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Governance Innovation

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The Case of the Banking Industry

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Amr ElAlfy is a Ph.D. candidate and sessional instructor at the School of Environment, Enterprise and Development (SEED). Amr's background is in corporate social responsibility (CSR) with an emphasis on using big data and artificial intelligence to optimize corporate reporting. He has also held several prestigious fellowships and awards. Before joining SEED, Amr spent more than eight years in business development in multinational conglomerates, namely Nestlé and 3M, where he led the marketing and CSR functions for the Middle East and Africa Region. He has applied his expertise in research, program management, CSR, impact measurement and capacity development. Amr is also a co-founder and the managing director of Synergy Sustainability and Development Group.

Olaf Weber joined CIGI as a senior fellow in March 2015. His research with CIGI focuses on sustainability and the banking sector, including sustainability guidelines and regulations for central banks and regulatory bodies. He is currently associate professor and program director of the master's program in sustainability management as well as a professor in SEED at the University of Waterloo. Since 2010, Olaf has held the Export Development Canada Chair in Environmental Finance.

Olaf 's background is in the areas of environmental and sustainable finance, with emphasis on sustainable credit risk management, socially responsible investment, social banking and the link between sustainability and financial performance of enterprises. His current research interests include financial risk and opportunities caused by climate change and environmental regulations. Previously, Olaf was managing partner at GOE in Zurich, Switzerland, developing credit risk management and sustainability rating systems, and was head of the sustainable finance group at the Swiss Federal Institute of Technology, Zurich. He earned his Ph.D. from the Technical Faculty, University of Bielefeld, Germany, and his M.A. from the Department of Psychology, University of Mannheim, Germany.

About the Global Economy Program

Addressing limitations in the ways nations tackle shared economic challenges, the Global Economy Program at CIGI strives to inform and guide policy debates through world-leading research and sustained stakeholder engagement.

With experts from academia, national agencies, international institutions and the private sector, the Global Economy Program supports research in the following areas: management of severe sovereign debt crises; central banking and international financial regulation; China's role in the global economy; governance and policies of the Bretton Woods institutions; the Group of Twenty; global, plurilateral and regional trade agreements; and financing sustainable development. Each year, the Global Economy Program hosts, co-hosts and participates in many events worldwide, working with trusted international partners, which allows the program to disseminate policy recommendations to an international audience of policy makers.

Through its research, collaboration and publications, the Global Economy Program informs decision makers, fosters dialogue and debate on policy-relevant ideas and strengthens multilateral responses to the most pressing international governance issues.

Acronyms and Abbreviations

3BL	triple bottom line
CDP	Carbon Disclosure Project
CS	corporate sustainability
CSR	corporate social responsibility
ESG	environmental, social and governance
FSB	Financial Stability Board
G20	Group of Twenty
GHG	greenhouse gas
GRI	Global Reporting Initiative
IIRC	International Integrated Reporting Council
ISO	International Organization for Standardization
PRI	Principles for Responsible Investment
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals
SSE	Sustainable Stock Exchanges Initiative
TCFD	Task Force on Climate-related Financial Disclosures
UNEP	United Nations Environment Programme
UNEP FI	UN Environment Programme Finance Initiative
WBCSD	World Business Council for Sustainable Development

Executive Summary

Corporate social responsibility (CSR) reporting is a common task for many corporations. Because of missing standards and not being mandatory, however, CSR reports are hard to compare and often it is not possible to evaluate corporate social performance based on voluntary reporting. This is also true for the financial industry with its complex and often indirect interactions with the environment and society. Therefore, initiatives such as the Task Force for Climate-related Disclosure (TCFD) and the Sustainability Accounting Standards Board (SASB) have developed recommendations to standardize CSR reporting and to make it mandatory. The authors propose to follow these approaches and to standardize CSR reporting in the financial industry by addressing the UN's Sustainable Development Goals (SDGs). Finally, the paper argues that the current definitions of materiality that are used to standardize CSR reports is too narrow. Reporting should not only consider sustainability risks for the financial industry, but also positive and negative impacts of the financial industry on sustainable development. Consequently, investors and stakeholders can use CSR reports to evaluate sustainability risks and opportunities of the financial industry.

Introduction

The relationship between corporations and their stakeholders is not new, and theorizing about this relationship has a long history in the academic literature as well as in practice. The debate on what is now referred to as CSR has existed in the academic literature for more than 70 years without a global consensus on its definition (Carroll 1999). Organizations, both public and private, have realized their role in serving diversified stakeholders, who have concerns over the societal and environmental implications of businesses. As a result, these organizations have reported not only on their financial performance and enterprise risk management but also on their social and environmental performance. In most cases, CSR reporting, also referred to as sustainability reporting, is a voluntary tool that organizations use to report qualitative as well as quantitative information that communicates the organization's abilities to address stakeholders' concerns. Sustainability reporting, however, is not only a tool to communicate to stakeholders but also to achieve the ultimate goal, namely corporate sustainability (CS).

In this paper, CS is defined in the broad sense as the ability of a firm to manage sustainability impacts that are material, such as environmental or societal risks and opportunities, and to manage these impacts on sustainable development, such as positive and negative impacts on the environment and society. This definition is in line with Porter and Kramer (2006) who found that CSR has an inside-out dimension focusing on impacts of a firm on the environment and society and also an outside-in dimension addressing the impact on a firm.

These two dimensions are also current drivers for CS reporting in the financial industry. Following the warnings from Mark Carney (2015), the governor of the Bank of England, that climate-related risk might influence the stability of the financial industry, the Financial Stability Board (FSB) of the Group of Twenty (G20) founded the Task Force on Climate-related Disclosure (TCFD) (TCFD 2017a). The TCFD has developed reporting guidelines that should enable the financial industry to manage these risks.

The Global Reporting Initiative (GRI), the most widespread CS reporting standard internationally, has also addressed the financial industry. The GRI has developed a financial services supplement (GRI 2011) that includes specific sustainability indicators for the financial industry.

The management expression, "only what can be measured, can be managed," has remained a challenge for sustainability reporting in general and in the financial industry. Organizations have implemented sustainability management and measurement systems that capture the impact of their operations on sustainable development and vice versa. Meanwhile, diverse stakeholders have been advocating for periodical sustainability disclosures. In addition, there has been an increase in national policies that address sustainability reporting in countries such as France, Sweden and Germany. Despite the increasing number of corporations and financial institutions that report on their sustainability performance, investors and other stakeholders have constantly criticized current reporting

mechanisms for failing to provide material information that can guide decision making.

