FINASTRA

ESG & sustainable finance – riding the data wave

How banks can rely on accurate and authentic data sources to manage reporting and regulatory taxonomies.

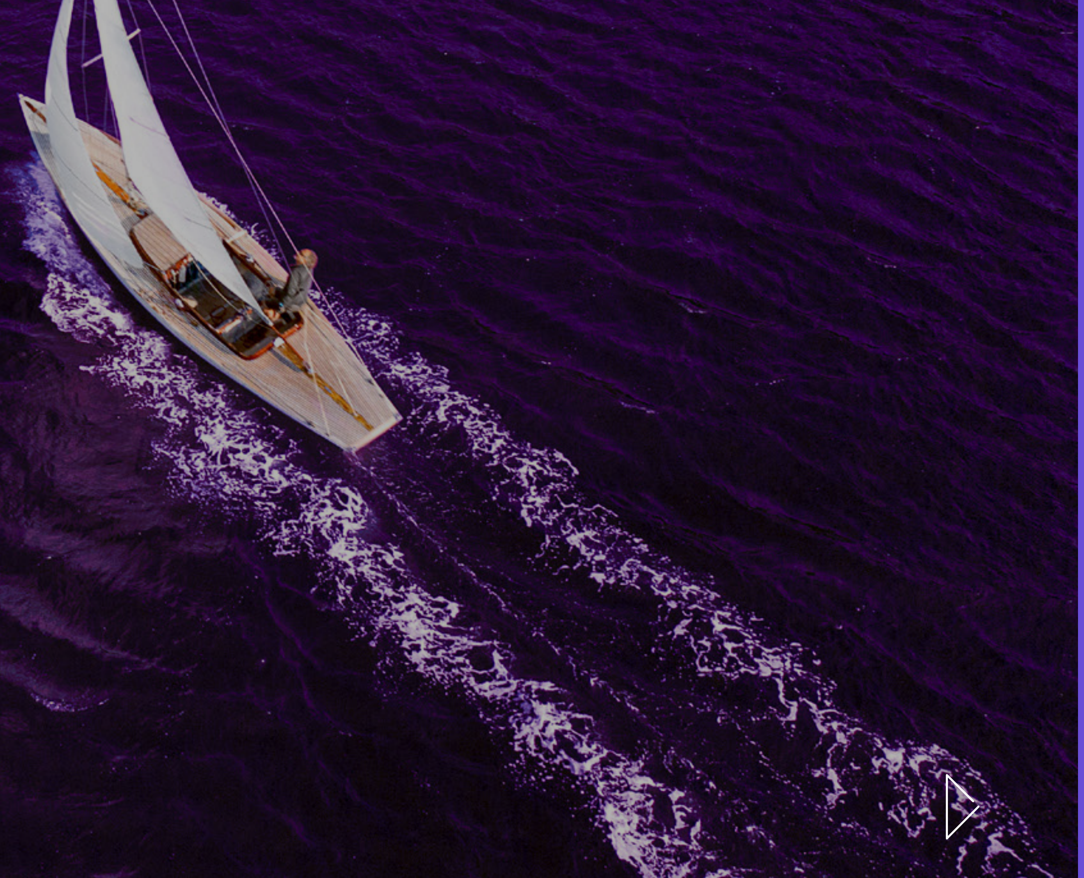


Table of contents

Introduction

The proliferation and complexity of ESG data points creates challenges for financial institutions: there is a sea of data, but no accepted standard

In the past, demand for environmental, social and governance (ESG) scoring systems was low, and the data relatively simplistic. Today, the requirement to show real progress towards a bank's ESG agenda has risen to the top of boards' priorities.

For this reason, banks are building larger teams to manage and validate the ESG data collection and reporting process, which can include hundreds of data points across multiple systems.

An interconnected ecosystem of service providers has also developed to support in-house teams, and digital technologies are playing an increasingly important role in helping to gather data.

The question that remains is how financial institutions should be using tools and processes such as sustainable report assurance to make sure that they are as transparent as possible to stakeholders - including customers, employees and investors.

