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ISEAL Summary Paper

Data-driven decisions on sustainability risk and performance: Insights from the finance sector

Good decision-making depends on good information. Data can provide valuable insights, help identify risks and opportunities, drive improvement, inform strategies and improve communication.

Traditionally, sustainability standards have relied on physical third-party audits to assess the performance of certified operators. When risks of non-conformance are detected, they are independently investigated at site level. This assurance system underpins the credibility of standards systems, and also provides a valuable source of information.

But there are limitations with a model like this. It's not always possible to send auditors to investigate every incident of perceived risk everywhere. And when most data comes directly from audits themselves, it leaves information gaps. Drawing on additional sources of data is crucial if sustainability standards are to increase their scale and impact.

Other sectors are also looking to make better use of sustainability data to guide decision-making. As failing to identify and address risks across sustainability issues can have significant financial implications, the finance sector has begun to look beyond financial data in its risk profiling and investment decisions. Financial services providers – including banks, insurers and ratings agencies – now routinely incorporate data on environmental, social and governance (ESG) issues in their decision-making.

To learn more about this topic, ISEAL contracted Efeca, a consultancy firm based in the UK. Efeca conducted nine interviews across investment and commercial banking, insurance and ESG rating agencies. These interviews were supplemented by a desk-based review of more than 30 reports and documents on assessing sustainability risk in the finance sector. In this paper, we share some key insights from this research, and discuss how these link with other areas of work that the standards community is involved in.

Defining sustainability and risk assessment challenges

While sustainability is becoming a mainstream consideration for all financial players, there is no common definition of sustainability nor any aligned approaches to sustainability risk assessment. Nevertheless, financial institutions often use an ESG framework to assess, and sometimes quantify, sustainability risks. Although there isn't a definitive list of ESG issues, common elements include:

- E: climate change, pollution, resource efficiency, water use, biodiversity
- S: human rights, labour standards, health & safety, diversity policies, community relations, development of human capital (health & education)
- G: corporate governance, corruption, rule of law, institutional strength, transparency

On top of challenges with definitions, interviewees noted the need to consider sustainability more broadly, across all issues and sectors. A common practice is to explore risk on a relatively small scale with a narrow scope – looking at water risk in a specific area, for example. Ideally, though, a multidimensional risk framework would be able to capture the 'ripples' and impacts beyond one specific sector. So an assessment of water risk should also take account of competing current and future demands on the same water resources within a specific river basin, including considerations such as possible hydropower developments, population growth and the flow levels needed to sustain freshwater ecosystems. Similarly, deforestation is strongly linked to climate change and biodiversity loss, but also has implications for food security.

A need is emerging for regulatory and risk frameworks that can assess and cut across sectors and commodities. This is a space where solutions are still being developed and it remains a challenge for everyone – but wide coordination and cross-sectoral thinking are very much required.

Data sources and processes

The availability of good data and information is key in investment decision-making processes. Technology is improving data quality and availability all the time – but this in turn can increase complexity. The diversity of definitions of sustainability, risk rating systems and related data needs make data collection and analysis challenging, and different data sources are not always comparable or compatible. Interviewees highlighted the need for simplification, through increased standardisation around data types and definitions.

In terms of data sources, typically, the finance sector relies on a mixture of company data disclosure reports and third-party data services providing ESG risk assessments and analytics. The table below highlights some of the more common means by which financial institutions acquire their data and for what purpose.

	Publicly (and freely) available data sources	External data providers (under subscription)	Internally gathered data
Used by who?	Financial institutions focusing on specific sectors.	Large financial institutions working across diverse sectors.	Large financial institutions or very 'localised' ones.
Why?	Only assessing specific sustainability risks related to specific commodities and/or regions.	Need to assess many clients across diverse sectors. Need to comply with 'internal' sector-specific policies/ requirements (including commodity-specific ones).	Operating in niche sectors in which there is no available data and/or Have resources available.
How?	Sometimes integrated with additional data (sometimes gathered on the ground, but more often acquired through desk-based research).	Data collected/gathered and 'packaged' by the external data providers, offering ESG-specific data as well as ESG ratings (under subscription).	Through established networks.
Result?	Analysis of the data in-house (using own methodology).	Potential to combine and/or cross-check data acquired from different data providers for greater assurance.	More tailored data gathered for more precise analysis.

