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FINANCIAL SERVICES ESG

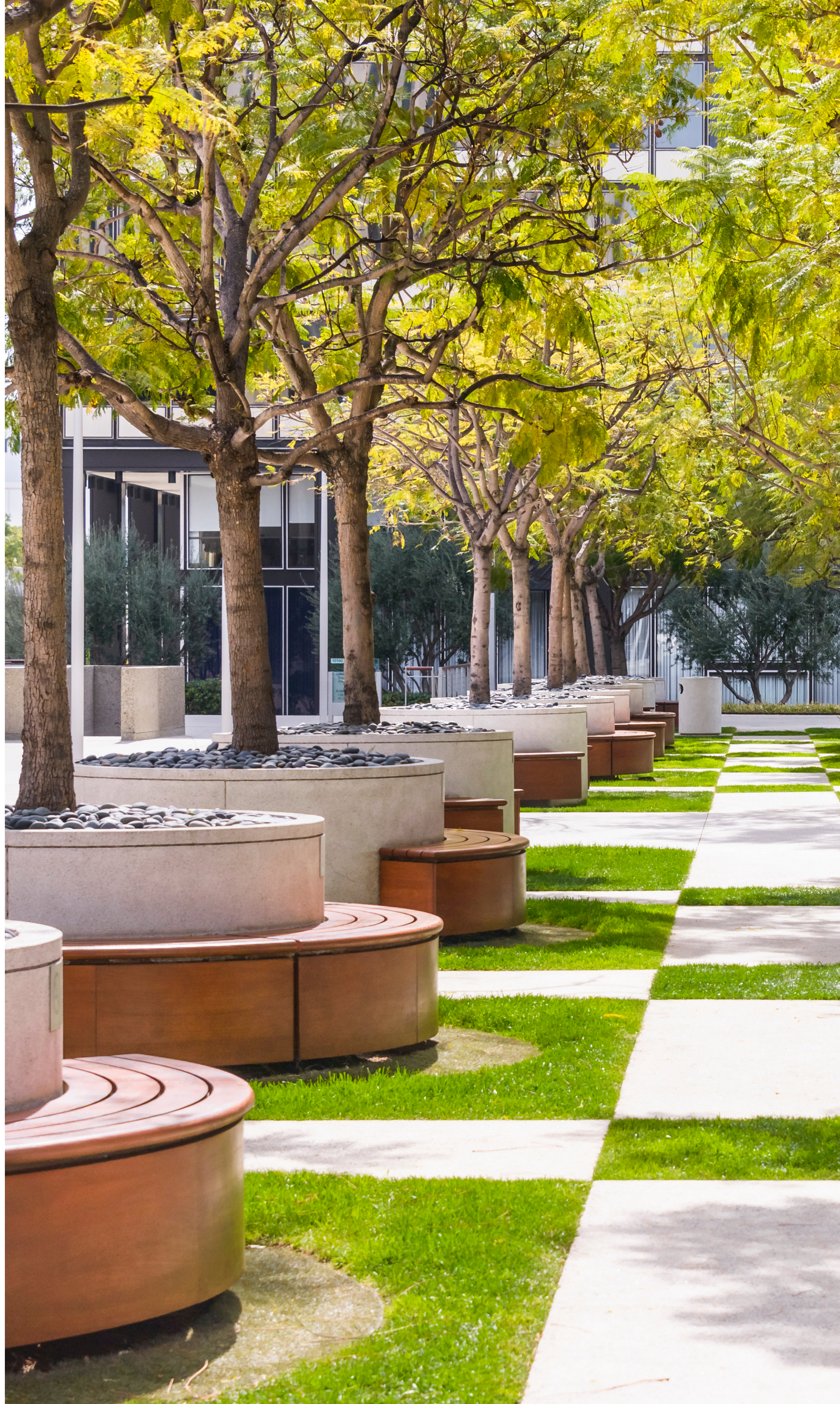
The Complete Checklist: Financial Services ESG Musts in 2022

The financial industry is facing a host of changes. Businesses and investors are placing greater focus on Environmental, Social and Governance (ESG) than ever before. Sustainable finance is experiencing unparalleled growth, with 2021 seeing an estimated $120 billion poured into sustainable investments- more than double the $51bn invested in 2020.

