ESG RISK MANAGEMENT

SUBJECTS

- **Module I**: What is ESG risk and why is it important for business
- **Module II**: ESG risk identification methods
- **Module III**: ESG risk analysis and impact assessment
- **Module IV**: ESG risk management strategies
- **Module V**: Practical tools and techniques for ESG risk assessment
- **Module VI**: Planning and implementing effective ESG risk management strategies in the organization

MODULE I

WHAT IS ESG RISK AND WHY IS IT IMPORTANT FOR BUSINESS

DEFINITION OF KEY CONCEPTS IN THE AREA OF ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG)

- **Environmental:**
  - Aspects related to the organization's impact on the environment, such as greenhouse gas emissions, energy consumption, and waste management.
- **Social:**
  - Areas related to social relations, including matters related to employees, the local community and diversity.
- **Governance:**
  - Aspects of management and organizational structure, including business ethics, corporate principles and managerial responsibility.

ESG area expansion:

ENVIRONMENTAL:

Greenhouse gas emissions:

- It includes the amount of greenhouse gases a company emits, a key indicator of its impact on climate change.

Natural resource management:

- Assessing how a company manages natural resources such as water, energy and raw materials.

Responsibility for waste:

- Focusing on the amount and type of waste generated by the company and the approach to its disposal and recycling.

SOCIAL RESPONSIBILITY:

Employee rights:

- Assessment of the application of ethical standards to employees, including working conditions, pay, equal opportunities and safety.

Diversity management:

- Striving for diversity and equality in the workplace, both in terms of gender, age and ethnicity.

Engaging the community:

- Active participation in local communities, supporting social projects and responding to their needs.

GOVERNANCE:

Management structure:

- An assessment of how the company's management is structured, including the board's competencies and decision-making structures.

Financial transparency:

- Ensuring transparency in financial reporting, compliance with regulations and an ethical approach to reporting.

Ethical practices:

- Ensuring that the company adheres to high ethical standards in all aspects of its operations.

Sustainable Development Goals (SDGs)

are an action plan for changes and transformations in the world, adopted by the United Nations at the summit in New York. It assumes 169 actions to be achieved jointly by state governments, international organizations, non-governmental organizations, the science and business sectors, as well as citizens. They focus on 5 areas: people, planet, prosperity, peace, partnership: (5xP – People, Planet, Prosperity, Peace, Partnership).

THE ESSENCE OF ESG

HUMAN IMPACT ON THE CLIMATE	THE IMPACT OF REGULATIONS ON QUALITY OF REPORTING	CLIMATE IMPACT ON FINANCIAL INSTITUTIONS	COMPETITIVE ADVANTAGE
• Another step in the fight against the negative impact of intensive economic development, burning of fossil fuels and unsustainable consumption	• Unification of reporting standards, introduction of transparency and greater reliability of data published by enterprises.	• Response to the impact of climate change on the increase in investment risk, resulting in an increase in financing costs.	• Effective management of ESG issues is a good indicator of the quality of management and the potential increase in company value and attractiveness for investors and customers in the supply chain.

ESG REPORTING OBLIGATION

2023 CSRD

Entry into force of the CSRD Directive and preparation of delegated acts in the form of ESRS.

2024 TIME FOR IMPLEMENTATION

Preparing companies for new guidelines, establishing a system for reporting, collecting and consolidating data.

2025 REPORT FOR 2024

Reports for 2024 will be published by companies that have: Over 500 employees and meet one of two criteria: Balance sheet total over EUR 20 million, Annual revenue over EUR 40 million.

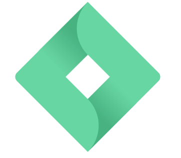
2026 REPORT FOR 2025

The reporting obligation will apply to all large companies meeting any 2 of the 3 criteria: Having over 250 employees, Balance sheet total above EUR 20 million, Annual revenues above 40 million euros.

2027 REPORT FOR 2026

SMEs listed on a regulated market meeting any 2 of the 3 criteria: Above. 10 employees, Balance sheet total over PLN 350,000. euro, Annual revenues above 700 thousand euro.

ESG TRENDS



In the ESG area, 7 emerging trends are identified that will shape the ESG program for the coming years. Therefore, it is a space for diagnosis and verification in terms of possible risks in the management of ESG areas

Trend 1: From competition to cooperation

Trend 2: Greater powers for sustainability directors

Trend 3: Automation of ESG reporting

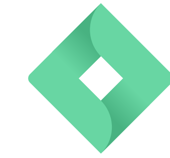
Trend 4: Transforming ESG into a competitive advantage

Trend 5: Using AI capabilities in ESG management

Trend 6: Mitigating the supply chain

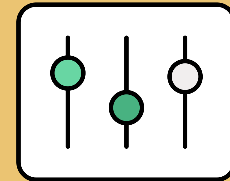
Trend 7: Sustainable development in principle - a new approach to products and services

What is risk anyway?



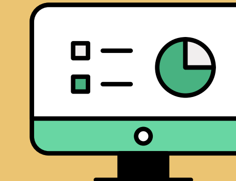
- What intuition tells us
- It has its source in the unpredictability and uncertainty that always occurs
- It has its cause and consequences if it occurs
- The cause and consequences can be manipulated to some extent if we identify the risk in advance and if it is profitable!
- We can't always identify risks, but whenever we can, we need to do it ASAP (experience!)

DEFINITIONS



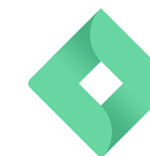
ESG RISK

is the possibility of undesirable events related to environmental, social and governance aspects that may affect the organization.



RISK

is defined as the probability of a given event occurring and the consequences that may result from this event in the context of the organization's values and achieving its goals.



ESG risk

is a type of risk related to the ecological, social and governance factors that affect business operations. Modern companies must take these factors into account to minimize their risks while contributing to sustainable development.

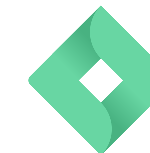
ESG risk is an increasing challenge for companies as customers, investors and market rules increasingly demand that companies operate in a sustainable manner. Ignoring ESG risk can lead to negative financial and reputational consequences for a company.

FMA guidance

ON THE SCOPE OF SUSTAINABILITY RISKS

Sustainability risks refer to events or conditions related to sustainability factors, the occurrence of which could have an actual or potential material adverse effect on the value of assets or net assets, financial condition and operating results, as well as the company's reputation.

