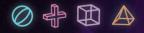


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Building Sustainable Systems: The Convergence of ESG, ERM and Internal Controls

Lew Shu Yuan Vice President, Strategic Risk Consulting, Marsh Advisory, Asia



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About Marsh

Marsh is a business of Marsh McLennan, the world's leading professional services firm in the areas of risk, strategy, and people.



Marsh

Insurance broking and risk management solutions.

GuyCarpenter

Reinsurance and capital strategies.

Mercer

Health, investment, retirement and career consulting and solutions.

OliverWyman

Strategy, economic, and brand consulting.



Strategy, ecor Risk Beyond Is Hosted by Enterprise Risk Management Academy www.erm-academy.org

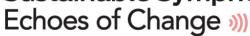


Sustainable Symphony:









Marsh Strategic Risk Consulting (SRC)

The Strategic Risk Consulting Team helps identify enterprise-wide, business continuity, sustainability and cybersecurity risks for organizations across different industries and geographies. We collaborate with key stakeholders on preparedness, and recovery plans to ensure that the business is ready to bounce back from any unexpected event.

Six Pillars of Marsh SRC











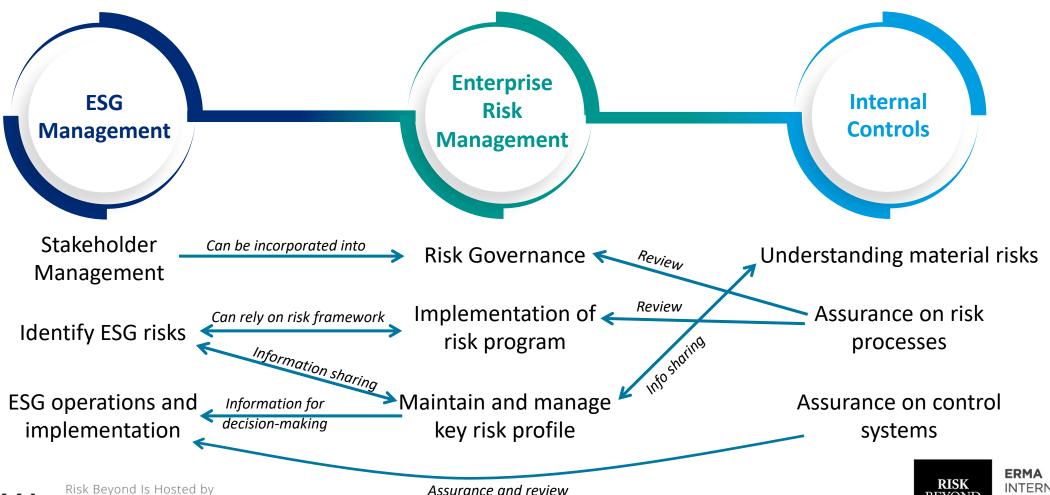








Simple on the surface, but more inter-connected than you think





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Assurance and review



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Understanding ESG











When you see the term "ESG", which aspect comes to mind first?

Environmental

Social

or

Governance?











Sustainability is often illustrated as the balance between 3 areas



People

Universal human rights and basic necessities are attainable by all people. Fundamental to this is — personal, labor and cultural rights are respected and all people are protected from discrimination.





Planet

All of Earth's environmental systems kept in balance and natural resources used at a rate where they are able to replenish themselves.



Profit

Beyond financial impact towards economic impact including creating employment, generating innovation, paying taxes and wealth creation.













ON ERM







The Environment encompasses a wide range of critical issues that reflect a company's impact on our planet.



Reduced household income

Reduced soil moisture and health

Reduced labour capacity

Reduced labour capacity

Reduced labour not prices increase

Increased and quality losses

Increased malnutrition (particularly maternal malnutrition quality of life (particularly maternal malnutrition)

"E" issues remain top-of-mind

58% of Asian Businesses

face more challenges with dealing with environmental issues than from social and governance issues

BNP Paribas, 2024

"E" issues go beyond climate change

< 50% of top 250 businesses globally

recognize biodiversity loss as a risk to their business Global Survey of Sustainability Reporting 2022



