accenture

Sustainable lending

An action plan for banks

The opportunity to finance the environmental, social, and governance (ESG) agenda

In the wake of the COVID-19 health and financial crisis, banks face an urgent call to play their part in addressing today's environmental and social concerns.

To help shape a fairer, greener and more resilient world through sustainable lending, banks can position themselves as trusted partners in building sustainable economies that work for everyone. The leaders are looking beyond today's immature regulatory guidance and sustainable lending category to craft strategies that will position them to lead as regulatory and market expectations continue to rise.

Banks will play a key role in financing the sustainable transformation of their commercial client ecosystems, which in turn will enable them to gain a range of tangible benefits, including:

- higher loan volumes (ESG lending could form up to 30% of their total loan portfolio);
- new value generation;
- risk mitigation (up to 4.5% higher total returns for shareholders on high-performing ESG initiatives);
- lower cost of funding;
- new revenue streams linked to loans (e.g. non-financial ESG services); and
- brand differentiation.

The increase in volumes of ESG products such as sustainability-linked loans will be bolstered by the allocation of public capital to environmental and social initiatives and business opportunities, such as the €806.9 billion NextGenerationEU recovery plan[1] (with 37% allocated to climate-related programs) and the US's $2 trillion climate plan.[2]

With ESG criteria becoming integrated in creditworthiness processes, two segments are emerging:

1. **Companies with positive creditworthiness in industries with transformative needs (such as those with higher greenhouse gas emissions):** Here, banks will seize the lending opportunity by engaging with clients about the benefits of transformation and of their product/ service offering. This could impact 30-50% of a client's total loan portfolio according to our recent experience.

2. **Companies with less or no residual creditworthiness:** Banks will balance transformation support with an adequate risk mitigation strategy based on ESG KPIs.

Banks will leverage their investments in automating and speeding up credit processing (e.g. data-driven credit, digital lending, operations automation) as they incorporate ESG considerations into lending decisions. Among other steps they will:

Transform their lending value chain: prioritizing the implementation of an operating model that has zero-net impact and enables banks to make ESG-coherent lending decisions.

Reskill their lending practice: training and upskilling programs around sustainable lending value propositions and ESG criteria.

Set up ESG data platforms: building data platforms, creating ESG scoring models and tapping into third-party data to link ESG considerations to credit policies and, ultimately, product offerings.

Most banks today do not yet have a clear view on how they can take full advantage of the opportunities that sustainable lending offers, or of the potential risk of falling behind.

Those that are not acting now will face growing pressure to change from regulators, customers and investors. They could even be dropped from certain funds, and may face an increase in credit risks or a decline in profitability. Those that lead in sustainable lending, conversely, could benefit from an enhanced reputation, higher market valuations and better financial performance.

This is an inflection point where tomorrow's leaders will separate themselves from the rest by maintaining speed and agility in the end-to-end processing of their loans, even as they position to make the most of the opportunities of sustainable lending.

Banking on a greener future

With lenders issuing $120 billion in sustainability-linked loans in 2020,[3] sustainable loans are today just a drop in the ocean for a global lending market worth around $6.8 trillion a year.[4] Yet with S&P Global Ratings forecasting that the global issuance of sustainability-linked debt instruments (including bonds) will grow from $130 billion in 2020 to surpass $200 billion in 2021, a new opportunity is emerging that banks would be remiss to ignore.

The parallels with sustainable investment are instructive: after several years of strong growth, around 45% of total assets under management in Europe[5] and nearly a third of the total $51.4 trillion assets under management in the US[6] are today managed with ESG considerations. Sustainability-linked lending appears to be on a similar growth trajectory, skyrocketing from $5 billion in 2017 to 2020's $120 billion.[7]

Yet, despite growing interest in the topic, banks are sitting on the sidelines. Out of 60 of the world's largest banks analyzed by BankTrack, 50 were classified as laggards in fossil fuel financing.[8] So why are banks holding back while their colleagues in asset management teams are retooling themselves to analyze investment decisions through an ESG lens?

Some say it is due to a lack of clear standards and regulatory guidance. Many are worried about the challenges of assessing risk profiles associated with unproven business models and technologies, or potentially longer payback periods. There are also apprehensions about the maturity and bankability of some of the organizations and projects in the sustainable lending category.

Understandable as these concerns are, banks that are hesitant risk falling behind the expectations of the market and regulators.