Above all, amid increasing concerns about so-called greenwashing (where organizations make claims about ESG-related key performance indicators (KPIs) that are either inaccurate or too vague), stakeholders want to be confident that the information financial institutions publish about their activities is both genuine and proven.

Banks themselves want to see much more sophisticated and granular levels of data, which give them measurable insights into an individual organization, but also help them create a benchmark for comparison with others.

How should financial institutions go about approaching their ESG reporting process, and helping their clients create relevant KPIs, given that there are so many elements and systems to bear in mind?

The rules and regulations will change

One of the challenges with ESG reporting is the wide range of evolving standards and frameworks to comply with, adding to the costs and resources required

ESG covers many strands of governance, from physical carbon emissions and the global transition to net zero, to social issues such as low paid workers in the retail sector, or diversity and inclusion in the workplace.

Some of the ongoing environmental initiatives to be aware of include Sustainable Finance Disclosure Regulation (SFDR) in the EU, climate-related disclosure requirements in the UK, climate disclosure for public companies in the USA, and environmental risk management for asset managers, banks and insurers in Singapore.

Opportunities lie ahead

The increasing focus on ESG creates new opportunities for banks. These could be in areas such as green loans for projects designed to have a positive impact on the environment, for example the construction of wind farms or clean transportation networks.

A second area includes social loans, where multiple parties may collaborate on activities designed to address issues of importance to the general public, such as affordable housing or healthcare.

The third area includes sustainability-linked loans, or SLLs, which should be ambitious, material, and relevant to the borrower's core sustainability and business strategy.

These loans can apply to multiple industries across the world, notably within sectors that have capital-intensive strategies such as telecoms, manufacturing and utilities, as well financial services.

How to succeed with sustainability-linked lending

According to data compiled by Refinitiv LPC, and LSEG business, green and ESG financing reached a record US$133 billion in Q1 of 2022.

Securing success in this fast-growth sector relies on banks having the right understanding of how to price green loans and SLLs. They also need to be aware of the important role of assurance and collaboration, and how to measure material KPIs when addressing loan agreements.

Regulation of the green lending sector will continue to grow to prevent organizations from falsely securing loans for a sustainability-related project. As ever, having fast access to accurate data sources within a single banking platform will be an important element of ESG reporting.

A third (33.8%)

of LMA members report that lack of availability and/or quality of data is the main obstacle to the integration of ESG issues in the syndicated loan market.

Two thirds (66.7%)

of LMA members see sustainability-linked loans as having the most potential for growth in the sustainable lending market over the next 12 months.

Almost nine in ten (86%)

professionals within financial institutions believe it is important for the banking sector to support ESG initiatives.

"What we're hearing from our clients is that there is so much data and manual intervention required, as well as a number of collection points, that the whole process of reporting is increasingly complex and needs to be automated."

Simon Thorogood,
Senior Director, Product Management, Corporate and Syndicated Lending, Finastra

Assurance is one of the most important elements of ESG reporting

Banks will continue to play a crucial role in sustainable lending, and many are already introducing changes to their own strategies in line with sustainability objectives.

This process can include everything from in-depth staff training to transformation in lending criteria. Assurance is not a one-off exercise, but follows the whole lending supply chain, from initial lending assessments and origination to monitoring of activities throughout the whole period of a loan.

ESG introduces change

Monitoring is particularly important in the case of two-way pricing, where a margin decreases when the borrower satisfies the criteria and/or increases if the borrower falls short of the set targets or fails to provide the requisite information.

Banks will also need to plan product offerings to embed new risks and pricing structures, remain compliant with evolving regional and sector-based regulations and follow the new reporting and disclosures requirements.

Assurance is necessary to support all of these initiatives, but a bank cannot support the massive resources required to check all of the data points manually. Automation through digital solutions used collaboratively within an ecosystem is the only sensible way to proceed.

