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ESG: Is it Bogus or is it the New ERM?

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Presenter Introduction

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Jaime is an experienced executive in the delivery of governance, risk and compliance services. He has more than 20 years of hands-on practical experience. He is responsible for developing RGP's capabilities to assist clients in properly identifying and managing their enterprise risks through delivery of robust internal audit capabilities for both regulatory compliance and operational efficiency and effectiveness.

Prior to RGP, Jaime held various leadership roles as Chief Audit Executive across a diverse set of industries where he worked with their boards and senior executives to integrate their risk strategy while delivering sustainable value. He has an extensive Big-4 background where he served companies around the world improving organizational performance through the implementation of Shared Service Centers/ Center of Excellence (CoE).

RGP is global consulting company that serves over 2,200 clients, includes 76% of the Fortune 500. RGP enables rapid business outcomes by bringing together the right people who together create transformative change.

Today's Agenda

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- What is ESG?
- Enterprise Risk Management
- IA Function – Key Trends
- What capabilities do I need to develop in my team

What is ESG?

"ESG [environmental, social, and governance] is no longer just about a philanthropic desire to do good and be a good corporate citizen. It heavily influences the way that investors, customers, and potential hires look at us as well."

CORPORATE PURPOSESUSTAINABILITYINCLUSIVE ECONOMY

What is ESG?

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Environmental

Assesses the risk of a company and its suppliers/partners from climate events and its impact on the physical environment

Mitigation, transition, and adaptation across:

- Climate Change & GHGs
- Air Pollution (non GHG)
- Water & Wastewater Management
- Circularity
- Biodiversity & ecosystems, rehabilitation

Social

Assesses a company's relative social impact and associated risk from societal actions, including from its direct and indirect employees, customers, and the communities in which it operates

- Labor practices
- Health (physical & mental health) & safety
- Employee engagement, diversity & inclusion
- Community relations, local economic contribution
- Product & service attributes

Governance

Assesses the timing and quality of decision making, governance structure, and the distribution of rights and responsibilities across different stakeholder groups, in service of positive societal impact and risk mitigation

- Business ethics, data security
- Capital allocations, supply chain management
- Governance structure & engagement, Incentives
- Policies, external disclosures, position & advocacy

"Environmental, social, and governance (ESG) refers to nonfinancial factors that may **influence** how **investors,** donors, consumers, and workers **choose** to engage with an organization. ESG management and reporting focuses on **tangible measures** and **intangible values** of an organization. Those measures reflect standards of sustainability, ethical management, and quality of employment within an organization."

Source: Gunnar Friede et al., "ESG and financial performance: Aggregated evidence from more than 2000 empirical studies," Journal of Sustainable Finance & Investment, October 2015, Volume 5, Number 4, pp. 210–33; Deutsche Asset & Wealth Management Investment & McKinsey

ESG Has Gained Significant Momentum in the Past 2 Years Relative to CSR

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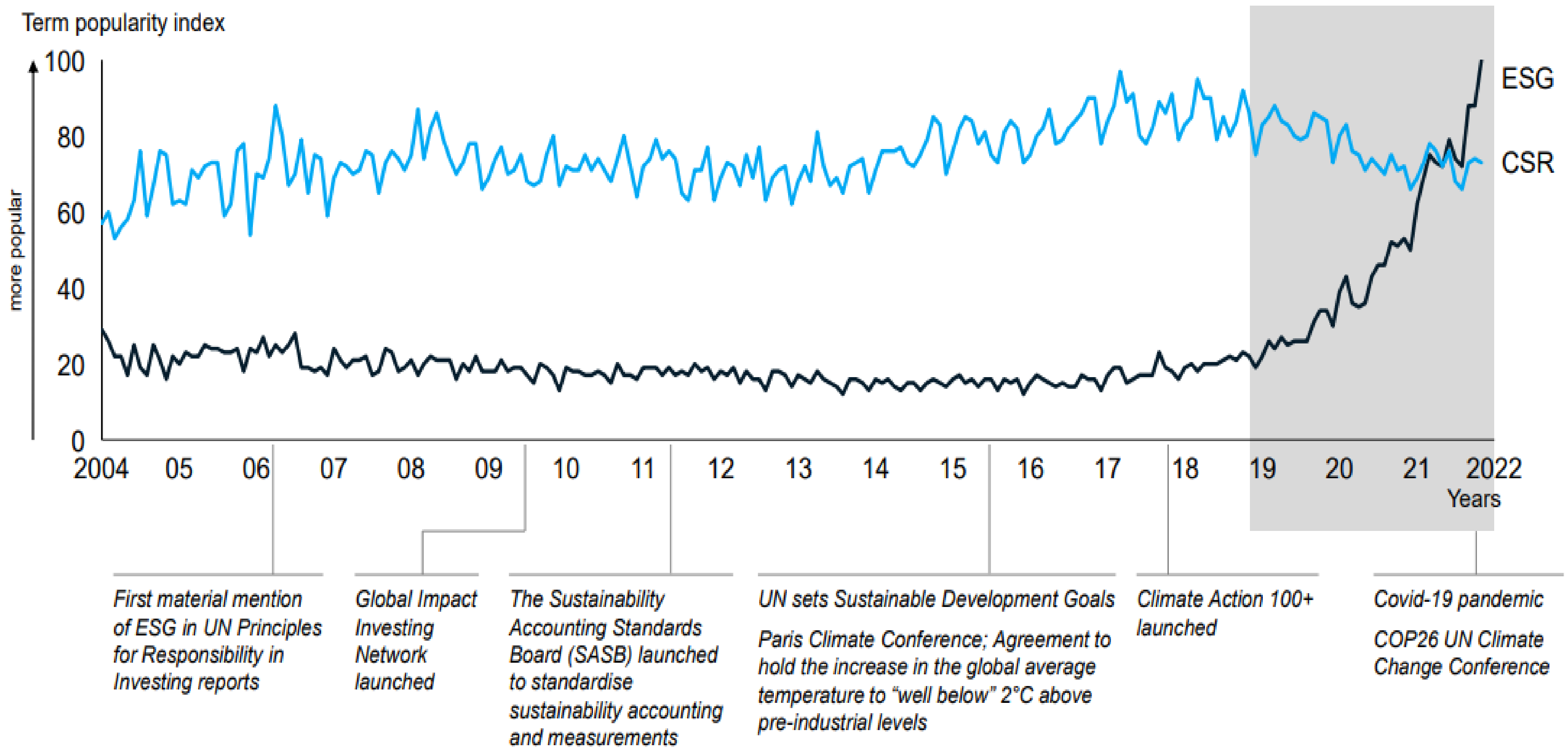
Preliminary WIP



