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Exploring Environmental, Social, and Governance (ESG) Criteria and Ratings in the US Banking Industry: An Analysis of the MSCI Databases

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Abstract

Environmental, Social, and Governance (ESG) issues have been broadly discussed for at least the past decade. Institutional investors are now making investment decisions based on a company's ESG ratings. Prospective customers and employees now want to know a company's position on ESG matters. The brightest spotlight has been on environmental issues, aka climate change, over the past few years. We explored the proprietary MSCI Direct Database, which contains over 2,700 US companies, including ratings for 188 US banks. We analyzed the US Banking industry using Stakeholder Theory to determine if banks' stakeholders had significant influence. MSCI classified banks into three sectors: Large Diversified Banks (6); Thrifts and Mortgage Type Banks (28); and Regional Banks (154). We found that MSCI evaluated US Banks on only 14 of their 35 key risk issues and clustered the US Banking industry into the BBB or BB ratings range where AAA (Leader) is the highest and CCC (Laggard) is the lowest. We found that the three sub-industries of banks, diversified, thrifts and mortgage type, and regional banks experienced an increase in their MSCI ESG ratings in the most recent period available versus the prior three periods. We concluded that the ESG ratings in the US Banking industry improved because banks have become increasingly aware that ESG ratings are important to their stakeholders (employees, customers, creditors, community, and shareholders) and can lead to ESG risk mitigation as well as long-term value creation and sustainability.

Keywords: Environmental, Social, and Governance; ESG; MSCI; MSCI key criteria; MSCI ESG Ratings; United States Banking Industry; Large Diversified Banks; Thrift or Mortgage Type Banks; Regional Banks

1 Introduction

In this paper, we explore ESG through MSCI, the largest ESG data provider in the world. We will use the MSCI ESG Industry Materiality Map interactive database to identify the ESG Key Issues criteria used by MSCI in assessing companies in general and in the US Banking industry. We will use the MSCI Direct Database to study the ESG Ratings for the US Banking industry.

1.1. What is ESG?

ESG acronym represents three pillars for creating long-term value: Environmental – every company uses energy and resources that affect the environment; Social – relationships and reputation in communities where companies do business; Governance – internal system of self-governance and effective decision-making, meeting the needs and expectations of all stakeholders.

1.2. What is MSCI?

Institutional investors use 39 primary ESG data providers and MSCI ranks #1 out of the top 10 most frequently sited according to Georgeson, a global provider of strategic shareholder services (*Figure 1*). MSCI has a mission of enabling better-informed investment decisions and promotes itself as the largest ESG rating service in the World, controlling over 60% of ESG ratings influencing over $1 trillion in ESG investments.

1.3. Banking Sub-Industries

MSCI groups US Banks in its database into three sub-industry categories: Large Diversified Banks, Thrift and Mortgage Type Banks, and Regional Banks. The Federal Reserve defines these categories by size (*Table 1*): Large financial institutions have total assets of $100 billion or more; Regional banks have between $10 billion and $100 billion total assets; and Community banks have total assets of less than $10 billion.

2 Literature Review

Doddi, Todarao, Giacomo and Frey (2020) compiled a literature review describing the various theories used in climate change studies. They identified 28 different management theories but observed that many of these studies used a descriptive approach in lieu of an actual theory. Out of 28 theories, four were more popular than the rest:

(1) Stakeholder theory – one of the most popular in the field of sustainable business
(2) Institutional theory – why do all organizations look and act the same way
(3) Transactional cost theory – costs should be part of the design of a sustainable policy
(4) Planned Behavior theory – investigates several climate-related behaviors

The authors found that research articles focused on only one theory and not multiple theories at a time.

Henisz, Koller and Nuttall (2019) outlines five ways that create value. Here are the ways:

(1) Top Line Growth – access to resources through stronger community relations
(2) Cost Reduction – lower energy consumption
(3) Regulatory and legal intervention – receiving government support
(4) Productivity uplift – boost employee motivation
(5) Investment and asset optimization – avoid equipment that is not sustainable

Schanzenbach and Sitkoff (2020) saw ESG as an umbrella that encompasses any investment strategy that emphasizes a firm's governance structure or the environmental or social imports of the firm's products or practices.

