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A STUDY ON SUSTAINABILITY IN THE FINTECH BANKING INDUSTRY AND THE EVOLUTION OF SUSTAINABLE RATINGS IN FINTECH

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Abstract

The assessment and promotion of responsible and ethical practices within the dynamic fintech banking sector are crucial, and sustainable ratings play a pivotal role in achieving these objectives. As the fintech industry disrupts traditional banking, it becomes imperative to evaluate its environmental, social, and governance (ESG) performance to effectively manage risks and maximize positive impacts. This abstract delves into the significance, challenges, and recommendations surrounding sustainable ratings in fintech banking. Although fintech and digital banking offer great potential, they also pose ESG risks. Innovations in areas like digital payments, decentralized finance, big data analytics, robo-advisory, and lending platforms reshape the financial landscape and contribute to financial inclusion, consumer empowerment, and efficiency. However, the long-term sustainability implications of these advancements remain uncertain. To address this, tailored ESG rating mechanisms are needed to assess fintech banking based on material sustainability issues. These ratings evaluate performance across key metrics such as climate action, ethical AI, data stewardship, financial inclusion, and governance. Stakeholders can leverage these ratings to identify sustainability leaders and align investments with the United Nations Sustainable Development Goals. Mainstreaming fintech sustainability ratings requires collaboration among multiple stakeholders, encompassing the establishment of reporting standards, disclosure frameworks, assurance mechanisms, and capacity-building initiatives. Challenges in this pursuit include the absence of sector-specific measurement standards, the reluctance of fintech firms to allocate resources to sustainability efforts, limited internal expertise, and concerns surrounding confidentiality and security. Overcoming these challenges necessitates the introduction of mandatory sustainability disclosure policies by regulators, the development of industry-specific reporting standards by industry associations and standard setters, and the integration of sustainability due diligence into the decision-making processes of investors. Furthermore, capacity-building programs are essential to educate fintech leaders on material ESG risks and integrate sustainability considerations into their strategic planning. Ultimately, sustainable ratings in fintech banking serve as a framework for evaluating and incentivizing responsible practices, empowering stakeholders to direct investments towards sustainable fintech innovation and fostering an inclusive and sustainable financial ecosystem.

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1. INTRODUCTION

The Fintech and Banking sectors are placing a strong emphasis on sustainability, aiming to incorporate responsible and sustainable practices into their operations. This integration of sustainability principles addresses the environmental, social, and governance (ESG) challenges faced by the financial industry and aims to create a positive long-term impact.

In the realm of fintech and banking, sustainability refers to various initiatives aimed at creating a financial system that is environmentally conscious, socially responsible, and governed ethically. This approach involves aligning financial services with global sustainability targets, like the United Nations Sustainable Development Goals (SDGs), while also considering the broader impact of financial decisions.

A key element of sustainability in fintech and banking is green financing. Both fintech firms and traditional banks are increasingly funding projects that support environmental sustainability, such as renewable energy, sustainable infrastructure, and energy-efficient technologies. Through green financing options, the industry is playing a vital role in supporting the shift to a low-carbon economy and addressing climate change.

Digital transformation also plays an important role in promoting sustainability within fintech and banking. The move towards digital banking and paperless processes helps reduce the industry's environmental footprint by cutting down on paper waste. Digital banking services, mobile apps, online payment systems, and electronic identity verification enhance accessibility and efficiency, while also contributing to sustainability goals.

Another major facet of sustainability is impact investing, where financial decisions are made based on environmental and social considerations. This enables both individuals and institutions to support projects and organizations that deliver positive societal and environmental outcomes along with financial returns. Impact investing channels funds into sustainable sectors like clean energy, affordable housing, and social enterprises.

To cater to the rising demand for responsible investments, fintech and banking institutions are increasingly offering sustainable investment products. These products apply Environmental, Social, and Governance (ESG) criteria, allowing investors to support companies that prioritize sustainable practices, ultimately contributing to a more responsible and sustainable economy.

Technologies such as data analytics and artificial intelligence (AI) are becoming essential for assessing ESG factors. Fintech companies and banks utilize these technologies to evaluate the sustainability performance of businesses, identify investment opportunities that align with sustainability objectives, and manage risks related to environmental and social issues.