Source: Google Trends

"CSR practices are usually self-regulated and can have a lot of variation. It is a more **qualitative** measure and can be challenging to define. ESG, on the other hand, provides investors with a **measure** they can use to decide which companies to invest in."

Significant Changes in Attitude Across Stakeholder Groups

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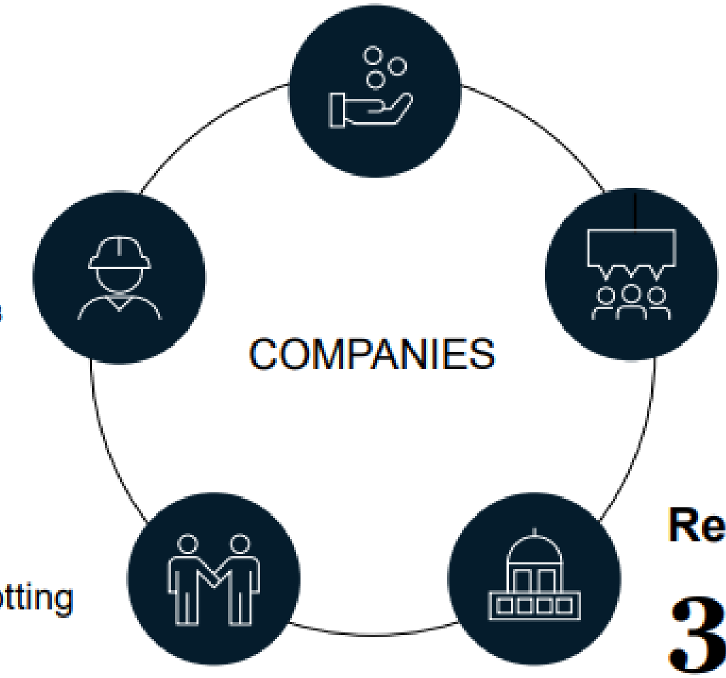
130% p.a. growth in global sustainable funds flow in 2020 vs. 2018[5]

Investors



Employees

70% of employees consider a company's stance on social issues to stay in their current job[3]

Activists and general public

92% of people want large corporations to address societal issues and built an economy serving all stakeholders[1]

Customers/consumers

38% of consumers are currently boycotting products or services due to a mismatch in values[2]

Regulators & governments

35% growth in ESG related policy instruments in 2020 vs. 2019[6]

1. Just Capital 2020 Roadmap for Stakeholder Capitalism; 2. 2020 Compare Cards survey – 87% of consumers say they would boycott according to a 2017 Cone communications CSR study;
3. 2019 Brunswick Insight survey; 5. Global Sustainable Investment Review, 2018 - Calculated for five major markets (EU, US, Japan, Canada, AU/NZ); 6. According to PRI

Source: McKinsey

ESG Will Have a Material Impact in Financial Performance and Reporting

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Top-line growth

- 8% more likely to announce positive net revenue guidance
- 60% more likely to announce a rise in product price

Cost reduction

- 43% more likely to announce a decrease in expense guidance

Regulatory relief

- 35% less likely to announce they are a named defendant in a lawsuit
- 44% less likely to announce they are the subject of a regulatory inquiry or investigation

Productivity uplift

- 20% less likely to experience a labor strike or disruption

Investment/ CAPEX

- 4% more likely to announce the launch of new products/patent issuance
- 6% more likely to announce they are exploring an acquisition/alliance
- 52% less likely to announce they are exploring a divestment

Source: Support from Research of the S&P 1500 by The ESG Analytics Lab of the Wharton School; McGlinch, James and Witold Henisz (2020) “Stop Asking Whether ESG Creates Value and Explore How”

How Exactly Does a Strong ESG Proposition Make Financial Sense?