The role of ESG risk management in achieving goals by managers:



THE IMPORTANCE OF RISK MANAGEMENT:

- Explaining the role of risk management as a key tool for managers in achieving business goals.
- Emphasizing how effective risk management can contribute to optimizing operations in the tourism industry, minimizing the negative effects of risk on daily operations.
- Explain why ESG risk management should be closely integrated into the tourism organization's core strategy.
- Emphasizing the need to jointly define risk management objectives and strategies to ensure consistency of activities.

More and more companies realize that ESG risk is important for business and increasingly affects their functioning.

REASONS:

ESG risk can lead to negative financial impacts for a company, such as loss of market value, regulatory costs and penalties for regulatory violations.

ESG risk can also impact a company's reputation, which may lead to a loss of trust from customers, investors and other stakeholders.

Ignoring ESG risk can lead to a company losing its competitiveness as more and more customers and investors pay attention to sustainability and choose companies that operate in a manner consistent with ESG principles.

Companies that manage ESG can find new business opportunities and their market value.

As more and more companies realize that ESG risk is crucial to their success over time.

MODULE II

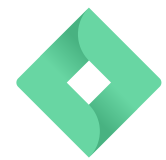
ESG RISK IDENTIFICATION METHODS

RISK CATEGORIES

Types of risks according to TCFD

Climate-related physical risks can be acute (resulting from specific events) or chronic (intensifying over the medium or long term).

Sudden	Chronic
physical risks are particularly weather-related – natural disasters, storms, floods, fires or heatwaves can destroy production facilities and disrupt supply chains.	physical risks manifest themselves through long-term weather changes, changes in extreme rainfall events, higher average temperatures, persistent heatwaves and increased water (sea and ocean) levels.



Types of risks according to TCFD

Transformation risks include, among others: legislative changes regarding climate change, fluctuations in market sentiment and consumer expectations and choices. In other words, it is the risk of moving towards a low-carbon and climate-resilient economy. We can distinguish risks in this group:

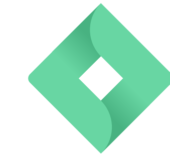
Regulatory and legal – legislators' response to climate change may reduce or increase the costs of doing business, as well as materialize the risks associated with litigation due to failure to avoid or reduce adverse impacts on the climate or failure to adapt to climate change through long-term changes in weather, changes in extreme rainfall, higher average temperatures, persistent heat waves and increased water levels (seas and oceans).

Market – changes in the forces of demand and supply, including increased ecological awareness of consumers, may reduce the profitability of some projects.

Technological – the possible transition to less climate-damaging technology involves additional costs.

Reputational – an irresponsible approach to climate risk may jeopardize the company's good name if the company's climate declarations are insufficiently ambitious or are not reflected in action.

ESG AREAS - ENVIRONMENT

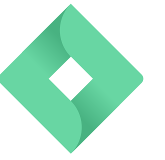


ENVIRONMENTAL RISK REFERS TO A COMPANY'S IMPACT ON THE ENVIRONMENT. THESE INCLUDE FACTORS SUCH AS:

- Carbon footprint
- Water consumption
- Waste disposal
- Greenhouse gas emissions
- Impact on biodiversity
- Deforestation

Environmental risk management includes compliance with environmental regulations. Failure to do so can be costly.

ESG AREAS - SOCIAL



Social risks are generally diverse and may be subjective. Common social risks include:

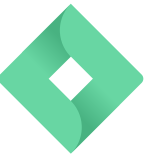
- Equal pay
- Work safety conditions
- Supplier/vendor practices
- Human rights violations
- Diversity, equity and inclusion
- Data privacy

When managing social risks, we recommend focusing on 3 key areas:

- Make sure suppliers meet your ESG standards.
- Ensure that workplace conditions support the health and safety of employees.
- Ensure that the organization does not unethically exploit its customers or employees.

Social risks affect brand image and customer loyalty.

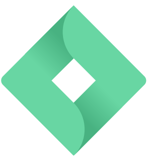
ESG AREAS - GOVERNMENT



Management risk refers to the way the company operates, including the rules that govern it.
Examples are:

- Clear communication
- ESG disclosures
- Board structure and diversity
- Prevention of corruption and fraud
- Integrity and ethics of the organization
- Management remuneration

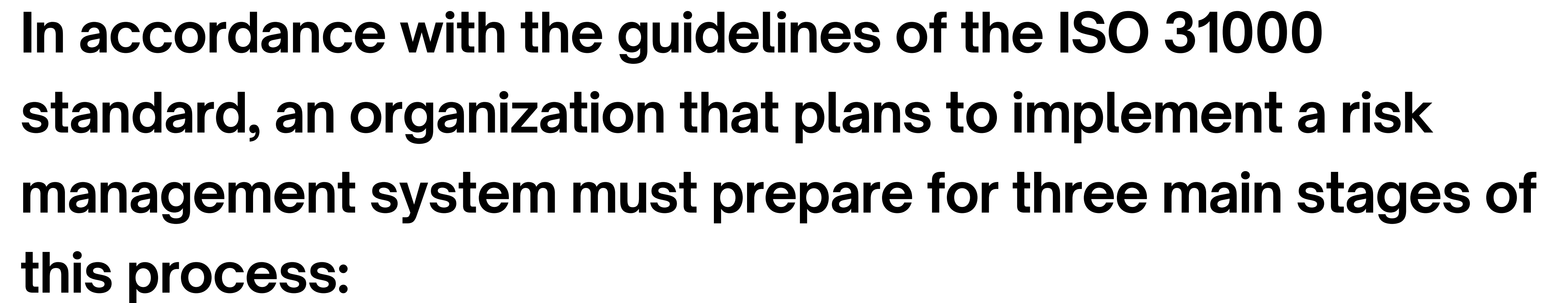
Companies should consider industry-specific compliance regulations and the role of management when overseeing risk management policies.



