ISSUE BRIEF

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Supply Chain Sustainability in the Financial Sector

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Supply chain sustainability refers to the management of social, economic, and environmental impacts, and the encouragement of good governance practices through the entire life cycle of goods and services. For financial services, expanding efforts to include their supply chain gives companies a way to further integrate sustainability into their business, minimizing risks and enhancing opportunities that can be derived from supplier relations. While many FS companies do not face traditional supply chain risks, such as sourcing from factories in developing countries, they do have exposure to environmental, social, and governance issues on a variety of levels.

Introduction

The financial sector (FS) does not traditionally get much coverage in regard to supply chain sustainability. Attention, understandably, has tended to be directed toward industries with more visible and severe supply chain impacts, such as the apparel sector. Nonetheless, sustainable supply chains are important for the FS as well. In this brief, we seek to shed some light on why this is a relevant topic for the industry.

The FS industry is very broad. It includes many different types of players, business models, and supply chains. With this in mind, we have analyzed 15 FS companies, including banks, insurance providers, credit card companies, and investment management companies, which we believe provide a good representation of the sector. In order to understand how these organizations are managing the sustainability of their supply chain, we analyzed publicly available information such as corporate responsibility reports and company websites.

For FS firms, many environmental and social impacts come not from direct operations, but from their supply chains. Considering, for instance, the purchasing power and the number of suppliers that many of these firms have, responsible choices can have profound impacts. Companies in the sector can use their clout to drive sustainable development forward among their suppliers.

To get a sense of the scale of procurement spending in FS, consider the figures published by Wells Fargo. In 2014 the company reported expenditures on suppliers of more than U.S.$14.7 billion[1], which constituted 30 percent of the company's total noninterest expense. Another FS company, TD Bank, reported spending U.S.$5.7 billion on sourcing in 2014.[2] Although not all supply chains within the FS are the same, we have identified some of the main spend categories for the industry, which are noted in the box below.

Main Spend Categories for Financial Service Companies[3]

- Information technology
  - Computers, printers, and scanners (office equipment)
  - Mobile banking software and related services
  - Servers and networks for data storage
- Employment and professional services
  - Consulting and training
  - Call centers
  - Cleaning services
  - Temporary staffing
  - Security
- Energy
- Transport and travel
- Facilities and real estate
- Marketing and advertising
  - Branded products such as promotional items
- Paper, postage, and office supplies

Common business drivers for supply chain sustainability include an increased ability to manage business risks, fostering sustainability-driven productivity, cost cuts, and growth based on sustainability.[4] Some of the risks that are traditionally connected with poor management of the supply chain are damage to reputation, reduced capacity to attract and retain employees, and loss of customers.

In our research, we have focused on identifying material issues in the supply chain of FS companies, recognizing both risks and opportunities. Additionally, this brief looks into emerging trends in the industry and points out their implications on supply chain sustainability. Changes such as technological

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[1] Wells Fargo, 2014. This amount includes expenditures in equipment, net occupancy, outside professional services, outside data processing, contract services, travel and entertainment, postage and stationary supplies, advertising and promotion, insurance, and telecommunications.

[2] TD Bank, 2014

[3] While these categories were identified mostly by analyzing reports from Banks, we find that almost all of them are applicable to FS sector as a whole.

[4] UNGC and BSR, 2015

advancements, increasing geographic diversity in sourcing, and a rising middle class in developing economies present interesting challenges and opportunities for the industry.

The FS industry is well positioned to address sustainability challenges and minimize risks in its supply chain. Some industries have been forced by rapidly changing circumstances, and sometimes by scandals, to take action and incorporate more sustainable procurement practices. In contrast, we believe that under the current landscape, financial services companies have an opportunity to be proactive instead of reactive in implementing sustainability practices in their supply chain.

Emerging Trends

There are several interesting trends currently taking place in the industry that have an impact on FS supply chains. In this section, we highlight a few of these that we believe are having the strongest effect on the FS supply chain, raising new concerns as well as presenting new opportunities.