Collaboration among fintech firms, banks, governments, and environmental organizations is crucial for advancing sustainability initiatives. Such partnerships encourage knowledge exchange, resource sharing, and the establishment of industry-wide standards, accelerating the adoption of sustainable practices across the sector.

Furthermore, internal sustainability practices within fintech and banking institutions are vital. By embracing energy-saving initiatives, sustainable supply chain strategies, and fostering diversity and inclusion, these organizations set a positive example and inspire change within the industry.

The fintech revolution has transformed the banking and financial services landscape through innovative technologies like blockchain, AI, big data analytics, and mobile platforms. While fintech holds the potential to enhance financial inclusion and sustainable development by improving access and efficiency, it also introduces risks related to data privacy, ethical AI usage, and the social impacts of automation. Therefore, it's important to evaluate the ESG performance of fintech companies, which requires developing tailored sustainability ratings that reflect fintech-specific business models and relevant issues.

While still in its early stages, sustainability rating mechanisms that benchmark fintech players on sustainability factors have begun to emerge. Momentum is building through disclosure requirements from regulators and increasing demands for transparency from investors and consumers. Pioneering initiatives in this space include the Upright Project's Fintech Sustainability Assessment framework, the World Benchmarking Alliance's fintech inclusion benchmarks, Corporate Knights' Digital Clean 200 sustainability leaders ranking, and MSCI's fintech impact ratings service. As stakeholders become aware of the risks associated with exclusion from algorithmic lending, unethical use of consumer data, and energy-intensive crypto-mining, as well as the potential of fintech to expand sustainable investing platforms and green lending, the demand for sustainability ratings is expected to grow.

Fintech sustainability ratings empower stakeholders to assess risks, opportunities, and leaders in the industry, guiding innovation and investments towards models that have a positive impact. These ratings promote transparency on material ESG issues such as data ethics, climate action, financial inclusion, and governance. They also incentivize fintech leaders to excel in sustainability factors that are crucial for long-term success. To mainstream reliable sustainability ratings in the fintech sector, tailored frameworks, mandatory disclosures, capacity-building initiatives, and incentives for sustainable fintech innovation are necessary.

Key conclusions regarding the trajectory of fintech sustainability ratings include the recognition that while the field is still in its early stages, it is of growing importance. Tailored frameworks and metrics are needed to address sector-specific measurement standards that reflect the material issues of digital finance, such as data stewardship, algorithmic fairness, and climate impact. Regulator-mandated sustainability reporting is pivotal in motivating fintech firms to monitor and disclose their ESG performance. Incentives and recognitions for fintech sustainability leaders can encourage responsible innovation throughout the ecosystem. A multi-stakeholder collaboration involving standard setters, industry groups, regulators, investors, and companies is crucial for the mainstream adoption of fintech ratings. Additionally, extensive education and training on ESG topics are vital, particularly for smaller fintech startups that may lack sustainability resources and expertise.

However, there are challenges to advancing fintech sustainability ratings, including limited ESG capacities within startups that are intensely focused on growth, the absence of measurement standards suited to digital business models, concerns regarding the confidentiality of disclosed information, and the need to incentivize fintech leadership over short-term gains. Addressing these challenges requires collaborative multi-stakeholder strategies that focus on tailored ESG frameworks and metrics, mandatory sustainability reporting, capacity building for startups and smaller firms, integration of ratings by investors, and rewards for sustainable fintech innovation.

As fintech continues to expand its reach in the financial services sector, sustainability ratings can help assess and mitigate ESG risks while harnessing opportunities for positive impact. These ratings empower stakeholders to make informed decisions and guide fintech innovation towards responsible practices in digital finance. Mainstreaming fintech sustainability ratings through coordinated efforts is crucial to transparently steer this disruption towards sustainable transformation.

