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SOLUTION BRIEF

TCS ESG INTEGRATION SOLUTION

Simplifying ESG Portfolio Construction

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Ashley Longabaugh

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WHY IT MATTERS

Environmental, social, and governance (ESG) investing is becoming increasingly popular among global financial institutions and investors. Two major forces are behind the growing trend of ESG investing: subpar growth across the wealth management industry seeking alternative growth for assets under management (AUM), and investors' desire to create a more positive social impact through their investment choices while receiving long-term financial returns. However, ESG data ratings lack standardization, quality, and audited and timely data. Tata Consultancy Services (TCS) aims to solve for the data quality issue by offering a bespoke ESG data integration framework that serves as a container for aggregating and reconciling third party data. The TCS ESG Integration Solution is designed to address the industry's concerns around unclear data ratings and misaligned scoring correlations. Celent believes that the solution is differentiated from other offerings in the market by its ability to sanitize data from leading data providers. The solution also provides much-needed transparency across the ESG data ratings process, particularly during portfolio construction. ESG investing has increased in popularity over the last couple of years, driven by demand among financial institutions (FIs) and retail investors.

COVID-19 has highlighted unsustainable business practices and how they are interconnected and impact the supply chain, biodiversity, and treatment of employees. The demand for sustainable investing is driven by financial institutions (FIs) and retail investors. Europe has traditionally been the leader in ESG investing, particularly on the regulation front; the United States is catching up quickly.

The wealth management industry continues to face margin pressure, which has been exacerbated by the pandemic. To align with investor demand and grow AUM, wealth managers are offering diverse investment strategies, launching new sustainable funds, and converting existing funds into sustainable ones. The ESG market grew to more than \$30 trillion in 2018, and estimates show that it could reach \$50 trillion over the next 20 years¹. Celent's research shows that the US and the UK will account for approximately 80% of the market share for ESG investing.

Retail investors increasingly express a desire to create a positive social impact through their investment choices while adding value to their long-term investments, and ESG investing has become the backbone of many investors' portfolios. Although

¹ Global Sustainable Investment Alliance

millennials are often thought to be drawn to ESG investing at a higher rate than other generations, ESG investors span generational cohorts.

While the demand for ESG and sustainable investing from FIs and investors is high, there are a host of challenges around ESG data ratings and in creating sustainable portfolios. In the end, transparency and standardization of data will mitigate doubt that ESG investing is simply a marketing ploy. Figure 1 identifies some of the key business focus areas for firms moving to sustainable investing. The TCS ESG Integration Solution aims to address each of these critical focus areas.

Figure 1: Key Business Focus Areas for Firms to Move to Sustainable Investing



Source: TCS

Context

ESG has gone mainstream, and the European Union's new Sustainable Finance Disclosure Regulation (SFDR) went into effect March 10, 2021. SFDR imposes new rules around transparency and reporting requirements for investment management firms at the product and manager level. Although sustainable investing is gaining momentum, the sheer volume of data that is incorporated into an ESG rating is hard to process and can result in questions about a rating's accuracy. To discuss these issues, Celent connected virtually in January 2021 with Subramanian Kuppuswami, head of TCS' Sustainable Banking, Finance & Insurance (BFSI) business unit, for a briefing and demo on the TCS ESG Integration Solution.

Company and Solution Overview

Tata Consultancy Services is an IT services, consulting, and business solutions organization that has been partnering with many of the world's largest businesses in their transformation journeys for more than 50 years. As noted in Celent's [TCS profile in VendorMatch](#), TCS offers a consulting-led, cognitive powered, integrated portfolio of business, technology, and engineering services and solutions delivered through its Location Independent Agile delivery model.

A part of the Tata group, India's largest multinational business group, TCS employs over 448,000 consultants in 46 countries. The company generated consolidated

revenues of US\$22 billion in the fiscal year ended March 31, 2020, and is listed on the BSE (formerly Bombay Stock Exchange) and the NSE (National Stock Exchange) in India.

The TCS ESG Integration Solution has been available to TCS customers since September 2020. The solution leverages cognitive technologies and AI/ML algorithms that enable an agnostic and transparent view of ESG performance of assets and investments.

The TCS ESG Integration Solution is primarily leveraged by banks and investment and asset management firms. Most FIs have been investing in building an ESG strategy and research teams in addition to sector-specific ESG expertise within their businesses, and these will be the typical users for the TCS ESG Integration Solution.