Outsourcing

Attracted by lower labor costs in emerging markets and seeking to increase strategic advantage, financial companies have increasingly turned to outsourcing their services. The global market for FS outsourcing is expected to continue its positive trajectory through 2017, rising at an annual rate of 8 percent.[5] Some examples of activities that are commonly outsourced by the FS sector include IT management, data processing and gathering, and billing. As services are moved to other locations, risks are transferred as well and it becomes more challenging to control them because they are further away from the company's sphere of control.

Increased regulation

In large part as a response to the financial crisis of 2009, the FS industry has been undergoing substantial regulatory changes. One of the most notable examples of this is the Dodd-Frank Act, which applies to both U.S. and non-U.S. companies doing business in the United States, and which seeks to bolster the accountability of financial firms. In an effort to protect consumers in transactions with FS companies, Dodd-Frank created the Consumer Finance Protection Bureau (CFPB), which has established that FS companies must ensure that all of their suppliers comply with CFPB regulations, and may be held accountable for violations within their supply chain, potentially leading to fines and penalties. The CFPB applies to any organization that provides a material service in connection with offering or provision of a consumer financial product or service.[6] The Dodd-Frank Act has another direct impact on supply chains, as it requires companies to disclose whether they or any of their suppliers are using conflict minerals.

Online and mobile banking

[5] Fersht et al, 2013

[6] KPMG, 2013

In the United States, more than half the adult population uses online banking services.[7] Worldwide, global online banking penetrations are estimated to be nearly 30 percent.[8]

Within the overall digital banking trend, mobile banking has played a crucial role. EY (Ernst & Young)[9] points out that there were around 590 million users of mobile banking services in 2013. By 2017, that number is projected to grow to 1 billion. Novel mobile payment mechanisms are also a substantial component of technological transformation in the FS sector. In 2001, only one mobile payment system was available on the market; today, more than 150 such systems are being used and approximately 90 others are being developed. This trend is relevant to the FS supply chain if we consider that two important components of the digital trend in this industry are the reliance on cloud computing services and the need for software development, for which FS firms commonly turn to specialized suppliers.

Big Data analytics

The term *big data* refers to a combination of an approach to providing input for decision-making with analytical insight derived from data. The term also refers to a set of enabling technologies that allow that insight to be derived from at times very large and diverse sources of data.[10] Greater computational power, the rise of new analytical tools, and an increasing number of digital transactions have all contributed to the growth of big data analytics. In 2015, the big data market is estimated at U.S$5.1 billion, and it is expected to grow to $32 billion by 2017.[11]

More than other sectors, FS firms have worked to leverage the power of data analytics. Companies in this sector can now collect and process more data than ever about their customers and the markets they operate in. According to research conducted by IBM, by 2014 the use of big data in the financial sector grew 97 percent in just two years and is expected to continue its upward trajectory.[12] Considering that many FS firms rely on third-party vendors for their big data related processes, this trend is very pertinent to supply chain management.

Emerging markets expansion

By 2050, the banking sector in emerging economies is expected to greatly surpass the assets and profits of the developed world. By 2023, some analysts estimate that China and India could have the world's first-and third-largest banking sectors, respectively.[13]

The growth of emerging markets will likely result in a geographic expansion of FS services. This will increase the need for firms in the industry to develop local supply chains. Whether it is construction firms to build bank branches or IT service providers, companies will need to understand and manage a new set

[7] Statista, 2012

[8] Statista, 2012

[9] EY, 2015

[10] Akred, cited by Duther, 2015

[11] PwC, 2015

[12] Turner, 2014

[13] PwC, 2011

of risks and navigate different (and often weaker) sets of regulations and standards, which will pose higher risks.

With today's technology, it's worth noting that the expansion of FS to emerging markets will be done differently from how it was done in developed nations. For example, there will probably be less need for physical bank branches, while digital banking will play a bigger role. This will undoubtedly create a different supply chain.

