As published in 'Fintech News' on February 21, 2022

ESG and Fintechs: Technology enables impact goals

By Sasha Grutman, Demetris Papademetriou, and Rishabh Madhok

The current surge in ESG ("Environmental, Social, and Governance") investing has influenced a material shift in the Financial Services sector. Whether it's the billions of Dollars being invested in green and sustainable instruments, serious institutional efforts to address ESG as a risk factor in lending and investing, big banks restructuring themselves to adopt net zero pledges, or fintechs developing new solutions to address climate-related issues, all these efforts point to recognition that the Financial Services Industry can play a major role in addressing ESG objectives.

As merchant bankers focused on Financial Services and impact investing, Middlemarch Partners believes that ESG-focused fintechs have a unique ability to achieve rapid growth, deliver ESG-focused innovation, and attract investment capital to support their efforts to improve the environment and society while generating substantial returns.

We believe that major financial institutions in their effort to adopt these ESG tenants, will be compelled either to partner with these sustainable fintech firms or to invest/acquire them to gain an upper hand with their industry peers.

VC interest in ESG-related fintechs has surged in the last twenty-four months. MasterCard issued a report which stated that venture funds deployed approximately 2.5 times more equity into ESG-related fintechs in 2020 relative to what they invested in 2019 (from ~$0.7B to ~$1.8B). Middlemarch believes this trend will continue as earlier stage ESG fintechs mature (and need growth equity) and more innovative fintechs enter the market to address unmet ESG needs in the financial services industry.

Rise of Climate Fintechs

Climate action – addressing damage done to the environment by human activities– is perhaps the most talked about and researched topic among all the Sustainable Development Goals promoted by the United Nations and embraced by ESG investors and thought leaders. There is no surprise then, that Climate Tech was one of the fastest sub-sectors to emerge within Fintech. While there are many interesting segments in this space, we focus on banking and lending as well as payments, investing, trading and risk analysis. For each segment, we present unique companies that are building innovative products to tackle climate change through financial innovation.

Banking

Over the last few years, some of the largest and most influential banks globally have committed to reducing emissions attributable to their operations. They have also pledged to reshape their lending and investment portfolios to produce a net zero carbon footprint by 2050. Although it remains to be seen how much this 'Net Zero Banking Alliance' can actually achieve among the largest banks, Middlemarch believes next-generation fintechs are winning the battle for ESG-focused consumers who choose their banking providers based on the strength of their ESG-related banking products and their ability to address climate-related objectives.

One traditional financial institution that is taking actions to advance ESG goals in a material way is Amalgamated Bank, a US-based regional bank. It is a great example of a traditional bank focused on sustainability. A net-zero bank powered by 100% renewable energy, Amalgamated Bank believes in supporting sustainable organizations, progressive causes, and social justice. It does not lend to fossil fuel companies, and 24% of its loan portfolio is dedicated to climate protection loans and PACE financing (e.g., financing for energy efficiency upgrades, water conservation upgrades). Amalgamated Bank has made tangible progress in aligning its long-term business to achieving Paris Climate Agreement targets. Amalgamated Bank offers a strong business case for how a bank can deliver against socially responsible investment objectives.

A compelling example of a fintech using ESG to market as well as to address environmental issues is Aspiration Bank, a US-based, online-only fintech which offers a 'Spend & Save' cash management account (CMA) where the deposits are not used to fund any oil and gas projects. It also offers a zero-carbon footprint credit card which claims to plant a tree every time a purchase is made from the card. The bank is set to go public in a $2.3B SPAC transaction later this year. With celebrity investors like Leonardo DiCaprio, Orlando Bloom, Robert Downey Jr. and Drake, a multi-million sponsorship deal with Los Angeles Clippers and a multi-billion SPAC in process, Aspiration Bank sets the tone for high-profile, ESG-linked fintechs to disrupt the banking industry by attracting a younger and more environmentally oriented consumer demographic.

Similarly, Ando, a US-based, online banking platform, invests customers' deposits exclusively in green initiatives like renewable energy and responsible agriculture. By allocating more than $12M of its customers' money to green loans since launch, Ando has empowered its users to make meaningful impact with their savings. Launched in Jan 2021, the Company announced a $6M seed round in Oct 2021, with over 30,000 customers.

