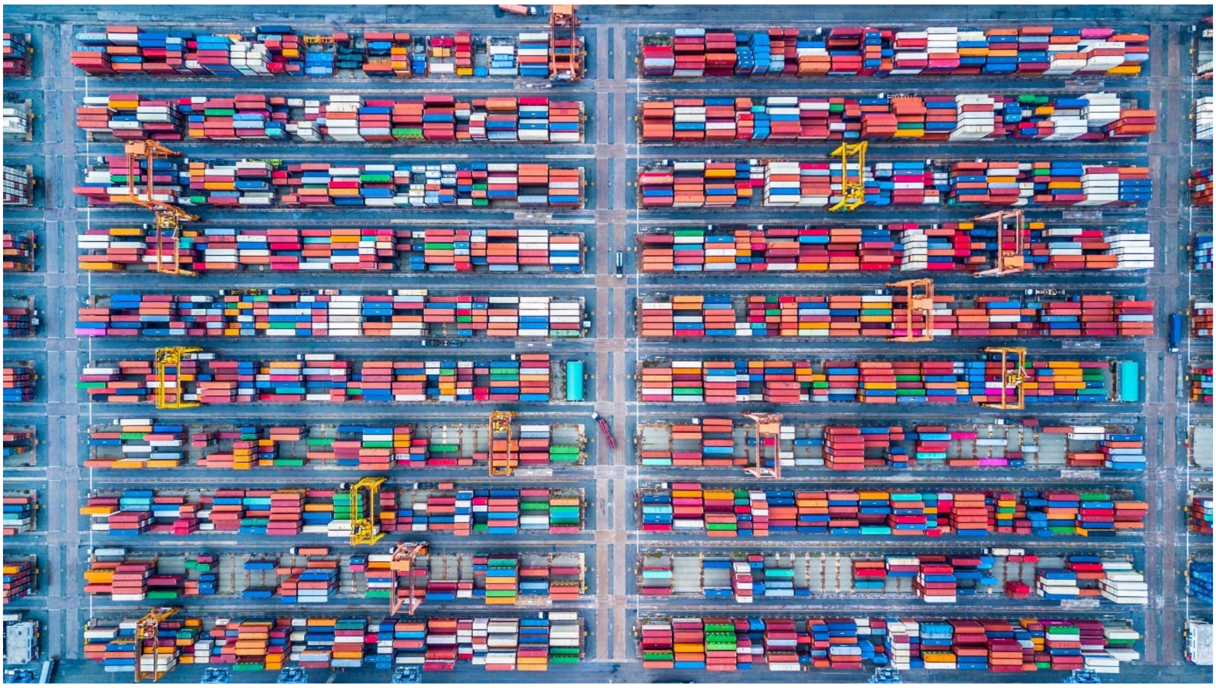

Julius Bär

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An Informative Analysis of Sustainable Initiatives within Corporate Banking & Maritime Finance

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By:

Sebastiao Sandkamp

Senior Client Executive Intern

Research Abstract

This research explores the integration of Environmental, Social, and Governance (ESG) principles within the maritime finance sector, with a focus on corporate banking's role in promoting sustainability. The study assesses the ESG foundation in maritime operations, showing the financial and environmental impacts of such initiatives. By using the MSCI (Morgan Stanley Capital International) methodology, this research looks into the maritime industry's approach to reducing carbon emissions and improving governance practices. Given that the maritime industry is responsible for transporting 90% of the world's trade—including commodities like crude oil—its role in global resource supply chains makes it a crucial area for sustainability efforts. Through case studies like the Poseidon Principles, the paper investigates how banks incentivize sustainable shipping practices by providing financial rewards for decarbonization efforts.

Additionally, this work talks about the rising consumer demand for ethical investment options—particularly from high-net-worth Brazilian clients—which is pushing financial institutions toward sustainable banking solutions. It also touches on banks responding to these demands through sustainable strategies that align with emerging consumer preferences and corporate responsibility laws. By spreading awareness about challenges like greenwashing and corruption, the research shows the risks and complexities involved in implementing ESG standards.

The findings show how ESG-compliant practices don't only improve environmental goals but also help boost economic value. This research supports the notion that sustainable finance, particularly within the maritime sector, is both a driver for environmental management and a pathway to long-term profitability for financial institutions.

Words of Inspiration

"If everyone were aware of the potential impact of their investment decisions, the effect on the world around us could be considerable. I encourage you to challenge us, and those around you to work harder to build a greener future for coming generations."

