Future Leaders Presentation:

Developing a Client Due Diligence Questionnaire for Sustainability Purposes

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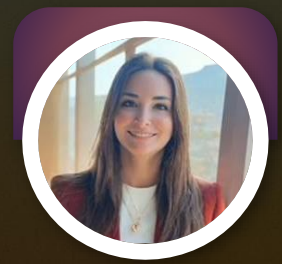

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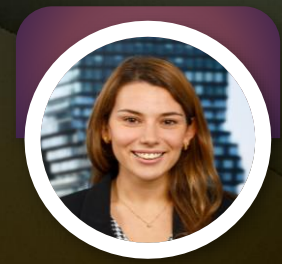

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Developing a Sustainability DDQ

Objective: Standardizing the Sustainability-linked data collection process to help Financial Institutions in supporting their Corporate Clients during their Sustainability journey

Why develop a Sustainability DDQ?

Enabling a widespread provision of Sustainable Transaction Banking solutions starts with an effective client Due Diligence (DD).

The adoption of a minimum DD standard can drive effectiveness by minimizing clients' efforts in sourcing, sharing and enabling independent validation and comparability of Sustainability data.

It would ultimately accelerate the convergence towards globally recognized common standards for Sustainable Transaction Banking.

What did we develop?

An "off-the-shelf" tool to support both Sales and Risk Management functions that embed the inherent complexities of an ever-evolving fragmented regulatory landscape

A flexible tool that can be leveraged in many ways including:

- Basic reviews for sales pitching and onboardings covering 12 Industries
- detailed assessments supporting transaction structuring and execution
- ongoing risk monitoring

How would it add value to Banks?

The DDQ would help Banks in gaining a deeper understanding of their Clients' Sustainability sophistication and maturity, leading to a targeted and ongoing sales engagement.

The DDQ can also be used as a tool to simplify reputational & greenwashing risk management

With standardized Sustainability reporting disclosures being more present, the information requested during the DD process can be leveraged by Corporates reporting purposes – this would make the process beneficial to Corporates as much as it is for Banks

Regulatory Landscape

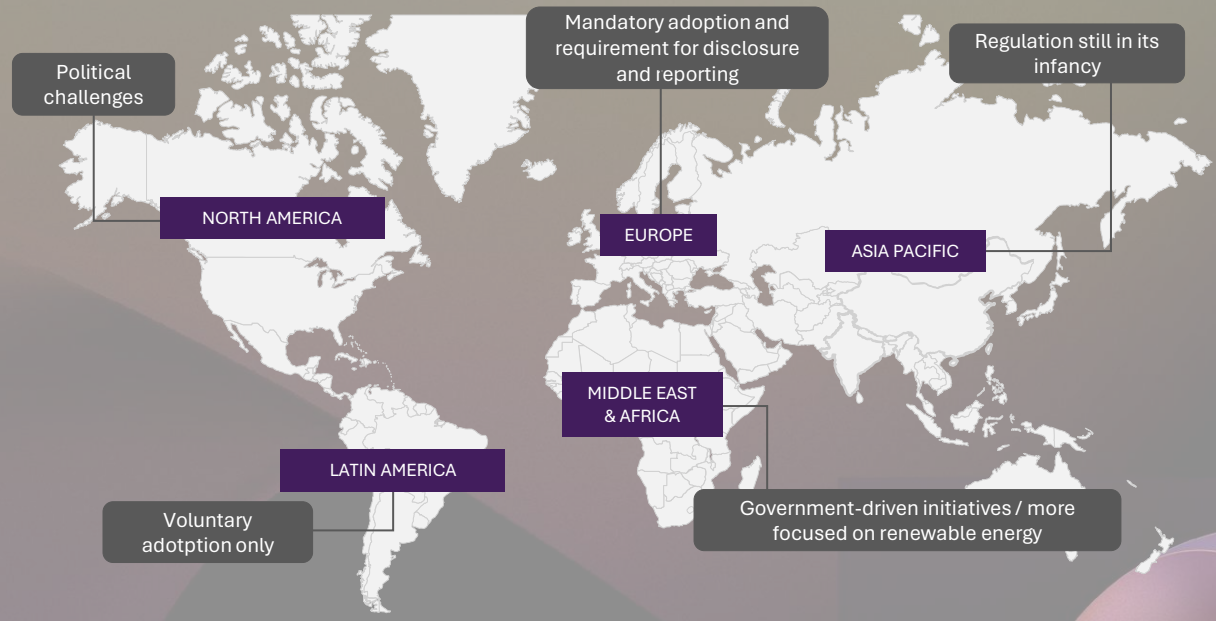
Key Findings

- The Regulatory landscape will continue to evolve; However, there is a significant variation in terms of speed, scope and stringency of Regulations across the globe.
- Fragmented Regulatory backdrop presents a major challenge for global businesses.
- Regulatory driven vs Incentive driven approach to reach Net Zero transition (i.e EU approach vs US)
- Strong case for regulators to strive towards a high level of international alignment, but there are differences among countries in terms of economic development, investment needs, maturity of financial markets and regulatory regimes.

