



LATHAM & WATKINS<sup>LLP</sup>

# Business Recovery and Return to Normal

*ESG, Enterprise Risk Management and Risk Screening*

Summer 2021



# Foreword

Effective risk management balances risk exposures, benefits and expenditures. Establishing robust environmental, social and governance (ESG) risk management capability is necessary for organizations to assess and address the impact of ESG risks on business strategy and objectives. With the link between ESG factors and enterprise risk management (ERM) becoming increasingly explicit, organizations must find ways to examine business vulnerabilities towards a wider and more diverse range of risks.

ESG-related risks can be challenging to identify, assess and prioritize. By their nature, the financial and business implications of ESG risks may not be immediately clear or easily measurable. This challenge may be exacerbated by a company's limited knowledge of ESG risks, varying risk emergence periods relative to financial or operational risks and difficulties related to quantifying risks and assessing outcomes.

Further, the pandemic has underscored how organizations are challenged by the increasingly complex and interconnected global context and evolution of markets. In addition, disruption of markets, shifts in global economic power and changes in internal and external stakeholder expectations are driving the need to demonstrate stronger, more transparent and robust management of ESG risks across business activities and operating models.

Early identification of the onset of risks, whether ESG or broader risks that are collectively considered as part of an organization's ERM process, allows risk owners to take timely action to mitigate business vulnerabilities. When combined with assessment of the connectivity of risks, this process of early stage risk screening (ERS), helps to develop a strategic and coordinated management response to business threats and for the company to be first-movers on business opportunities - building business agility and resiliency and protecting stakeholders, performance and the planet.

This document shares the joint insight of Latham & Watkins and WBCSD, as we discuss approaches to ERS in the context of ESG and ERM. Our findings are based on analysis and interviews with corporate risk professionals, and we thank those individuals and organizations for their contributions. This work complements and extends the perspectives on corporate approaches to ESG risk management described in our [ESG Litigation Roadmap](#).

# Overview of Topics

1. What do we mean by ERS?
2. Outline of work undertaken by Latham & Watkins and WBCSD
3. Integrating ESG into ERM
4. ESG screening in more detail
5. Findings from WBCSD working group survey
6. Key takeaways





What Do We Mean by ERS?



# What do we mean by ERS?

- Examining the business landscape, operating environment and market context to identify events or potential changes that could jeopardize the attainment of companies' objectives
- Meeting future risk assessment challenges by mining new sources of data, developing new analytical tools and methods and broadening networks of scientific knowledge
- Recognizing risk resulting from a newly identified hazard to which a significant exposure may occur, or from an unexpected new or increased exposure or susceptibility to a known event or scenario
- Using methodologies, tools and expert opinion to assess possible signals of the emergence of identified or new risks to business performance
- Identifying emerging risks in the value chain early, and supporting risk managers in anticipating risks and taking effective and timely prevention measures to protect stakeholders (including consumers, clients, employees, shareholders, etc.) and the planet
- Examining future risk scenarios to model the risk and opportunity landscapes so that they can be evaluated and reflected in business development and strategies

# How can ESG support ERM practices?

- Connecting ESG and risk management practices (as part of ERM) to support the strategic integration and management of ESG-related risks
- Leveraging ESG and resilience assessment techniques – such as horizon scanning and trend analysis – to close the gap between issues reported in ESG/Sustainability reports and ESG/Sustainability risks reported in disclosures
- Demonstrating to investors and other stakeholders capabilities to identify and respond to ESG-related risks
- Extending the identification of key ESG risks and building awareness of potential risk triggers
- Facilitating a proactive role in understanding and addressing ESG-related risks by reducing or removing risk, adapting and preparing for risk in a timely manner and being more transparent about how the organization is addressing risk
- Broadening and deepening ESG data sources and analysis in order to develop ESG performance indicators
- Informing stress testing and scenario analysis and in turn supporting resilience planning, business continuity management and ESG performance reporting (e.g. TCFD)