Lending

The financial services sector that has most embraced ESG-related efforts is Debt Financing. There have been many green bonds and sustainability-linked loans issued. In additional to these bonds and loans that are promoted by large financial institutions, specialized fintech lending companies are emerging that focus on sustainability and have developed dedicated lending platforms and products to address the ESG objectives of their consumer clients.

Both Goodleap and Mosaic Inc. are excellent examples of lending platforms focused on financing sustainable home improvements. Goodleap, America's top point-of-sale platform for sustainable home solutions, offers home upgrades with flexible payment options. With more than $9B in loans deployed through its platform, the Company is valued at $12B post its recent $800M capital raise. Mosaic is a leading financing platform for US residential solar and energy-efficient home improvement projects. The company surpassed $5B in loans through its platform in July 2021 as well as closed its 10th solar securitization — more than any other solar loan issuer in this space. Both these platforms offer simple financing solutions for their customers and are poised to capture a critical component of the sustainable lending market in the years to come.

Carbon Zero, a US-based credit card issuer, offers a simple way for customers to offset their carbon impact. The credit card fee collected by the Company is invested in industry-leading forestry and carbon capture projects instead of environmentally harmful ones. Users can automatically neutralize their carbon footprint and achieve a Carbon Zero lifestyle. Incumbent credit card provider Visa recently announcing a similar card program called FutureCard which offers 5% cashback on green spending to reward consumers who demonstrate ESG-supportive purchase behavior.

Payments

Climate Fintechs in the payments segment focus on influencing the spending and shopping behavior of consumers to help influence them towards embracing brands, companies, and practices which both are more sustainable and help reduce their consumer carbon footprints. And while all these offerings advance ESG objectives, they also help Climate fintechs attract a key demographic segment and sustain their transaction revenue by aligning financial transactions with ESG goals.

Ecountabl is a US-based, purpose-driven tech company that helps consumers shop and spend on brands and companies that align with their social and environmental goals. Ecountabl seeks to make consumers more aware of their spending tendencies. Users can connect their credit card or bank account to Ecountabl so that it can monitor the ESG impact of their purchases. Ecountabl achieves this by maintaining one of the largest databases in the world monitoring the level of ESG adoption for brands and employers. The Company is venture backed with funding from CRCM Ventures.

Meniga, a UK-based Company, focuses on addressing the issue of carbon emissions produced by consumer spending patterns. It offers a carbon insight platform that banks can use to inform their customers about their carbon footprint based on their spending. The platform also helps offset this emission by inviting customers to take challenges, adopting green products, participating in the bank's CSR initiatives, or finding other ways to offset their carbon footprint. Meniga drives insights from the Meniga Carbon Index to provide accurate estimations using transaction data.

Alipay, the mobile payment app by Ant Group of China, launched an initiative called Ant Forest which encourages users to make decisions that lower their carbon footprint through the spending behavior using the Alipay app. The resulting reduction in carbon emissions are recorded, and users are rewarded with "green energy" points which can be used to plant actual trees that users can monitors using satellite imagery. Ant Forest has helped over 600 million users plant more than 326 million trees since it launched in 2016.

All three of the examples above focus on influencing the customer to make better energy consumption choices, rather than help them offset their emission by investing in environmentally friendly projects. By putting the customer in charge of their emission's behavior, these companies help consumers focus on their own contributions to advancing ESG goals. It appears that these firms are intent on changing behavior and are leaving the carbon trading investment opportunity for more institutional investors who are likely to be more effective participants in that market.

Investing

Asset Management and Wealth Management are key focus areas for ESG-focused Fintechs. These companies help individual investors generate a more ESG-compliant portfolio by either by offering a specialized marketplace to access ESG-friendly investments or by managing consumers' portfolios with a focus on composing an aggregate portfolio that achieves measurable ESG goals.

Raise Green is one of the first green crowd investing portals in the US that offers investors a marketplace for local impact investing. The portal helps investors get fractional ownership in clean energy and climate solution projects. The firm is focused on appealing to the younger demographic segment which favors impact investing. The firm completed an angel round of equity financing in April 2021.

There are numerous fintech portfolio management providers like Arnie Impact and Carbon Collective that offer personalized or pre-built portfolios which focus on sustainable investments and are aligned to the personal values and financial goals of the ESG-focused individual investor. Arnie recently completed its early-stage venture round in September 2021 while Carbon Collective completed one in January 2021. Both companies offer a new option for retail investors to build a long-term sustainable portfolio.

