APPROVED	12.70	34	8.67	18	22.50	28	5.93	19	Green	10	24.33	8.00	49.66

UBS Group AG	APPROVE D	7.30	60	7.03	39	38.29	1	14.36	9	Ora nge	3	23 .6 3	9. 0 0	48.2 2
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main	APPROVE D	13.43	29	4.79	58	25.22	25	2.80	4 5	Gree n	10	23 .6 3	1 0. 0	48.2 2
ING Groep N.V.	APPROVE D	11.80	44	9.03	11	28.51	15	2.80	4 5	Yell ow	7	23 .1 4	1. 0 0	47.2 3
MORGAN STANLEY		7.90	59	7.41	30	27.79	17	14.36	1 2	Yell ow	7	22 .9 7	1 3. 0	46.8 8
OVERSEA-CHINESE BANKING CORPORATION LIMITED	APPROVE D	16.20	8	7.38	31	19.70	39	5.93	1 9	Gree n	10	23 .0 4	1 2. 0	47.0 3
HSBC HOLDINGS PLC	APPROVE D	15.70	11	6.96	40	34.47	3	12.80	1 4	Ora nge	3	22 .7 5	6. 0 0	46.4 4
BARCLAYS PLC	APPROVE D	10.20	53	10.19	4	30.91	8	18.76	1	Ora nge	3	22 .6 7	7. 0 0	46.2 7
INTESA SANPAOLO SPA		14.40	22	10.00	6	25.34	24	5.93	1 9	Yell ow	7	22 .8 3	4. 0 0	46.6 0
VIRGIN MONEY UK PLC/Clydesdale		15.50	13	8.77	16	18.34	46	4.36	2 6	Gree n	10	22 .8 3	5. 0 0	46.5 9
NATWEST GROUP PLC	APPROVE D	12.40	37	5.77	46	32.96	6	18.66	2	Ora nge	3	21 .9 3	9. 0 0	44.7 5

DBS GROUP HOLDINGS LTD	APPROVED	11.90	42	7.25	35	19.04	44	4.36	26	Green	10	22.14	18.00	45.18
QATAR NATIONAL BANK (Q.P.S.C.)		17.00	4	4.84	56	19.44	43	4.36	26	Green	10	21.85	20.00	44.58
National Bank of Kuwait S.A.K.P		19.00	3	6.93	41	16.24	51	4.36	26	Green	10	21.60	21.00	44.09
WESTPAC BANKING CORPORATION	APPROVED	12.20	39	4.80	57	28.07	16	2.80	45	Yellow	7	21.32	23.00	43.50
SOCIETE GENERALE SA	APPROVED	15.20	17	10.03	5	27.66	18	14.36	9	Orange	3	21.37	22.00	43.61
COMMONWEALTH BANK OF AUSTRALIA	APPROVED	15.80	10	10.25	3	29.14	14	2.80	45	Orange	3	20.95	28.00	42.75
CANADIAN IMPERIAL BANK OF COMMERCE	APPROVED	15.50	13	7.31	32	23.86	26	4.36	26	Yellow	7	21.12	24.00	43.10
Svenska Handelsbanken AB	APPROVED	16.60	6	4.59	60	15.74	57	12.80	14	Green	10	21.07	25.00	43.00
CLOSE BROTHERS GROUP PLC		15.30	15	10.69	2	12.04	60	4.36	26	Green	10	21.06	26.00	42.98
Banco Santander, S.A.	APPROVED	13.40	31	6.82	43	30.14	10	15.93	6	Orange	3	21.05	22.70	42.96



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CREDIT AGRICOLE SA	APPROVED	10.70	51	5.28	50	26.11	20	5.93	19	Yellow	7	20.89	29.00	42.62	
TORONTO-DOMINION BANK	APPROVED	13.30	32	8.26	21	21.58	33	8.21	17	Yellow	7	20.76	30.00	42.36	
BNP PARIBAS SA	APPROVED	8.90	57	11.33	1	25.86	22	15.93	6	Orange	3	20.69	31.00	42.23	
NATIONAL BANK OF CANADA	APPROVED	21.00	1	8.36	20	12.04	60	2.80	45	Green	10	20.54	32.00	41.92	
FIRST ABU DHABI BANK P.J.S.C		14.90	18	4.06	65	17.64	47	2.80	45	Green	10	20.45	33.00	41.73	
BANK OF MONTREAL	APPROVED	13.70	27	8.82	14	20.02	38	5.93	19	Yellow	7	20.17	35.00	41.16	
Woori Financial Group Inc.		14.90	19	9.30	8	19.59	40	5.93	19	Yellow	7	20.31	34.00	41.44	
Mitsubishi UFJ Financial Group, Inc.	APPROVED	15.60	12	5.13	51	23.46	27	4.36	26	Yellow	7	20.10	36.00	41.02	
Skandinaviska Enskilda Banken AB	APPROVED	13.70	27	6.49	45	22.04	31	4.36	26	Yellow	7	19.88	37.00	40.58	