120bn

USD invested in sustainable companies and initiatives in 2021, more than two times that invested in 2020.

Bloomberg, 2021



The challenge in the coming year will be to manage this growth in a way that passes the scrutiny of regulators and consumers. We have provided a brief overview of ESG criteria, alongside the steps your organisation should be taking in 2022 to maintain compliance and meet customer expectations.

“ESG has become one of the biggest issues for financial institutions. Financial services may be ahead of many other sectors when it comes to addressing this topic, but it will still be an important factor shaping risk for many years to come. Social and environmental trends, such as diversity and climate change are increasingly sources of regulatory change and liability, while increased disclosure and reporting will make it much easier to hold companies and their boards to account."

- David Van den Berghe, Global Head of Financial Institutions at AGCS

ESG Criteria Overview

ESG criteria address an organisation's impact on the world as a measure of value.

ENVIRONMENTAL

Criteria to examine your organisation's direct and indirect impact on the environment:

- Energy consumption
- Responsible use of natural resources
- Greenhouse gas (GHG) emissions
- Pollution and waste practices
- Investment projects and their impact

SOCIAL

Criteria to examine how your organisation treats and values internal and external parties:

- Labour management policies
- Health, safety, and wellbeing
- Community support
- Customer privacy
- Diversity and inclusion policies

GOVERNANCE

Criteria to examine how your organisation handles governance and regulatory compliance:

- Diverse board structure
- Audit quality
- Ethical conduct
- Reporting transparency
- Leadership accountability

Source: Marsh and Deloitte

1. Plan for key dates

All organisations will have to ensure they are on track for the rules and regulations being enforced across the UK. Businesses will need to plan ahead, assessing if they are in scope for the following new requirements:

- The first phase of the Sustainable Finance Disclosure Regulation (SFDR) will come into play in June 2022. It will apply to all UK financial institutions operating in or transacting with the EU, requiring firms to disclose their impacts on climate change mitigation and adaptation. Further areas will follow, including water use and transitions to a circular economy.

- The framework delivered by the Task Force on Climate-Related Financial Disclosures (TCFD) will require asset managers and owners to report the risks and opportunities posed to it by climate change. Its goal is to improve the level of sustainability reporting by obtaining greater granularity from firms, helping to prevent greenwashing.

- The UK is planning to implement its Sustainable Disclosure Requirement (SDR) and Taxonomy by 2023. This will require firms to report on social metrics such as labour conditions and community, which have thus far been seen as unquantifiable.

Source: AlixPartners

1.*

"ESG regulations and guidance will be a driver of risk going forwards. With new rules on disclosure and taxonomy, and around green investments, the compliance risk for financial institutions is growing,"

- Hannah Tindal, Head of Directors and Officers, AGCS.

2.*

"The pressure on financial services firms to integrate ESG issues into systems, processes and overall decision-making is growing on all sides. Shareholders, investors and pension funds are all starting to make their voices heard on the link between corporate attention to ESG matters and business sustainability and resilience."

Source: Risk.net

2. Integrate into existing frameworks

Risk is intrinsic to banking and other financial activities. A vital aspect of futureproofing your firm is by managing and integrating ESG into every stage of your risk management framework, embedding it within all relevant processes. For a holistic approach, organisations need to:

- Frequently engage with sustainability experts to stay informed on policy.
- Identify whether investments are concentrated in specific industries or regions.
- Consider dependencies on financial, manufactured, human, social, natural, and intellectual capital to inform risk analysis activities.
- Influence the board and senior management to appreciate, understand, and incorporate the assessment of risk as part of their ongoing agendas.

Sources: PWC and EY

3. Collect and utilise data

Data collection is business-critical for financial institutions, allowing them to successfully identify and assess ESG risks in order to integrate them into pre-existing risk modelling. For instance, investors can utilise Know Your Customer (KYC) practices to gather information on aspects that affect ESG risk, such as client supply chain structure. Key activities to carry out are:

- Assess the current state of data and determine any gaps, putting in place solutions for sourcing the remaining information.
- Establish a data hub, accessible to everyone that contains information from a wide spread of sources.
- Create transparent reporting capabilities, utilising visualisation tools to easily communicate key data.
- Use established insights to inform decision making and format company strategy.

