ESG RISK MANAGEMENT

Co-funded by the European Union

GREEN INDUSTRY FOUNDATION

EURECYS

WSTiE

DIALOG of Transformation
Certified Service EDU SMART Training Centre
UKPRN 10066595

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.

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.

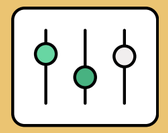
2026 REPORT FOR 2025

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

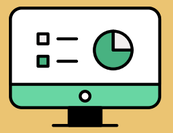
SMEs listed on a regulated market meeting any 2 of the 3 criteria: Above. 10 employees, Balance sheet total over PLN 350,000. euro, Annual revenues above 700 thousand euro.

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.

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.

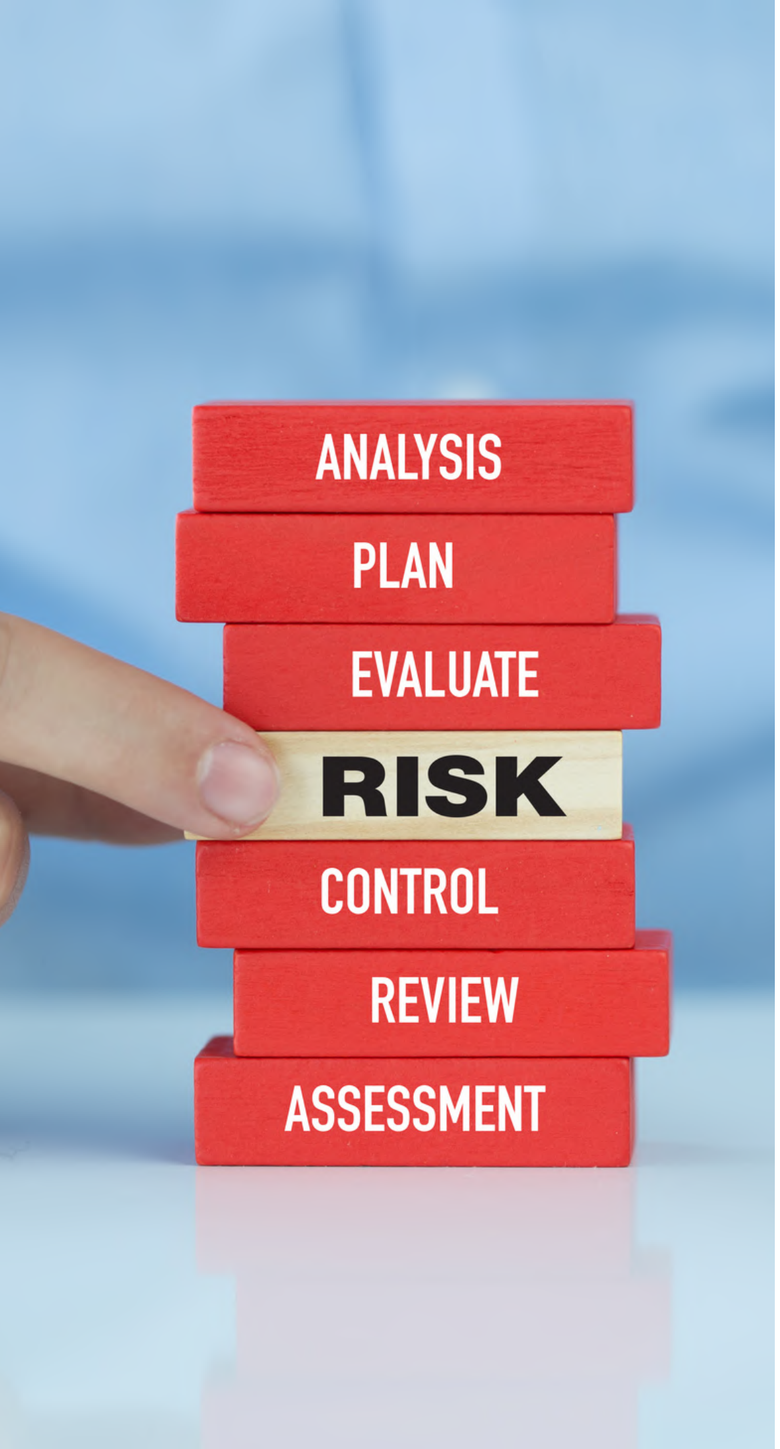
The role of ESG risk management in achieving goals by managers:

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.

MODULE II

ESG RISK IDENTIFICATION METHODS



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.

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.