# Outline of Work Undertaken by Latham & Watkins and WBCSD

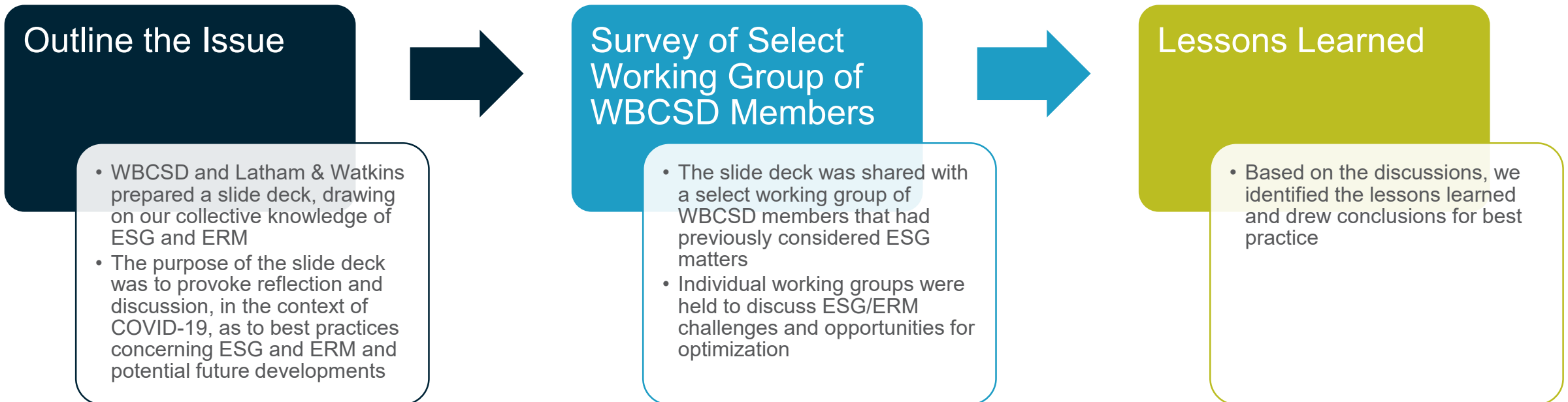


# What did we do?

“We know that climate risk is investment risk. But we also believe the climate transition presents a historic investment opportunity. **There is no company whose business model won’t be profoundly affected by the transition to a net zero economy.**”

Within industries – from automobiles to banks to oil and gas companies – we are seeing another divergence: **companies with better ESG profiles are performing better than their peers, enjoying a ‘sustainability premium.’**”

*Larry Fink, BlackRock letter to CEOs 2021*



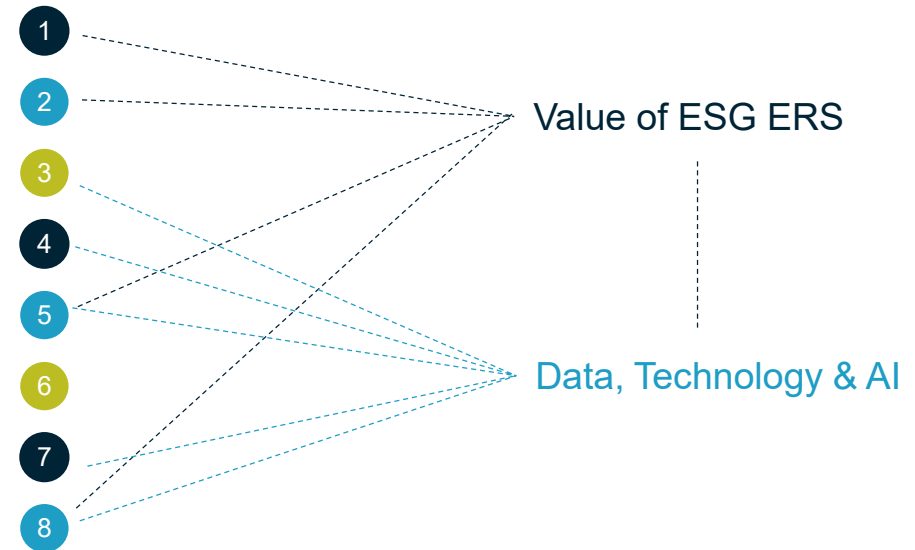


# What did we do?

- Surveyed the views of a sample of member companies
- Elicited views on ESG and ERS in the business context
- Identified common themes across member companies



- Mapped common themes to ESG screening factors – e.g.



- Highlighted key considerations to integrate ERS and ESG into ERM





# Integrating ESG into ERM



# Why integrate ESG into ERM?

- Organizational resilience is the ability to anticipate, respond, adapt and eventually prosper again in the face of internal or external political, economic, social or environmental shocks and stresses
- Organizational resilience requires an integrated approach that combines risk management with a holistic view of business continuity and success



# Who predicted COVID-19?

- Little or no identification of pandemics or infectious diseases as material risks or ESG issues in annual, integrated or combined reports
- 8 instances across 350 reports examined
- Search terms: pandemic, infectious disease, health, flu, influenza, virus, outbreak and SARS
- Limited continuity planning to respond to pandemics/infectious diseases

## Top 10 risks in terms of Likelihood

- 1 Extreme weather
- 2 Climate action failure
- 3 Natural disasters
- 4 Biodiversity loss
- 5 Human-made environmental disasters
- 6 Data fraud or theft
- 7 Cyberattacks
- 8 Water crises
- 9 Global governance failure
- 10 Asset bubbles

## Top 10 risks in terms of Impact

- 1 Climate action failure
- 2 Weapons of mass destruction
- 3 Biodiversity loss
- 4 Extreme weather
- 5 Water crises
- 6 Information infrastructure breakdown
- 7 Natural disasters
- 8 Cyberattacks
- 9 Human-made environmental disasters
- 10 Infectious diseases

