2022 | ISSUE 4

THE NSIDE

OakNorth's Credit Intelligence Magazine for Commercial Banking Leaders

PUTTING THE "RELATIONSHIP" BACK IN RELATIONSHIP MANAGER

AUTOMOTIVE INDUSTRY DISRUPTION

Fifth Third Bank: leading the charge on sustainability in commercial banking

Meet Chief Sustainability Officer Mike Faillo

GD USA
AMERICAN INHOUSE DESIGN AWARDS
2022 WINNER

ON Industries

A granular, forward-looking view of future industry performance, drawn from one of the largest commercial lending data sets in the market.

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CREDIT INTELLIGENCE

OakNorth's growing data set represents $420B of Commercial & Industrial lending over 950 NAICS. In our ON Industries series, we demonstrate this granularity, by going down to NAICS level 5 across several industries, including automotive, agriculture, and more.

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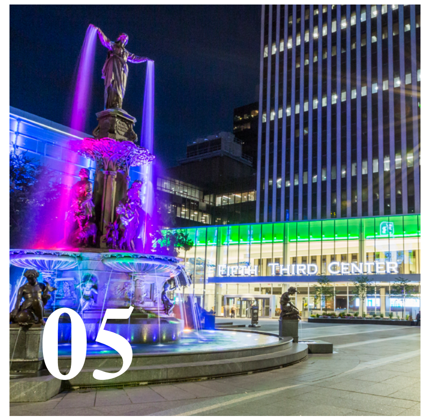
CONTENTS



INSIDE THE ONSIDE

RISHI KHOSLA

> "...Certain sectors are temporarily "vetoed" or "black-listed" as ones the bank is unwilling to lend to. This approach disregards the fundamental differences in how businesses operate and means many either get an immediate rejection because they belong to a specific sector."

"OUR CURRENT BANK HAS DECIDED THAT THE hospitality sector is not for them. Do you do commercial term loan refinancing?"

This was a message our UK bank, OakNorth Bank, received on Twitter recently from an entrepreneur with a small pub and hotel portfolio. Upon speaking with the customer, we learned that they'd been banking with their current bank for 10 years. So, even a "relationship" of a decade didn't help.

This is an issue we hear about time and again in commercial banking – the economy looks like it's heading for a rough period, and as a result, certain sectors are temporarily "vetoed" or "black-listed" as ones the bank is unwilling to lend to. This approach disregards the fundamental differences in how businesses operate and means many either get an immediate rejection because they belong to a specific sector, or end up with a facility that's not a good fit for their specific business needs.

I don't know what the future holds, but if the economy is heading for a downturn, I'm comforted by the wise words of one of our customers, Daryl Moore, Chief Credit Executive & Senior EVP at Old National Bank, who said: "As bankers, we know the clients you support in the tough times and during the cycles, often become your most loyal."

Banks such as Old National and Fifth Third, the focus of this issue's cover feature, understand that lenders have a responsibility to support businesses. If they can anticipate how different scenarios – further increases in inflation, changes to housing prices or employment, ongoing supply chain issues, climate change, etc. – will impact their borrowers, they'll be in a better position to support them. And, as demonstrated by the message OakNorth Bank received on Twitter, all at a time when many of their peers will be retrenching.

We hope you enjoy this latest issue of the ONside and if you have any feedback about our magazine, please email **ONside@oaknorth.com**

Fifth Third: Leading the charge on sustainability in commercial banking

Q&A with new Chief Sustainability Officer, Mike Faillo

FIFTH THIRD BANK WAS FOUNDED IN CINCINNATI, OHIO IN 1858. YET DESPITE its name and age, it is a bank that has proven it's not afraid to be a first mover and innovation leader. Over the last 164 years, Fifth Third has grown into the 10th largest US bank, with over $211B in assets (as of March 31, 2022), of which roughly 25% is commercial loans.

In May, it announced the establishment of a Sustainability Office and the appointment of Mike Faillo as Chief Sustainability Officer (CSO). Mike began his career at Fifth Third in 2015 and most recently served in Investor Relations as the director of ESG reporting and analytics. Since 2019, Mike has led the Bank's ESG strategy and reporting and serves as chair of the ESG Committee.

Following the recent publication of Fifth Third's 2021 ESG Report, we were delighted to have the opportunity to sit down with Mike to hear about his new role and how Fifth Third is leading the charge on sustainability within the banking sector.

Q: Mike, congratulations on your new role. Please can you share what it entails and what your responsibilities as CSO are?

A: This role is a first for Fifth Third, so I'm honored and humbled to have been given this opportunity. As CSO, I lead the newly created Sustainability Office and Fifth Third's comprehensive environmental, social and governance strategy. This includes our climate strategy and sustainable finance initiatives, as well as social and governance reporting – including the recent publication of our 2021 ESG Report. I work with several lines of the business to develop financial solutions and drive innovation to ensure Fifth Third's transition to a sustainable and inclusive economy. This includes achieving the $100 billion environmental and social finance target we've set from 2021-2030, as well as our operational sustainability targets we've set by 2030.

