ESG Risk Management
Mitratech
White Paper

MITRATECH

INTRODUCING MITRATECH'S ENVIRONMENTAL, SOCIAL & GOVERNANCE (ESG) RISK FRAMEWORK

by Karl Viertel

Harness Risk Analytics and Assessments combined with expert ESG content to deliver cutting-edge ESG Governance, Risk and Compliance (GRC) capabilities across your enterprise.

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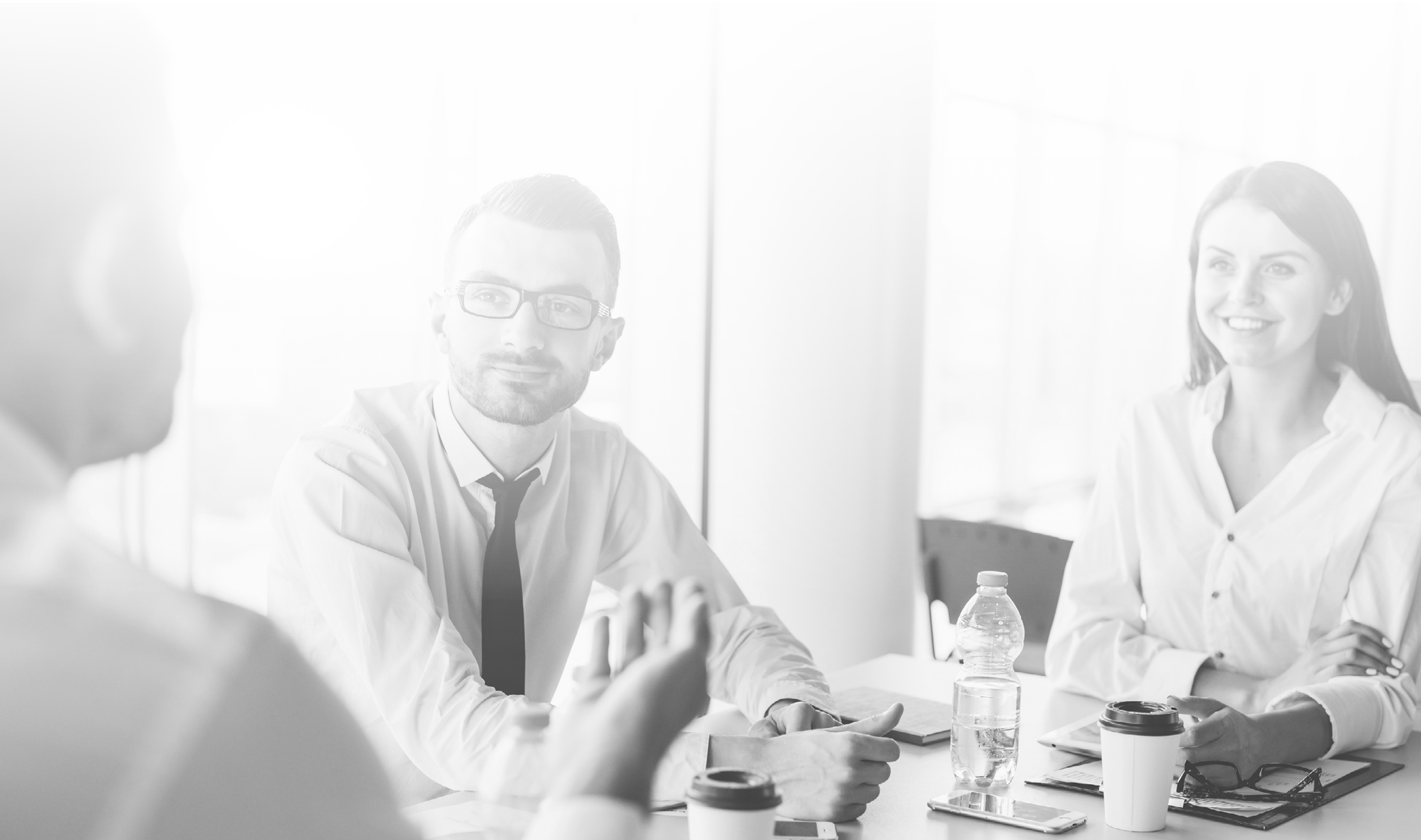
