Closing the disconnect in ESG data in financial services

ESG voices podcast series

Musical intro

Announcer:

Hello and welcome to another episode of ESG voices! This podcast series addresses the opportunities and challenges within ESG, through interviews with ESG and IMPACT specialists from KPMG and beyond. Throughout this series, we will discuss a broad range of environmental, social and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future for all.

The financial services industry's shift toward a business model that embraces ESG factors is a powerful movement with unstoppable momentum. But as the financial services industry thinks about how to do good while also meeting business goals, they face some fundamental questions. For today's episode, I am joined by Pat Woo, Global Co-Chair Sustainable Finance, KPMG International, Rachel Tracey, FS Data Partner, KPMG in the UK, and Paul Henninger, Global Head of KPMG Lighthouse Data, AI & Emerging Technologies, KPMG International who will be diving into the ESG data challenges and opportunities faced by the financial services industry.

Pat, to kick off the conversation today could you describe what ESG data means for financial service firms?

Pat:

Well, I think that ESG data is essential for all financial services firms going forward because I think that the stakeholders really demanded it. I think that there are two kind of like sides to the coin. One is the market pressures And the other side is the regulators and I think that, you know, when you're talking about financial services firm to talking about capital allocators of the world, so all the asset managers, banks and insurance companies when you take those three sectors you're talking about, everybody who wants to do business irrespective of which industry which sector you will have to touch the asset management, banking and insurance sectors because without that without investment without loans, without insurance, you cannot do business. But at the same time, I think the investors in these organizations, the financial services industry, also the other stakeholders are all asking them to really incorporate ESG into that decision making process, that they're not going to invest in land to ensure certain organizations that may not actually live up to what they say that they're supposed to be doing. And then also the regulators understand that in order for us to be able to change the dynamics of the economy as a whole, where should we start? The starting point is always a financial services firm because if you, if you change the way that capital is allocated, you really do change behavior. So, I think that in the end, every financial services firm will have to incorporate ESG data into all of their decision-making processes.

Announcer:

Rachel, turning to you could you describe some of the ESG data related challenges financial services firms grapple with?

Rachel:

ESG is more complex than ever with multiple regulations and frameworks all over the globe. You know, multiple different vendors, I think there is about 600 different data vendors that you can source your data form. You know, I just spoke to a client quite recently that has 30 -40 plus data vendors that are trying to grapple with, what assumptions have been made on their data set and granularity under sourcing and adjusting them to the environment. And then separately, an organization needs to capture data within their own firm and obviously ingest and be able to get another level of granularity to calculate that as well. So, a lot of challenges. Organizations that focus more on collections sourcing, rather than thinking strategically on how they manage this data longer term and how they actually drive insight that doesn't become an ESG swamp or to just pull in every single piece of data. So, it's really important for organizations to really think about the issues or the materiality that they really want to focus on. Obviously, keeping in mind the regulatory landscape and make sure they prioritize those as well. I would say, benchmark from the start, think about, you know where you are now, where you want to be so you can actually track the improvement over time. And then finally, you know, one of the other key challenges is variety, making sure you've got consensus as well on terminology and definitions of data, and having that audit ability or traceability back to where you're sourcing and collecting that data.

Announcer:

Thank you, Rachel. To build off that question, how are you seeing the financial services sector begin to confront the ESG data challenges we just discussed?

Rachel:

So, to confront these data challenges in the financial sector, first and foremost, an organization needs to be really, really clear on their data strategy. That is a must have. They need to understand how they're sourcing their data, if it's from a third party or internally, what assumptions or limitations for that data, how they're calculating it. So, being very clear on the lineage of traceability back to source. If there is gaps, how are they extrapolating that data? What supplementation has been made, profiling the data to get a clearer view of data quality and look to improve that over time as well? And then making sure as well you've got your architecture and technology improvements integrated into your strategy, looking at, over time, how you're going to set yourself up for success. Now we see organizations that are moving to ESG data utilities, centralized repository, often sitting more in the finance domain, you know, so you need to take is it is a one repository, one common data model is it linked into your other data models. How are you using AI machine learning? Is there tools on the market to actually do your source and target mapping from your third party and internal systems quickly clear and efficiently as well. And then off the back of that you need to have a clear roadmap, you know, with focus on your priority areas, and your use cases to really, really get you started and set you up for success because there is more change coming into ESG space. So, it needs to be flexible and scalable.

Announcer:

Pat, turning back to you, could you walk us through some of the opportunities financial services firms have to gain when integrating ESG data into decision making?

