

IPMC ESG REPORT LAUNCH

For Nigerian Banks



JUNE 2024

INDEPENDENT PROJECT MONITORING COMPANY LIMITED

Environmental, Social, And Governance Evaluation

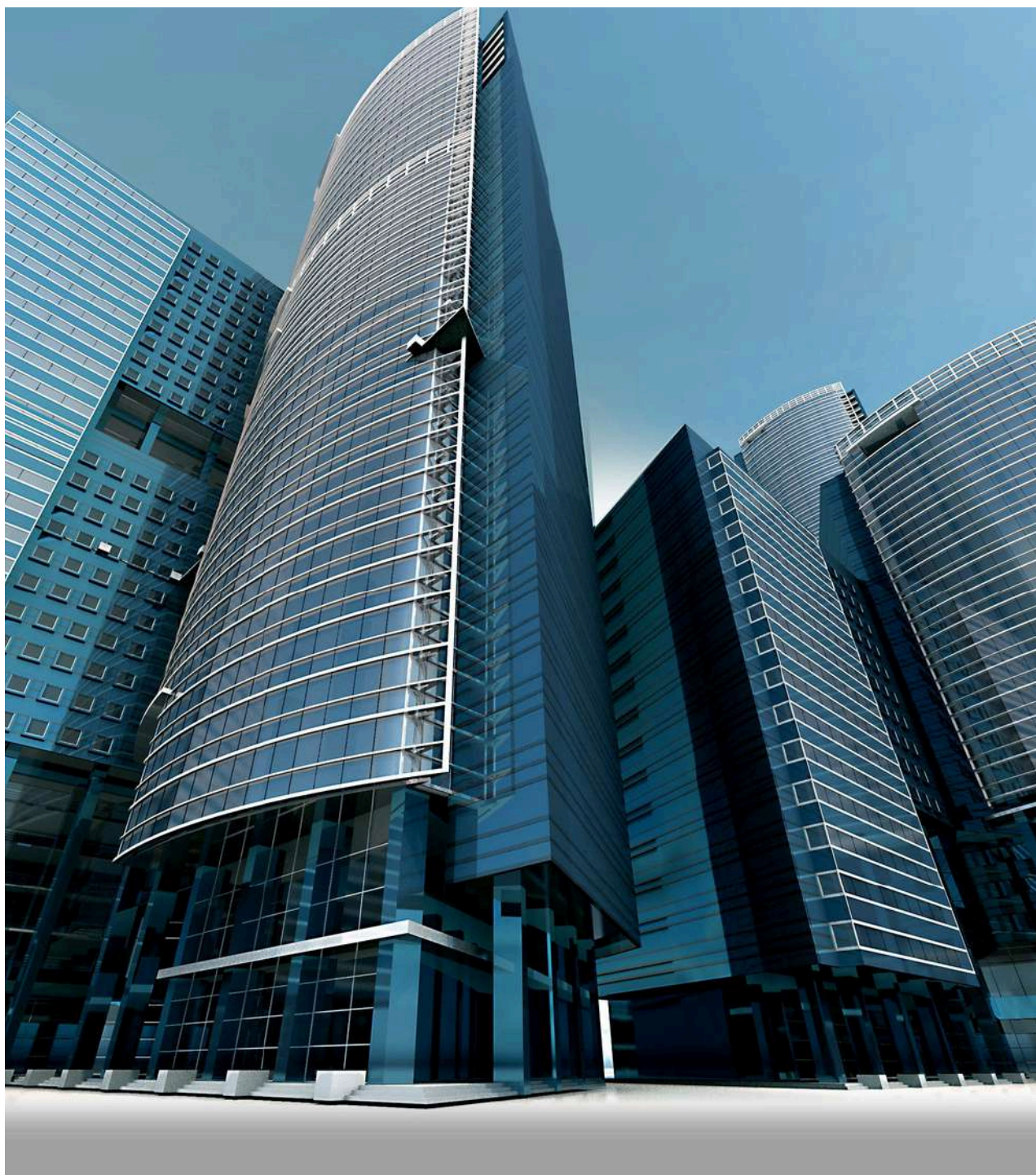
Overview of IPMC ESG Ratings

Globally, there is a growing demand for corporate organizations across sectors to integrate sustainability practices into their corporate strategies. Environmental, social, and governance (ESG) ratings are one of the platforms to drive industry players to scale up their sustainability reporting and compliance. This has propelled IPMC to launch the 2023 ESG ratings report for the banking and the insurance sectors, which was themed: "Driving Impact: Harnessing ESG for Sustainable Finance". A keynote speech was given by the Special Assistant to the President on National Economic Council (NEC) and Climate Change, Rukayat El-Rufai. She underscored the urgent need to integrate ESG considerations into the core of our financial systems. As financial institutions navigate the complexities of the modern financial landscape, it becomes increasingly clear that sustainability is not just a moral imperative but a strategic necessity. She stressed that corporations could leverage frameworks, standards, ratings, and guidelines to establish clear expectations and avoid blind spots in their operations. Ratings will help corporations set ESG performance standards, benchmark performance, and stimulate healthy competition in ESG performance. It also fosters accountability and transparency. Our ESG ratings have highlighted key gaps in the governance, environmental, and social reporting practices of banks. These findings reveal a pressing need for regulatory intervention to enhance transparency and accountability in the banking sector. Some of our findings reveal that 69% of rated banks have a board diversity policy explicitly reporting factors such as gender, race, ethnicity, country of origin, nationality, or cultural background, while 14% lack a publicly available diversity policy. 48% of rated banks disclose details of their materiality issues and processes, but 21% do not.

Alarmingly, only 3% of rated banks set relevant ESG targets and measure progress towards them. The environmental findings are equally concerning, with only 24% of rated banks reporting Scope 1 emissions (direct emissions from owned or controlled sources), 21% reporting Scope 2 emissions (indirect emissions from the generation of purchased electricity), and a mere 10% reporting Scope 3 emissions (all other indirect emissions occurring in