

RiskLogix

White Paper



Proving Corporate Integrity with ESG

A Practical Guide

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Introduction

Environment, Social and Governance (ESG) reporting is a hot topic. Investors want to know the ESG credentials of their potential investments, and reputations can be won and lost if those ESG credentials are found wanting. Indeed, failing to meet a key ESG requirement, for example, finding the use of child or forced labour in the supply chain, is a huge risk to any business. It takes many years to build a good reputation and the resulting brand value, but only one news headline to destroy it, with the possibility of never being able to recover investor, shareholder and customer confidence.

As a measure of corporate integrity ESG is being taken extremely seriously by Board level management, who recognise that driving their business strategy in conjunction with ESG is now key to success. However, ESG is a broad subject that impacts organisations and their stakeholders in every area of the business. Organisations need to build an in-depth understanding of how they impact the world around them providing annual assurance to investors and all stakeholders that they are managing ESG topics effectively.

Despite being several years away from a single set of standards for ESG reporting, there are plenty of papers written on the subject and regulation in this area is likely to grow exponentially in the coming years. For example, in the UK the Financial Conduct Authority has published its Guiding principles on design, delivery and disclosure of ESG and sustainable investment funds; in the EU there is the Sustainable Finance Disclosure Regulation (SFDR); and in the US, while ESG reporting is still voluntary, the Securities and Exchange Commission has announced a new enforcement taskforce focused on climate and ESG issues to identify ESG-related misconduct.

Other regulations that may be applicable include: ISAE 3000, United Nations 17 Sustainable Development Goals, Sustainability Accounting Standards Board, EU Sustainable Finance Taxonomy, Streamlined Energy and Carbon Reporting, and WEF – ESG Metrics.

This white paper takes a practical approach to ESG, laying out a process that any size of business can follow, that will adapt and grow over time. We provide practical guidance on what firms should do in the short term, with a coherent strategy to develop a continuously evolving ESG program for the longer term, something that we will explore further in future white papers.

Developing an ESG Strategy

It is important to have an organisation-wide ESG strategy that sets out long-term goals while effectively managing short-term aims that reflect the organisation's ESG appetite. Bland statements about achieving gender pay equality within a year, for example, may not be realistic in the timeframe, setting the business up to fail. Whereas a well thought through ESG strategy, that provides a graded approach, building on each ESG milestone, will support corporate statements around ESG. This stepped approach helps to ensure that charges of 'greenwashing' are avoided, something that US, EU and UK regulators are now focusing attention on.

With an agile approach to ESG businesses can start with manageable objectives and grow and evolve ESG goals over time.

A measure of ESG Appetite across the Business

ESG is not just about the regulators, it is also market driven and therefore needs input from all key stakeholders. The first step is for the business to identify its ESG appetite, i.e. what elements of ESG are most important to the company and its stakeholders. What does the company want to stand for and how does this fit within its brand values and corporate identity? ESG issues could be:

Environmental

- Emissions
- Severe weather effects
- Waste disposal
- Renewable energy

Social

- Diversity and equality
- Employee well-being
- Consumer safety
- Data privacy

Governance

- Tax transparency
- Bribery & corruption
- Executive remuneration
- Shareholder relations
- Compliance

The most important ESG issues are known as material topics. These are the topics that matter most to the company stakeholders, including investors and customers, that need to be managed and reported. The GRI Standards suggest ESG topics that could be considered material. However, it is up to the individual organisation to decide what the most important topics are for them and their stakeholders.

What is Materiality?

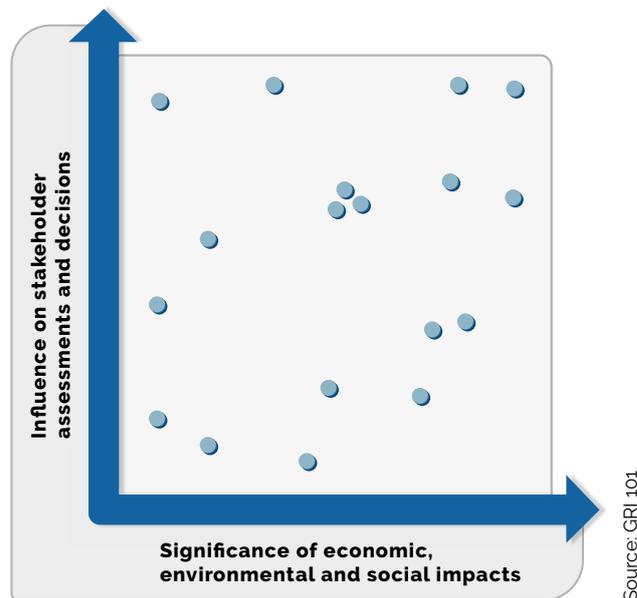
In its broadest form, materiality looks to capture the significant impacts an organisation has on the economy, environment, and people. These impacts are not necessarily captured by enterprise value and there will be parties that are interested in an organisation's contributions to sustainable development.