Q: Can you share a bit more about these targets?

A: Just recently, we achieved our original $8 billion renewable finance goal, more than two years earlier than our 2025 goal. We are committed to continuing our leadership in sustainability through our new 10-year target to provide $100 billion in environmental and social financing by the end of 2030. We have published a framework on our investor relations website to outline the eligible categories and methodology for this target.

Our new operational sustainability targets build upon the Bank's initial five goals set in 2017, which established the foundation for Fifth Third to reduce the environmental impact in its own operations. Our new and enhanced operational sustainability targets for 2030, relative to our initial goals are to:

— Continue purchasing 100% renewable power

— Reduce location-based Scope 1 and 2 GHG emissions by 75% (previously 25%)

— Reduce energy use by 40% (previously 25%)

— Reduce potable water use by 50% (previously 20%)

— Divert 75% of waste from going to landfills (previously 20% waste reduction goal)

— Reduce paper use by 75% and purchase remaining paper from certified sources

> "We are partnering with OakNorth to help develop our climate scenario analysis capability, quantify our climate risk in commercial lending, guide future conversations with our commercial borrowers, and enable us to continue our climate leadership through disclosure."
>
> **MIKE FAILLO, CHIEF SUSTAINABILITY OFFICER, FIFTH THIRD BANK**

Q: Why is setting and measuring sustainability targets important to Fifth Third?

A: Measurement drives action and at Fifth Third, we understand that integrating environmental sustainability into all aspects of our business creates long-term value and strengthens the communities we serve. We recognize the financial sector plays an important role in making the changes necessary to adapt to a changing planet and create more resilient communities. Banking is key to supporting the development of new technologies, financing new infrastructure, and helping customers transition their operations.

As one of the largest banks in the country, we feel we have a responsibility to lead by example which is why we have reduced our location-based Scope 1 and 2 emissions by more than 50% since 2014. We have also been carbon neutral for these emissions since 2020 with the purchase of 100% renewable power and verified carbon offsets for the remaining emissions.

Q: Are there any other actions that Fifth Third is doing which demonstrate its commitment to environmental sustainability?

A: There are a number of initiatives that make me incredibly proud to have spent the last seven years with Fifth Third:

— We're the only bank among peers to have achieved an A-CDP Leadership Score for three consecutive years (2019, 2020, 2021).

— In October 2021, we issued our inaugural Green Bond and became the first U.S. financial institution with under $250 billion in assets to issue an ESG bond of any type. Proceeds from the Bond will support the funding of green projects that align with our sustainability priorities.

— In February, we published our second Task Force on

FIFTH THIRD BANK

How Fifth Third Bank is funding green new business

$3B+
New loan origination

$2B
Lending & capital for renewable energy projects

$500M
Financing to eligible green buildings

$350M
Financings to solid waste processing and recycling businesses

Climate-related Financial Disclosures Report.

— In May this year, we acquired Dividend Finance, one of the top national social lenders in renewable energy.

Q: Last year, the US experienced 20 extreme weather events causing $1 billion or more in damage. How will commercial lending change in the future as a result of climate change?

A: Climate change represents real risks and real opportunities - at Fifth Third, we're looking at both. First, our Climate Risk Officer and her team are evaluating climate related risks through scenario analysis to understand possible exposure to both physical risk, such as extreme weather events as you mentioned, and transition risk, or how changes in technology or carbon tax pricing could impact our borrowers. We believe that carbon-intensive companies still play an important role in today's economy, at least in the short term, so we're trying to examine how we can work with these businesses and support our customers in the transition to the green economy. That transition will likely require investment which is why commercial lenders such as Fifth Third have such an important role to play.

There are also numerous green businesses that will require funding support - for example, last year, we provided over $2 billion in lending and capital raising for renewable energy projects, $500 million of financing to eligible green buildings; and we provided $350 million of financing to solid waste processing and recycling businesses. These are just some examples, but they equate to over $3 billion of new loan origination – providing just a glimpse of how significant an opportunity this is for commercial lenders. I'm excited about how we can continue integrating sustainability into new business lines and solutions, such as participating in loans with sustainability metrics, and incentivizing borrowers with reduced rates if they meet ambitious climate-friendly targets.

Q: Can you share a bit more about Fifth Third's partnership with OakNorth?

A: We are partnering with OakNorth to help develop our climate scenario analysis capability, quantify our climate risk in commercial lending, guide future conversations with our commercial borrowers, and enable us to continue our climate leadership through disclosure. Working with Michele Mullins, who was appointed as our first ever climate risk officer in September last year, we've run climate risk analysis across all industries that face direct / indirect impact of changing climate policies (~25% of C&I portfolio), applied scenarios aligned with industry standards (NGFS) and aligned ON Climate analysis with our own Scope 3 financed emission calculations. We will build on this with our recently released 2021 TCFD report to continue quantifying and reporting on our climate risk.

