ESG and ERM Alignment

White Paper Series
St. John's University, Tobin College of Business
Center for Excellence in ERM
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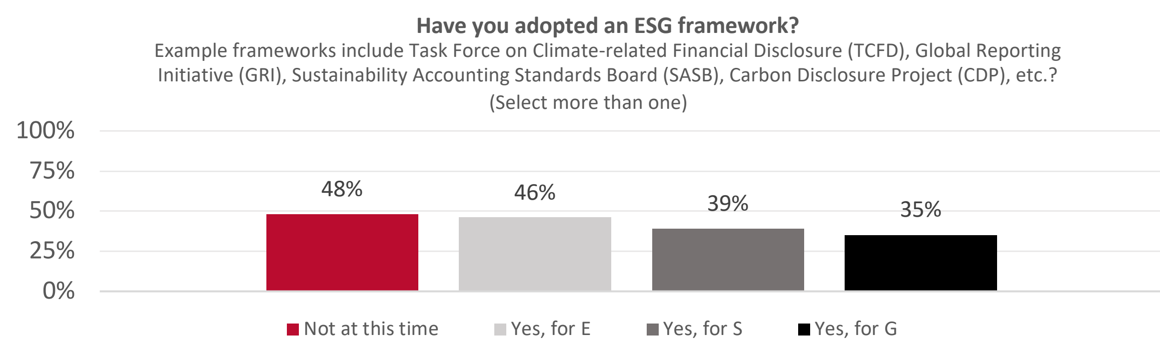
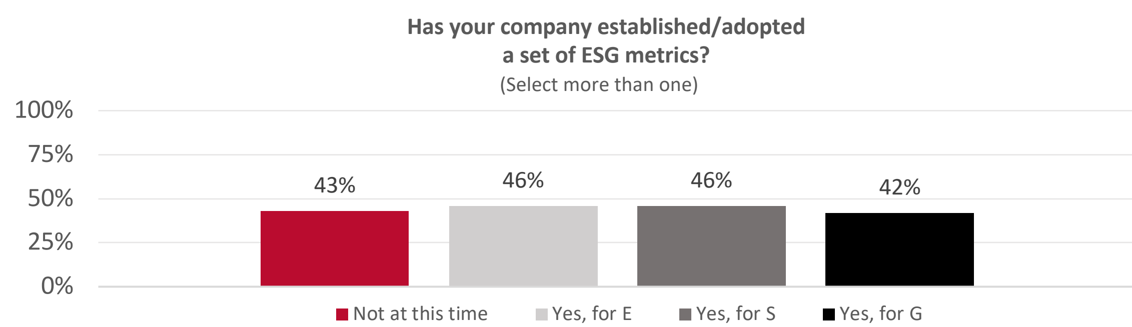
Over 100 risk executives, board members, investment professionals, and strategy executives gathered to dive into the topic of ERM and ESG alignment for the April 22, 2021 Center for Excellence in ERM Summit at St. John's University and the Tobin College of Business. A variety of views were shared including views from investment managers, board members, and risk leaders.

ESG experts led the group in a discussion of Environmental, Social, and Governance foundations. They pointed out that ESG includes several dimensions. For example, Environmental issues might cover climate change, natural resources, pollution and waste, and environmental opportunities. Social can include human capital, product liability, stakeholder opposition, and social opportunities, while Governance issues can include corporate governance and corporate behavior.

Several signals suggest ESG is growing in importance including things like growth in investments in sustainable funds and surveys of consumers and employees about company purpose, sustainability, etc. There are also a growing number of ESG and climate regulations coming out around the world as well as standards around sustainability. Internally, companies are developing and evolving their ESG programs and it should be no surprise that ERM is getting involved.

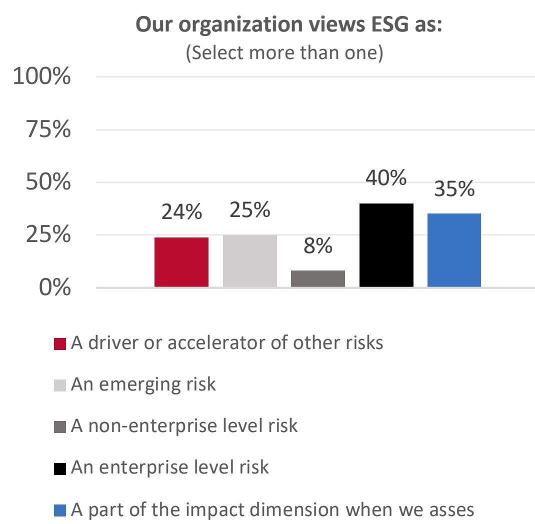


To gain some background information the ERM Summit participants shared information about their use of ESG frameworks and metrics. Almost half (48%) had no ESG framework, but many had adopted frameworks in the specific ESG areas (e.g., 46% had a framework for the E in ESG and 39% for the S). Additionally, almost half had established metrics for ESG (46% for S and E and 42% for G).