2. LITERATURE REVIEW

Bittar (2019) There is currently a notable surge of interest in FinTech companies within the financial sector. Despite this, limited research exists on how these firms impact financial institutions, particularly in Sweden. This study sought to bridge that gap by examining the influence of FinTech companies on Swedish financial institutions. The rising discussions and curiosity surrounding the potential of FinTech companies sparked this research. Previous studies on FinTech didn't deeply explore their effects on financial institutions or consider the implications for the future, leading to an essential question that had yet to be addressed.

Karsh and Abufara (2020), FinTech companies are reshaping the global banking landscape by providing user-friendly digital financial services and products to both consumers and financial institutions. These companies operate across various areas, such as digital wallets, insurance, payments, and crowdfunding. While the disruptions caused by FinTech may currently seem modest, the financial industry is paying close attention. For the banking sector to stay competitive, it must adapt its strategies and integrate digital technologies; otherwise, there's a risk of being outpaced by FinTech rivals.

Legowo, Subanidja, and Sorongan (2020) A particular study took a novel approach by developing a research model using a "mixed methods" strategy, focusing on creating a sustainable development framework based on FinTech within Indonesia's financial and banking sectors. The study found that FinTech, driven by business dynamics, plays a significant role in sustainable growth within Indonesia's financial and banking landscape. The researchers also highlighted the need for further studies to assess the long-term effects of the FinTech model on bank performance in Indonesia.

Varma, Nijjer, Sood, and Grimaand (2022) It has been observed that emerging technologies have transformed many aspects of life, such as how we communicate, shop, and conduct business. These advancements have also changed the way people interact with their finances, their expectations from banks, and the operations of banks themselves. Emerging technology has led to shifts in consumer behavior and engagement with money, streamlining processes, minimizing errors, and enhancing communication. However, the disruption caused by FinTech is unlike previous technological shifts, leading to profound changes in financial services and the risks involved. The current body of research reflects a growing academic interest in this field, with studies focusing on FinTech, banking, and blockchain from individual, primary, and empirical perspectives.

3. OBJECTIVES OF THE STUDY

- To analyze the evolution of sustainability in Fintech specific to the banking industry.
- To explore the regulatory framework of authorities and assess the sustainable rating initiatives undertaken by Indian regulatory bodies for the FinTech sector.

4. RESEARCH METHODOLOGY

This research employed a case study approach to explore sustainability practices within the FinTech sector, with a specific focus on the banking industry. The main goal was to gain a comprehensive understanding of the strategies and techniques that FinTech companies employ to incorporate sustainability into their operations. By examining both past and current sustainability initiatives, we aimed to highlight how these organizations are embedding sustainable practices in their business models. Additionally, the study assessed the implementation and influence of sustainable ratings in the FinTech sector, particularly within the banking industry. A descriptive research methodology was utilized, enabling us to systematically gather, analyze, and interpret data related to sustainability efforts. Drawing from the findings of our research, we formulated a series of conclusions and practical recommendations to support the enhancement of sustainability practices in the sector. This study not only provides valuable insights into the evolving landscape of sustainability in FinTech but also serves as a guide for industry stakeholders seeking to improve their sustainable practices.

5. SUSTAINABLE RATING IN THE FINTECH

The rapid growth of fintech and digital banking presents significant opportunities as well as risks from an environmental, social, and governance (ESG) perspective. Fintech advancements in digital payments, decentralized finance, Big Data analytics, robo-advisory, and lending platforms are revolutionizing the finance industry. While these innovations promote financial inclusion, consumer empowerment, and efficiency, their long-term impact on sustainability is uncertain. Therefore, it is crucial to develop specialized ESG rating systems to assess the sustainability of fintech banking concerning critical environmental and social issues.

Through the evaluation of various criteria such as climate action, ethical AI, data management, financial inclusion, and governance, these ratings can identify leaders in sustainable fintech banking. They provide stakeholders with valuable information to direct investments toward responsible fintech innovations that align with the United Nations Sustainable Development Goals. However, achieving widespread adoption of fintech sustainability ratings requires collaboration among multiple stakeholders to establish customized reporting standards, disclosures, assurance mechanisms, and capacity-building initiatives within this rapidly evolving sector.