Source: World Economic Forum global Risk Perception Survey 2019-2020

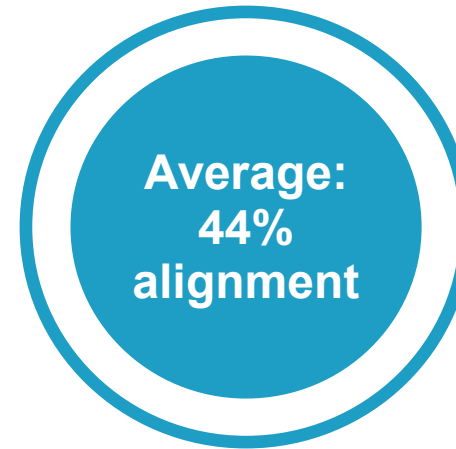


# COVID-19 pandemic observations

- Focus on assessing **business resilience, adaptability and effective continuity planning**
- **Review and assess supply chain and distribution vulnerabilities** – increased focus on understanding supply chain components, practices and performance
- Consideration of **what effective ERM will comprise** in the “new normal” state – every business will need to **rebuild its risk map** to reflect this new environment
- **Increased awareness of the role of social media** (positive and negative) and the speed of onset of reputational risks
- Concerns of **managing return-to-work protocols**, synchronization across geographies and operations, and litigation and employment risks
- Calls for post-COVID **funding and support to be aimed at ESG-positive** businesses and projects
- **Clear need for organizations to better identify and assess emerging ESG risks and challenges**

# Low alignment of ESG and ERM

Research reveals **companies struggle to identify ESG-related risks** in annual risk filings despite identifying them as material in sustainability reports

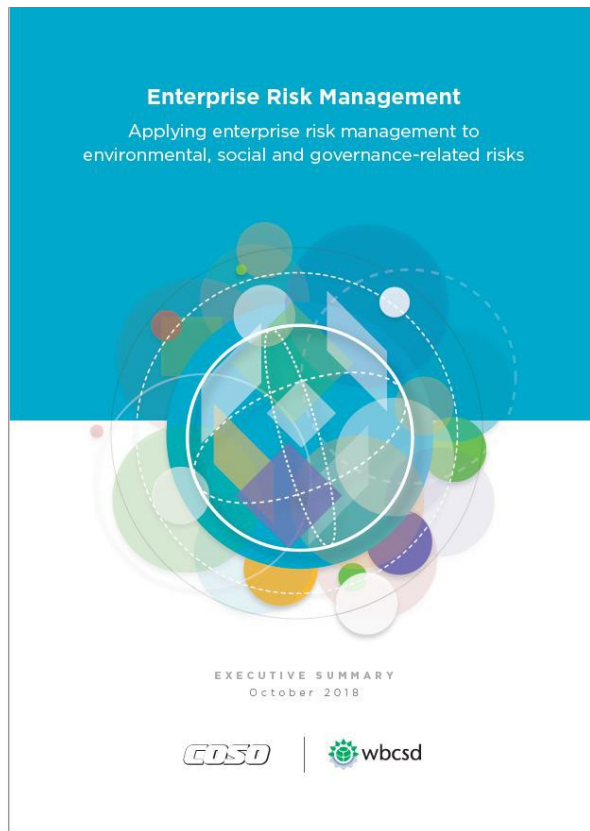


[www.wbcspd.org/Programs/Redefining-Value/Business-Decision-Making/Making-Measurement-Valuation/Resources/Sustainability-and-enterprise-risk-management-The-first-step-towards-integration/](http://www.wbcspd.org/Programs/Redefining-Value/Business-Decision-Making/Making-Measurement-Valuation/Resources/Sustainability-and-enterprise-risk-management-The-first-step-towards-integration/)





# WBCSD guidance on applying ERM to ESG-related risks



# Identifying ESG-related risks

- Many organizations have an ERM process in place to identify risks and capture these in a risk inventory
- The process may include surveys, workshops and interviews with risk owners and executives to confirm existing risks or understand new risks
- ESG-related risks can be challenging to identify. They may be:
  - New or emerging
  - Not well known to the business and include “black swans” or unforeseen events
  - Longer-term, going beyond the timeline of strategic planning or traditional risk assessment
  - Beyond the scope of one entity or requiring a collaborative response

## Connecting the business context and strategy to risk identification

### Understanding of internal and external environment strategy to risk identification

- Megatrend analysis
- Strengths, weakness, opportunities and threats
- Stakeholder engagement
- Materiality assessment
- ESG-related resources