a company's value chain). From a social perspective, 73% of participating banks publicly report on social indicators, indicating a strong emphasis on social issues. However, only 3% of rated banks have a comprehensive group-wide strategy guiding their corporate citizenship or philanthropic activities. Research has shown that few African banks are making public commitments to achieve net-zero financed emissions in support of the Paris Agreement targets. This is evidenced with only four African banks namely; Abu Dhabi Commercial Bank PJSC (UAE), Commercial International Bank (CIB) (Egypt), First Abu Dhabi Bank P.J.S.C. (UAE) and Investec Group (South Africa) out of 145 global members signing the United Nations Environmental Programme Net Zero Banking Alliance aimed at aligning lending, investments and capital market activities with the net zero greenhouse gas emission target by 2050. This commitment requires the banks to individually and independently set and publicly disclose long-term and intermediate targets that support meeting the net-zero 2050 GHG emission goal. Secondly, members are committed to establish an emissions baseline and annually measure and report the emissions profile of their lending, investment and capital market activities.

Thirdly, the banks are committed to use widely accepted science-based decarbonization scenarios to set both long-term and intermediate targets that are aligned with a net-zero by 2050 goal. Finally, they are equally required to regularly review targets to ensure consistency with current climate science.

The first phase of our ratings focuses on 29 Nigerian banks. The Nigerian banking sector plays a vital role in the country's economy by expanding financial services and access. Notably, the financial and insurance sectors have emerged as among the fastest-growing sectors in Nigeria, with real GDP growth rates of 26.36% and 26.53% recorded in 2022 and 2023 respectively.



“88% of investment professionals currently rely on third party ESG ratings, with projections suggesting this figure will rise to 92% in the future.” Stanford University, 2022

This assessment is prepared in response to the growing awareness of the importance of Environmental, Social, and Governance (ESG) practices in the financial sector, with banks looking to integrate ESG considerations into their operations, risk management, and reporting, to stay adaptive to changing regulations, increasing expectations from regulatory institutions, customers, intergovernmental agencies, investors and general public.