A more focused approach to ESG reporting is taken by SASB, which looks at financial materiality in the context of sustainability information that affects enterprise value in the shorter and longer term.

A tighter definition is where ESG information is taken from financial accounts and used to improve economic decisions.



Material topics are assessed for reporting in two dimensions which can be; significant economic, environmental and social impacts by or to the firm, or, substantive influence on the assessments and decisions of stakeholders.



These topics can represent threats due to negative impacts, or they can represent opportunities. Each topic should be assessed for impact both on and by the organisation and influence on stakeholders. While it is possible to identify the current material topics, it is also advisable to monitor other topics to provide visibility should previously benign topics become material.

Program Milestones – one step at a time

Having identified the priority issues and topics, an ESG project should aim to provide a program of continual delivery milestones, rather than taking a 'big bang' approach to the go-live target date.

A strategy based on continuous improvement and step by step achievements, will deliver quick wins in the short term which is critical for getting board-level and stakeholder buy-in, and enable a longer term set of goals to be realised.

As each milestone is reached, review and adjustment can take place, ensuring that the overall goals are kept in sight, while individual objectives are met within the strategic plan of delivery.

ESG and Risk – closely aligned

There is a growing realisation that strong ESG performance is closely linked to financial performance and is increasingly important to investors. An ESG risk can have an existential impact on an organisation – the previous example given of finding child or slave labour within the supply chain, would have serious implications for any manufacturer or retailer, or firm that invested in such an operation. Therefore ESG risk needs to be incorporated into a firm's risk framework from a number of perspectives.

Additional points to consider:

- Direct or indirect impacts of ESG topics on the organisation's operations, for example, the impact of climate change on loan portfolios.
- Reputational risks due to supply chain ESG breaches/failures (as per the example given above).

Once ESG material topics have been identified, organisations need to establish a framework for assessing ongoing risk of non-compliance with established ESG goals. Mitigants must be put in place to avoid a failure to meet stated goals. A similar structure is required to establish governance and oversight for suppliers and the supply chain.

Key Indicators with workflow notifications should be established within the framework for ESG compliance covering:

- Own products and component (OEM) constituent parts
- ESG targets
- Supplier and supply chain behaviour
- Material topics exceeding appetite.

