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# ESG Synergy for Prosperity: Integrating Social Transformation into Risk Management

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2023



**INTO THE UNKNOWN:**  
CHARTING THE FUTURE AGENDA



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# Understanding and Managing Emerging Risks

## Introduction to Emerging Risks

Emerging risks have a number of characteristics that differentiate them from other risk themes:<sup>1</sup>



A new risk, or a familiar risk in a new or unfamiliar context.



Perceived as potentially significant.



Rapidly changing in nature.



Probability and consequences are not widely understood or appreciated.

These characteristics mean that organisations should seek to have an understanding of the emerging risks that could impact them and have an approach in place to effectively manage risks if they materialise.

## WEF Global Risks Report 2023

In its 2023 Global Risks Report<sup>2</sup>, the World Economic Forum (WEF) identified “five newly emerging or rapidly accelerating risk clusters”.

<b>NATURAL ECOSYSTEMS</b>	Deteriorating risks to natural capital due to growing trade-offs and feedback mechanisms relating to climate change, taking us past the point of no return.
<b>HUMAN HEALTH</b>	Chronic risks that are being compounded by strained healthcare systems facing the social, economic and health aftereffects of the COVID-19 pandemic.
<b>HUMAN SECURITY</b>	A nascent reversal in demilitarization and growing vulnerability of nuclear-armed states to emerging technologies, emerging from new weapons and multi-domain conflicts.
<b>DIGITAL RIGHTS</b>	The potential evolution of data and cyber insecurity, given the slow-burning, insidious erosion of the digital autonomy of individuals, putting privacy in peril.
<b>ECONOMIC STABILITY</b>	Growing debt crises, with repercussions for financial contagion as well as collapse of social services, emerging from a global reckoning on debt and leading to social distress.



# Global risk landscape is constantly evolving

## Top 5 Global Risks in terms of impact (severity)

■ Economic 
 ■ Environmental 
 ■ Geopolitical 
 ■ Societal 
 ■ Technological

	2016	2017	2018	2019	2020	2021	2022	2023
1	Climate action failure	Weapons of mass destruction	Weapons of mass destruction	Weapons of mass destruction	Climate action failure	Infectious diseases	Extreme weather	Cost of living crisis
2	Weapons of mass destruction	Extreme weather	Extreme weather	Climate action failure	Weapons of mass destruction	Climate action failure	Livelihood crises	Natural disasters and extreme weather events
3	Water crises	Water crises	Natural disasters	Extreme weather	Biodiversity loss	Weapons of mass destruction	Climate action failure	Geo-economic confrontation
4	Involuntary migration	Natural disasters	Climate action failure	Water crises	Extreme weather	Biodiversity loss	Social cohesion erosion	Failure to mitigate climate change
5	Energy price shock	Climate action failure	Water crises	Natural disasters	Water crises	Natural resource crises	Infectious diseases	Erosion of social cohesion and societal polarization

### OBSERVATIONS:

- 4 out of 5 Top risks are related to climate changes and the environment. This implies that the risks of a slower and more disorderly transition have now turned into reality, potentially leading to dire planetary and societal consequences.
- Failure to mitigate climate change – ranked as one of the most severe threats in the short term and one we are least prepared for, with 70% of survey respondents rating existing measures to prevent or prepare for climate change as “ineffective” or “highly ineffective”.



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Source: World Economic Forum, Global Risks Report 2023, Global Risk Perception Survey  
Note: Over the ten years, the report has streamlined some risks and added new risks as a result of observed economic, geopolitical, societal and technological trends, as well as exacerbated or emerging trends from the COVID-19 crisis. Consequently, names and definitions of some risks were revised and, where applicable, have been modified and/or expanded to reflect new ways in which the risks may materialize and the potential adverse outcomes they may cause



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# In the long run, climate related risks are increasingly prioritized and becoming more severe

## Short-term

0-2 years

Rank	Risk
1	Cost-of-living crisis
2	Natural disasters and extreme weather events
3	Geo-economic confrontation
4	Failure to mitigate climate change
5	Erosion of social cohesion and societal polarization

## Long-term

5-10 years

Rank	Risk
1	Failure to mitigate climate change
2	Failure of climate-change adaptation
3	Natural disasters and extreme weather events
4	Biodiversity loss and ecosystem collapse
5	Large-scale involuntary migration

■ Economic  
 ■ Environmental  
 ■ Geopolitical  
 ■ Societal  
 ■ Technological

### OBSERVATIONS:

- The top 4 long term climate risks are also perceived to be the **most severe**.
- In WEF's Global Risk Perception Survey that received **1249 responses** worldwide, respondents were asked to rank each risk on a scale of 1 (low severity) to 7 (high severity).