Sustainable lending regulation is coming from three directions. Firstly, it is being built directly into banking laws and regulations. For example, a recent resolution by the European Banking Authority[9] specifies that banks in the EU should publish a "green asset ratio" (GAR) from next year, which could enable investors to easily compare banks by the climate-friendly loans, advances and debt securities on their balance sheet as a proportion of total assets.

Secondly, banking clients will be subject to increasingly strict industry-specific regulation. For example, the EU's Corporate Sustainability Reporting Directive (CSRD) will move the union closer to its goal of attaching the same weight and importance to sustainability reporting as is ascribed to financial reporting. The requirements will apply to all large and listed companies in the EU. The CSRD requires the audit of reported information, introduces more detailed reporting requirements, and requires companies to report according to mandatory EU sustainability reporting standards.[10]

Finally, subsidiary finance or public incentives will drive new demand for sustainable lending. Consider for example the EU's recovery fund, NextGeneration, which aims to rebuild a greener, more digital and more resilient Europe.

Those banks unable to cope with this trifecta of new regulation may find themselves under growing pressure from customers and institutional investors to change—or be forced to accept unfavorable terms for financing.

Banks not taking visible actions for a positive societal impact could even be dropped from certain funds. Large investors have, in some cases, dropped companies which do not disclose their emissions. What's more, sustainable lending laggards may face an increase in credit risks and a decline in profitability as ESG risks such as exposure to fossil fuels become concentrated in their loan books.

The direct link between ESG and financial performance—and its indirect link with credit risk—is becoming more and more evident from a short- and long-term perspective. Our Circular Economy Handbook shows an EBITDA margin potential increase of up to 15% in relevant industries through large-scale adoption of circular economy business models. According to Accenture research, 4.5 trillion dollars are at stake to be unlocked by the circular economy by 2030.[11]

Accenture estimates that companies pursuing a twin transformation (finding new sources of value at the intersection of digital technologies and sustainability) are two and a half times more likely to be among tomorrow's leaders.[12] This is happening both for supply reasons (rising cost of resources versus declining cost of ESG technologies) and for demand reasons (customer behavior).

In the last decade, banks have made significant investments in straight-through processing (STP), automating document collections, developing e-documentation and reducing collaterals. They cannot allow their move to sustainable lending to undo the steps they have taken in recent years towards a smoother end-to-end lending process.

Moving to sustainable lending carries the risk of returning to burdensome manual interventions. Forward-thinking banks will find ways to incorporate ESG considerations into lending decisions, while continuing to leverage the significant investments they have made in automating and speeding up credit processing to reduce the "time to yes" and the "time to cash."

Banks that put sustainable lending front-and-center in a bold sustainability agenda will be best positioned to thrive in a world where the public, shareholders and regulators expect them to do the right things. Those that take the lead today will develop the knowledge and skills in their lending practices to thrive in the sustainable lending market of the future. This, in turn, could help them to drive higher market valuations and better financial performance as investors, regulators and customers focus more closely on ESG factors in years to come.

Options for sustainable lending products abound

Sustainable lending, like sustainable investing, means that ESG considerations play a crucial role in all decision making. There are many examples of sustainable lending products.

Green mortgages give houseowners a discount on the mortgage rate if the house meets specific energy standards. The Nordic bank Handelsbanken offers a 0.1 percentage point discount on the mortgage rate for buildings with high energy efficiency ratings.[13]

Green loans promote a greener economy, facilitating investments in renewable energy, green buildings and sustainable farming. Singapore-based OCBC is providing a £85.5 million (US$119 million) green loan to Sun Venture to refinance an office and retail development in central London. The building was restored in 2017 to make it a future-proof, sustainable building.[14]

Sustainability-linked loans or revolving credit facilities give borrowers a discounted interest rate for achieving ESG goals or benchmarks. Global water technology company Xylem signed up for a sustainability-linked revolving credit facility in 2019 that ties the interest rate to its overall sustainability performance as rated by Sustainalytics.[15]

Sustainability-linked supply chain finance gives suppliers preferential rates if they meet sustainability-linked metrics. In 2021, Tesco became the first UK retailer to offer sustainability-linked supply chain finance to its suppliers through a new program with Santander. Tesco's suppliers get preferential financing rates from Santander if they meet targets on carbon data disclosure and emissions reduction, and make progress towards other sustainability goals.[16]