Trading

Trading is a sector where fintechs can leverage blockchain technology to lower costs, reduce intermediary involvement and at the same time establish exchanges and marketplaces that enable the trading of carbon credits to advance environmental goals while monetizing that effort.

Aircarbon, a Singapore-based, global carbon exchange platform built on blockchain technology, bundles carbon credits from different projects into a single instrument that can be traded on its digital platform. Unlike the current system of carbon credits trading, where companies purchase credits linked to individual projects, Aircarbon aims to create and offer standardized carbon credits instruments via bundling of projects. This approach could enable a more standardized carbon credit economy which could catalyze large-scale, institutional commodity trading.

Climate Impact X is another Singapore-based global carbon exchange and marketplace for carbon credits jointly established by DBS Bank, Singapore Exchange Limited (SGX), Standard Chartered Bank, and Temasek. It supports trading of carbon credits created from projects involved in the protection and restoration of natural ecosystems. The company recently completed an auction of a portfolio of 170,000 carbon credits connected to eight recognized forest conservation and restoration projects located in Africa, Asia, and Central- and South America. The company aims to have such auctions on a regular basis starting in 2022. The development of an expanded carbon credit supply via auctions could help the carbon offset market reach $100B in tradable carbon by 2030.

Risk Analysis

Risk analysis is a Climate Fintech category which has seen the highest rate of exits and mergers & acquisitions based on a report issued by New Energy Nexus. Risk analysis companies focus on measuring two kinds of climate risk data: 1) transition risk, which relates to the process of transitioning to a lower-carbon economy and 2) physical climate risk, which focuses on the physical impact of climate change. Both of these risks are important to investors, and investors rely on these analytical solutions to guide their investment decisions.

Carbon Delta, a Swiss company, provides insights that evaluate climate change risk in public companies for investment professionals. A key example of a company that measures this transition risk – Carbon Delta calculates 'Climate-value-at-Risk" which provides forward looking and return-based valuation assessments for an investment portfolio. By offering a calculation of the value of the future costs related to climate change, the company can help influence how investors and operators can direct capital to less environmentally harmful projects. This company was acquired by MSCI in 2019.

Jupiter Intel, on the other hand, measures physical risk of climate change at the asset level by using satellite data, artificial intelligence, machine learning and Internet-of-Things connectivity. The Climate Score provided by its platform enables users to project the effect of climate change on a portfolio of assets. Banks, asset management firms, and other financial services companies can leverage this data to manage risk and allocate capital to assets that maximize positive climate impact. The Company raised $54M in Series C venture funding in a deal led by MPower Partners Fund and Clearvision Ventures in September 2021.

Middlemarch is Poised to Support ESG-focused Fintechs

Middlemarch Partners believe that fintechs as well as traditional financial services players can use ESG to attract customers who care about changing how we interact with our environment and each other. Not only is Middlemarch Partners focused on helping capitalize next-gen financial services companies that want to focus on environmental objectives, but we also want to help established traditional financial services companies find ways to reorient themselves towards ESG efforts.

Middlemarch Partners is also cultivating investors who want to help lead the charge in ESG-oriented financial services companies. We know those investors are looking for those businesses that can deliver strong returns and, at the same time, advance ESG objectives. That is the winning strategy that will allow us all to do well by doing good.

About Middlemarch Partners

Middlemarch Partners is a New York-based merchant bank. The firm has two operating divisions. Middlemarch Securities LLC is a FINRA-registered broker dealer that assists companies with capital raises and M&A advisory services and is focused on alternative finance, payments, financial technology, business services and impact investing sectors where companies require sophisticated equity and debt investment solutions ranging from $25 - $500 million. Middlemarch Capital Partners is a registered investment advisor that designs special purpose investment vehicles that deploy investment capital in venture and growth capital transactions ranging from $5 to $20 million. The firm sources capital from institutional investors, family offices, and accredited high net worth individuals. Middlemarch can serve as an independent sponsor of transactions but frequently co-invests alongside blue-chip lead sponsors that are sourced by Middlemarch Securities. For more information about Middlemarch Partners, LLC please visit www.middlemarchllc.com.

Link to the article: *ESG and Fintechs: Technology enables impact goals - Fintech News*