Environmental, Social and Governance

An integration to long-term strategy via risk management

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How companies could respond to ESG development

Companies can no longer ignore environmental, social and governance (ESG) impacts on their future strategy. ESG expectations are continuously intensifying across Hong Kong, starting with investors and ending with the real-world influence of each investment. Society at large increasingly expects companies in every industry to dedicate serious efforts to their own ESG-related actions.

On top of all that, new rules from the Stock Exchange of Hong Kong Limited (HKEX) will soon require companies to enforce accountability and be more transparent with their ESG agenda so that investors and society can judge if these efforts match their expectations.

May 2019	December 2019	March 2020	July 2020
HKEX issued a consultation paper on a review of its ESG Reporting Guide to ensure the ESG framework is up to date with investor expectations.	Conclusions of the consultation released to require listed companies to publish ESG reports in accordance with the revised ESG Reporting Guide.	HKEX published (i) Step-by-step Guide to ESG Reporting and (ii) Guide for Board of Directors on Leadership Role and Accountability in ESG.	The revised ESG Reporting Guide will become effective for financial years commencing on or after 1 July 2020.

Companies are expected to take a more proactive approach to manage ESG matters in response to the increasing expectations from regulators and investors. However, we have noted a majority of companies in Hong Kong manage ESG issues as a standalone compliance requirement, instead of integrating them into their business model and risk management. To truly understand the challenges of managing ESG as part of the business, companies must first ask themselves;

- Is the Board equipped and presented with the right information to adequately evaluate and oversee the ESG aspects of the company's strategy?
- Has the company identified and assessed all ESG-related risks and issues that are material to the business?
- Are there clear ownership and accountability assigned within the company to oversee material ESG issues?
- Are ESG drivers incorporated into the company's performance evaluation and management?
- Is the company's reporting transparent to clearly articulate the influence of ESG issues on strategy?

Fret not. ESG can easily be built alongside the company's risk management initiatives – which are also a part of the board's agenda and strategy. In other words, the integration of ESG as a part of risk management would address most, if not all, of the questions asked above. The benefit of doing so would be the minimal additional resources required to be incurred, and the minimal change to the company's existing practices, which all lead to an easy buy-in from the company's internal stakeholders.

This resonates with the suggestion from the Committee of Sponsoring Organisations of the Treadway Commission (COSO) and the World Business Council for Sustainable Development (WBCSD) who trust that a company's Enterprise Risk Management (ERM) framework should be leveraged to address ESG issues. It is not surprising as existing risk management structures and processes provide an optimised approach to support the identification, assessment, monitoring and responding to ESG-related risks.

Applying the ERM Framework on ESG related issues

Despite the guidelines issued by COSO and WBCSD, many companies are still struggling to apply the ERM framework to manage ESG-related risks. The roles of ESG and ERM often work in silos within an organisation. ESG disclosures should be integrated and align to the risks reported in an organisation's risk disclosure and business review sections of the Directors' Report. Given the importance of this issue, we have illustrated below an ERM framework that considers ESG issues, which are embedded / integrated into the framework:

Risk strategy and appetite

- Consider ESG-related risks while establishing business objectives at various levels that align and support the strategies of the company.

Risk governance

- Enhance terms of reference of current risks board committees to oversee ESG issues.
- Define roles and responsibilities on ESG issues for each function across the company.

Risk assessment and measurement

- Review material issues identified in the ESG report and review their accuracy. Consider how their related risks can be incorporated into current ERM process.
- Identify material ESG risks as part of the risk management from (i) current ERM processes, such as surveys, interviews and workshops by expanding the scopes; and (ii) various analysis, such as megatrend analysis and materiality analysis to gauge feedbacks from stakeholders on material ESG topics.
- Tailor risk assessment criteria, in terms of impact and likelihood to assess and prioritise ESG risks.
- Obtain advices / insights from experts on ESG topics and potential risk responses, such as physical risks and transition risks of climate change.

Risk management and monitoring

- Set specific Key Performance Indicators (KPI) or directional / forward looking statements on ESG targets, including environmental- and social-related risks.

Risk reporting and insights

- Leverage existing ERM reporting mechanisms to set the frequency and form of reporting on ESG performance to the board / board committees.
- Enhance disclosure of ESG risks and discussion on how ESG issues are related to the business in the Directors' Report.

Risk culture

- Enhance an ESG risk awareness culture by embedding ESG elements into the mission, objectives and core values of the company

Data and technology

- Review current KPI tools for ERM to further enable ESG KPI reporting in terms of data availability and reliability.
- Enable automation to store, manage and report real-time risk data on KPIs, including ESG.

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