Solidatus

Whitepaper

Practical data strategies for meeting **ESG obligations** in Financial Services

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With each passing month, the pace at which environmental, social and governance (ESG) principles are being addressed has been accelerating.

> *"...almost half the world's assets under management involve a commitment to meeting climate change goals, according to pledges under the Net Zero Asset Managers initiative.*

Introduction

In one small but telling sign of change, the acronym 'ESG' was mentioned a record 129 times by companies in the S&P 500 index on their fourth quarter earnings calls, compared with 70 in the same quarter a year earlier, as monitored by Factset. Since the launch of UN PRI (Principles for Responsible Investment) in 2006, responsible investing has evolved from avoiding 'sin stocks' to a full-on drive to understand the ESG profile and impact of target investments. The money trail backs this up: almost half the world's assets under management involve a commitment to meeting climate change goals, according to pledges under the Net Zero Asset Managers initiative. UN PRI reached a milestone of 4,000 signatories in June , 2021 representing over US$121 trillion in AUM, all promising to incorporate the breadth of ESG factors.

The acceleration is happening even as financial institutions grapple with an acronym soup of standards and taxonomies. Nor is there a global regulatory mandate applicable to ESG.

This is about to change. The ESG investing landscape is poised to become more defined, as competing definitions, standards and regulatory initiatives start to converge. Notably, the G7 group of leading industrialized nations, meeting in June 2021 in the United Kingdom, issued a landmark statement in support of moving towards mandatory climate-related financial disclosures for companies, including the development of a consistent reporting standard based on the Task Force on Climate-related Financial Disclosures (TCFD). The US Securities and Exchange Commission has just been tasked with developing a mandatory climate risk disclosure rule proposal.

Looking beyond the climate concerns of the 'E' and toward the 'S' and 'G'

Meanwhile, beyond the climate concerns of the environmental 'E' and looking at the social and governance factors of the 'S' and 'G', the emerging ESG regulatory framework is starting to resemble existing regulations on conduct, such as the Senior Managers and Certification Regime (SMCR). Revisions to Japan's Corporate Governance Code went into effect in June 2021, requiring greater independence of listed companies' board members and disclosure of HR policies promoting employee diversity. The US SEC is similarly ramping up focus on workforce disclosures such as diversity, pay, and employee health and safety. It remains to be seen how such policies will align with existing requirements, such as the EU's Non-Financial Reporting Directive (NFRD).

What is clear is that financial institutions will have to respond, requiring them to put in place ESG measures and structures across the organization and institute technologies and data workflows to support them.

The impact of ESG will be felt far and wide across the financial services community, from investment banks and brokerages, to buy-side firms, ratings agencies, exchanges and clearing houses. It will change the way trading and investment groups conduct client engagements and will require them to have an awareness in 'real time' of their own ESG status as well as that of the firms whose securities they help design, market, trade and hold.

Given this background, the practical challenge for financial institutions is how to develop and implement an ESG strategy that is both effective and avoids box-ticking – and thus greenwashing risks.

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Making sense of the **evolving rules landscape**

Companies often say — with some justification — that they are unsure of ESG because of the potential commercial impact of implementing it, a lack of internal data on climate and other impacts, on top of competing reporting standards — such as the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB) — and lack of agreement on best practice.

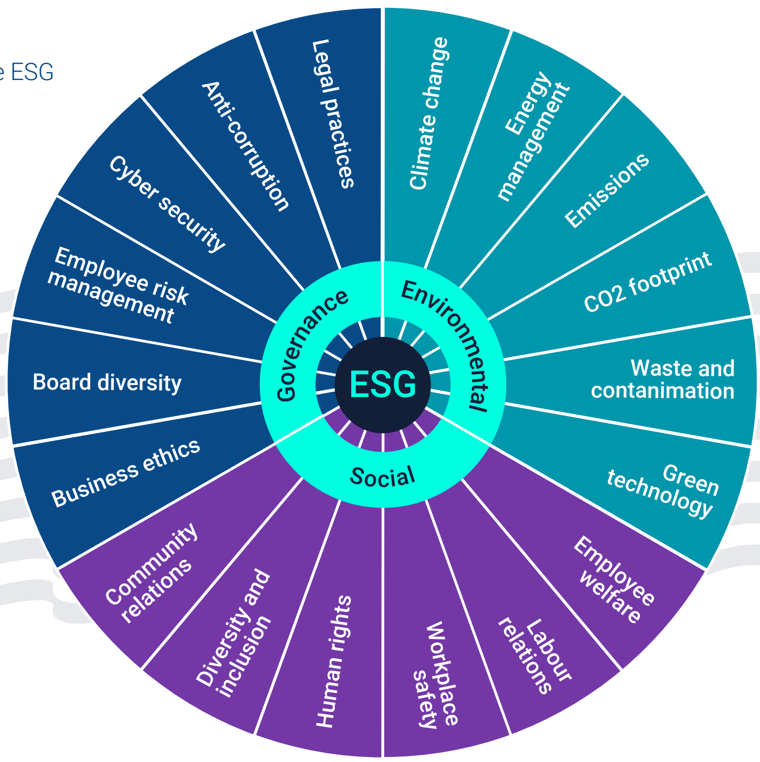
The current market expectation, however, is that recent regulatory moves are finally bringing more coherence — and thus the prospect of improved practical application — to ESG compliance. Notably, the IFRS Foundation, known for setting accounting standards, is set to launch a global Sustainability Standards Board at the UN's COP26 climate summit in November, and backed by the International Organization of Securities Commissions (IOSCO). Additionally, as of March, the Sustainable Finance Disclosure Regulation (SFDR) requires mandatory ESG disclosure for asset managers and other financial markets participants for the first time.