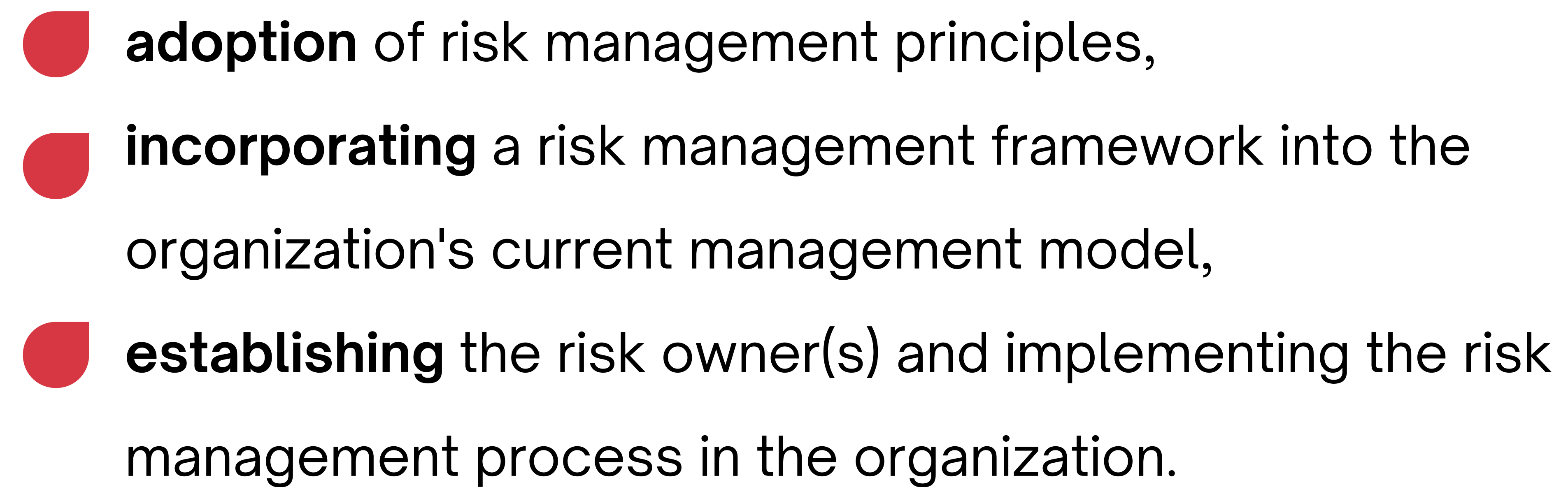
Identifying significant impacts, risks and opportunities related to climate change

Climate-related risks can be divided into risks related to the transition to a low-carbon economy (transition risk) and risks related to the physical impacts of climate change (physical risks).

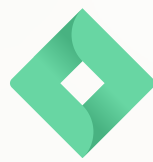
In the risk identification phase, a clear and clear description of the risk is particularly important, enabling the determination of actions to reduce the identified risk at later stages. The risk description should precisely indicate the most probable, direct causes and possible deeper reasons for the described situation.



In accordance with the guidelines of the ISO 31000 standard, an organization that plans to implement a risk management system must prepare for three main stages of this process:



- **adoption** of risk management principles,
- **incorporating** a risk management framework into the organization's current management model,
- **establishing** the risk owner(s) and implementing the risk management process in the organization.

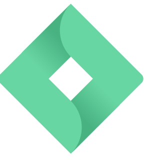


According to the ISO 31000 standard, a properly implemented and implemented risk management system should:

- create and protect value, thus supporting the achievement of goals and increasing the effectiveness of the organization,
- be an integral part of all organizational processes, in particular management, remain within the responsibility of managers,
- constitute an element of decision-making, which means that risk should be one of the criteria for the hierarchy of goals, projects and tasks and motivate managers to present alternative scenarios of events and decisions,
- clearly take into account uncertainty in the adopted objectives, scenarios and the risks associated with them, be carried out in a systematic, structured and timely manner, because it is not a one-off activity but a repeatable process,

According to the ISO 31000 standard, a properly implemented and implemented risk management system should:

- be based on the best available information, including historical data, experience, stakeholder feedback, forecasts, observations, expert assessments and divergent opinions,
- adapt to the specificity of the organization, which means that there is no single effective risk management system. The level of detail of the collected risk information should therefore be adapted to the complexity of the organization's structure, processes, specificity of the industry, product, and communication processes with stakeholders.



Risk identification methods

- documentation reviews and data analysis
- SWOT analysis
- brainstorm
- interview
- checklist of previous activities
- consultations with stakeholders
- benchmarking analysis
- scenario risk
- external sources of information
- integrated management systems

Risk identification methods - development of selected methods

Document review and data analysis:

- Analysis of documents such as annual reports, sustainability reports, and minutes of board meetings can provide information about a company's ESG activities.
- Analyzing data on resource consumption, greenhouse gas emissions, and social indicators can facilitate the identification of areas of potential risk.

Stakeholder consultations:

- Dialogue with stakeholders such as employees, customers, suppliers, local communities, investors can provide perspectives on existing or potential ESG issues.
- Conducting surveys, advisory meetings and public consultations can help identify priorities and areas for improvement.

Benchmarking analysis:

- Comparing a company's activities to industry practices and ESG standards can help identify gaps in a company's operations.
- Benchmarking analysis allows the company to understand what initiatives competitors and industry leaders are taking in the field of sustainability.

Risk identification methods - development of selected methods

Scenario risk:

- Conducting a scenario analysis, i.e. modeling different situations, can help you understand what potential ESG risks may occur in different conditions.
- Examples of scenarios include regulatory changes, natural disasters, changes in consumer preferences, and social crises.

External sources of information:

- Monitoring information from external sources, such as environmental reports, ESG rating analyses, market research, can provide additional data on the risks associated with a given industry or region.

Integrated management systems:

- The use of integrated management systems, such as quality, environmental and health and safety management systems, can facilitate risk identification through consistent monitoring of key performance indicators in various areas.

MODULE III

ESG RISK ANALYSIS AND IMPACT ASSESSMENT

ESG RISK ANALYSIS

Qualitative risk analysis	Quantitative risk analysis
determines how strongly the risk affects the project if it occurs and what is the probability of the risk occurring	determines its consequences using established methods and estimates the possible impact on the project

Qualitative risk analysis

- Its aim is to determine the importance and importance of risks (prioritization).
- It is the foundation on which we build quantitative analysis and a response plan.
- It should be valid throughout the duration of activities in a given area.

The effect of qualitative risk analysis

- Overall risk assessment of the project
- List of prioritized risks
- List of risks requiring further analysis and management (high and medium priority)

Qualitative risk analysis

We analyze two dimensions - IMPACT AND LIKELIHOOD

INFLUENCE
Definition:
Impact refers to the extent to which the possible occurrence of a risk may affect the organization. It may include financial losses, reputational damage, operational problems, etc.