The launch of this rating report provides an opportunity to communicate key findings, insights, and recommendations to stakeholders, raise awareness about the importance of ESG considerations in corporate decision-making, and demonstrate organizational commitment to transparency, accountability, and sustainability. It serves as a platform for engaging stakeholders, building relationships, and catalyzing action towards a more sustainable future. We benchmark our process against the leading global ESG rating companies such as S & P Global and MSCI Sustainability Ratings.

These weightings were determined following a comprehensive analysis of both global rating standards and the specific nuances of the Nigerian business landscape, resulting in allocations of 13% for environmental factors, 43% for social factors, and 44% for governance factors.

The environmental pillar focuses solely on greenhouse gas emissions, decarbonization strategy, and climate strategy.

The social pillar encompasses aspects such as labour practices, human rights, human capital development, talent attraction and retention, corporate citizenship, social reporting coverage, and privacy protection.

Our governance pillar weighting structure covers key sub factors such as corporate governance, risk management, business ethics, policy influence, information security/cybersecurity, and materiality.

The questions are designed to measure the performance of the participants banks across the each of the pillars of sustainability.

Process Review: Our ratings methodology, process and procedures were reviewed and validated by PriceWaterhouseCoopers(PwC).

Some of the key gaps identified at within the Banking industry and the recommendation are highlighted below:

- **Inconsistent Governance Practices:** The lack of a public diversity policy in 14% of banks and the failure of 21% to disclose materiality issues undermine stakeholder trust and transparency.
- **Weak Target Setting and Monitoring:** Only 3% of rated banks are setting and measuring targets which signifies a major gap in accountability and long-term strategic planning.
- **Inadequate Environmental Reporting:** The low reporting rates for Scope 1, 2, and especially Scope 3 emissions reflect insufficient environmental responsibility.
- **Fragmented Social Strategy:** While many banks report on social indicators, the absence of a cohesive group-wide strategy for corporate citizenship suggests a lack of integrated social responsibility.
- **Expand Environmental Reporting Requirements:** Create incentives for banks to conduct mandatory reporting of Scope 1, 2, and 3 emissions to ensure comprehensive environmental accountability.
- **Develop Comprehensive Social Responsibility Strategies:** Encourage banks to adopt and publicly share group-wide strategies for corporate citizenship and philanthropic activities and reporting. Subjecting the report to third-party limited or full assurance will help mitigate the effect of greenwashing.
- **The regulators have a key role to play in enhancing the governance, environmental, and social practices of banks, leading to a more transparent, accountable, and responsible banking sector.**

To address these gaps and foster a more accountable and transparent banking sector, the following regulatory measures are recommended:

- **Drive More Public Disclosure of Governance Metrics:** The regulators can require all banks to develop and publicly disclose comprehensive board diversity policies, detailing factors such as gender, race, ethnicity, nationality, and cultural background.
- **Promote Materiality Reporting:** Implement regulations that compel banks to publicly disclose their materiality issues and the processes used to identify them.
- **Require Target Setting and Progress Measurement:** Obligate banks to set clear ESG targets and regularly report on their progress towards these goals

Sector Risk Summary

Environmental exposure

Scope 1 addresses an organisation's direct emissions, whereas Scope 2 addresses indirect emissions. Through these scopes, financial institutions such as banks contribute to environmental risk by operating diesel generators, burning fuel from company-owned vehicles (direct emissions), and purchasing electricity to power their buildings (Indirect emissions). Financial institutions can reduce their carbon footprint by implementing renewable energy production strategies (such as solar panels) or by driving electric vehicles. Scope 3 emissions are indirect emission which can take the form of financing organisations that harm the environment. Some of the negative impacts are air pollution, land pollution, and water pollution. Financing organisation with poor environmental sustainability pose as key risks as the bank can be found to cause harm to the environment and community they operate, which exposes the bank to credit, legal and reputational risk.