As a result, now is the time for firms to start planning for new responsibilities with respect to their own activities as well as those of their clients and the firms whose securities they trade. This new world comes with a complex set of organizational, accountability and data management challenges, as well as the talent to see it through.

As a critical first step, organizations need to understand how they are affected by the myriad rules and regulations governing ESG. A useful starting point here is the identification of common elements between the various standards currently being formulated and promoted by the various bodies and task forces working to bring some structure to the ESG segment.

Practitioners need to consider the specific requirements and metrics outlined under SFDR and TCFD. But many initiatives are not so clear cut, and few are mandatory. Often, it is helpful to model the impact on data and workflows of new rules and emerging changes to existing ones. To do this kind of dynamic impact shadowing effectively, it is essential to keep on top of the rule changes and to keep the model consistent and intact.

Diagram: The ESG framework is complex



Ultimately, success in meeting ESG obligations depends on the ability to understand the data supply chain and how it intersects throughout the organization.

Getting **organization** right

Companies need to figure out how best to organize themselves in order to deliver on their obligations.

Here, best practice suggests creation of an internal framework for identifying people and teams responsible for meeting ESG obligations; interpretation of rules and regulations to define the obligation; and defining the deliverable to meet the obligation.

To be sure, this need to assemble the right people and processes is challenging in several ways. For a start, the expertise and IP required to understand the requirement and translate it into actions, workflows and responsibilities is expensive. Firms have largely failed to reuse the knowledge gained from earlier regulatory experience, often acquiring and re-acquiring expertise in reaction to waves of regulatory change, whether it is GDPR, SMCR, MiFID II or Dodd Frank. This reacquisition of expertise adds to costs, often unnecessarily.

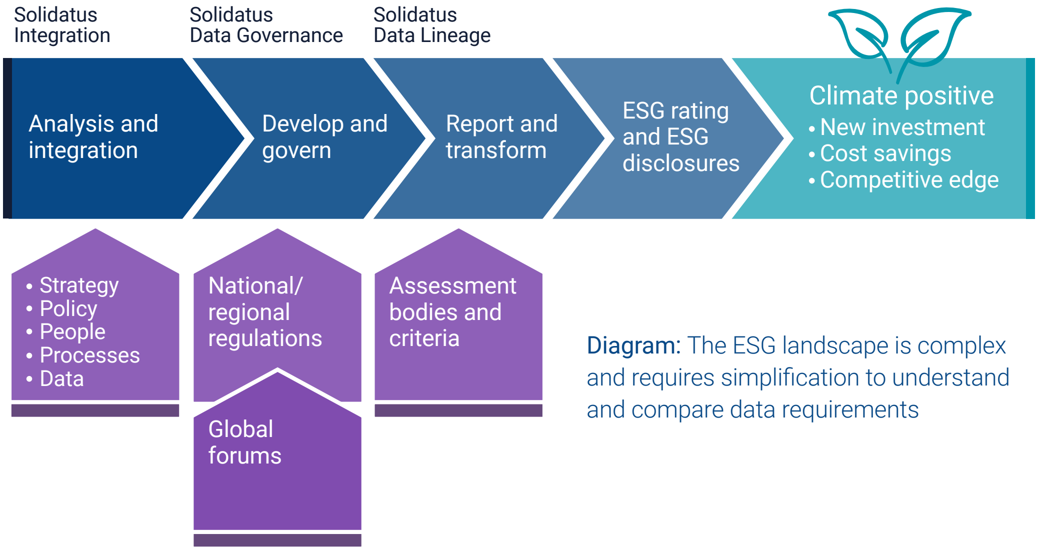


Diagram: The ESG landscape is complex and requires simplification to understand and compare data requirements

Another challenge is purely organizational. In many cases, the person identified as responsible for delivering the obligation under a policy or regulation does not have the proper authority or resource to deliver on that obligation. In such instances, it falls upon various intermediaries within the firm to actually carry out the required tasks, which can be difficult to manage and often leads to quality of delivery issues.