Table 1: Summary table on the three categories of data sources identified through research. (Efeca, 2020, *Developing Risk Profiling Methodologies – insights from financial services in the quantification of sustainability risk at different spatial scales*)

Although the data and tools used depend greatly on the type and size of the financier and on the commodities, sectors and regions where they operate, the value of better information cannot be overstated. Particularly in riskier sectors and geographies, rigorous and quantitative data will increase the creditworthiness of a client and will facilitate decision-making processes.

For standards systems, it's well worth considering the value of drawing on data from a variety of sources – not just relying on internal audit data. Supplement internal knowledge with free resources when available, and consider data-sharing agreements and [aligning data collection and measurement frameworks](#) with organisations that share your purpose.

From information to action – integrating data into everyday decision-making

Once seen as an add-on, sustainability is becoming embedded in financial institutions. Sustainability data is an organisational asset and needs to be a fundamental part of thinking across and within teams and departments. Because sustainability issues are multi-faceted and cross business functions, decision-making requires integrated and collaborative thinking.

It's a challenge to get this right, of course. Methodologies and decision-making processes are fragmented and often ad hoc, making them difficult to align and/or replicate across different financial sector players, or even across different teams within the same institution.

However, the paper highlights numerous examples of company policies and processes set up to address this. One response is to set up dynamic feedback loops between initial risk assessment results and the due diligence processes that follow, allowing for continuous monitoring and triggers to escalate actions as needed.

In terms of determining risk, it's important to consider the many types of risk – ranging from the reputational (e.g. being associated with human rights abuses or deforestation) to fundamental questions of operational resilience, such as the impacts of climate change. Having access to the right data, incorporated into day-to-day activities, will help determine not just the level but also the types of risk, and will inform follow-up remedial actions. It can also reveal material risks and opportunities that might otherwise be overlooked, helping to identify investments that may lead to enhanced risk-adjusted returns and reduced downside risk.

What next?

All of us, both in the finance sector and as sustainability standards, need to evaluate the sustainability risk of a client. This applies equally to assessing new investments or certifications, and to monitoring on-going performance and triggering remedial actions when needed. Certification schemes have traditionally relied on physical audits to generate this information. However, drawing on other sources of data can help to improve our understanding of risk, as well as improving efficiency and accessibility. In addition, some standards systems have begun carrying out remote audits during the pandemic, and this is something we could be seeing more of in future. Taking steps to evolve the data ecosystems that support decision-making processes can bring many benefits. With more information at hand, for example, a standard system could trigger physical audits only when and where this is most needed and effective. Additionally, increased understanding of where the highest risks of unsustainable production practices are can guide policy development, monitoring and evaluation, capacity building and research efforts. Ultimately, increasing sustainability standards community's capacity to handle and analyse data will be crucial to support its strategic development – including branching out into new and emerging markets, experimenting with landscape approaches and forming partnerships with other standards and external actors to achieve sectoral transformations.

The standards community and the finance sector share similar challenges when working with sustainability data – around the lack of data standardisation, lack of common definitions around major sustainability issues, data not being fully integrated within the organisation, risk not being considered more holistically, and more. We hope this can inspire future engagement opportunities, since both sustainability standards and the finance sector are working towards similar solutions across the same topics – including [improving access to finance for smallholders](#) and [measuring progress towards the Sustainable Development Goals](#).

Perhaps increasing the transparency and accessibility of standards data and analytical outputs is the bridge that can enable us to set up better working relationships with actors in this sector.

[The full report by Efeca](#) is publically available on the ISEAL website.



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