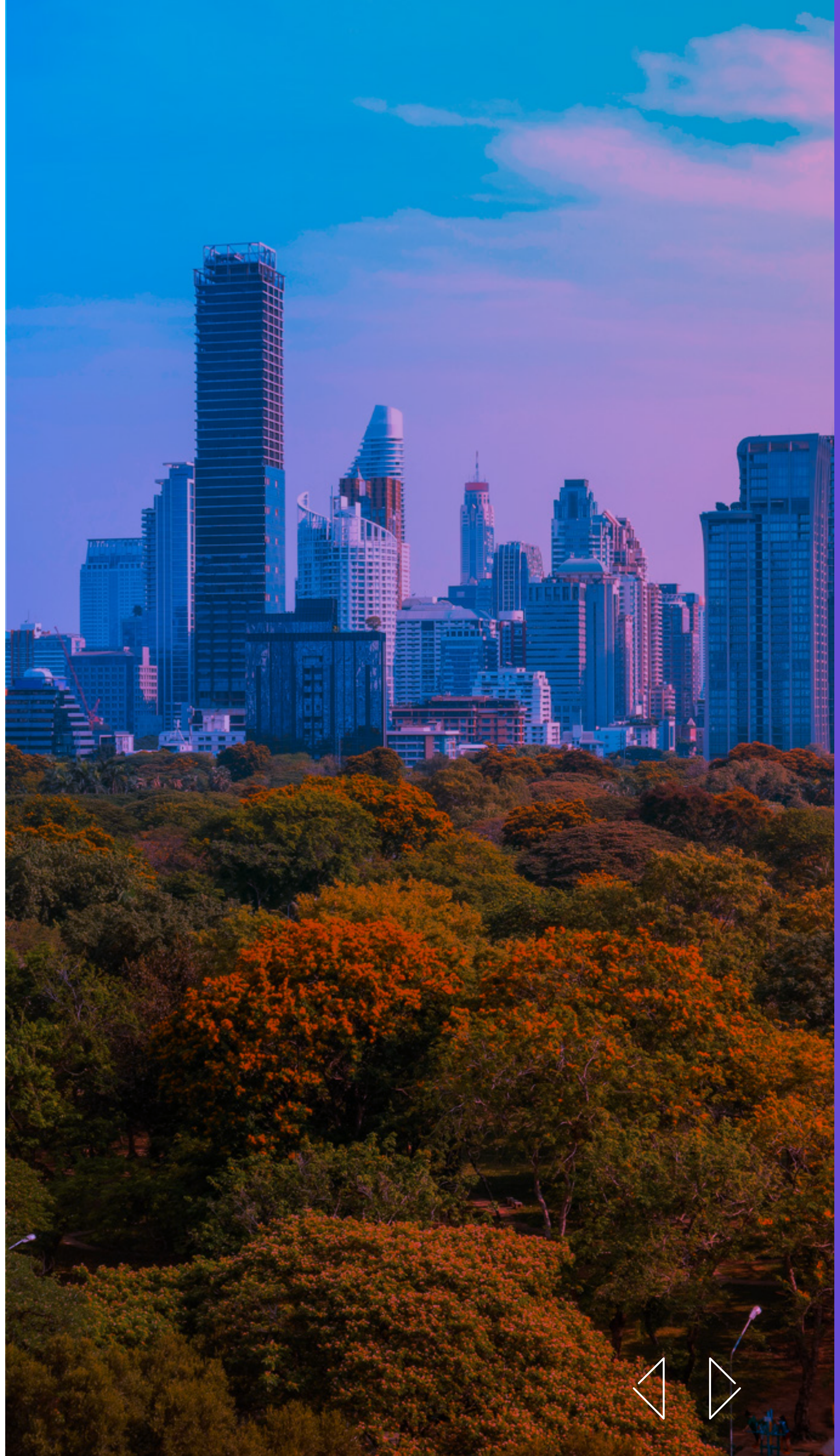
A platform such as Finastra's Loan IQ creates one source of truth, available through a central system. Not only can banks access information about loan terms and agreements, but they can increasingly access accurate third-party data from one location.