2.1. Stakeholder Theory

We looked at ESG ratings and the banking industry using a stakeholder theory lens. Daddi, Todaro et al (2018) categorized theories used to evaluate climate change issues and found that Stakeholder Theory was an exceedingly popular approach. One definition of stakeholder theory was that the involvement of stakeholders in corporate decisions is not only an ethical approach but also a strategic variable to obtain a competitive advantage. Another definition is that the higher the importance of stakeholders, the greater the influence on climate strategies. In the banking industry, we will look at the stakeholders and see what influence they have on Large Diversified, Thrift/Mortgage, and Regional banks.

3 Hypotheses

H1: Large Diversified banks experience significant stakeholder influence and, therefore, should be further along their ESG journey than other banks.
H2: Thrift and Mortgage banks have moderate but changing stakeholder influence and should be improving.
H3: Regional Bank stakeholders have less significant stakeholder influence in the Environmental and Social areas but should be strong in Governance.

4 Methodology

4.1. Measurement

4.1.1 Key Issues Criteria

MSCI uses 35 criteria (*Figure 2*) to assess and score ESG efforts in businesses: 13 Environmental; 16 Social; and 6 Governance. Governance applies to all companies in all industries and is shown as one criterion (the six criteria for this pillar are grouped for reporting purposes).

The 35 ESG criteria are weighted for impact and time horizon of risk and opportunity given a company's core business and industry specific considerations. In late 2020, MSCI implemented enhancements to *Financing Environmental Impact* (E pillar) and *Consumer Financial Protection* (S pillar), both criteria relevant to the US banking industry.

4.1.2 ESG Ratings

An MSCI ESG Rating measures long-term resiliency to industry specific ESG risks. Rules-based methodology identifies industry leaders and laggards. ESG risk exposure and management of risks relative to peers is also considered. *Figure 3* shows available alphabetical ratings, with triple letters "AAA" ranking higher than double "AA" and then single "A" for example.

4.2. MSCI Databases

We utilized the MSCI ESG Industry Materiality Map interactive database to review the 35 ESG Key Issues Criteria used by MSCI in assessing companies. We examined the 14 ESG criteria that MSCI uses for assessing the US banking industry.

We utilized the MSCI Direct Database, which consists of 2,715 companies. We reviewed and summarized ratings of 188 US banks contained in the database. We investigated and analyzed the specific ESG ratings over the past several years of 26 US banks, including 11 Regional banks, 5 Large Diversified banks, and 10 Thrift and Mortgage banks. The analysis included comparison of overall ratings and trends. Periods were up to five years ending December 2020.

5 Results

5.1. US Banking Industry ESG Key Issues Criteria

We noted that the three sub-industries of the US Banking industry have similar ESG weightings, which are across only 14 ESG assessment criteria of the 35 used by MSCI (*Table 2*).

MSCI assessed US Banks using 2 of the 13 Environmental criteria, 6 of 16 Social criteria, and 6 of 6 Governance Criteria. The Governance criteria were grouped as one because the six criteria for the G pillar applies to all industries.

Large Diversified and Regional banks had similar weights: Environmental 13%; Social 54%; and Governance 33%, total 100%. The Thrift/Mortgage banks had a slight difference with less weight given to Environmental (7%) and more put on Social (60%) due to these banks focus on consumer lending; Governance was the same at 33%, total 100% for Thrift/Mortgage banks.

5.2. US Banking Industry ESG Ratings

We reviewed all 188 US banks in the MSCI database and their current ratings, sorting and summarizing the information by ESG rating letter and category (*Table 3*). MSCI ESG ratings of over 76% of US banks are in the Average categories of "BBB" and "BB" with another almost 10% in the highest Average category of "A".

