Financial Services

ESG Evaluation
Key Sustainability Factors

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Approach

Our key sustainability factors identify the most material environmental and social risks assessed in our ESG Evaluation. We assess the materiality[1] of those risks across the industry's value chain and reflect them in the weighting of our environmental and social factors. We also provide the quantitative indicators[2] used to assess an entity's performance relative to its industry peers on each of those factors. For further information, please refer to our "Environmental, Social, And Governance Evaluation: Analytical Approach."

Scope

The financial services sector encompasses a wide variety of companies. The scope of this document covers the banks, insurance, and asset management subsectors. In this report, we use the terms "financial services" or "FS" to refer to these subsectors.

Material Environmental Risks

Climate change: Banks, insurers, and asset managers are largely exposed to climate change issues, both transition and physical risks, due to their role as financiers of the economy. We anticipate those risks to be proportional to the impact of climate change on the economy. Although a risk, it also offers business opportunities for new financial products and services promoting a greener economy. That said, while FS companies have good expertise in managing their traditional risks and leveraging opportunities, they currently lack standardized data, methodology, and human resources to effectively address climate-related issues. Insurers, because of their expertise in insuring climate-related risks, have been relatively more aware and better equipped in this area. In general, asset managers have also been catching up relatively well, mainly thanks to a more focused business model and their demanding institutional clients who are requesting innovative climate-related investment solutions.

Environmental Factors: Weighting And KPIs

We place a strong emphasis in our ESG Evaluation on the environmental impact financed (i.e., funded, insured, and/or invested in) by FS companies, because any direct impact from their own operations is generally limited. The higher weight on greenhouse gas (GHG) emissions reflects a relatively larger exposure to this factor for most financed sectors. The equal weight to the other three factors reflects a relatively lower exposure but equally important environmental challenges facing the economy.

We use both qualitative and quantitative indicators to inform our opinion on an entity's management of its environmental impact relative to its industry average. Our qualitative analysis focuses on the effective integration of environmental factors into the lending/investing/insurance underwriting processes, and whether this results in actual and comprehensive measures, such as financing/insuring restrictions, engagement with clients/investee companies, or targeted green products and services. The main quantitative performance indicators are listed below.

Factor	Weight	Key performance indicators	Other performance indicators
Greenhouse gas emissions	40%	– Share of most carbon intensive sectors* in the financed portfolio (% total amount financed) – Share of companies/assets assessed on GHG criteria/engaged with on GHG or climate related themes§	– Share of green products and services targeting GHG or climate change-related issues (% total amount financed/% insurance revenue)
Water	20%	– Share of most water intensive sectors* of the financed portfolio (% total amount financed) – Share of companies/assets assessed on water criteria/engaged with on water related themes§	– Share of green products and services targeting water-related issues (% total amount financed/% insurance revenue)
Waste and pollution	20%	– Share of most waste intensive sectors* of the financed portfolio (% total amount financed) – Share of companies/assets assessed on waste criteria/engaged with on waste related themes§	– Share of green products and services targeting waste and pollution-related issues (% total amount financed/% insurance revenue)
Land use and biodiversity	20%	– Share of sectors most exposed to biodiversity risks* of the financed portfolio (% total amount financed) – Share of companies/assets assessed on biodiversity criteria/engaged with on biodiversity related themes§	– Share of green products and services targeting land use and biodiversity-related issues (% total amount financed/% insurance revenue)

*Sectors with exposure above the global average across sectors and geographies.
§As number and % total corporate suppliers, clients, and investee companies.

Material Social Risks

Customers: FS companies serve a large number and various categories of customers. Therefore, they depend greatly on customer satisfaction and trust, and on effective customer management to maintain their franchises. Conduct issues with retail customers, especially at banks and insurers, such as the occurrence of potential discriminatory practices, mis-selling, lack of transparency, or fraudulent activities, can undermine customer trust and damage reputation and finances. Technological issues and cybersecurity could disrupt customers' access to online services and raise concerns over the treatment of personal data. There has been mounting regulation in recent years to strengthen cyber systems and ensure fair treatment of customers, such as the TCF (Treating Customers Fairly) principles of the U.K. Financial Conduct Authority.

Workforce: The heavy dependence of FS companies on skilled labor resources poses significant social risks that continue to test their human capital management skills. Fierce competition, increasing use of automation, artificial intelligence, and digitalization bring new challenges and force FS companies to adjust business models and workforce management. This includes continuous training to reskill employees on new roles, products, or regulations, and fair treatment of employees, especially in cases of downsizing or reorganization. As they also outsource and offshore a growing number of functions to reduce costs, responsible management of their supply chains is becoming more important. Insurers and asset managers rely more extensively on third-party distributors to sell products; hence, making sure their distributors apply similar ESG principles as they do is critical, yet complex. Another challenge for the FS sector is to attract and retain talent, especially programmers and cyber risk experts, as well as the younger generation.

Social Factors: Weighting And KPIs

Our assessment of the social profile in our ESG Evaluation is balanced between social issues occurring in own operations and the rest of the value chain. We put more emphasis on both customer engagement and workforce and diversity because we expect those factors to remain more material for FS. Treating employees and customers fairly and effectively managing the impacts of changing business models on the workforce and customers are key challenges for the FS companies. As financiers of the economy, they also play a significant role in communities, primarily by promoting financial inclusion.