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Note: WEF Global Risk Perception Survey (1249 responses worldwide).  
Source: World Economic Forum; MMC analysis



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# Upcoming climate risks accelerating rapidly may have adverse impact on organisations.

**Most severe climate risks in the long term (10 years)**

**Potential implications for a company**



## Natural disasters and extreme weather events

Loss of human life, damage to ecosystems, destruction of property and/or financial loss at a global scale due to extreme weather events.

Examples include land-based, water-based, atmospheric and extra-terrestrial events / incidents.

- Damages to a company's assets
- Health and safety of employees
- Disruption to business operations and manufacturing



## Failure to mitigate climate change

Failure of governments, businesses and individuals to enforce, enact or invest in effective climate-change mitigation measures.

Examples include the decarbonisation of economic activity.

- Stakeholders' distrust
- Negative brand perception
- Economic losses from operational disruptions, failure to comply with regulations



## Large-scale environmental damage incidents

Loss of human life, financial loss and/or damage to ecosystems due to human activity and/or failure to co-exist with animal ecosystems.

Examples include deregulation of industrial accidents, oil spills / radioactive contamination.

- Financial losses and damages to a company's assets
- Health and safety of employees



## Failure of climate change adaptation

Failure of governments, businesses and individuals to enforce, enact or invest in effective climate-change measures to adapt to climate change.

Examples include the lack of climate-resilient infrastructure.

- Stakeholders' distrust
- Negative brand reputation
- Economic losses from operational disruptions, failure to comply with regulations



## Natural resource crises

Severe commodity and natural resource supply shortages at a global scale as a result of human overexploitation and/or mismanagement of critical natural resources.

Examples includes chemicals, food, minerals and water.

- Environmental degradation
- Increased geopolitical tensions in the region/globally

# What ESG aspects are we already addressing as part of ERM?

## What is Governance?

### Governance is...

*system by which the whole organisation is **directed, controlled and held accountable** to achieve its core purpose over the long term*






*Governance deals with the **accountability of a whole organisation to all its stakeholders** (i.e. Boards, employees, investors, customers, wider communities)*

*the system by which companies are **directed and controlled***



# What ESG aspects are we already addressing as part of ERM?

Key objective of ERM framework is to ensure value is delivered to the wider group of stakeholders

Stakeholder groups	Shareholders	Customers	Employees	Public and wider community	Environmental authority
					
Example primary expectations	Return on investments	High quality products / services delivered	Safe work environment	Responsible business conduct	Compliance with environmental regulation
ERM role in supporting the goals	Risk assurance to achieve business objectives and optimal cost of risk	Visibility over risks affecting products / services	Driving risk awareness culture (including health and safety)	Ensuring corporate social responsibility roles are met	Management of key risks associated with environmental and sustainability targets

## Common queries faced upon integrating ESG to ERM

Risk register alignment	<i>'There is an ESG / Climate change risk in our risk register. How it should be aligned with an overall ESG / ERM framework?'</i>
ESG aspects in risks	<i>'How can we manage the fact that several risks we face have an ESG angle, e.g. People risk?'</i>
Impact criteria	<i>'Environmental is one of the impacts within our risk assessment criteria. How this should be addressed?'</i>
Interaction	<i>'We have both ERM team and ESG risk manager. How they should interact?'</i>
Risk reporting	<i>'Should ESG-related risks be reported separately, compared to other risks we face?'</i>





# COSO provides useful guidance to risk practitioners supporting changes to ESG risk culture in their organisations

Risk Culture is an essential element in supporting an organisation to achieve its risk management and wider strategic objectives. Applying ERM to ESG-related risks includes raising the board and executive management's awareness of ESG-related risks – supporting a culture of collaboration among those responsible for risk management of ESG issues.

## ESG Risk Culture

COSO (Committee of Sponsoring organisations of the Treadway Commission) provides some guidance on how to enhance ESG culture and integration:



Do the organisation's **mission, vision and core values** address ESG-related risks?



Does the **tone from the organisation's leaders** convey expectations on ESG?



Does **management carry out the entity's mission**, vision, core values and strategy?



Is the entity **hiring the right talent** and is the selection process compatible with building an inclusive and talented workforce that reflects its business needs?



Does the entity **tie compensation and promotion decisions to the metrics that advance performance** on critical ESG issues?



Is the entity **empowering people and giving authority** to teams that can make decisions by considering ESG information reflecting local knowledge?



Is the entity's culture promoting **employee behaviours** that are consistent with priorities?



