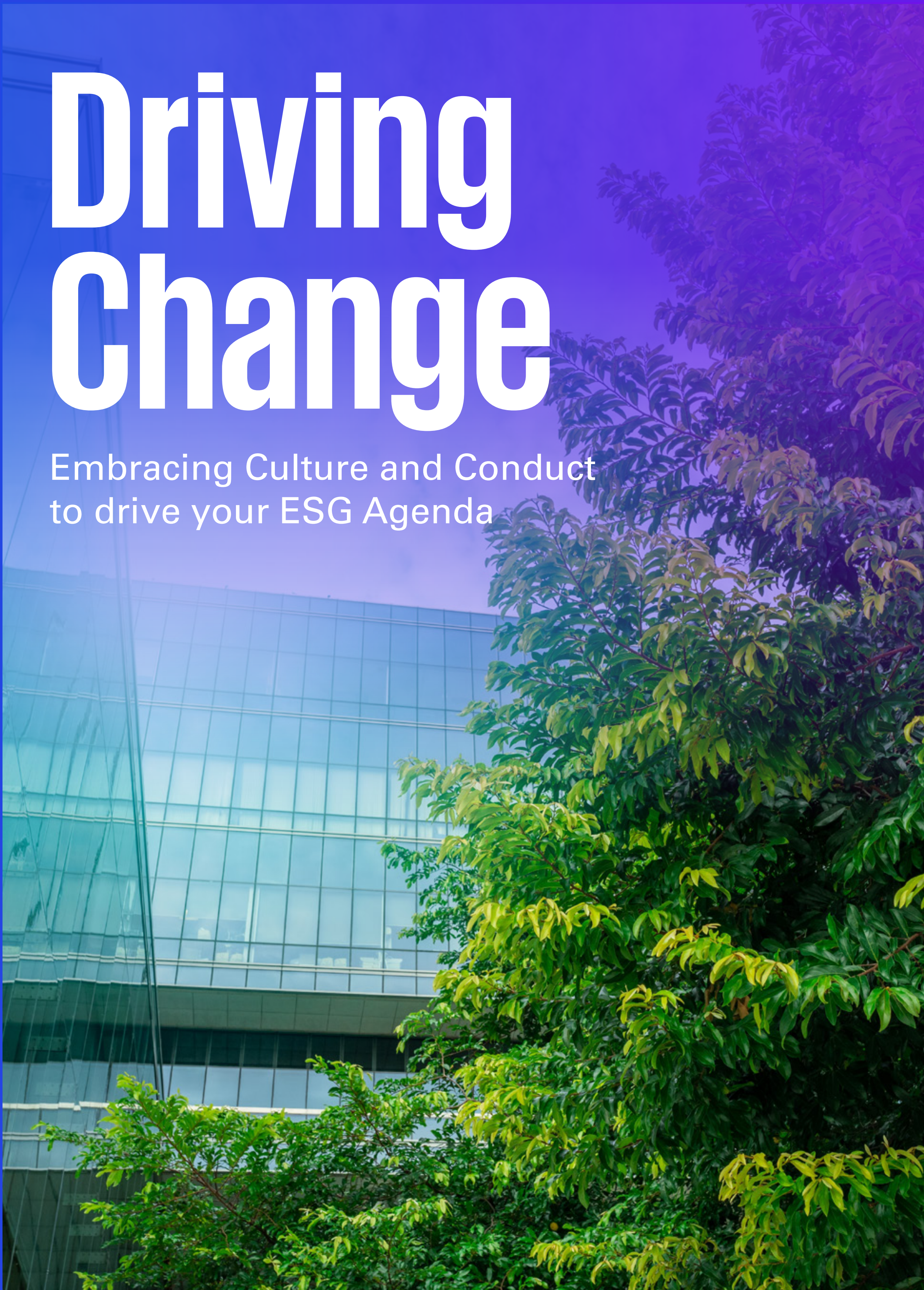
KPMG

Driving Change

Embracing Culture and Conduct to drive your ESG Agenda



Introduction

In today's fast-paced landscape where Environmental, Social and Governance ("ESG") considerations are shaping investor perceptions, corporate reputation and sustainable business practices, the **focus on Conduct Risk has never been more intense.** Whilst navigating the landscape of ethical conduct is complex, there are profound implications for an organisation's ESG performance if prompt action is not taken. Therefore, it is essential that organisations **adapt swiftly to stay ahead of the curve** to manage and mitigate the drivers of poor conduct and culture.