Key Similarities

- Transparency and disclosure
- Government level sustainability agendas exist & drive regulation
- Sustainability Reporting Requirements
- There is an ambition among regulators to align regulation across geographies and drive standardization

Key Differences & Challenges



Fieldwork – SME Interviews

Interview Methodology

Key Themes and Findings

Regulatory Requirements:

- Generally fractured global requirements leads to confusion
- Demand for increased global legislation
- Opportunity to leverage best practices of SFDR and CEQA

Sustainability Frameworks:

- Few leading global frameworks
- Many frameworks still developing
- Limited Accessibility
- Too many models makes it difficult to achieve standardization and progress

Data Collection

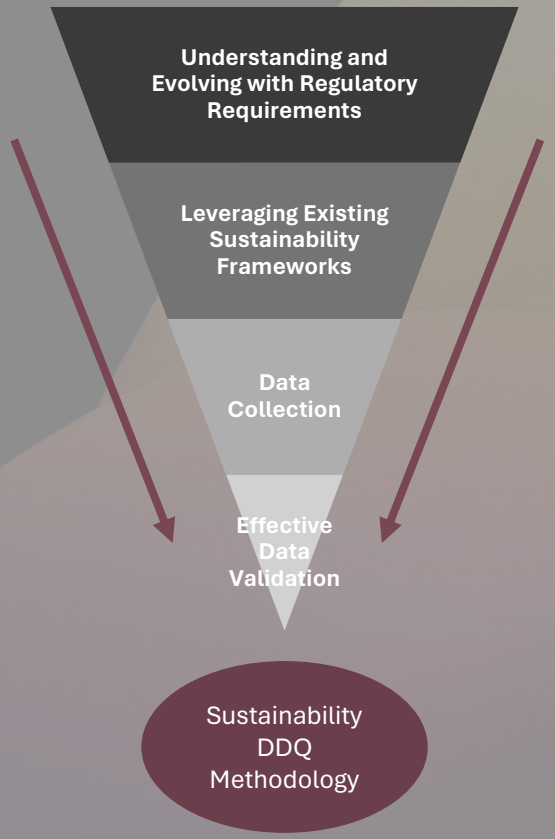
- Ensure equal weight on Environmental, Social and Governance aspects
- Standardize data collection across client segments /type (e.g. private corporates should be asked to provide similar information than a publicly listed entity)
- Request disclosure of association or accreditations with external industry association and disclosures required as part of that

Data Validation

- Request corporates to ensure data sources are varied (corporate, third party providers, accreditations and industry associations)
- Include questions on methodology applied and request for explanation on differences
- Include questions on whether sustainability framework and disclosures are audited and request the provision of such report findings.

Sustainability DDQ - Methodology

Critical Building Blocks for Sustainability DDQ



The regulatory research and findings together with the fieldwork supported us in defining key objectives for the Sustainability DDQ:

The DDQ should define a minimum standard for the BAFT community and provide an off-the-shelf solution for small banking and corporate counterparties.

The benefit from setting a minimum standard and encouraging wide adoption is that we can increase the **speed of adherence of minimum standard across the industry**.

The Sustainability DDQ should address the following key aspects:

1. **Regulatory considerations:** regulations, existing disclosure requirements, emerging regulations etc. Approach with global lens which allows for industry or regional differences.
2. **Leveraging existing frameworks**: review available Sustainability DDQs, avoid duplication. Leverage existing 3rd party assessment and models. (e.g. incorporating TCFD, TNFD and HIGG index)
3. **Data collection:** standardized data collection across client segments and industries, request disclosure or association memberships, accreditations, 3d party assessments etc.
4. **Data Validation:** Ensure data can be corroborated through 3rd party assessments or audited reporting.

Sustainability DDQ

This DDQ was developed to evaluate the Sustainability Performance of the Client for Risk Management and decision-making purposes