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*Source: COSO: Enterprise Risk Management - Applying enterprise risk management to environmental, social and governance-related risks*



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# Understanding the WBCSD-COSO Guidance

COSO provides useful guidance to risk practitioners supporting changes to ESG risk culture in their organisations

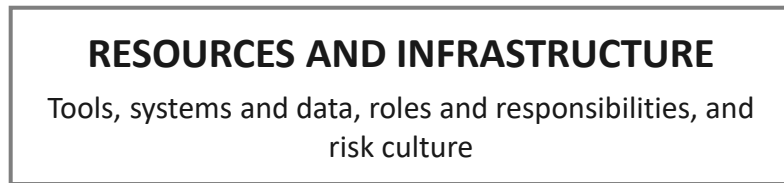
The WBCSD-COSO Guidance covers 5 components...





# Ensuring ERM framework is designed to capture ESG risks

## ERM framework



*Marsh's ERM framework*

## How each element can incorporate ESG angle

- ESG-related requirements
- Board awareness
- Committees and ToRs
- Reporting structures and accountability
- Internal governing documents
- Risk appetite and alignment to SDGs

- ESG-related risks gap analysis
- Involvement of ESG practitioners in the risk identification process
- Ensure risk assessment criteria include environmental, social and governance considerations

- Monitoring external and internal changes that may affect the business
- Embedding ESG in culture and core values
- Communication and reporting





# A strategy should articulate the foundational philosophy and approach to managing risk

Risk is inherently linked to the strategic objectives of an organisation, as it is included within the definition of risk:

**Risk is defined as:**

Effect of uncertainty on objectives.

An organisation's strategy will differ but may include objectives to **increase revenue, reduce injuries or develop new products**.

Increasingly, **ESG** has become a part of organisational objectives.

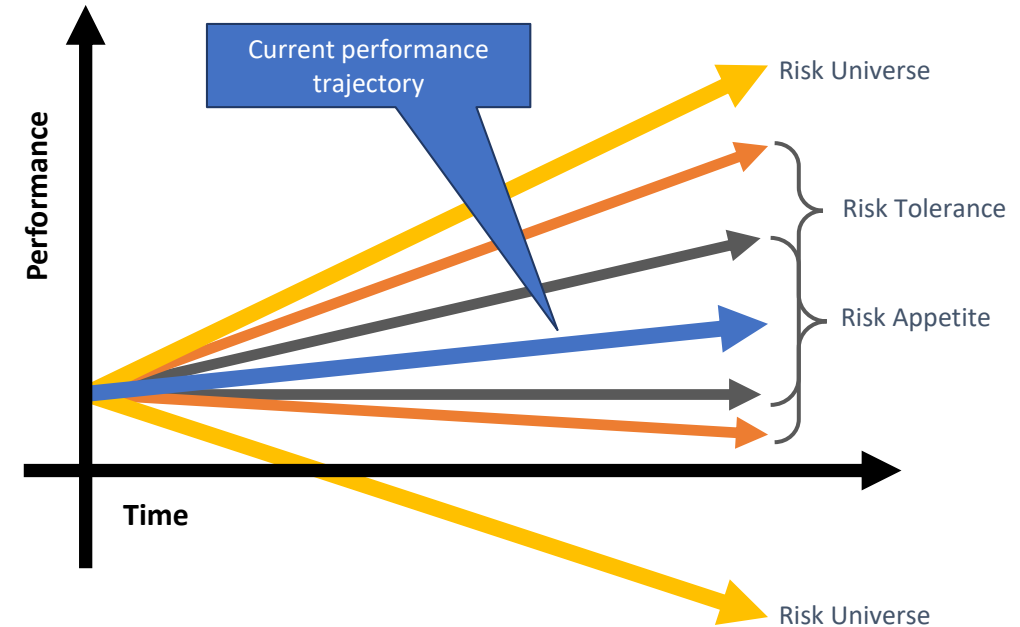
Fundamentally, an organisation should set a strategy for how it will **manage all risks within scope, including ESG risks**. This should include **all areas of uncertainty that impact upon their objectives**.

However, if the approach to risk management is **significantly different, separate policies** should be developed for ESG risks. This is often seen in other areas of risk, such as **credit risk, market risk or supply chain risk** where more specific policies are in operation.