Our purpose is to improve the lives of our customers and the well-being of our communities. We can only deliver on this if we understand the future challenges our customers are facing and have the data to continue confidently supporting them.

Join a 1:1 demo and discover what ON Climate can do for your bank.

Putting the relationship back in 'relationship manager'

OVER THE LAST FEW DECADES, COMMERCIAL LENDING HAS BECOME MORE AND MORE commoditized, leaving commercial banks feeling like pricing is the only way to differentiate from other lenders. This race to the bottom has become an expensive proposition for banks looking to grow their commercial books. With shrinking margins and talent costs at a premium, it's a hard sell to executives to hire specialized lending talent that can bring a new book of business or enter new markets.

THE DATA DIFFERENTIATOR

In today's world, data are assets that can help banks differentiate themselves and develop much stronger relationships with customers. Armed with the right data, relationship managers can become trusted partners and build relationships that will continue to evolve and grow through the different growth stages of a business. With the proper tools, data can help lenders both identify new opportunities, and potential headwinds earlier, leading to deeper, more meaningful relationships with current and prospective borrowers.

GETTING GRANULAR

Many commercial lenders tend to lump businesses into one of a dozen or so categories – retail, hospitality and leisure, agriculture, etc. The issue with this approach is that it misses the fundamental differences between businesses – differences that could have a significant impact on a business' creditworthiness and future growth potential.

During COVID-19 for example, the experiences of different businesses from within the same sector varied dramatically at different stages of the pandemic. Take an amusement park and a movie theatre for example: both are classified as "leisure" businesses, but as an activity based outdoors and with infrastructure that can be revived relatively quickly, the amusement park would have been able to re-open sooner and recovered more quickly as a result. Meanwhile, the movie theatre which is indoors and where movies take at least several months to produce, would likely have re-opened later, with limited occupancy due to social distancing, and spent a significant amount of money on sanitization.

By developing a granular view of a business, relationship managers will be able to structure a facility that works for that business and have much more collaborative and strategic conversations with them – thereby ensuring the relationship flourishes.

TAKING A FORWARD-LOOKING VIEW

Many lenders view young, or high-growth businesses as high risk because they're making decisions based on historical information. If a business is growing

20% year-on-year, the difference between their last 12 months and their next 12 months is 40%. So, if a lender is only considering lending to a business by looking at their historic data, they're not lending based on that business' future potential, or what's needed to support its current growth trajectory. This isn't the most effective way to begin a lending relationship.

Of course, banks shouldn't disregard historical data – the key to forward looking models has its foundation in historical information. Bankers should understand the assumptions driving those models and periodically re-evaluate them, ensuring consistency with what is currently happening. In fact, this is something I heard during a fireside chat at a recent commercial lending conference. They stated that banks need to keep evolving and developing their approach, as forecasting is both an art and a science. History teaches us important lessons, but by taking a forward-looking view, lenders can work with borrowers to find a path to 'yes' more often – an outcome that is clearly much better for the relationship. They can do this while maintaining credit quality, enabling them to grow their loan book and ultimately create a better experience for borrowers.

PAYING FOR A PREMIUM PARTNERSHIP

What we've learned from working with banks across the US and growing our own bank in the UK (OakNorth Bank) is that businesses value speed, certainty of decision, and having a trusted partner, alongside price. They are willing to pay a premium for a better borrowing experience where the lender has a granular understanding of their business and can take a forward-looking view to structure a facility that is customized to their business. They are willing to pay a premium to avoid the opportunity cost of having to wait months for an answer even if it's a 'no'. They are willing to pay a premium to work with a lender that's able to provide them with useful insights about their peer set and what's happening in their industry. They are willing to pay a premium for a genuine partnership with their lender.

With rising interest rates and inflation, commercial lenders are going to have to find other ways to differentiate beyond price, or risk seeing stunted loan growth. By embracing data, getting granular, and taking a forward-looking view, they can put the relationship back in 'relationship manager' and lend faster, smarter and more to businesses.

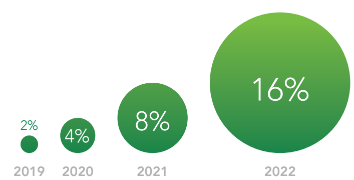
SCENARIO ANALYSIS

HOW THE AUTOMOTIVE SECTOR IS BEING DISRUPTED AND WHAT YOUR BANK CAN DO ABOUT IT

THE AUTOMOTIVE SECTOR IS A VITAL PART OF THE US ECONOMY – accounting for 3% of the country's GDP – but with increasing demand for electric vehicles (EVs), evolving battery and fuel cell technology, rising gas prices, and a regulatory push towards greener technologies, it is witnessing incredible disruption. The ripple effects of which will be felt across the entire automotive value chain.