The impact of poor culture and conduct **extends beyond financial losses**, it delves into the broader implications for stakeholders and the overall integrity of the financial system. From fostering trust and social responsibility, to unlocking regulatory expectations and stakeholder expectations, **the intertwined components of culture, conduct and an organisation's ESG agenda need to be recognised and embraced** in order to embed a future of responsible, **sustainable and resilient business practices**. Without action, the risk increases for:

- Harm to consumers or investors;
- Detriment to market stability; or
- Adverse impact on fair competition.

Simply complying with rules and regulations is no longer sufficient and whilst it is widely acknowledged that a **proactive mindset is at the heart** of an organisation's ESG agenda however, too often we see **resistance to change** with **efforts fragmented** and **output disjointed**.

At KPMG, our team is comprised of specialists across ESG, Conduct and Culture from our Risk and Management Consulting practice to ensure a **unified approach and mindset** whereby **culture and conduct are rooted in all ESG efforts** and initiatives to **achieve the desired results** with **outcomes meaningful**.

We tailor our solutions to meet your requirements

The ESG Imperative

ESG considerations have emerged as pivotal factors shaping the strategies and operations of companies across various sectors, ranging from corporations to financial institutions. Whether motivated by intrinsic values or compelled by evolving laws and regulations, organisations are proactively gearing up to incorporate sustainability into their fundamental frameworks.

The holistic nature of ESG factors allows businesses to be evaluated not only on financial performance but also on broader aspects such as sustainability practices, ethical conduct, and community impact. This paradigm shift underscores the interconnectedness of good business conduct and the imperative for heightened awareness regarding climate change among stakeholders.

Despite this increasing recognition, businesses face challenges navigating the uncertainties inherent across the ESG landscape, where expectations are not always clear, and regulatory landscapes can be occasionally ambiguous, particularly in times of rapid evolution.

The significance of ESG considerations is underscored by their relevance to diverse stakeholders, including investors, consumers, and regulators. Stakeholders now view ESG factors as crucial metrics for evaluating an organisation's long-term viability and ethical standing. The shift towards prioritising ESG is not only driven by societal expectations but also by regulatory initiatives that emphasise sustainability in strategy, policy, and processes. Companies find themselves at the intersection of environmental responsibility, social consciousness, and effective governance, where the integration of ESG metrics is becoming increasingly vital to comply with evolving regulations and meet stakeholder expectations. In a world where business conduct is scrutinised through the lens of sustainability, organisations must navigate this complex terrain with strategic clarity to foster trust and resilience.

Time is of the essence for organisations to capitalise on the benefits and opportunities that ESG presents.

The Journey Ahead

The future of ESG and conduct risk is marked by significant regulatory developments that have reshaped reporting standards and governance practices. Several new ESG reporting standards, which came into effect at the start of 2024, along with the proposed European Parliament regulatory amendments, have dramatically transformed the ESG reporting landscape. When considering the scale of change in ESG reporting, it is essential that businesses are prepared to ensure they have the effective mechanisms embedded to comply with current and upcoming regulatory changes as follows:

01 **Corporate Sustainability Reporting Directive ("CSRD"):**
The CSRD came into effect on January 1st, 2024 and represents a comprehensive effort to elevate existing reporting requirements for EU companies. This directive aims to establish a robust framework for disclosing sustainability-related information, impacting internal controls, reporting processes, and overall governance structures. The evolving regulations are poised to play a transformative role in how companies interact with shareholders, customers, suppliers, and key partners.