Impact assessment scale:

1. **Low [1]:** Minimal or no impact on business operations.
2. **Moderate [2]:** Moderate impact that may require some remedial action.
3. **High [3]:** A powerful influence that can significantly impact organizational effectiveness and results

Impact assessment:

1. Determining whether the potential consequences associated with a given risk are mild, moderate or severe.
2. The impact may vary depending on the area in which the risk may materialize (finance, reputation, operations).

Quantitative risk analysis

PROBABILITY

Definition:

Probability involves assessing how likely it is that a given risk will actually occur.
Probability is a subjective assessment of the chances of a given risk occurring.

Probability rating scale:

1. **Low [1]:** Low chance of risk occurring.
2. **Medium [2]:** Moderate likelihood of risk occurring.
3. **High [3]:** High probability of risk occurring.

Probability rating:

1. Determining whether a given risk is slightly, moderately or highly likely to occur.
2. It is also worth taking into account the history of events and the availability of data regarding a given risk.

Quantitative risk analysis techniques

PROBABILITY
Definition:
Probability involves assessing how likely it is that a given risk will occur
will actually occur. Probability is a subjective assessment of the chances of a given risk occurring

Probability rating scale:

1. **Low [1]:** Low chance of risk occurring.
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Probability rating:

1. Determining whether a given risk is slightly, moderately or highly likely to occur.
2. It is also worth taking into account the history of events and the availability of data regarding a given risk.

Quantitative risk analysis

Quantitative risk analysis is an approach that transforms impact and probability assessments into tangible numbers, enabling more precise risk assessments.

Quantitative risk analysis, unlike qualitative, provides more precise numerical data, which facilitates a more accurate comparison of different types of risk and making more rational management decisions. However, detailed data and advanced analysis tools are often required to perform quantitative analysis.

ESG Quantitative risk analysis

- Its aim is to mathematically (numerically) describe risks and their impact on ESG areas
- Quantitative risk analysis is a process that allows you to transform risks and opportunities into specific numbers, enabling you to more precisely estimate the impact on your organization.

The effect of quantitative risk analysis

- Prioritized list of risks
- Possible completion dates and costs for various risks
- Probability of maintaining the assumed costs and scope

Quantitative risk analysis techniques

Point scale method:

- It involves assigning numerical values to assess impact and probability.
- The scales are usually standardized (e.g. from 1 to 5 or from 1 to 10), which allows for the calculation and comparison of various risks.

Event tree analysis:

- It uses an event tree to model different combinations of events leading to risk.
- It is useful for identifying the most critical paths that are most impacted by the occurrence of an event.

Monte Carlo simulations:

- It uses numerical algorithms to simulate thousands of scenarios to assess the likelihood of various outcomes.
- It allows for a better understanding of the range of possible outcomes and the likelihood of specific scenarios occurring.

Quantitative risk analysis techniques

Threat duration analysis (PERT):

- It uses three duration ratings: optimistic, realistic and pessimistic.
- It allows you to obtain the probability distribution of the event duration.

Statistical models:

- It uses statistical analysis and mathematical models to predict risk.
- Outputs can be historical data, and models help predict future trends.

Sensitivity analysis:

- Examining what effects changes in particular variables (e.g. costs, revenues) have on the risk score.
- It helps identify key factors influencing risk.

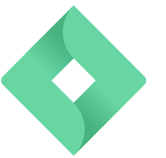
Quantitative risk analysis techniques

Financial simulation models:

- It uses financial models to simulate various financial scenarios depending on the occurrence of risk.
- It helps in assessing the impact of risk on the company's financial results.

Network models (CPM, PERT):

- Uses network models to analyze projects and identify critical paths where risk can have the greatest impact on the schedule.



Risk multiplier - risk analysis technique

RISK CALCULATION:

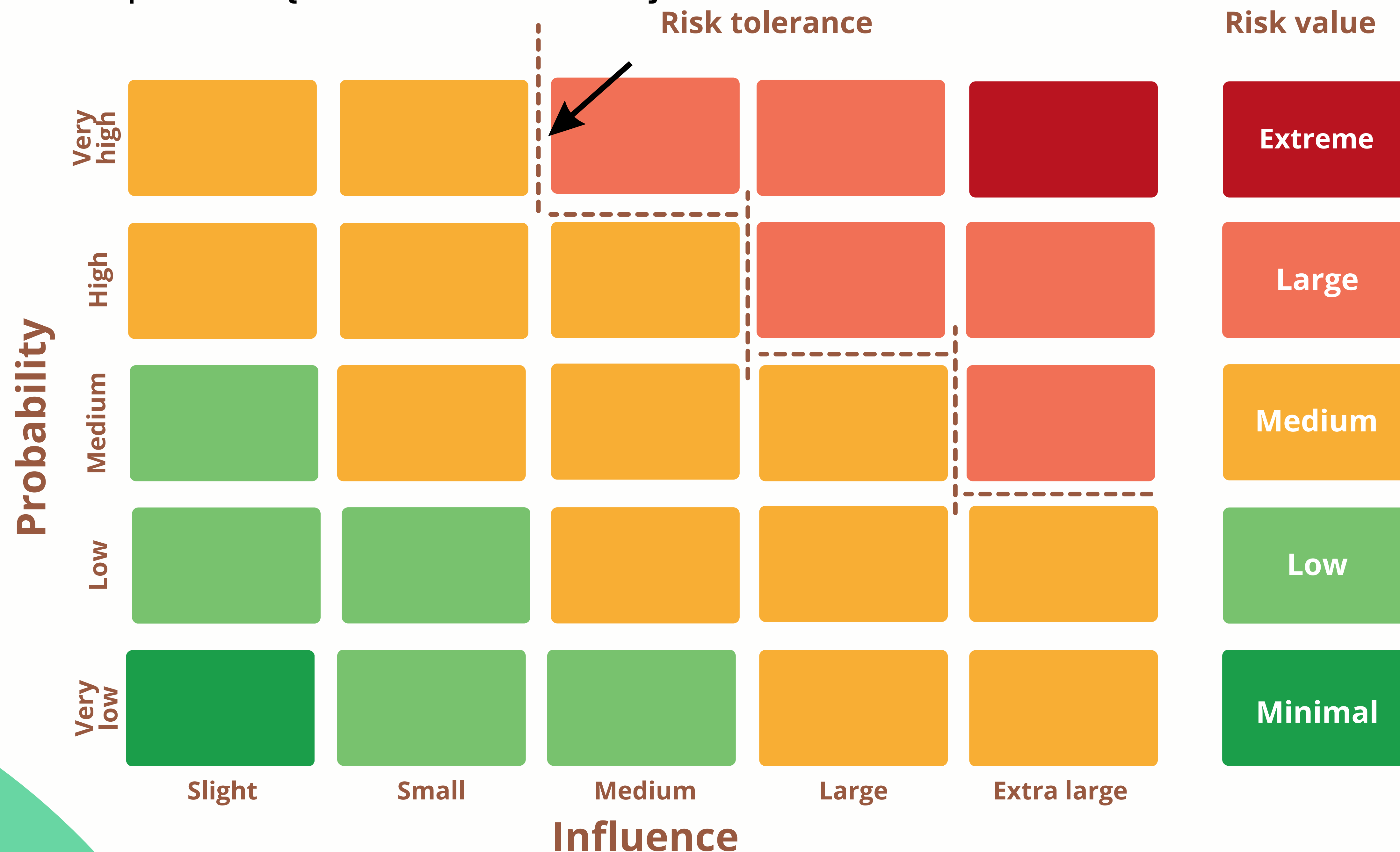
- Multiplying the impact score by the probability score to get a risk multiplier.
- Formula: Risk Multiplier = Impact x Probability.

