The ESGpectations are set _ The Financial Express

(Madhav Nair & Srinath Sridharan)

The growing consciousness about ESG among governments, policy makers, regulators, investors is an important trend for financial institutions to build on. ESG in the Indian banking sector is both a challenge and a transformational agenda. It won't be easy; the sector cannot simply stop financing conventional sectors, and yet it needs to price their risks to insulate itself from any bias or regulatory challenge.

The banking sector understands risk at its core. ESG is evolving with newer trackable metrics around the world. Loans and pricing are now being linked with the borrower's ESG performance. India's banking sector, too, is evolving with newer learnings, technology adoption, and directions from regulators. This is a good thing, because an engaged banking sector will be an important contributor to India's net-zero journey.

ESG is not exactly a new concept for India or Indian banks. However, investor outlook and expectations from ESG outcomes have sharpened considerably. Banks in India operate as per stringent licensing norms and work with regulators to ensure compliance of business operations. These norms cover financial inclusion, anti-money laundering, KYC, consumer protection, and many other socially Interconnected aspects. These help not only in maintaining financial stability but also in shutting down non-state miscreants.

Moreover, banks today are expected to address all issues in their portfolio, pertaining to corporate governance; insider trading norms; related party transactions; business model changes; shifting regulations; political risks; employee safety; business ethics; environmental protection; societal license to operate; greenwashing, and other aspects. This is only the beginning of a growing momentum for normalising ESG norms in the operating models of banks, and it should be viewed in the context of global volatility; geopolitical developments; the nationalist approach of many nations; low interest rates; rising operating and capital costs accelerated by the perception divide, and the resultant capital-premium between the developed and developing nations.

ESG reimagined.

ESG is not CSR++, as some mistakenly think it to be, nor is it simply a matter of compliance. ESG is about good for people, all living things, communities, society, and the world. What's good for them is good, in a business sense, for banks and financial institutions too. However, the markets and the ongoing dialogue around this topic expect the banks to formally implement ESG practices almost overnight, which is an impossible task. What's actually needed is a transition plan, guided by regulatory directions.

ESG initiatives should cover all downstream activities of clients and projects financed by the banks. They should cover the entire supply chain, which currently faces challenges with traceability and provability of ESG metrics, whether across the entire carbon footprint or social intensity or governance behavioural impact. The regulators and the industry together should steer the design of feasible ESG technical solutions. This transition to higher ESG standards will need cautious trade-offs between short-term needs and long-term vision.

Next steps in key areas

Culture: ESG-oriented banking will require fresh perspectives and a mindset change across the industry. Aspects such as consumer behaviour, enterprise risk management, product strategy, investment governance, and regulatory processes will need to be aligned to ESG principles. Stakeholders will need to be oriented to the new business models that emerge.

Change Mmanagement: Implementing ESG practices is a complex undertaking. To succeed, it must be supported by a variety of skills and technologies. This will necessitate new risk management approaches, data and analytical capabilities, automation, and auto-tracking parameters to ensure operational resilience.

ESG Sponsorship: Banks should create a cross-functional steering committee for ESG data governance — including leaders from the business, technology, data, risk, and finance functions — with joint accountability and joint decision-making processes.

Training: To successfully make the transition to ESG-ready operations, banks should readily accept ESG principles and integrate them into their organisational values and culture. ESG-training with unlearning and learning for the staff can be of considerable help in this direction.

Data Governance: Banks will need to redesign their data architecture and governance around ESG data. New data sources are constantly emerging, as are smarter digital solutions. Data collection strategies will need to adapt to these developments as well as on national data policies and regulations. Data robustness and testing for climate risk models, ESG scorecards, climate stress tests, and climate-adjusted ratings will all keep improving in the years ahead.

Technology: The current banking IT systems needs to be strengthened to collect, aggregate, analyse, and report ESG data. They will have to allow for embedding ESG data into risk reporting and assessments.

Taxonomy: There is no formal and banking-ready ESG taxonomy yet. Without these, lending norms and variables to track and measure the periodicity of stress testing will be undefined or vague. This is an area that needs careful attention.

Reporting: There's a need for proper reporting and disclosure by banks that includes, among other things, the ESG impact of bank loans and investments. This will help in introducing regulatory changes and product upgrades, as and when needed, to address emerging ESG gaps.

Connecting the dots

Banks must emphasise ESG for both short-term and long-term gains, and they must continually adjust to shifting compliances and expectations from various stakeholders. Additionally, banks must stay informed on how to easily access the enormous quantity of data and frameworks, as well as how to save time and money by executing their ESG policies quickly and easily. The benefits include accelerating growth, driving cost-reduction, attracting talent, and focusing on the customers of the future, underscoring why ESG is more crucial than ever.

It would be critical in building an ESG talent pipeline for the banking sector, as well as downstream knowledge partners. At some point soon, ESG will be crucial enough, not to be outsourced as a compliance role, as well as the need to build an organisational moat with it. This would also push for having board members who have expertise in this space, as well as proven capabilities. Needless to say, ESG agenda needs to be driven by the board and the leadership teams. A governance framework around it would need relevant capabilities, Risk controls, measurable ESG metrics and incentive structures be clearly established to inculcate ESG as part of organisational DNA.

Societal consciousness, respect for humanity, and bank capital can all work together, if we only connect the dots across ambition, buy-in, capabilities, digital, empathy, finance, governance, humanity, internet, people and planet. With incorporation of relevant Indian cultural ethos, native intelligence around business, banking can nudge the society for higher-order behaviour. Integrating ESG has been shown to be wise for banks as well as for the environment, society, and humanity as a whole. Doing good, and being good can be a good business model.

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