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Fintech, sustainability, and ESG reporting:

Is now the time for fintechs to become early movers in adopting a formal ESG strategy?

Key points

1. The ongoing evolution of environmental, social, and governance (ESG) policies has created opportunities for fintech companies to be early movers in this fast-moving area.

2. The SEC Proposed Rule on Climate Disclosure, announced in March, has accelerated timelines for assessing impacts to many organizations. But even before this announcement, fintech companies had a number of compelling reasons to invest in a formal ESG strategy integrated into the corporate-level business strategy.

3. The list includes demonstrating their commitment to making an environmental and social impact to an increasingly demanding base of stakeholders—from employees to consumers to investors—which may also result in organizational benefits.

As a sector, fintechs appear well positioned to capitalize on the benefits of adopting a formal ESG strategy. As fintech executives consider their next ESG moves, they may have questions about the risks, rewards, and roadmap of formally integrating their ESG reporting and other initiatives with their overall corporate strategy and operations—questions this report is designed to help answer.

Introduction

Over the past year, ESG strategy continued to evolve into an important focus area for companies in a wide range of industries, including the fintech sector. With business models focused on environmental and social progress, many fintechs may be naturally drawn to ESG as a key business priority.

Yet despite ESG's growing importance, at the end of 2021, less than one-quarter of US companies had established an ESG council or working group to drive their strategic focus on ESG matters, according to a recent Deloitte executive survey.[1] This finding offers some insight into the size of a similar demographic group: ESG early movers—companies that are investing in a formal ESG strategy to demonstrate value to their stakeholders ahead of their peers. Data from numerous studies over the past five years strongly suggests that these early adopters have and may continue to realize a host of competitive advantages for their foresight and proactiveness—ranging from increased return on assets (ROA) and return on equity (ROE) to better stock performance.[2]

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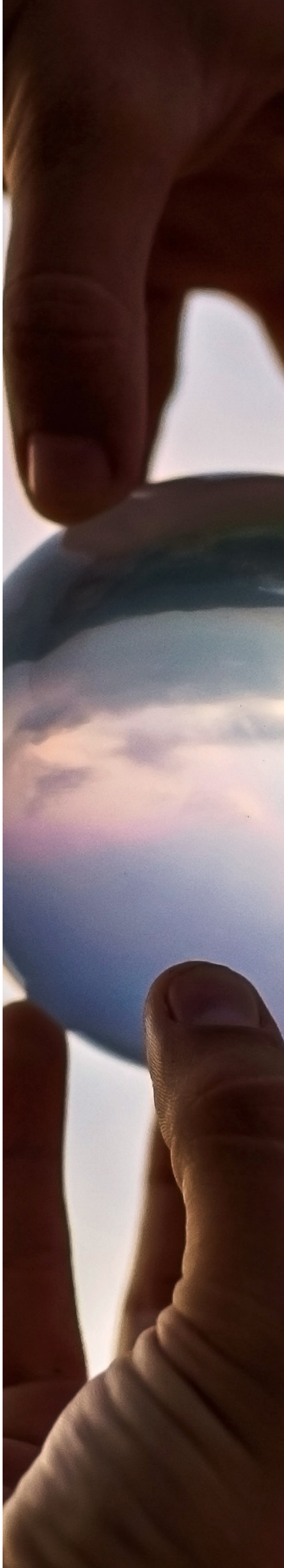
New SEC guidance on ESG reporting

On March 21, 2022, the SEC issued a proposed rule that would enhance and standardize the climate-related disclosures provided by public companies. In his statement expressing support for the proposal, SEC Chair Gary Gensler emphasized that "if adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions and would provide consistent and clear reporting obligations for issuers."

Under the proposed rule, a registrant would be required to provide disclosures about greenhouse gas (GHG) emissions (with attestation for Scope 1 and Scope 2 disclosures), certain financial statement disclosures, and qualitative and governance disclosures within its registration statements and annual reports (e.g., Form 10-K).

Learn more



A pivotal moment for the fintech sector

Why should fintech companies that have been getting by with their current ESG initiatives consider moving to the rigor of a formal ESG strategy? The reasons are as varied and nuanced as they are compelling. They include rising expectations and influence wielded by environmentally and socially minded stakeholders.

Fintech consumers, investors, employees, and other stakeholders may have extremely high expectations, not only for innovation in areas such as green fintech, but also for leadership on environmental and social issues—from sustainability and climate change to diversity and financial inclusion. This, of course, is not surprising considering how many fintechs are focused on environmental and social progress as part of their business model.

With rising stakeholder demands for greater ESG performance, the fintech sector is rapidly approaching an inflection point where having an informal ESG strategy—one without formal governance and controls, materiality assessments, KPIs, and assurance—may no longer be enough to keep pace with expectations.

