The Rising Influence of ESG Reports on Financial Institutions

The financial health of banks, investment firms and nearly every corporation is now linked to environmental, social and governance (ESG) factors. It's clear that business ethics and environmental impacts are influencing corporate reputations. Now, many of the world's top markets have ESG-focused reporting mandates that reflect the public's concerns.

Additionally, as the public and regulators become increasingly savvy about these matters, financial institutions must offer more than lip service to ESG efforts. Investors should be looking for concrete and consistent data points from investment opportunities. Financial institutions must also collect data about their own ESG factors and impacts.

Here are some ESG considerations for financial institutions looking to boost their report scores and positions in the marketplace.

The "E" in ESG for Financial Institutions

Financial institutions will have a larger part to play in environmental movements than one may assume at first blush. For instance, lenders will significantly impact the shift from fossil fuels to renewable energy. Investors may also face legal complications for engaging in business with disreputable polluters, suffer reputational damage for their involvement with companies harming the environment or sustain financial losses from investments injured by climate-related disasters.

The need to account for a financial institution's relationship with the environment, both directly and through investments or debtors, is essential for projecting financial health. Soon, it may also become the law. In the UK, for example, proposed laws would force large companies to disclose climate-related risks and opportunities in 2022. The US Securities and Exchange Commission (SEC) is likely also adding ESG mandates this year.

Furthermore, companies that exaggerate their efforts may face consequences as the world grows intolerant to "greenwashing."

In the US, environmental groups filed a false advertising claim with the Federal Trade Commission against Chevron Corporation for allegedly false or exaggerated environmental statements. UK investment funds seeking ESG authorization prompted a "Dear CEOs" letter stating many claims "do not bear scrutiny." Finally, the European Commission deemed 42% of environmental claims as misleading, false or exaggerated statements, potentially amounting to unfair practices under EU regulations.

When it comes to environmental concerns, the public and governments take these matters seriously, and financial institutions must also.

Financial Institutions, DEIA and ESG

The "S" in ESG stands for "social" and relates to diversity practices, impacts on communities and labor relations. Many social factors overlap with those related to another increasingly popular acronym- DEIA, which stands for diversity, equity, inclusion and accessibility.

Some experts believe that social factors, including human rights considerations, often fail to get enough attention. One example is that many companies lacked effective responses when pandemic-related workplace and family life stresses pushed many women to leave the workforce, reversing decades of gender-equality progress. Gender equality is one of the many matters that fall into this area of ESG reporting.

In fact, part of what makes this pillar of ESG more complicated is that it covers such a wide range of issues. Despite those challenges, some financial institutions promote social policies that will benefit their ESG reports. For instance, the Bank of America and UniCredit Bank in Austria are two institutions with a strong focus on hiring and supporting people with disabilities.

Accommodating employees who have disabilities is often simpler and less costly than it sounds. Examples may include captioning video conferences to support people who are Deaf and hard of hearing and many employees with neurodiversity. Ensuring screen reader compatibility and audio description on video content can allow people who are Blind equitable work experiences.

The social factor extends beyond employment and includes outward-facing content, like marketing and earnings calls. Additionally, any positive or negative effects on the people living in places where an organization does business may influence an institution's social ESG score.

Governance and Financial Institutions

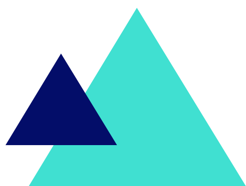
The fact that good governance is critical for the health of a financial institution won't be news to anyone in the industry. Unlike the environmental and social areas, governance issues have been serious concerns for financial institutions for decades.

The governance category involves both the internal corporate structure as well as the institution's integrity. Some examples of matters that fall into this pillar include fiduciary duties, reporting requirements, ethical conduct and leadership accountability. Issues that negatively impact the "G" category of a report could include anything from a tax violation to lacking proper data security.

For financial institutions, the governance branch may extend to partners and other companies with which the organization shares connections through its investments. Funding an unethical business could result in poor marks even if the violations were not directly those of the investor.

ESG Reporting Tips

ESG reports will continue to influence financial institutions and are likely to become an even more significant concern. While the SEC is pushing for US regulations, efforts to create global ESG measures by the International Financial Reporting Standards Foundation (IFRS) are gaining traction. Now that worldwide ESG alignment seems likely in the near future, financial institutions should take steps to prepare.



Find the Right People

ESG professionals need experience in business, must be flexible enough to pivot to shifting standards and have the ability to understand connections between ESG factors and financial outcomes. However, they should also believe in the principles of ESG and that they can make the world a better place through responsible business practices. As mentioned, there is a growing awareness of ingenuine ESG efforts like greenwashing, and false or exaggerated reports are likely to backfire.

Make Reports Data-Driven, and Consistent

Currently, many companies that report on ESG fail to offer enough data to support their claims. However, more companies are starting to complete data-driven ESG and DEIA reports. Vague statements and efforts that don't yield measurable results won't carry much weight.

Data reporting can also cause issues if the institution doesn't ensure a consistent message. Internally, an organization should agree on official data and metrics to keep everyone on the same page, so they don't share conflicting information.

Be Proactive, Not Reactive

There is no reason to hold off on integrating ESG principles into your organization and representing a commitment to ESG. Institutions which wait until there are specific ESG regulations will struggle to remain competitive. Data already shows that ESG reporting and socially responsible practices are good indicators of financial performance.

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