



# The Potential Impact of ESG on Due Diligence in Enterprise Financial Services



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## INTRODUCTION

Legislation around Environmental, Social, and Governance (ESG) initiatives and disclosures are gaining momentum in all industries, including the Enterprise Financial Services (EFS) industry.

More and more investors and legislators are calling for EFS firms to pay more attention to ESG, so these companies cannot afford to be non-cognizant of these developments.

That's why professionals, whether they be asset managers, network managers, or other risk and due diligence professionals within EFS, must all seriously consider how they will evaluate and collect evidence to meet its ESG compliance and reporting requirements.

In this article, we discuss ESG and its implications for EFS. We also analyze the challenges around due diligence for EFS organizations and how platforms like CENTRL's [DD360](#) and [BNM360](#) can help.

## WHAT IS ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG)?

An Environmental, Social, and Governance (ESG) program includes three criteria that enable socially and environmentally-conscious investors or partners to assess other potential investments or business partnerships.

- ▶ Does the company follow sound environmental practices? E.g., are its factories contaminating the land or polluting the water supply?
- ▶ Are there any social issues or red flags? E.g., is the company (allegedly) involved in human rights abuses?
- ▶ Are there governance weaknesses? E.g., do business partners implement the necessary cybersecurity controls to prevent exposure or theft of sensitive data or assets?

The **E (Environmental) criteria** consider whether the organization aligns with global/industry/legislative commitments to environmental sustainability and if the company manages environmental risks related to:

- ▶ Pollution, e.g., due to the use of fossil fuels
- ▶ Waste/water management
- ▶ Biodiversity
- ▶ Raw material sourcing
- ▶ Climate risk
- ▶ Energy consumption
- ▶ Responsible use of natural resources

The **S (Social) criteria** assess how the organization manages its social relationships with employees, customers, third parties, and the broader community. They incorporate considerations about:

- ▶ Human rights
- ▶ Diversity
- ▶ Equity and inclusion
- ▶ Workplace conditions
- ▶ Community relations
- ▶ Labor management

Finally, the **G (Governance) criteria** pertain to its corporate governance controls that impact its functioning and decision-making. These criteria cover:

- ▶ Business ethics
- ▶ Executive pay
- ▶ Board governance
- ▶ Fiduciary responsibility
- ▶ Audits
- ▶ Reporting transparency
- ▶ Internal controls
- ▶ Shareholder rights
- ▶ Intellectual property protection

## WHY IS ESG IMPORTANT FOR ENTERPRISE FINANCIAL SERVICES?

ESG is important for many reasons. Companies investing in ESG initiatives are, according to a recent [Harvard Law report](#), considered "ahead of the pack, and in prime position to utilize their reputations to garner greater mainstream buy-in towards sustainable business practices."

Specifically, ESG-focused organizations can more effectively encourage public trust, meet their regulatory requirements, and improve long-term sustainability in the financial services industry.

Evaluating and validating ESG criteria also reinforce beneficial business partnerships and investments by helping these parties to avoid sub-optimal investments or partnerships that could pose a significant financial risk due to lax governance.

## THE CHALLENGES OF INCORPORATING ESG INTO DUE DILIGENCE IN ENTERPRISE FINANCIAL SERVICES

Most financial institutions know they need to focus more on ESG. Moreover, their risk management and due diligence professionals understand that they must implement ESG requirements in their evaluation process.

However, some significant challenges hamper their ability to do so. These challenges are explored more below.

### ***Lack of widely accepted measurement frameworks and metrics***

Recently, several voluntary ESG disclosure frameworks and regulatory guidelines have emerged. Some disclosures particularly relevant for EFS include:

▶ [Diversity Project](#) is a UK-based initiative used to drive standardization in collecting D&I data from asset managers.

▶ [AIMA & Albourne Diversity and Inclusion Questionnaire](#) focuses on diversity, equity, and inclusion (DEI) aspects, such as workforce diversity, anti-harassment policies, and recruitment and retention for institutional investors and fund managers.

- ▶ [ILPA DDQ](#) and Diversity Metrics Template standardize frequent due diligence questions related to DEI and provide an ESG framework to monitor DEI progress.
- ▶ The [Network for Greening the Financial System \(NGFS\)](#) is a group of central banks tasked with providing industry best practices around key systemic challenges (such as climate-related risks) for banks and financial institutions.
- ▶ [Bank of America](#) has also designed a framework derived from principles administered by the International Capital Market Association to help banks advance equality and economic opportunities.

However, in the global economy, the current regime of voluntary standards and disclosures does not produce consistent, comprehensive, and comparable information, which makes it difficult for risk and due diligence professionals in this space to make informed decisions.