Sources: Mindtree and PWC

3.*

"With the surge of ESG investing, fund managers need ESG data, tools and analytics to aid decision making."

Jason Stevens, CTO, Ultimus Fund Solutions

4.*

"Changes in consumer demand are beginning to affect the corporate bottom line as consumers are increasingly aware of ESG practices. They have higher expectations of the companies behind the products to operate their businesses ethically and responsibly, and demand greater transparency about how they conduct their business."

Source: KPMG

4. Maintain trust

Building integrity will be vital when communicating ESG goals and achievements. Consumers must be able to trust that firms will carry out sustainability claims, maintaining credibility without resorting to greenwashing techniques.

The FCA will be taking on the role of regulating this in the financial industry, stating that they "aim to ensure that the financial sector operates fairly, effectively and with integrity. And that it delivers high-quality instruments, products and services that genuinely meet investors' ESG preferences and are free from 'greenwash'."

The consequences for those who do not comply will be two-fold. As more regulations come into play, fines and other measures will be imposed on organisations that do not substantiate their claims. Additionally, customer acquisition and retention will be put in jeopardy. 44% of surveyed consumers see ESG issues as an especially important factor when choosing a financial provider, alongside ¼ customers likely to switch banks due to ESG concerns.

5. Promote Transparency

As noted in section 1, the UK will soon be implementing mandatory disclosures as part of its roadmap to sustainable investing. Transparency will be a vital element in building trust, with enhanced disclosures to clients and consumers assisting them with making informed financial decisions.

This will also contribute towards the overarching Net Zero goal, as institutions that maintain ESG transparency will gain a competitive edge, encouraging the flow of funds to be directed towards more sustainable projects.

Going forward, stakeholders and other key players must work together to:

- Standardise reporting techniques
- Increase knowledge and tools to suitably evaluate ESG metrics
- Increase scrutiny on sustainability statements

Source: Catena Investments

5.*

"Money is the most basic form of democracy because where we chose to spend our money reflects our values and beliefs, therefore it is important to take responsibility and ownership of the impact of our money, but we can only do this when we know the whole truth and the full extent of where our money is really going."

Zoe Sear, Head of Communications at Triodos

6.*

“It is clear that next-generation ESG leaders will look quite different from earlier archetypes, as the scope of the role grows and requires a far more senior and agile executive to be considered as a credible ‘ESG 2.0’ leader.”

- Harvard Law, 2021

6. Create strong and diverse leadership

In periods of change, organisations need strong leaders. When adjusting to regulatory shifts and implementing ESG goals, boards with diverse members and appropriate ESG skills will ensure that business strategies are sustainable and relevant.

This will also guarantee that your workforce is representative of your customers, communities, and business partners, offering a varied range of expertise and viewpoints.

The key traits of a strong ESG-focused leader are:

- Empathy
- Transparency
- Accountability
- Strong analysis skills
- An ability to recognise blind spots and look at the bigger picture

Source: Sustainability Mag

7. Invest in the right tech

To ensure that financial institutions can carry out necessary changes, companies must deploy the right technology. Research has shown that firms who allocate a higher portion of their technology budget to change experience fewer incidents. This has led 85% of investors, financiers and developers to make technology considerations a key element in their decision-making process.

There is a variety of ESG tech currently available to fulfil multiple roles, including:

- Artificial intelligence for quickly sourcing more accurate ESG data
- Dedicated platforms for in-depth analysis and management of sourced data
- Specialised software to reduce environmentally harmful processes, for example, the digitisation of paper communications.

"Ultimately, as more businesses commit more strongly over time to the spirit (and not just the letter) of ESG – promoting stronger fairness, inclusivity, reliability, safety, transparency, privacy and accountability across their organizations – technologies will be a crucial determinant of how successful they are."

- Chris Marsh, S&P Global Market Intelligence

Does your firm have a strong ESG proposition for 2022-3? Use our ESG Checklist to get you started in planning out your ESG strategy and continually refine it for success.

If you need help with your digital transformation, contact us at Beyond Encryption. We empower financial services organisations to communicate digitally, securely, and compliantly. We're protecting communications throughout the financial services industry, connecting advisers, providers, platforms, and third-party services through our secure email solution, Mailock. Get in touch today to see how our team could support you to secure your digital communications.

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