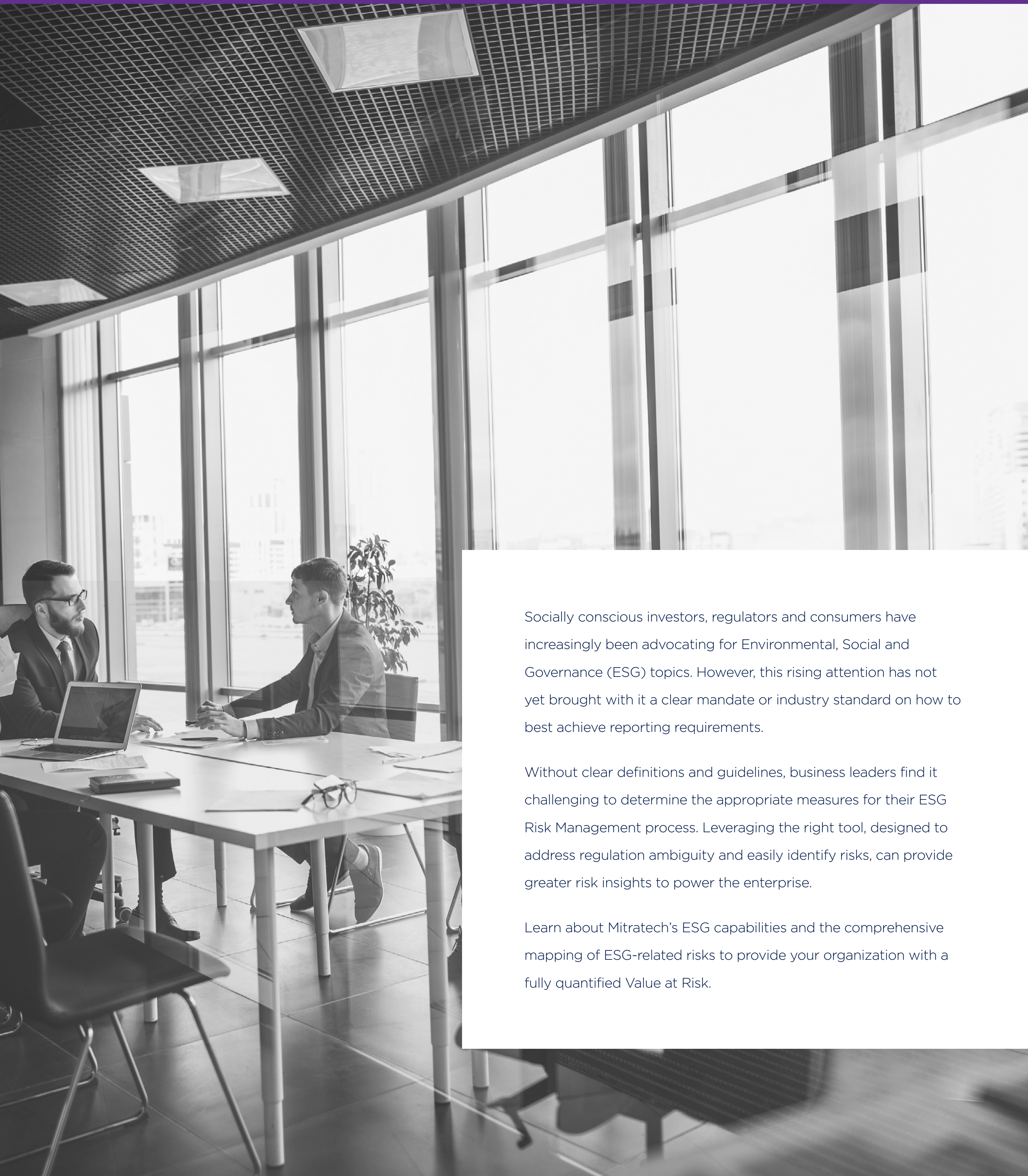


ABOUT THIS WHITE PAPER



Socially conscious investors, regulators and consumers have increasingly been advocating for Environmental, Social and Governance (ESG) topics. However, this rising attention has not yet brought with it a clear mandate or industry standard on how to best achieve reporting requirements.