NORTHERN TRUST CORPORATION		10.50	52	7.71	25	13.50	59	2.80	45	Green	10	19.81	38.00	40.43
Riyad Bank SJS		14.50	20	9.00	12	10.79	64	4.36	26	Green	10	19.80	39.00	40.41
AGRICULTURAL BANK OF CHINA LIMITED		11.80	44	4.45	62	16.05	52	3.06	43	Green	10	19.69	40.00	40.18
NATIONAL AUSTRALIA BANK LIMITED	APPROVED	11.90	42	7.20	36	29.90	12	2.80	45	Orange	3	19.64	41.00	40.08
Deutsche Bank Aktiengesellschaft		5.30	64	7.50	27	30.68	9	2.80	45	Orange	3	19.41	42.00	39.62
THE GOLDMAN SACHS GROUP, INC.		7.30	61	5.44	48	29.15	13	13.90	13	Orange	3	19.29	44.00	39.37
DANSKE BANK A/S	APPROVED	6.80	63	5.09	52	32.25	7	2.80	45	Orange	3	19.23	45.00	39.24
Sumitomo Mitsui Trust Holdings, Inc.	APPROVED	14.00	25	7.28	33	20.14	37	2.80	45	Yellow	7	19.32	43.00	39.42
Hana Financial Group Inc.		13.90	26	7.42	29	19.59	40	2.80	45	Yellow	7	19.14	46.00	39.06
Caixabank, S.A.		12.90	33	5.03	53	21.76	32	4.36	26	Yellow	7	19.11	44.70	38.99

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Mizuho Financial Group, Inc.	APPROVED	14.40	22	7.28	34	19.44	42	2.80	45	Yellow	7	19.07	48.00	38.93
Sumitomo Mitsui Financial Group, Inc.		16.50	7	5.43	49	20.21	36	4.36	26	Yellow	7	19.01	49.00	38.79
Qatar Islamic Bank (Q.P.S.C)		14.40	21	6.66	44	10.79	64	4.36	26	Green	10	18.86	50.00	38.48
ANZ GROUP HOLDINGS LIMITED	APPROVED	12.00	40	7.53	26	27.50	19	2.80	45	Orange	3	18.82	51.00	38.41
The Bank of East Asia, Limited		13.43	29	5.01	54	12.04	60	4.36	26	Green	10	18.60	52.00	37.96
ABN AMRO Bank N.V.	APPROVED	11.50	48	4.25	64	20.70	34	3.64	40	Yellow	7	18.16	53.00	37.06
The Bank of New York Mellon Corporation	APPROVED	11.70	46	8.51	19	16.00	54	4.36	26	Yellow	7	18.08	54.00	36.89
JPMORGAN CHASE & CO.	APPROVED	9.50	55	8.78	15	18.89	45	16.89	5	Orange	3	17.04	56.00	34.78
Nomura Holdings, Inc.		7.20	62	7.50	28	22.09	30	12.80	14	Orange	3	17.17	55.00	35.04

CITIGROUP INC.	APPROVED	12.70	35	6.85	42	20.25	35	14.36	9	Orange	3	16.88	57.00	34.45
CHINA CONSTRUCTION BANK CORPORATION		10.00	54	5.66	47	16.75	48	2.35	64	Yellow	7	16.86	58.00	34.42
INDUSTRIAL AND COMMERCIAL BANK OF CHINA LIMITED		12.40	38	4.90	55	15.79	56	3.01	44	Yellow	7	16.48	59.00	33.64
BANK OF CHINA LIMITED		11.70	46	4.27	63	16.75	48	2.31	65	Yellow	7	16.48	60.00	33.63
CHINA CITIC BANK CORPORATION LIMITED/CITIC Group		11.10	50	4.56	61	16.05	52	2.45	62	Yellow	7	16.26	61.00	33.19
MACQUARIE GROUP LIMITED.		9.40	56	8.01	22	12.04	60	3.64	40	Yellow	7	15.99	62.00	32.63
BANK OF AMERICA CORPORATION	APPROVED	8.20	58	7.87	23	15.82	55	15.51	8	Orange	3	15.18	63.00	30.98
ROYAL BANK OF CANADA	APPROVED	12.60	36	8.75	17	14.99	58	6.06	18	Orange	3	14.70	64.00	30.00
WELLS FARGO & COMPANY		3.50	65	7.85	24	16.26	50	2.40	63	Orange	3	13.57	65.00	27.69