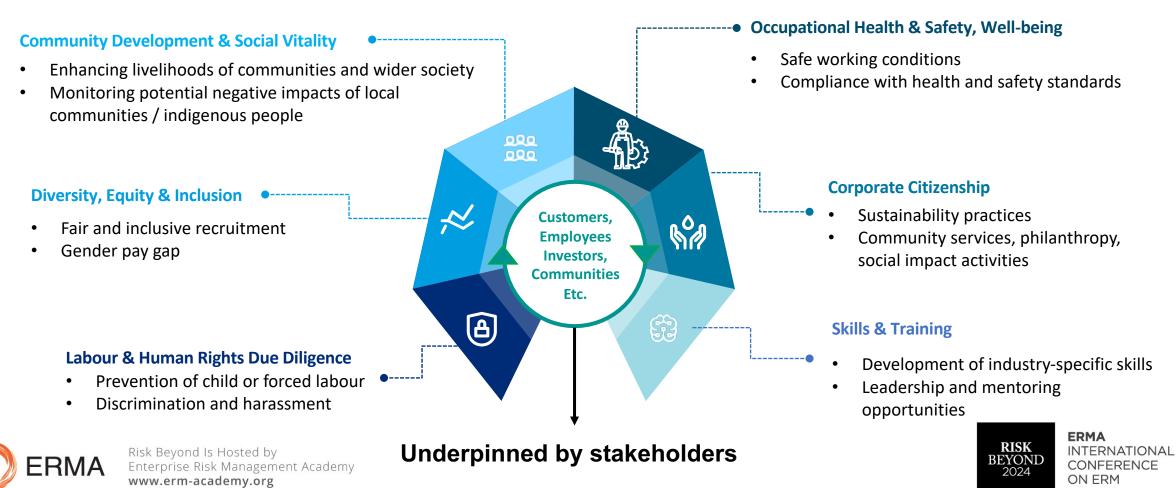
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<u>Social</u> examines how a company manages relationships with investors, employees, suppliers, customers, and the communities where it operates.









<u>Governance</u> refers to processes and practices that ensure the organization operates ethically, transparently, and in compliance with laws and regulations.

Key Concerns at Board Level

- Structure and composition
- Remuneration
- Capital allocation and selection

- Governance and leadership
- Effectiveness in integrating sustainability into operations

Organization Level

Transparency & Disclosures

Taxation

Strategies

Risk and Crisis Management

Ethical

Behaviour &

Corporate Culture

Supply Chain Management

Stakeholder Engagement

Innovation of Products and Services

Health & Safety

Environmental Considerations

Social Considerations

Studies indicate that organizations prioritizing **strong governance practices** often achieve **better financial performance and attract more investors.**





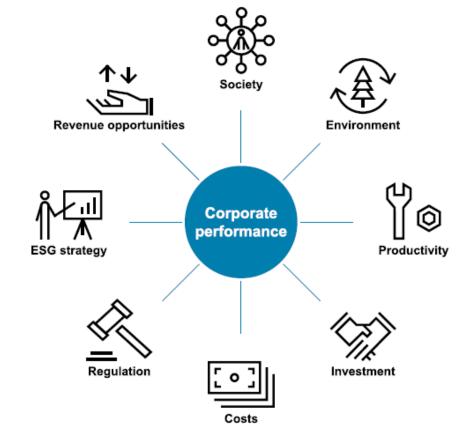






- Facilitate top-line growth
- Reduce current operational costs
- Minimize regulatory, legal interventions and penalties
- Optimise investment and capital expenditures
- Improve the company's reputation and branding
- Strong risk management practices
- Increased shareholder value

The Links Between ESG And Financial Performance



Source: S&P Global Ratings.



ESG is a collaborative effort that takes place across the organization

Every stakeholder has their objective – how do we bring everyone together?

CEO COO **CFO** How does our How are **ESG** impact our **How does our ESG** shifting ESG How do we risk profile? profile impact our priorities align our supply How to assess cost of capital? impacting our chain to ESG and reduce Where should we reputation and commitments? physical climate direct our capital? share price? risk exposure? GC CSO **CHRO** What can prevent How can we stay us from achieving Do our ESG goals ahead of shifting our whole-ofchange our regulations and company employee value other reporting sustainability requirements? proposition? strategy?



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Understanding Enterprise Risk Management



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Risk is inherently linked to the objectives of an organization

ISO31000 defines risk as:

The effect of uncertainty on <u>objectives</u>.

Strategic objectives

- Establish 5 strategic
 partnerships with key industry
 players within the next 3 years
 to enhance market reach.
- Achieve a 20% increase in employee engagement scores within two years.