The financial industry, for instance, is often criticized for not disclosing the impacts of their financial products and services, such as loans and investments, on the environment. Instead, they mainly focus on reporting direct impacts of their activities, such as energy use of their buildings or use of materials (Weber and Feltmate 2016). Although, this is far from saying that banks are responsible for the negative environmental and societal impacts of their clients; failing to disclose these indirect impacts means not to have disclosed major material risks.

To contribute to the discussion about CS reporting in the financial industry, a critical review of how the CSR literature and sustainability reporting have evolved is detailed in the first section. The second section will examine the leading reporting frameworks to understand the diverse stakeholder's needs for sustainability and climate-related disclosures. The third section will shed light on the financial sector CSR and sustainability practices with a focus on climate-related reporting. The challenges of sustainability reporting are explored, namely the limited understanding of the scope of corporate responsibility, the existence of multiple reporting frameworks and the confusion of reporting cycles. Finally, the paper will provide recommendations that should enhance the quality of sustainability reporting and address climate change-related risks and opportunities in the financial sector.

CSR – Conceptual Foundation

The starting point for an analysis of CS reporting stems from the overarching concepts of CSR and sustainability. Reporting on sustainability and CSR performance has been recognized as a driver for corporate reputation as well as the financial performance of organizations that report on their economic, social and environmental performance. In order to understand the shifts in the focus and development of sustainability reporting, this section will provide a brief review of the evolution of corporate responsibility.

The origins of corporate responsibility have a rich and multi-faceted history in the academic literature. Wallace B. Donham, one of the earliest pioneers of CSR, emphasized the responsibilities of businesses toward the communities in which they operated, in what he referred to as "the art of living together" (Donham 1927; 1929, 385). Later scholars such as Chester Barnard (1938) and Theodore Kreps (1940) also highlighted the obligations of businesses toward society. Howard Bowen's work (1953) has been a touchstone in defining corporate responsibilities, which he defines as "the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action, which are desirable in terms of the objectives and values of our society" (ibid., 6).

It is worth mentioning that the first debate about the scope of corporate responsibility started with Theodore Levitt's *Havard Business Review* article (1958, 47) "The Dangers of Social Responsibility," in which he emphasized that "government's job is not business, and business's job is not government." Levitt's economic viewpoint centred around the profit maximization of firms and was adopted by Milton Friedman, who argued that the main role of businesses is to generate profits for stockholders (Friedman 1970).

Additionally, the 1960s and 1970s witnessed counter debates between scholars on the scope and scale of corporate responsibilities. Friedman's neoclassical viewpoint has been refuted by socio-economists, who adopted Archie Carroll's CSR pyramid as a starting point to define the economic, legal, social and discretionary responsibilities of businesses. The literature in the 1980s centered around the power dynamics between diverse stakeholders of organizations. Scholarship in the 1990s cast a broader scope after the Brundtland Commission's definition of sustainability, which describes corporations' attempts to achieve competitive advantage via environmental stewardship. The literature on balancing the economic, environmental and social aspects of corporate responsibility also first appeared in the 1990s (Elkington 1998).

In the twenty-first century, corporate agendas were profoundly influenced by sustainable development. This was evident when the World Business Council for Sustainable Development (WBCSD) (2017) emphasized "the continuing commitment by business to behave ethically and contribute to economic development while

improving the quality of life of the workforce and their families as well as of the local community and society at large." Since 2015, organizations have drafted their sustainability agendas around achieving the SDGs, which are the 17 goals that will shape the UN's view of sustainability until 2030.

In the financial industry, early CSR approaches mainly addressed internal environmental and social issues, such as energy use, philanthropic donations and employee satisfaction (Bouma, Jeucken and Klinkers 1999). The main motivations were to avoid costs, to attract talent, to be a role model for clients and to increase reputation. Later, the industry was criticized for not reporting on their financed impacts, such as financed emissions (Collins 2012) and for not disclosing the exposure of their financial portfolios to social and environmental risks. As stated above, recent approaches have attempted to close this gap and proposed the disclosure of climate-related risks on the financial stability of the industry (TCFD 2018). The Chinese banking regulator made green finance reporting mandatory because of the introduction of the green credit policy that should increase the amount of green finance in China and decrease the financing of industries with a high negative environmental impact (Cui et al. 2018).

Corporate Responsibility and Sustainability Reporting

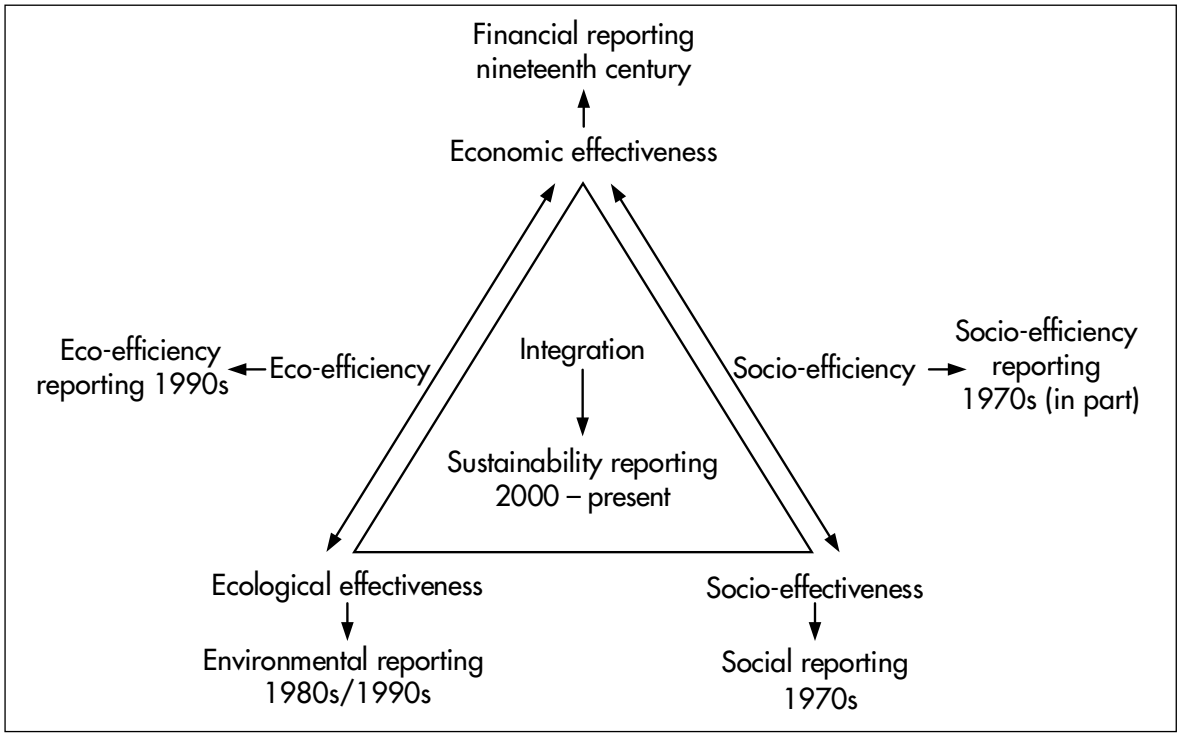
Sustainability accounting and reporting have a long history as an approach to help managers improve CS and responsibility. In the 1920s, the areas of financial, cost and managerial accounting dominated business discourse. Subsequently, environmental accounting was developed after the Brundtland Commission's agenda, which proposed long-term environmental strategies to achieve sustainable development (Brundtland 1987). As a result, accountants started reporting to management and external stakeholders on firms' environmental performance and impacts (Schaltegger and Burritt 2000; KPMG 2011).