The Laggard category includes 12% of US banks and less than 2% are considered Leaders. Three Regional banks and no Large Diversified or Thrift/Mortgage type banks achieved Leader status. All Large Diversified banks are classified as Average.

5.3. ESG Ratings of Sample US Banks

We investigated and analyzed the specific ESG ratings over the past several years of 26 US banks, including 5 Large Diversified, 10 Thrift/Mortgage, and 11 Regional banks (*Table 4).* Highlights of our findings are summarized in the sections below. The three pillars are rated by MSCI using a scale of 0 to 10, with 10 being the best score available.

5.3.1 ESG Ratings, Large Diversified Banks Examined

Large Diversified bank ESG ratings (*Table 5*) improved in the current year examined versus prior years for all sample banks. Environment scores were high with all but one bank greater than an 8 score and one bank received a perfect ten. The E pillar is weighted only 13%, yet the high scores positively impact a bank's overall rating. The average Governance score was low at 4.34.

5.3.2 ESG Ratings, Thrift/Mortgage Banks Examined

Only two of the ten Thrift and Mortgage banks sampled had improved ESG ratings from the prior period with both staying in the Average category. Two of these bank-types declined, with the rating dropping to a Laggard for one, and 60% of the sample experienced no change in ESG rating year-over-year. Environmental was clearly not a focus for this bank subindustry, as the 5-9% weighting would indicate. With Social weighting at 62%, the ratings ranged from a low of 2.2 to a high of 4.9 *(Table 6*).

5.3.3 ESG Ratings, Regional Banks Examined

Like the Thrift/Mortgage banks, the rating trends of our sample Regional bank (*Table 7*) showed two banks with improved ratings, both moving up within the Average category, and two banks' ratings declined with one dropping to a Laggard. Governance scores are consistent across the banks sampled with an average score of 5.42 (versus 4.34 for Large Diversified). Social scores were also within a tight range, especially as compared to Thrift/Mortgage banks.

5.4. ESG Criteria for Sample Banks Compared to US Bank Industry Averages

For our sample of banks, we examined the MSCI bar charts that compare each bank's ESG criteria rating to the US Bank industry average rating for the criteria. MSCI categorizes the comparisons as positive to, negative to, or at industry average. We further categorized the bar chart information as decidedly positive or negative and slightly positive or negative to offer more color to our comparison analysis. Our examination revealed that as compared to US bank industry averages:

(a) Large Diversified banks (*Table 8*) had all positive comparisons for the Environmental pillar. The Social criteria of *Consumer Financial Protection* for Large Diversified banks were all negative.

(b) Thrift/Mortgage banks (*Table 9*) were decidedly negative in many criteria comparisons. For the *Consumer Financial Protection* Social criteria, some positives and at industry exist.

(c) Most notable in Regional banks (*Table 10*) was their comparisons in the Governance pillar with only two samples negative to industry and the remainder positive including several decidedly positive. Regional banks also had strong comparisons in the *Consumer Financial Protection* Social criteria with only one sample at a negative comparison.

6 Conclusions

We believe that ESG stakeholder influence is increasing and as a result, ESG matters are in fact gaining momentum and ESG ratings are increasing in the US Banking industry. We found that the "S" Social pillar is weighted most in assessing the US Banking industry (55% to 60%), at least partly driven by new assessment criteria, Consumer Financial Protection. Almost 77% of the 188 banks are concentrated in BBB and BB rating categories.

6.1. Results Generally Support our Hypotheses

Large Diversified banks with significant stakeholder influence are further along their ESG journey than other banks. They had the best Environmental ratings vs. other banks because they have resources to invest and are expected to lead the way and be the best.

We thought that consumer-focused Thrift and Mortgage banks would be gaining stakeholders influence and should be improving. We found that some Thrifts and Mortgages are ahead of others, but there is work to be done in all pillars. These banks are following the leaders.