- Philipp Rickenbacher, former Julius Baer C.E.O. (2019 - 2023)

The 3 Pillars of E.S.G.

In order to understand the significance of ESG within the Maritime Industry, a clear understanding of the term is essential. **ESG ratings provide a measure of how well companies manage the risks and opportunities of environmental, social, governance (ESG).**

1. Environmental concerns of how a company manages its impact on resource depletion, air pollution, water, and gas emissions.

2. Social concerns of how a company manages relationships with employees, suppliers, customers, and communities. This might involve labor practices, safety standards, and community engagement.

3. Governance and Involvement of the structure and quality of a company's management, board, and internal controls. This includes transparency, shareholder rights, and ethical conduct in business practices. rating providers, covering a wide range of sectors and companies.

The Morgan Stanley Capital International Group **(MSCI)** is one of the main ESG rating providers.

These rating are evaluated within the following **5-step** methodology:

Example: A.P. Moller – Maersk Shipping

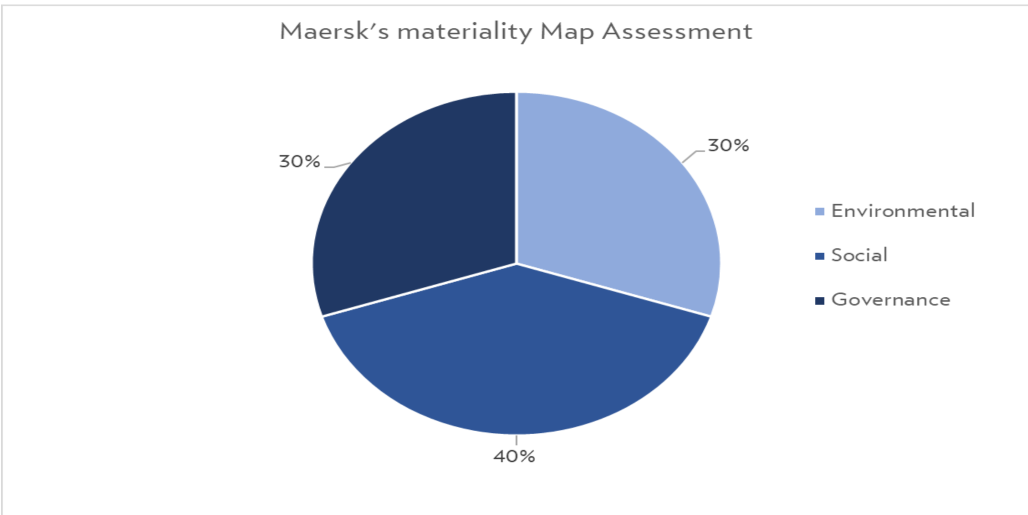
1. Identifying Key ESG Issues:

   Viewing the company's Carbon Footprint (The total amount of greenhouse gases a company adds to the atmosphere), Labor Management, and Corporate Governance Practices.

2. The "Weight":

   (Importance of Industry) in the ESG Issue for **Maersk** within the 3 different sectors is noted according to the graph below:

- MSCI's ESG Industry Materiality Map Assessment of **Marine & Port Services:**



3. Evaluate Exposure & Management:

Environment: Maersk has high exposure to the environment due to the nature of shipping and fuel

Social: Adherence to human rights standards

Governance: Strong business ethic policies and anti-corruption practices.

4. Calculate Scores:

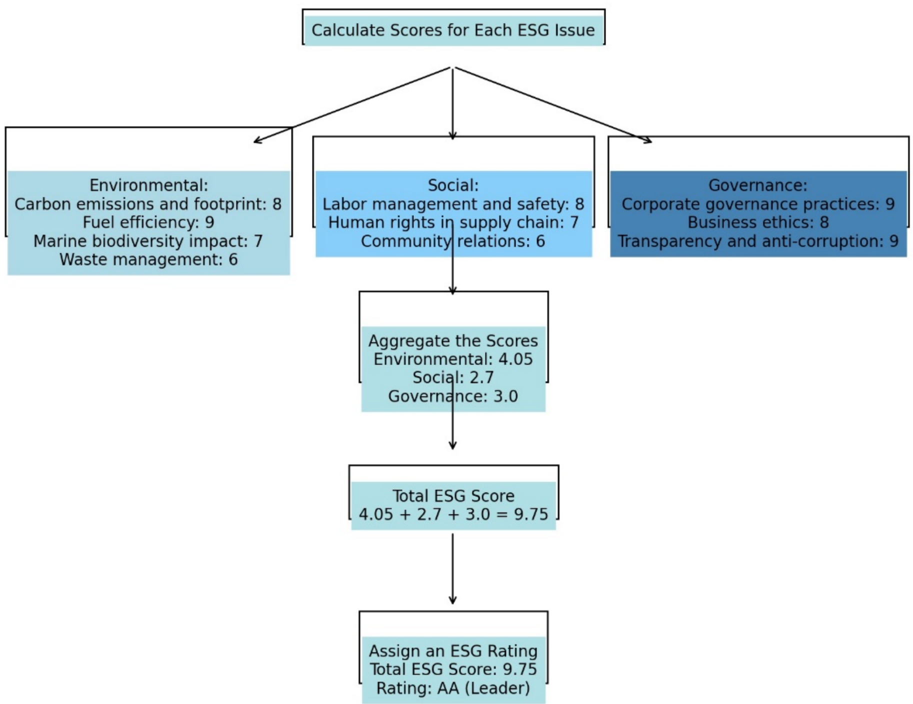
Each ESG Issue is scored on a scale from 1-10 (1 being least effective) based on Maersk's exposure and management practices.