## Risk appetite supports organisations to understand whether the level of risk and type of risk is acceptable

### Defining risk appetite

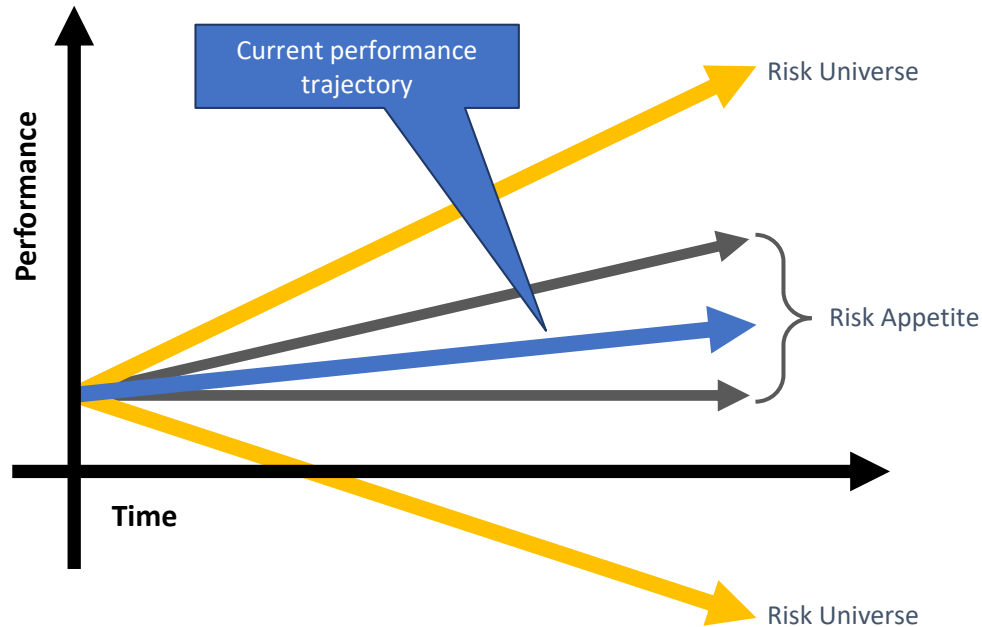
- Collectively, the range of performance outcomes is informed by the **risk universe** and includes all the risks that the organisation may face.
- Those events (threats) with downside consequences that the organisation would be able to withstand, as well as the events (opportunities) with upside consequences which it could pursue, is collectively defined as the **risk tolerance**.
- **Risk appetite** is defined as the amount and type of risk that an organisation is willing to take in order to meet its strategic objectives.





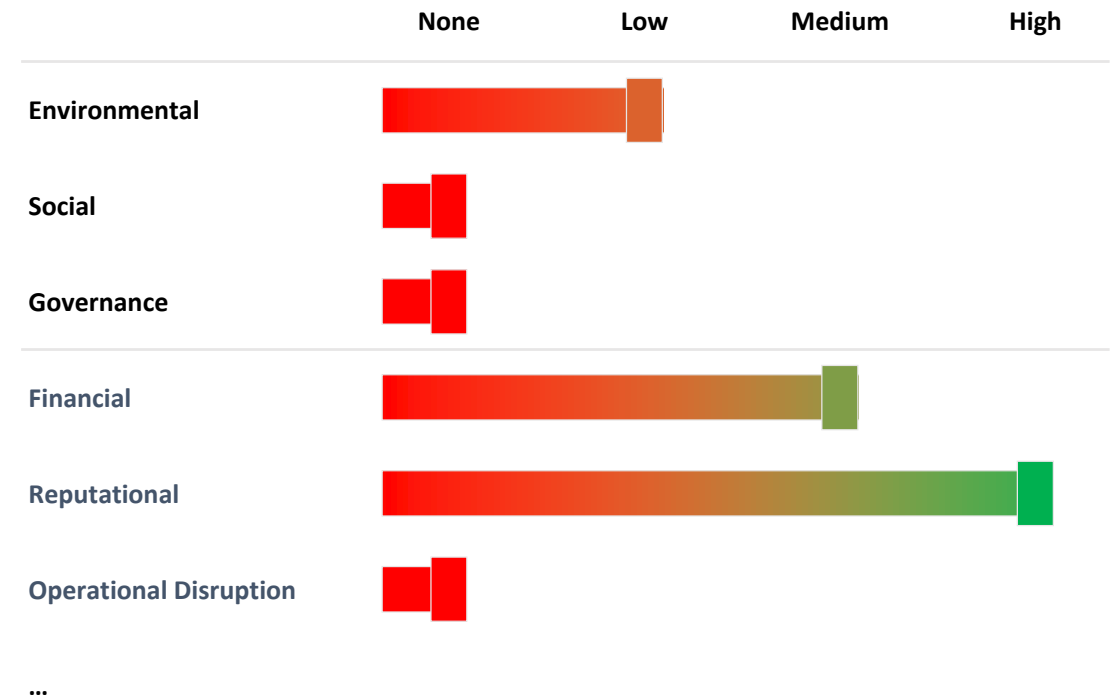
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### Articulating ESG risk appetite