We expected that Regional banks with a strategic focus on growth through merger and acquisition activity would have less stakeholder influence in the Environmental and Social areas, trailing the Large Diversified banks, but would lead in the Governance category and they did. Regionals had a 5.42 average Governance score vs. 4.34 average of Large Diversified banks, indicating Regional banks are driving the industry average to a higher level. This rating was a good sign but there is work to be done in Environmental and Social pillars.

Driven by stakeholder influence, banks working to improve their ESG ratings will turn today's risks into tomorrow's opportunities in creating sustainable value.

7 Further Research

Further research could be focused on a deeper understanding of rating criteria and how MSCI positions (at/positive/negative) individual banks against the US Banking industry average. Also, researchers could continue to look at the banking industry with 2022 data to determine if the rankings have changed after the pandemic. We also would recommend a study to look at all 188 banks, including their ESG positions compared to other industries.

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Supporting Figures and Tables

Figure 1. Top Ten ESG Data Providers, *as reported by Georgeson*

Table 1. Federal Reserve Banking Industry Definitions

Banking Organization	Total Assets
Community banks	< $10 billion
Regional banks	between $10 and $100 billion
Large financial institutions	$100 billion or more
https://www.federalreserve.gov	

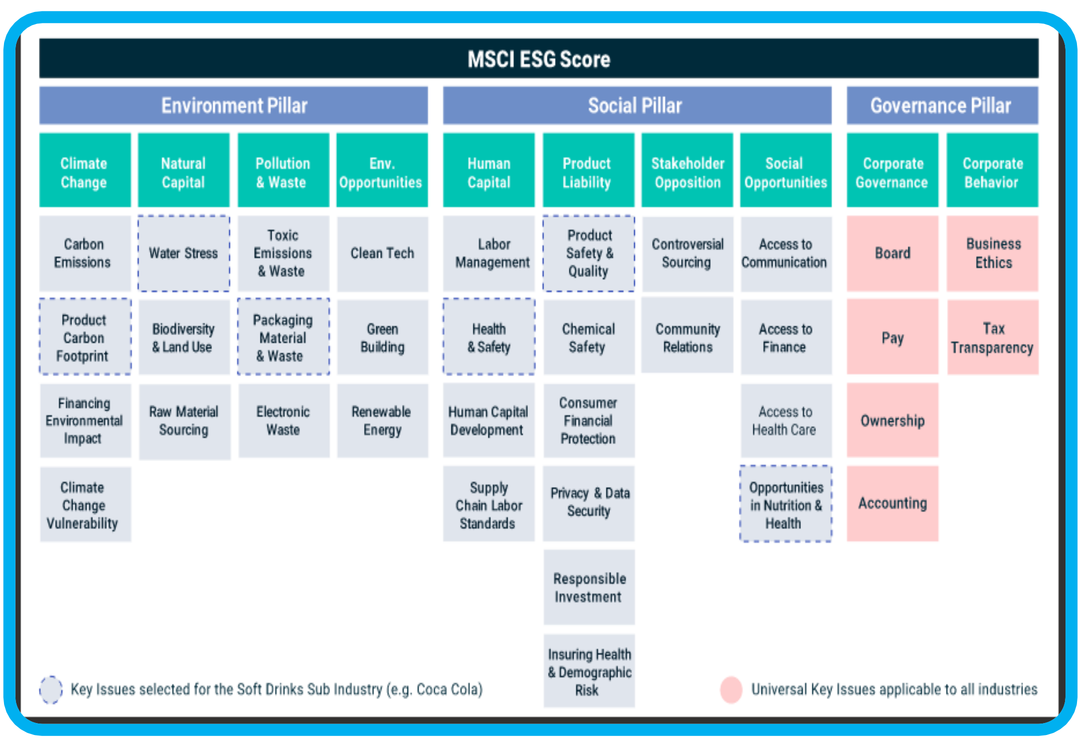

Figure 2. MSCI ESG Ratings: underlying 35 Key Issues Criteria, https://www.msci.com/our-solutions/esg-investing/esg-ratings/esg-ratings-key-issue-framework