It also prevents them from pinpointing a single source of truth to achieve ESG compliance. Ultimately, many EFS firms struggle to integrate ESG considerations into their due diligence process.

They must be more aware of ESG metrics and standards relevant to them and their respective partners or investments to deal with this challenge. They must also implement the reporting process, choose the right reporting tools, and design the architecture for effective ESG reporting.

## ***Supply/Demand gap for skilled ESG professionals***

ESG considerations are a key focus area for EFS regulators, customers, investors, and directors and will remain so in the foreseeable future. To keep up with these demands, EFS companies need seasoned ESG talent.

The demand for skilled and knowledgeable ESG professionals is booming across the board. Companies require experts who can collect and disseminate data for ESG reporting and incorporate critical ESG considerations to add value to the company's business strategy.

However, according to one 2020 [survey](#) by the CFA Institute, this demand seriously outpaces supply. Thus, while companies can find mid-level professionals individuals who can coordinate ESG data, they can't quite find experts who can:

- ▶ Lead EFS teams to merge and coordinate efforts
- ▶ Deal with different types of stakeholders
- ▶ Position the company's reporting and strategy based on investors'/regulators' requirements

- ▶ Drive sustainable outcomes based on a thorough understanding of the interconnected worlds of business, finance, strategy, and regulations
- ▶ Ensure that the firm can meet its responsibilities
- ▶ Help investors achieve their ESG-driven investment goals

The recruitment process for ESG experts is also more complex in EFS because there is a lack of understanding of what skills ESG professionals should have.

## ***Location-specific ESG expectations***

Although ESG implementation is accelerating worldwide, different regions prioritize the various ESG elements differently.

KPMG Internationals 2021 publication, [ESG Risks in Banks](#), noted that,

*"The identification of ESG risks highly depends on location. The physical dangers that banks and their customers see themselves exposed to (e.g., weather damages to assets, danger to employees due to political unrest, or the effects of persistent droughts) are, of course, determined by which locations are particularly important for maintaining the respective businesses."*

Similarly, on the investment side, a [2021 survey](#) of 140 global private equity LPs found that:

- ▶ European asset allocators focus on environmental concerns and climate-related disclosures.
- ▶ North American asset allocators focus on social concerns, including Diversity, Equity and Inclusion (DEI), and board diversity.
- ▶ APAC asset allocators view governance as a critical ESG focus area.

These differing expectations have tangible real-world implications for EFS companies and make it challenging to identify metrics that can be universally applied to normalize the data collected during the due diligence process.

## ***Mandatory ESG regulations are still in progress***

All over the world, risk and due diligence professionals in the EFS space rely on data-driven disclosures to identify companies that align with their ESG goals and thus make meaningful investment or partnership decisions.

However, a lack of such disclosures constrains their decisions. Thus, many countries will soon enact legislation that requires companies to disclose information on ESG issues, with the goal of:

- ▶ Helping due diligence professionals to gain access to relevant ESG information to inform their evaluation
- ▶ Enabling companies to demonstrate the tangible impact of their ESG initiatives
- ▶ Minimize the risks of greenwashing

These disclosures are often a part of traditional financial disclosures or provided in standalone forms such as within corporate social responsibility (CSR) reports.

For instance, in mid-2021, the U.S. House of Representatives passed the *H.R.1187 – the ESG Disclosure Simplification Act of 2021* to impose new ESG due diligence and disclosure requirements on public companies.

The EU parliament also passed legislation in 2021 around mandatory ESG due diligence and disclosures for both small and large companies operating in the EU.

Some other countries – particularly those where large multinational companies are domiciled – are also moving towards mandatory ESG due diligence and disclosures.

Mandatory reporting is still irregular and highly localized despite these efforts, and most ESG disclosures remain largely voluntary. For instance, the U.S. SEC does not require companies to disclose information about their ESG commitments or adhere to a standard taxonomy to disclose such information.

The current lack of mandated requirements reinforces the decision by some organizations to put off ESG concerns while simultaneously leaving those who would like to be proactive with no source of truth to incorporate ESG into their due diligence processes.

### ***Information requests are complex and numerous***

In the current ESG climate, risk and due diligence managers must contend with multiple stakeholders requesting the same type of ESG information (along with other risk and due diligence data), albeit in different formats.

As the volume of these requests increases, these professionals must not only manage these large number of requests but also meet specific expectations around reporting formats.

This significantly burdens these managers and distracts them from other high-value tasks.

## *A need for solutions to streamline ESG due diligence and risk monitoring in the EFS sector*

In a space where asset managers and network managers alike are looking to expand their relationships, partnerships, and investments to support growth, it has become critical that risk and due diligence programs also be scalable.