KEY BRIEFING TAKEAWAYS

The TCS ESG Integration Solution is a bespoke framework designed to sanitize and reconcile data ratings from major ESG data providers by leveraging today's transformative technology, such as cognitive technologies and AI/ML. The model creates a 360-degree view of the ESG performance of assets and investments.

TCS ESG Integration Solution: Key Facts

Celent believes that the solution has a robust indicator library and data acquisition and analytics capabilities. The solution's key features include:

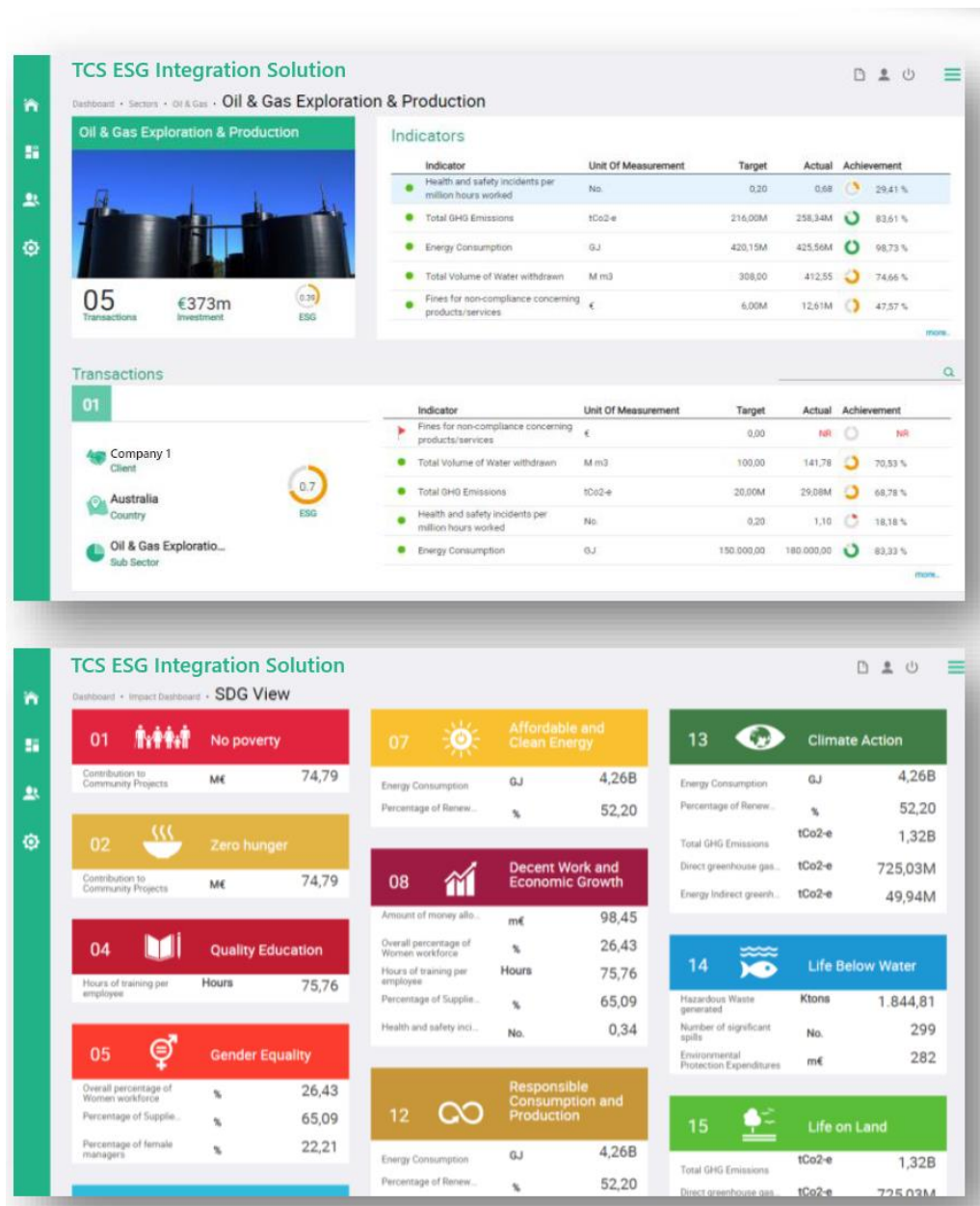
- Offer 300-plus indicators (whereas competitors offer fewer) across environmental, social, and governance parameters.
- Set portfolio monitoring targets around qualitative and quantitative indicators against regulatory standards.
- Add new indicators and/or create an indicator stack specific to the FI's ESG objectives, thereby creating a truly bespoke and customizable tool for portfolio managers.
- Capture unstructured data from multiple formats such as tables, images, or sentences; capture structured data from public disclosures, such as annual or sustainability reports.
- Normalize qualified through data homogenization algorithms.
- Track the origin of data for increased transparency.