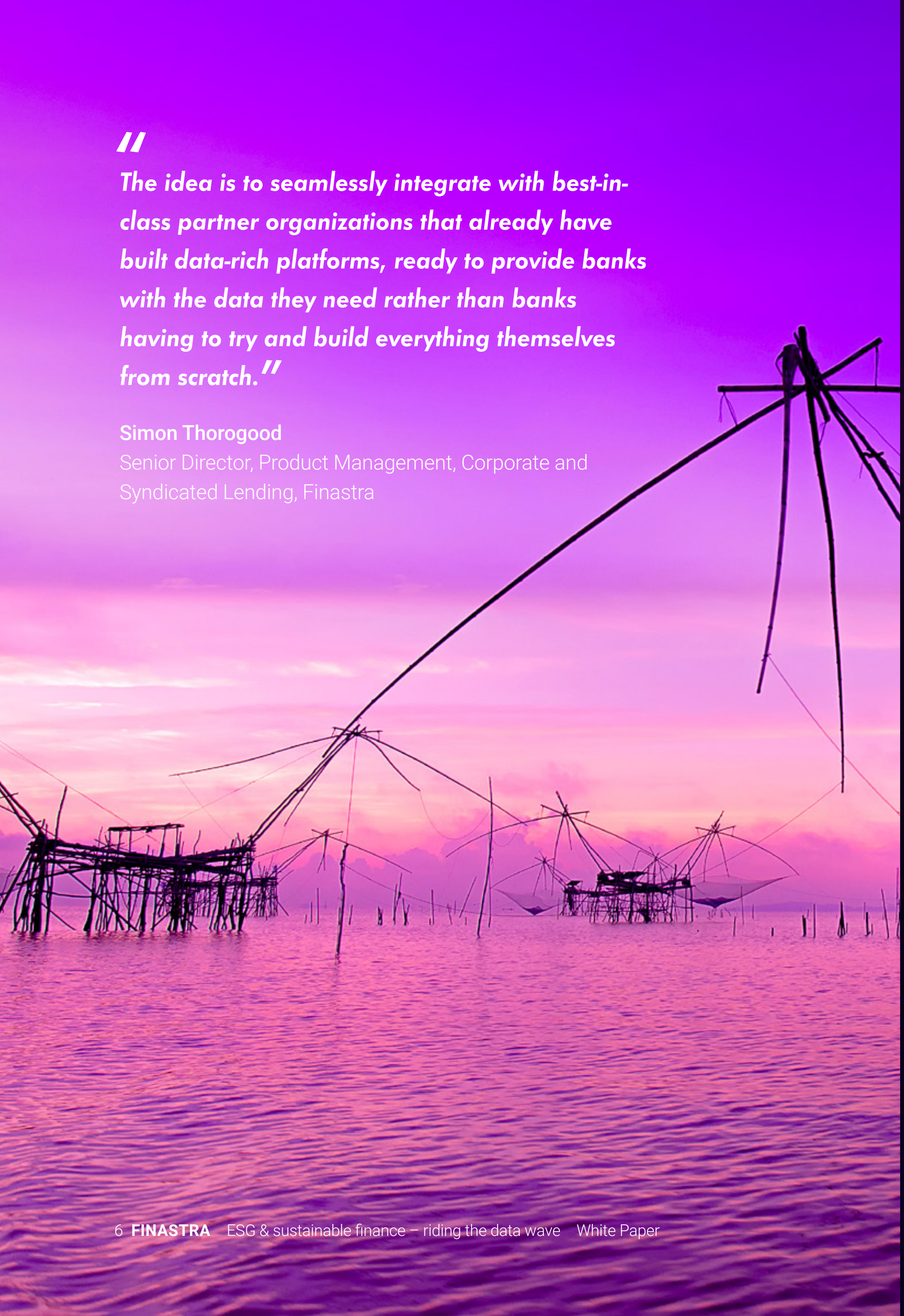
> *"We are looking to use our open API framework to connect to external sources and partners, to bring value-add data on to our platforms."*
>
> **Simon Thorogood**
> Senior Director, Product Management,
> Corporate and Syndicated Lending, Finastra

Supporting the lending lifecycle

Once banks have the data they need to understand a corporate customer's position, they can use it throughout the whole lending process. With open APIs, they have the capability to access evergreen data sources that support flexibility in lending terms and risk management.