However, environmental scholars have been cynical about the foundations of environmental accounting since its primary focus is profit generation rather than addressing ecological and social challenges (Gray and Bebbington 2000). Technical issues in corporate environmental accounting result from the complexity of the socio-ecological systems that cannot be commodified in monetary terms using the existing conventional financial accounting tools. These limitations are evident in cases where ecological damage cannot be reversed (Milne 1996) or when natural resources have a sacred value to local communities (MacDonald 2010). Furthermore, impacts on the environment or society might be indirect. This is the case in the financial sector that predominantly does not have direct environmental impacts, but channels funds into industries that might have negative impacts (Weber 2014a). These indirect effects, however, are not easy to disclose.

As a response to the limitations of environmental accounting, "triple bottom line" (3BL) accounting (also known as TBL) was introduced in 1994 by the British scholar John Elkington. The 3BL shifted corporate reporting, which was dominated at the time by the financial bottom line, to include the evaluation of social and environmental performance (Elkington 1998; 1999). However, the 3BL framework remains a voluntary and non-mandatory practice for corporations that usually suffer from an unbalanced proration between the economic, social and environmental domains (Schaltegger and Burritt 2000). Rob Gray and Markus Milne (2002) argue that the 3BL is an ineffective reporting framework that has been dominated by economic measures where environmental and social sections were only considered as add ons to economic reporting. Also, 3BL was developed as a concept and not as an accounting tool although it is frequently used this way.

Kai Hockerts (1999) shed light on the limitations of the 3BL accounting system and introduced the six principles of corporate sustainability, which managers should satisfy, namely: sufficiency, ecological equity, eco-efficiency, eco-effectiveness, socio-sufficiency and socio-effectiveness. The six criteria were further developed by Stefan Schaltegger, Martin Bennet and Roger Burritt (2006) into the Sustainability Triangle (see Figure 1). The authors emphasize the importance of accounting for ecosystems and societies where decision makers balance and manage efficiency and effectiveness. Rob Gray (2001; 2006) highlights that sustainability reporting has treated the three

Figure 1: Sustainability Triangle



Source: Schaltegger, Bennet and Burritt (2006, 305)

pillars (economic, social and environmental) in isolation, whereas integration is needed to provide relevant and reliable information regarding CS.

The interrelation between the three domains as interacting systems should provide reliable and material information regarding sustainability performance as well as the risk associated with corporate activities. David L. Owen and Brendan O'Dwyer (2008) are skeptical about contemporary sustainability reporting frameworks that lack a robust integration and financial materiality, which is core to setting corporate strategies.

Further, annual sustainability reporting is a tool to communicate an institution's performance to its stakeholders (Ziek 2009). Burritt and Schaltegger (2010, 833) argue that the systemization of reporting frameworks is "the first step in a methodological development process toward sustainability accounting providing useful and high-quality information." There are several reasons, both internal and external, that could motivate decision makers to adopt sustainability reporting. Decision makers use the reports to leverage financial and non-financial performance. In essence, reporting should enhance the decision-making processes through benchmarking corporate performance in other organizations and sectors (Rikhardsson et al. 2005). Self-regulated reporting may help a company achieve sustainability stewardship, which can save the firm's time and money in case mandatory government regulations are established (Gunningham, Phillipson and Grabosky 1999). Sustainability reporting may also help a company achieve operational efficiency through cost reduction or increased sales resulting from enhanced corporate reputation (Schaltegger and Wagner 2006). Finally, effective reporting may help external stakeholders and investors understand a firm's vision, mission and performance levels, which should enhance a firm's goodwill (GRI 2018).

All these criteria also apply to the financial industry. The problem, however, is that most of the environmental and social risk does not have a direct effect on the industry. Instead, the industry is influenced through their clients. One example is the insurance industry that may be affected by the impact of increasingly frequent extreme weather events caused by climate change on properties of insured homes (Thistlethwaite and Wood 2018). Another example

is investment portfolios that might be affected by stranded assets (Hunt and Weber 2018).

An Overview of Reporting Frameworks

Analyzing the historical review of CS reporting triggers one question: why have various sustainability conceptualizations failed to enhance the relationship between corporations and societies? Answering this question requires a lucid evaluation of the existing reporting frameworks in order to highlight the existing reporting gaps and explore a set of conditions that may help organizations and financial institutions act in a socially responsible corporate behaviour.