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For many financial organizations, the commitment to ESG principles has been made by senior management in the C-suite – often without a defined plan to implement. Firms are now recognizing the need to track their ESG compliance against internal policies and internal governance practices and structures. As with the Senior Managers and Certification Regime (SMCR), they need to understand who is responsible for the outcomes.

Finally, there is the challenge of ensuring ESG considerations are applied to the firm's trading and investment activities across the board. This may include assessment of clients', counterparty and issuer supply chains, board and workforce diversity, and environmental metrics. Conducting this depth of analysis is difficult without the necessary information, which points to the need for expert resource in understanding how to approach this function.

“We’re helping companies move from disconnected PDFs, spreadsheets, Visio diagrams and PowerPoint presentations to current, transparent and valuable data assets for planning and executing their ESG programs – in one fell swoop.

John Tobin
Data Architect, Solidatus

Data mastery to the fore

Ultimately, success in meeting ESG obligations depends on the ability to understand the data supply chain and how it intersects throughout the organization. Yet firms are finding that they are ill-equipped to gather the data they need, both to identify their obligations and to assign responsibility and resource to deliver on them. For example, consider the need to bridge employee, hiring and pay data from the human resources department to the compliance team, who is likely the party responsible for the actual reporting of diversity, equity, and inclusion (DEI) disclosures.

Where possible, companies should strive to reuse data assets, documentation, processes and workflows already in place to meet their deliverables requirement. They need to develop data models and templates for specific elements of the deliverable. This requires the adoption of strong governance and lineage disciplines to ensure regulatory obligations are mapped to appropriate data sources to ensure consistency and compliance. They also need to ensure flexibility to be prepared to meet regulations and reporting requirements as they evolve.

In addition, the role of the Chief Data Officers and Heads of Analytics are paramount. Organizations need to get their data operations teams involved, typically through the office of the CDO where applicable. Specialist data teams can identify data, workflows and governance structures that ensure firms transparently identify the impact of ESG rules on their business and put in place mechanisms to track the progress and outcomes of their response against their commitments.

How **Solidatus** can help

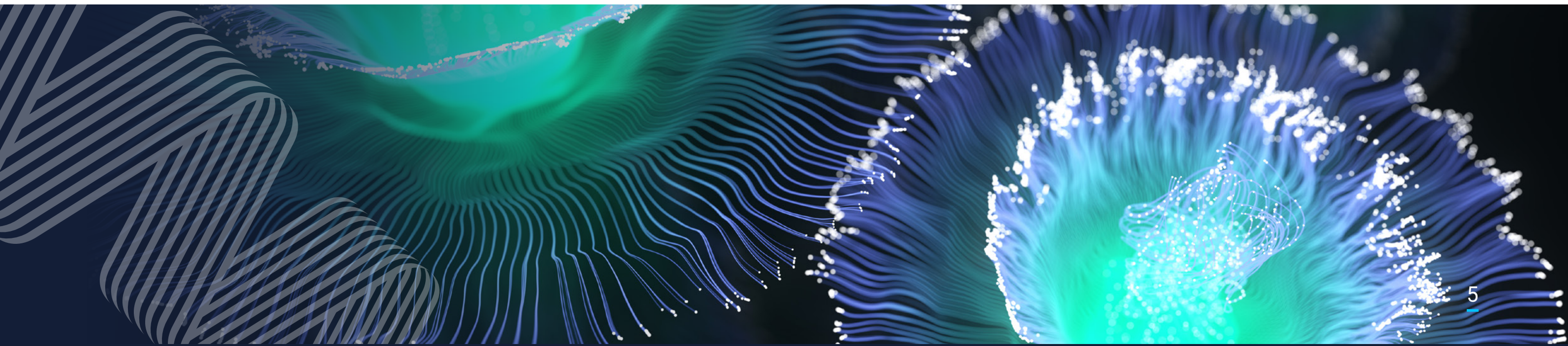
The sophisticated integration capabilities at Solidatus can help with these challenges. Our ground-breaking lineage-first approach brings together ESG principles, company priorities, assessment methodologies and data sources and metrics to give a full end-to-end picture of the impact of ESG initiatives.

We bring ESG priorities, reporting and assessments together with the data flows, processes and their owners in a managed, sharable and maintained environment — meaning better governance, less waste, more efficiency and more effective socialisation of ESG programs.

We relate metrics to data flows through the company, both to understand where existing data can be used and to identify and plan for additional sources. The result is a live map of ESG initiatives, showing how ESG aims translate through to delivery providing assessment bodies with every piece of the puzzle. It also provides focused views for different stakeholders, highlighting problems such as missing data and duplicate sources.