Financial objectives

- Increase annual revenue by 15% over the next 3 years.
- Achieve a profit margin of 20% by the end of the fiscal year.

Operational objectives

- Streamline production processes to reduce lead time by 30% within 18 months.
- Achieve ISO 9001 certification within 2 years to enhance quality management.

ESG objectives

- Reduce total waste generated by 50% within five years and implement a zero-waste policy by Q4 2025.
- Decrease water usage by 30% over the next 3 years through efficiency improvements and recycling initiatives.

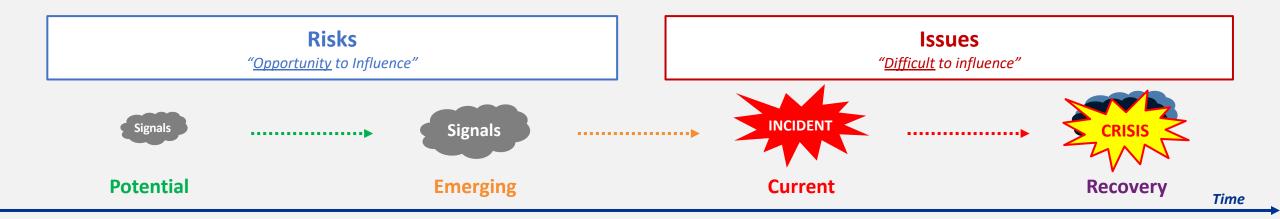








Risk management is meant to enhance proactive decision-making



Risk is an uncertain event or event that might happen in the future

> **Precautionary actions to be** taken

<u>Issue</u> is an event that has already occurred

Too late for precautionary actions. Reactive measures to be taken



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"E" and "S" issues are significant risk topics

Top 5 Global Risks in terms of impact (severity)

(2-year timeframe)

2019

2020

2021

2022

2023

2024

2024

Economic	Environmental	
Geopolitical	Societal	Technological

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.
- Social and environmental issues feature heavily in both the 2- and 10-year timeframes in recent years

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

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Source: World Economic Forum, Global Risks Report 2024, 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

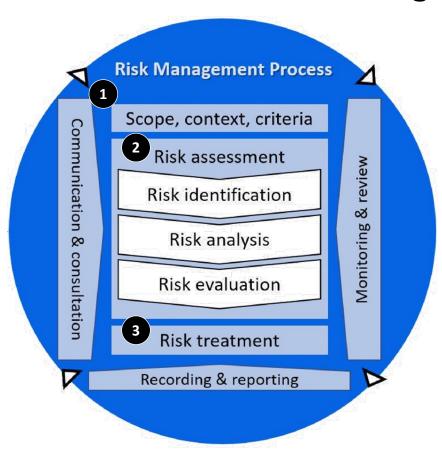








ISO31000 provides a set of principles and guidelines for the design and implementation of a risk management framework



- 1 Establish scope, context and criteria
 - Scope types of risks to be managed under the framework
 - Context strategic or operational objectives of the organization
 - Criteria risks that a company is (un)willing to take
- 2 Conduct risk assessment
 - Identify highlight risks that may prevent an organization from reaching objectives
 - Analyze deep dive into these risks and determine likelihood & impact
 - Evaluate priorities the risks and compare with risk criteria
- 3 Carry out risk treatment
 - Terminate, Tolerate, Treat, Transfer, Increase (Pursue)



3rd line of Defence





The Three Lines of Defence provides clear roles & responsibilities for risk management

Risk ownership

1st Line of Defence

- Perform business activities to fulfil objectives
- Accountable for risks
- Manage and treat risks
- Design and operate primary controls and procedures in line with existing policies

(E.g.: Risk Owners)

2nd Line of Defence

Risk oversight & advisory

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

(E.g.: Risk Management function)

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

(E.g.: Internal and External Audit)

Shared purpose of protecting the organization by having a comprehensive approach to risk management, governance and oversight







Risk Management's Traditional Practices

- Narrow, silo-centric risk identification
- No systematic understanding of correlation among risks
- Risk not considered in strategic decisions
- Risk mitigation and risk finance practices not coordinated across functions
- Risk works alone

Risk Management of Today

- ✓ Risk management is a systematic, comprehensive and integrated activity that is linked to strategic objectives
- ✓ Risk Management plays multiple roles as a source of information, facilitates the ERM process, supports business decisions and protects the organization.
- ✓ Takes into account perspectives from all parts of the organization







ERM serves as a bridge to other aspects of the organization

Insurance Management

Effective risk management informs risk transfer (insurance) strategies, ensuring adequate coverage and cost efficiency.