Without clear definitions and guidelines, business leaders find it challenging to determine the appropriate measures for their ESG Risk Management process. Leveraging the right tool, designed to address regulation ambiguity and easily identify risks, can provide greater risk insights to power the enterprise.

Learn about Mitratech's ESG capabilities and the comprehensive mapping of ESG-related risks to provide your organization with a fully quantified Value at Risk.

EXECUTIVE SUMMARY

In recent years, corporate sustainability has become a widely used global benchmark for non-financial performance. 'Sustainability', a term used to encompass a broad spectrum of topics, is today a concept that is not just about environmental factors but involves building resiliency into infrastructures. With the recent press release from the US Securities and Exchange Commission (SEC), the Climate and ESG Task Force will be coordinating and developing initiatives to identify ESG-related misconduct, in response to the increasing investors' focus and reliance on ESG-related performance and disclosure.

Consistent with the non-profit organizations that are championing ESG causes, regulators are also imposing stricter ESG regulations and demanding greater transparency and accountability through ESG disclosures. In the past decade, we have witnessed the growing investor requirement for ESG data in response to increased awareness of the financial materiality of ESG risks, amongst other factors. In doing so, these socially conscious investors will use ESG ratings in several ways, including assessing and managing their exposure to ESG-related risks and engaging with investee companies. As a result, most firms recognized the commercial need to take action; such that they do not miss out on valuable investment opportunities.

The increased scrutiny and pressure on ESG topics can be felt, even as business leaders continue to wait for a clear mandate for their sustainability reporting. While there are varying requirements for corporates and sovereign bodies, and no single framework has yet emerged as an industry standard, there are different relevant classifications and approaches that organizations can take. Mitratech has selected three key standards to map the Mitratech ESG Risk Framework, to simultaneously support corporate reporting.

Enterprise Risk Management (ERM) and ESG risks have a significant intersection. It is important that your organization understands its ESG performance, risks, and impacts.

In this document, we will be sharing Mitratech's ESG Framework and Risk Management approach, which may help you achieve the ESG-related objectives that your organization has set. You will learn how Mitratech can help you identify ESG risks applicable to your organization and obtain a fully quantified Value at Risk.

THE THREE PILLARS OF CORPORATE SUSTAINABILITY

E
ENVIRONMENTAL

S
SOCIAL

G
GOVERNANCE

Environmental (E), Social (S) and Governance (G) refer to the three central pillars in measuring the sustainability and societal impact of a company. In 2021, ESG transparency has become a key focus, with more information on how companies are managing the environmental and social impact that their business has on the broader community and how to work towards a more sustainable future. In the foreseeable future, we can see that the way organizations deal with ESG risks will directly impact their financial, amongst other aspects, credit ratings. Good governance is an integral part of every ESG strategy, and it will be up to leadership to drive these goals, implement sound practices and deliver transparency. In most cases, a robust governance framework is always supported by a sound internal system of controls and policies that drive effective business decisions.

The Evolving Sustainability Landscape Across Borders

Individual jurisdictions have been gaining traction and taking on different approaches towards building a sustainable business that aligns with Environmental (E), Social (S) and Governance (G) factors. Some focus on climate sustainability while others emphasise comprehensive ESG disclosure. As business leaders continue to wait for a clear mandate for sustainability reporting it is clear that regardless of jurisdiction, there has been increased scrutiny and pressure on ESG topics. Despite the varying requirements for corporates and sovereign bodies, these prospective regulations address the reform of reporting obligations to integrate ESG considerations as we work towards a more sustainable future.