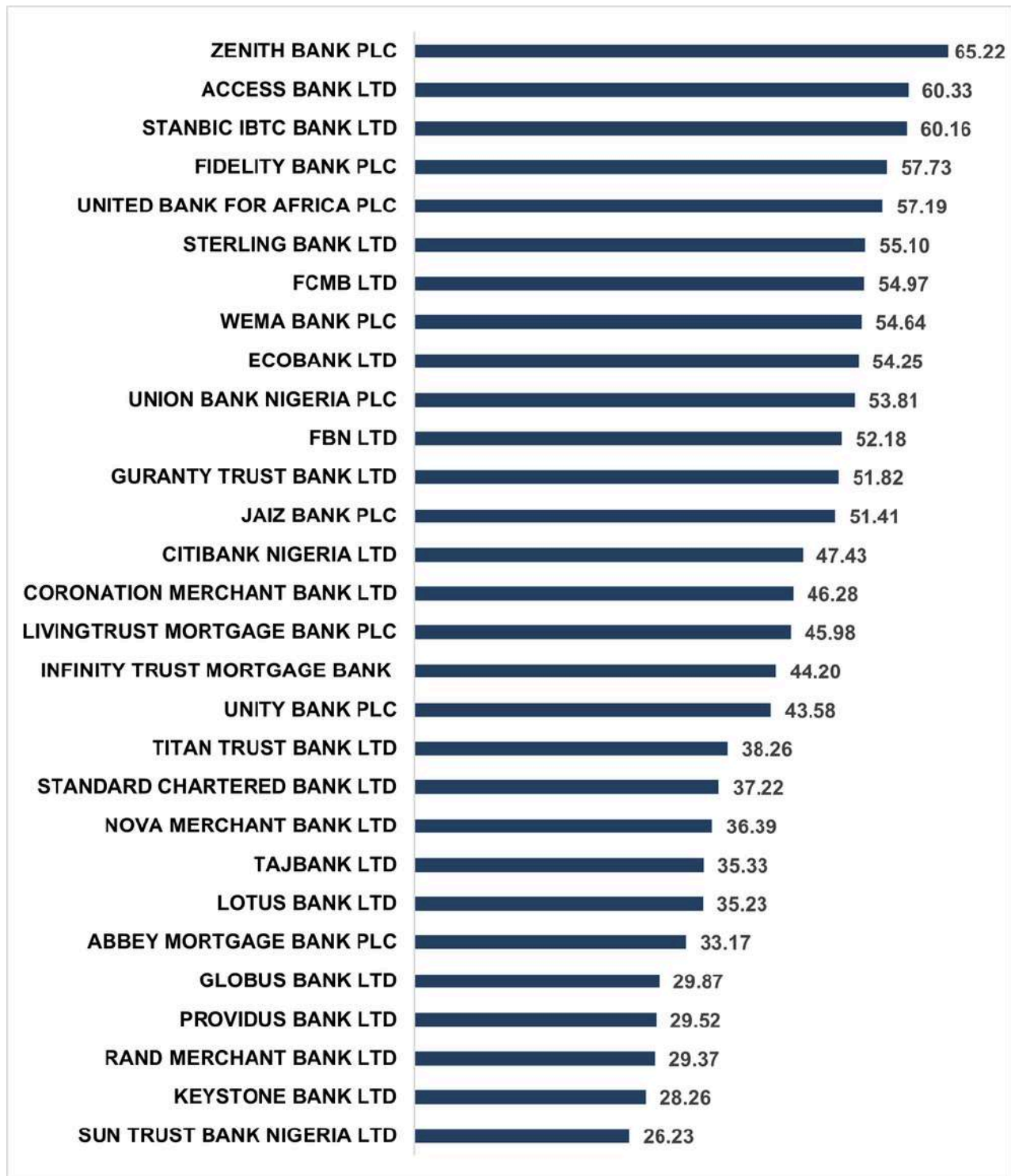
Governance exposure

Financial institutions are exposed to regulatory risks especially when the business activities contradict the regulatory framework of Central Bank of Nigeria and National Insurance Corporation. The Nigerian financial sector is highly regulated and the regulators continually roll out policies to achieve the macroeconomic stability and financial system stability. It is imperative for the industry players to keep abreast with the emerging regulations and support policies that will improve the industry performance. Recommendations from various regulatory examinations should be implemented and monitored. There is need for continuous engagement with the regulators. IT infrastructure governance has remained a major challenge in financial institutions. It is crucial to periodically review, assess and audit to ensure that information assets are safe and secure.