**Risk identification:** threats or opportunities to achieving strategy and business objectives

**Risk inventory**



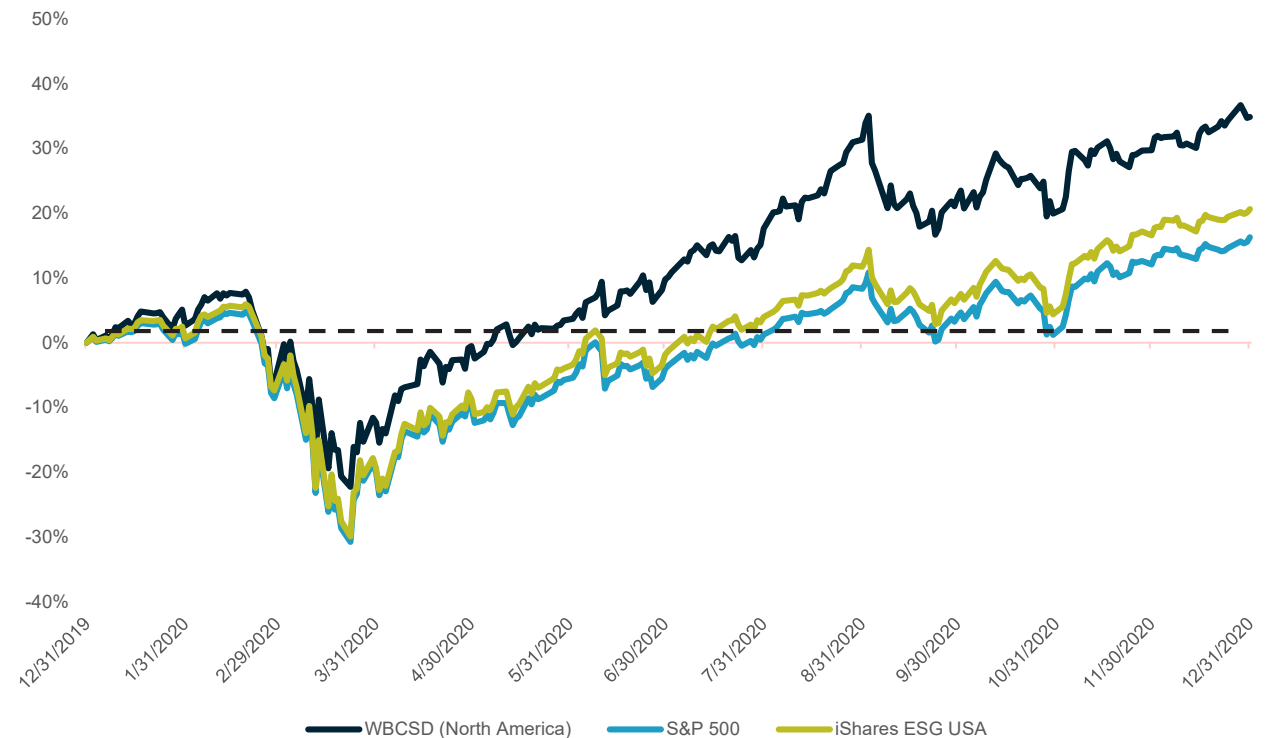
# ESG outperformance amid high volatility due largely to COVID-19

31 North American member stocks weathered downturn better than the market

**Consistently outperforming:** By the end of 2020, WBCSD portfolio's return was 18.6% higher than the S&P 500 index, and 14.2% higher than the iShares ESG MSCI USA ETF

**Rapid recovery from the crisis lows:** WBCSD members experienced faster recovery than the market and returned to the beginning of the year performance level in early May

WBCSD North American Members Stock Performance in 2020



# ESG outperformance amid high volatility due largely to COVID-19

67 stocks of European members are more resilient in the view of investors

**Consistent superior performance in the bearish market:** WBCSD European members beat STOXX Europe 600 benchmark by a margin of **4.0%**

**Recovery:** Market recovery is slow but still reflects investors' interest and confidence in ESG factors as a defensive characteristic