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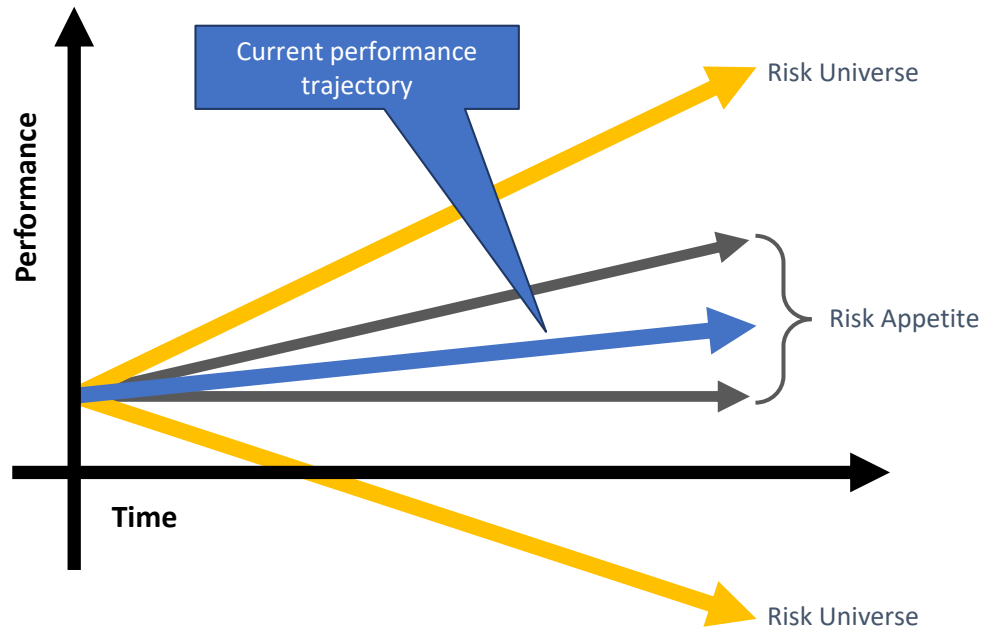
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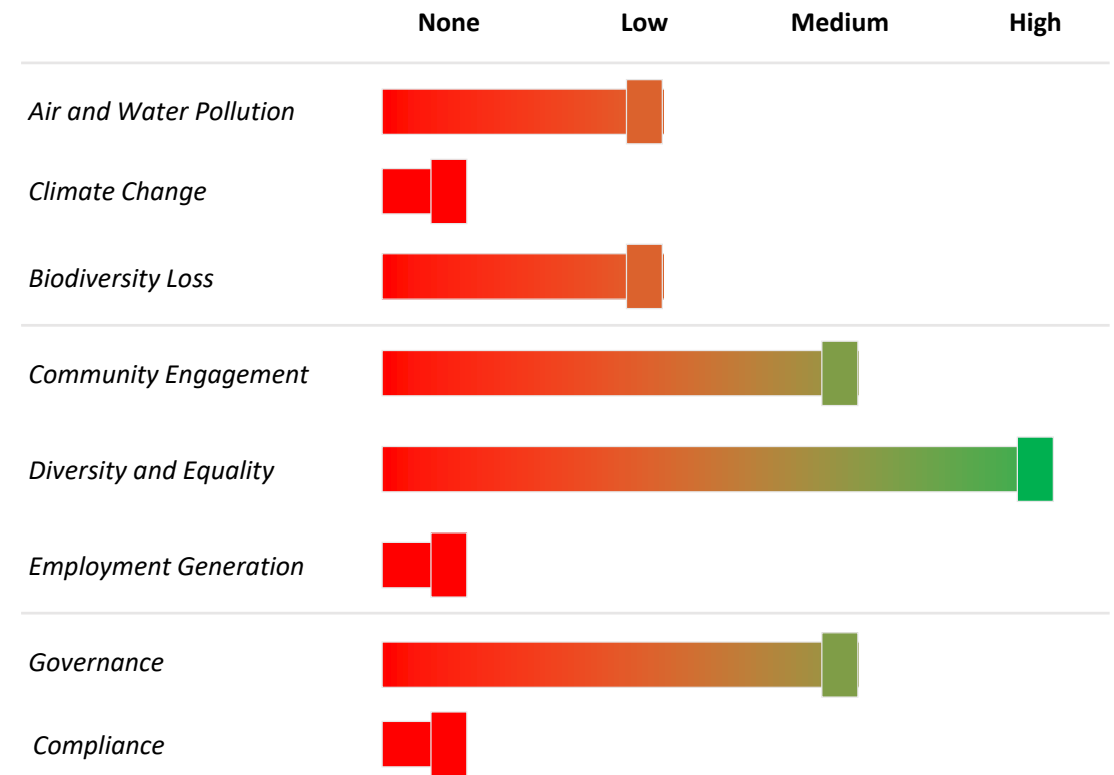
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### Articulating ESG risk appetite



**What other risk categories can be addressed as part of ESG, and what can be the risk appetite considerations?**



## A Three Lines of Defence model provides clear roles and responsibilities for risk management, including ESG risks

To ensure that there is adequate oversight and assurance for risk management, and that roles and responsibilities are allocated appropriately, organisations often use a **three lines of defence model**. This model is used for other functions, such as compliance.