RISK MULTIPLIER SCALE:

- Low [1-3]: Acceptable risk, low importance for the organization.
- Moderate [4-6]: Moderate risk, requires attention and remedial action is possible.
- High [7-9]: High risk, requires urgent remedial action and detailed analysis.

Risk matrix

A risk matrix, also known as an impact-probability matrix, is a tool that helps visualize and prioritize risks based on the dimensions of impact and probability. This matrix is often used as part of qualitative risk analysis.



Source: https://strefapmi.pl/strefa-studenta/jest-ryzyko-jest-zabawa/

RED - critical risks, unacceptable risks, requiring immediate, additional actions - Risk Mitigation Plans and establishing control and monitoring

YELLOW - significant risks, requiring the establishment of control and monitoring, decisions (cost-justified) on Risk Mitigation Plans can be made

GREEN – negligible risks, requiring periodic verification and assessment, not requiring systemic controls and monitoring

DARK GREEN – full acceptance

MODULE IV

ESG RISK MANAGEMENT STRATEGIES

Risk management process

It is a systematic process:

- Identifying
- Analyzing
- Reacting

to risks occurring in ESG areas.

What is the purpose of RISK MANAGEMENT?

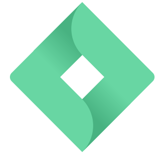
- Maximizing the probability of positive events and their consequences

and

- Minimizing the probability of negative events and their consequences

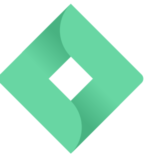
Processes

- Risk management planning is deciding on the approach and method of risk management in the project.
- Risk identification is determining what risks may affect the project and documenting (description) these risks.



Processes

Planning a response to risk	Risk monitoring and control
involves determining what actions we will take to minimize the probability of the risk occurring and possibly the consequences of its occurrence.	involves identifying new risks, monitoring already identified ones, implementing risk reduction plans and assessing their effectiveness throughout the entire project cycle.



RISK MANAGEMENT PLAN

As part of the risk management process, a **RISK MANAGEMENT PLAN** should be created

The RISK MANAGEMENT PLAN should include:

- Methodologies – tools, approaches, data sources
- Roles and responsibilities
- Budget
- Schedule

The plan identifies and divides potential risks and threats based on the probability of their occurrence and severity (this is the so-called risk matrix), and also takes into account solution mechanisms.

Nowadays, when sustainable development is increasingly desirable, ESG risk is becoming an integral element of business strategy. Companies that invest in sustainable practices not only contribute to protecting the environment and improving social conditions, but can also increase their competitiveness in the market.

CHOOSING A RISK MANAGEMENT STRATEGY

The choice of a specific strategy and the accompanying risk depends on the awareness of managers, the company's vision and its risk appetite, i.e. the acceptable level of threat assumed by managers for a given strategy or area of activity.

Taking into account the duality of risk (threats and opportunities and their level), as well as the increasing business importance and impact of sustainable development areas in recent years, we can distinguish four types of strategies: a bold strategy, strategy focused on taking advantage of opportunities (optimal, conservative strategy, unsustainable strategy.

A BOLDSTRATEGY

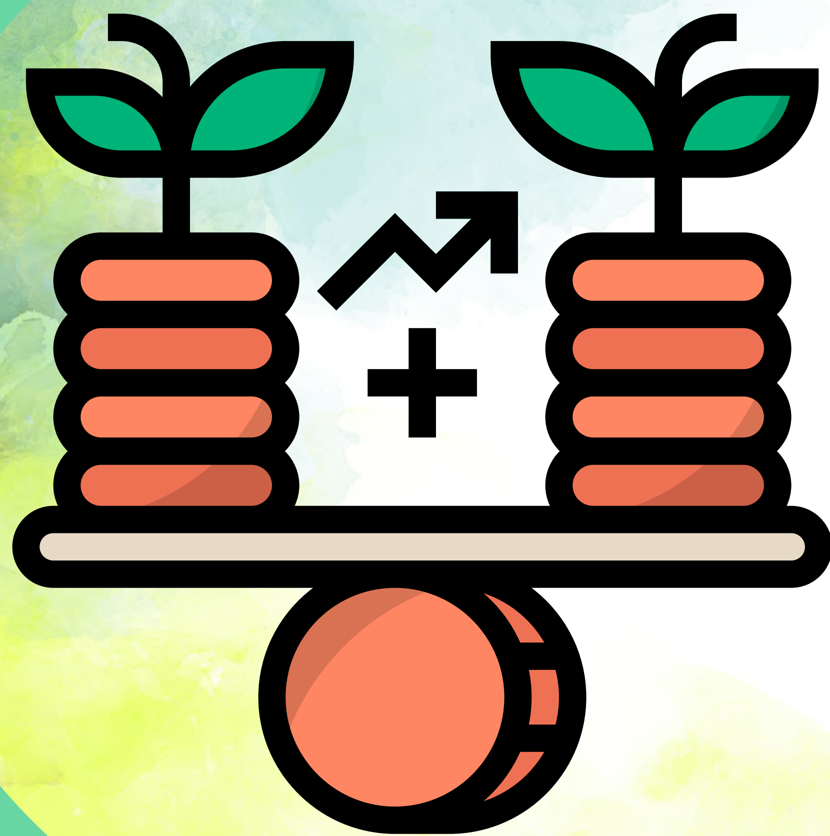
Characteristics: big opportunities, big threats