Rising investor, consumer, and employee expectations for ESG accountability

It's a staggering statistic: **Investors** with more than $17 trillion in United States–domiciled assets (which is one-third of all US investments) have adopted sustainable investing strategies.[3] At the current growth rate, ESG-mandated assets (defined as professionally managed assets in which ESG issues are considered in selecting investments or shareholder resolutions are filed on ESG issues at publicly traded companies) are expected to make up 50% of professionally managed assets globally by 2024.[4]

These figures tell us that investors with considerable capital are intent on investing in companies making an environmental and social impact. And they're using impact investing strategies and tools developed by fintechs such as Flourish and Quona Capital to do it.[5] The accountability and transparency of a formal ESG program is likely to be increasingly seen as the primary vehicle for demonstrating this social and environmental impact to investors.

Similar **consumer** trends are taking shape across fintech markets—from digital banks and wealthtech investment platforms, to mobile payments, lending, and insurtech companies, to name just a few. Consumers have demonstrated their strong support for environmental and social issues that underpin fintech's mission-driven business models. Banking customers, for example, may choose digital banks like Aspiration because of their pledge not to invest deposits in fossil fuels, private prisons, or rainforest destruction. Meanwhile, underserved borrowers can now access credit through lending platforms that focus on financial inclusion as a primary differentiator from traditional lenders. Make no mistake, however: Simply having a mission-driven green or social equity-focused business model may no longer be enough. Today's consumers expect the commitment, transparency, and accountability inherent in a formal ESG program.

Employees, another major stakeholder group, are also making their ESG preferences felt by where they choose to work. People generally want to work for companies with values that align with their own.[6] Disclosing ESG objectives with specific goals at a companywide level through a formal strategy can help fintechs attract and retain like-minded talent in a time when voluntary turnover is high.[7] Moreover, being an early mover in rolling out a formal ESG strategy may help address staffing and capacity challenges. As more companies adopt formal ESG plans in the coming years, competition for employees with ESG skill sets will likely increase, providing an opportunity today to gradually build those skill sets over time rather than compete for them in the future.

How demographics are changing the ESG landscape

Generational shifts have a great deal to do with this changing fintech landscape. A majority of financial app users (52%) are 18 to 34 years old—in the sweet spot of Gen Y (millennials) and Gen Z.[8] These two generations have more economic power than any generation that precedes them, and they are the recipients of an unprecedented wealth transfer of trillions of dollars, which is well underway.[9]

Gen Z and millennial customers have a strong and well-documented preference for allocating their wealth to companies committed to protecting the environment and promoting social equity. Consider these trends:

- The percentage of millennials interested in sustainable investments increased from **84%** in 2015 to **95%** in 2020, according to Morgan Stanley Institute for Sustainable Investing[10]
- **90%** of Gen Z consumers are more willing to buy products that benefit the environment or society[11]
- **94%** of Gen Z consumers expect companies to address important social and environmental issues[12]

Less talk, more action: Accountability and performance matter

Consumers also demonstrated an increased willingness to reward companies they consider transparent and accountable on ESG performance.[13] Fortune observed a similar trend among investors.[14] Accordingly, both consumers and investors are becoming more sensitive to "greenwashing"—false, misleading, or simply unsubstantiated claims of being a leader in the area of climate change and sustainability.[15] Superficial ESG initiatives and goals that do not have a tangible, measurable impact on the environment or society—from carbon neutrality to diversity and inclusion—are increasingly being seen as lip service.

In light of this less-talk-more-action skepticism, it is important for fintechs to be able to demonstrate their concrete commitment to ESG or risk losing credibility with investors, consumers, employees, and others. One of the clearest ways companies can achieve this objective is by disclosing meaningful, timely, and understandable ESG performance metrics with measurable results that are integrated into a corporate-level program.

Financial performance benefits for ESG early movers

Considering the tremendous amount of capital being poured into companies with proven ESG transparency and accountability records, it should come as no surprise that completing an ESG transformation has been shown to produce tangible financial benefits. In reviewing more than 1,000 studies published between 2015 and 2020, research published by NYU Stern Center for Sustainable Investment found a positive relationship between ESG performance and financial performance. Specifically, 58% of "corporate" studies found improvements in metrics such as ROE, ROA, or stock price resulting from superior ESG performance, with 13% of the studies showing neutral impact, 21% mixed results (the same study finding positive, neutral, or negative results), and only 8% showing a negative relationship.[16]

The research further found:

ESG-related drivers of financial performance: ESG strategies implemented at the corporate level can result in better financial performance through drivers such as more innovation, higher operational efficiency, and better risk management, among others.[17]