### Example Three Line of Defence Model

#### Oversight

- Hold senior management accountable
- Approve the organisation's strategy together with its risk appetite
- Support independence of 2nd and 3rd line

#### 1<sup>st</sup> Line of Defence

##### Risk Ownership

- Perform business activities to fulfil strategic objectives, in line with risk appetite
- Accountable for risks incurred in these activities
- Manage risks via avoidance, mitigation, transfer or acceptance
- Design and operate effective primary controls and procedures in line with frameworks and policies

#### 2<sup>nd</sup> Line of Defence

##### Risk Advisory and Support

- Support the establishment of an effective risk management framework and definition of risk appetite
- Monitor risk profile and escalate as appropriate
- Provide advisory support and challenge to 1st line of defence

#### 3<sup>rd</sup> Line of Defence

##### Assurance

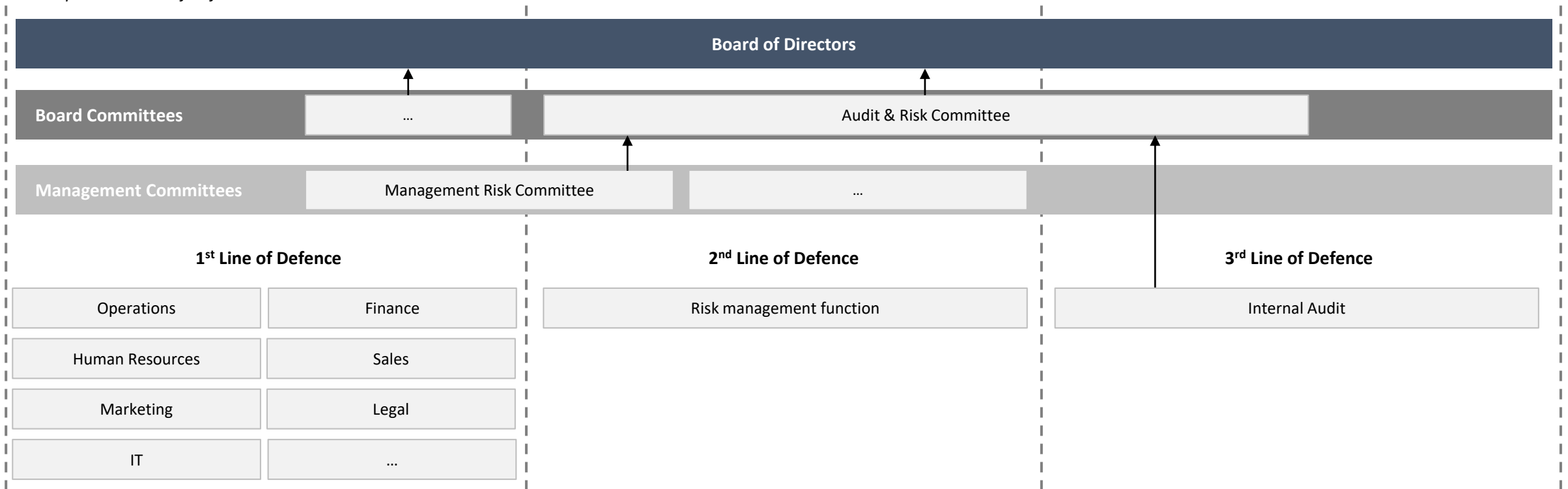
- Independent review of adherence to risk and control standards, mandates and guidelines
- Opine on adequacy and effectiveness of 1st and 2nd line risk management approaches



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*Example Three Line of Defence Model*