WBCSD European Members Stock Performance in 2020



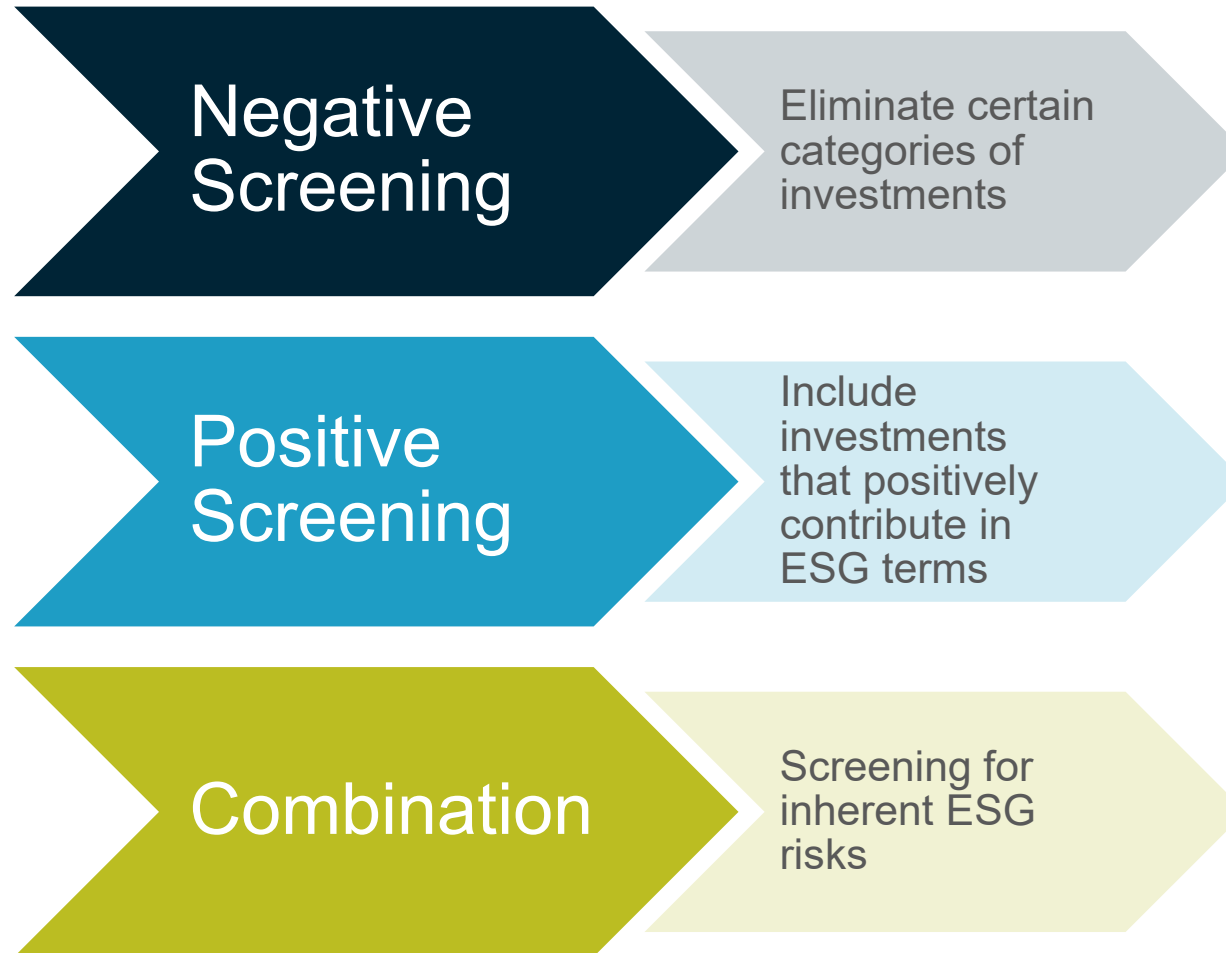




ESG screening in more detail



# ESG ERS





# Essential aspects of ESG ERS



Sector Risk



Geography Risk

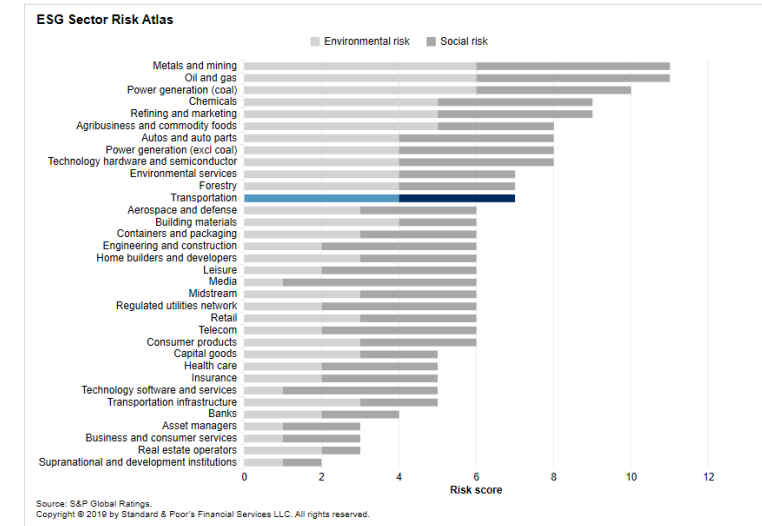


Company-Specific Risk



# Sector risk: Sources of information

- There are a number of sources of ESG risks analyzed on a sector basis
- SASB is regarded as one of the more comprehensive sources of information and is a standard that many entities align to
- It is possible to develop bespoke sector-based risks, and a number of entities do this – particularly financial institutions
- However, developing bespoke solutions is time-consuming and requires ongoing maintenance