02 **IFRS Sustainability Disclosure Standards:**
There's a palpable demand for transparency in ESG disclosure, as evidenced by regulations like the Sustainable Finance Disclosure Regulation (SFDR) and the CSRD emerging in the EU. The International Sustainability Standards Board (ISSB) has contributed to this global momentum by issuing two standards, IFRS S1 and IFRS S2, which aim to enhance the consistency of sustainability reporting worldwide, effective from January 1st, 2024. These standards are envisioned to instil confidence in company disclosures, aiding stakeholders in making informed investment decisions.

In Ireland, we have taken a proactive step by establishing an International Sustainable Finance Centre of Excellence and positioning ourselves as a hub for the finance industry's response to sustainability imperatives, contributing to Ireland's net-zero transition. Ireland's readiness exemplifies our commitment, as a nation, to sustainability, aligning with the CSRD.

03 **Proposed Benchmarking of ESG Ratings by the EU Parliament:**
In early February 2024, the European Parliament reached a provisional agreement on a proposal for increased regulation on ESG rating activities. The proposed rules aim to strengthen the reliability and comparability of ESG ratings by improving the transparency and integrity of the operations of ESG ratings providers. The agreement promotes more rigour into ESG investing as regulators suspect "greenwashing", or companies over-inflating their sustainability profile. Under the proposed new laws, ESG rating providers will be regulated by the European Securities and Markets Authority (ESMA). ESG ratings will encompass both the ESG risks faced by an organisation, but also its ESG impact on the environment. The agreement foresees the possibility to provide separate E, S and G ratings. If a single rating is provided, the weighting of the E, S and G factors must be explicit, according to the European Council statement.

03 **The Central Bank of Ireland's Consumer Protection Code reform:**
Enhancements to the Consumer Protection Code, expected to be published in early 2024 are placing a renewed focus on organisations to support a climate neutral future, in addition to ensuring that organisations are resilient to client risks to mitigate against the impacts posed on customers.

As the regulatory landscape evolves, stakeholders expect organisations not only to comply with the changing norms but also to demonstrate a steadfast commitment to sustainability and social responsibility. Regulations such as SFDR and CSRD, along with the proposed benchmarking of ESG ratings, underscore the growing emphasis on ESG considerations in the EU.

To navigate this shifting landscape effectively, companies need to assess their readiness for upcoming ESG regulatory requirements by conducting thorough examinations of reporting prerequisites. This proactive approach is crucial for establishing robust reporting processes and initiating data collection at the outset of the relevant reporting period, demonstrating accountability and commitment to sustainable practices.

Environmental Stewardship: The 'E' in ESG and the Interlock of Ethical Conduct

The 'E' in ESG, which is widely recognised as environmental stewardship, has gained paramount significance in evaluating an organisation's long-term viability and ethical standing. Beyond the traditional realm of corporate ethics, the escalating concerns around climate change and resource depletion have propelled environmental consideration into a critical factor.

Environmental Conduct Risk and its Implications:

Environmental conduct risk can take many different forms, such as:

- **Unsustainable resource management:** Consuming resources in excess or modelling them in an ineffective way can lead to higher environmental costs including fines or penalties and will also raise concerns amongst stakeholders.
- **Environmental incidents:** Business actions which unintentionally or purposely cause harm to the environment can have negative effects on the environment, including biological or ecological damage, reputational damage to the organisation, and severe financial and legal penalties.
- **Environmental regulation non-compliance:** Violations of the substance and spirit of environmental laws and regulations may result in fines, penalties and harm to the reputation of the organisation.