The scores for Maersk Shipping can be calculated using this format:

5. Assign an ESG Rating:

- **AAA and AA – Leaders**
- **A and BBB – Average**
- **BB, B, and CCC: Laggards**

Based on the total ESG score, a score of 9.75 translates to a rating of **AA** indicating that Maersk is a leader when it comes to managing ESG risks and opportunities within the shipping and logistics sector.



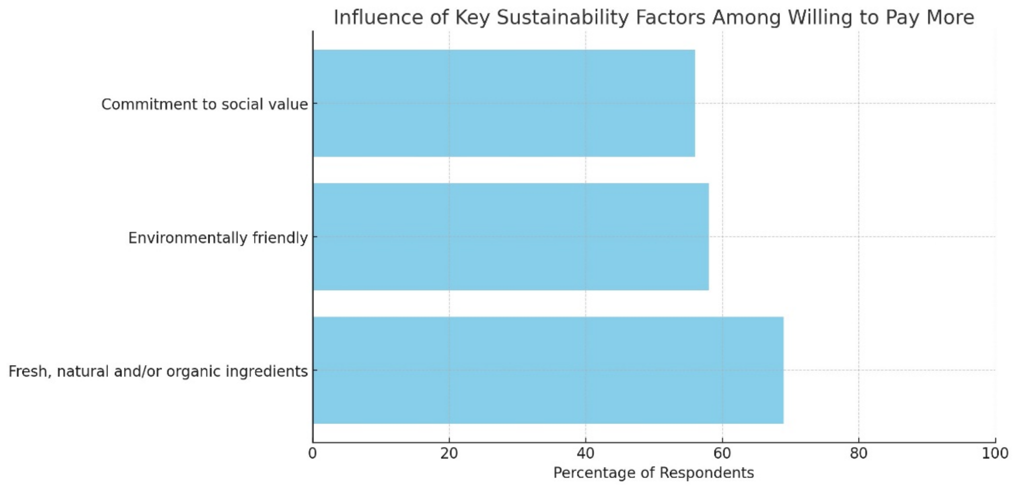
Significance of the ESG: Maritime Industry

The maritime industry is responsible for transporting 90% of the world's trade. In particular, one of earths most crucial commodities, crude oil. Carried via large oil tankers commonly known as Very Large Crude Carriers (VLCCs), crude oil is transported from various Middle Eastern countries like Saudi Arabia major ports and consumer hubs worldwide. According to the International Energy Agency (IEA), a Europe receives an average of 14.4 million b/d (Barrels per Day) which equates to around 1 billion CHF per day, 32 billion CHF per month, and around 384 billion CHF per year. **This massive volume of trade depicts the critical role of the maritime industry in ensuring a constant supply of resources essential to todays societies, like energy, to meet global demand.** Although these numbers may play a crucial component of the global economy, the maritime industry is responsible for emitting approximately 1,056 million tons of CO_2 yearly. This figure is expected to increase by 47% by 2050 depending on future economic demands and energy developments, (Maya Weber 2021). These pollutants, among many others, increase global temperatures at a significant amount given the maritime sector's scale and essential role in trade.

That being said, environmental concerns to improve sustainability and incorporating ESG evaluations are rising within the shipping industry. However, the concepts of ESG are not only beneficial for environmental sustainability, with an inclination of corporations exploring a variety of financial opportunities too.