Characterized by a high level of threats, but also a high level of opportunities. Examples include: failure to comply with ethical principles in purchasing or sales processes - allows obtaining lucrative contracts, reducing purchase costs, or gaining an advantage over the competition in obtaining raw materials with limited supply, but may result in high penalties and loss of reputation, avoiding the costs of nature compensation or reducing environmental costs - allows you to achieve above-average profits, but if unfavorable changes in the environment are detected, it exposes the company to court penalties and suspension of operations, avoiding staff maintenance costs in markets that strongly respond to changes in demand and supply by using outsourcing or temporary work - may have a negative impact on the company's reputation due to the low quality of services provided (e.g. information and communication technologies or automotive industry).

STRATEGY FOCUSED ON TAKING ADVANTAGE OF OPPORTUNITIES (OPTIMAL)

Characteristics: high chances, low threats

The optimal strategy is focused on taking advantage of opportunities and avoiding threats. A good example of its application is the so-called a responsible investor who, when implementing strategic investment projects, pays particular attention to consultations with the environment. This allows him to avoid the risk of social protests, shortens project implementation times and has a positive impact on the time and amount of return on capital employed. An additional benefit of implementing this type of strategy is the improvement of the company's reputation and the possibility of obtaining capital for further development. The effort put into properly conducting social consultations in industries involved in infrastructure investments (such as energy, telecommunications or construction) in comparison with the total expenses incurred for the entire investment does not cost much, and significantly reduces the risk of protests and suspension of key projects constituting the gaining a competitive advantage.



CONSERVATIVE STRATEGY

Characteristics: little chance, little threat

Examples of safe strategies are the strategies of some companies operating on regulated markets, such as energy or telecommunications. Their goal is to establish stable business conditions thanks to which these companies can obtain a constant return on the capital employed, however, the level of this return (EBIT and ROACE) is supervised and predetermined (by the regulator), as well as limited by social expectations regarding the low price of the services provided. services.

UNSUSTAINABLE STRATEGY

Characteristics: small opportunities, big threats

Examples of strategies characterized by a high risk of threats and relatively low chances are: the use of temporary work in areas where there are no large fluctuations in employment (e.g. in banks or large-scale retail). Employment variability is not significant here, and at the same time companies are exposed to many legal threats (e.g. court cases for concealing employment, decreased employee motivation, theft and embezzlement, high staff turnover significantly limiting the quality of services provided).

MODULE V

PRACTICAL TOOLS AND TECHNIQUES FOR ESG RISK ASSESSMENT

ESG risk management process for managers

Skills risk management therefore involves strengthening the organization's resistance to emerging threats and, at the same time, taking anticipatory actions enabling optimal use of available resources and emerging development opportunities.

The risk management process should use the structures, processes and communication channels existing in the organization.

Remember

Excessive formalization of the risk management process significantly limits its effectiveness, because employee resistance and lack of involvement make it difficult to integrate risk management mechanisms with existing business processes (both strategic and operational).

ESG risk management techniques

Risk avoidance is a strategy that involves identifying and eliminating potential threats by changing plans or decisions to completely avoid their impact on the organization. For example, if the risk analysis indicates a high probability of a serious problem, the company may decide to abandon a particular project or activity.

Risk minimization is an approach that focuses on reducing both the effects and the likelihood of threats occurring. For example, by implementing additional security procedures or using technology, an organization can reduce the negative effects of potential problems.

Risk acceptance means consciously accepting potential threats without taking special corrective actions. In situations where the risks are low or the benefits outweigh the possible losses, the organization may decide to accept them and continue with the planned activities.

Risk transfer involves delegating the responsibility for risk management to another party, for example through insurance. By transferring risk, a company transfers some or all of the financial burden associated with potential losses to the insurance company.

Important in ESG risk management

Excessive formalization of the risk management process significantly limits its effectiveness, because employee resistance and lack of involvement make it difficult to integrate risk management mechanisms with existing business processes (both strategic and operational).

ESG risk control and monitoring

- Risk control and monitoring are key elements of effective risk management in an organization.
- We monitor whether everything is going according to our expectations.
- We check whether:
  - Were the responses to risks as planned?
  - Were they effective enough or should we develop new ones?
  - Are the assumptions in the implementation of ESG areas still true
  - Trend in risk (more or less? what?)

ESG riskcontrol - objectives:

Threat prevention:	Compliance with policies and regulations:	Optimal use of resources:	Protection of goodwill:
Risk control enables you to detect and eliminate potential threats early before they become serious problems.	Risk control helps an organization maintain compliance with applicable regulations, industry standards and internal policies.	Thanks to focused control on key risk areas, the organization is able to optimize the use of resources, eliminating less significant risks.	Effective risk control contributes to the protection of the company's value, both in financial and reputational terms.

ESG riskcontrol - objectives:

Increasing process efficiency:	Identification of changes:	Response to changing conditions:	Risk prediction:
Good risk control allows you to identify areas of processes that can be improved, which in turn contributes to increased efficiency.	Risk monitoring allows for ongoing identification of changes in the organizational environment, including changes in regulations, market trends and competitive situations.	Thanks to continuous monitoring, the organization is able to adapt to changing market, social and environmental conditions.	Systematic monitoring enables the organization to anticipate potential risks and prepare for their possible occurrence.

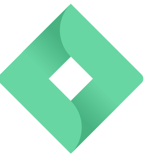
ESG riskcontrol - objectives:

Early detection of problems:	Strategy adjustment:
Monitoring allows for early detection of problems, which allows for quick response and minimization of effects.	Based on the monitoring results, the organization can adjust its strategies and goals to better manage risk.

