FISER CONSULTING
FINANCIAL SERVICES

Sustainable Finance

Positioning Paper

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Executive Summary

The awareness of the importance of sustainability has increased through the pandemic. Investors call for sustainable future, the EU action plan and newly legislation require for actions. Financial institutions are seen as crucial and front-row players to lead this transformation to achieve the sustainable economy.

Sustainable Finance – the process of taking **e**nvironmental, **s**ocial and **g**overnance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects

There are factors that accelerate the growth of sustainable finance such as Paris agreement, natural disasters, green products, the Eu green deal and the EU action plan. Importantly, the EU Taxonomy timeline starting from 2022 to 2025 will shift sustainability from “nice to have” to “need to have”.

An impact of sustainable finance on the financial services sector will take place on the whole organisation: at the management level, risk management level, sales level, and information technology level.

To integrate ESG risks into the organisational core policies and practices successfully, the organisation needs to strike the right balance to the relevant risks, translate the ESG strategy into the organisation’s ecosystem, adapt stakeholder management and spread ESG knowledge internally, collect, map and use ESG data for risk-modelling, finally deliver and communicate on non-financial factors commitment. At this point, our FiSer approach is developing in helping you to get through the challenges of integrating ESG risks to your organisation.

Introduction

The financial sector holds enormous influence in terms of funding and raising awareness on environmental issues, whether by allowing for the research and development of renewables or by supporting businesses that adhere to fair and sustainable labour practices and standards.

Sustainable finance is defined as investment decisions that take into account the environmental, social, and governance (ESG) factors of economic activity or project.

Environmental factors include climate change mitigation and the use of sustainable resources. Human and animal rights, as well as consumer protection and diverse hiring practices, are components of social factors. Governance factors refer to the leadership and management, employee engagement, and remunerations of both public and private organizations.

With the emergence of several action plans in response to new global sustainable initiatives, the European Union (EU) takes a step to promote sustainable economic, environmental, and social growth. For example, the Paris Agreement is an international treaty on climate change that addresses mitigation, adaptation, and finance. EU green deal and EU action plan that aim to promote sustainable investment, including EU Taxonomy, a strategy to create a harmonized understanding of what actually constitutes sustainable activities across the European Union that attempts to define 'green activities' and provide guidelines of economic activities that should be complied with to be considered environmentally sustainable.

Starting from 2022, companies and financial institutions in the EU need to report Taxonomy eligibility and have to report the Taxonomy alignment by 2025. As shown in figure 1 – EU Taxonomy timeline. The new action plans and regulations then have brought new challenges to every sector, especially the financial sector.

Figure 1 – EU Taxonomy Timeline

New challenges for the financial sector

An economy increasingly structured on the basis of sustainability benchmarks necessitates a financial sector in which the same standards are integral to strategy and operation. When it comes to sustainable finance, simply complying with the legal requirements is not a viable strategy for financial institutions in the long run. When it comes to sustainability, customers, investors, regulators, politicians, and society all expect and demand more. Banks, insurers, pension funds, and asset managers will need to incorporate environmental, social, and governance considerations into their products, services, processes, systems, strategy, and culture. Only in this manner can they continue to be assured of a license to operate, maintain a viable revenue model, and contribute to the further restoration of confidence in the financial sector.

The changing customer preferences, the EU Sustainable Finance Initiative and the initial reactions of the banking industry influence all domains of a financial services provider.

Sustainable Finance affects the entire value chain of a financial product, i.e. it raises fundamental questions at the top management level as well as at the sales level and all internal units:

- At the management level, the strategy promoting sustainable growth must be developed and embedded in the core of an organization.
- At the risk management level, the lending and compliance risks should be analysed and addressed. The criteria for assessing the risks should be updated. New risks should be added to the system.
- At the IT management system, new data and parameters need to be collected and processed.
- At the sales level, there are new product opportunities that the financial sector can develop in response to changes in regulations and investors' demand.