Figure 3. MSCI ESG Ratings
https://www.msci.com/our-solutions/esg-investing/esg-ratings

Table 2. US Banking Industry, Summary of Key ESG Issues Examined

Environmental		Regional Banks	Diversified Banks	Thrift & Mortgage
1.	Financing Environment Impact	13%	12.9%	6.5%
2.	Climate Change Vulnerability	0	0	.2%
	Total	**13%**	**12.9%**	**6.7%**
Social				
1.	Consumer Financial Protection	16.9%	15.1%	20.6%
2.	Human Capital Development	13%	14.7%	13.9%
3.	Privacy & Data Security	12%	12.1%	12.8%
4.	Access to Finance	12%	12.1	12.4%
5.	Responsible Investment	0	0	.4%
6.	Insuring Health & Demographic Risk	0	0	.1%
	Total	**53.9%**	**54%**	**60.2%**
Governance				
1.	Governance	33.1%	33.1%	33.1%
	Total	**33.1%**	**33.1%**	**33.1%**
Total Banking		100%	100%	100%

Table 3. MSCI ESG Ratings, US Industry/Banks, Summary of Recent Ratings 2021

MSCI ESG Ratings, USA, Industry/Banks						
	ESG Rating	**Large Diversified Banks**	**Thrift or Mortgage Type Banks**	**Regional Banks**	**Totals**	**%**
Leader	AAA	0	0	0	0	0.00%
	AA	0	0	3	3	1.60%
Average	A	2	3	13	18	9.57%
	BBB	3	6	52	61	**32.45%**
	BB	1	14	68	83	**44.15%**
Laggard	B	0	3	18	21	11.17%
	CCC	0	2	0	2	1.06%
	Totals	6	28	154	188	100.00%
	%	3.19%	14.89%	81.91%	100.00%	

note: of the 2 "other", one included in diversified and one in regional

Table 4. Specific Banks Examined by Banking Sub-Industry

Large Diversified

BAC	Bank of America
CIU	Citigroup
JPM	JP Morgan Chase
USB	U.S. Bancorp
WFC	Wells Fargo

Thrift & Mortgage

FBC	Flagstar Bancorp
FHLMC	Freddie Mac
FNMA	Fed Nat'l Mortgage Assoc.
HIFS	Hingham Institution for Savings
KRNY	Kearny Financial Corp.
LBC	Luther Burbank Corp
NYCB	NY Community Bancorp
OCN	Ocwen Financial Corp
PFSI	Pennymac Financial Services
RKT	Rocket Companies

Regional

AMAL	AMALGAMATED BANK
BOH	BANK OF HAWAII CORPORATION
CFG	CITIZENS FINANCIAL GROUP, INC.
HONE	HARBORONE BANCORP, INC.
MTB	M&T BANK CORPORATION
RBCAA	REPUBLIC BANCORP, INC.
SBCF	SEACOAST BANKING CORPORATION OF FLORIDA
SBNY	SIGNATURE BANK
WAL	WESTERN ALLIANCE BANCORPORATION
WASH	Washington Trust Bancorp, Inc.
WBS	WEBSTER FINANCIAL CORPORATION

Table 5. Summary Scores – Large Diversified Banks Examined

Weight	Pillar Score (0-10)	BAC	C	JPM	USB	WFC
13%	Environmental	10.0	8.7	9.4	5.8	9.0
54%	Social	4.2	3.9	4.5	3.6	2.6
33%	Governance	5.3	5.0	4.4	4.9	3.0
	Weighted average Key Issue score	5.3	4.9	5.1	4.3	3.6
	Industry-Adjusted Score	5.7	7.0	7.1	5.1	4.3
	Most recent ESG Rating	**BBB**	**A**	**A**	**BBB**	**BB**
	Leader/Average/Laggard	Avg	Avg	Avg	Avg	Avg
	Preceding period ESG Rating	**BB**	**BBB**	**BBB**	**BB**	**CCC**
	ESG Rating Change	**+**	**+**	**+**	**+**	**+**
	+ improve; - decline; = same					
100%	Improve					
0%	Decline					
0%	No change					

