Banking and Financial Services

ESG as a critical success factor for future-readiness for the banking sector in Benelux:

How a consistent compliance framework can lead to sustainable growth

The future ready business

In an era of uncertainty, our clients and prospects need to be ready for anything: ready for any economic, political, social or environmental shift or shock, at any time. Businesses need to operate as if everything is, and will continue to be, in an infinite state of flux— but how can they do that? Modern businesses must be able to read early warning signs, predict what's ahead and act in time to emerge with relevancy. Cognizant, as engineer of the modern business, understands what it means to be a business that's 'future-ready' and has the expertise to guide you on the steps you can take today to prepare.

We commissioned Economist Impact to launch the Future Ready Business Benchmark program. It assesses the progress businesses have made in orienting themselves for the future competitive landscape, more specifically their preparedness for success regarding four thematic focus areas: firm fundamentals, technology, innovation talent and environmental, social, and governance (ESG).

Many businesses are experiencing strategic paralysis; with so many competing priorities, leaders are struggling to identify where to focus. A lot of them have their main focus on long-term as opposed to short-term planning and the adoption of modern technology has firmly advanced.

We've identified three critical and interrelated characteristics of a business that is ready for anything:

- Captures full value from rapid technology acceleration and data
- Has a workforce strategy that unifies people and technology
- Has made a commitment to close the gap between ESG concerns and actions

Closing the gap between ESG sentiment and activity

While business leaders recognize the importance of ESG and the sea change in opinion from a wide range of stakeholders, a gulf is emerging between sentiment and tangible action. Nine out of 10 respondents from our Future Ready Business survey agreed that environmental sustainability is an integral part of being a future-ready business, and a similar proportion recognizes the importance of both social responsibility and workforce diversity and inclusion.

Customers, employees, regulators and investors now scrutinize the ESG credentials of businesses, piling pressure on executives to make decisions that positively impact all stakeholders—not just shareholders. Not to mention, it's increasingly clear that environmentally and socially responsible business is "good" business, in the form of resilience to any shift or shock that comes along.

Business leaders have more tools, technologies and approaches than ever before to make a difference. Those that have implemented specific environmental targets are doing so because the risk of doing nothing cannot be ignored, especially when you factor in increased taxation, resource costs, business risk, regulatory compliance mandates and fines.

Even still, only 47% of respondents are incorporating environmental sustainability into their corporate strategy, and this percentage drops to 35% when it comes to social responsibility. 31% indicate having dedicated staff and resources. When it comes to implementing an array of specific environmental targets, no more than 54% report doing so, and the percent drops to 44% when it comes to measuring social impact.

Digital technologies can enable sustainability initiatives at the more granular level—for example, collecting, measuring and analyzing data unique to sustainability and biting off small sections with specific initiatives.

But there's a need for more holistic changes: using technology to anticipate and act on systemic signals of change in a volatile and uncertain world. Leaders can then make informed decisions on how to embed sustainability into strategy and operations and build resilience beyond risk mitigation.