ROADMAP OF ESG REGULATIONS

As with the overarching ESG responsibility, the practice of ESG has received a lot of attention in both national and international standards. This is a timeline of some of the key dates of ESG regulations.

2015: United Nations 17 Sustainable Development Goals (SDGs)

The Sustainable Development Goals (SDGs) were adopted by the United Nations in 2015. These 17 key goals for sustainable developments act as a universal call to action and are intended to be achieved by 2030.

June 2020: EU Sustainable Finance Taxonomy

The European Union (EU) regulation was established to facilitate sustainable investment in the finance industry.

October 2020: UK's Financial Reporting Council

The UK's Financial Reporting Council published the UK Stewardship Code 2020 to ensure standardization of ESG stewardship and investment decision making.

September 2021: Disclosure Regulations CDP, CDSB, GRI, IIRC and SASB

The CDP, CDSB, GRI, IIRC and SASB published a joint statement of intent which details the desire to work towards a comprehensive corporate reporting system. It requires firms to make strategic business and policy decisions regarding their approach to ESG.

March 2021: Sustainability Accounting Standards Board

The Sustainability Accounting Standards Board (SASB) was founded in 2011 to develop standardized sustainable accounting standards. In March 2021, the World Economic Forum and SASB released a joint statement outlining intent to work together towards global corporate reporting.

January 2022: EU Disclosure Regulation Applies

Periodic reporting requirements apply for the Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (also known as the Disclosure Regulation, ESG Regulation or SFDR).

January 2022: Taxonomy Regulation Applies (2 of 6 objectives)

Disclosure obligations to apply for the Taxonomy Regulation ((EU) 2020/852) on climate change mitigation (Article 10) and climate change adaptation (Article 11).

January 2023: Taxonomy Regulation Applies (4 of 6 objectives)

Disclosure obligations to apply for the sustainable use and protection of water and marine resources (Article 12); transition to a circular economy (Article 13); pollution prevention and control (Article 14); and protection and restoration of biodiversity and ecosystems (Article 15).

WHAT DOES THE INCREASING FOCUS ON ESG MEAN FOR YOUR ORGANIZATION?

The size, influence, and complexity of the ESG ecosystem have all increased significantly in recent years. Today, many companies are being evaluated by entities known as Sustainability Rating Agencies (SRA) who measure companies' resilience to various ESG indicators. These indicators are developed with the aim to better support and inform all stakeholders to identify industry leaders and laggards based on their ESG risk exposure and opportunities.

In this changing environment, the bottom line is that ESG requirements are becoming increasingly critical for many large companies, as regulators and investors start to filter out companies that may not be aligned with good ESG practices and may pose a financial risk as a result. The growing role of ESG ratings is constitutive of a broader trend towards ESG-related investment and framed the public perception of companies. In fact, consumers are also making buying decisions, based on a company's ESG standings. ESG risks are now playing a much larger role in contributing to the overall risk exposure of organizations. The rising attention for ESG means that many organizations and financial institutions must start incorporating associated risks into their risk management strategy to remain attractive to investors.

We understand that the first step of defining standards and terminology can be challenging for business leaders.

As such, we have developed the Mitratech ESG Risk Framework to help business leaders best identify ESG risks applicable to their organization.

HOW CAN YOU APPROACH ESG RISK MANAGEMENT?

Risks from ESG factors are already contributing significantly to the overall risk exposure of organizations. In a similar vein, ESG risks can be extensive and their impact on organizations is likely to increase significantly over the coming years.

From the perspective of socially conscious and influential stakeholders, it is no wonder that a structured approach to managing ESG risks is a major factor for new regulation, laws, and other risk frameworks.

ESG Risk Management will be highly relevant for Mitratech customers across industries as they manage higher stakeholder expectations and demands to actively and positively adjust to the requirements of ESG.

Mitratech's ESG capabilities focus on four core drivers:

1 Quick Time to Value

Gaining insights into the ESG exposure on a specific asset or organization quickly is more valuable than an extended analytical process. When information is available at the click of a mouse, stakeholders can extract the full value from this information, to make risk-informed decisions.