After the scandals of the 1990s, for example, the Enron Corporation's demise, several institutions utilized their annual reports to gain corporate legitimacy and their stakeholders' trust. Corporations have made several attempts to offer tools intended to assist organizations to develop their sustainability policies and reporting frameworks. Some frameworks have an integrated sustainability scope for all economic, social and environmental performance. Others have a particular focus on certain sectors or specific sustainability challenges, such as climate change, greenhouse gas (GHG) emissions or water management issues. These tools and frameworks have evolved into internationally accepted sustainability reporting frameworks, many of which have harmonizations and synergies with each other. However, CSR reporting still often does not reflect all environmental and social issues connected with businesses. Volkswagen has been rated as a sustainable business leader and at the same time was responsible for the diesel emissions scandal in 2015. In November 2018, Deutsche Bank was accused of money laundering, despite the fact that the bank is often heralded as a sustainability leader in the financial industry. The list of these controversial activities by businesses that are, apparently, sustainability leaders is long (Weber and Feltmate 2016). Therefore, a brief review of key sustainability reporting frameworks that have been used by corporations and financial institutions in the last decade is provided.

International Organization for Standardization

The quality standard certification is issued by the International Organization for Standardization (ISO), namely the ISO 9000, to measure corporate quality performance. Other ISO certifications have focused more on environmental issues, such as ISO 14001, which measures firms' interaction with ecological resources; ISO 14063 for environmental communications; and ISO 26000, which provides guidance on firms' social responsibility. ISO 26000, which can be implemented by all types of firms and institutions regardless of their size or activity, focuses on seven core areas in which institutions report on their sustainability performance to concerned stakeholders. These areas are corporate governance, human rights, labour issues, environmental performance, operational practices, stakeholder engagement, consumer issues and community development. The ISO standards have been widely adopted by corporations in different sectors as a positive response to internal and external stakeholders, who advocate for eco-efficient operational strategies (Clapp 1998). Some banks, such as Credit Suisse, have also adopted ISO 14000 because they have been classified as suppliers for firms that use their financial services. In general, however, ISO 14000 and ISO 26000 are not widespread in the financial industry (Weber and Feltmate 2016).

AccountAbility 1000

The AccountAbility Principles for Sustainable Development were published in 1999. The AccountAbility Principles are guidelines for enhancing CS performance and stakeholder engagement in corporate governance that aim to ensure the inclusivity, materiality and responsiveness of reports (AccountAbility 2011). In the banking sector, UBS, HSBC and RBS use this standard.

Sustainability Performance and the SDGs

The WBCSD has made several attempts to create reporting platforms that scale up business performance toward achieving the UN's SDGs (WBCSD 2017). Shaping corporate performance and reporting around the 17 goals can help provide robust guidelines for decision makers to contribute positively toward society and the environment. Unlike the Millennium Development Goals, which were mainly state-centred, the 2015 SDGs represent a transformative shift in government

and private sector cooperation. Warhurst (2001) argues that CSR agendas should be governed through "tri-sector partnerships" between governments, private sectors and civil society, where sustainability indicators should incorporate the UN development goals as an effective way to engage stakeholders. Nonetheless, the integration of the three pillars has remained a challenge, despite the introduction of the WBCSD's "SDG compass" for businesses. The compass is a guideline available free on the WBCSD's website to help companies to understand the SDGs, align the firm's goals and operations with the 17 goals and assure the integration of CS into corporate governance (SDG Compass 2017). According to the United Nations Global Compact and KPMG International (2015), to demonstrate how banks address the SDGs, banks should report on financial inclusion, financing renewable energy and sustainable infrastructure, including how sustainability risk analyses evolve into financial decision-making and the measures taken to influence corporate clients to address environmental, social and governance (ESG) criteria in their businesses.

Carbon Disclosure Project

The Carbon Disclosure Project (CDP) represents a global disclosure system, which enables organizations, corporations and cities to measure and manage their environmental performance, opportunities, strategies and risks. The CDP reporting framework focuses on three main aspects: GHG emissions; forests and climate change risks; and water strategies. More than 6,000 organizations, over 100 states and 550 cities use the CDP platform to report their impacts on the environment and natural resources. This growth in sustainability reporting reflects the interest of investors as well as other stakeholders to assess and measure their organizations' sustainability performance to deploy programs that respond to contemporary environmental risks and opportunities. Within the financial industry, 24 percent of businesses report on the CDP reporters. However, a CDP report found that the financial industry performs at a mediocre level with regard to climate disclosure and at a low level with regard to corporate climate governance. Finally, only six percent of reporting financial institutions disclose emissions caused through investments (PwC and CDP 2013).

Sustainable Stock Exchanges Initiative

The Sustainable Stock Exchanges (SSE) initiative is a collaborative peer-to-peer platform that explores how exchanges can enhance corporate transparency. The SSE initiative provides investors, regulators and corporations a peer-to-peer platform that allows sharing of best ESG practices, thus enhancing corporate transparency and performance. The first meeting of the SSE was conducted in New York City in 2009 and was opened by then UN Secretary-General Ban Ki-Moon. The SSE is organized and supervised by the UN Global Compact, the UN Conference on Trade and Development and the Principles for Responsible Investment (PRI), and the United Nations Environment Programme (UNEP) Finance Initiative (UNEP FI). The first five SSE partner exchanges, namely the Johannesburg Stock Exchange, Nasdaq, Borsa Istanbul, the Egyptian Exchange and the B3 (Brazil), are providing listed corporations in developed and developing countries with guidance on sustainability reporting. Since September 2015, all SSE partners have requested all listed companies to disclose not only their financial reports but also material ESG reports.

The GHG Protocol

With a special focus on GHG emissions, the GHG Protocol is the most widely accepted framework for governments and business to understand, measure and report their GHG emissions. The GHG Protocol is a result of a partnership between the WBCSD and the Resources Institute, both of which aim at building effective programs to address climate change. This partnership provides an accounting platform for GHG inventories for governments, businesses and environmental groups, which helps decision makers in these institutions to address climate change issues. In response to the global marketplace demands for sustainable products, many developing countries are utilizing the GHG protocol as a tool to measure and disclose information regarding their climate change issues and strategies.

The PRI

The PRI is an international network of responsible investors, who work together to put the UN-supported six PRIs into practice. The principles are listed in the annual report as follows:

- → Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- → Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- → Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- → Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- → Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- → Principle 6: We will each report on our activities and progress towards implementing the Principles (PRI 2016, 75).

The PRI reflect an increase in the awareness of responsible investors, who understand that incorporating ESG principles into their investment activities aligns with their fiduciary responsibilities. In essence, the PRI should help these investors meet economic targets while meeting the broader interests of environmental and social stakeholders. Finally, they lower barriers for the financial industry to engage in sustainable finance by offering direction including reporting guidelines (Gond and Piani 2013).