To navigate this challenging course, the financial services sector needs to assess and manage ESG risks, increase disclosure and reporting, have greater standardization, and be stewardship. ESG risks must be assessed and integrated into core strategy and embedded into investment decision making processes and due diligence through ESG frameworks and standards such as EU Taxonomy

regulation, Sustainable Finance Disclosure Regulation (SFDR), amendments to the Undertakings for collective investment in transferable securities (UCITS) directive and Alternative Investment Fund Managers (AIFM) directive. Additional non-financial elements are required to be disclosed in non-financial reporting

Steps to tackle the challenges

Customer preferences, the EU Sustainable Finance Initiative, and the banking industry's initial reactions all have an impact on all domains of a financial service provider. It raises fundamental questions at the top management, as well as sales and all internal units. Adopting sustainable finance regulations not only helps ensure regulatory compliance, but also drives financial institutions toward long-term value creation and economic activities. ESG risks encompass issues ranging from a company's response to climate change to the promotion of ethical labor practices to how a company deals with privacy and data management concerns. A growing number of investors, both institutional and retail (non-institutional), in developed and emerging markets, view ESG risks as a proving ground for their portfolio companies. The number of financial institutions incorporating ESG into their decision-making processes is increasing globally, and this trend is expected to continue in a post-Covid economy.

Several publications on sustainable finance have been released by the EU Commission and its working groups. Financial institutions should begin tracking down the potential effects of current publications on their organisations in general, and their business models in particular. Furthermore, they must stay up to date on the latest developments.

To address the challenges of sustainable finance, the first step is to break down environmental, social, and governance risks. Understanding the specific risks or issues related to non-financial factors will allow financial institutions to focus their time, energy, and resources on fewer but more influential risks. Non-financial risks, for example, can be classified by a financial institution in its role as an employer, lender, or investor. Non-discrimination and privacy can be important factors of bank as an employer. When considering the bank as an investor, it is necessary to consider the bank's sector and geographic exposure – issues such as land rights, impacts on indigenous people, or human rights defenders in a specific market may be more prominent than standard labour risks.

When the ESG risks are defined, it is essential to integrate the associated risks into the process and practice. ESG factors should be considered by financial institutions throughout the investment process, from loan origination to completion. Before banks make any investment, additional criteria such as sustainable rating, investment attributes, or other risks addressed must be screened.

People, both internally and externally, are also key success factors in integrating ESG risks into financial institution practice because they are key stakeholders in financial activities with banks. Banks must manage the companies in their portfolio. The ESG data gathered during each process, such as due diligence, post-investment, and reporting, will be collected and analysed to evaluate a company in the portfolio. To effectively analyse ESG risks, the working team must have a thorough understanding of them. Banks must ensure that everyone on the working team has access to adequate and reliable information and training. Furthermore, it is challenging for the bank to obtain data from each client in the portfolio during the data collection process because each business is unique and the data solutions provided for each business differ depending on the nature of the operation. Data providers may also participate in this challenge in order to simplify available data and make it comparable across industries.

Besides, embedding ESG risks into every process in the value chain will ensure long-term value creation for the bank and demonstrate the holistic integration of risk practices. For example, banks should be kept up to date on related frameworks and regulations developed by the European Committee and working team in order to monitor relevant risks. Physical climate change risks such as water scarcity, temperature, and weather events should be incorporated into the valuation model to better reflect both financial and non-financial risks. Non-financial risks, such as operational risks, business and strategic risks, and reputation risks, should be considered when identifying overall organisational risks. Climate stress testing can be used to assess ESG risks. Finally, ESG risk can be mitigated through exclusion policies or risk premiums that are customized to the condition.

Having valid and reliable data is one of the most challenging things for financial institutions in the sustainability domain because each data provider, particularly third-party data providers, differs in terms of criteria, definitions, asset coverage, regional or global coverage, industry-specific coverage, and other factors. As a result, there are differences in ESG data, scores, ratings, and

rankings, which can be difficult to sort through and understand. The banks must then address this challenge by diversifying their collection of ESG data sources, focusing on data quality and granularity, and building up ESG capabilities alongside the growing investment trend in order to satisfy customers.

As new regulations and taxonomy are enforced, the financial sector needs to incorporate ESG initiatives at several points during the investment process. To tackle the new challenges, the financial services sector should list key impacts and how to deal with them as shown in Table 1 – Key Impacts.