Our aim is to work with our clients to provide sanitised data through seamless channels that can be used throughout the lending lifecycle. Collaboration with fintech partners in the ESG space is crucial and we are actively working to simplify and enhance the end-to-end value chain for our customers.





> *"The idea is to seamlessly integrate with best-in-class partner organizations that already have built data-rich platforms, ready to provide banks with the data they need rather than banks having to try and build everything themselves from scratch."*
>
> Simon Thorogood
> Senior Director, Product Management, Corporate and Syndicated Lending, Finastra

Collaboration will create winners

Proven solutions can provide the ESG data needed to report accurately

The importance of ESG strategy has driven the development of ready-made solutions that can help organizations and their banks measure and report on their positions.

Different fintechs and specialists cover all aspects of the ecosystem and can be used together to address different elements of ESG reporting, from carbon emission calculations, to assurance, to testing.

Carbon emissions calculations
Organizations such as CarbonChain collect data about sectors and equipment that enables organizations to calculate much more accurate data about emissions in the real world, which can then be used as proof that their claims are realistic. By assessing all of the inputs to a complete supply chain, organizations can come up with a plan for future reduction in carbon emissions. In turn, this helps banks to build a more detailed picture of a corporate and its future strategy, which could help determine the terms of a green loan.

Assurance
Sustainability Report Assurance (SRA), provided by companies such as SGS, is an evaluation of ESG factors in a company's policies and practices that provides a thorough picture of company behavior. It ensures that the company's sustainability report meets certain standards.

ESG data
Proprietary data and technology platforms including ESG Book, for example, make detailed information available about the sustainability and financial performance of companies across ESG factors, and how companies are capturing climate-transition opportunities. This provides a benchmark for companies following their own journeys, as well as vital data for banks.

There are a number of benefits associated with using third party applications and data sources within a banking platform.

One is that responsibility for maintaining the accuracy and timeliness of such applications lies with their developers, not with end-user organizations.

Developers will keep up-to-speed with global developments in regulation, for example, so that banks and their customers can be sure that they are always on top of the latest requirements.

A second benefit is that applications can be useful proof points for corporates and their banks. Instead of having to investigate every claim about ESG measures and strategies, banks can trust in the capabilities of specific data sources or technical know-how when assessing lending requests.

Success and KPIs must be measured differently when providing ESG-related lending

Banks evaluate sustainable projects and select them for funding according to environmental or social benefits. The use and management of funds for a specific cause is also monitored throughout the life of the loan.

Agreement on key performance indicators (KPIs) is vital when making sure that banks are happy that corporates can measure progress.

Another reason to use a third-party assurance application is the ability to prove that KPIs are genuine, and that the agreement is correct, so there are no greenwashing elements at all.