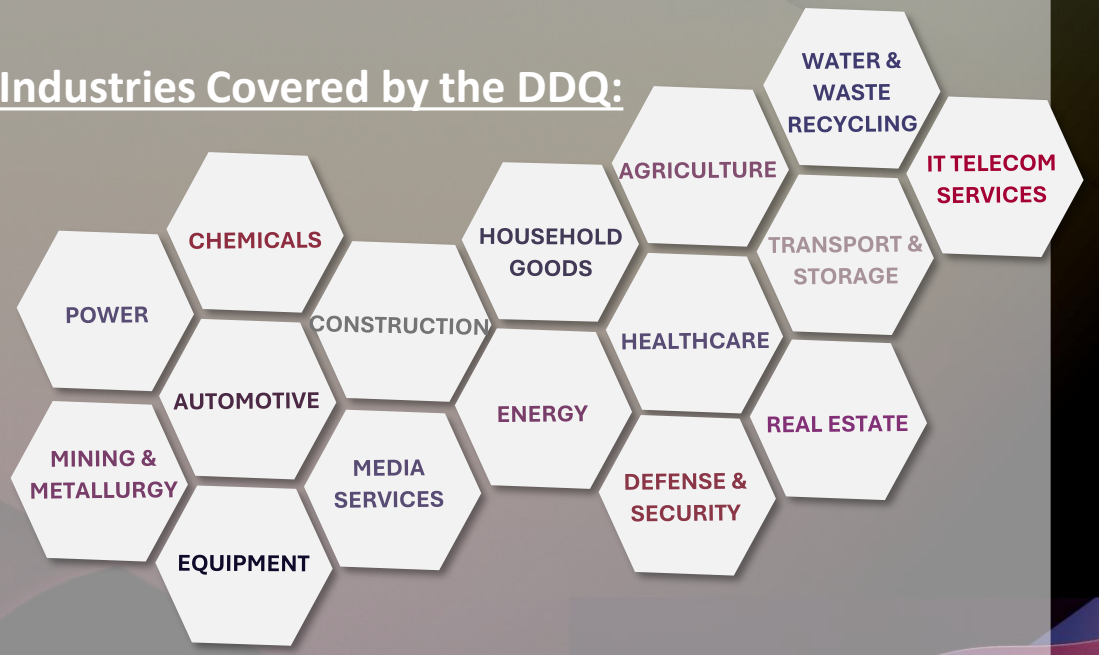
The Assessment is conducted by focusing on **3 key** pillars

1. Corporate Governance Pillar
2. Climate, Biodiversity & Environmental Pillar
3. Human Rights & Social Pillar

This DDQ should be filled by the Client's Relationship Manager (RM) using both internal and external sources; The responses will subsequently be evaluated against the below rating criteria:

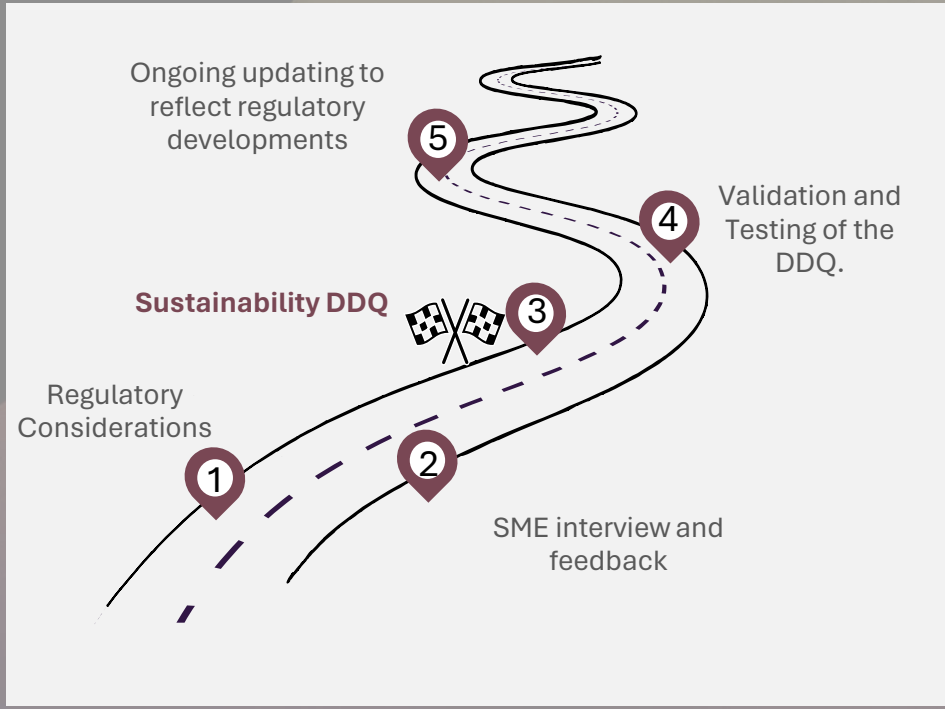
1	2	3	4	5
Very High Risk	High Risk	Moderate Risk	Low Risk	Minimal Risk
Insufficient Information	Below Industry Standard Practice	Slightly Below Industry Standard Practice	Industry Standard Practice	Industry Leader

Industries Covered by the DDQ:



Conclusion

"Sustainability is a trade-off. If you look at the UN SDGs, the goals are not mutually exclusive. Achieving one goal may worsen another, achieving all at once is extremely difficult, if not impossible" – SME Expert from a G-SIB



We see the role of BAFT as a leading organization that can support the adoption sustainability practices, with the DDQ being an integral part of that.

More specifically, we believe the real value-add of such DDQ is to raise the bar and set a minimum standard for corporate and banking counterparts across geographies and industries

Our white paper aims at providing a methodology to which a Sustainability DDQ can be derived. We recommend further work to be performed on the DDQ and propose testing and validation with industry SMEs and corporates from varying industries.

It is important to note that Sustainability is under a fast-changing regulatory environment and the model which would need to be reflected on the DDQ over time

Meet the team!

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