Differentiators

The ratings market consists of data providers that broadly lack material ESG considerations that factor into an ESG score or niche ESG solution providers that offer curated ESG solutions and services to FIs. The TCS solution goes one step further by contributing directly to scoring methodologies on a deeper and more holistic level.

Celent notes the importance of real time access to ESG research and data and the automated sourcing of data. As such, a truly integrated ESG platform that offers these capabilities and is backed by automated machine learning capabilities to create custom ESG scoring is critical to achieving sustainable investing. It is important that these ESG indicators and weightings are customized to clients' preferences. The ability to decipher alternative sources of data accurately and in real time is a pillar of an effective platform.

Figure 2: TCS ESG Integration Solution Overview



Source: TCS

The TCS ESG Integration Solution has been leveraged by various organizations across industries. TCS' European banking and investment management clients have used the tool to assess the sustainability performance of assets and track the ESG performance of their investment portfolios. The intent of the platform is to give each organization the flexibility to control what it wants to achieve from a ratings perspective. For example, if an asset manager decides, "I want to invest in companies that are at a certain level of emissions," they are able to do so. This level of detail is not available from other providers. As mentioned above, targets can be set against

regulatory standards or suggested thresholds, which is also unique to the TCS solution.

Celent also highlights the platform's inherent ability to reconcile inaccuracies between reported targets and regulatory standards. Figure 3 is a snapshot demonstrating how the platform can flag unreported data. The "actual" column is what the company is reporting, while the "target" is where the company should be; one can see that "business units analyzed for corruption risk" is not reported. The issue is that the lack of reporting on key indicators leads to a misaligned ESG rating and inaccuracies across ratings for all companies; companies may still receive a high ESG score despite not disclosing all data. TCS achieves this type of data sanitization using ML-based scoring.

Figure 3: TCS ESG Integration Solution Indicators

Indicator	Unit Of Measurement	Target	Actual	Achievement	Year
GHG Emissions	1Co2-e	18,500.00	22,525.00	82.13 %	2019
Energy Consumption	GJ	252,277.20	242,359.20	104.09 %	2019
Lost Time accident	hours/million hours worked	0.50	2.87	17.42 %	2019
Business units analyzed for corruption risk	%	0.00	NR	NR	NR
Water withdrawn	M m3	0.16	0.16	100.00 %	2019
Child labor incidents	No.	0.00	0.00	100.00 %	2019
Percentage of Women Board members	%	50.00	38.00	72.00 %	2019
Significant fines and sanctions	EUR	0.00	0.00	100.00 %	2019

Source: TCS

There is a gap in the ESG data ratings market for deeper and independent ESG integration that can drive business decisions. Currently, traditional data providers do not offer deep insights into the material considerations or the components contributing to an ESG score, while newer and data-driven platforms offer curated ESG solutions and services to financial institutions for their portfolio of investments. The TCS ESG Integration Solution seeks to address this emerging market need by leveraging cognitive technologies to enable transparent and holistic ESG integration. The TCS ESG Integration Solution has the capability to pull the ESG scores and insights, if available, from the traditional external data providers, enabling a 360-degree view of ESG insights for banks and financial institutions. Currently, banks and financial institutions rely on independent rating agencies that give summarized ratings and/or their own manual research on companies' ESG performance, which is time consuming, tedious, and highly intensive due to the volume and highly unstructured nature of the data. The TCS ESG Integration Solution is a digital solution that will accelerate the financial institutions' objectives of integrating transparent ESG considerations into their business and investment strategies.

Opportunities and Focus Areas

The drivers for embracing sustainable investing are clear; however, wealth managers face multiple challenges in the adoption of sustainable investing. Notably, the issue of data quality stands out as the primary obstacle to achieving truly sustainable investing. The opportunities and focus areas listed below range from industry hurdles to FI-specific challenges.

