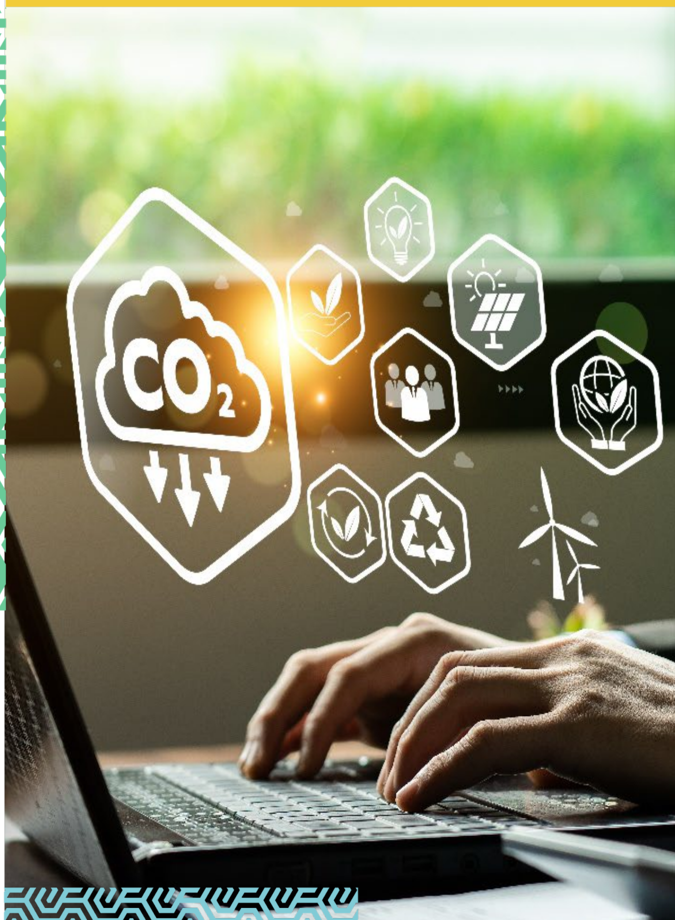
Risk control

ESG



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ESG

Background

ESG….Environmental, Social, and Governance – but what does it mean? Broadly speaking ESG refers to the examination of an organisation's environmental, social and governance practices.

For public sector organisations, much of this is not new. The sector has operated under the guise of the International Framework: Good Governance in the Public Sector for many years. The aspects of 'Environmental' and 'Social' are more recent additions, with guidance around the expectations of the sector still forming.

ESG first captured our attention back in 2005 when an unsponsored report – Who Cares Wins: Connecting Financial Markets to a Changing World argued that embedding ESG considerations into capital markets would lead to better societal outcomes.

Whilst the basis of the report was primarily concerned with ESG in relation to investments, the concept has grown exponentially, with many organisations placing ESG at the centre of their strategic planning processes and board-level considerations.

The use of ESG ratings is becoming an increasingly common method of being able to progress and report on the improvements being made. In March 2023, the UK Government through HM Treasury launched a consultation process to consider whether regulation for providers of ESG ratings should be introduced and on the potential scope of a regulatory regime. The outcome of the consultation was that the then Conservative Government committed to regulating ESG ratings through legislation. It is to be seen whether the current Labour Government will continue with this commitment.

ESG is now big business and there are few organisations who have not yet considered ESG, its impacts and how it will respond to the increasing need to demonstrate positive action in this space.

What is ESG?

The three strands of ESG all focus on different elements of how an organisation operates, but due to the interlinking nature of the elements there can be crossover and the focus of each organisation may be slightly different.

Environmental

In general terms, the focus here is to work to reduce the organisational environmental footprint and make conscious choices about how to operate with the environment in mind. This element concentrates on how to drive environmental efficiency; minimising carbon footprints and maximising the positive impact organisations can have on our planet.

This strand could include - climate change, greenhouse gas emissions (GHG), biodiversity, pollution, water, waste, renewable energy, recycling, and impact from travel.

Of key importance within the environment element is the journey towards Net Zero status. The term 'Net Zero' is now commonplace in our vocabulary as the UK has set its own Net Zero target for 2050. UK organisations are now working to achieve this target by that date or earlier if possible.

The United Nations defines Net Zero as cutting greenhouse gas emissions to as close to zero as possible, with any remaining emissions being re-absorbed from the atmosphere, for instance, by oceans and forests[1].

Social

This relates to the desire for organisations to foster an inclusive culture where people feel supported and stay connected to the communities that surround them at work and home. This element is concerned with organisations fostering a safe work environment and putting in place steps to nurture talent and futureproof their growth and sustainability.

This strand could include - customer relations, labour rights, occupational health and safety, supply chain, employee relations, sustainability, campaign initiatives, volunteering, mentoring and work experience, inclusion and diversity initiatives, mental health, wellbeing, and leadership development.

Governance

This relates to ensuring that organisations work to the highest standards of moral and ethical behaviour. This element is about operating responsibly and making ethics, transparency. and compliance a priority of the organisation and encouraging an open and honest culture throughout the organisation.

This strand could include - executive compensation, transparency, reporting and disclosure, supply chain management, industry collaboration, compliance, human rights, modern slavery, and training.

When considered together, the pillars of ESG provide an indication of the organisation's corporate culture and how ethically and sustainably it operates.

Why Does ESG Matter?

The aim is to take steps today to create a more sustainable and resilient future. It is about working in a way that considers environmental, social and governance elements –

focussing on conducting 'business is ethically in all three areas.