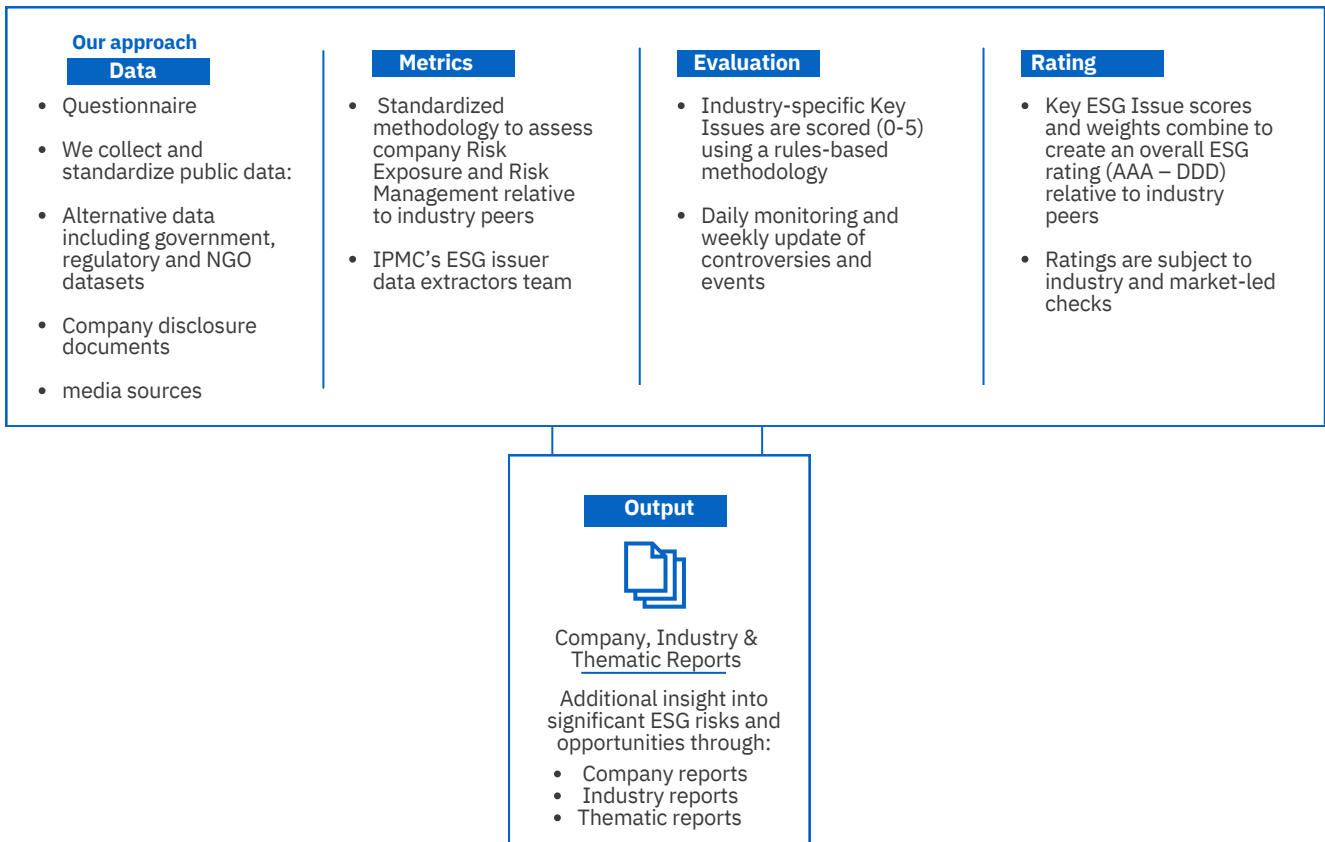
Social exposure

The Nigerian banking industry is currently grappling with challenges related to staff retention, as evidenced by a notably high attrition rate driven primarily by various push and pull factors. The proliferation of payment banking and fintech ventures has further exacerbated this attrition trend, compounded by a significant exodus of banking staff seeking opportunities in developed countries. In addition to staffing concerns, players in the banking and insurance sectors face heightened social media risks, whereby dissatisfied customers can leverage these platforms to tarnish the reputation of financial institutions, particularly in instances of service failure. Furthermore, the banking industry remains a prime target for cyberattacks aimed at compromising customer data or disrupting operations. Thus, the implementation of robust cybersecurity measures is imperative to safeguard sensitive information and maintain operational integrity. Moreover, the prevalence of nonperforming loans poses a significant risk within the banking sector, underscoring the importance of prudent risk management practices. Additionally, the industry grapples with challenges related to working conditions, particularly concerning the contractual employment terms prevalent among the banking and insurance workforce, which can exacerbate human rights concerns. The bank develops structured processes for transitioning high-performing and experienced contract staff into permanent positions. This not only enhances workforce stability but also mitigates human rights issues associated with contractual employment arrangements, fostering a more sustainable and equitable work environment. The Bank's Board and Management should develop and implement effective talent retention strategies which position the staff to be retained and they should provide better career opportunities and a suitable work environment to retain the talents in their organization.

Nigerian Banks ESG Rating Results



IPMC ESG Rating Framework and Process Overview



Methodology

We applied a comprehensive ESG (environmental, social, and governance) rating methodology to evaluate the performance of industry players in the financial sector. Our methodology integrates ESG considerations at all levels of evaluation and decision-making, ensuring a holistic approach to sustainability.

ESG Integration and Governance

We consistently monitor ESG risks and integrate them into our management practices. The methodology involves normalizing the scores of individual sub-factors relative to expected values, allowing for a standardized assessment across diverse parameters.