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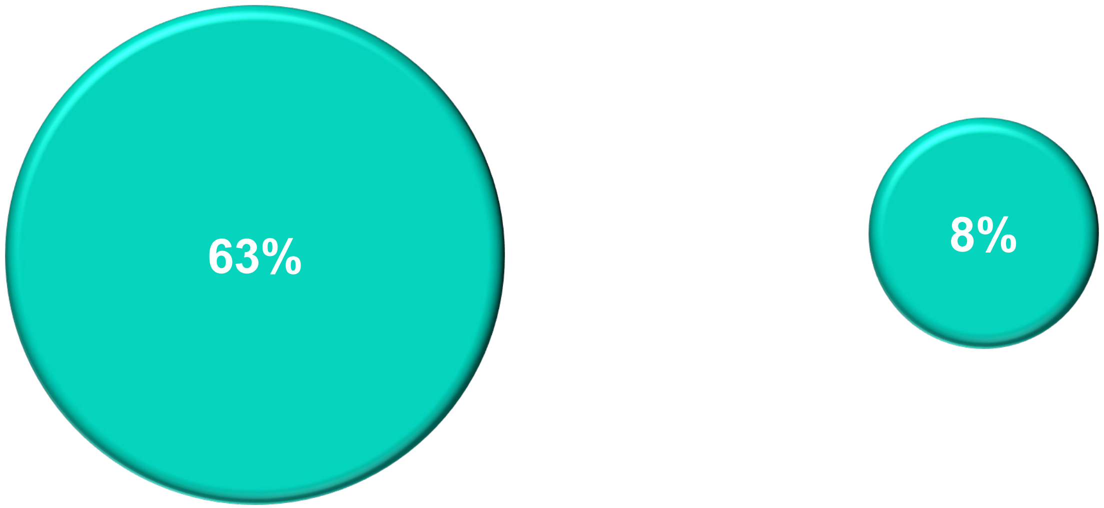
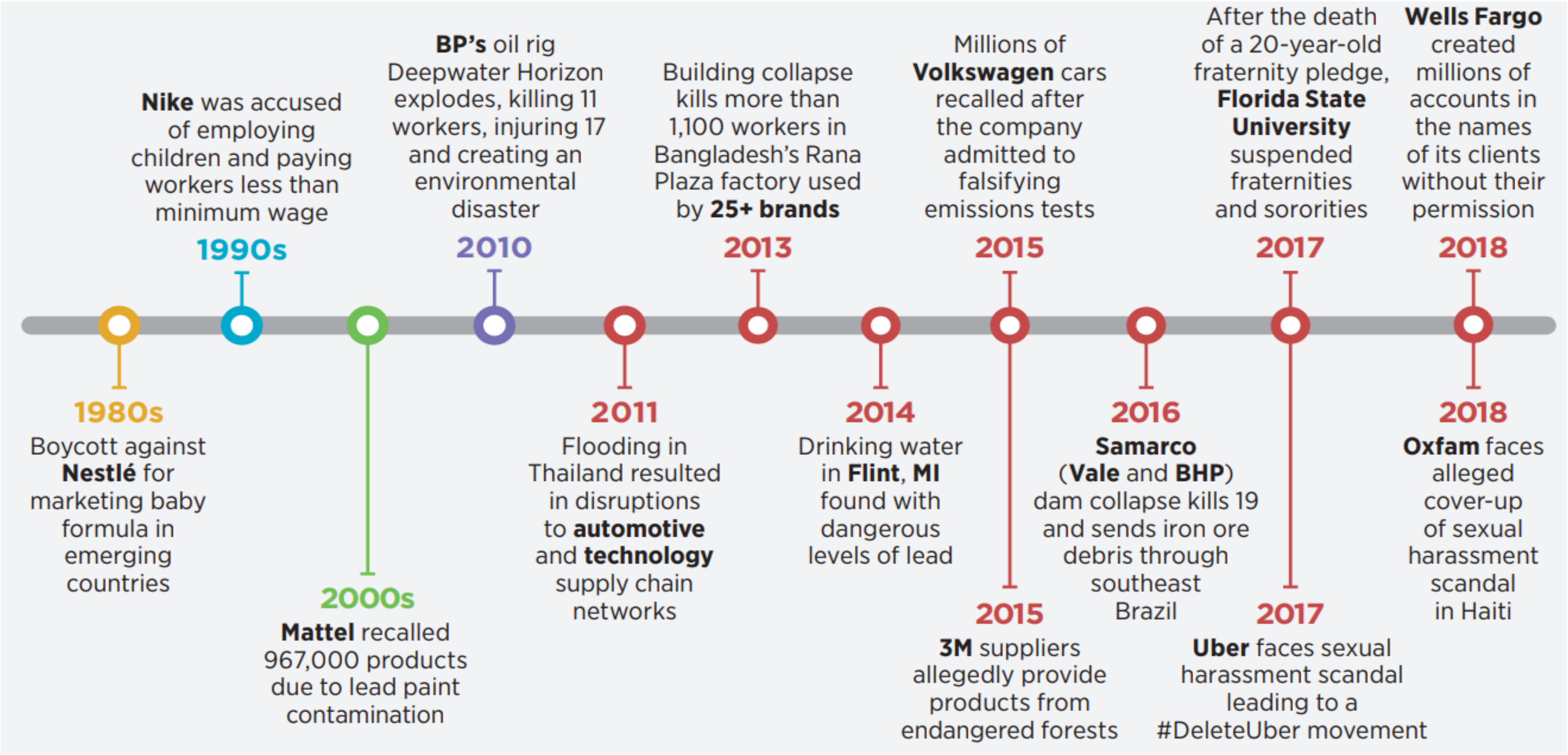
Results of >2,000 studies on the impact of ESG propositions on equity returns