Three years ago, EVs represented just 2% of all new car sales in the US. A year later, it doubled to 4%. Last year, it doubled again to 8%, and this year, it's forecast to double yet again to 16%. Earlier this year, California regulators unveiled a proposal to ban the sale of all new gas-fueled cars by 2035, as the state pushes for more EV sales in the next four years. So, we can only expect this trend to continue.

How will these future challenges – changing consumer demand, policy, and technological disruption – impact the creditworthiness of the 18,000 new-car dealerships, 140,000 used-car dealerships, and 234,700 auto repair and maintenance centers across the country? And what will the implications be of this for the banks that lend to them?



Sales of EVs are doubling every year

2035

California regulators are proposing a ban on the sale of all gas-fueled cars

By 2035 - only 13 years from today - GM plans for all its new car sales to be EVs

OakNorth

GREEN IS THE NEW GOLD

Some of the world's largest automotive brands have published bold commitments – last year, Ford announced that it expects 40-50 percent of its global vehicle volume to be fully electric by 2030, while GM plans to exclusively offer electric vehicles by 2035.

But these commitments won't just impact the Fortune 500 companies that are making them – businesses of all sizes, across the automotive value chain, will be affected. In order to stay in business, they will need to update their supply chains and distribution models, invest in new technologies, processes, people, and products, and potentially in some cases, even build an entirely new brand.

Banks will have an important role to play in funding much of this transition.

THE POOL OF POTENTIAL BORROWERS IS THEREFORE GETTING BIGGER

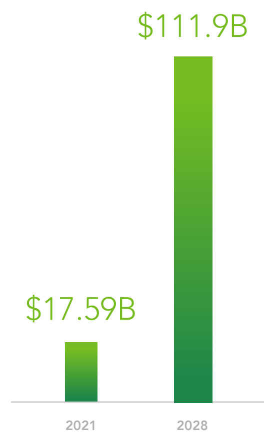
Opportunities don't just exist in being a partner in helping automotive businesses transition, there are also a growing number of new automotive businesses and business models designed for the net zero future which will require funding as they scale. Tesla isn't even two decades old but last year, more than 75 percent of US all-electric cars were produced by the company. With growing consumer demand for EVs and a desire from governments to reduce our dependence on fuel, the need for more EV charging stations is also rising. According to Fortune Business Insights, the global EV Charging Stations Market is estimated to grow from $17.59 billion in 2021 to $111.90 billion in 2028.

Electrify America, Charge Point, and EVgo are brands that didn't exist 15 years ago because they didn't need to. How many more businesses will be born in the next 5, 10 or 15 years that will require loans and investment to help them scale? This represents a multi-billion-dollar-a-year opportunity for banks – one they will only be able to address if they have the ability to run scenario analysis to anticipate what's coming next and take a forward-looking view.

THE SMALLER THE DETAIL, THE GREATER THE VALUE

Currently, most scenario analyses work at a broad sector level, looking no deeper than the sub-sector level. This provides some indication of a bank's risk exposure, but such a broad view lacks the insight needed to really understand the impact and trends at the individual borrower level. ON Scenarios provides banks with forecast financials and credit metrics at the borrower level – across several scenarios and time horizons. These outputs can directly input to banks' existing risk rating models and be applied across the full credit lifecycle – from origination and ongoing monitoring, to conducting portfolio level scenario analysis.

With inflation at its highest level in decades, the cost of living increasing, gas prices becoming unaffordable, ongoing supply chain issues, a potential recession looming, and extreme weather events occurring on an almost weekly basis, businesses face numerous challenges ahead. Commercial banks can be better prepared to support these businesses if they understand how these challenges will impact them in the future. In a downturn, many lenders retrench from commercial lending, but by understanding future scenarios, they can become trusted partners and support customers at a time when many of their peers are reluctant to.



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CREDIT INTELLIGENCE

The Ultimate Guide to Commercial Lending & Climate Impact

Climate change is a
$145B
RISK[1]

And a
$9.2T
OPPORTUNITY[2]

Are you prepared?

The opportunity to address climate risk is now - before regulations demand it and before your portfolio is negatively impacted by ongoing US weather disasters with staggering annual costs of $2.1T, changing consumer demands, technological disruption, and policy.

Access the Ultimate Climate Guide for an action plan to get started and seize the opportunity today.

[1] *In 2021 alone, extreme weather events cost the US economy $145 billion. National Centers for Environmental Information.*
[2] *McKinsey estimates that the investment in new infrastructure and systems needed to meet international climate goals could be as much as $9.2 trillion, annually. The net-zero transition: What it would cost, what it could bring.*