Integrating Environmental Stewardship into Conduct Risk Management:

Organisations aiming to exhibit proficient corporate conduct risk management should contemplate integrating:

- **Environmental impact assessments:** To identify possible environmental hazards and create mitigation plans, environmental impact assessments are to be carried out as part of the project of product approval procedure.
- **Environmental compliance review:** In order to ensure that the organisation is detecting possible non-compliance concerns and putting remedial steps in place, ESG analysis should be undertaken whenever an issue or investigation is conducted.
- **Environmental training and awareness programmes:** Employee training and awareness programmes on the environment should be put in place in order to inform staff members at all levels about best practices and environmental regulations as well as to ensure that the organisation's environmental protection policy is ingrained in the organisation's culture and core values.
- **Environmental due diligence:** To identify and evaluate any environmental liabilities and hazards, a thorough environmental due diligence procedure should be carried out during the product review and approval process.
- **Proactive Mindset:** To ensure that your products continue to meet the demands, attributes and goals of the specified ESG targets for that product, as well as legal requirements, it is imperative that you monitor and review them on a regular basis, along with the policies that support them.

> **"Through the integration of environmental stewardship into risk management for business conduct and the cultivation of a robust environmental responsibility culture, firms can minimise their environmental footprint, enhance their reputation, and lay the foundation for long-term sustainability and success!"**
>
> **Yvonne Kelleher**
> Managing Director and Conduct Risk Lead
> KPMG Ireland

Social Responsibility: The 'S' in ESG and the Interlock of Ethical Conduct

The 'S' in ESG signifies social responsibility, encapsulating an organisation's influence on society and its commitment to ethical conduct in interactions with employees, customers, suppliers and the communities it operates in.

Social Conduct Risk and its Implications

Social conduct risk can manifest in various forms, including:

- **Unsustainable sourcing practices:** Purchasing products or services from vendors that use unethical or unsustainable business methods can put an organisation's reputation at danger and provide legal issues.

- **Community relations issues:** A company's reputation may suffer and customers may leave if it does not interact with or respect the communities in which it works.
- **Labour practices violations:** Violations of labour rules, such as pay standards and discrimination based on gender identify and gender, can result in legal ramifications, harm to one's reputation and a higher rate of employee and customer turnover.
- **Human rights violations:** Taking part in activities that violate human rights, such forced labour and modern slavery, can seriously harm one's brand and alienate customers.

Integrating Social Responsibility into Conduct Risk Management

Effective corporate conduct risk management should incorporate social considerations, including:

- **Monitoring of Human rights practices:** Regular reviews of the workforce and across the value chain help assess compliance with human rights standards and identify potential violations or risks within supply chains.
- **Social due diligence:** Comprehensive social due diligence during the product review process is crucial to identify and assess potential social risks and liabilities.
- **Labour practices reviews:** It is important to evaluate hiring and labour practices to make sure that labour regulations are being followed, to spot any infractions, and to address any possible cultural issues that may lead to:
    - **End to End supply chain behaviour guidelines:** To guarantee that there is a comprehensive approach to moral and socially conscious behaviour at every point of the product supply chain, a strict code of conduct should be created and upheld; and
    - **Community and end user impact assessments:** Impact analyses on the community and final users should be carried out for new initiatives and goods in order to detect any social hazards and create mitigation plans.

Governance Excellence: The 'G' in ESG and the Imperative of Ethical Conduct

The 'G' in ESG encompasses the principles of governance excellence, covering an organisation's corporate leadership, risk management, and transparency practices. A robust culture of corporate governance extends beyond mere compliance with regulations or formalities in the boardroom; it serves as the cornerstone upon which an organisation's long-term success is constructed. Effective governance ensures responsible, ethical management in the best interests of all stakeholders.

The role of corporate conduct risk and culture is vital in shaping an organisation's governance performance. Conduct risk pertains to the potential for financial or reputational damage arising from unethical or non-compliant behaviour, while corporate culture encompasses the shared values, norms, and beliefs shaping employee behaviour and decision-making.

The CSRD introduces a new level of transparency on organisational governance, disclosing board composition, including a specific focus on gender, as well as the level of competency and knowledge on ESG topics.