Setting up an ESG Program – first steps

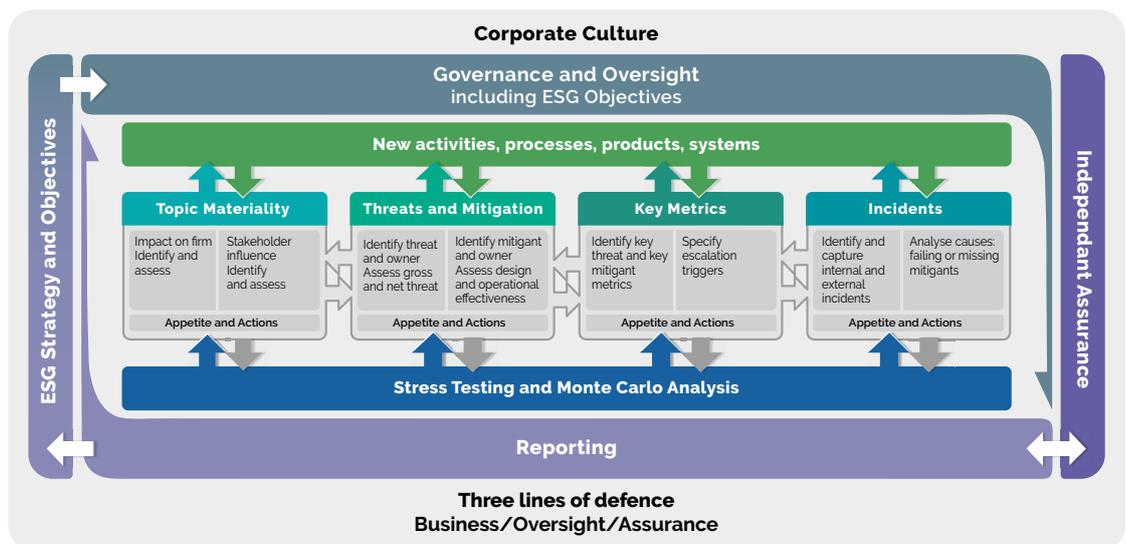
An ESG program, no matter how modest at the beginning, needs to be supported with appropriate systems rather than manual tools. Therefore, it is worth investigating the use of existing technology that is being utilised for Operational Risk Management (ORM). Keep in mind that ESG is interrelated with other GRC activities and the best strategy is to integrate solutions, rather than relying on an ESG point solution. At all costs, avoid spreadsheet solutions, they are tempting but flawed. All of the well-known issues around using Excel for ORM (multiple versions of information, silos of data, difficult and timely to collate into a single version of the truth, lack of transparency, etc.) and other GRC activities are amplified for ESG.

Technology requirements

When assessing a software solution, these are the key areas that will need to be covered by the system:

- Full business universe
- Risk Control Self Assessment – Materiality assessment
- Libraries, ideally a solution that has a pre-built ESG Framework and Library
- Analytics, Business Intelligence and Reporting
- Action plans
- Key Indicators
- Incident capture and management
- Dashboards
- Mechanisms to monitor third party supply chain.