In our ESG Evaluation, we use qualitative and quantitative indicators to inform our opinion on an entity's management of its social impact relative to the industry average. Qualitative analysis focuses on the effective integration of social factors into the lending/investing/insurance underwriting processes, and whether this results in actual and comprehensive measures such as financing/insuring restrictions, engagement with clients, or ESG products and services with social targets. The main quantitative performance indicators are listed below.

Factor	Weight	Key Performance Indicators	Other performance indicators
Customer engagement	35%	– Customer satisfaction metrics – Comprehensiveness of data privacy policies (number of policies) – Number of complaints on data privacy	– Share of companies assessed on customer criteria/engaged with on customer related themes§
Workforce and diversity	30%	– Voluntary and involuntary turnover rate (%) – % of woman in senior management positions, and in revenue-generating functions – Training hours/employee versus employees filling internal roles (% of roles filled by employees)	– Share of companies assessed on workforce criteria/engaged with on workforce related themes§ – ESG products and services targeting workforce related issues (% total amount financed/% insurance revenue)
Communities	20%	– Philanthropic contributions by category (% of total contributions) – Inclusive banking/investment/insurance products (% of total amount financed/% insurance revenue)	– Share of companies assessed on communities criteria/engaged with on communities related themes§
Safety management	15%	– Absenteeism rate (% of total days scheduled) – Comprehensiveness of occupational health and safety (OH&S) oversight measures (number of measures) – Share of most safety intensive sectors* of the financed portfolio (% total amount financed)	– Share of companies assessed on safety criteria/engaged with on safety related themes§ – ESG products and services targeting safety related issues % total amount financed/% insurance revenue)

*Sectors with exposure above the global average across sectors and geographies.
§As number and % total corporate suppliers, clients, and investee companies.

Material Governance Risks

Cyber security: Banks, insurers, and asset managers are heavily reliant on IT systems, using digitization (or computer processing of information) extensively. Growing use of data mining and artificial intelligence (AI), and the digitalization of business models have brought significant efficiency gains and facilitated financial access. However, this has exposed FS companies to the risk of IT infrastructure failures, cyber attacks, and new and quickly evolving risks, such as AI-related ones (e.g., privacy, opacity, unintended bias, and unemployment, to name a few). The resulting business disruptions, loss of information, and data privacy issues could subject companies to high and unpredictable costs and reputational risks, given the large number of customers and business partners involved. Several analyses, such as the IMF Working Paper dated August 2017 - Cyber Risk, Market Failures, and Financial Stability - have shown that cyber incidents affecting FS companies could evolve into a systemic cyber crisis, given FS companies' role in ensuring financial stability. Preparing to manage such risks to ensure business continuity remains an important challenge in this sector.

Business ethics: Although they apply to most sectors, issues related to business ethics are highly material to our ESG Evaluation for FS companies, given their role in financing the economy and in ensuring financial stability. Some banks have been involved in serious controversies related to, for example, mis-selling of financial products and failures of controls to identify and prevent money laundering, tax evasion, or other unlawful activities. The resulting financial and reputational damage of such instances can be significant and spread over several years. Despite this, some banks are still struggling to implement fully effective business ethics policies, as highlighted by the recurrence of serious controversies. Insurers can face scrutiny over opaque terms in insurance contracts and even claims of mis-selling or other abusive practices, such as delaying claims settlements. Although traditionally not considered to be particularly susceptible to financial crimes, insurance companies may be increasingly vulnerable to such activities, given criminals' mounting sophistication. At the extreme, serious misconduct could undermine confidence in FS companies, thus threatening financial stability. Therefore in our ESG Evaluation, we pay particular attention to the remuneration structures and practices at FS companies to ensure pay does not encourage excessive risk taking.

Governance Factors

We consider four key entity-specific factors in our ESG Evaluations (structure and oversight, code and values, transparency and reporting, and financial and operational risks) to determine whether the entity is actively and effectively managing its exposure to governance risks and opportunities. The governance factors are common to all sectors. Please refer to our "Environmental, Social, And Governance Evaluation: Analytical Approach."

Submit Feedback

You can submit your feedback **online** or by **email**.

Please specify which sector you are commenting on when submitting feedback.

We would particularly like to hear from you regarding:

1. Which risks are missing or not relevant?
2. Which KPIs are missing, could be enhanced, or are not relevant?
3. What views do you have on the suggested factor weights for the environmental and social analysis?
4. Do you have additional feedback on this document?

Endnotes

[1] Events and issues are material for the ESG Evaluation when in our view they could meaningfully affect the entity's business operations, cash flows, legal or regulatory liabilities, access to capital, reputation, or relationships with key stakeholders and society more generally, either directly or through its value chain (upstream or downstream).

[2] Some may be produced using different methodologies and scopes.

Related Research

- The ESG Risk Atlas: Sector And Regional Rationales And Scores, July 22, 2020
- Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide, July 22, 2020
- Environmental, Social, And Governance Evaluation: Analytical Approach, June 17, 2020
- How We Apply Our ESG Evaluation Analytical Approach: Part 2, June 17, 2020

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