Share of positive findings | **Share of negative findings**



Source: Gunnar Friede et al., “ESG and financial performance: Aggregated evidence from more than 2000 empirical studies,” Journal of Sustainable Finance & Investment, October 2015, Volume 5, Number 4, pp. 210–33; Deutsche Asset & Wealth Management Investment & McKinsey

Examples of Organizations that Have Experience Significant ESG-related Impacts



In the business world, this evolving landscape means ESG-related risks that were once considered "black swans*"are now far more common – and can manifest more quickly and significantly.

* The black swan theory was developed by Nassim Nicholas Taleb, who describes it as "first, it is an outlier, as it lies outside the realm of regular expectations, because nothing in the past can convincingly point to its possibility. Second, it carries an extreme impact. Third, in spite of its outlier status, human nature makes us concoct explanations for its occurrence after the fact, making it explainable and predictable." For more information, refer to the 2007 New York Times article "The Black Swan: The Impact of the Highly Improbable."

“Fundamentally, you need to play defense on risk and offense on growth. That means figuring out how your climate strategy ties into the value creation story.”

SUSTAINABILITYSTRATEGYDECISION MAKINGCORPORATE PURPOSE

Enterprise Risk Management

Why It Matters for Internal Audit

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Each year, Gartner creates an annual Audit Plan Hot Spots report based on input from our global network of client organizations as well as extensive secondary literature reviews. This report highlights current risks and trends in the business environment. It helps audit teams identify risks to the organization more effectively and highlight key risks for stakeholders. This year, four themes underlie the 12 hot spots:

2018	2019	2020	2021	2022
Data Privacy	Cybersecurity Preparedness	Data Governance	IT Governance	Ransomware
Cloud Vulnerabilities	Data Governance	Third-Party Ecosystems	Data Governance	Data and Analytics Governance
Strategic Workforce Planning	Third Parties	Cyber Vulnerabilities	Cyber Vulnerabilities	Digital Business Transformation
Information Security Behaviors	Data Privacy	Data Privacy	Business Continuity and Disaster Recovery (BCDR)	IT Governance
Business Continuity and Disaster Recovery (BCDR)	Ethics and Integrity	Risk Culture and Decision Making	Talent Resilience	Third Parties
Digital Preparedness	Operational Resilience	Project Management	Corporate Responsibility	Business Continuity and Organizational Resilience
Corporate Culture	Cloud Computing	IT Governance	Third-Party Management	Environmental, Social and Governance
Fraud	Digital Business Transformation	Regulatory Developments	Risk Culture and Decision Making	Supply Chain
Shareholder Intervention	Regulatory Uncertainty	Organizational Resilience	Corporate Financial Management	Strategy Execution
Growth and Innovation Pressures	Strategic Workforce Planning	Supply Chain	Data and Analytics	Workforce Management
Geopolitical Volatility	Acquisition Integration	Strategic Workforce Planning	Supply Chain	Retention and Recruitment
New Revenue Recognition Standards	Trade and Tariffs	Artificial Intelligence (AI)	Total Workforce Management	Economic Uncertainty

How confident are you that the organization is managing the risks that really matter?