Industry

Lack of Transparency

There is uncertainty around ESG ratings due to the lack of visibility of the underlying data. Regulation is insufficient, but this is changing for the better as the issue becomes more evident and FIs and investors demand a unified response.

Lack of Standardization

There are dozens of ESG data providers and rating agencies that provide ESG risk ratings or scores. However, there is a distinct lack of standardized scoring methodologies, which leads to inconsistent ratings for the same company.

Widespread “Greenwashing” and Inconsistent ESG Disclosures

“Greenwashing” describes when a company or person provides misleading information about the impact of their activities on the environment. ESG scoring is heavily dependent on the interpretation of disclosures and is often self-reported, which can lead to increased “greenwashing.” The inability to benchmark and compare a company’s ESG disclosures with those of peer companies affects investment decision-making and increases risk.

FI Adoption of the TCS ESG Integration Solution

One of the challenges that vendors encounter is the lack of a clear ESG strategy from financial institutions. While the TCS ESG Integration Solution addresses the challenges of lack of a common methodology and the abundance of unstructured ESG data, FIs need to be certain about what is material to their ESG decisions. The TCS ESG Integration Solution is built based on a loosely coupled microservices architecture with built-in application programming interfaces (APIs), enabling flexible implementation and integration with the existing core systems of financial institutions. This flexible architecture and “API-ification” enable the solution to seamlessly interface with other ESG data sources, resulting in a 360-degree view of ESG insights².

TCS ESG Integration Solution

The industry is calling for a solution that facilitates transparent ESG scoring, particularly one that is bespoke to the portfolio construction process. With ESG integration capabilities at the core of its new solution, TCS has created capabilities for offering a 360-degree view of ESG insights, tracking real time, on-speed ESG data to offer a leading indicator for ESG performance and an Investment Insights solution that offers a holistic view of investment portfolios, combining financial and nonfinancial ESG parameters. The platform offers a sandbox for portfolio managers to experiment with portfolio construction as it pertains to ESG scoring, fund performance, tracking against regulatory standards, and other critical components.

One of the hurdles that providers, including TCS, will encounter is the need to continually update their frameworks to stay relevant in the face of the quickly evolving ESG regulatory domain. Additionally, as an increasing number of data providers open

² TCS

their ESG datasets, the sheer data volume set will become enormous; thus, the ability to seamlessly decipher billions of data points to build a harmonized 360-degree view of ESG will become critical. This point is something TCS plans to address in future iterations of the solution.

While the solution is bespoke to the client, Celent foresees a potential focus area around the application of the TCS standard methodology in which users can modify the determining factors for scoring.

Path Forward

The undeniable shift toward sustainable investing among FIs, wealth managers, and investors is a cause for celebration, albeit a cautious one. There is much work to do to overcome data quality issues, such as the lack of standardization, vague scoring methodologies, and overall “greenwashing” across the industry. With options such as the TCS ESG Integration Solution, the industry is one step closer to overcoming these hurdles and making sustainable investing a reality for institutional and retail investors.

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For more information please contact info@celent.com or alongabaugh@celent.com

Americas

USA

99 High Street, 32nd Floor
Boston, MA 02110-2320

[+1.617.262.3120](tel:+16172623120)

USA

1166 Avenue of the Americas
New York, NY 10036

[+1.212.345.3960](tel:+12123453960)

USA

Four Embarcadero Center
Suite 1100
San Francisco, CA 94111

[+1.415.743.7960](tel:+14157437960)

Brazil

Av. Dr. Chucri Zaidan, 920
Market Place Tower I - 4° Andar
Sao Paulo SP 04583-905

[+55 11 5501 1100](tel:+551155011100)

EMEA

Switzerland

Tessinerplatz 5
Zurich 8027

[+41.44.5533.333](tel:+41445533333)

France

1 Rue Euler
Paris 75008

[+33 1 45 02 30 00](tel:+33145023000)

Italy

Galleria San Babila 4B
Milan 20122

[+39.02.305.771](tel:+3902305771)

United Kingdom

55 Baker Street
London W1U 8EW

[+44.20.7333.8333](tel:+442073338333)

Asia-Pacific

Japan

The Imperial Hotel Tower, 13th Floor
1-1-1 Uchisaiwai-cho
Chiyoda-ku, Tokyo 100-0011

[+81.3.3500.3023](tel:+81335003023)

Hong Kong

Unit 04, 9th Floor
Central Plaza
18 Harbour Road
Wanchai

[+852 2301 7500](tel:+85223017500)