The necessity for customized sustainability ratings in fintech banking arises from the industry's rapid expansion and uncertain sustainability trajectory. Global investment in fintech has soared from $50 billion in 2017 to over $125 billion in 2021. However, less than 1% of this substantial influx of capital has been directed towards driving impact and implementing ESG solutions. As fintech banking grows at a remarkable pace, the lack of transparency regarding sustainability performance poses regulatory, consumer trust, and systemic risks. For example, there are concerns about potential exclusion risks resulting from the widespread adoption of algorithmic lending platforms and energy-inefficient digital currencies.

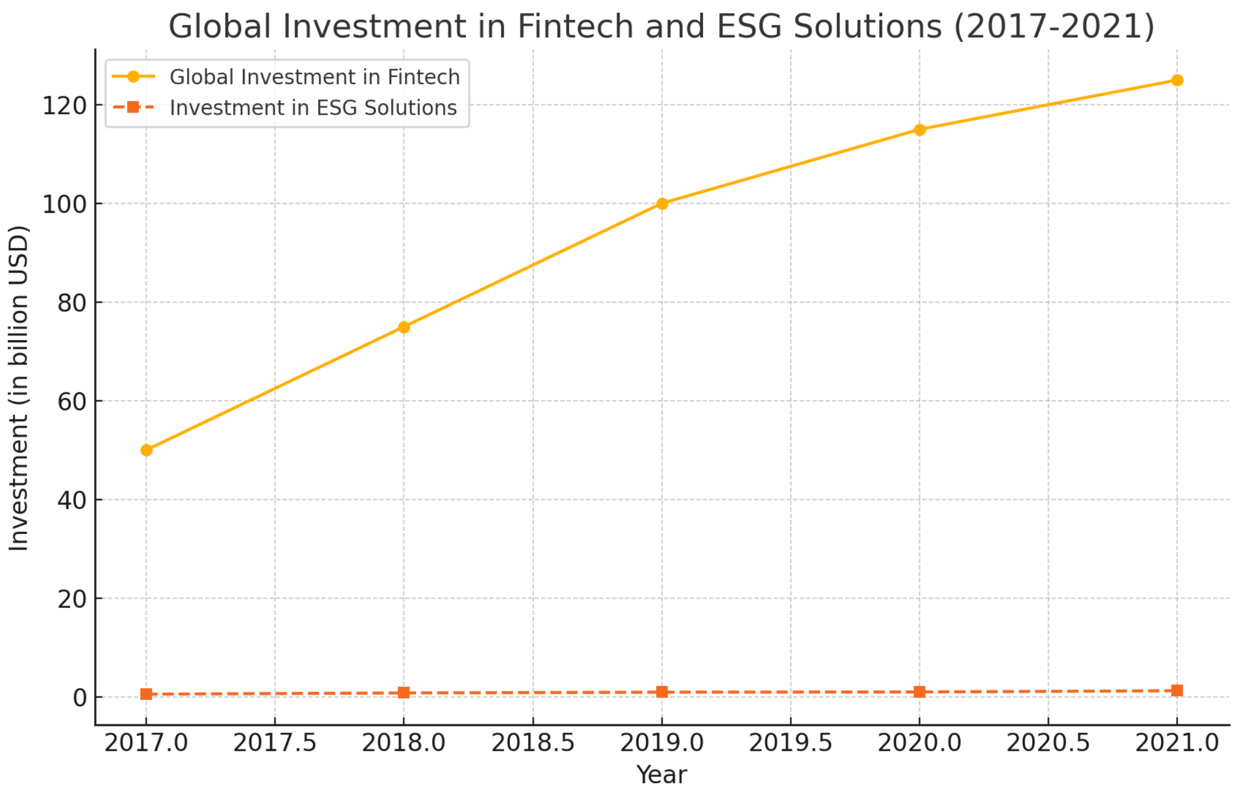
Tailored ESG ratings have the potential to identify fintech banking entities that prioritize sustainability and serve as an incentive for others to follow suit. These ratings empower stakeholders to evaluate risks and opportunities associated with leveraging fintech's potential as a catalyst for sustainable development. Significantly, ratings enable investors, consumers, and governments to allocate capital and establish partnerships with fintech banking firms that firmly integrate ethics, climate action, and financial inclusion into their business models.