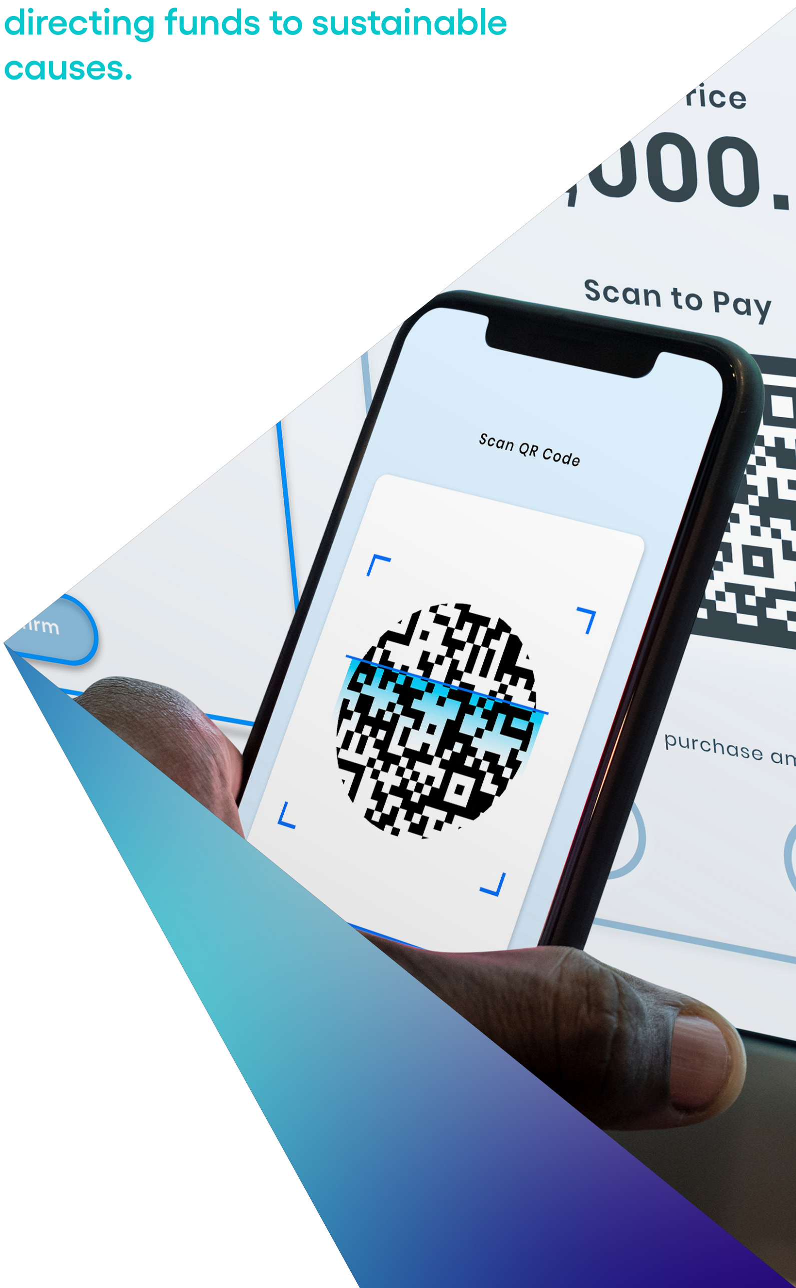
The global banking perspective: banks have built a solid digital foundation from which to address the future, but could benefit from better cross-organizational alignment and extracting value from advanced and emerging technologies.

Banks strive for modernization—with data-driven operations and a digital-first business model topping the list of business-critical strategic imperatives. But only about 40% of global banking executives report strong leadership support for modernization efforts, and just under 30% say cross-organizational strategic alignment is a business-critical priority for their companies. Process transformation (business-critical priority for 33%, medium/high priority for 58%) and operational alignment (business-critical priority for 31%, medium/high priority for 60%) also rank highly, highlighting the need to evolve capabilities to meet the needs of customers—particularly as expectations shift in the wake of the pandemic and new experiences created by fintechs.

Banks have enthusiastically embraced the cloud, and nearly 70% are realizing significant value from their cloud investments.

The financial services industry shows an appetite for translating data generated in client interactions through all different touchpoints into informed insights and actions, with 82% of companies having adopted or planning to adopt big data analytics (and 69% in the case of AI/machine learning). Banks, asset managers and financial intermediaries can do more to extract value from their investments in personalization-enabling technology. For example, while 60% of those that have adopted big data analytics are seeing significant value from it, this figure drops to 40% for AI/machine learning.

ESG in the banking sector in the Benelux: the European Commission's strengthened sustainability focus requires consistent and efficient data capturing and encourages directing funds to sustainable causes.