COSO's Enterprise Risk Management Framework

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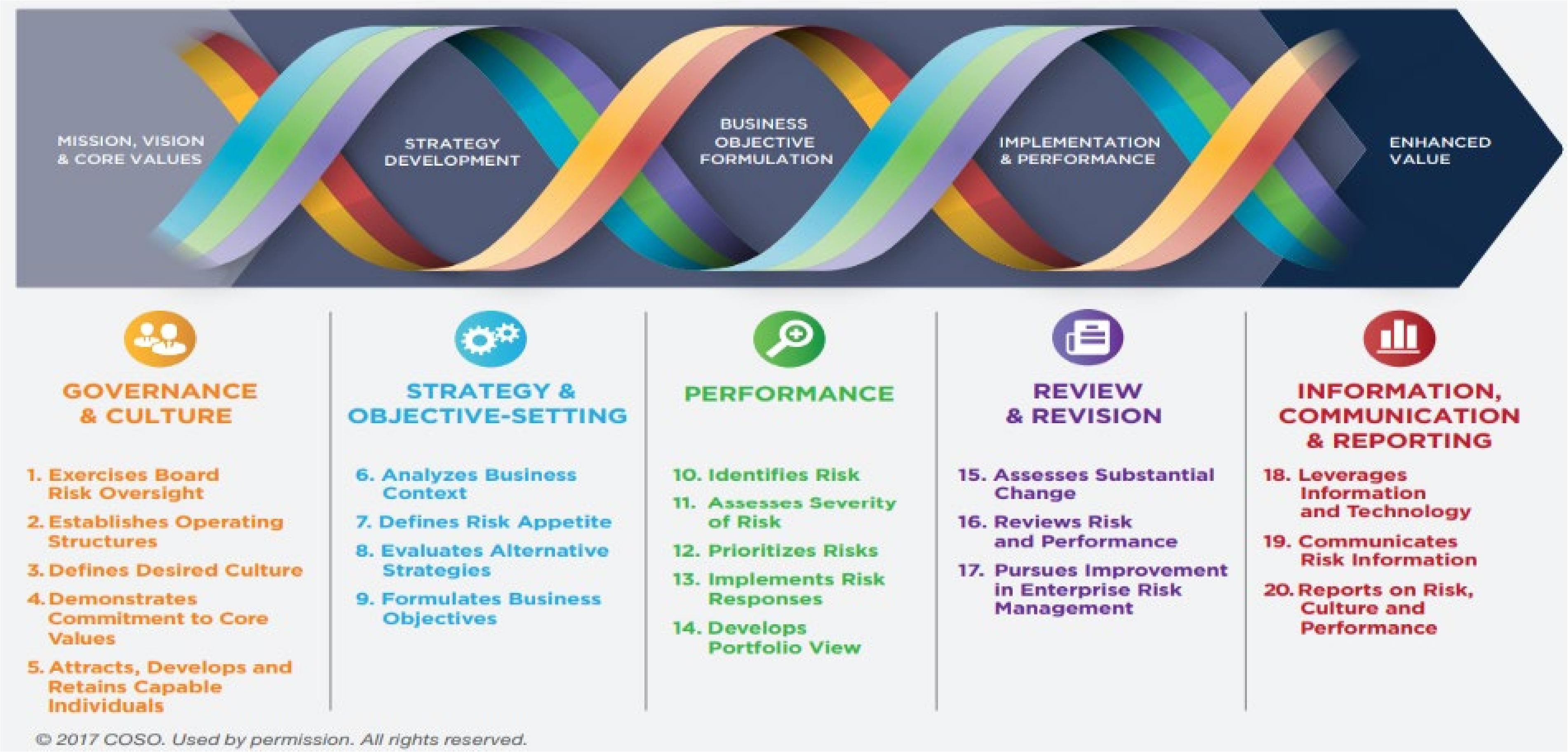

More than 90 percent of S&P 500 companies now publish ESG reports in some form, as do approximately 70 percent of Russell 1000 companies. In several jurisdictions, reporting ESG elements is either mandatory or under active consideration.

How are ESG risks integrated into the overall risk management framework?

Governance and Culture for ESG-related risks

- Is the AC aware of the ESG-related risks that may impact achievement of the entity's strategy and objectives?
- Does the AC have access to the information needed to evaluate risks emerging from ESG trends?
- What are AC members' expectations relative to ERM and ESG?

What does the concept of "risk management" encompass? Is this the responsibility of select functions or an enterprise-wide responsibility?

Strategy and Objective-setting for ESG-related Risks

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- Examine the value creation process and business model to understand impacts and dependencies on all capitals in the short, medium and long term.
  - Megatrend analysis to understand the impact of emerging issues in the external environment
  - Strengths, weaknesses, opportunities and threats (SWOT) analysis
  - Impact and dependency mapping for all types of capital
  - An ESG materiality assessment to describe significant ESG issues
  - Engagement with internal and external stakeholders to understand emerging ESG trends
- Throughout the risk management process, align with the entity's strategy, objectives and risk appetite
- Consider the ESG-related risks that will impact the entity's strategy or objectives

"To effectively manage ESG-related risks, it is critical to understand the strategic and operating plans of the business. Risk management and sustainability practitioners should not attempt to identify, assess or respond to ESG-related risks in isolation from the entity's strategic direction, business objectives or risk appetite."

How do you know that you are getting the most from your risk management strategy?

Performance for ESG-related risks

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- Examine the entity's risk inventory to determine which ESG-related risks have or have not been identified
- Involve ESG risk owners and sustainability practitioners in the risk identification process to leverage subject-matter expertise
- Convene meetings with both risk management and sustainability practitioners to understand ESG-related risks
- Identify the ESG-related risks that may impact the organization's strategic and operational plans
- Define the impact of ESG-related risks on the organization precisely
- Use root cause analysis to understand drivers of the risk

Does your organization see risk as an opportunity or a threat?

Review and Revision for ESG-related Risks

- Identify and assess internal and external changes that may substantively affect the strategy or business objectives
- Review ERM activities to identify revisions to ERM processes and capabilities
- Pursue improvements in how ESG-related risks are managed by ERM

Is your approach to risk focused solely on compliance, or does it provide strategic value that improves performance?