2 Comprehensive Overview

ESG risks must extend beyond purely focusing on climate change risks. These are a major focus, however ESG governance is broader than purely addressing climate risk. Mitratech's approach is focused on providing a comprehensive view of ESG risk.

3 Adaptable to Your Organization

The ESG Risk Framework must be adaptable to the context of the asset, object, or organization. Areas of the ESG Framework that are not applicable should not be applied to the asset as it reduces risk data quality.

4 A Scalable Platform

ESG governance becomes meaningful when the coverage extends to all areas of risk. This is especially relevant on the credit side of financial institutions such as banks or funds, where investments must be included as a source of ESG risk in the context of ESG financing.

How Can You Integrate ESG Risk into Your Core Strategy?

Lawmakers and regulators are asking corporations to include ESG risks in their mandatory disclosures.
To meet the greater range of demands from investors and consumers alike, organizations are expected to maximize comparability against commonly used legal reporting standards to close the gap. This directive implies that ESG risks can be compared, managed, and aggregated with other risk types.

ESG RISKS & RISK MANAGEMENT

How Are ESG Risks Like Other Risks?

1 Process for Risk Identification

The same process for identification can be applied to ESG risks. Mitratech leverages the categorizations of assets through funnels and define a maturity rating based on an ESG Risk Assessment.

2 Risk Management

General tracking and treatment of risks remain unchanged. Organizations still have the option to accept, close or treat a risk. When it comes to risk management for ESG topics, the same mechanics apply.

3 Risk Rating Guidelines

ESG risks are at the core, still defined through impact, probability, affected assets and financial loss potential.

How Are ESG Risks NOT Like Other Risks?

1 Predictability of Potential Future Events

ESG risks aim to predict complex and long-term future events. These can be significantly more uncertain than other risk types.

2 Risk Mitigation Processes

Often mitigations are not directly possible for the assessing organization due to the magnitude of the risks addressed.

3 Externally Driven Factors

Many traditional enterprise risks are driven through decisions and factors rooted within the organization's operations. For ESG risks, these are mainly driven through external factors.

How Does ESG Integrate with Enterprise Risk Management?

Enterprise Risk Management (ERM) and ESG risks have a significant intersection. Your ERM ESG approach should leverage existing processes and frameworks but apply new metrics for evaluating ESG risks. The following key elements should be considered when setting up an ESG governance capability:

1 Clear Ownership

Determine who is responsible for the ESG Risk Assessment processes. This responsibility is likely to fall under operational risk or non-financial risk teams, or even a newly dedicated role.

2 Mitigation Strategies

Strategize on how your organization can best utilize information gathered from identified ESG risk analyses. How will you use these conclusions to drive decision-making based on the identified ESG risks?

3 Prioritize Risk Data

Evaluating ESG risk exposure might potentially require multiple data sources. Identify and narrow down the relevant data to include in your analysis – an important step for further process.

4 Reporting Structure

Identify a reporting structure that will allow your company to align with regulatory reporting requirements and consider key decision-makers – such as operational risk teams, ESG sustainable finance teams, shareholders and of course regulators.

When deciding on your reporting structure, always ask:

Who will consume the risk information and make decisions based on it?

ESG RISK FRAMEWORK

What are ESG Megatrends?

Most ESG analysis is based on identifying so-called Megatrends. These describe development that is set to significantly influence the risk exposure of an affected asset. Focus on climate change and pollution as the key Megatrend in the ESG context is a common misconception.

The "E" for "Environmental" is important and climate change will be a challenge for humanity. However, "S" and "G" are equally part of a comprehensive analysis.

The Mitratech ESG Risk Framework is based on our own in-house expertise and research from various ESG expert sources such as the World Economic Forum Global Risks Report, MSCI ESG Megatrends and the United Nations Sustainable Development Goals (SDG).

Mitratech's ESG Risk Framework

The Mitratech ESG Risk Framework consists of 16 ESG Megatrends. These have been further broken down into 95 additional sub-trends. This structure contains more than 300 individual data points.