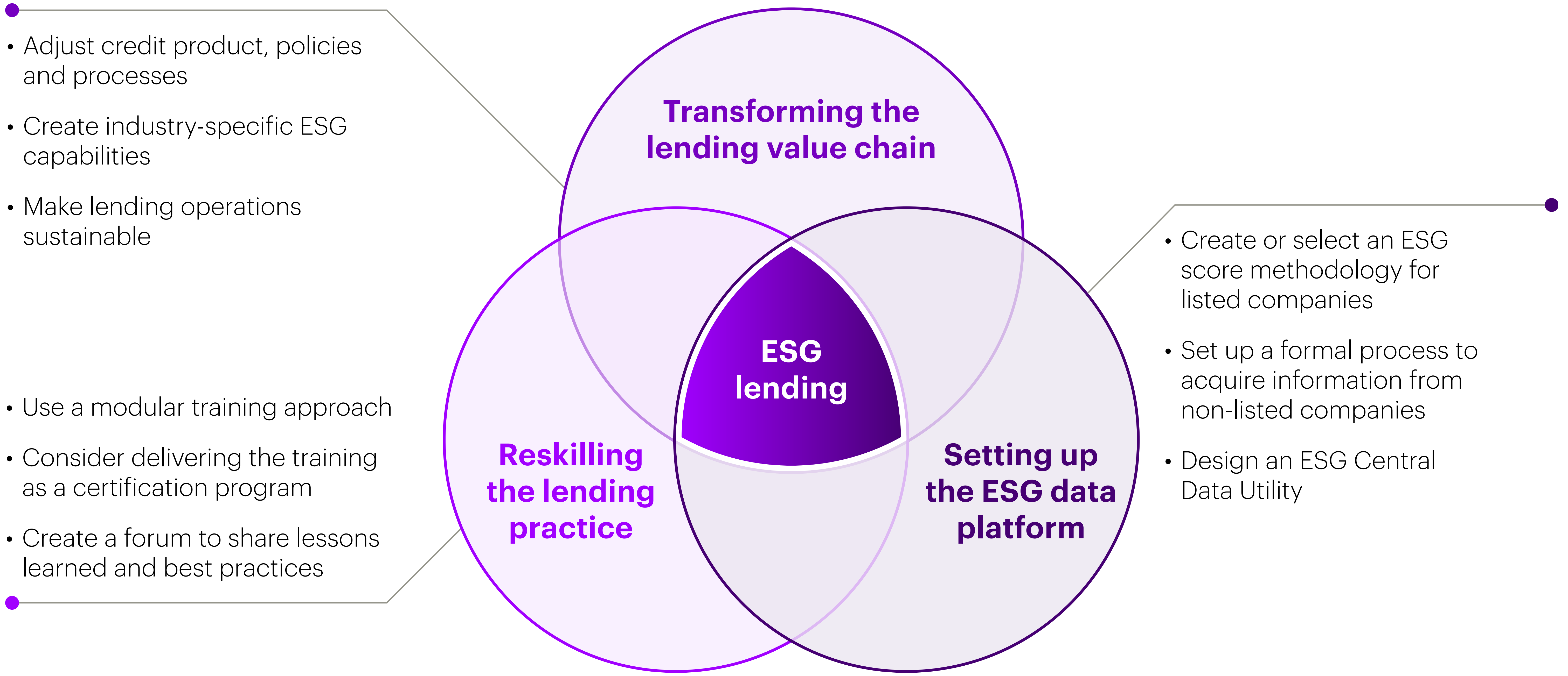
Green loans securitization—asset-backed security with proceeds raised to finance loans for green infrastructure. Toyota has created asset-backed security using auto loans issued to finance the purchase of hybrid, electric, and fuel-efficient vehicles.[17]

Retooling the bank for sustainable lending

Most banks today are not yet ready to take full advantage of the opportunities that sustainable lending offers.

The leaders, however, are acting now to prepare for the surge in sustainable lending by adjusting the end-to-end lending process. They are reskilling their lending practice employees, transforming their lending value chains and building the data and analytics platforms they need to ingest and analyse ESG data at scale. And they are doing this while maintaining speed and agility in the end-to-end processing of their loans.

Figure 1. A strategy for sustainable lending



Source: Accenture

Transforming the lending value chain

The shift towards sustainable lending is transforming the entire credit value chain, requiring banks to incorporate ESG criteria and business principles into their end-to-end lending process. As volumes of sustainable loans begin to rise and impact large segments of the customer base, they will find that patchwork solutions and labor-intensive tasks such as manually integrating ESG data into the credit assessment will be inefficient and unproductive. They will also not be effective in measuring the correlation between ESG and risk.

Actions to consider

In their medium-term ESG roadmap, the leaders will prioritize the implementation of an operating model that has zero-net impact and enables them to make ESG data-led lending decisions.