International Integrated Reporting Council

The International Integrated Reporting Council (IIRC) is a coalition of non-governmental organizations, regulators and companies that aim at establishing an integrated reporting framework across global business. In 2014, the IIRC started the International Integrated Reporting Framework, which aims at providing material information for long-term investors. The IIRC represents a shift away from the 3BL approach and toward more integrated sustainability reporting. The 3BL is associated with conventional accounting and is ineffective as an economic tool.

The SASB

The SASB is a US-based institution incorporated in July 2011 that aims at establishing industry-based sustainability standards to help corporations and organizations traded on US exchanges to measure and disclose their ESG impacts. The SASB represents a shift in reporting toward integrated material information, which is needed by multiple stakeholders, especially regulators and investors who face pressures to address ESG issues. Recently, stakeholders have acknowledged that ESG factors influence an organization's performance in the long term as a result of its ability to manage risks and opportunities. As such, investors and management use ESG reports for a robust overview of an organization's performance and, accordingly, to evaluate its long-term value. The SASB provides a transformational tool that enables investors and managers to enhance the effectiveness of disclosures by participating in the development of reporting standards and expecting organizations to disclose material information on ESG factors. For the financial sector, the SASB proposes a number of indicators for disclosure, such as the integrations of ESG criteria in financial decision-making and financial inclusion (SASB 2017).

The GRI

The GRI is an independent international organization that, since 1997, has made extensive efforts to institutionalize sustainability reporting. The GRI aims at helping businesses, governments and institutions understand and communicate their impacts on global sustainability issues (GRI 2018). Although the SASB and the IIRC provide better integrated and material reporting frameworks, the GRI initiative has been more successful in transforming niche individual corporate efforts in CSR reporting into a more standardized global trend. In essence, the GRI has been adopted by the majority of global market leading companies for CSR reporting and continues to be replicated across different sectors (Fifka 2012). In 2011, a KPMG survey, which focused on the world's largest 250 corporations, showed that 95 percent of participating companies provide annual reports on their sustainability performance, of which 80 percent follow the GRI guidelines (KPMG 2011).

William Q. Judge and Thomas J. Douglas (1998) show that the GRI guidelines provide a useful tool to report and analyze financial and non-financial measures for corporate performance. Olaf Weber et al. (2008) highlight some benefits of using the GRI as a reporting framework as it provides quantifiable indicators that can be utilized by decision makers. The GRI guidelines have evolved toward a more standardized format that aims at integrating the four pillars of reporting: economic,

social, environmental and governance (Kolk 2004; 2008). However, some scholars have argued that the GRI standards lack the needed integration between sustainability pillars as well as materiality. These limitations stem from existing deficiencies in sustainability accounting — in particular, forward-looking techniques that may help monetize risks and socio-ecological variables. (Gray 2001; 2006). Also, the early versions of the GRI guidelines lacked a standardized format, where corporations could manipulate the selection of indicators to serve their greenwashing tactics (Adams and Evans 2004; MacLean and Rebernak 2007).

In addition to general reporting guidelines, the GRI publishes sector guidelines. The Sustainability Reporting Guidelines and Financial Services Sector Supplement (GRI 2011) contains indicators that are tailor-made for the financial industry, such as financial products and services that include sustainability aspects and interaction with clients with respect to environmental and social risks and opportunities.

TCFD

The TCFD was established in 2015 in response to the G20's request to provide better reporting on the financial implications of climate change. The FSB, the international body that monitors the global financial system, selected the TCFD members from various organizations, including large banks, large non-financial companies, credit rating agencies and consulting firms. The TCFD acknowledges the reporting problem and the need for standardized reporting in all industries to enable the financial industry to assess climate change-related risks (TCFD 2017a). The task force sheds light on how existing reporting standards focus on climate-related information such as GHG emissions. However, current disclosures lack information on the financial implications of those climate-related aspects. Consequently, the TCFD recommends that climate-related disclosure should: represent relevant information; be specific and complete; be clear, balanced and understandable; be consistent over time; be comparable among companies within a sector, industry or portfolio; be reliable, verifiable and objective; and be provided on a timely basis (TCFD 2017a).

As a result of deploying the TCFD, financial executives should recognize improvement on disclosure quality, especially disclosures covering the financial impact of climate-related risks on an organization (TCFD 2017a). This is useful for the financial sector to evaluate existing and potential risks posed by climate change, as well as channels for hedging the risk. Similar to the SASB, but focusing on climate-related issues, the TCFD published industry-specific key performance indicators that will assist the financial industry to identify climate-related risks for their lending and investment portfolios. Furthermore, the TCFD recommends the development of climate-related scenarios to enable the financial industry to manage climate-related risks that might influence the industry's stability (TCFD 2017c). Finally, the TCFD has developed guidelines to implement the proposed indicators (TCFD 2017b).

The Financial Sector and Sustainability

Building on the TCFD, it is worth mentioning that financial institutions play an important role in leading sustainable development. Weber (2014b) analyzes this relationship in four aspects. First, the financial sector has control over access to funds, which has a direct impact through investment in certain sectors or an indirect one through their lending activities. Second, stakeholders of financial institutions can influence, through their pressures, the reputational risks of financial institutions. Third, with the advent of consequences of global warming, for example, floods and hurricanes in many areas in North America, financial institutions have started to respond to sustainability risks by incorporating shadow prices. Fourth, the financial sector has a real challenge to technically test the relationship between finance and the impact on the economy, society and the environment. However, while banks have annual reports on their non-core business activities, such as programs that enhance employee welfare and philanthropic activities, there has been minimal reporting on the long- and short-term sustainability impact of their finances (Weber and Feltmate 2016). Banks and financial institutions should report on this allocation within their portfolios. Such reports will not only enable investors and depositors to allocate their funds toward sustainability but also proactively develop systems for future transparency regulations.

Further, sustainable development requires substantial investments in the fields of renewable energy, environmentally friendly infrastructure and green technologies. While governments and public-sector institutions can provide financing for green investments, financial institutions could remove any bureaucratic obstacles to accessing required investment funds. Therefore, financial institutions should be more proactive in responding to green investment opportunities that could drive economic growth. Such green investments require close collaboration between financial instituitions' managers and policy makers to ensure the effective development of sustainability policies as well as the optimization of available funds allocation. Sustainability scholars and practitioners argue that financial institutions are the most powerful stakeholder in driving environmental change. However, this influential role has been criticized or ignored by other stakeholders such as regulators, financial managers and policy makers.