Pat:

Integrating ESG into the decision making is non-negotiable. So, say for example, if an asset management company, what they really need to do the whole time is to fund-raise. And the LPS that are going to put their money into their organization will be asking them these kinds of questions of how are you actually incorporating ESG into investment decision making, and then they're going to give them an ESG DBQ Due Diligence Questionnaire, and ask them these very pointed questions, so they better have the right answer, otherwise, those big mandates are going to go somewhere else. And similarly, I think for banking, and insurance industries, I think that their stakeholders are asking them like exactly the same thing. And you know, banks and insurance companies are very much at the forefront of media attention, and if they're not seen to be doing the right thing then their stakeholders which include their investors or their customers, right, they you know, their customers don't want to interact with them from the reputational standpoint, or all of these aspects has to be considered. So, from that perspective, I think having ESG integrated is non-negotiable. And it's just kind of like gives you business sustainability is not just kind of like ESG it's really about kind of like are you able to survive this wave and to be able to sustain your business on an ongoing basis with this changing environment with ESG incorporated.

Announcer:

Thanks, Pat. Paul, could you describe where the financial services industry can find the tools and engines it needs to make sense of the growing universe of ESG data — both to access those untapped pools of information and to draw insight from them?

Paul:

I think there is three answers to that question. I mean, one place a lot of financial services companies are going to find the data that they need and the tools they need are the places they find them today. The reality is that ESG completely changes in some respects the calculation we all make in terms of where we invest in what we even think of as a return, but ultimately, things like risk calculations or risk calculations. And so the platforms that people use to do that today need to be extended in some respects, but are the ones that they're going to use to do that type of analysis. And equally, you know, the, the data providers of financial services firm's work are as quickly as they can starting to pull together some of the data people need to start to incorporate a view of a quantitative view of ESG into their decision-making processes and into their products, into their risk management processes. So that's where it begins. The second place though, and where we're seeing a lot of initial work and planning are from sources, both in terms of technology and data that are relatively new for the financial services industry and that from places like some of the hyper scalars as well as even from regulators. The ESG data is fundamentally different. It's not just you know, data from a balance sheet or data from trade calm firms, it's, you know, it's every piece of information somehow turns into something like quantitative value across the impact, you know, across an incredible range of different activities from climate diversity, to human diversity, to innovation policy. And what we're starting to see through some of our work and some of our conversations is that some of the big data companies are working and collaborating with others to start to solve the problem of where that data comes from and how does it get converted into a form that is useful for financial services firm? I think the regulators may also take a role on that, you know, some of the data would benefit from having a centralization to some degree such that we're not all having to go off and hunt ourselves for a source of information that there's some baseline, some foundation on which basic ESG metrics or certain types of ESG information is shared. But the third point, I think, is in the long run the most important, which is that ESG data is not conventional. And although the sort of initial rounds required in terms of reporting on climate performance and stuff like that comes from the places you'd expect or comes from places that are relatively obvious. In the long run a lot of information on smaller companies that you can invest in various ways on certain types of asset classes are not going to come from a survey or, or just from, you know, a sort of public database. And so, it's the sort of nontraditional data sources that I think will ultimately prove to be the key to getting a really proactive really, real time and a really competitive view of where ESG performance opportunities are. And that will come from, you know, initially places like you know, pulling data out of news sources, to a lesser extent social media, which is a really noisy source. But equally it's things like local documents, if you can't get information on water usage about a particular company. You can get information that's quite related to that from a local municipality who has documents on all of the water usage in their area.

You wouldn't want to cull through those files a page at a time to try to create a database, but ultimately, certain tools and techniques are going to allow us to pull data systematically out of that and turn it into something that's useful and logically arranged such that ultimately financial services firms can start to build it into their day to day. I think it's going to come from various places and I think the starting point is much were people would expect and I think the place where we'll get to is if not unexpected is going to be interesting and innovative and will change fundamentally the way financial services firms think about data, both ESG data and possibly otherwise.

Announcer:

And Paul, how does transforming ESG data capabilities help secure competitive advantage for financial service firms?

Paul:

I think in the early days, competitive advantage comes from ESG data in the form of first mover advantage. So, some of the most early ESG investment assets for exclusion and disease and other types of products that essentially just removed unacceptable companies or unacceptable elements of that investment fund, or an index, or other kind of packaged assets. And the folks that got out ahead of that quickly, for the most part, enjoy competitive advantage by tapping into an accelerating public and institutional interest in making those types of investments. I think in the slightly longer run, positive competitive advantage will come from the ability to find and adopt data sources and types of information that are harder to find. So again, you can go to one of a number of data vendors today and at various levels of completeness and quality, get information on the top, you know, 10 to 15,000 largest publicly traded firms globally. But a lot of assets involve entities, whether they're non corporate, or things like municipals, as well as companies that are that are outside of that. There's literally tens if not hundreds of thousands of other companies that are operating, that are part of the investment ecosystem. And so, the question a little bit in terms of competitive advantages, where do you start to get information on those entities? Where do you start to get information that's not just something from a data provider, and the more a financial services firm can start to build in a practice by which they can not only identify where that data might come from, but also create some processed and tools and test and learn in a way that allows them to understand how they reliably use that information to build products, to do risk calculations to provide investment ideas to clients. That's where I think the competitive advantage is going to come from and in some respects, that's where it's always come from, you know, people that got access to data quicker got access to figure out how to sort of read the tea leaves and triangulate on certain types of, you know, events or likelihood of events from data sources, that were more financial in nature were the ones that, for a while were able to implement the strategy that creating competitive advantage. But I think I think we're going to see the same thing play out, but it will, it will take a form where kind of data curation, data hunting, but equally, you know, building up the capability to quickly understand how that data can be useful in a way that's safe, reliable, investment grade, if you will. That's where the competitive advantage will come from in the long run.