We have assigned overall weightings to the ESG pillars as follows:

Governance (44%): Focuses on corporate governance, risk management, business ethics, policy influence, and information security/cybersecurity.

Corporate Governance (11%): Evaluates board composition, board independence, board diversity, rate of board performance assessment, board election process, practices, and ownership.

Risk Management (9%): Assesses the company's risk management frameworks, emerging risks and their impacts, risk mitigating strategies,

Business Ethics (11%): Looks at ethical practices, codes of conduct, anti-corruption measures, anti-competitive practices, and customer satisfaction measurement.

Policy Influence (4%): Measures the company's involvement in public policy.

Information Security/Cyber-Security (5%): Examines data protection measures, information security, cyber security and systems, cybersecurity governance, cybersecurity infrastructure,

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Materiality (4%): Considers the material issues, business case for material issues, impacts of material issues on costs, revenue, and risks, and materiality disclosures.

Environmental (13%): Includes environmental reporting, greenhouse gas emissions, decarbonization strategy, and climate strategy.

Environmental Reporting and Greenhouse Gas Emissions (2%): Looks at reporting practices and emissions levels.

Decarbonization Strategy (5%): Evaluates efforts to reduce carbon footprint.

Climate Strategy (7%): Measures plans and actions to address climate change.

Data Requirements and Scoring

A minimum data requirement for participating banks and insurance companies is the provision of audited financial statements. The IPMC ESG Score is on a scale of 0 to 100, where 100 signifies the highest attainable score. We established a predefined scoring framework to guide the assessment of responses to questions, aligning them with their respective degrees of materiality.

Transparency and Disclosure

Transparency is a pivotal aspect throughout the entirety of the rating process. Banks and insurance firms with a high level of publicly disclosed data receive higher scores. Our qualitative data undergoes scrutiny based on its availability and the depth of policies influencing the scoring process. For instance, in areas such as corporate governance and climate strategy, companies can only attain the maximum sub-factor score if they adequately disclose the requisite supporting evidence.