Materiality matters: A study entitled "Corporate Sustainability: First Evidence on Materiality" demonstrated the potential for above-average stock performance when incorporating "material" ESG issues in a corporate ESG strategy, with the stock performance of companies focused on material issues outperforming those that focused on immaterial ESG issues or no ESG issues at all.[18]

Disclosure without strategy is ineffective: An ESG disclosure program without an accompanying organizational ESG strategy does not drive financial performance, according to the NYU Stern research. The report found a 26% positive correlation between financial performance (such as stock price) and having an ESG disclosure process. However, it noted a 53% correlation between financial performance and having an ESG strategy with performance measurements in place (e.g., assessing a company's performance on issues such as greenhouse gas emission reductions).[19]

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The advantages of implementing a formal ESG strategy outweigh the risks

Despite the many benefits of implementing a formal ESG strategy, some fintech leaders may still have lingering questions about the need for one. After all, just 21% of executives polled in Deloitte's ESG survey said they already have a formal ESG council or working group—indicating, perhaps, a lack of urgency around creating formal ESG governance structures. However, in the same survey, 57% of senior executives said they are in the process of establishing an ESG council/working group.[20] This finding points to an accelerating trend toward formalized ESG.

Other concerns about implementing an integrated corporate-level ESG strategy include:

- **Cost:** The cost of assembling the staff, controls, KPIs, materiality assessments, reporting, and assurance needed for a formal, integrated ESG program may seem prohibitive for an emerging fintech. However, for fintech startups whose processes are still emerging, the cost of implementing a new framework and additional staff may be less now than years down the road when processes are more rigid and competition for available ESG-trained employees may be greater.[21]

- **Skepticism about the value for fintechs:** Fintech executives may believe they don't need to formally adopt an ESG strategy because ESG is already in the DNA of most fintechs. Therefore, fintechs already gain ESG credit and credibility by virtue of their green, sustainable, or social equity-focused business models. However, with rising concerns around greenwashing, just having an ESG-focused business model may no longer be enough to demonstrate ESG leadership or accountability. It is very likely that stakeholders will increasingly expect evidence that the ESG goals incorporated in a fintech's business model are being achieved. Disclosures associated with a formal ESG strategy can be an effective mechanism to deliver this information to stakeholders.

- **Confusion about ESG standards and frameworks:** Until recently, confusion resulting from overlapping standards governing ESG disclosure and reporting was enough to give some executives pause. However, recent developments by global standard-setting bodies have simplified matters. At the 2021 United Nations COP26 Conference, IFRS Foundation trustees announced its proposal to form the International Sustainability Standards Board (ISSB). The ISSB is tasked with consolidating the Climate Disclosure Standards Board and the Value Reporting Foundation (which includes the Integrated Reporting Framework and Sustainability Accounting Standards Board (SASB) Standards) in 2022. If finalized, this standards consolidation and the proposed rule on climate disclosure communicated by the SEC in March 2022 will bring greater clarity to ESG governance, reporting, and disclosure.