Developing robust sustainability rating mechanisms for fintech banking entails the identification of significant ESG issues associated with digital financial services and the establishment of relevant key performance indicators (KPIs) for benchmarking purposes. However, due to the relatively early stage of the sector's development, there are challenges in creating appropriate measurement frameworks. To overcome these challenges, collaboration among leading ESG standard setters, fintech associations, academics, and industry practitioners is crucial in formulating industry-wide reporting standards and materiality principles.

It is essential to evaluate key cross-cutting ESG aspects that encompass the climate footprint, data management practices, ethical safeguards for AI, consumer protection, impact on financial inclusion, and governance practices. Additionally, specific issues related to sub-sectors such as blockchain, digital lending, Big Data analytics, and robo-advisors require tailored indicators for evaluation. Regular review of these frameworks, as the fintech sector evolves, is also of utmost importance. Third-party assurance of self-reported data and capacity-building initiatives for fintech firms in sustainability management are essential elements to enhance the credibility and reliability of the ratings.

	Year	Global Investment in Fintech (in billion USD)	Investment in ESG Solutions (in billion USD)	ESG Investment Percentage
1	2017	50	0.5	1.0
2	2018	75	0.75	1.0
3	2019	100	0.9	0.9000000000000001
4	2020	115	0.95	0.826086956521739
5	2021	125	1.2	0.96

(Table 1: Refering the Global Fund Investment in the Fintech)



(Chart 1: Refering the Global Fund Investment in the Fintech)

5.1 Achieving the full potential of fintech sustainability ratings requires coordinated efforts across four key areas:

5.1.1. Financial regulators play a vital role in establishing relevant sustainability disclosure requirements for fintech firms. These requirements should focus on reporting material ESG metrics, taking into account the need for innovation in the emerging fintech sector. Initially, principles-based reporting that addresses universally significant issues, rather than detailed prescriptive standards, may be more appropriate. Regulators also need to ensure flexibility to accommodate fintech players at different stages of maturity. Regulatory-backed disclosure requirements enhance the completeness, comparability, and reliability of sustainability data provided by fintech companies, which in turn supports the effectiveness of rating mechanisms.

5.1.2. Collaboration between leading ESG reporting standard setters, industry groups, and sustainability experts is necessary to develop frameworks for fintech materiality assessment and performance measurement. Existing standards like GRI, SASB, and TCFD can serve as a foundation, with additional metrics tailored to fintech business models and impacts, such as ethical AI, algorithmic bias, and blockchain platform transparency. It is also important to raise awareness within the fintech sector about the utilization of these standards.

5.1.3. Investors have a crucial role to play by integrating insights from sustainability ratings into their due diligence and decision-making processes when allocating capital to fintech ventures. This involves examining and analyzing the ESG disclosures of existing and potential fintech banking portfolio companies. Sophisticated investors can also advocate for robust ESG due diligence by fintech banking firms to manage indirect sustainability risks associated with their investees.

5.1.4. Multilateral institutions, foundations, governments, academia, and associations should facilitate capacity-building programs to educate fintech leaders about the importance of sustainability management, including the utilization of ratings. It is particularly important to raise awareness about sustainability risks and opportunities related to emerging technologies like AI and blockchain. These programs will enhance the understanding and implementation of sustainability practices within the fintech sector.

5.2 The mainstream adoption of reliable fintech sustainability ratings faces several challenges that require coordinated efforts to address:

5.2.1. The absence of sector-specific measurement standards on material ESG issues hinders comprehensive sustainability reporting and disclosures by fintech players. Financial regulators should implement mandatory principles-based reporting while standard-setting bodies need to develop appropriate fintech sustainability reporting frameworks to support consistent disclosure.

5.2.2. Early-stage fintech firms often prioritize rapid growth and product development, which may lead to a reluctance in allocating resources and management focus to formalize sustainability programs. In this regard, capacity-building initiatives led by industry associations are crucial, along with incentives for sustainability leaders who can demonstrate competitive advantages to encourage others to follow suit in talent recruitment and accessing capital.