Climate Change

Increased emission of greenhouse gases in the atmosphere may lead to change in the global climate.

Environmental Pressure

Human activity, destruction of natural habitats and overuse of the planet's resources may increase environmental pressure on flora and fauna.

Future of Work

Shifts in technology and society may fundamentally change the way that we work and the relationship between people and businesses.

People and Values

New generations with a different set of values, an ageing population, growing inequality and new risks to global health may change what people value in their lives.

Democracy and Politics

The power structures in the world may change with current alliances and democracies weakening, with nationalism, advanced weaponry and totalitarianism rising.

Privacy and Cyber

Increased complexity in technology and an increase of malicious actors may lead to rising cyber threats to people's privacy and corporate assets.

Resource Scarcity

Finite supplies of fuels, resources and the land mass needed for growing production may lead to resource scarcity in some industries and regions.

Technology Advancement

Science and technology have never been developing faster. Humanity may be on a trajectory towards new discoveries that can fundamentally transform business and personal life.

ESG RISK FRAMEWORK

Shifting Economic Powers

Traditional elements of the financial system such as interest rates and traditional asset classes may no longer be drivers of capital markets, giving way to economic fragility and digital alternatives.

Poverty Reduction

Existential poverty may be eradicated within the coming years resulting in a new generation of economies and societies on the rise.

Digital Power Concentration

Digital infrastructure providers may continue to accumulate market power creating significant imbalances and dependencies on certain vendors or nations.

Digital Inequality

Access to digital infrastructure is becoming more essential to modern life, which may lead to greater digital inequality for those left behind.

Human Rights

A greater focus on the fight for human rights in global supply chains may lead to higher scrutiny on modern slavery, health, and safety at work.

Health

Many humans may be faced with greater threats to their health while some will benefit from fundamental breakthroughs in medical research.

Travel and Mobility

The way we move people and goods may shift through new modes of transport and energy sources, and in its wake, disrupt entire industries.

Energy

Transitioning the global economy from fossil fuel to renewable sources may transform our approach to energy, from generation and transmission to consumption.

MAPPED ESG FRAMEWORKS

While no single framework has emerged as an industry standard, there are different relevant classifications and approaches.

Nonetheless, firms are expected to follow the recommended disclosures to the extent that is necessary for all stakeholders to understand their ESG position, development, and performance. There are three key standards to map the Mitratech ESG Risk Framework to simultaneously support corporate reporting based on these standards or classifications.

United Nations 17 Sustainable Development Goals

The United Nations have agreed on 17 key goals for sustainable development. These are to be reached by the year 2030.

The 17 Sustainable Development Goals or 17 SDG were agreed in 2015 and serve as a good structure for analyzing risks. Some organizations are guided by the structure for their reporting. On its own, the UN SDG is not a complete ESG Framework to assess risks, however the enrichment of it through the Mitratech Framework adds considerable value.

Sustainability Accounting Standards Board

The Sustainability Accounting Standards Board (SASB) has built an extensive framework of ESG risks. These are further broken down by individual industries.

The focus is on measurability and comparability for sustainable finance decisions and accounting. The breadth can be overwhelming, but the structure is certainly helpful. We have mapped the SASB Materiality Dimensions and the General Issue Category to the Mitratech ESG Risk Framework.

The Mitratech ESG Risk Framework is mapped to these core objectives. This enables ESG Risk Assessments and Reporting based on this structure.

EU Sustainable Finance Taxonomy

The European Union Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment has published a taxonomy. It is widely followed in the ESG sustainable finance industry.

Article 9 of the act identifies six core environmental objectives:

- Climate Change Mitigation
- Climate Change Adaptation
- Sustainable Use and Protection of Water and Marine Resources
- Transition to a Circular Economy
- Pollution Prevention and Control
- Protection and Restoration of Biodiversity and Ecosystems

APPLICABLE MEGATRENDS & SUCCESS FACTORS

Identify Applicable Megatrends

Leveraging Mitratech's Funnel functionality, objects can be analyzed based on exposure to individual Megatrends. The individual Assessments are then generated based on the applicable Megatrends and sub-trends.