One size does not fit all

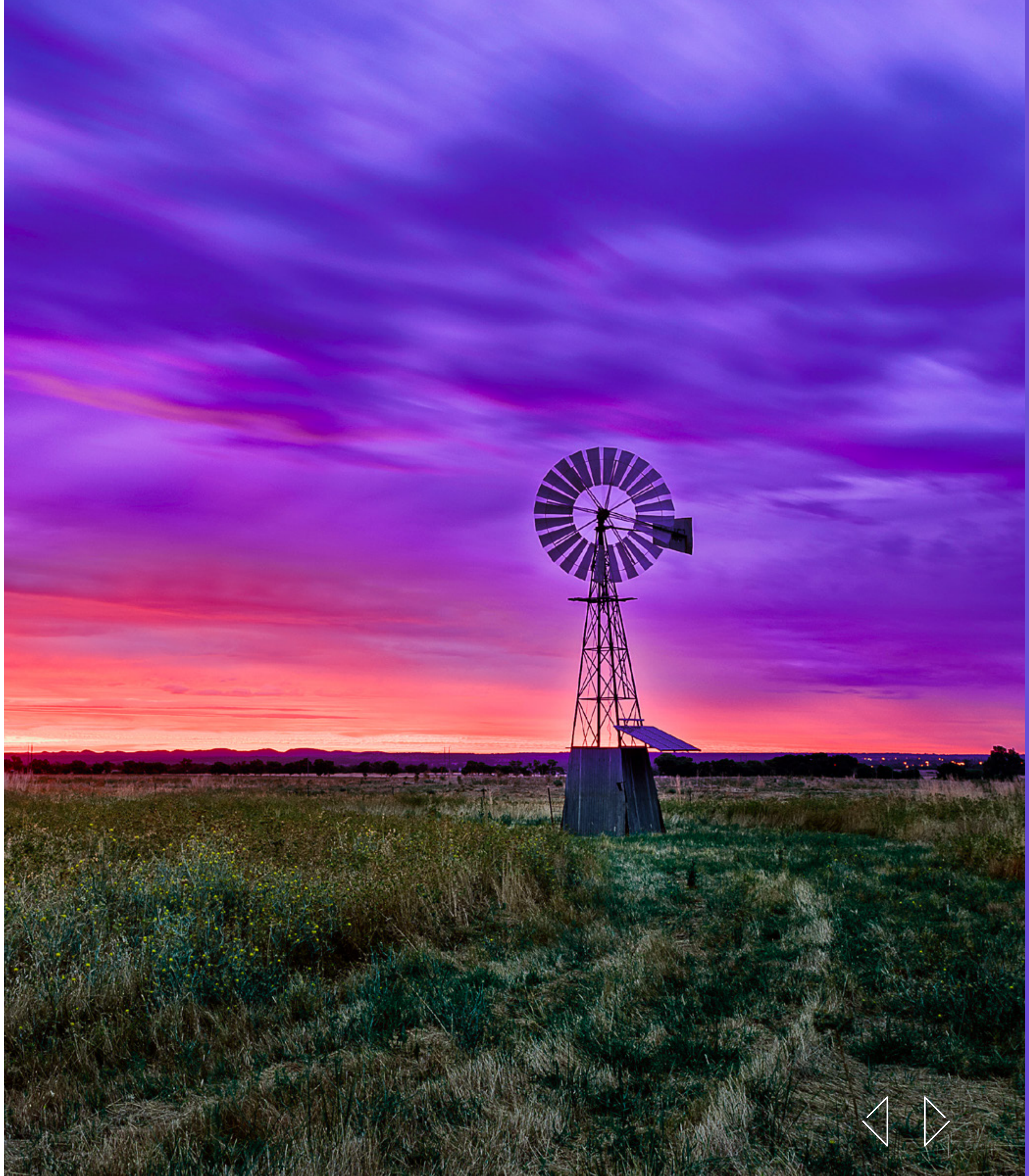
KPIs must be material to the industry sector and to the corporate's own stated ESG goals. For SLLs, a borrower's performance that is related to sustainability is measured periodically, usually on an annual basis, throughout the loan's lifecycle using sustainability performance targets (SPTs). These could include KPIs such as achieving carbon neutral status by 2025 or eliminating the use of plastic, for example.

Simon Thorogood explains what this means for banks using a lending platform: "What we want to do is work out how to fit together the lending process from origination right through servicing and see how data can be used through the whole end-to-end lending cycle. This will allow banks to look at their clients and origination, see which KPIs in the industry they've had before and how they can suggest suitable SPTs."

These agreements are being made during relationship-driven conversations with clients rather than applying any standardized solutions, he adds.

"This is because while there are some discussions about industry ratings, it will take some time before these are finalized," he says. "The main aim is to get access to the data needed, and to make sure it is correct. This will enable clients to manage the reporting required to adhere to industry regulations and borrowing commitments."