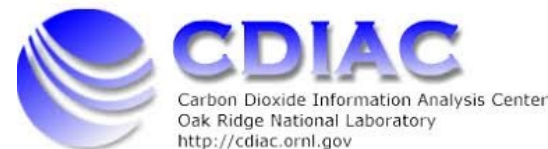
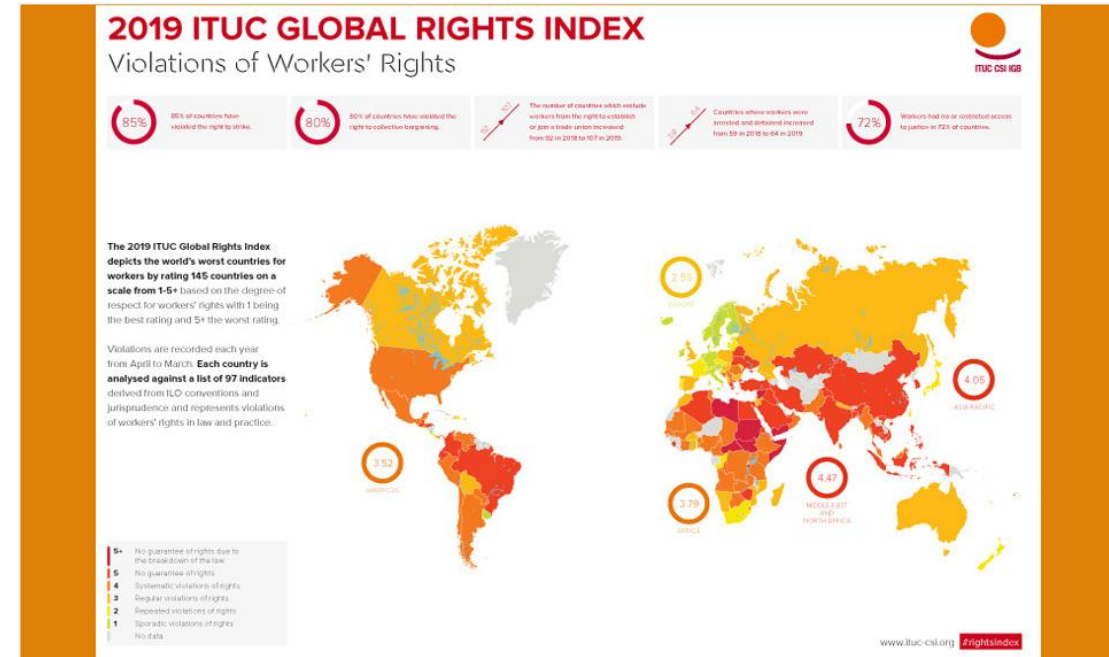
Materiality	Climate Change	Water	Waste	Energy	Greenhouse Gas Emissions	Human Rights	Community	Product Safety	Customer Privacy	Anti-Corruption	Anti-Money Laundering	Other
Climate Change	High	Low	Low	Low	High	Low	Low	Low	Low	Low	Low	Low
Water	Low	High	High	Low	Low	Low	Low	Low	Low	Low	Low	Low
Waste	Low	Low	High	Low	Low	Low	Low	Low	Low	Low	Low	Low
Energy	Low	Low	Low	High	Low	Low	Low	Low	Low	Low	Low	Low
Greenhouse Gas Emissions	High	Low	Low	Low	High	Low	Low	Low	Low	Low	Low	Low
Human Rights	Low	Low	Low	Low	Low	High	High	Low	Low	Low	Low	Low
Community	Low	Low	Low	Low	Low	High	High	Low	Low	Low	Low	Low
Product Safety	Low	Low	Low	Low	Low	Low	Low	High	High	Low	Low	Low
Customer Privacy	Low	Low	Low	Low	Low	Low	Low	High	High	Low	Low	Low
Anti-Corruption	Low	Low	Low	Low	Low	Low	Low	Low	Low	High	High	Low
Anti-Money Laundering	Low	Low	Low	Low	Low	Low	Low	Low	Low	High	High	Low
Other	Low	Low	Low	Low	Low	Low	Low	Low	Low	Low	Low	High





# Geographic risk: Sources of information

- ESG risk screening on a geographic basis is complex due to the number of discrete sources of information that must be obtained
- There are many available sources of information, but they are typically limited to single aspects of ESG, such as bribery and corruption, labor rights, GHG analysis, innovation, business environment, etc.
- There are limited resources that collate this information together

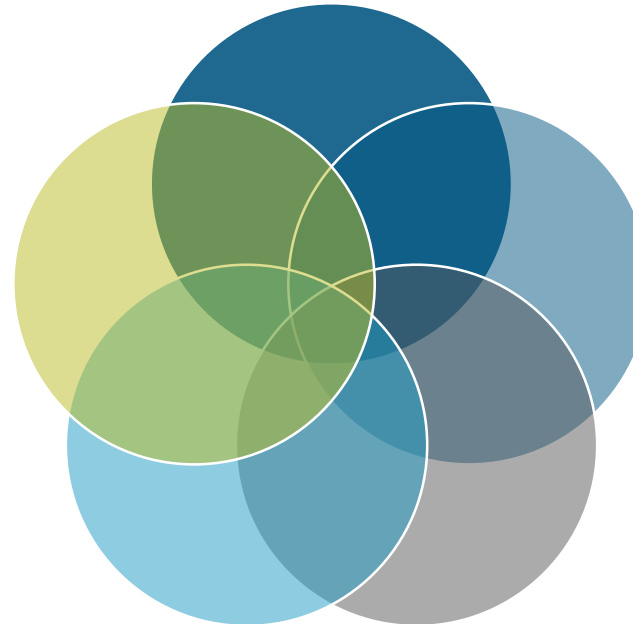


# Company-specific risk: Sources of information

Company-specific information does not always form part of an early-stage risk screen – it can be undertaken at the more detailed stage of diligence

In addition, some simple manual checks can be undertaken – e.g., company website, social media accounts and news searches

These functions can be limited in the case of smaller private companies



However, our experience is that an ESG risk screen that includes some elements of company-specific issues can help refine and focus any further diligence steps and considerations