ESG matters because:

1. It is often viewed as the more tangible aspect of Corporate Social Responsibility (CSR).
2. It refers to three key elements that affect the sustainability of an organisation – with the environmental aspect leading the charge
3. It is a set of standards of how an organisation operates with regards to the planet and its people
4. How an organisation 'performs' with its ESG journey could impact on partnership arrangements with others
5. It ensures the organisation is socially responsible, mitigates risks and generates sustainable strategic goals
6. It improves an organisations reputation and drives innovation.

Being able to demonstrate strong ESG credentials can have a positive impact on the culture within the organisation. This can create a happier workplace, positively influencing recruitment and retention and reflect well with supply chain partners.

ESG and the Law

There is no single Act relating to ESG, but rather it is captured by a number of pieces of legislation each of which covers specific elements.

Of note are the following:

- **The Climate Change Act 2008**[2]

  The Act mandates the reduction of carbon emissions and was updated in 2019 to commit the UK to achieve Net Zero status by 2050.

- **The Public Services (Social Value) Act 2012**[3]

  This Act makes clear reference to ESG, requiring public sector agencies when they are procuring to consider how the commissioned service could bring added economic, environmental, and social benefits. This Act requires provider organisations to the public sector to include social value responses in their tender documentation.

The public sector has a significant impact on the environment given its size across the UK. It also has a dual role as a provider of essential services such as public transport and waste collection, but these inevitably contribute to climate change. It is also a regulator and standard setter – putting forward a framework of environmental rules. This reality means that the public sector will be instrumental in meeting Net Zero targets.

In 2021, CIPFA commissioned 'Evolving Climate Accountability' – which examined the practice of sustainability reporting in the public sector. This is a useful report in setting out both the expectations and the barriers to sustainability reporting[4].

The ESG Journey

In embarking on an ESG journey, there is first a need to understand the baseline – what is the starting position? What is in place now? Where does the organisation need to get to?

Planning is essential. Net Zero will not be achieved overnight and there will be a need to manage expectations of the board, senior leaders, and elected officers that this is a long-term strategy for change.

Within each element of ESG activity, there will indeed be quick win solutions, but once the low hanging fruit has been picked, the hard work will begin in earnest.

Everyone is on the same journey, and so this can help in sharing plans, initiatives, and learning opportunities.

As with any large programme or transformational change project, there is a need to identify, analyse and manage risks that could impact on the achievement of objectives.

In addition, steps taken to make ESG improvements could create new risks to existing processes that may subsequently need to be managed. The Risk Manager within the organisation needs to be involved in the process, supporting, and guiding to ensure risks are not missed.

ESG Risk Management

An ESG programme is a form of risk management. ESG data which includes scores and ratings is used to assess the ESG profile and level of ESG risk exposure. ESG rating providers use different methods and question sets to rate organisations, but all will be helpful in highlighting gaps in ESG risk management.

Integrating ESG elements into decision-making processes represents good risk management. It should be part of standard risk processes and built into a risk management framework[5].

ESG risks are effectively the strands highlighted earlier for the elements environmental, social and governance.

For example, these could include:

- Carbon footprint
- Water usage
- Greenhouse gas emissions

— Deforestation
— Wage equality
— Supplier practices
— Data privacy
— Human rights violations
— ESG disclosures
— Corruption and fraud prevention

Embedding ESG

Building an effective enterprise risk management framework will help organisations to assess ESG risks and develop strategies to manage and control them.

Six key steps to consider are:

1. Coordinate all responsible parties
   — ESG needs collaboration across the organisation
2. Rate and prioritise ESG risks
   — Focus on the most impactful ESG risks for the organisation first, and then the others will follow.
3. Determine the risk tolerance
   — Allocate budget and resources in accordance with the risk tolerance levels
4. Define and set sustainability development goals (SDG's)
   — Know the organisation's ESG management objectives. Will environmental practices change? Set achievable goals with a defined timeline and metrics to track progress and measure success
5. Align internal and external communications
   — Be sure to share the journey
6. Monitor and adjust risks as needed
   — As the organisation moves through the journey, ESG will also move forward and so the risk process needs to be dynamic as the risks and requirements change[6].

Summary

Requirements to improve the ESG risk profile and work towards a Net Zero target continue to become more formalised. Much of the guidance remains non-mandatory, but the UK Government is stepping up its efforts in shifting corporate responsibility by making non-mandatory guidelines mandatory. This is particularly so in respect of climate change issues. We will likely see more ESG conscious procurement exercises being run, and a growing importance placed on social value[7].

References

1. https://www.un.org/en/climatechange/net-zero-coalition
2. Climate Change Act 2008 (legislation.gov.uk)
3. Public Services (Social Value) Act 2012 (legislation.gov.uk)
4. Not yet sustainable: the public sector is lagging behind on ESG reporting (globalgovernmentforum.com)
5. What is ESG and Why It's Important for Risk Management (sustainalytics.com)
6. 6 steps to build an ERM framework to encompass ESG risk | EY - US
7. ESG and its relevance to the public sector (localgovernmentlawyer.co.uk)

Further information

For access to further RMP Resources you may find helpful in reducing your organisation's cost of risk, please access the RMP Resources or RMP Articles pages on our website. To join the debate follow us on our LinkedIn page.

Get in touch

For more information, please contact your broker, RMP risk control consultant or account director.

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FP1391-2024