The move toward emerging markets also presents opportunities. Whenever possible, companies can prioritize local sourcing alternatives to promote local development, foster diversity, engage with the community, and reduce greenhouse gas emissions associated with transport.

Main Sustainability Issues of the FS Supply Chain

Below, we have summarized the key issues that we believe FS companies should address to manage the sustainability of their supply chains. Our selection is based on international guiding standards such as the Dow Jones Sustainability Index, ISO 26000, and the Global Reporting Initiative, as well as on the spend categories that we have identified for the industry. While this is not a comprehensive list, we believe it is illustrative of the areas that are most likely to have important repercussions, and where the greatest risks and opportunities can be found. The major issues we have found are GHG emissions, human rights, data security and privacy, conflict minerals and e-waste, and security. In the section after this one, we will provide examples on how FS companies are managing these issues.

Greenhouse gas emissions (GHG). Many regard climate change as the most urgent challenge of our time. U.S. President Barack Obama recently stated, “no challenge poses a greater threat to our future and future generations than a change in climate.” All business sectors have a role to play in addressing this issue. In the FS supply chain, the most relevant spend categories that have an impact on climate change are energy consumption, and transportation and travel. In terms of transport, business trips, courier services, armored vehicles, employee commutes, and business trips all contribute to GHG emissions. Facilities’ energy consumption and the power required for office IT equipment and server farms for data storage are also significant sources of emissions in this sector.

In light of data provided by the CDP (formerly the Carbon Disclosure Project, a nonprofit that helps companies manage the risks and opportunities associated with climate change on GHG reporting), there is significant room for improvement in the FS. Although most financial companies provide some disclosure on their scope 1 and 2 emissions, few of them report on their vendors’ emissions, which may have a larger impact on climate change. The CDP observes that in terms of GHG in the FS, “there is a general lack of understanding of the full impact of companies’ value chains.”[14]

Human rights. Given that employment and professional services are one of the most important spending categories for FS companies, human rights are a fundamental issue in supply chain sustainability. Moreover, this is a topic that can be addressed across all spending categories because every supplier has a workforce and a responsibility to respect their rights. Some of the main challenges related to human rights include providing a healthy and safe work environment; guaranteeing a diverse workplace and fostering non-discrimination; protecting employees from being overworked; eliminating the use of child

[14] CDP, 2013

and forced labor; ensuring that workers have the right to join or form unions or workers' association; and making sure all workers receive a fair wage.

Data privacy and security. Privacy is so fundamental that it is recognized in the Universal Declaration of Human Rights, which states, "No one shall be subjected to arbitrary interference with his privacy." As the movement to collect more and more data continues to grow, along with a tendency to outsource associated services such as data storage and processing, risks pertaining to data privacy are transferred to suppliers. A vendor's ability to protect sensitive or personal data to prevent issues such as privacy intrusions, cyber attacks, and frauds should be a key criterion in the supplier selection process.

E-waste and conflict minerals. Although FS companies do not manufacture IT equipment, they do have substantial spend on IT and their choices in selecting responsible suppliers can have an influence on fostering more sustainable practices. Two of the main problems associated with IT are the proper management of waste from electronic equipment and the use of minerals that are commonly sourced in conflict zones. E-waste is a problem because it contains hazardous substances and is often handled in crude, informal, and unsafe ways. Frequently, this waste ends up in landfills after being illegally exported to developing nations, and occurrences of forced and child labor are not uncommon.

Security. Many FS companies—most notably banks—have a need to employ security staff to protect branch offices and guard money that is being transported. Usually, this staffing requirement is met through the use of contractors. Using third-party labor introduces an additional component of risk because it is further away from internal company control mechanisms.

Sustainable practices in facilities and property management. Choosing the right suppliers to handle the design and construction of your facilities can have important repercussions on sustainability. For example, according to the International Energy Agency, buildings account for about 40 percent of the world's primary energy consumption.[15] Consequently, selecting suppliers that follow green building standards can have significant impacts on energy consumption, as well as on other sustainability-related issues such as water use and GHG emissions.