There are a number of sources that may be able to provide a company-level analysis – e.g., ESG rating agencies, ESG data collation and search functions



# ESG data – technology and artificial intelligence

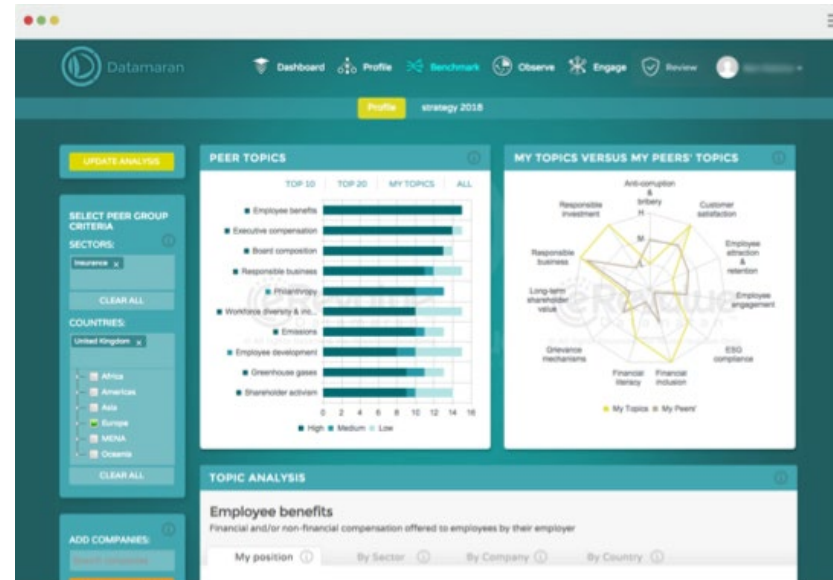
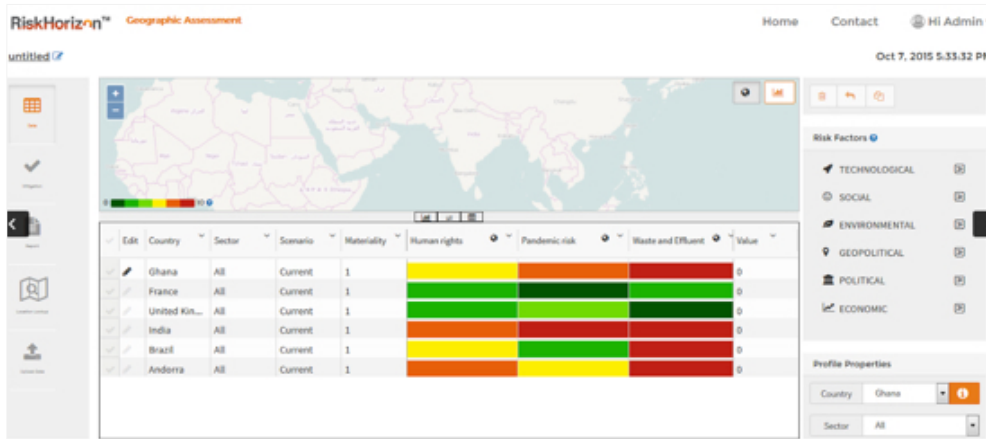
Sources of ESG data come from a wide variety of sources – company reporting, third-party assessments, social media, news reports, NGO investigations, political and regulatory developments, etc.

The amount of ESG data will only continue to proliferate as increasingly ESG reporting and ESG assessments become mainstream and mandatory

The most efficient means of sorting and processing this data lake is through the deployment of technology, including AI

Technology – including AI – allows organizations to ensure their risk screening remains dynamic and can be more easily adjusted to take account of new strategies, new priorities and emerging risks

# Examples of ESG risk screening tools



### EcoVadis' Assessment process

- 01 Register online**  
Create a company profile  
A profile used to optimize survey to your size, industry sector, location, etc.
- 02 Questionnaire Data collection**  
Answer CSR Assessment survey & upload documents  
A secure, confidential & multilingual survey with a support team ready to help
- 03 Expert analysis**  
EcoVadis distills your answers into an easy-to-read Scorecard  
An independent document audit, evaluation & analysis from CSR experts
- 04 Share & Improve**  
Online access to Scorecard results, Sharing & Corrective Action Plan  
Share results, collaborate directly online with clients, and improve performance

ecoVadis

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**TRUVALUE LABS**  
A FACTSET Company

**RepRisk**  
Due diligence on ESG and business conduct



# Undertaking ESG risk assessment

ESG analysis requires:

Use ESG expertise and tools to evaluate the importance of the relevant ESG factors and risks identified. Formulate a clear strategic approach to the business application of ERS services that is supplemented by an internal expert assessment

Continue to update, repeat and revise the ESG risk screening process to ensure it remains current and can take account of emerging and unforeseen risks – e.g., pandemic risks

Calibrate risk analysis to align with corporate strategy. In particular:

- Consider any ESG matters or themes of particular importance to the company – e.g., supply chains, reputational risk management issues, etc.
- Consider the application of weightings to ensure that the most important ESG matters come to the fore