Financial institutions could identify green investments as an opportunity to improve the quality of their operations. For example, banks could improve risk management techniques by including environmental risks in the decision-making process. In essence, risks are incorporated into loan's assessments as an environmental liability. Such techniques should also improve the quality of investment advice offered to their clients. Banks have been involved in environmentally responsible investments since the UNEP statement (2017) on banks and sustainable development, which recognized the role of financial institutions in "making our economy and lifestyles sustainable." Since then, many banks have developed their environmentally responsible investment portfolios such as green stocks, green bonds and green money market accounts. These portfolios finance projects aimed at the conservation of natural resources and the implementation of environmentally responsible business practices. Such investments, however, have remained minor when compared to other conventional banking portfolios.

One of the challenges that sustainable banking faces is that customers do not perceive significant differences among financial institutions and the available banking services (Chousa, Castro and Gonzáles 2009). Such perceptions about financial institutions have increased after the dramatic financial scandals of the late 1990s as well as the 2008 financial crisis, which led to a decline in clients' confidence in the financial system and banking institutions (Weber and Feltmate 2016). Many regulators and policy makers are concerned about restoring confidence in the financial system. As a result, there has been an increase in the awareness and social conscience of shareholders, regulators and other stakeholders, who advocate for sustainable business operations. Internal and external stakeholders have requested mandatory reporting on the economic, social and environmental impacts of their institutions' operations, which has been provided and covered through annual CSR reports.

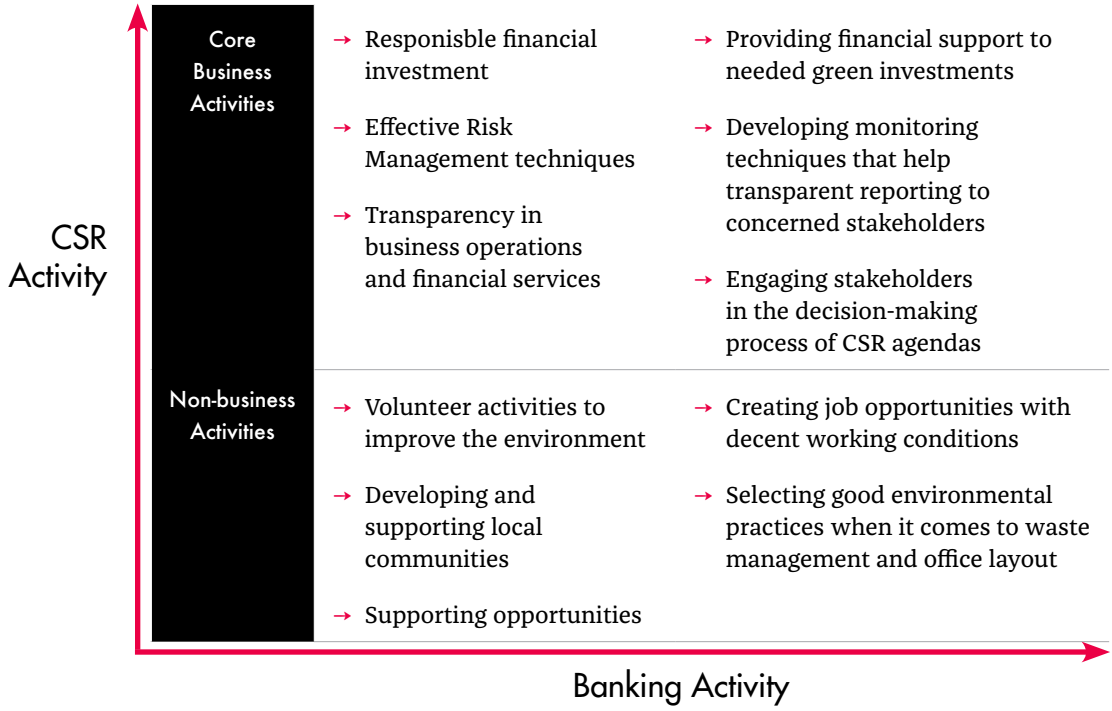
Sustainability Reporting in the Financial Sector

Since the economic crisis in 2008, the banking industry has adopted principles to ensure that banks' business operations not only respond to economic goals but also address other environmental and social issues. One of the conventional roles of financial institutions is to serve as an intermediary that channels savings into investments. Such a role incorporates an efficient allocation of resources through managing risks in a responsible manner that protects the legitimate interests of investors and other stakeholders. Responsible financial institutions should acknowledge not only the direct ecological impacts of their operations but also the indirect impacts that result from their lending activities.

Table 1 presents the main areas of CSR in the banking sector, which vary from strategic core banking activities to peripheral philanthropic activities.

Financial institutions need to explore ways to shift to core sustainability-related domains that do not just incorporate ethical banking systems and traditional philanthropic activities. Banks need to communicate the responsibility to all stakeholders, who should share the costs and risks of engaging in green investments. Conventional banking can evolve into more ethical banking approaches when shifting their funds toward green investments. As a result, having robust reporting frameworks is essential for effective communication of ESG performance

Table 1: CSR and Banking Activities



Source: Adapted from Lenter, Szegedi and Tatay (2015, 100).

to diverse stakeholders as well as disclosing material climate-related financial disclosures.

Sustainability Reporting Challenges in the Banking Industry

Over the past decade, sustainability reporting has witnessed huge leaps in the financial industry and in general. On the one hand, there has been an increase in transparency, improvements within standards and reporting frameworks and better engagement for stakeholders within the decision-making process. On the other hand, sustainability scholars have been cynical about the validity, reliability and materiality of sustainability reporting frameworks (see Kolk 2004). The dynamic changes in the complex socio-economic systems mandate continuous development of reporting standards. As a result, close collaboration between sustainability stakeholders is needed in order to identify new risks and opportunities and to set the required amendments in reporting standards annually. In the last decade, sustainability reporting has faced three main challenges: limited understanding of the scope of corporate responsibility; the existence of multiple reporting frameworks and a target audience; and the confusion of reporting cycles, given the lack of mandatory reporting. These limitations are also valid for financial industry sustainability reporting.