Information, Communication and Reporting for ESG-related Risks

- Identify relevant information and communication channels for internal and external communication and reporting
- Communicate and report relevant ESG-related risk information internally for decision-making
- Communicate and report relevant ESG-related risk information externally to meet regulatory obligations and support stakeholder decision-making
- Continuously identify opportunities for improving the quality of ESG-related data reported internally and externally

"The primary aim of internal communication and reporting is to provide decision-useful information on an entity's risk management approach and performance. Internal communication and reporting can enhance awareness of ESG-related risks to the appropriate level of the entity, communicate how well the risks are being managed and provide information to support better decision-making across the entity."

Do you know which risks, if managed well, will increase — or decrease — the value of and results for your organization?

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“In an era where disruptive change has become the norm, the need for accurate benchmarking is paramount”

2022 North American Pulse of Internal Audit

Benchmarks for Internal Audit Leaders

The Institute of Internal Auditors

NUMBER OF RESPONSES

CAEs	430	85%
Directors/ senior managers	75	15%
Total	505	100%

Pulse Of Internal Audit - Trends for Risk & Audit (Publicly Traded Organizations)

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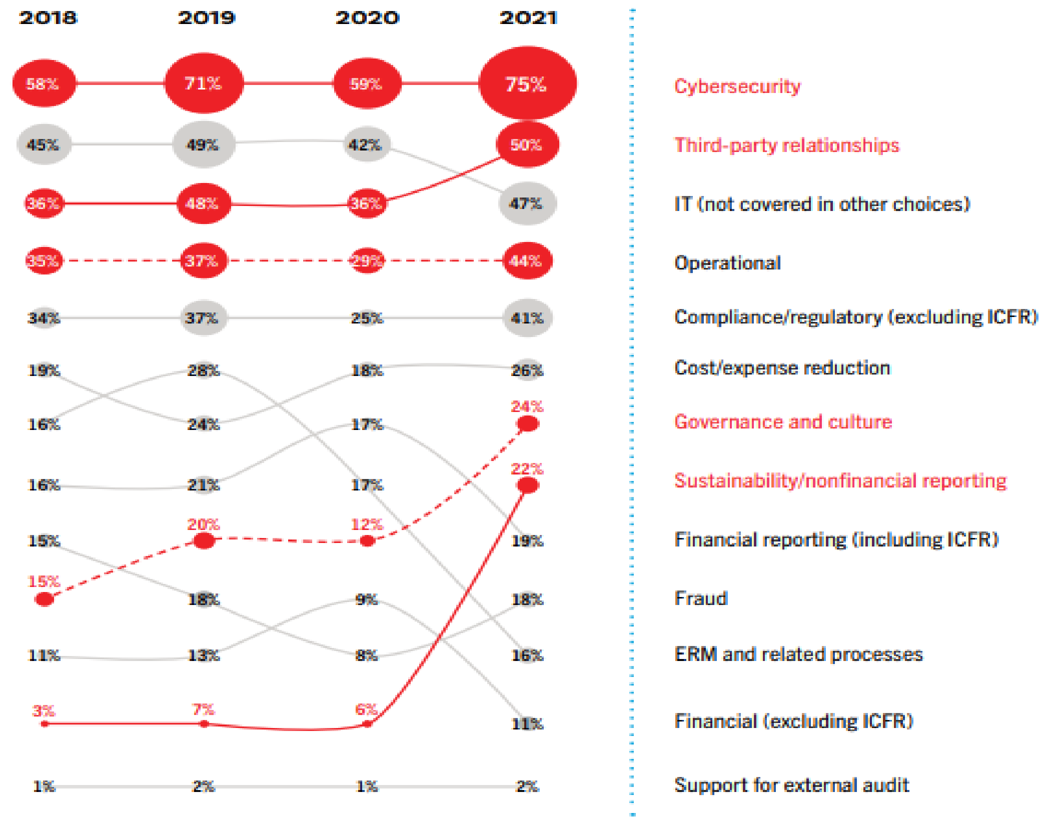
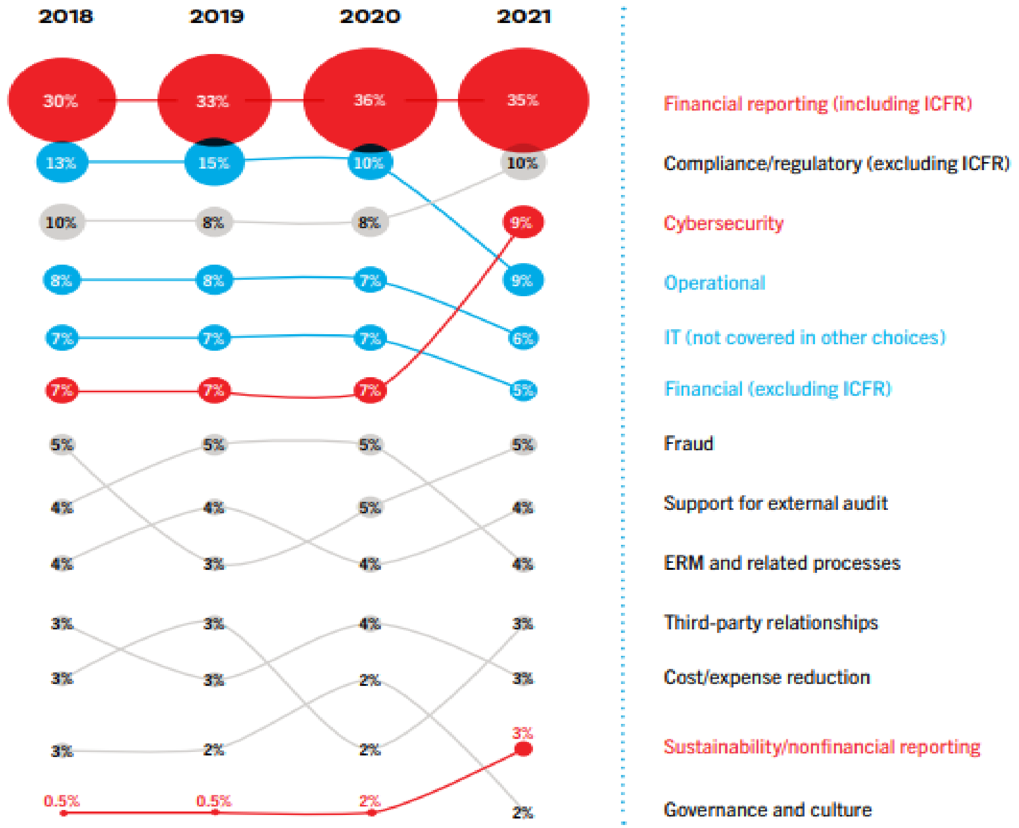
Trends for Risk Areas Rated as High/Very High Risk