MODULE VI

PLANNING AND IMPLEMENTING EFFECTIVE ESG RISK MANAGEMENT STRATEGIES IN THE ORGANIZATION

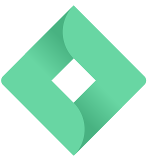
In today's dynamically changing business environment, strategic management of ESG factors and analysis of opportunities and risks related to them (environmental, social and corporate governance) is becoming a key aspect of a company's long-term strategy. Properly understanding and managing these issues can help secure enterprise value for stakeholders and turn these challenges into competitive advantages.



Corporate Sustainability Reporting Directive

The adopted CSRD (Corporate Sustainability Reporting Directive) imposes new disclosure requirements on companies, according to which companies will be obliged to include and demonstrate the impact of ESG factors in business decisions and energy and climate transformation programs. These requirements confirm the need for the company to conduct a reliable analysis of the financial and business impact of ESG factors on its value and strategy. First of all, it will be necessary to include non-financial factors in an orderly and holistic manner in operational processes.

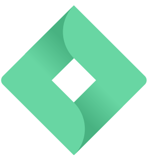
Without a long-term management vision and connection with the business strategy, there is no security of value. Including ESG factors in a business strategy not only shows stakeholders and investors the maturity of the organization, but also gives the opportunity to look more broadly, including the company's operations, its processes, products and services and the exploitation of gaps that the competition has not yet noticed. This also allows for easier access to funds for sustainable development and innovation, or to gain an advantage in the fight for talents on the labor market.



ESG risk and enterprise value

Most key Polish companies are currently conducting accelerated processes of analyzing the risks, objectives and compliance of their ESG policies with the latest regulatory changes. For many other entities, e.g. due to cooperation within the supply chain with EU companies, the need to diagnose their needs, create an ESG strategy and consistently build their ESG profile has also become an urgent need.

ESG risks such as climate change, social inequality and supply chain issues can impact company value at various levels. They not only generate costs related to adapting to new regulations or market requirements, but may also affect the company's reputation, which in turn may affect its market position and relations with stakeholders. A proper understanding of ESG risks is crucial to managing risk and protecting enterprise value.



Strategic management in the context of ESG

ESG diagnostics are a key element of the strategic management process. A significant number of companies in our region, due to lack of prior preparation and postponing similar activities to the so-called "better time" does not have sufficient knowledge about ESG and strategic management of the area, which may lead to inappropriate risk management and loss of value.

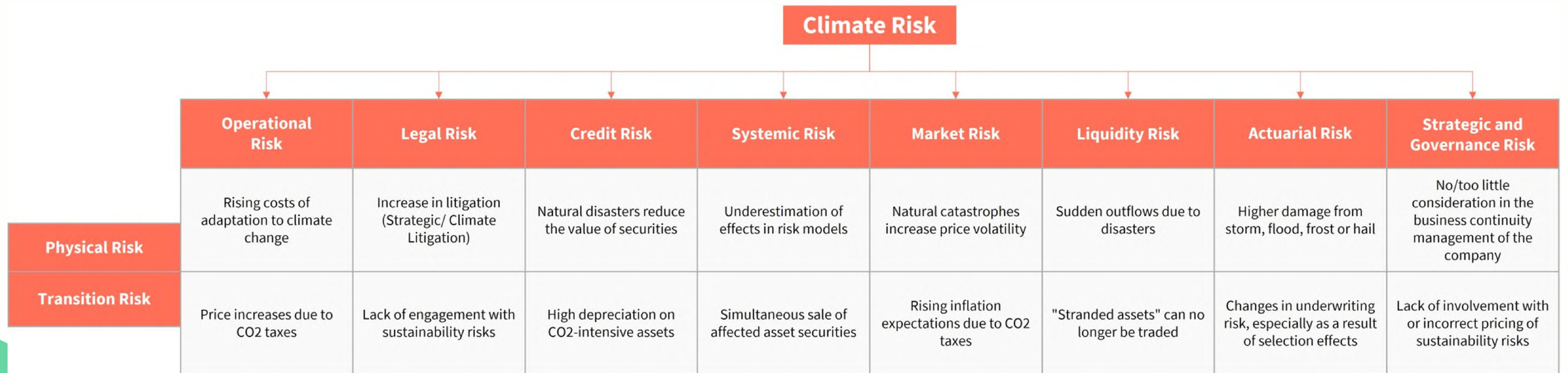
The use of diagnostics allows for the assessment of the company's current practices, ESG indicators and sustainable development goals, taking into account industry dynamics, strategic position and regulatory changes. This approach enables the identification of areas in which the company can gain a competitive advantage, improve efficiency or better manage risk.

ESG RISK MANAGEMENT

- The challenge with ESG risks is that they are not generally a separate risk category. Rather, they are cross-cutting risks that impact all risks differently. Sustainability risks should therefore be classified within existing risks and integrated into risk management accordingly. It is also necessary to review the entire risk management system for possible corrections.

- Let's take a closer look at ESG risk using the example of climate risk. The figure below shows the impact of climate risk on eight risk categories: operational risk, legal risk, credit risk, systemic risk, market risk, liquidity risk, actuarial risk, and strategic and governance risk.

Example of ESG climate risk classification



	Operational Risk	Legal Risk	Credit Risk	Systemic Risk	Market Risk	Liquidity Risk	Actuarial Risk	Strategic and Governance Risk
Physical Risk	Rising costs of adaptation to climate change	Increase in litigation (Strategic/ Climate Litigation)	Natural disasters reduce the value of securities	Underestimation of effects in risk models	Natural catastrophes increase price volatility	Sudden outflows due to disasters	Higher damage from storm, flood, frost or hail	No/too little consideration in the business continuity management of the company
Transition Risk	Price increases due to CO2 taxes	Lack of engagement with sustainability risks	High depreciation on CO2-intensive assets	Simultaneous sale of affected asset securities	Rising inflation expectations due to CO2 taxes	"Stranded assets" can no longer be traded	Changes in underwriting risk, especially as a result of selection effects	Lack of involvement with or incorrect pricing of sustainability risks

Source: https://www.boc-group.com/en/blog/grc/esg-risk-management-how-integration-succeeds/

OPPORTUNITIES AND RISKS

Companies that do not implement and report ESG-related issues may be perceived by investors and their clients as having a higher level of risk.

The availability of capital and the form of financing may be better for companies involved in ESG issues. Many banks withdraw from financing unsustainable projects, others require data on their impact on the environment.

Investment funds prefer to invest in companies that are ESG compliant.