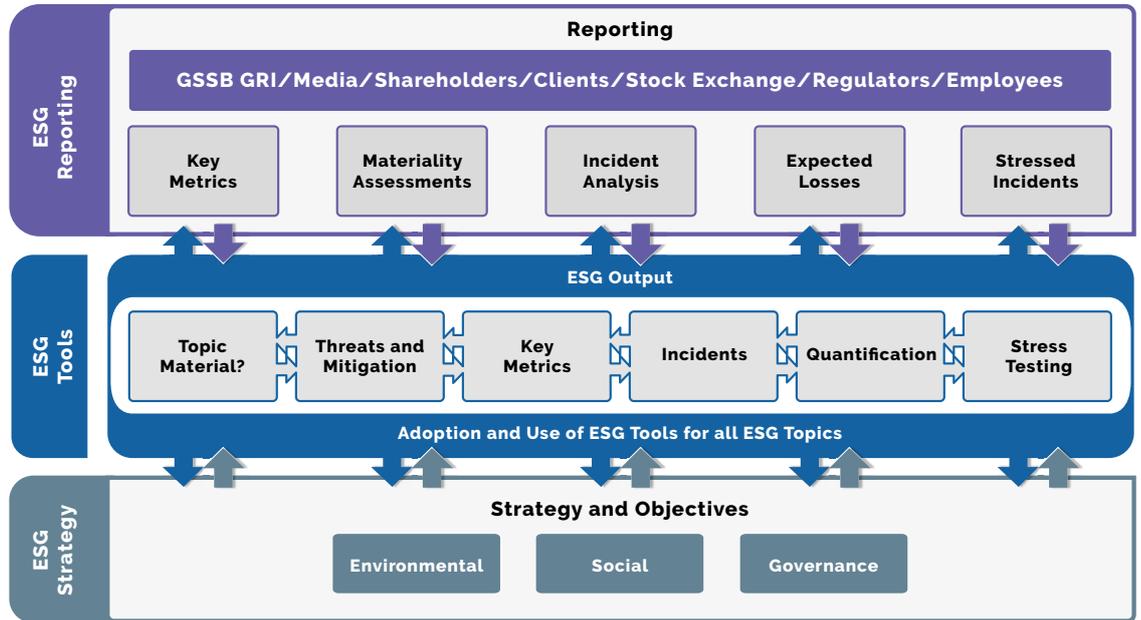
ESG Tools Framework – example



Ten Point Action Plan for ESG Fast Start

- 1. Prepare for a Project**
If you don't have the required technology prepare a project to implement it.
- 2. ESG library**
Consult with stakeholders and develop an ESG library – suppliers such as RiskLogix will already have created one that can be used as a template to get you started.
- 3. Establish an ESG responsibility group**
This should comprise operational as well as product focused personnel. To go back to our earlier example, there is no point having 'green products' if suppliers employ slave labour.
- 4. Create ESG governance structure**
The diagram in the next section is a good example.
- 5. ESG Materiality Principles**
Establish the principles for determining ESG materiality which will be used to identify which ESG topics have an impact on your business and influence your stakeholders.
- 6. Materiality Assessment Process**
Set up the materiality assessment process to decide which of the ESG issues in the library you should report on, and those that you simply wish to monitor (that may in time become material topics).
- 7. Involve Stakeholders**
Involve all stakeholders, documenting the materiality criteria used and the resulting decision, seek agreement on decisions.
- 8. Identify priority ESG subjects**
Having identified the material topics, decide on the priority of each. Once a process has been established and become embedded, additional ESG subjects can be added to the library in time.
- 9. Link to all Business Divisions**
Link ESG subjects back to business structures, by country and/or product lines to ensure the entire business is covered and to encourage organisation-wide buy-in and adoption.
- 10. ESG annual statement**
Create a proforma ESG annual statement, which will help to clarify what needs to be monitored.

ESG Architecture – example



Putting Actions into Practice

Allocate actions to named individuals to ensure ownership.

- Set goals for each ESG activity with objectives and timeframes.
- Create action plans for meeting each target.
- Assess the likelihood of the material topics as well as the impacts, and identify and assess mitigants.
- Create Key Indicators for monitoring progress and stating appetite.
- Capture comparative data from other companies in establishing goals and monitoring progress.
- Create and design information gathering on incidents that could impact ESG targets. Information gathering should be accompanied by detailed workflow to disseminate information out to relevant parties, with Root Cause Analysis.
- Identify key suppliers and supply chains, and the associated information that needs to be reported, for example:
 - Sanctions
 - Fines
 - ESG reports.

Ongoing Longer Term Requirements

ESG Governance Structure

Create and formalise a governance structure process for continuous feedback, reporting and review. This could consist of an Executive Council for ESG with senior leaders, that defines and drives the organisation's ESG strategy.

They should meet on a regular basis, monthly or quarterly to consider the interim reports. The Executive Council would liaise with ESG Taskforces within functional areas across the business, taking feedback and recommendations.

The Executive Council is also responsible for reporting to the Board including briefing on any materiality assessments, and highlighting any ESG issues.

Process to continually review Materiality

Establish a formal framework for continuous reviews of materiality assessments. There should be a process for garnering feedback from external stakeholders (investors, partners, suppliers, etc.) on emerging ESG topics. This should take place at least annually. When new topics are identified, they should be reviewed for their impact on strategic goals.

Monitor Regulation and Market Updates

As well as being cognisant of regulations and emerging guidance, it is important to ensure the ESG team are also up to date with market best practice within similar industry groups. There is a growing number of ESG conferences and events where practitioners can network with peers and keep abreast of current thinking.

Summary and Next Steps

In summary, we advocate taking a stepped approach to ESG management and reporting. By identifying important ESG goals and setting achievable deadlines, firms can demonstrate that they have the strategies and processes to back up their ESG statements. In laying out a cohesive ESG strategy and then delivering on it, businesses of every size can demonstrate corporate responsibility and integrity. In so doing, organisations will reap the benefits of a strong reputation on ESG issues with more involved stakeholders, and the resulting investment opportunities and financial performance.

Connect with RiskLogix Solutions Limited

RiskLogix has worked with financial services firms around the globe, providing innovative software solutions, training and consultancy services. We provide tangible, actionable advice and guidance to help organisations achieve their strategic goals and deliver true business value.

For more information about how RiskLogix can help your organisation achieve its ESG goals contact us today:

Global HQ

Eagle House
167 City Road
London
EC1V 1AW
+44 207 377 2250
enquiries@risklogix-solutions.com

www.risklogix-solutions.com

www.linkedin.com/company/risklogix-solutions

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