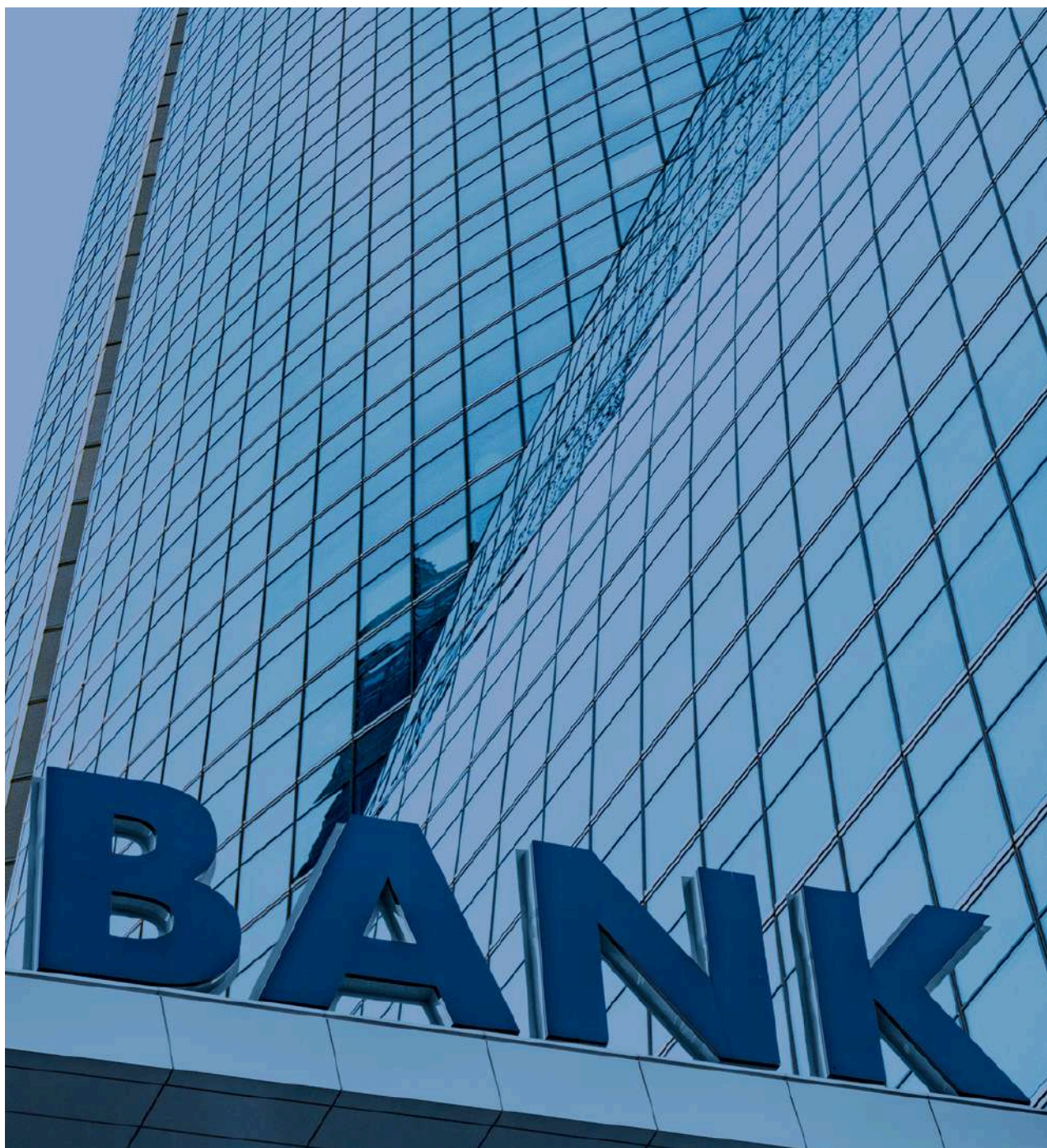
Transparency and Disclosure

The primary data from participating banks and insurance companies, as well as data extracted through secondary sources, are subject to detailed review to enhance validity and accuracy. This process aims to rectify any discernible errors and improve overall credibility.

Our ratings methodology, process, and procedures are reviewed and validated by PriceWaterhouseCoopers (PwC).