As an ESG-compliant supplier, your company becomes more credible and trustworthy.

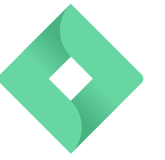
By verifying your supply chain and documenting it transparently, in line with ESG values, you increase your credibility and improve your image on the market, while mitigating the risk of losing customers.

Thanks to the implementation of the ESG strategy, employee involvement in the activities undertaken by the company increases.

Regular analysis of the organization's strengths and weaknesses as well as the initiatives and projects it undertakes allows for ongoing adjustments to the business strategy.

Work on the creation and publication of a non-financial report provides the opportunity to revise the decision-making processes and management model in the organization.

Publishing data as part of a non-financial report is not for comparative purposes, but only for information about the company's level of awareness and planned activities. There is no such thing as a bad or good report, provided it complies with the directive.



Why are ESG risks important in risk management?

As the previous example shows, ESG issues can pose significant risks for companies. By integrating ESG considerations with risk management, companies can more effectively identify and manage ESG risks, reduce their impact, and thereby improve their overall risk profile. Therefore, to identify material risks and potential opportunities, companies should consider the complexity of ESG risks at an early stage and conduct in-depth risk analysis and integration with the existing risk portfolio.

Companies need to carefully consider which ESG risks may negatively impact future processes, how this changes the company's risk profile, and the implications for risk management. Overall, companies that prioritize ESG risk management are better positioned to achieve sustainability and long-term success.

How to integrate ESG risks with risk management?

1. Analyze business processes and identify sustainability risks
2. Assign sustainability risks to existing risk categories
3. Integrating sustainability risks into the sustainability strategy
4. Continuously monitor and manage sustainability risks

Stages of ESG risk management

Key stages of effective management of relationships with external entities

1. **Due Diligence and Assessment:** In this stage, the organization builds a business case or requests additional information to identify potential partners and areas of potential risk. The due diligence and assessment phase should be a defined and well-documented process within the organization.

2. **Implementation and Operationalization:** After due diligence, selecting a supplier and signing contracts, the next step is to establish and operate the relationship. Once a third party is deemed operational, the business owner is expected to manage the relationship

Stages of ESG risk management

Key stages of effective management of relationships with external entities

3. Monitoring: Monitoring is a critical step in a vendor's third-party risk management process. Throughout the relationship, the business owner periodically evaluates whether the supplier's performance is meeting expectations. There may be performance metrics measuring success in terms of productivity, efficiency or return on investment that have been established during the due diligence and onboarding process. Any changes or updates to your supplier contract should be noted to keep your organization informed of any potential risks.

Stages of ESG risk management

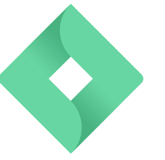
Additional issues to consider during the monitoring phase include:

Governance:	Legality of the contract:	Business Operations Satisfaction:
It's simple, but it's worth mentioning that it also includes IT risk, and in particular data management, especially as more organizations start using cloud services. It is extremely important to ensure compliance with data privacy rules and regulations, data security and protection, and the completeness, accuracy and reliability of data from third parties.	Make sure the contract is in writing and, more importantly, that mechanisms are in place to ensure compliance with the essential terms of the contract. The legal department, purchasing department, or business department may be responsible for ongoing monitoring of all legal and contractual obligations of both the organization and the third party. Auditors can also check whether 'right to audit' clauses are included in contracts where appropriate and can ensure that these clauses are used on a risk-based approach.	Continue to measure the relationship against established risk requirements. This step may require a lot of records and documentation. Business should periodically evaluate the relationship with the external entity and determine the level of satisfaction. Measurements should be performed against the original drivers and documented to ensure that the organization receives the level of service and/or product quality that was originally agreed.

Greenwashing

The term "greenwashing" is a combination of the word "green", i.e. ecological by default, and the word "whitewash", which in the context of ESG may be interpreted as covering up information, manipulation, and intentional misleading.

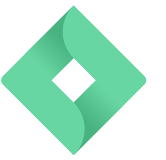
- In light of new regulations (the EU Corporate Sustainability Reporting Directive ("CSRD") of 2019, together with target national regulations), ESG marketing messages, which could previously be perceived as an aggressive marketing tactic, may soon expose the company to reputational damage , violation of the value chain, negative legal and financial consequences.
- Entrepreneurs should consider in advance whether and how the reported non-financial information will be supported by evidence. Will they be able to authenticate the ESG message they send to the market and how?



Risk areas in ESG reporting

When expanding the operating model with an ESG strategy, entrepreneurs may realize that mandatory reporting will involve additional risk. If ESG initiatives are siloed within the organization and internal communication is insufficient, there may be concerns about the reliability of data and their potential impact on decisions made, financial and non-financial reporting, and ultimately also on the company's image.

Typical pitfalls in this regard will be, for example, overstating ESG liabilities and investments (companies may overestimate ESG expenditures) or the previously mentioned greenwashing. Individual risk areas arise naturally depending on the specific nature of enterprises (e.g. understanding the issue of forced labor in the global chain must take into account the geographical factor). In principle, however, programmatic management of ESG programs is key to mitigating business risk.



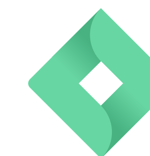
ESG risk management

Companies define risks for ESG areas as the possibility of occurrence of environmental, social or corporate governance situations or conditions that could have an actual or potential material negative impact on the financial situation, results of operations and reputation of the Companies, as well as on the value of investments made by the Companies in own risk and customer risk.

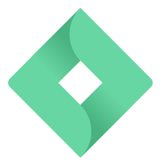
Task Force on Climate-related Financial Disclosures (TCFD)

The TCFD standards are based on four pillars, around which, for the sake of transparency, this report has also been organized:

Corporate governance	Strategy	Risk management	Metrics and targets
description of liability management in the area of threats and opportunities related to climate change of the bank.	a description of the actual and potential impact of climate-related risks and opportunities on the organization's operations, strategy and financial planning.	the processes used by an organization to identify, assess and manage climate risk.	disclosures regarding metrics and targets used to assess risks and opportunities, including information on CO2 emissions.



We understand that ESG risk is a key element of business strategy because modern companies must take into account ecological, social and governance factors to minimize their risks and contribute to sustainable development. Ignoring ESG risk can lead to negative financial and reputational consequences for a company.



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