Governance Conduct Risk and its Implications

Risk related to governance conduct can take many different forms, such as:

- **Bribery and corruption:** Taking part in or being suspected of taking part in kickbacks, bribes, or other corrupt activities can result in criminal charges as well as serious harm to one's image.
- **Boardroom misconduct:** Financial losses, legal liabilities, and reputational harm can result from board members' breaches of fiduciary duty, conflicts of interest, or other unethical actions.
- **Absence of responsibility and supervision:** The probability of wrongdoing and risk can be raised by weak corporate governance frameworks, insufficient internal controls, or a failure to hold management accountable. Inadequate managerial information frequently makes this easier.

Integrating Governance Excellence into Conduct Risk Management

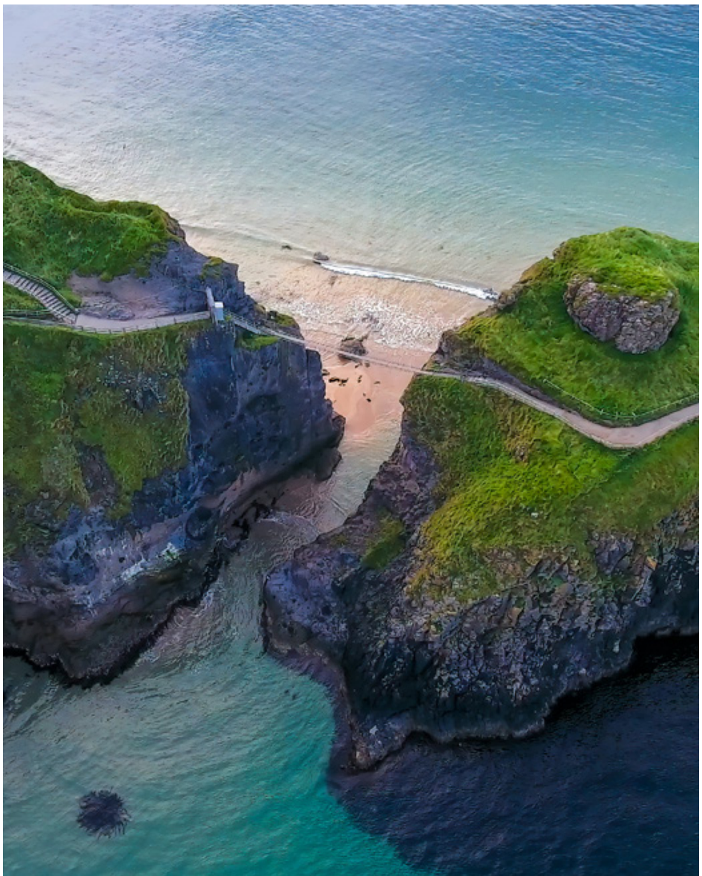
Governance factors such as the following should be taken into account for corporate behaviour risk management to be effective:

- **Evaluation of Board Effectiveness:** Evaluations of the board's efficacy should be carried out on a regular basis to determine the makeup, level of experience, and capacity of the board to carry out its oversight duties.
- **Whistle-blower protection policies:** Strict rules protecting whistle-blowers should be in place to encourage staff members to disclose environmental issues without worrying about facing consequences
- **Management Reporting Reviews:** To guarantee proper monitoring of the company's actions and culture, organisations should examine the efficacy of their management reporting.
- **Review of Internal Controls:** In-depth analyses of internal controls should be carried out to make sure they are sufficient to stop and identify fraud, corruption, and other wrongdoing.
- **Governance risk assessments:** To detect and analyse possible governance risks and conduct threats, conflicts of interest, and regulatory compliance difficulties, as well as other causes of bad behaviour, regular governance evaluations should be carried out.
- **Ethics and compliance training:** Employees should undergo ethics and compliance training on a regular basis to help them understand their roles, make moral decisions, and report misbehaviour.