5.2.3. Limited internal resources, expertise, and systems within small fintech players make it challenging to collect, verify, and assure ESG data. Collaboration with external consultants, auditors, and fintech solution providers specializing in ESG digitization can help overcome this barrier.

5.2.4. Concerns about confidentiality and security surrounding transparency on material issues such as diversity metrics, pay equity, and customer data management may impede comprehensive reporting. Principles-based reporting focused on material themes rather than granular data can provide reasonable insights to investors and consumers without compromising competitive dynamics.

5.2.5. The complexity of tracing the climate impacts of digital financial services and blockchain platforms requires the development of suitable indicators. Proximate indicators related to renewable energy usage, the energy efficiency of data centres, and estimating the burden of e-waste can enhance climate-related disclosure in the fintech sector.

6. DISCUSSION AND CONCLUSION

In conclusion, the implementation of customized sustainability rating mechanisms for the rapidly growing fintech banking sector is crucial to guide responsible innovation, promote ethical conduct, and drive climate action and financial inclusion. While still in its early stages, there have been promising developments with pioneering rating frameworks that assess fintech firms on material environmental, social, and governance (ESG) issues. Additionally, there is growing momentum with the introduction of initial disclosure requirements by financial regulators and increasing pressure from investors and consumers for transparency in sustainability practices.

However, to fully unlock the potential of fintech sustainability ratings, it is necessary to address key challenges such as limited ESG capacities, particularly in smaller startups that prioritize rapid growth and market share acquisition. Other challenges include the lack of measurement standards suitable for digital business models, concerns about the confidentiality of sustainability data, and the need to incentivize fintech leaders compared to laggards. These challenges require collaborative efforts involving regulators, standards bodies, industry groups, investors, and fintech firms themselves.

Strategic recommendations include the introduction of mandatory, principles-based sustainability reporting requirements by regulators to ensure the disclosure of performance on material ESG metrics by fintech firms. Furthermore, there is a need for the development of tailored fintech sustainability reporting standards and materiality frameworks by leading ESG standard setters and industry associations to establish a consistent basis for disclosure and benchmarking. Integrating sustainability ratings into the due diligence processes and decision-making of investors is also crucial. Extensive capacity-building programs led by foundations, academia, and industry groups can assist fintech firms in effectively measuring, managing, and reporting on their ESG performance. Additionally, multi-stakeholder collaborations involving regulators, standard setters, industry associations, academic institutions, and fintech firms themselves are necessary to mainstream fintech sustainability ratings. Incentives and recognition from government bodies, investors, and industry groups can also inspire and encourage fintech sustainability leaders, fostering positive change throughout the ecosystem.

6.1 To advance fintech sustainability ratings strategically, targeted recommendations should be provided to key stakeholders:

6.1.1. For financial regulators and policymakers:

Implement mandatory, principles-based sustainability reporting for fintech firms, focusing on the most material ESG issues such as climate, data ethics, governance, and innovation for sustainable development goals.

Allow reasonable flexibility in the adoption of sustainability reporting across fintech players at different stages of maturity, avoiding overly prescriptive requirements that may burden startups.

Collaborate with sustainability standard-setting bodies to develop appropriate fintech sustainability reporting standards.

Offer incentives, such as expedited licensing, to fintech firms that demonstrate leadership in addressing material sustainability parameters.

6.1.2. For standard-setting organizations and industry associations:

Formulate fintech-specific sustainability reporting standards, materiality frameworks, and rating methodologies in collaboration with diverse stakeholders, including regulators, investors, companies, and subject matter experts.

Build internal capacities within fintech firms, especially smaller startups with limited resources, by providing training programs and establishing partnerships to enhance sustainability measurement, management, and disclosure.

Create platforms for collective learning, experience exchange, and mentoring to foster collaboration and knowledge sharing on fintech sustainability topics among both younger and established firms.

6.1.3. For investors:

Incorporate analysis of fintech firm sustainability ratings into due diligence processes when considering investments and engage in ongoing discussions with portfolio companies on sustainability performance.

Direct investments toward fintech firms that demonstrate clear sustainability leadership on material issues that are crucial for long-term performance.