Limited Understanding of the Scope of Responsibility

Decision makers and corporate stakeholders should not treat sustainability reports as a tool for extracting short-term values, but rather as a strategic process that defines the future of the ecosystems in which they exist. Corporations develop their reports from an "outside-in" approach to communicate the corporate efforts to solve social issues. Corporations prioritize their agendas and activities based on the ranking schemes of sustainability institutions, for example, the Dow Jones Sustainability Index

and the European Sustainability Reporting Awards scheme to green market their activities (Daub and Karlsson 2006). Instead, managers should develop their sustainability agendas from an "inside-out" approach, where firms define their sustainability weaknesses and develop a strategy to reduce their operational externalities and enhance their socio-ecological impacts. Therefore, corporations are required to design "internal information and reporting systems" that measure and report "key performance indicators," which flows from a corporate strategy across each function (Schaltegger and Burritt 2000).

The three main variables that distinguish strategic CSR from other literature in the field are the scope of operations, time span and stakeholders' scale. Managers should develop and implement their sustainability agenda via a strategic planning process that cascades from the corporate level to functional and operational-level strategies. Accordingly, responsibility becomes "core" across all of a firm's operations and not merely a "function," such as marketing or public relations (Hawkins 2006). For example, in a production firm, strategic CSR starts with choosing responsible suppliers who can procure eco-friendly raw materials to ensure an eco-efficient production process. Customers can be engaged as strategic stakeholders who are impacted by the environmental footprint resulting from production and consumption. The final and most significant variable of strategic CSR is the transition from a short-term to a long-term temporal outlook, which is the core of Gro Harlem Brundtland's definition of sustainability (Gibson 2006).

Chief executive officers' focus should shift from quarterly economic performance to long-term investments with an outlook that exceeds three years. The longer the time, the less the trade-off between financial gains and CS, which is an investment that realizes its rewards over the long haul. Essentially, responsibilities, costs and risks should be shared and communicated via effective dialogues among all stakeholders. Therefore, strategic CSR provides a better framework for a firm to retain its societal legitimacy and CS through a process that maximizes a firm's growth, adapts to market dynamics and considers a broader array of strategic stakeholders (Searcy 2009).

In the financial industry, the scope of responsibility is harder to define than in other industries. A good example of this is the direct and indirect effects of the financial industry on climate change. As mentioned above, previous approaches to financial industry reporting focused on waste, on the direct impacts of using energy, materials, water and other environmental resources and on the direct impacts on job satisfaction of industry employees (Jeucken 2001). Later, some non-governmental organizations criticized banks for not addressing the impact of their products and services on GHG emissions. They claimed that banks ignore their financed emissions, i.e., GHG emissions of commercial borrowers (Collins 2012). Although banks neglected their responsibility regarding their clients' impacts, they began to disclose environmental and social impacts of their products and services (Weber and Feltmate 2016). Most of the reporting, however, addresses positive green impacts and social finance products and services, while negative impacts, for instance through fossil fuel financing, are not disclosed. This missing piece in reporting is one of the reasons banks have problems assessing climate-related risks, which are predominately caused by their clients, for their portfolios. Because the banks neglected to take responsibility for their clients' emissions, they were not able to assess the climate-risk exposure of their portfolios.

Another reason for this lack of disclosure is the allocation of responsibility. The question remains as to whether a financier is responsible for impacts of their finance. Furthermore, if a limited responsibility is accepted, it is hard to allocate the responsibility to different parties involved to avoid double counting. To allocate the responsibility for GHG emissions for a fossil fuel operation, for instance, all stakeholders have to be considered. For example, a bank might finance a fossil fuel company that operates, for instance, an oil-sand mine and emits GHG; a refinery that refines the bitumen and emits GHG; or clients who purchase the end-product and emit GHG. Finally, clients purchase the end-product and emit GHG. Hence, to allocate all the responsibility to one of the parties would not be suitable.

Multiple Reporting Frameworks and Target Audiences

The standardization of reporting frameworks plays an essential role in increasing the quality of decision making for managers, investors and other stakeholders. However, unlike financial reports, where investors are the sole audience, sustainability reporting has multiple audiences and stakeholders, each of which has various expectations of what the company should report. In essence, each group has their definition of the "right" disclosure in order to take the "right" decisions. Consider, for example, the term "materiality," which, according to the US Supreme Court, is defined as a substantial likelihood that the disclosure of the omitted fact would make a shareholder consider it important in deciding whether to buy or sell a share or how to vote in an annual general meeting (Anonymous 2012). However, beyond investors, the term "materiality" has been incorrectly used by other sustainability stakeholders to refer to the prioritization or relevance of sustainability issues (SASB 2017).

Christian Herzig and Stefan Schaltegger (2006, 309) define a guideline as "a non-binding guidance document based on practical experiences." On the other hand, regulations are usually enforced by governing institutions to ensure the systemization of reporting. Moving from voluntary guidelines to standardized frameworks is the first step toward quality and meaningful reports. However, each of the current reporting frameworks has its own rationale and audience, which makes it confusing and sometimes conflicting for reporters to choose from the different reporting frameworks. Some scholars argue that having multiple reporting frameworks can be considered a "race to the top" in terms of reporting standards (Green 2013). This was evident in the collaboration between the GRI and CDP after the Paris Agreement in 2015. The GRI in 2017 used a CDP questionnaire to enhance its reporting on climate, water and forests (GRI and CDP 2017). However, this proliferation complicates the sustainability reporting practices given the varying definitions, priorities and indicators.

Significant collaboration between the GRI board and the SASB occurred after multiple corporations voiced concerns regarding the negative implications of competition between the two entities. In April 2017, the Ceres Conference was held in San Francisco and included renowned sustainability non-profit organizations. During the meeting, Tim Mohin, chief executive of the GRI, and Jean Rogers, chief executive officer of the SASB, refuted the rivalry between the GRI and the SASB (Mohin and Rogers 2017). There has been extensive collaboration between the two reporting entities to enhance the quality of integrated reporting (SASB 2017). Nonetheless, judging the materiality of environmental impacts has remained a controversial area of dispute. This can lead to frustration with the reporting process for organizations that struggle to satisfy the demands of their stakeholders (Christianto 2018).