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

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

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:

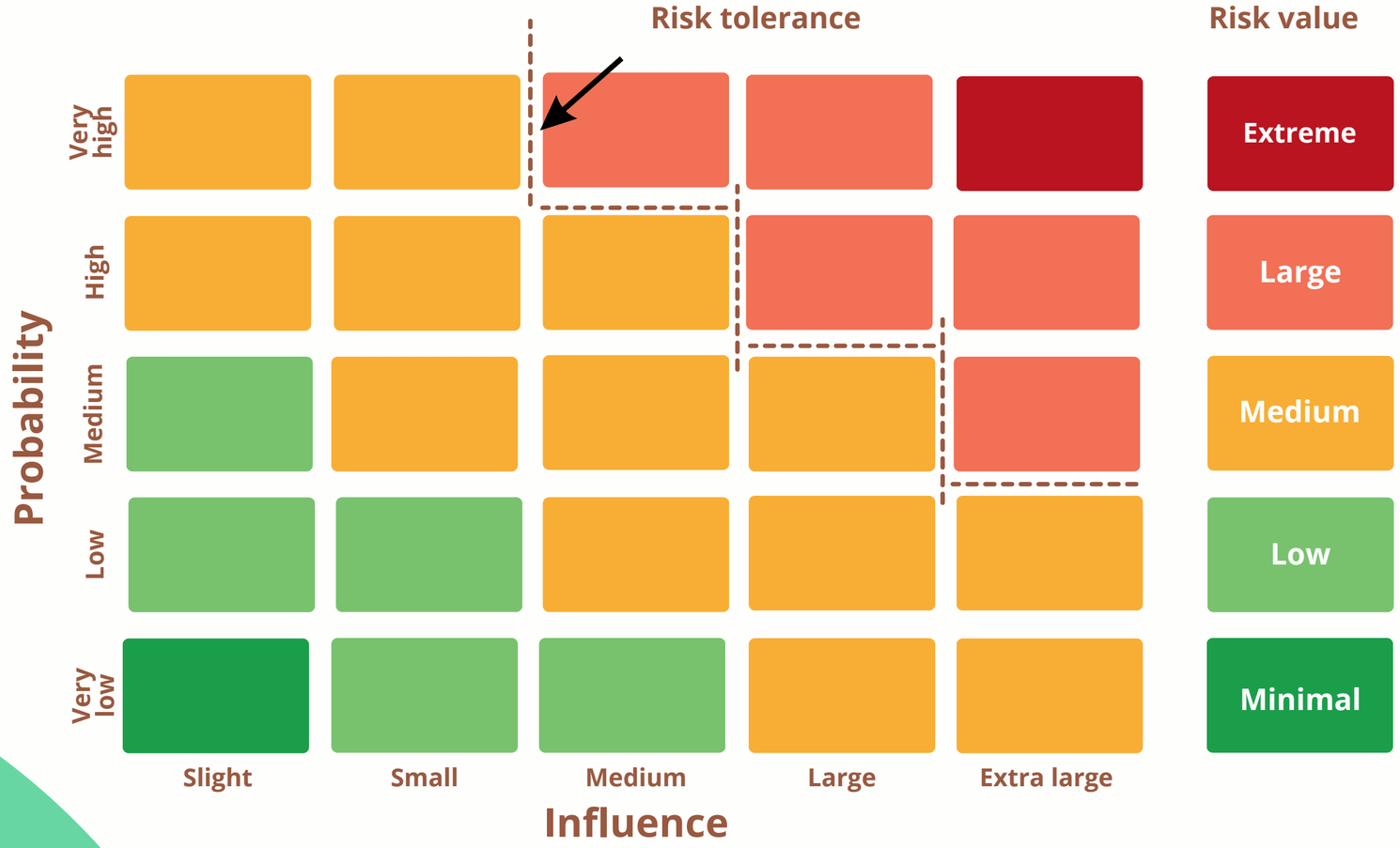
- It uses financial models to simulate various financial scenarios depending on the occurrence of risk.
- It helps in assessing the impact of risk on the company's financial results.

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 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.



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

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

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.

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.

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?)

MODULE VI

PLANNING AND IMPLEMENTING EFFECTIVE ESG RISK MANAGEMENT STRATEGIES IN THE ORGANIZATION

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

Climate Risk

	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.

Bibliography

- Risk management in the process of sustainable business development, Tomasz Gasiński, SławomirPijanowski
- Archer, ESG and Integrated Risk Management. How ESG efforts and Integrated Risk Management are converging to manage uncertainty, 2021
- Responsible Business Forum, 7 emerging trends in ESG An experts' report on the trends shaping the sustainability domain over the coming years, 2023
- Risk management for sustainable tourism, 2016
- Deloitte, European supervisors define action plans and good practices for banks' ESG risk management, 2023
- https://www.boc-group.com/en/blog/grc/esg-risk-management-how-integration-succeeds/
- https://esg.santander.pl/2021/zdrowie-bank-environment/raport-tcfd/metodologia/

Thank you for participating in the training!

The European Commission is not responsible for the content produced.

Co-funded by the European Union