Trends for Audit Plan Allocation



Audit plans for publicly traded organizations are greatly impacted by SOX requirements, currently averaging 35% of the audit plan and trending up since 2018. Audit plan allocation is also increasing for cybersecurity and sustainability/nonfinancial reporting, which were also areas of increased risk. Decreasing areas are operational, IT, and financial (excluding ICFR).

Pulse Of Internal Audit - Trends for Risk & Audit (Privately Held Organizations)

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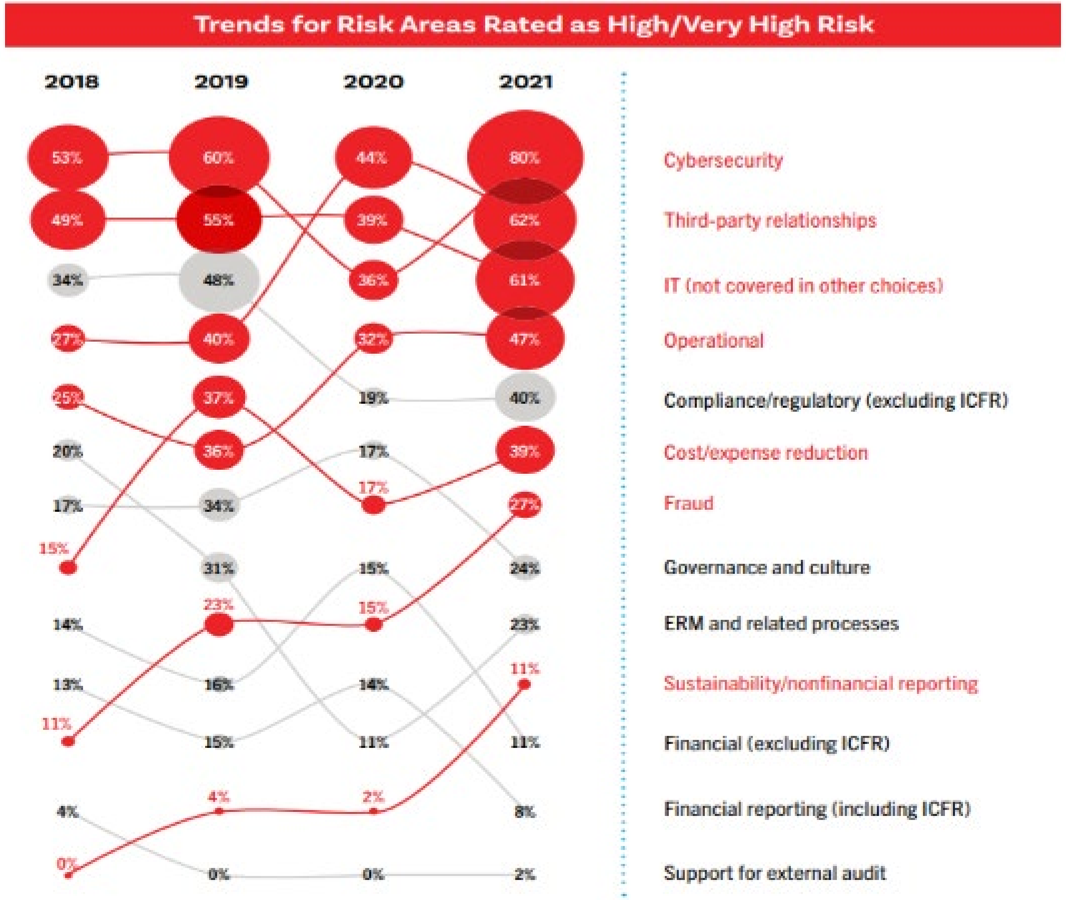