The confusion about different reporting frameworks is one of the reasons that the TCFD proposed standardized climate-related indicators to disclose risks and opportunities. The problem, however, is that then there would be one more standard to be used. Given that the GRI and CDP already provide climate-related indicators, the question remains as to whether an additional standard will be helpful. In fact, the problem might be that the banking industry lacks a consistent strategy to address climate-related financial risks. Even if all clients report their climate-related risks in a transparent and standardized way, the banking industry has to develop strategies, tactics and operations to manage these risks. Disclosure is just a first step to fulfill this task.

The Confusion of Reporting Cycles

The multitude of stakeholders' demands on sustainability reports, especially with increased expectations of the significance, credibility and materiality of disclosed data, can negatively impact the quality of reports. Reporting teams within institutions, due to time and data limitations, could disclose information based on a tactical and reactive approach rather than a strategic one that aims at tackling real sustainability issues. The time spent responding to different stakeholders sometimes limits the reporter's capacity to deploy strategies that could otherwise enhance corporate sustainability. Sustainability reports are larger in scope than financial reports since they incorporate not only the economic results of an organization but also ESG issues of institutions (Gray 2006).

Unlike mandatory financial reporting, which has fixed reporting cycles, voluntary sustainability reporting has remained subjective to the reporter's motivations in deciding the timing to disclose ESG information. Setting standardized

reporting cycles should increase the quality of reports through the setting of benchmarks for performance measurement and development. The standardization of reporting would help achieve better transparency and accountability. However, achieving more robust and reliable strategic reporting frameworks requires continuous collaboration among states, private sectors and local community members. Managing sustainability agendas should incorporate a tripartite of government, private sector and civil society. This tripartite is essential for balancing the power among stakeholders and for ensuring a democratic implementation of pre-agreed-upon agendas in order to avoid any potential trade-offs (Mintzberg 2013). This tripartite should work for change that enhances the resilience of the decision-making process, achieves modularity in the targeted outcomes and is more flexible to meet market dynamics (Waddock and Bodwell 2007).

Although voluntary sustainability reporting has had a tumultuous legacy, it has become more prominent because integrated reporting standards and governmental regulations have been adopted in South Africa, replicated in France and are currently under negotiation in other countries. Before discussing the recommendations for enhancing the future of sustainability reporting, one should highlight the progress that has happened in CS discourse and practices since the introduction of the SDGs.

Banks have started to connect sustainability risks and financial risks in their reporting, although transparent and standardized reporting is still rare. Even banks that follow guidelines, such as the Equator Principles reporting guideline,[1] often do not report the information necessary to evaluate environmentally and socially induced financial risks (Weber 2016). Banks that report on negative impacts of their financing are still exceptional cases. The Chinese Industrial Bank is one of these exceptions. This bank reports on financing industries that are controversial with regard to their environment and provides data about meeting and missing the goals of transitioning to green finance in different sectors (China Industrial Bank 2017).

1 The Equator Principles are a set of internationally accepted guidelines to manage environmental and social risks in project financing.

Policy Recommendations

Based on the analyses above, the following policies to improve sustainability reporting in the banking industry are proposed.

Standardization of reporting frameworks

The standardization and institutionalization of reporting requires close collaboration between intergovernmental departments. Standardized reporting should focus on key performance indicators that allow stakeholders to analyze risks and opportunities arising from the sustainability performance of a financial sector institution.

The direct and indirect impacts of the financial sector must be acknowledged, and standard indicators for both impacts should be developed. Having a sustainability agenda that is negotiated and implemented from an effective stakeholder approach is the first step to reduce future trade-offs. Standardized indicators also help stakeholders to plan strategically for future changes given the dynamic markets and risks. The financial sector can lead the standardization of reporting since banks have a high level of transparency given the nature of their operations, where they can start recognizing their green clients in a way that promotes responsible environmental and social behaviour and performance across multiple sectors. However, although the TCFD strives for standardized reporting, there is a risk of creating another standard in addition to all those that already exist. The GRI, CDP and SASB already provide standardized indicators the banking industry can use. In addition, the Equator Principles, PRI and UNEPFI provide reporting guidelines. Therefore, the TCFD should develop concepts that enable banks to use the already existing standards to assess financial risks induced by environmental and societal risks.

Continue using the SDGs as a framework to implement and report on strategic CSR

Corporations are facing pressure from responsible stakeholders to move toward green investments that have higher risk, yet maintain the balance between achieving economic gains and creating positive social and environmental returns (Weber and Feltmate 2016). Governing sustainability agendas is a key competitive advantage for corporations as well as financial institutions. In fact, governing sustainability agendas should produce

better results for financial institutions stemming from enhanced risk management techniques (Weber 2014a). Additionally, shaping CSR agendas to meet the SDGs should serve as a transformational tool toward sustainable economies for corporations in different sectors as well as the financial sector. Because of the need for finance to achieve the SDGs (Weber 2018), the banking industry might play a major role in SDG-related reporting.

Developing annual impact reports that show the negative and positive repercussions of investment portfolios

Banks and other financial institutions have started to implement sustainable operations internally that vary from energy conservation practices and recycling programs in branches and offices to reduce their operational footprints. The financial sector can lead investment in low-carbon portfolios and green energy, which is evident in cases where banks offer mutual funds that invest in green companies. Also, several financial institutions have now adopted the Equator Principles to manage environmental and social risks in project financing. Within the sustainable-lending operations domain, banks have been working collaboratively with clients to minimize their environmental footprints. The financial sector is a key enabler in the field of sustainability because it serves several industries and sectors such as insurance, asset management and retail. Each of these sectors and its subsectors play an important role in shaping the global economy. Having annual impact reports will set benchmarks, which should improve the performance of financial institutions and guide investors on the ecological footprint of their investments.

Defining materiality of sustainability risks and opportunities in the banking industry

Currently, materiality is often defined as the direct, mostly negative impacts of sustainability, environmental, social and climate-related risks. This is a rather narrow definition that has some risks, in particular for the financial industry with its predominantly indirect connections to the environment, society and sustainable development. Following Carney (2015), who mentioned transition risks as a major risk for the financial industry, the TCFD also addressed indirect risks, such as reputation risks, litigation risks and transition risks for the financial industry. This addresses a topic that has been neglected by the industry for a long time. Although it is obvious that most financial risks and opportunities in the banking industry come from their clients, the sustainability performance of borrowers and investees and the impact on investment and lending portfolios has not been reported. Therefore, a standard to report about environmental, social and climate-related risks and opportunities that bank portfolios are exposed to is recommended.

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