This is only possible with the right technological solutions to streamline and automate workflows.

In the new and evolving ESG landscape, they also need to build a flexible ESG assessment framework that allows them to use external data and ESG ratings to:

- ▶ Identify the ideal business opportunities (while also pinpointing riskier ones)
- ▶ Perform due diligence on these investments
- ▶ Monitor and measure their sustainable investing activities

## ■ NEXT STEPS FOR ESG DUE DILIGENCE AND RISK MONITORING IN EFS

Recent developments around ESG considerations, compliance, and reporting have created a need for a standardized and defensible due diligence framework for the EFS sector. While a sole standard has yet to be identified, we're seeing leaders in the EFS sector prepare in the following ways.

### *Integrating ESG factors into the assessment process*

Despite the lack of standardization, some are setting the tone for the rest of the pack by evaluating which ESG factors are most relevant based on region and beginning to incorporate those into their evaluations and certification processes.

Risk and due diligence professionals are now expected to integrate sustainable practices into their processes and assess the extent to which this is being done by potential investments, custodians, and business partners.

To this end, they must consider such aspects as:

- ▶ What ESG initiatives are or should be deployed,
- ▶ Which disclosure and reporting frameworks are being used to measure progress and adherence, and
- ▶ All party's level of preparedness for regulatory reporting requirements (current and upcoming).

In addition, it's worth noting that more organizations are getting requests to forgo ESG questionnaires, a common option in recent years, in favor of a more in-depth consultative process. This is likely due to the need for risk professionals to have more control, visibility, and validation into ESG reporting.

## *Determining impact metrics for sustainability and DEI initiatives*

In the ESG era, impact metrics and KPIs around these initiatives are becoming increasingly important, with common considerations being:

- ▶ How is the impact measured?
- ▶ What goals does it align with?
- ▶ What are the known gaps, and how can we develop portfolio or network-wide assessments?

For this, risk and due diligence professionals are asking how impact should be measured and which factors are most relevant to strategic business goals and the particular region. For example, many are now requesting carbon footprint evaluations done on portfolio companies.

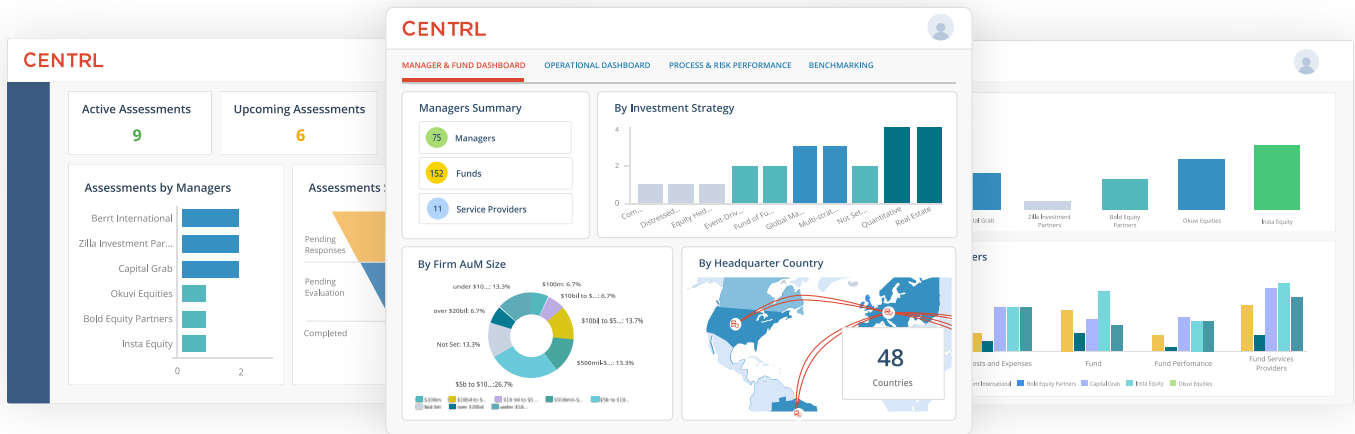
They're also thinking ahead to how these metrics can be applied across the portfolio or network for data normalization.

# ■ DD360 AND BNM360: STREAMLINING ESG DUE DILIGENCE AND REPORTING FOR FINANCIAL SERVICES FIRMS

The co-mingling of ESG, risk management, and due diligence evaluation has spawned a need, particularly in the enterprise financial services sector, for digitized and automated solutions that can help simplify and streamline these workflows.

CENTRL offers two advanced platforms to assess ESG risks and perform due diligence for asset management and global bank network management sectors of enterprise financial services.