Risk

Management

Internal Audit

ERM and IA can build on each other's efforts to mitigate risks and ensure the effectiveness of mitigating controls.

Sustainability

Integrating risk management with sustainability initiatives helps identify and mitigate environmental and social risks.





Business Continuity

Risk management is essential identifying potential disruptors to the business, allowing the organization to strengthen its resilience capabilities.





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Bringing ERM, ESG and Internal Controls Together











The COSO-WBCSD guidance is designed to help risk and sustainability practitioners apply ERM concepts and processes to ESG-related risks.



WBCSD – World Business Council for Sustainable Development

COSO - Committee of Sponsoring Organizations of the Treadway Commission

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Enhance Resilience

Viability and resilience of the organization depends on its ability to anticipate and respond to an array of complex and interconnected risks.



Common Language for Articulating ESG-Related Risks

Articulating ESG-related risks brings ESG issues into mainstream ERM processes and evaluations.



Improve Resource Deployment

Enables management to assess overall resource needs and help optimize resource allocation in managing entity-level and ESG-related risks.



Enhance Pursuit of ESG-related Opportunities

Identifying ESG trends and considering both positive and negative aspects of ESG-related risks can lead to new opportunities.



Improve Disclosures

Provide the transparency and disclosure investors expect and achieve compliance with jurisdictional reporting requirements.



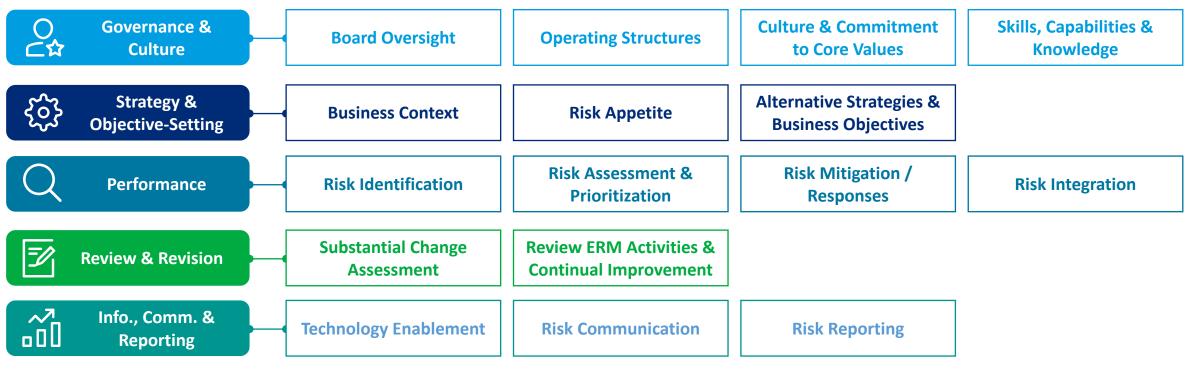






The COSO-WBCSD guidance is designed to help risk and sustainability practitioners apply ERM concepts and processes to ESG-related risks.

The guidance covers 5 components





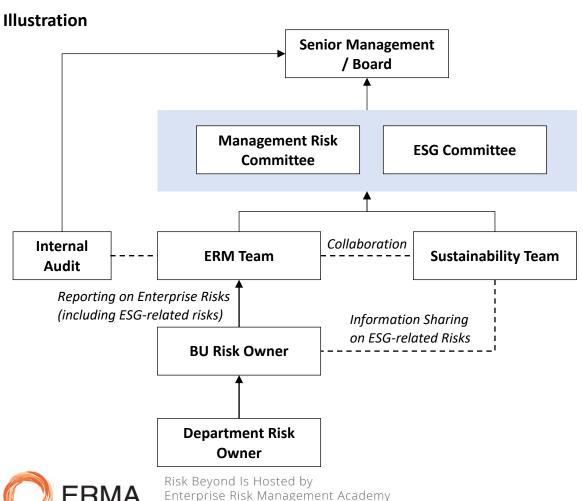








Governance – Collaboration between teams is key



The ERM Team and Sustainability Team should maintain a close working relationship.

- The **ERM Team** should coordinate and review all risk information, and facilitate the management of ESG risks within the ERM process.
- The Sustainability Team should work with the ERM Team to identify opportunities for knowledge-sharing. The team can rely on the inputs from risk owners to understand key risks which can be used to support ESG-related decisions.