Best Practices and Recommendations

Although supply chain sustainability in the FS is still relatively nascent, some companies have been working on the matter and provide excellent illustrations on how responsible procurement can be applied to this industry. In the section below, we describe some of these practices. Additionally, we provide recommendations that are informed by the work that BSR has done with other industries and that are applicable to FS. We believe that good practices are applicable to all industries, and there are lessons to be learned for FS from leading firms in other businesses. The practices and recommendations we present are framed around three key steps: identifying priorities, taking action, and evaluating impacts.

1. IDENTIFYING PRIORITIES

[15] International Energy Agency, 2015

*Mapping sustainability impacts of the supply chain***.** In order to set up a platform for a responsible procurement program, it is initially necessary to have a clear understanding of the impacts that the organization's supply chain has. Westpac, which was ranked by the Dow Jones Sustainability Index as the most sustainable bank in 2014, summarizes their process in the following way: "We can map our supply chain by tracing the key activities of organizations and people involved in bringing a product or service from raw material to market. This can help us gain a better understanding of the extent to which our supply chain impacts on our environmental and social footprint. This helps us to identify the most significant challenges that we and our suppliers face, and prioritize our efforts accordingly."[16]

*Identifying and prioritizing suppliers and categories***.** Large FS firms tend to have thousands of suppliers. In order to be most effective in addressing sustainability issues, organizations can benefit from prioritizing their efforts based on the potential impact that their suppliers can have. UBS, for example, reports that they "identify high-impact suppliers of newly sourced goods or services based on their provision of goods and services that have either a substantial environmental and social impact or are sourced in markets with potentially high social risks."[17] TD Bank has a similar practice, assigning a risk rating to each of their sourced products and services and applying heightened due diligence to categories identified as having a higher risk. AXA is another FS company that uses a risk assessment process for their supply chain, through which they identify high sustainability impact categories for their operations, such as "promotional items and gifts," and lower risk categories, such as "software."[18]

Looking beyond the first tier and setting up traceability. In evaluating the impacts of the supply chain and implementing corrective actions, a good practice is to look beyond the first tier. Extending supply chain sustainability programs past first-tier suppliers allows companies to greatly enhance their positive impacts. This is certainly relevant for FS because some of the most severe risks can be found with second- and third-tier vendors.

Associated with the practice of analyzing impacts beyond the first tier is the practice of setting up traceability programs. Traceability is the capacity to identify and trace the history, distribution, location, and application of products to ensure the reliability of sustainability claims on issues such as human rights and environmental impacts.

2. TAKING ACTION

Developing a code of conduct. Our findings reveal that in managing sustainability of the supply chain for this sector, one of the most widespread practices is the development of a supplier code of conduct. Thirteen out of 15 analyzed companies have a publicly available code of conduct or set of standards for suppliers. However, the specific content of the codes varies, as does the way in which they are implemented and monitored.

Integrating sustainability into procurement. The consideration of sustainability criteria in procurement decisions is a fundamental direction forward in supply chain sustainability. FS companies that have

[16] Westpac, 2014

[17] TD Bank, 2014

[18] AXA, 2015

incorporated sustainability criteria into their supplier selection processes include AXA, Bloomberg, and Westpac. In the interest of institutionalizing this practice, these firms have included specific corporate responsibility clauses in their service contracts and requests for proposals (RFPs). AXA, for instance, has adapted a Corporate Responsibility section for each new contract, which outlines the need for compliance with the International Labor Organization's major principles.

Integrating sustainability into category strategies. Many FS companies have developed a code of ethics for their vendors. However, some companies have taken this practice to a higher level by creating particular guidelines for each of their main procurement categories. This is a reasonable approach, considering that the vendors that service the FS industry are quite diverse and the potential impacts they can have are very different. Deutsche Bank, for instance, has developed Green Supply Chain frameworks for various sourcing categories, such as power from renewable energy, paper, multifunctional printers, and servers. Every framework establishes specific sustainability criteria for the goods or services in question.[19] ANZ is another leader in this regard: They have also developed Sustainability Guidelines for Procurement of specific categories in an effort to help sourcing managers assess and reduce environmental and social impacts.