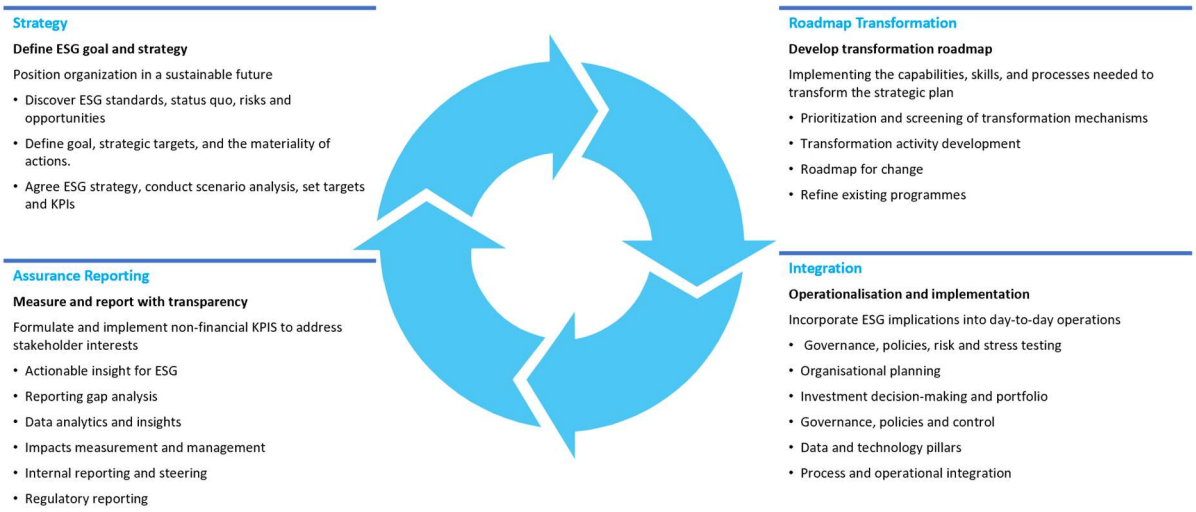
Key Impacts	Description
Policies	Maintain and comply with sustainable risk and adverse impact policies[1]
Due Diligence	Maintain, monitor, and update ESG due diligence policies
Portfolio Construction	Maintain and update risk disclosure at a product level and incorporate new risk and impact considerations in decision making
Engagement	Reflects additional ESG metrics and considerations in engagement practices and databases
Research	Incorporates additional ESG metrics and consideration in checklists and quantitative scoring
Risk Management	Includes updated risk management policies on sustainable risks
Operations and technology	Build and maintain architecture, systems, and processes for disclosure of adverse impact metrics from June 2022
Product manufacturing framework	Develop and maintain a framework for product classification aligned to Art. 6, 8, 9 (SFDR)

Table 1 – Key Impacts

[1] **Sustainability Risks** refer to environmental, social or governance events, or conditions, such as climate change, which could cause a material negative impact on the value of an investment.
Principal Adverse Impacts are any negative effects that investment decisions or advice could have on sustainability factors. Examples could include investing in a company with business operations that significantly contribute to carbon dioxide emissions, or that has poor water, waste or land management practices.

Our solutions

We can help the financial institutions to transform these challenges to be opportunities by facilitating our clients to manage non-financial risks and impacts and create long-term value-led throughout these value chains. We categorize our service in the sustainable finance domain into 4 services ranging from strategy formulation to implementation to support our clients to accelerate their net-zero transition journey and help execute change projects in the organisations.



- ❖ Strategy formulation

We are developing a strategy for our client to integrate new initiatives into the core policy by defining ESG ambition and positioning the organisation. We start by understanding the ESG relevant standards, status quo, risks, and opportunities. Then, we will define the organisation's ambition, strategic options, and materiality of actions. Finally, we agree on the organisation's strategy, scenario analysis, set targets and KPIs.

- ❖ Roadmap transformation

After formulating a strategy, a transformation roadmap including data, portfolio, purpose, people, and culture, will be developed to put capabilities, skills, and processes into the place where an organisation can translate and execute. At this phase, the transformation lever is selected and prioritised. Activities needed will be specified and developed. Organisation's existing program will be revisited and refined if needed.

- Assurance reporting

Another service we can offer is to measure our client's non-financial report by defining and implementing non-financial KPIs to address stakeholder interests including:

  - Actionable insight for ESG
  - Reporting gap analysis
  - Data analytics and insights
  - Impact measurement and management
  - Internal reporting and steering
  - Regulatory reporting and assurance
  - External reporting and assurance