Process – Embed ESG thinking into existing processes

Risk Identification and **Analysis**

- How do you ensure that all risks are identified that could impact your ESG strategy or performance?
- How do you analyse what the impact of other risks could be on ESG?
- Who should own risks related to ESG?

Risk Assessment and **Evaluation**

- Are risks assessed with regards to the impact that they can have on E, S and G considerations?
- Is there defined assessment criteria for ESG, and should there be?
- Are risks prioritised based on defined appetite for ESG?

Risk Response and Control

- Are appropriate controls used to manage risks that could impact upon ESG?
- Is there adequate expertise to manage this risk / impact using controls?
- Are there any controls that support many ESG risks, such as policies, procedures or training?

Risk Monitoring and Reporting

- Are there defined metrics for measuring risks related to ESG?
- Is the organisation able to clearly report which risks have an impact on ESG?
- Is the organisation able to report when incidents arise (risks materialising) that could impact ESG?

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











Process – Understanding ESG risks will require an understanding of certain key characteristics

Time Horizon

- ESG risks can manifest in both the immediate and long-term (>15 years).
- As such, thinking about ESG risks may require extending beyond traditional planning horizons,







Stakeholders

- Integrating ESG into ERM requires balancing the interests of various stakeholders
- Goes beyond just meeting customer expectations
- Every part of organization and external parties are involved / have a point of view – management can be challenging for risk teams

Short-term E.g. Compliance cost

Medium-term E.g. Regulatory change

Long-term E.g. Sea level rise











Process – The key objective of the ERM-ESG 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









Process - ERM, ESG and IA speak a common language of risk & controls

The COSO Internal Controls Framework provides guidance on how establishing an effective internal control system, that can be applied to non-financial or internal reporting.

Calabas	Environment

Demonstrate commitment and support to integrity and ethical environment.

Risk Assessment

Specifies objectives with sufficient clarity to enable identification and assessment of risks.

Control Activities

Selects and develops control activities that contribute to the mitigation of risks.

Information and Communication

Obtains or generates relevant information to support the functioning of internal control (control and oversight system)

Monitoring Activities

Ongoing and/or separate evaluations to ascertain whether IC framework is present and functioning.







Process - ERM, ESG and IA speak a common language of risk & controls



Entity-level controls designed to manage risks across the organization (e.g. policies and procedures, training and communication, hiring policies)

Process-level controls specific to a particular activity or function. Controls for ESG risks may already be in place for some of these processes.

Documentation of controls is key:

- What is the control about?
- Who is performing the control?
- When / how often is the control performed?
- Why is the control performed?
- Where / How is the control performed?









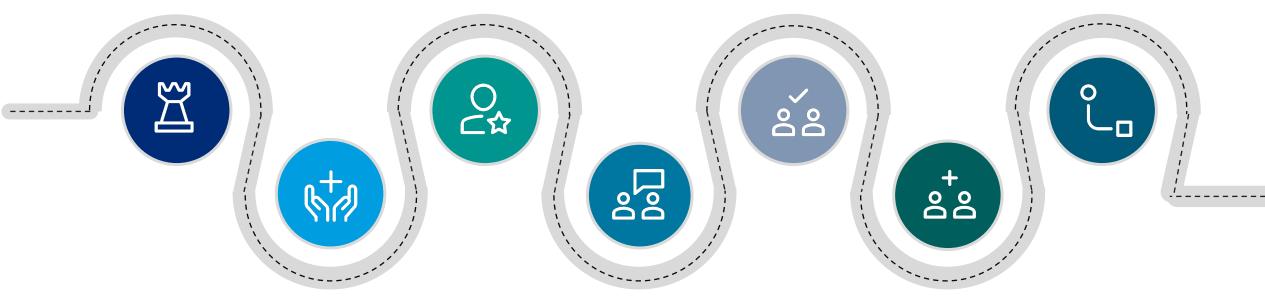
People – the keys to success

Tone from the Top – the leadership "talking the talk" and "walking the talk"

An **organizational culture** that embraces risk management

Technical understanding of ERM, ESG and its elements

Understanding that effective ERM is a **journey**, not a destination



Understanding that effective ERM adds value to the organisation

Transparent communication as the norm

Adequate **resourcing** to effectively manage risk



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- **Con**tinuous
- **Con**sistent



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Terimakasih