1 Run At Scale Assessments

The Assessments are automatically generated based on a combination of base templates to match the ESG exposure profile. A hypothesis is formulated for each Megatrend and sub-trend and a specific question is asked should these hypotheses apply.

2 Qualify Exposure Against Megatrends

The Mitratech Assessment Containers enable dynamic portfolio analysis. Users can understand which Megatrends the portfolio assets are exposed to. Clusters of exposure become visible. This can also be analyzed in the context of different standards, as well as by the timeline of exposure.

Success Factors

Leveraging Mitratech's Funnel functionality, objects can be analyzed based on exposure to individual Megatrends. The individual Assessments are then generated based on the applicable Megatrends and sub-trends.

1 Integrate with Existing Methodology

Do not try to reinvent the wheel from a process perspective. If you have sound and comprehensive ERM processes in place, leverage these to address ESG risks as well. This reduces friction in business lines, people consuming the reports and your auditors. Your ESG GRC does not need to be a fundamentally new capability.

2 Develop a Comprehensive View of ESG

Extend your ESG scope beyond the environmental factor, ESG is defined more broadly. Taking too narrow of a view on the topic will lead to rework, audit findings and lost effort. In the case of ESG financing, this may also lead to misinformed investment decisions.

3 Account for ESG Risks and Opportunities

Make sure to account for both opportunities and risks within a certain Megatrend. Let us assume your organization produces battery technology. Resource scarcity might be a risk. However, increased demand and technology innovations might be an opportunity.

4 Keep It Simple

ESG Risk Management may be new to many organizations. Understanding core risks and gaining an overall perspective on ESG exposure should be your first priority.

Focusing on complex methodology or data structure should follow.

CONCLUSION

The developments described in this document have all pointed towards greater ESG disclosure in mainstream reporting to meet both investors and regulatory demands. It is clear that it is time for organizations to consider ESG risks and other financially material ESG factors. The challenge, however, comes in when only a handful of companies have the expertise to assess ESG risks and the opportunities it presents, in financial terms.

As national jurisdictions implement explicit references to ESG-related disclosure, it is imperative to speak in the language of socially conscious investors and lenders on ESG factors. In fact, delaying ESG non-financial disclosure can vastly outstrip the financial investment that organizations require towards continued success.

Having only a singular focus to understand your risk profile to make risk-adjusted decisions is no longer sufficient to keep your organization ahead of the curve. Rather, you should aim for a broader focus to proactively act on existing non-financial reporting requirements to cater to the growing appetite of responsible investing to truly be accountable on material ESG aspects, high-quality disclosure of ESG information and seamless integration into your core business strategy is necessary.

Learn more about how Mitratech's ESG Risk Framework can help you to best identify ESG risks applicable to your organization, and how it's ESG GRC capability can not only help to kick-start your ESG program but take you right through to fully quantified Value at Risk.

ABOUT THE AUTHOR

Karl Viertel is responsible for Mitratech's global GRC business as Managing Director of the business unit.

After working in the technology and risk divisions of Accenture and Deloitte, Karl co-founded one of the first RegTech companies - Alyne, in 2015. In late 2021, Alyne was acquired by the legal and risk software leader Mitratech.

ABOUT MITRATECH

Mitratech is a proven global technology partner for corporate legal, GRC, and HR teams seeking to maximize productivity, decrease costs, and mitigate risks by deepening operational alignment, increasing visibility, and spurring collaboration across their organizations. By partnering with customers to design, develop, deliver and support the best legal, GRC and HR software solutions on the market; Mitratech enables departments to become hubs of efficiency, innovation and excellence for the entire organization.

Mitratech's Platform provides expert product offerings to organizations worldwide, supplying end-to-end solutions that enable them to implement best practices and standardize processes across all lines of business, as well as effectively manage risks and ensure business continuity.

Mitratech serves over 1,800 organizations worldwide, spanning more than 160 countries.

For more information, please visit: www.mitratech.com

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