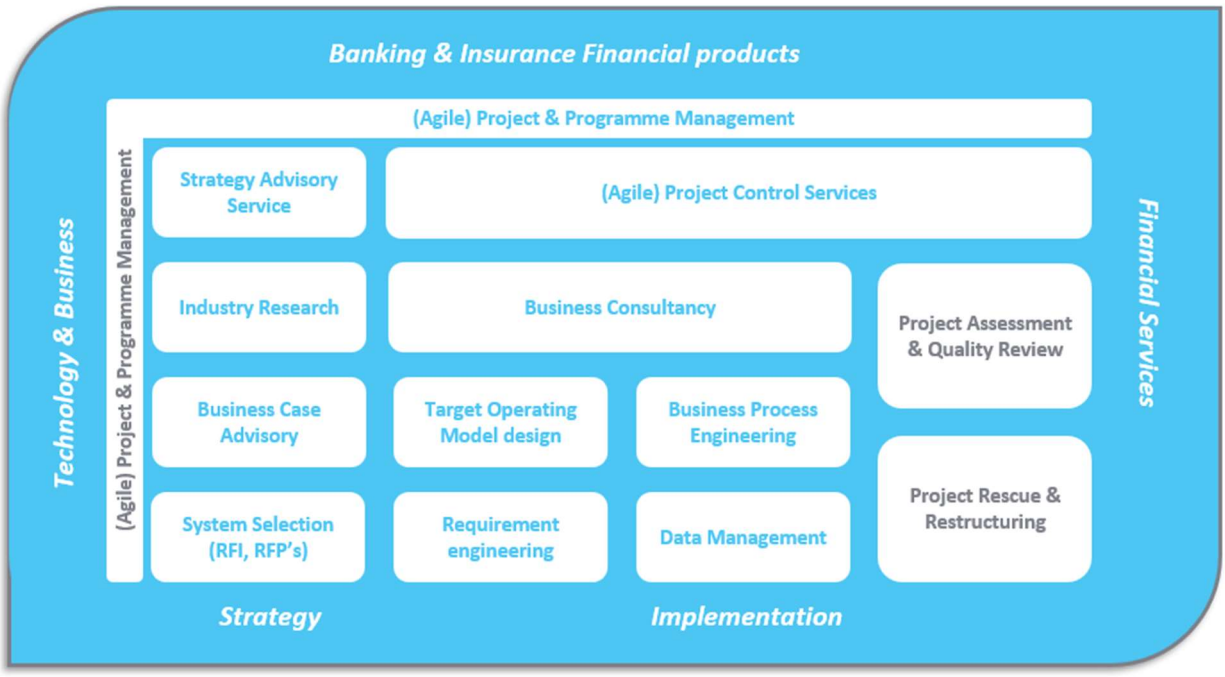
- Integration and transformation

After we created the strategy, roadmap, and transformation plan, it is time to implement ESG aspects into daily operations. Governance, policies and stress testing will be conducted. ESG aspects will be embedded in the organisational core policy including:

  - Organisational planning such as tax
  - Investment decision-making and portfolio
  - Culture, workforce, inclusion, and diversity topics
  - Management's remuneration and reward
  - Data and technology backbone
  - Business process and functional integration
  - Customer experience including product

Our services

FiSer Consulting can assist in this transformation process with different services, from strategy to implementation, with a business and technology perspective:



- Business Case Advisory

With major systems, modelling, and business processes changes, our consultants can formulate a solid Business Case that will cover an assessment of the potential costs and benefits, project risk evaluation a high-level delivery approach.

- Project & Program Management

Integrating ESG initiatives into policies and implementation involves changes that affect many stakeholders. Our Project & Program Management capability can structure and manage a variety of stakeholders across the business. Our managers and consultants combine multiple years of experience with in-depth knowledge of the Financial Services and regulatory space.

- Requirements Management

Our consultants will assist the organisation in translating and identifying key requirements of the regulation keeping in mind the interaction with other regulatory constraints and existing processes, systems, and organisational structure

- Target Operating Model

Our consultants have a strong content background and will assist you in interpreting the new ESG risks and requirements and designing a target operating model. We will define the infrastructure, processes, controls and organisational.

Next step

For further information, please contact:

FiSer Consulting | Dirk Worm

Dirk has over 20 years of experience in Global Financial Markets, particularly in the Investment Banking and Corporate & Commercial Banking industries. Dirk's consulting skills lie in risk management, capital management, front office transaction management, the implementation of asset & liability management and treasury functions, and the implementation of regulatory processes, including Basel II, III, MiFID and EMIR.

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FiSer Consulting | Penpisut Chaovanayan

Penpisut has over 5 years of experience as a consultant in financial services. She has cross-worked with functional teams in implementing IFRS system transformation projects, leading stakeholders toward organizational change in accounting practices, policies, and information technology that helped improve quality measures for clients. Moreover, she has keen interest in PMO Support and Business Strategy and knowledge of financial services, IFRS, risk modelling, finance and accounting, and sustainability.

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Glossary of terms

Term	Definition
ESG	Environmental, Social, and Governance
EU	European Union
IT	Information Technology
KPIs	Key Performance Indicators
SFDR	Sustainable Finance Disclosure Regulation
UCITS	Undertakings for the Collective Investment in Transferable Securities