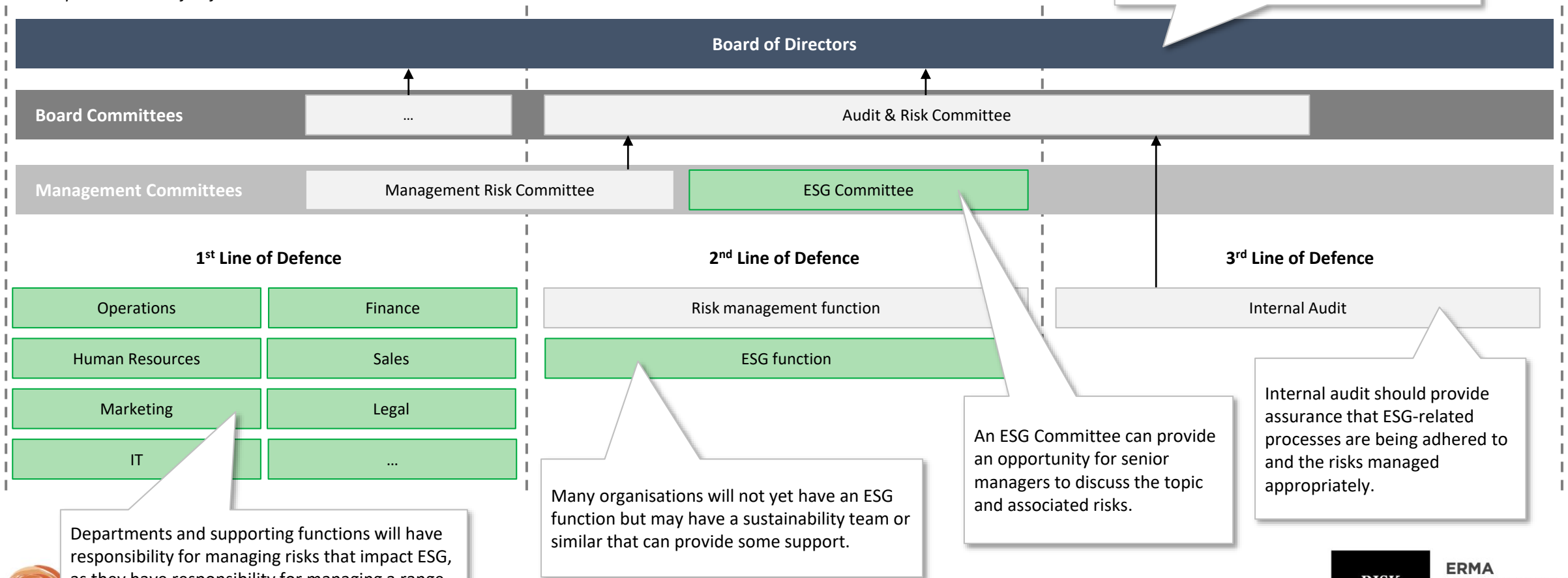


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To ensure that there is adequate oversight and assurance for risk management, and that roles and responsibilities are clearly defined, organisations often use a **three lines of defence model**. This model is used for other functions, such as compliance and ESG risks.

Boards are likely to have accountabilities for ESG risks and reporting as new legislation is introduced globally.

Example Three Line of Defence Model



An ESG Committee can provide an opportunity for senior managers to discuss the topic and associated risks.

Internal audit should provide assurance that ESG-related processes are being adhered to and the risks managed appropriately.

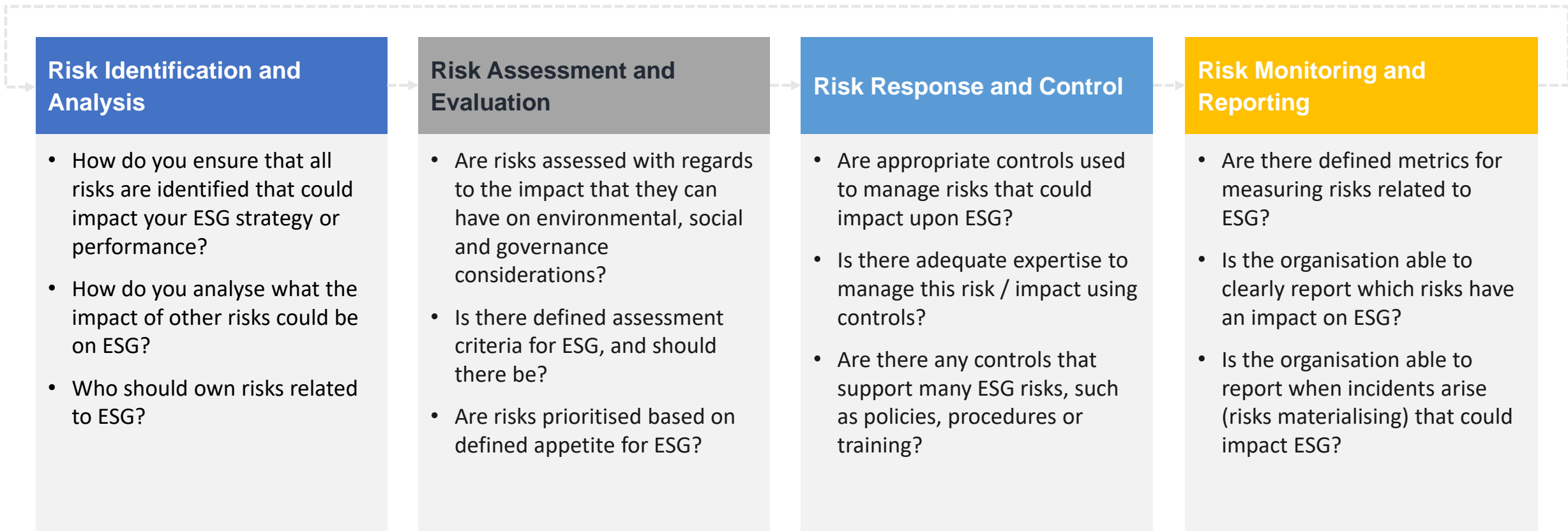
Many organisations will not yet have an ESG function but may have a sustainability team or similar that can provide some support.