Transparency is fundamental to the success of financial services practitioners’ ESG programs, both internally within the organization and externally to supervisory bodies, the media and the public. Firms need to show the link from the regulation to their own commitment, responsibility, response and ultimately outcomes.

Without the ability to evidence their efforts, market participants will be accused of greenwashing, and will have to face the reputational repercussions that entails. The good news is that a roadmap and the toolkit to help organizations on this journey is available.



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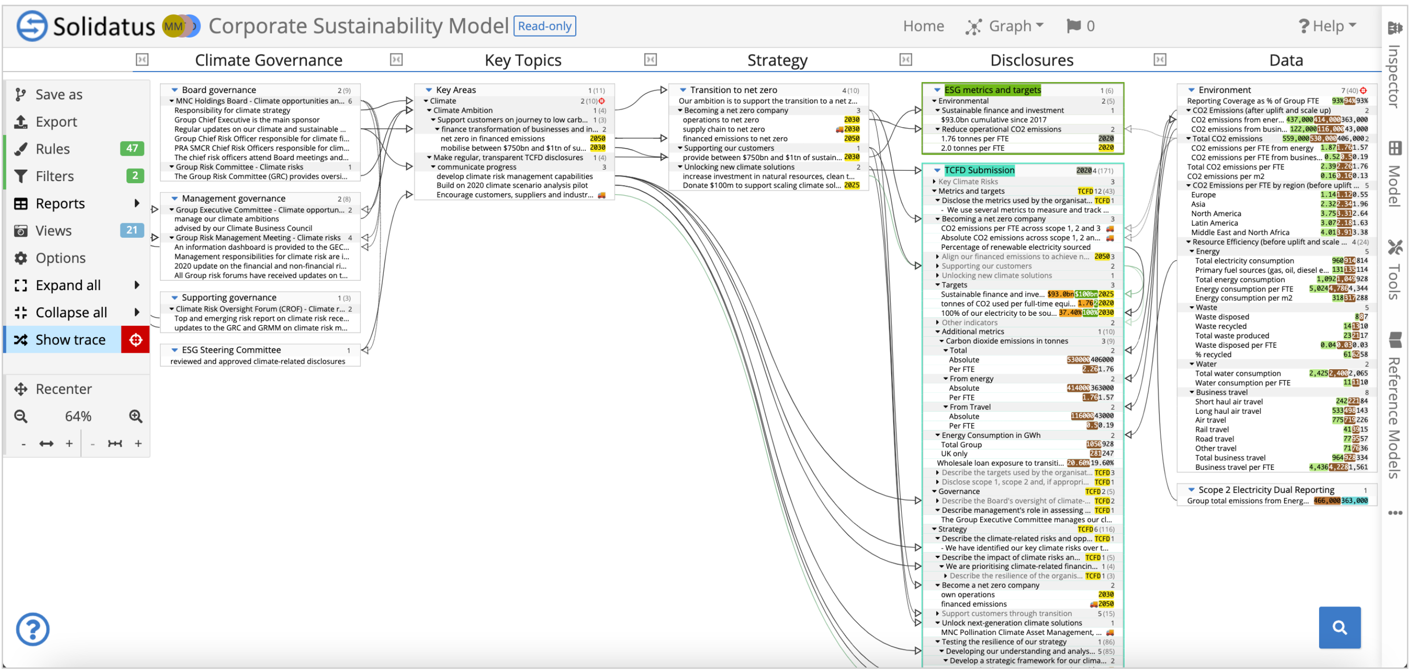
Delivering a sustainable solution for ESG

- Instantly show compliance
  Quickly assess compliance against requirements and standards and demonstrate your company's adherence to ethical practices.
- Efficiently respond to a changing landscape
  Maintain a dynamic map of ESG initiatives that prevent a panicked response to new regulatory demands that can disrupt day-to-day business. Crowdsource knowledge, break down silos and leverage automation to seamlessly integrate sustainable data governance into the fabric of your organisation.
- Contextualise ESG initiatives
  Design, view and track ESG initiatives across a broad spectrum of markers and to the supporting metrics and new data source requirements.
- Establish organisational-wide understanding
  Owners of parts of the data landscape can contribute collaboratively, with all changes versioned for full change management and comparison.



Model: ESG transparency from roles and responsibility through to disclosures and data

About Solidatus

Solidatus is an innovative data management technology company, empowering organizations to unlock the true business value behind their data. Our lineage-first technology enables organizations to connect and visualize data relationships across the enterprise, simplifying how they identify, access and understand them. Launched in 2017, Solidatus is the chosen data management tool for both the regulators and the regulated. Its clients and investors include top-tier global financial services brands such as Citi and HSBC, healthcare and retail organizations as well as government institutions. Solidatus has offices in the United Kingdom, the United States and Singapore. For more information, visit www.solidatus.com

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