Table 6. Summary Scores – Thrift and Mortgage Banks Examined

Weight 1	Weight 2	Pillar Score (0-10)	FBC	FHLMC	FNMA	HIFS	KRNY	LBC	NYCB	OCN	PFSI	RKT
5%	9%	Environmental	0.4	5.2	6.4	1.3	1.4	1.3	-	3.5	3.5	3.5
62%	58%	Social	3.7	3.4	4.9	2.6	3.0	2.5	3.2	2.2	3.7	3.9
33%	33%	Governance	6.7	3.6	5.8	3.0	4.0	5.0	4.3	5.5	6.5	4.0
		Weighted average Key Issue score	4.4	3.6	5.3	2.7	3.3	3.2	3.4	3.4	4.6	3.9
		Industry-Adjusted Score	5.4	4.1	6.8	1.1	2.2	3.3	3.0	2.5	5.4	4.1
		Most recent ESG Rating	**BBB**	**BB**	**A**	**CCC**	**B**	**BB**	**BB**	**B**	**BBB**	**BB**
		Leader/Average/Laggard	Avg	Avg	Avg	Lag	Lag	Avg	Avg	Lag	Avg	Avg
		Preceding period ESG Rating	**BB**	**BB**	**BBB**	**-**	**BB**	**BB**	**BBB**	**B**	**BBB**	**-**
		ESG Rating Change	**+**	**=**	**+**	**na**	**-**	**=**	**-**	**=**	**=**	**na**
		+ improve; - decline; = same										
		20% Improve										
		20% Decline										
		60% No change										
weight 2: FBC,LBC,PFSI,OCN												

Table 7. Summary Scores – Regional Banks Examined

Weight 1	Weight 2	Pillar Score (0-10)	FBC	FHLMC	FNMA	HIFS	KRNY	LBC	NYCB	OCN	PFSI	RKT
5%	9%	Environmental	0.4	5.2	6.4	1.3	1.4	1.3	-	3.5	3.5	3.5
62%	58%	Social	3.7	3.4	4.9	2.6	3.0	2.5	3.2	2.2	3.7	3.9
33%	33%	Governance	6.7	3.6	5.8	3.0	4.0	5.0	4.3	5.5	6.5	4.0
		Weighted average Key Issue score	4.4	3.6	5.3	2.7	3.3	3.2	3.4	3.4	4.6	3.9
		Industry-Adjusted Score	5.4	4.1	6.8	1.1	2.2	3.3	3.0	2.5	5.4	4.1
		Most recent ESG Rating	**BBB**	**BB**	**A**	**CCC**	**B**	**BB**	**BB**	**B**	**BBB**	**BB**
		Leader/Average/Laggard	Avg	Avg	Avg	Lag	Lag	Avg	Avg	Lag	Avg	Avg
		Preceding period ESG Rating	**BB**	**BB**	**BBB**	**-**	**BB**	**BB**	**BBB**	**B**	**BBB**	**-**
		ESG Rating Change	**+**	**=**	**+**	**na**	**-**	**=**	**-**	**=**	**=**	**na**
		+ improve; - decline; = same										
		20% Improve										
		20% Decline										
		60% No change										
weight 2: FBC,LBC,PFSI,OCN												

Table 8. ESG Criteria Compared to US Bank Industry Averages – Large Diversified Banks Examined

		Positioning Relative to Industry Average*				
	Key Issue	**BAC**	**C**	**JPM**	**USB**	**WFC**
E	Financing environmental impact	**decidely positive**	positive	**decidely positive**	slightly positive	positive
S	Access to finance	at industry	slighly negative	slightly positive	slighly negative	slighly negative
S	Consumer financial protection	negative	negative	negative	negative	negative
S	Human capital development	at industry	negative	at industry	positive	negative
S	Privacy & data security	slightly positive	positive	positive	negative	at industry
G	Governance	slightly positive	slightly positive	slighly negative	at industry	negative
	as of date	2/24/2022	2/16/2022	12/23/2021	1/14/2022	1/19/2022