Adjust credit products, policies and processes. Core components of the lending value chain will change as the transition to sustainable lending progresses. Product specifications, documentation and collaterals or covenants will need to reflect ESG principles. For more complex loan approvals, lending committees will have to incorporate ESG information and profiles into their decisions (see figure 2).

Create industry-specific ESG capabilities. Relationship managers will need to strengthen their industry knowledge so they can make financial decisions based on both ESG and industry considerations. As complexity rises, they need to be equipped with knowledge tools and industry insights.

Build on progress in process digitalization. The move to sustainable lending exposes the risk of relapsing to heavily manual lending operations. Banks should ensure that they embed the same digital standards used in the rest of the lending business into their sustainable lending operations. They should build on their progress in automating and speeding up credit processing rather than setting it aside.

Figure 2. ESG has profound implications for the lending value chain

ILLUSTRATIVE

Tools
Rules
Skills

Credit Policies and Planning

- Portfolio and market analysis
- Risk appetite framework
- ESG credit policies (e.g. by industry)
- Pricing policy
- Origination guidelines (prevention, transformation, support)
- Target setting (e.g. share of ESG loans)
- Loan ESG criteria
- Product offering evolution

Origination and Credit Granting

- ESG checks and collaterals evaluation (e.g. green mortgage)
- KYC checks with ESG
- Guarantees and subsidiary finance/ funding
- ESG lending structuring
- Underwriting analysis, proposal & approval (including ESG committee)
- Document management (e.g. linked to subsidiary finance)
- ESG-compliant loan operations
- Prepare for securitization

Credit Management and Monitoring

- Credit reclassification
- Termination for ESG non-compliance
- Covenant management
- Regulatory reporting
- Anomaly detection and monitoring based on ESG criteria
- ESG portfolio stress testing and ESG-adjusted write-offs
- Client clustering and delinquency management

Collection

- Responsible collection
- Portfolio segmentation (management / sales / outsourcing)
- Direct management and collection of non-performing loans (NPLs)
- Circular asset management

Source: Accenture

Consider how Singapore-based DBS Bank approached the revamp of its enterprise data platform,[18] designing it to emphasize continuous evolution, scale, and security. In doing so, the bank has democratized the access to data across the business and reduced the time from data to insight to enable better data-driven decision-making.

Setting up the ESG data platform

Most banks still use traditional credit risk models that look at a narrow set of key performance indicators rather than incorporating metrics to assess ESG-related risks. These might include data on exposure to non-renewable energy or flooding risks. They also do not have the data they need to power sustainable lending risk models—because they neither collect it from clients nor acquire it from external data providers.

Another impediment is the lack of consistency among data sources. Different rating agencies may base their scores on different datasets and different interpretations of data, with the result that comparisons are meaningless.

A study by MIT found that the correlation between different agencies' ESG ratings was, on average, 0.61—compared to a 0.99 correlation between the credit ratings of Moody's and Standard & Poor's.[19]

Green mortgages illustrate some of the complexities of sustainable lending. To offer a green mortgage, a bank would need to be able to measure carbon dioxide equivalents for the property it is financing. This would require the bank to have data on the characteristics of the building as well as energy consumption and performance information. In many cases, this would have to be sourced from third parties.

Inconsistencies and complexities in ESG data

Rapidly changing data structure: ESG data disclosures have yet to be standardized.

Availability gaps: Reliable sources for many categories of ESG and climate risk data—including scope 3 emissions, supply chain, and asset data—are not yet available.

Unclear data ownership: Some ESG use-cases rely on the enrichment of data that falls outside traditional ESG definitions, so ownership needs to be defined.

Lineage and certification: Reliance on unaudited disclosures creates doubts about the reliability and comparability of some ESG data and coverage for SMEs.

Predicting future usage patterns: How ESG data will be used in the wider business is still being defined, so future demand and usage patterns cannot be easily predicted.

Actions to consider

Leading banks are building data platforms, creating ESG scoring models and tapping into third-party data to link ESG considerations to credit policies and, ultimately, product offerings.

Create or select an ESG score methodology for listed companies. Banks can choose between third-party ESG score methodologies for assessing listed companies or develop a proprietary ESG methodology and certify it with an independent institution. Some are combining these approaches: using their own methodology for preliminary assessments and supplementing it with third-party ESG scores if necessary. Tapping into ESG data gathered by other players offers a quick way to get data on listed companies.