*Engaging external stakeholders***.** Collaboration among peers and other stakeholders has proven to generate positive impacts on supply chain sustainability. Examples of supply chain collaborations that FS can engage with include the Electronics Industry Citizenship Coalition (EICC) and the Better Work program of the International Labour Organization (ILO).

Leveraging the expertise of specialized organizations is an effective way to manage supply chain issues. For instance, in an effort to enhance supplier diversity practices, several FS firms have joined the National Minority Supplier Development Council. Council members from the financial sector include American Express, Bank of America, Capital One, Goldman Sachs, Citigroup, ING, Prudential Financial, JP Morgan Chase, and Wells Fargo.

Wells Fargo provides another illustration of how to enhance collaboration with third parties. The bank has set up a platform called the Wells Fargo Environmental Affairs Partner Forum for the purpose of interacting with external stakeholders on environmental issues. The organization's supply chain management team is one of the regular participants in the forum, which allows it to align practices with sector standards, listen to concerns, and receive feedback. Wells Fargo has used information gathered through this forum to develop tools and processes to better integrate sustainability into their supply chain. Through collaboration, companies can enhance positive impacts in their supplier network.

Fostering supplier diversity. FS seek to promote the development of traditionally vulnerable and minority communities, as well as expand their pool of talent, through the implementation of a diversity program specifically aimed at suppliers. In an industry in which one of the highest spend categories is professional and employment services, focus on this area is of significant importance.

Since 1977, Citi has been implementing its Supplier Diversity program. To promote opportunities for diverse suppliers, Citi provides mentorship, training programs, and local supplier development councils.[20]

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[19] Deutsche Bank, 2015

[20] Citi, 2014

Bank of America is another institution that has a longstanding diversity program specifically aimed at their suppliers. Bank of America has set up quantitative goals for spending with minorities, women, the disabled, veterans, and LGBT-owned suppliers. In 2014, the bank was included in the Billion Dollar Roundtable, which is made up of companies that have direct spend of U.S.$1 billion or more with diverse suppliers[21] — the first FS company to join the organization. TD Bank´s diversity efforts have been extended beyond their first-tier suppliers, as they have asked their primary vendors to report how much they are spending with diverse suppliers within their own network.

Worker empowerment. Giving employees access to technologies (e.g., mobile apps) that allow them to address issues such as personal safety and anonymously report violations. Leading companies are also working with local governments to increase minimum wages and provide better working conditions. With regard to women's rights, a good practice is to commit to the UN Women's Empowerment Principles.

*Digitization of the supply chain***.** Leading companies have been using digital platforms to track and measure impact. In addition to tracking individual supplier data, it is recommended to aggregate data in order to identify trends in regions and spend categories.

*Prioritizing renewable energy***.** One of the ways that FS companies can help tackle the challenge of climate change is through their selection of energy vendors. For example, UBS stands out due to its procurement of alternative sources of energy. In the company's Switzerland and Germany operations, 100 percent of its electricity comes from renewable energy sources such as hydroelectricity.[22] Worldwide, UBS's use of renewable sources of energy accounts for 50 percent of its overall needs.

*Screening for conflict minerals***.** As of 2014, TD Bank has required its IT suppliers to report on whether any raw materials they use come from the Democratic Republic of Congo or other countries where there are reported human rights abuses.[23] Similarly, Bloomberg has been working to "highlight and track the chain of custody for all precious and conflict minerals as well as other high-impact items" in its supply chain,[24] to ensure that the company is not indirectly encouraging the illicit mining of these minerals.