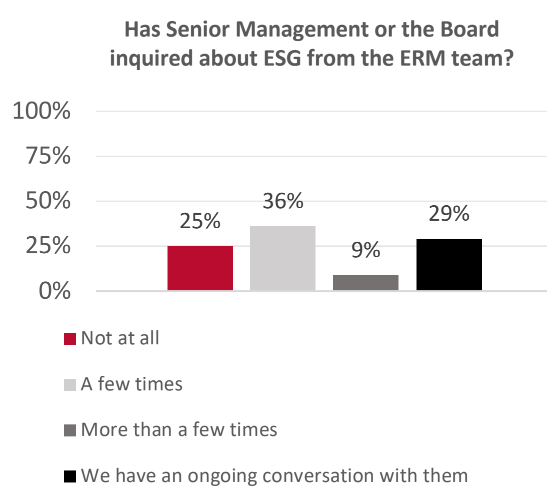


An investment manager perspective raised the bar about expectations for ESG risks and business impact and highlighted that investment managers represent the views of the shareholders and that these shareholders are concerned about how companies are approaching ESG. One key point brought up was that investment managers consider it a red flag if ERM leaders are not talking to the ESG group at their respective organization. A board member emphasized the importance of having the ESG conversation at the board and with the executive team, while also pointing out that ESG must be tied to the strategy and business model. One board member emphasized, "You've got to have an ESG story that aligns with your company strategy."

Risk leaders raised many questions about ESG. Some were concerned about the standards, uniformity or conflicting sections of the standards, and the role of the rating agencies. Other risk leaders addressed whether ESG is impacting hiring, strategy (especially for companies becoming more digital), the role of internal audit, and how ESG influences corporate trust. Still others were concerned about the need for senior level ESG committees, the potential need to work with third party experts (similar to cyber risk approaches), and whether certain companies had heightened urgency (due perhaps to being high-profile or some other reason).



Some of the best advice appeared to be to not to boil the ocean but to just get going and use the critical ESG issues or dimensions that align with the strategy. Other appreciated advice and comments pointed out that this is an opportunity! Organizations can use this opportunity to differentiate their products, services, business model – to show how they are "purpose driven." One risk leader stated that (for their organization) linking ERM and ESG was a "game changer."



Additional polling showed the need for digging deeper since about half showed that senior management and the board has not inquired or only inquired a few times about ESG from the ERM team. Furthermore, not everyone has a full ESG strategy as evidenced by the 33% stating theirs is being developed and 4% stating they have no ESG strategy at all. The good news was that 36% have a partially embedded strategy and 22% have an ESG strategy that is fully embedded in overall corporate strategy.

The divergence of current approaches to ERM ESG alignment showed up in a poll about how the organizations viewed ESG. Some (24%) view it as a driver of other risks, while others (35%) view it as dimension used when the impact of a risk is determined. Many organizations view it as a risk with 8% saying it's a non-enterprise risk, 40% saying it is an enterprise risk, and 25% saying it's an emerging risk.

A few risk leaders shared how they were aligning ERM and ESG. One company noted that they had seen an increased focus by investors on ESG and that they had set up a board level committee for oversight of sustainability. In addition to changes in the board, they also had ERM, Strategy, and Treasury (where Sustainability and ESG reported) all reporting to the same executive (the CFO). Their ESG approach was about People, the Planet, and Profits. And, since they viewed ERM as an approach to preserve long-term value, it was a natural fit with ESG. They even used ERM assessments to inform ESG risk disclosures.

Another risk leader pointed out that ERM and ESG risks, such as Sustainability, may have different purposes and audiences. They also may have different time horizons, terms, tools, and validation approaches (external vs internal). However, both ERM and ESG can include risk identification, risk assessment, and risk mitigation. Furthermore, ESG can be assimilated into ERM and action plans shared or coordinated. The COSO guidance on applying ERM was mentioned as something they had considered. One clear final message came through. Although organization strategy impacts both ESG and ERM, when they work together there is less risk to strategy and long-term viability.

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