Announcer:

Pat, could you share some practical steps FS firms can undertake to help implement ESG data into business activities?

Pat:

I think FS firms, you know there are many data providers out there and they're all good, but I think that it is very important to not just take the information at face value, because there would have been weightings done to certain criteria that are deemed more important by the rating agencies and data providers. Those weightings may not be the same as yours. And it is really important to consider your own strategy. What your own stakeholders are telling you. What your own customers are telling you and really go back into the raw data and just see, you know, kind of like make your own judgments as to the weighting. It's not it's not a cookie cutter solution out there because I think that the world is really looking for bespoken and really what you stand for, and you have to make sure that how you're using that ESG data is aligned with your corporate strategy, your culture, how you're talking to stakeholders and also, you know, aligned with your business goals.

Announcer:

To wrap up our conversation today, can I ask each of you to pass on some advice to today's listeners to better support them in bridging the gap between data and ESG in the financial services industry? Pat, if I can come to you first?

Pat:

I think first off is, it has to be cross functional. It has to be embedded, similar to any kind of data that you're using. This is not something that is independent of that, it needs to be incorporated with your financial, your risk, your compliance data, and how, you know, the multiple teams in the research side, on the compliance angle, or the front line colleagues, that they have a consistent view of this ESG data and to understand what this means for your organization and to use it in the same manner consistently across the organization.

Announcer:

And Rachel?

Rachel:

One piece of advice I would send out to listeners around the data challenges is really thinking about how you get holistic view of the regulations and frameworks across the jurisdiction that obviously affect your organization, how you get a clearer view of that interpretation, how it links through to your metrics and how that links through to your data catalog, and ultimately true to your data model. If you have a clear view on, you know, the datasets that are testing for each framework again, and again, you can make sure that you focus in on those priority areas to improve data quality, to improve data governance, to also improve obviously where you are sourcing that data if you are putting in proxy data to resolve the challenges that you do have around ESG data.

Announcer:

And finally, Paul?

Paul:

I think the best advice I can give and that I've been talking about a lot recently is particularly with ESG we need to embrace the idea of test and learn. And what I mean by that is that although even in the sort of early days, we're making quite a lot of progress on taking, you know, a bunch of fundamentally non quantified information, you know, so what's happening to the environment, what's happening to our ecosystems, what's happening to water quality, what is the you know impact of a certain company's hiring policies on minority populations, what's fair with regard to wages, all of these kinds of fundamentally social, political, moral and ethical issues. We're trying to figure out a way to convert them into data. And once we've done that, the question is, how do you use that to construct a product? How do you, what's the role that you know, a derivative, or a bond, or a fund, or a fund of funds should have in that conversation? And I think it's, it's going to be, it's going to be important to try different things, obviously, you know, in a controlled way, you can't just package up a bunch of investable assets and sort of see what happens you have to be confident that you know what the impact is going to be on investors and regulatory point of view, but equally, no one quite understands the road map, the path definitions that are going to be the things where we start to understand how that information becomes useful as it gets built into the sort of very data driven business of day to day, hour to hour, minute to minute, even second to second or less. And so, I think the willingness to cast a wide net in terms of the information that gets incorporated do some scenario analysis to understand what is possible, and then think about what's desirable and what's reliable. It's going to be really critical navigating the next few years of how we start to understand the role ESG plays in financial services.

Announcer:

Pat, Rachel and Paul, thanks again for speaking today. Collecting and analyzing ESG data is one of the biggest challenges we are seeing in the financial services sector, especially as regulations tighten. Clearly this is an evolving space, and there is going to be a bit of trial and error before we can report with relative certainty or provide reasonable assurance over this data. This is why conversations like these are so important, so we can continue to collaborate and navigate this complex topic. For more information on ESG data, you can find insights and information on our KPMG IMPACT website at home.kpmg/IMPACT.

Thanks for listening!

Musical exit

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