Significance of ESG: Earnings

When it comes to ESG, **financial contributions have long been overlooked by large corporations.** Studies are now showing an upwards trend of companies committed to ESG principles being recognized with a stronger reputation and even an increase in brand loyalty. As more people aim to be responsible global citizens, they expect the same from large corporations. That's why they are taking the time to do their homework before buying products. **There are many ways companies display their responsible side to the environment** in order to attract this emerging side of consumer behavior like, displaying sustainable practices and initiatives through food labels, elaborating on internal manufacturing practices on web sites, and even posting sustainable practice updates on social media.



(Nielson 2015)

Depicted in the graph above, "Among the 66% of global respondents willing to pay more, over 50% of them are influenced by key sustainability factors, such as a company being known for its commitment to social value (56%), and a company being environmentally friendly (58%)." **This shows the essence of personal values being more important than personal benefits such as cost, or convenience and the measurements companies can take to find middle ground in between earnings and sustainability.**

Sustainable Banking on the Rise

Furthermore, an industry that is on an upwards trend with ESG propositions is the world of **corporate banking.** According to a recent Economist Impact report done for Temenos, 73% of banks will increase their focus on banking options that are within consumer demands of positively Impacting social and environmental issues (Fintech Global 2024). Interestingly, the youngest generation with adult members, Generation Z, favor long term investments and in the UK alone, **61% of banking customers favor investments aligned with ethical and sustainable values.** These numbers lead to a variety of new initiatives and to multifaceted responses across corporate banks. In addition, 37% of banks are starting up low-carbon technologies, and 31% are using sustainable strategies that cover internal operations and supply chains. **One way or another, consumer preferences are putting great pressure into internal operations of corporate banks forcing change and solutions for clients' values.**

Case Study: The Poseidon Principles

Due to the outlined growth of sustainability in corporate banking, and the impactful size of the maritime industry, the world's first global maritime and climate group was formed. This development is known as the **Poseidon Principles** with some but not all founding signatories including Citi, Société Générale and Danske Bank. Together, these corporate banks represent a bank loan portfolio estimated at over $100 Billion.

The purpose of the principle is to integrate lending to shipping companies while incentivizing the decarbonization of the shipping industry.

The objective of the Poseidon Principles is to align the shipping industry with climate goals set by the **International Maritime Organization (IMO). Specifically, aiming to reduce carbon shipping emissions by at least 50% by 2050** compared with the levels recorded since 2008.

Implementation:

With ESG concerns on the rise internationally through legislation, shipping companies are facing increased pressure to comply with regulations on carbon emissions. **Therefore, when shipping companies agree to meet the (IMO) targets for reducing emissions, banks and insurers who are part of the Poseidon Principles give better loan conditions and easier access to capital in general.**

For vessels to qualify for such reoccurring financial incentives, shipowners must provide data on their vessels' yearly carbon intensity emissions (fuel consumption, distance sailed, and ship capacity). This data is then calculated into an overall **climate alignment score.** The score then indicates how well the banks shipping portfolio aligns to the (IMO's) decarbonization targets (S&P Global).

The rating is given in form of a letter A-E (Where **A is the best) depicting the ships energy efficiency**. If a ship is rated D for three consecutive years, it will have to submit a corrective action plan to show how it will achieve a C or above.

Ships can improve their ratings through measures such as speed optimization (Shorter routes, slower speeds), low energy light systems onboard, and even the installation of solar/wind accommodations to increase sources of renewable energy while onboard.

Insurance companies and banks are encouraged to provide incentives to ships that are rated as **A or B.**

The Yearly "Annual Disclosure Reports" show the climate alignment scores of banks which provides a benchmark for the industry. Despite the industry's recovery due to COVID-19 like port-congestion, and personnel shortages, there was a **95.4%** reporting percentage in 2023 showing transparency, yet the indication of still, a growing industry (IMO 2023).

"The reporting percentage of +95.4% stands as a testament to the strong endorsements from shipowners and clients" – Head of Maritime Industries, Société Générale