Established a cross-functional ESG council or working group
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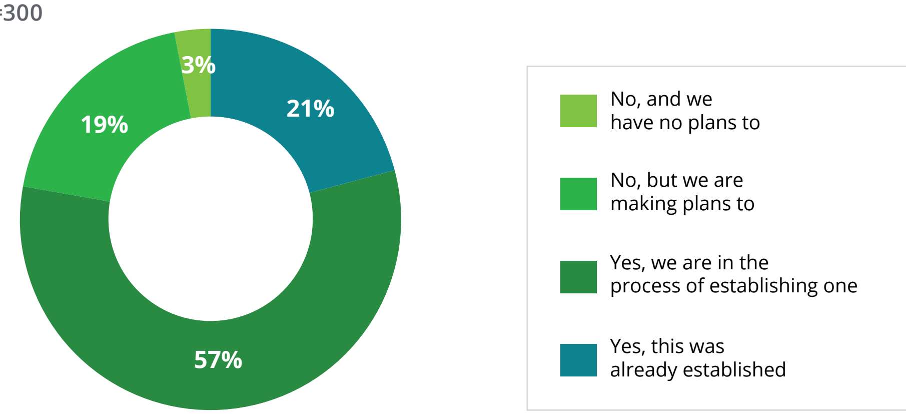
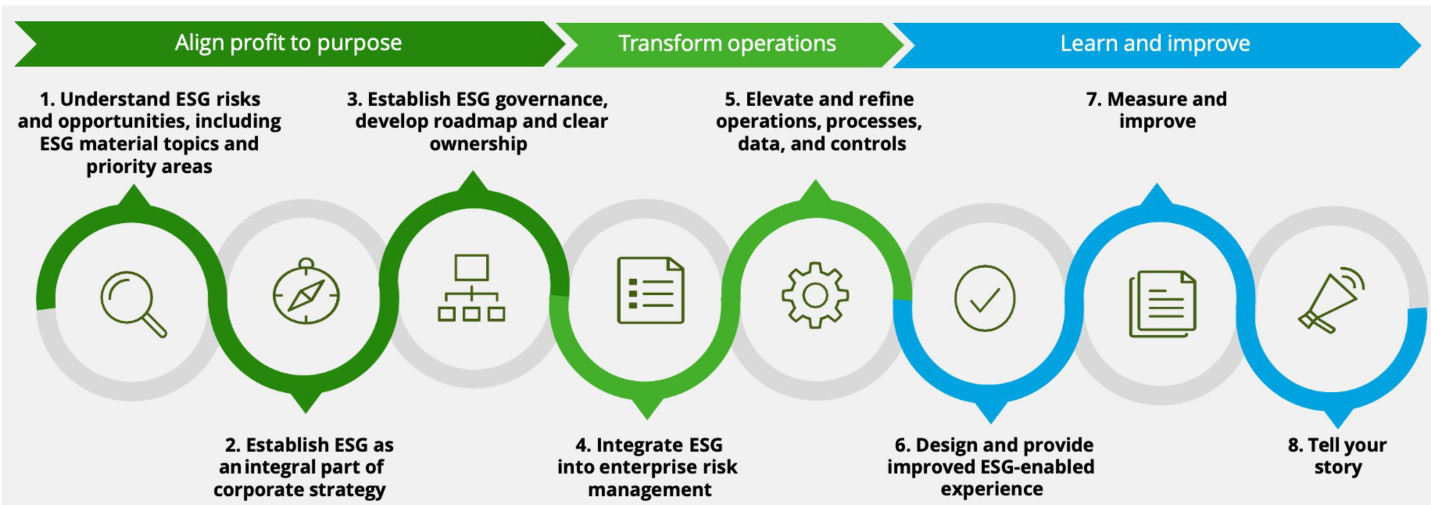


ESG transformation roadmap: Steps to achieving greater ESG performance, trust, and credibility

The case for implementing a holistic ESG strategy integrated at the corporate level continues to strengthen over time, while the process for doing so becomes less complex. The transformation roadmap to implement a formal ESG corporate-level strategy consists of eight steps as shown below:



The first step in the roadmap entails assessing materiality and understanding key data sources, systems, and owners responsible for topics of material impact. For ESG risks that are material to the business, it is important to understand how they are integrated into enterprise risk management. Metrics may also be a major consideration in the process of determining data sources and systems.

With their focus on innovation, environmental, and social goals, fintechs may have unique metrics that are relevant to their stakeholders. A fintech lending company, for example, may consider gathering metrics that help illustrate the financial inclusion its products enable for under-represented borrowers. A fintech payments company, alternatively, may consider capturing metrics showing the financial health created by its product and tools to its users. And an insurtech may measure incentives to its customers that lower their insurance for living healthier or greener lives. These metrics not only can be used to measure a fintech's market or financial performance but also can serve as ESG performance indicators and help a fintech stand out from the crowd.

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Conclusion

ESG governance, reporting, and disclosure is a fluid and evolving area. However, at this point in its development, certain things seem clear. Over time, the demonstrated benefits of adopting a formal, holistic ESG strategy should overtake the perceived risks for many organizations. Increasing or maintaining the trust and confidence of customers, investors, and partners in the ESG sphere may be enough to convince some CXOs and boards of directors to move forward with a formal strategy sooner rather than later.

For others, the clincher may be the documented financial benefits associated with having an integrated and materiality-focused ESG strategy. These benefits, which may include better stock performance and higher operational efficiency, have been shown to become more pronounced over longer time horizons.[22]

Fintechs, with their natural affinity for environmental and social matters, may have even more to gain by becoming early movers in adopting a formalized ESG strategy. The green, sustainable, or social equity focus of many fintechs—and their stakeholders—mean they may be well positioned to reap the rewards that can come with being an early adopter of a formal organizationwide ESG strategy and disclosure program.

How Deloitte can help

Deloitte can help transform your existing ESG initiatives into an effective business strategy and enterprise transformation. As a leader in ESG services, we bring deep knowledge and an approach tailored to the unique needs of the fintech sector. Our eight-step roadmap provides a comprehensive approach that considers ESG strategy, governance, and performance across the entire business starting with a materiality assessment to identify the most relevant ESG KPIs for your organization.

To learn more about Deloitte's ESG services for the fintech sector, contact one of our fintech ESG leaders.

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Endnotes

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