Sustainability is not a new topic in banking, especially not in the Benelux. Most banks in the region have been at the forefront in sustainability initiatives and have set up sustainability departments well over a decade ago. Reporting on sustainability has also been in place for quite some time. Despite initiatives already taken, the European Commission's sustainability strategy and regulatory enforcement poses an increasing challenge; one of the reasons being that a siloed approach to sustainability will no longer suffice. The requirements to capture additional data about customers, products, and assets to direct funds to sustainable causes and report on the same, while taking non-financial risk into account, impacts all value chains within a bank. This requires an integrated view of legislation, a unified strategy, and a coordinated approach to enable consistent and efficient capture of the additional data, and the ability to maintain and enrich the same, because the journey has only just started and is set to accelerate.

1. EC ambition and strategy: the financial sector as catalyst for sustainable growth

The European Commission has defined a clear role for the financial sector to drive sustainable growth. Building upon UN 2030 Agenda on Sustainable Development, the Paris agreement and the European Green deal, the EC is set to build a sustainable economy. To make Europe the first climate neutral continent by 2050. With the 2030 Climate Target plan, the Commission proposed to raise the EU's ambition on reducing greenhouse gas emissions to at least 55% below 1990 levels by 2030. This is a substantial increase compared to the earlier 40% target. The EC aims to achieve this by promoting investment in sustainable projects. The estimated additional funds required range between €170 and € 290 billion per annum as of 2021. The funding mechanism for these investments will largely depend on redirecting financial flows, with the help of financial institutions, because the EC budget will not suffice. The financial sector will play a key role in bridging the funding gap.

Channelizing financial flows, e.g., investments and loans, towards sustainable development in multiple financial services value chains.

To ensure financial institutions act, the EC has put in place an action plan on financing sustainable growth. To reorient capital flows towards sustainable investments, a unified classification system for sustainable activities, standards and labels for sustainable financial products, sustainability considerations in financial advice and sustainability benchmarks have been enforced. To manage financial risks stemming from climate change, resource depletion, environmental degradation, and social issues, sustainability is included in market research and credit ratings, institutional investors and asset managers now have sustainability duties and prudential requirements are in place for banks and insurance companies. The aim is to foster transparency and long-termism in financial and economic activity, secured by disclosure and accounting requirements.

To ensure objectives are met the EC has renewed its Sustainable Finance Strategy in 2021 and increase ambition with the 'Fit for 55' package incorporating new climate targets.

2. The challenge: a consistent data architecture for a holistic approach to meet future requirements

Sustainability and ESG reporting are not new to financial institutions. The extent to which current and upcoming requirements impact across value chains, risk and finance go beyond investments, business loans, residential mortgages, risk modeling, financial reporting. Though regulation is already in force, for example in the domains of investments and business lending, many financial institutions so far have taken a fragmented approach, meaning each business unit has taken action to comply in a focused, but usually isolated approach. This often leads to situations in which the same institution is acquiring similar data multiple times, which is costly and inefficient. Or, the case in which institutions are applying standards differently in separate business units. These not so uncommon challenges are caused by the fact that many financial institutions have a process in place that cascades regulatory requirements from entry point, the sustainability department, to compliance department, and from there to risk and finance departments and business units. The latter execute on what is needed, but not necessarily taking note of what is happening in other domains. When realizing that the ESG and sustainability journey has only just begun with many more data requirements to be met, getting the right foundation in place now will be of the essence to avoid serious challenges in the (near) future. The right foundation will be centered around a consistent data architecture and decomposition of data assets, in combination with federated orchestration to meet current and future requirements.

3. Lessons to build upon: a data-centric perspective on KYC

Why is a consistent data architecture and decomposition of data assets, or rather a data-centric approach, so important? To illustrate why, a comparison can be made with the Know Your Customer (KYC) topic. Initially, a process-driven approach was taken and defined separately in each business domain of the bank, since requirements of retail, private banking and business and corporate customers differ. Focus was on capturing the required customer information in a couple of steps defined as the KYC process, executed by the advisor that was servicing the customer. As this did not lead to the desired results, a control was put in place to check on quality and completeness. Again, the results were not at the desired level, and as such, the next layer of control was added. Centralization of KYC processes was the next step to optimize and improve results. Then standardization was put in place and finally automation of processes enabled quality and efficiency improvements.