Banks can play a particularly useful role with SMEs and mid-market companies that may not have the resources in-house to develop relevant KPIs or SPTs.



Conclusion

A bright future lies ahead for banks that can adapt to the new requirements for ESG-linked lending

> *"More affordable green, social and sustainability-linked loans funded by the ever-growing capital allocation into ESG investments can provide the financial incentives for corporates to make greener and more sustainable choices for both their own operations and their supply chains."*
>
> **Jay Mukhey**
> Global Director of ESG,
> Purpose & Impact, Finastra

Corporates and governments are now committed to the ESG agenda, particularly the environmental strand. Banks increasingly recognize that they have both the responsibility - and the opportunities - to support those activities by changing the agreed outcomes from lending to deliver ESG targets.

This will not be a minor tick-box exercise, but a radical shift in lending models, conversations with customers and the development of relevant know-how and skills in-house.

Subjects on the agenda for the near future include rebalancing lending portfolios, working on likely future scenarios, crafting the right conversations with corporates concerning their future ESG-led borrowing requirements, and staying abreast of fast-moving regulations.

Access to accurate and materially relevant data will be key to all of these activities, and the ability to use proven sources and applications alongside or within a core lending platform will be the most efficient way to achieve that.

No bank has the resources necessary to gather all of the data needed to assure or benchmark ESG positions, but the good news is that reliable sources and services already exist and can be used with confidence. Not only does this help corporates achieve their ESG-related goals, but it protects banks from the reputational risk of being associated with greenwashing.

The role of Finastra

Finastra is committed to supporting the financial services sector in its essential transition to a net-zero global economy, in line with the aims of the UN Sustainable Development Goals (SDGs) and the Net-Zero Banking Alliance.

Our aim is to facilitate compliance with emerging regulations and disclosure guidelines by enhancing our systems, introducing services to smooth workflows, and enabling integration with software vendors and fintechs across the value chain for ESG-related processes.

Making sustainability-linked lending simple

Finastra's ESG Service, is a cloud-native SaaS solution that streamlines sustainability-linked lending. Open and scalable, the ESG Service facilitates the integration of SPT criteria into ESG pricing for both Loan IQ and other lifecycle management solutions in the market, helping banks deliver a better sustainable lending experience to their corporate clients. For further guidance on which KPIs corporates will need to disclose as part of their reporting, banks can consult with the Sustainability Accounting Standards Board (SASB), the Climate Disclosure Standard Board (CDSB) and the Global Reporting Initiative (GRI) which provide ESG-related frameworks.

FINANCE IS OPEN

Finastra unlocks innovation across the world of financial services, through our trusted software and open platform.

About the author

Simon Thorogood
Senior Director, Product Management, Corporate and Syndicated Lending, Finastra

Simon is responsible for leading the strategic functional direction of Loan IQ and its partner products within Lending, with a focus on global client needs outside of the Americas. Working with the Sales, Solution Consultants and Product Managers, Simon is accountable for defining the strategic roadmap to ensure Loan IQ remains the leading global lending solution, meeting the needs of our corporate and syndicated lending clients. Simon has spent over 30 years in the lending industry at banks such as Credit Suisse, RBS/Natwest and HSBC, covering many roles within operations as well as technology, strategic change and programme management before joining Finastra in 2021.

Contact us

About Finastra

Finastra is a global provider of financial software applications and marketplaces, and launched the leading open platform for innovation, FusionFabric.cloud, in 2017. It serves institutions of all sizes, providing award-winning solutions and services across Lending, Payments, Treasury & Capital Markets and Universal Banking (digital, retail and commercial banking) for banks to support direct banking relationships and grow through indirect channels, such as embedded finance and Banking as a Service. Its pioneering approach and commitment to open finance and collaboration is why it is trusted by ~8,600 institutions, including 90 of the world's top 100 banks. For more information, **finastra.com**

Corporate Headquarters
4 Kingdom Street
Paddington
London W2 6BD
United Kingdom
T: +44 20 3320 5000

ID 30921 / 0123

FINASTRA