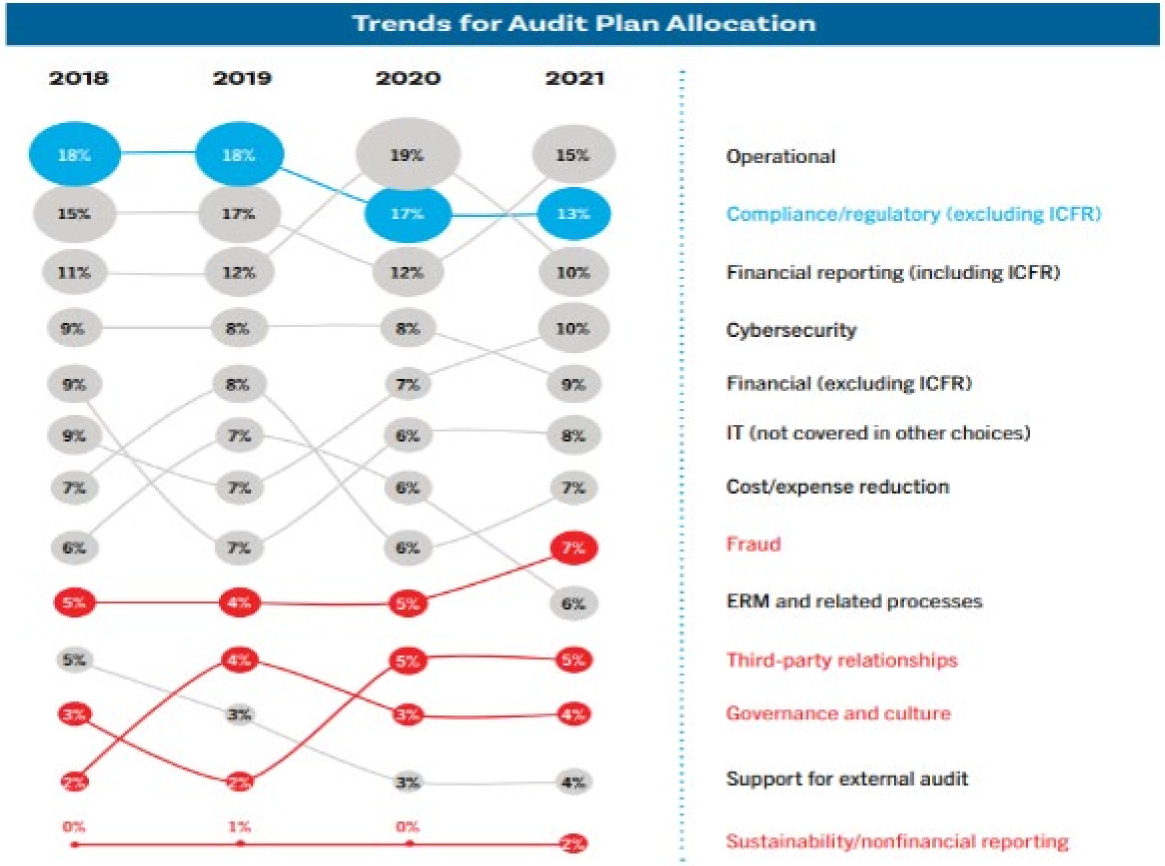

With risk level ratings increasing dramatically since 2018, privately held organizations have adjusted their audit plans. Allocation has decreased for compliance/regulatory (excluding ICFR), an area where risk levels were not rising as steeply. Audit effort was increased for areas with increasing risk: fraud, third-party relationships, governance and culture, and sustainability/ nonfinancial reporting.

“ It is not good enough to do what the law says. We need to be in the forefront of these [social responsibility] issues."

Anders Dalvin, CEO of IKEA

The role and focus of IA will direct the degree of influence across the organization

How Are We Preparing to Disrupt Ourselves?

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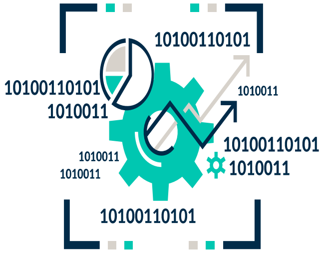
Strategy & ESG

Digital Acceleration

Modern Workforce

Stakeholder Engagement



Disruption

Has you risk strategy been designed to enable business performance or just to protect the business?

What would be the return on the risk investment, if compliance were no longer part of the equation?

"Your success in life isn't based on your ability to simply change. It is based on your ability to change faster than your competition, customers and business."
Mark Sanborn

SEC Proposal: Climate-Related Disclosures

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SEC Proposed Rule: Enhancement and standardization of climate-related disclosures

Registrant Type	Disclosure Compliance Date	
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3	GHG emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
SRC	Fiscal year 2025 (filed in 2026)	Exempted

Filer Type	Scopes 1 and 2 GHG Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

SEC Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures
RGP blog: ESG Reporting & Risk Management: Are You Ready for New Rules?

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Thank You For Your Time.