Still, even in the KYC factories with highest automation levels challenges remain around synchronizing data of sub-processes within the KYC context and with mainstream commercial and business as usual processes. There is a continued significant number of periodic reviews that are being processed by over 15,000 staff in the Netherlands alone. While financial institutions are working on getting ahead by building event-based triggers, to reduce the need and number of periodic reviews. Now the question is- if financial institutions had taken a data-centric approach, would the results have been the same?

4. Opportunity: a common data understanding and architecture across value chains brings the benefit of creating additional and sustainable value at pace

With ESG and sustainability there is an opportunity to ensure the foundation to capture current and future data on customer, product and asset are set right. Taking the opportunity to define a data architecture, that supports a common understanding and consistent decomposition of data assets. These should ideally be derived from the sustainability strategy of the financial institution across value chains and defined by the collective stakeholders. With a common understanding and architecture, and a federated and orchestrated approach to implementation, financial institutions will avoid duplications and will be able to accommodate future requirements at pace. This is easier said than done, since most financial institutions are still to excel in mastering the end-to-end data supply chains of their current value chain processes and risk and finance foundation. It will nonetheless be essential to be future-ready and competitive in the future. Getting it right will avoid the need for multiple data corrections or even remediation, enabling the focus to be on value instead. This comes with the additional benefit of being able to attract and retain talent. With an effective data core, the focus of talent can be set on creating additional and sustainable value and getting ahead. Rethinking customer journeys and reaping the benefit of defining new and circular business models with new sources of revenue.

5. Example: Measuring the impact of ESG on value chains across different business areas for a European bank

Cognizant has accelerated integration of environmental, social, and governance metrics to enable ESG compliance for a European bank, while focusing on the client's strategic priority. The main challenges for the bank were the increasing demand for disclosures and reports, pressure to improve data availability and accuracy, and the need to establish linkages across different business areas. This required changes to business strategy, lending processes, risk management and disclosures. Furthermore, the bank had to become more transparent concerning sustainability risks and principal adverse impact considerations, as there was a need for harmonized disclosures on sustainability-related information. We defined a holistic approach to measure the impact of ESG on value chains. The highlights of this approach included the definition of use cases across impacted value chains, the ability to ingest ESG data from multiple sources, interface with existing bank applications and channels, generate reports and disclosures at desired frequencies and the ability to customize dashboard features to fit consumer needs. In order to achieve results, a 5-step approach was taken.

6. Cognizant's five step approach for sustainable finance implementation

- **Regulatory alignment and strategy** – Define the company's strategic imperative is to comply with the regulatory framework within the regulatory timelines.
- **Baseline** – It is important to understand where the company stands considering several factors, including known overlaps, interdependencies, and stakeholder alignment.
- **Gap Analysis** – Difference between current and desired state of data, process and systems, aligned with strategy, translated to each value chain within the bank.
- **Solution Analysis** - Define the requirements and how they can be achieved by fit-for-purpose solutions, aligned to the company's strategy for each value chain.
- **Implementation** – Take a federated orchestrated approach.

7. Conclusion

ESG and sustainability put additional compliance pressure to financial institutions, however, it is up to every organization to either take it as a challenge or as an opportunity. We invite you to look at it from the latter perspective and are keen to assist and enable your journey, leveraging regulation to fuel innovation and building a future ready business- a business ready for anything.

Reach out to us directly, or take the Future-Readiness survey, see how you compare to the average global modern business and contact us to interpret the results and take fitting action.

Credentials

- Accelerating ESG integration and EU transition into a low carbon economy | The Cognizant Nordic Blog
- The True Meaning of AI: Action & Insight (cognizant.com)
- Data modernization: banks' opportunity to leverage regulation for innovation - Digitally Cognizant
- Cloud_in_Banking_and_FinancialServices.pdf (cognizant.com)
- Ready for anything: Cognizant perspective
- Ready for anything: Economist Hub, including Future-Readiness survey

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