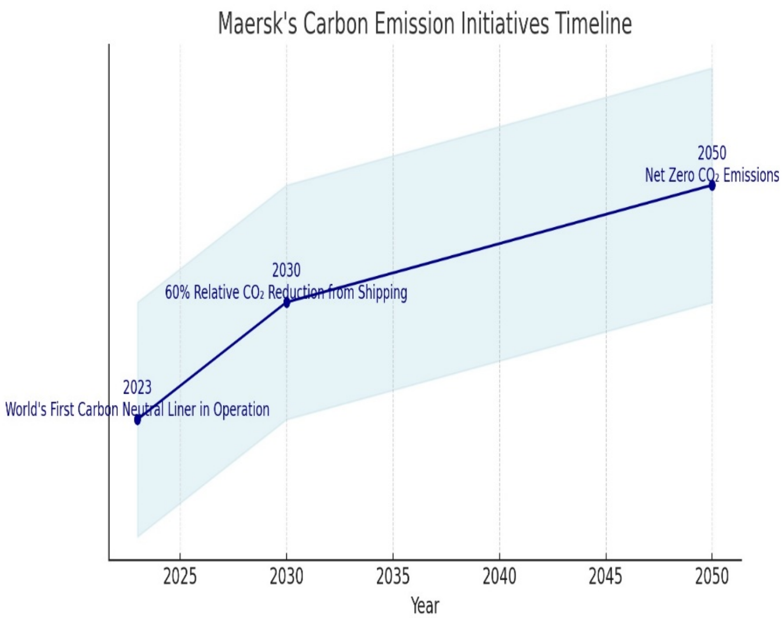
Notable Achievements:

In simple terms, it's almost like a chain of responsibilities in between the shipping companies to qualify for financial incentives and the banks to maintain the environmental reputation of their portfolios which is disclosed to the public. That being said, **the Poseidon Principles has seen incredible performance in the race of decarbonizing ships in just 5 years.**

Port of Singapore: 15 Km long, one of the largest ports in the world

1. Maersk's Carbon-Neutral Vessel:

Maersk increased its efforts to decarbonize marine operations with the launch of the world's first carbon neutral vessel in 2023. In addition, all future Maersk owned buildings will have a dual fuel technology enabling either carbon neutral operations or low fuel consumption.



This visual representation helps to clearly see the progression and major targets in Maersk's sustainability journey (Maersk Press Release 2021)

2. 168 New Green Fuel Contracts:

A fast rise in the transition to green fuels has been seen in the Maritime Industry. Green Fuels are fuels with very low (65-95%) carbon emissions over their life cycle compared to fossil fuels. An example of a green fuel is methanol and it's estimated that there will be around 257 methanol fueled ships by 2026.

However, it's important to note that most methanol available today is produced from natural gas or coal meaning that significant investment in green methanol production needs to be done (IACS – Classification Society)

3. Annual Report Success:

   The 2023 Annual Report highlighted a very important moment as bank signatories, for the 4th consecutive year, reveal their climate alignment efforts. Even though it's only the 4th year, the report showed the average amount of emissions above the IMO's initial trajectory which was only 2% over compared to 2022 which was almost 10% over.

Potential for Corruption:

In contrast, without an independent body to verify compliance of the Poseidon Principles, there could be potential for corruption or manipulation. **Financial institutions could interpret the goals of the IMO in ways that favor their portfolios.** For instance, the Volkswagen emissions scandal (September 18th, 2015) depicts the **danger of self-regulation** when the company manipulated the emissions tests to make their vehicles look more environmentally friendly than they were at the time (N. Mansouri 2016). With studies showing that earnings can significantly increase for companies involved with environmental efforts, **demonstrating commitment to aspects of sustainability may improve the institutions image as well.** This concept is known as **"greenwashing"**. The oil company known as BP rebranded itself as Beyond Petroleum and sporadically invested heavily in renewable energy projects to gain the attention of potential shareholders only to drop the multi-billion-dollar project to transition back into fossil-fuel investments. (R. Bousso 2021).

On the other hand, while the principles are still new with it only being established in 2019, there have not been any instances of corruption within the Poseidon Principles. In addition, the frameworks reliance on third-party groups helps relieve instances of corruption like regular audits and detailed public exposure of results and data sources. **Backed by over 35 financial institutions, the Poseidon Principles covers around 80% of the global shipping market** (Global Maritime Forum) and the establishment of a carbon intensity reporting agency ensures transparency across the public helping set a standard of consistency and anti-corruption efforts across the signatories.

Hence, the integration of ESG in the duo of corporate banking and the maritime industry is a large step within the right direction, especially due to the gradient of the two industries within the economy. While the maritime industry has a long way to go in their sustainable development initiatives, the Poseidon Principles highlight meaningful change. **Companies now have the opportunity to not only enhance their reputation but to also adapt to the emerging consumer preferences** which favor an environmentally friendly perspective. Even though the risk of greenwashing and corruption remains, third party frameworks are aimed to clear up any loose ends of transparency.

Lastly, numbers have been showing an incredible trajectory in sustainability in just a short span of time, and the impactful efforts of groups forming together to align financial interests with the environment are creating a more responsible future, **not only for global trade, but for the world as we know it.**

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