Set up a formal process to acquire information from non-listed companies. For companies that are not listed on a stock exchange or benchmarked by independent ratings agencies, banks can gather ESG information by means of interviews or online questionnaires.

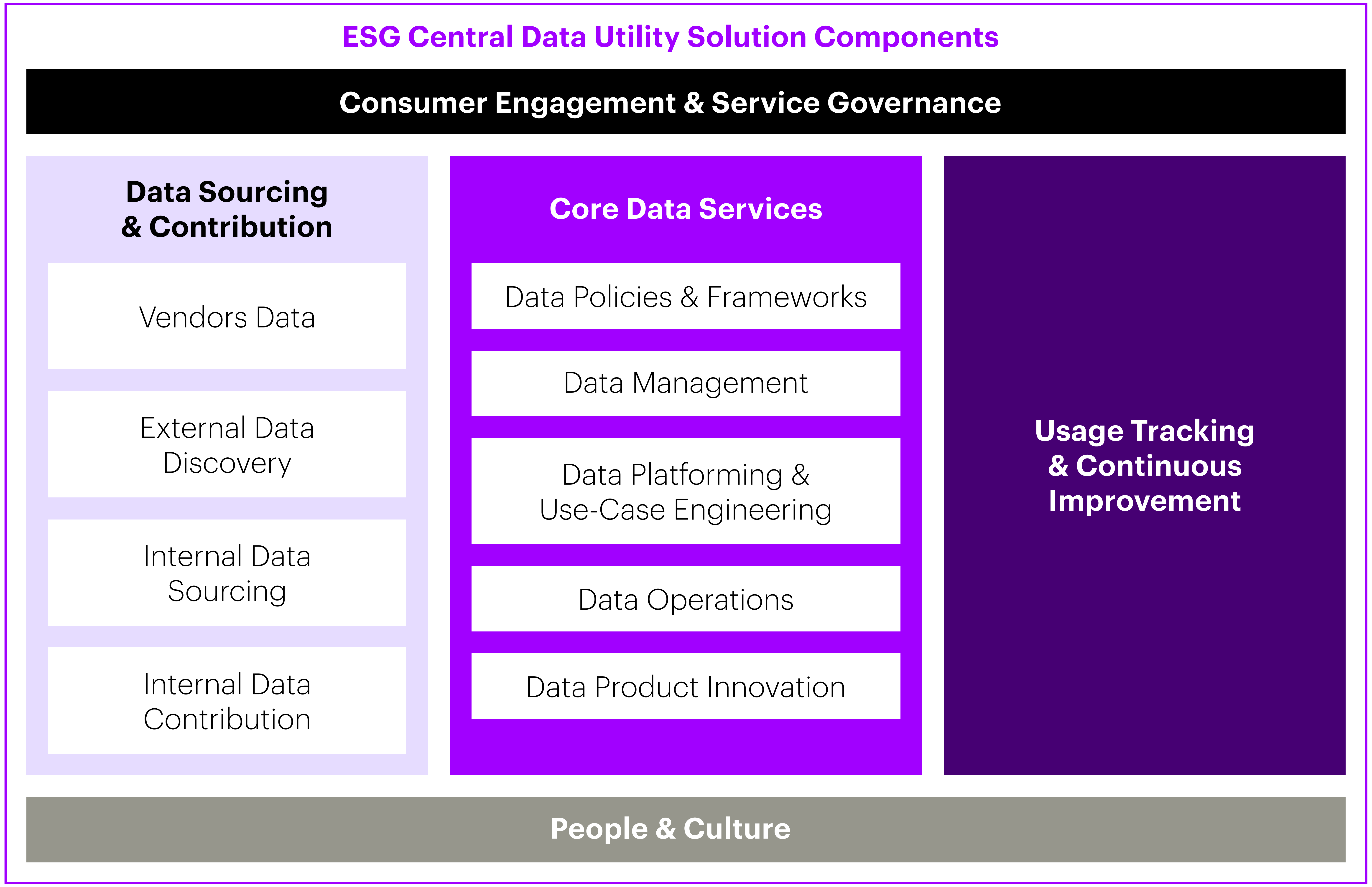
They can offer borrowers incentives such as accelerated loan processing in return for providing information about ESG factors like energy consumption, emissions, adoption of green policies, workforce composition, training and wellbeing programs, and board diversity. They can also explore many-to-many approaches as an alternative to gathering the information directly from customers.