Departments and supporting functions will have responsibility for managing risks that impact ESG, as they have responsibility for managing a range of other risks currently.





## The cyclical core risk management process should support management of ESG risks



Adapting the core risk management process to manage ESG risks is vital to success.





# Data is a vital tool to support risk management, especially for ESG risks

Reporting is an essential element of the global focus on ESG currently. Examples of reporting that is mandatory for a range of organisations in is **TCFD (Task Force for Climate-Related Financial Disclosures)** reporting which covers, among a range of requirements, tracking and reporting of GHG emissions.

## Measuring risks with data

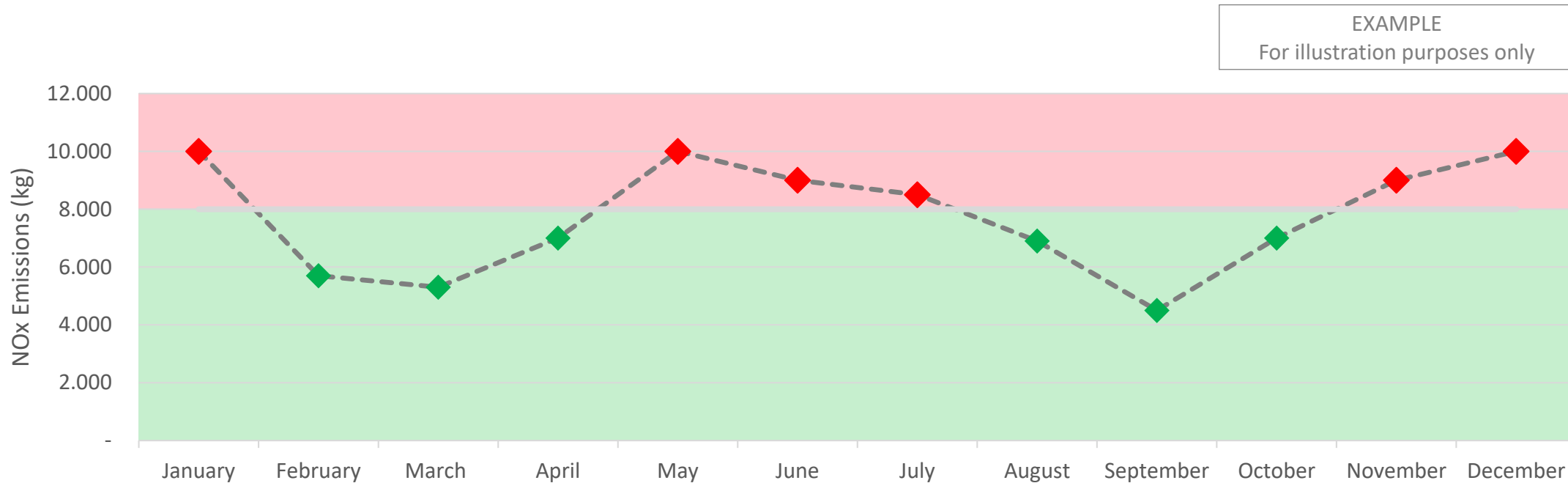
	None	Low	Medium	High	Metric example
<i>Air and Water Pollution</i>					Nitrogen oxides (NOx), sulfur oxides (SOx), and other significant air emissions
<i>Climate Change</i>					Direct (Scope 1) GHG emissions
<i>Biodiversity Loss</i>					Operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas
<i>Community Engagement</i>					Grievances that were addressed and resolved
<i>Diversity and Equality</i>					Ratio of basic salary and remuneration of women to men
<i>Employment Generation</i>					Average hours of training per year per employee
<i>Governance</i>					Governance body members that the organisation's anti-corruption policies and procedures have been communicated to, broken down by region.
<i>Compliance</i>					Confirmed incidents of corruption





# Data is a vital tool to support risk management, especially for ESG risks

## Measuring risks with data



# TERIMA KASIH



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