** positioning data is Positive or Negative to Industry Average. We took the liberty of further guidance breakdown into Somewhat Positive/Somewhat Negative; Positive/Negative; Decidely Positive/Decidely Negative based on viewing the MSCI bar chart*

Table 9. ESG Criteria Compared to US Bank Industry Averages – Thrift/Mortgage Banks Examined

		Positioning Relative to Industry Average*									
	Key Issue	**FBC**	**FHLMC**	**FNMA**	**HIFS**	**KRNY**	**LBC**	**NYCB**	**OCN**	**PFSI**	**RKT**
E	Financing environmental impact	negative	at industry	at industry	slighly negative	negative	negative	decidedly negative	slighly negative	slighly negative	negative
S	Access to finance	negative	slighly negative	at industry	slighly negative	decidedly negative	negative	negative	negative	negative	decidedly negative
S	Consumer financial protection	positive	decidedly negative	positive	at industry	decidedly negative	decidedly negative	at industry	decidedly negative	slighly negative	at industry
S	Human capital development	negative	at industry	slighly negative	negative	slighly negative	negative	decidedly negative	decidedly negative	at industry	at industry
S	Privacy & data security	slighly negative	slightly positive	positive	decidedly negative	negative	slighly negative	negative	slightly positive	at industry	negative
G	Governance	**decidely positive**	decidedly negative	**decidely positive**	decidedly negative	decidedly negative	slightly positive	negative	positive	**decidely positive**	decidedly negative
	as of date	12/24/2021	12/23/2021	12/24/2021	2/9/2022	1/12/2022	12/3/2021	12/23/2021	11/5/2021	12/24/2021	5/25/2021

** positioning data is Positive or Negative to Industry Average. We took the liberty of further guidance breakdown into Somewhat Positive/Somewhat Negative; Positive/Negative; Decidely Positive/Decidely Negative based on viewing the MSCI bar chart*

Table 10. ESG Criteria Compared to US Bank Industry Averages – Regional Banks Examined

		Positioning Relative to Industry Average*											
	Key Issue	**AMAL**	**BOH**	**CFG**	**HONE**	**MTB**	**RBCAA**	**SBCF**	**SBNY**	**WAL**	**WASH**	**WBS**
E	Financing environmental impact	slighly negative	negative	slighly negative	decidedly negative	decidedly negative	decidedly negative	decidedly negative	decidedly negative	decidedly negativ	positive	slighly negative
S	Access to finance	negative	negative	slighly negative	negative	slighly negative	at industry	decidedly negative	negative	negative	negative	slighly negative
S	Consumer financial protection	positive	positive	slightly positive	slightly positive	negative	slightly positive	positive	positive	slightly positive	slightly positive	slightly positive
S	Human capital development	slighly negative	slightly positive	slightly positive	negative	slightly positive	slightly positive	negative	slighly negative	negative	negative	slightly positive
S	Privacy & data security	slighly negative	negative	negative	negative	negative	decidedly negative	negative	slighly negative	decidedly negativ	decidedly negative	negative
G	Governance	**decidely positive**	**decidely positive**	**decidely positive**	slightly positive	slighly negative	negative	slightly positive	at industry	slightly positive	positive	**decidely positive**
	as of date	9/24/2021	1/27/2022	11/5/2021	1/7/2022	12/24/2021	1/14/2022	2/8/2022	2/7/2022	2/25/2022	5/25/2021	9/27/2021

** positioning data is Positive or Negative to Industry Average. We took the liberty of further guidance breakdown into Somewhat Positive/Somewhat Negative; Positive/Negative; Decidely Positive/Decidely Negative based on viewing the MSCI bar chart*