# DD360



DD360 simplifies operational due diligence for investors, fund managers, and consultants and empowers them to implement due diligence best practices in their workflows.

With this cutting-edge operational due diligence software, users can seamlessly manage their due diligence workflows from one centralized, multi-party platform. It completely automates DDQ and RFI processes to significantly improve efficiency and eliminate time-consuming and unscalable manual due diligence processes.

The platform automates scoring to speed up the auto-evaluation of most submissions while notifying you only about select issues requiring further attention. It also provides auditable reporting and a centralized document repository for your DDQ and certification documentation.

With DD360, our customers have experienced up to 50%+ increased efficiency along with significant cost savings from inefficient, manual processes.

To see DD360 live, [schedule a demo](#) with the CENTRL team.

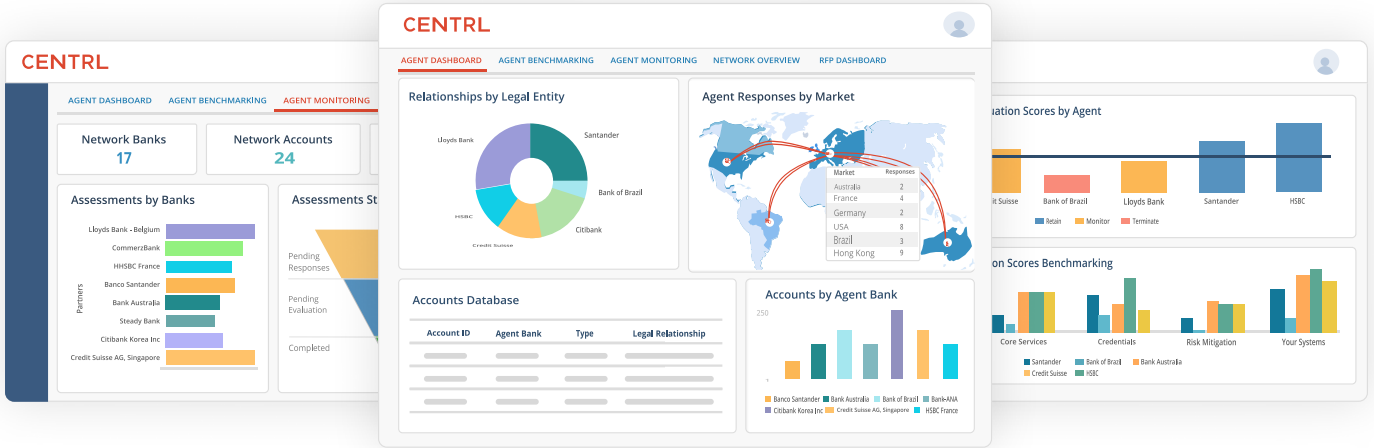
“ Now, it’s all there on the system, we can see where everything is and where it is at in the process... Process is far smoother. It saves our team a couple of months each year now. And, given the reduced back-and-forth over email and excel spreadsheets, it generally reduces the time it takes us to do our weekly, monthly, quarterly, and annual reporting activities by about 50%.

- Global Fund of Funds

“ We looked at all the due diligence solutions in the market and chose CENTRL because it was the most complete solution. It is very easy to use, has the greatest depth of functionality and analytics and provides flexibility to adapt it to our process.

- Leading Due Diligence Consultant

# BNM360



Traditional, manual bank network management processes cannot keep up with new and evolving banking network management trends.

BNM360 resolves this challenge by providing a comprehensive platform that can be used to automate much of the tedious manual follow-up involved in certification, risk monitoring, and due diligence processes.

With BNM360, network managers can analyze risks in real-time and easily oversee custodian monitoring across their expanding network. Just a few of its most valuable features include:

- ▶ [DDQ Monitoring & Issue Management](#)
- ▶ [Master Agent Bank & Account Database](#)
- ▶ [Account Opening and Closing Workflows](#)
- ▶ [Tracking of Issues & Resolution Management](#)
- ▶ [Account Re-certification Processes](#)
- ▶ [Detailed Analytics & Dynamic Dashboards](#)
- ▶ [Complete Platform For Agent Banks To Respond](#)

BNM360 is helping some of the largest global banking networks to achieve cost and efficiency savings of over 70%.

[Schedule a demo](#) of BNM360 to see it in action.

“ We had far too many manual workarounds with the current system and decided to take a look at CENTRL. During the demo, every time we asked if the system can do this or that, they showed us the functionality. We were all very impressed.”

- Network Management Specialist, Global Bank

“ CENTRL has met and in most cases exceeded every benchmark we had for cyber security and resilience. I am frankly surprised how quickly they were able to gain approval.”

- IT Director, Global Bank

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