Research Team and Expertise

Our multidisciplinary team, comprising experts in sustainability consulting, research, environmental analysis, statistical analysis, data analytics, graphic design, and content creation, collaboratively conducts the rating. Each team member contributes specific responsibilities and expertise to the project, ensuring the achievement of successful rating outcomes.



Sub-factor Calculation and Weighting

The weighting of fundamental factors, sub-factors, and questions is determined based on their relevance and material significance to the banking and insurance industry. The IPMC ESG Rating (IPMCESG) is calculated as a factor of E (environmental), S (social), and G (government). Environment (E = 13%): Includes environmental greenhouse gas emissions & reporting, decarbonization strategy, and climate strategy. Social (S = 43%): Covers human rights, human capital development, corporate citizenship, labor practices, and transparency. Governance (G = 44%): Encompasses corporate governance, risk management, board expertise, policy influence, information security, privacy protection, and materiality.

Commitment to Standards and Continuous Improvement

We are committed to adopting international frameworks to inform our impact activities. Our methodology aligns with renowned financial indices such as S&P and MSCI, reflecting their relative significance in assessing ESG performance. We continuously review and refine our process to enhance the accuracy and credibility of our ratings.



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2023 Annual Insurance Sector Assessment

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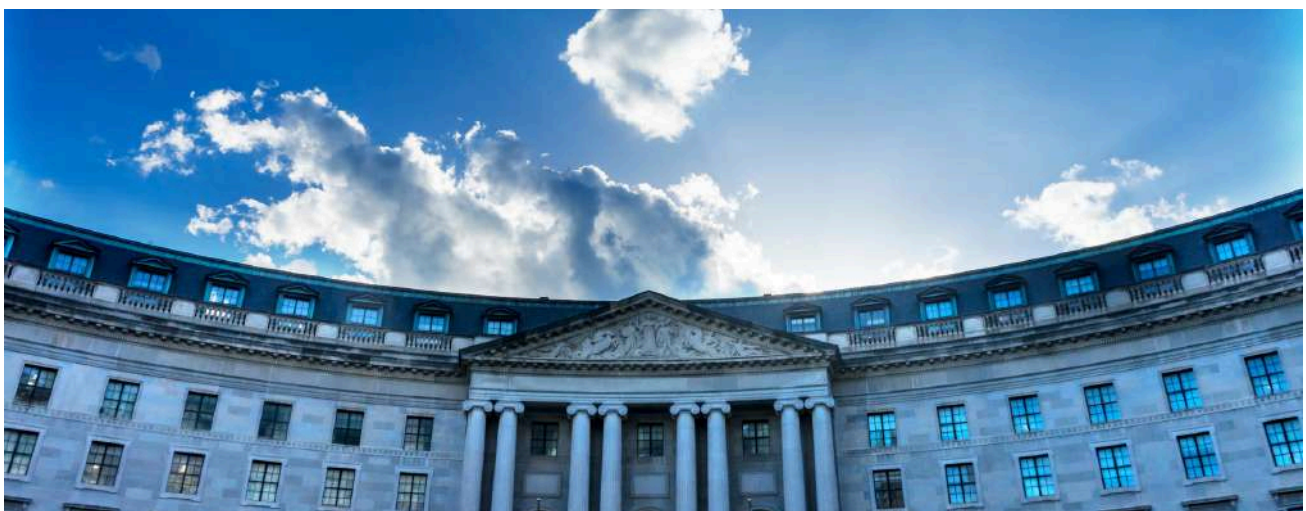
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We have developed a comprehensive report for stakeholders that offers valuable insights into the performance of banks and insurance companies across the ESG pillars. The report includes ESG risk exposures, trends, regulations in operating countries, key gaps, and recommendations. For further details, please contact our Marketing & Corporate Communications Officer, Timilehin Adelokun, at 07039536875/09168630022 or via email at timilehin.adelokun@ipmc-ng.com. We look forward to your response and the opportunity to work with your institution towards a sustainable future.

This report does not constitute credit rating.

The results showing detailed performance of individual companies can be assessed on the website. – www.ipmc-ng.com/esg/



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