*Managing e-waste***.** To minimize the impact of e-waste, companies can make sure that the supplier they work with has a good take-back program that can properly dispose of equipment after it reaches its end of life. Additionally, FS firms can join e-Stewards, a third-party initiative that works to promote stricter standards for e-waste recycling. The e-Stewards program provides a certification to identify responsible recyclers of e-waste. Bloomberg, Wells Fargo, and Bank of America are companies in this sector that have an e-Steward certification.

3. EVALUATING IMPACT AND REPORTING

Developing a supplier assessment approach. FS companies can use a combination of mechanisms, including supplier self-assessments, evaluations carried out by internal teams, and auditing to monitor

[21] Bank of America Social Responsibility Report, 2014

[22] UBS, 2014

[23] TD Bank, 2014

[24] Bloomberg Impact Report, 2014

supply chain compliance. Westpac has made it obligatory for new suppliers to complete their Sustainable Supply Chain Management Code of Conduct. If areas of opportunity are detected, the company will require that the supplier provide a specific action plan to address the issue. To ensure expertise and independence, self-assessments can be complemented through third-party audits. AXA, for instance, has been implementing this practice since 2008. For 2015, AXA set up a target to have 90 percent of its major suppliers assessed on their corporate responsibility performance by a third party.[25]

After evaluating supplier performance, the crucial next step is to take corrective actions and encourage supplier development. Leading companies have acknowledged that in doing this, it is best to engage with suppliers to address problems and to invest in capacity building, engagement programs, and other tools to help their vendors to improve their sustainability performance. UBS offers an example of engaging with suppliers to improve their performance. Following an impact evaluation, if the company identifies instances of noncompliance with its Responsible Supply Chain Standard, it works with the vendor to define and agree on measures to tackle the issues.

Bank of America has worked with its suppliers since 2009 in responding to the CDP Supply Chain Survey in order to keep track of their GHG emissions. What makes Bank of America's practice noteworthy is not the fact that it asks suppliers to answer the survey—which is a good practice and relatively common—but rather the engagement it provides during the process to encourage improvement. The bank has established an open dialogue with its vendors, providing feedback on their transparency and performance and assisting them in making improvements. Encouraging participation in the CDP survey helps to advance suppliers' climate change strategies, expanding the organization's overall impact on GHG emission reductions.

*Reporting***.** An essential element to sustainability in business is transparency. Reporting encourages companies to formally analyze their own practices, and to document and learn from them. Transparency allows stakeholders to be aware of companies' business practices, encourages feedback, establishes a relationship of openness and trust, and lays a foundation for accountability. When it comes to disclosure of responsible procurement practices, the FS industry has already begun moving in the right direction. In our sample of 15 firms, we found all that of the companies are reporting to some extent on their supply chain responsibility practices and the way in which they align with their overall sustainability strategies. However, most FS companies have room to improve on their sustainability disclosure.

For guidance on this issue, internationally recognized guidelines have been developed, with specific requirements for FS. Two of the most widely used standards are produced by the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB). With regard to supply chain issues of FS, GRI recommends reporting on the following aspects: percentage of suppliers that have been screened using labor practice and societal impacts criteria; negative impacts on society in the supply chain and actions taken, and the proportion of spending on local suppliers.[26]

Further guidance on ways to incorporate sustainable practices into your supply chain can be found in Supply Chain Sustainability: A Practical Guide for Continuous Improvement, developed jointly by the United Nations Global Compact and BSR.

[25] AXA, 2015

[26] Global Reporting Initiative, 2015

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ABOUT THIS REPORT

This report was written by Federico Sendel with contributions from Paula Peláez. In this brief, we seek to highlight the importance of having sustainable supply chains in the financial sector. We illustrate the benefits that can be derived from enhancing sustainability in procurement practices, pointing to benefits that can be derived from good practices and risks that can be minimized. In our analysis we have reviewed publicly available documents such as corporate responsibility reports, websites, and financial statements. For a comprehensive view of the industry, we have looked at information of banking firms, insurance providers, credit card companies, and asset management corporations.

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