In this model, a small business would not need to fill out a similar questionnaire for each bank it works with. It could fill out a single questionnaire shared among multiple banks, and perhaps by insurers and telecom operators. Several many-to-many solutions are already available or in development, including Accenture's blockchain-based supplier sustainability data hub, our partner Arabesque's company book,[20] and bank platforms like Invidem.

An example of a many-to-many initiative is Invidem, a utility founded in 2019 by six of the biggest Nordic banks.[21] The platform offers a single point of entry and access for know-your-customer (KYC) information. Instead of providing data to each bank it interacts with, a company needs to provide the data only once, in a format that complies with the standards to which all the banks have agreed.

Design an ESG central data utility. To facilitate accessing, validating and managing ESG data from inside and outside, leading banks will set up a new data unit. This structure will take care of data management, definition of data policies and data frameworks, and running ESG data operations in coordination with the bank's wider data strategy, channels and human resources (figure 3). The ESG central data utility will complement internal data with data from third-party sources. Examples include satellite data on water availability, crop health and patterns or pollution from providers like VanderSat, or sentiment data available on social platforms such as Yelp and Google.

Figure 3. A model of an ESG central data utility



Source: Accenture

Reskilling the lending practice

One of the major barriers banks face in driving their sustainable lending strategies is a lack of the knowledge and skills needed by their lending practices to support the new products. Their teams have not been trained to assess lending terms and conditions through the lens of sustainability, nor do they have skills in analyzing ESG data and building out the potential ESG use cases as requests to the data management teams.

Actions to consider

This is an opportune time for banks to provide their relationship managers with training and upskilling programs around sustainable lending value propositions and ESG criteria.

Use a modular training approach. Leading banks are taking a standardized, continuous and modular approach to reskilling their teams in sustainable lending. A good practice is to offer modules that comprise a mixture of interactive in-person and online sessions—potentially enriched with gamification elements. The benefit of a modular approach is that banks can train all team members to the same baseline of knowledge, while offering more specific modules tailored to each employee's role, responsibilities, and career aims. Relationship managers working with energy companies, for example, should have a good understanding of what sustainability means for that industry, while those working with retail companies will need insight into ESG in their specialist sector. A modular approach also allows the bank to easily add new modules as necessary.

Consider delivering the training as a certification program. Enabling employees to earn badges or certifications for completing modules will make it easy for leaders and colleagues to track specializations and expertise within their teams.

Create a forum to share lessons learned and best practices. The training program should also allow employees to share their experiences through ESG forums or committees. The asset management team could, for example, share what it has learned from its pivot towards ESG with the lending practice. In this way, the bank can define best practices and avoid repeating mistakes made earlier.

Standard Chartered has embraced a modular approach to training through its global learning hub, diSCover Lab, which was launched in 2020.[22] The Lab incorporates bite-sized learning modules for topics such as sustainable finance and cyber. Employees can update their skillsets and develop new skills—making for an individualized learning journey. The aim is to train and upskill 8,000 Singapore employees by 2022.

The opportunity to finance the sustainability agenda

Banks that embrace their central role in financing the sustainability agenda will not only be able to stay ahead of regulatory expectations. They will also be able to capture significant opportunities in a new market and strengthen public trust, at a time when consumers expect them to build sustainability into every aspect of their business model.

Some 66% of consumers agree that COVID-19 has strengthened the need for greater business involvement in improving social and environmental outcomes, while 52% ascribe high importance to sustainability credentials in making doing business with a company more relevant and more attractive to them.[23]

The journey starts with preparing the organization, its people and its technology infrastructure for a new paradigm in lending.

How Accenture can help

Accenture is ranked as one of the top consultancies in the Financial Times' Leading Management Consultants 2020 Sustainability Ranking, based on client input and endorsements.

We have over 11 years of partnerships with the UN Global Compact and more than 19 years with the World Economic Forum (WEF). This has kept us at the forefront of industry and sustainability developments and best practices.

We can help your bank on its entire journey of creating a sustainable lending agenda that gives it a first-mover advantage:

- Developing and launching green and sustainable products for banks and supporting your customers on their sustainability journey to safeguard their future growth;
- Implementing tools and platforms to aggregate ESG data and enable insights that support making sound decisions about sustainable lending;
- Designing and rolling out new end-to-end credit processes;
- Shaping and delivering the whole change management and training journey;
- Sharing best practices with relationship managers working with clients in industries such as energy, media, travel, health, and public services;
- Supporting the communication of your sustainability achievements to the market via our relationship with the WEF and our vast network of ecosystem partners;
- Delivering – as a service – credit ESG operations.

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