Utilize positions on company boards to actively encourage and support improved sustainability strategies, performance, and transparency.

6.1.4. For fintech companies:

Measure, monitor, and report on the most material sustainability issues even before mandatory requirements are in place, emphasizing sustainability as a value creator rather than merely a compliance burden.

Seek partnerships with ESG consultants, auditors, and sustainability-focused fintech providers to access expertise and technologies that enhance sustainability disclosure.

Actively engage with investors on sustainability topics of interest to them and participate in industry platforms aimed at building collective ESG capacities across fintech firms.

By implementing these recommendations, stakeholders can contribute to the advancement of fintech sustainability ratings and foster a more sustainable and responsible fintech ecosystem.

6.1.5. The strategic imperative for regulators and policymakers:

Regulators have a critical role in ensuring responsible growth in the financial sector, particularly in fintech. They can steward sustainability performance and transparency by implementing mandatory reporting requirements for fintech players. By focusing on disclosing the most material ESG metrics through a principles-based approach, regulators can provide flexibility for diverse fintech business models while increasing the availability of sustainability data from the sector. Regulators need to drive smaller start-ups to prioritize sustainability from their inception. Collaboration with reputable standard-setting organizations is necessary to develop sustainability reporting standards tailored to fintech business models, issues, and impacts. Regulators can also incentivize sustainability leaders in fintech through mechanisms like expedited licensing.

6.1.6. The strategic imperative for standard-setting bodies and industry associations:

To achieve fintech sustainability ratings, frameworks measuring performance on material issues specific to fintech operations and digital financial services are required. Given the nascent and dynamic nature of the sector, developing suitable reporting standards and materiality principles requires collaboration between ESG experts and various industry stakeholders. Capacity building is crucial, as many fintech start-ups lack the resources and awareness to implement sustainability measurement and reporting. Industry platforms that foster collective learning and progress among both younger and established firms can embed sustainability management into the fintech ecosystem.

6.1.7. The strategic imperative for investors:

Investors have a significant role in driving sustainability in fintech by integrating sustainability ratings into their capital allocation decisions and engaging with fintech firms. Analyzing fintech players' performance on material environmental, social, and ethical issues informs investment decision-making and enables better engagement. Directing more capital towards sustainability leaders encourages others to follow suit, unlocking the sector's potential for advancing equitable and sustainable development.

In summary, coordinated multi-stakeholder efforts focused on reporting requirements, measurement standards, capacity building, and investor integration are vital to mainstream fintech sustainability ratings. This approach harnesses the disruptive power of fintech to transparently drive ethical innovation in addressing pressing global challenges.

Targeted Recommendations for Advancing Fintech Sustainability Ratings

Stakeholder	Recommendations	Rationale
Financial Regulators and Policymakers	- Develop clear and specific ESG (Environmental, Social, and Governance) guidelines that are designed to fit the unique operations of fintech companies. - Require fintech firms to be transparent and openly share information about their ESG practices and impact.	Helps ensure fintechs are aligned with sustainability goals, mitigating systemic risks and ensuring market stability.

	- Promote partnerships between fintech companies and traditional banks to encourage and adopt more sustainable business practices.	
Standard-Setting Organizations and Industry Associations	- Create clear and consistent ESG metrics tailored to fintech operations. - Encourage the widespread use of ESG reporting standards across the industry. - Offer regular training sessions to help fintech companies understand and implement ESG best practices.	Aids in creating consistent benchmarks, enhancing comparability and fostering a culture of sustainability.
Investors	- Focus on investing in fintech companies that demonstrate a strong commitment to ESG practices. - Collaborate with fintech firms to help them enhance their sustainability efforts. - Incorporate ESG criteria as a key factor in investment decisions.	Encourages the flow of capital into sustainable fintechs, driving long-term value and promoting responsible investment.
Fintech Companies	- Embed ESG (Environmental, Social, and Governance) principles into your main business strategies and operations. - Consistently share ESG performance using clear and standardized measurements. - Develop innovative solutions that tackle issues like financial inclusion and climate change.	Enhances trust, attracts investment, and ensures long-term viability by addressing sustainability challenges.

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