Embracing Culture, Conduct and ESG: The catalyst to act now

Embedding culture and conduct into the fabric of an organisation is the cornerstone of an effective ESG strategy. Conduct and culture serve as the foundation for responsible decision-making and sustainable practices within the business ecosystem. They act as guiding principles that direct an organisation's approach to ESG considerations.

At KPMG, we believe that good conduct and culture must be incorporated into ESG and sustainability priorities. This orientation towards responsible business practices is not merely a compliance measure but also a strategic imperative that contributes significantly to an organisation's long-term success. The right culture and mindset are pivotal for the seamless integration of ESG practices into an organisation's operations.



An organisations's approach to sustainable actions, culture, and conduct is now intrinsically inked to their bottom line.

With change comes opportunity and there are endless benefits to establishing a strong organisational culture, including:

- Reduction of misconduct risk;
- Fostering an environment where ethical behaviour is not just encouraged but ingrained, creating a shield for an organisation against pitfall; and
- A positive work environment that will emerge as a by-product, enhancing employee satisfaction and productivity, which in turn contributes to the overall success of the business.

However, interlocking conduct and culture with your ESG strategy **is not without its challenges**. The regulatory landscape is intricate and ever evolving, presenting a hurdle for organisations aiming to align with ESG principles. Navigating through complex and dynamic regulatory sectors requires a proactive and adaptive approach, which demands ongoing monitoring and integration into organisational practices.

Furthermore, organisations **must dedicate resources to stay ahead** of changing regulations and guidelines, ensuring that their practices align with the diverse requirements of stakeholders, including their workforce.

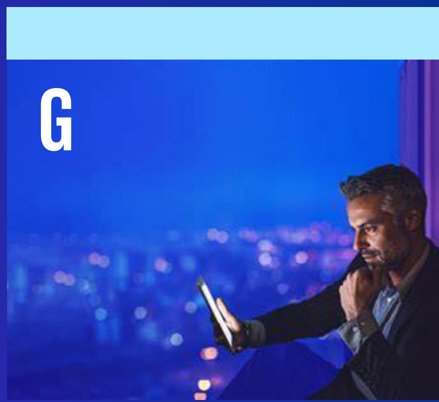
In essence, the synergy between conduct, culture and ESG is not a tick the box exercise – **it is a strategic choice that defines an organisation's trajectory** towards a sustainable and responsible future. By fostering the right culture and conduct mindset, an organisation can navigate the complexities of ESG, **contributing not only to their success but also to the broader goals of creating a more ethical and sustainable operating landscape.**

How KPMG can help?

KPMG is at the forefront of this effort and has a multidisciplinary team working with organisations and supporting them to manage conduct risk and drive their ESG agenda. By combining our expertise in conduct and product remediations, culture change and ESG Transformation, we can provide a holistic and integrated approach to manage ESG risk by helping organisations achieve their ESG goals, enhance their reputation, and create a more sustainable future.

KPMG has developed tailormade Product Assurance frameworks that integrate assurance roles to gain competitive advantage. Our experience extends to enhancing various aspects of clients' Risk Frameworks, by contributing to a comprehensive and proactive approach that addresses environmental concerns tailored to the organisation.

KPMG advises organisations on the interlock between Culture, Conduct Risk and ESG via scenario based learning. These tailored sessions go beyond regulatory compliance and emphasise ethical behaviour and sustainability practices using hypothetical scenarios. By educating employees on the importance of sustainable conduct, an organisation can fostering a corporate culture aligned with broader societal goals.



KPMG helps to prepare organisations to integrate ESG factors into their core business conduct. Recognising the interconnectedness of conduct risk and sustainability, we support organisations in assessing how conduct risk aligns with their sustainability goals. This involves identifying opportunities to enhance organisational resilience through sustainable practices, contributing to improved Governance.

We can provide a holistic and integrated approach to ESG risk

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