Consider sector- and company-specific ESG standards, company commitments to ESG disclosures, and interface with risk screening

# ESG ERS case study

A global company in the food and beverage/agricultural sector

## Potential sector ESG risks

- Supply chain issues – e.g., labor rights (including modern slavery), working conditions, materials sourcing
- Impact of climate change and climate transition – including long-term access to resources (such as water), potential for change in climate to impact crop production or well-being of livestock and transitions driving shifts in asset values, product demands or the cost of doing business
- Ecological impacts – in particular, issues concerning biodiversity
- Environmental compliance and resources – issues relating to the use of pesticides, fertilizers, waste arrangements and environmental practices
- Anti-bribery/corruption – extent of risk likely to depend on geographic locations
- Product quality/safety – e.g., health and safety arrangements for working practices
- Consumer issues – consider reputational impacts

## Potential company ESG risks

- Will be bespoke to the specific company
- Need to consider the company culture and ethos (particularly for a consumer-facing brand), public ESG disclosures, any ESG commitments/standards the company has signed up to and social media/news traffic concerning the company

## Potential geographic ESG risks

- Will depend on the location of the business
- Likely to see heightened ESG concern and supply chain risks associated with parts of Asia, Africa and South America
- Physical climate risks arising from the effects of climate change on financial institutions' and/or businesses' operations, workforce, markets, infrastructure, raw materials and assets
- Geopolitical and political risks – arising from conduct and impact of political decisions, events, or conditions and from interaction of geographical factors (natural resource access, proximity to countries in turmoil, etc.), policy decisions and local cultural climates

## Act on findings of risk screen

- Integrate findings into ERM, considering the likelihood of the risk arising and the potential significance of that risk if it does arise
- Consider any particular vulnerabilities associated with a risk
- Essential to continue to monitor and refresh risk screen – consider use of technology to enable more dynamic risk screening





# Findings from WBCSD working group survey



# Risk Identification

- In the risk identification stage, critical questions are:
  - Which factors signal threats or business opportunities to the organization?
  - How can the organization recognize these signals in a timely manner and be well prepared to address the risk or respond to the business opportunity?
  - Which business scenario and risk events could occur?
- Organizations need to be confident in their capabilities to identify and measure these signals
- At the same time, organizations have found it challenging to pick up indicators of ESG-related issues and to identify potential impacts (e.g., on business performance, supply chains, operating models, employees, etc.). Organizations have noted that ESG risks vary considerably by sector and geography and can be bespoke to the relevant company
- Early risk screening can be a powerful tool to enhance risk identification and build organizational resilience and responsiveness



# Corporate perspectives on risk context

- The pandemic has driven focus on resiliency, crisis management and business continuity capabilities
- ESG-focused risk assessment has moved into mainstream business practice
- The context, impacts and emergence periods of risk have had to be rethought
- Interconnected risks need more attention
- Greater use and reliance on ESG insight – especially from a horizon-scanning and forward-looking perspective
- Consideration of a greater range and diversity of risks
- Need for increased use of risk identification and screening tools



# Corporate perspectives on ESG risk screening

- Surveyed the views of a sample of member companies
- Elicited views on ESG and ERS in the business context
  - The role and benefits of ERS to business
  - Where and how ERS may be most effectively applied and most useful to the management of ESG and ERM processes
  - Experience of the application of ERS and challenges observed or anticipated
  - Specific ESG-related risks or issues to consider as part of ERS
  - Possible factors in the “new normal,” post-pandemic environment that may benefit from the application of an ERS approach

## Common themes





# ERS themes in more detail

1

## ERS alignment to strategic and operational goals

- The risk screening process needs to be comprehensive and robust to bring confidence that there are no operational gaps
- ERS needs to be focused and targeted on key operational and business needs – it can't be exhaustive
- False positives need to be avoided, and it is important to understand what factors and signals are really material

### Potential accelerators and enablers

- Technology tools to assess material ESG factors specific to sector and geographic relevance

2

## Stakeholder management and engagement are key

- The business needs to be part of the solution to ensure the right information is screened and reported
- The best solutions are likely to leverage internal business intelligence and capabilities
- ERS can enhance stakeholder discussions and engagement on resiliency, vulnerability and crisis management

### Potential accelerators and enablers

- Use the results of technology tools to drive materiality discussion with stakeholders

# ERS themes in more detail

3

## Core roles for big data, digitization and data management

- Acceleration of the strategic implementation of digitized data capabilities are seen as an opportunity to enhance risk assessment, monitoring and reporting
- Getting the right data is critical but can/will still be challenging
- To support effective ERS, strategic approaches to data collection, management and quality are important
- For some, portfolio ESG performance is material, but data availability and quality can be limited

### Potential accelerators and enablers

- Regulatory developments will drive further disclosure obligations and more data
- Maintain awareness of new technology tools and developments

4

## Machine learning and AI are critical enablers

- Consistent recognition that organizations will need to make better use of predictive technologies and tools
- There is appetite to develop capability to mine data more efficiently and in a more targeted form
- There is a lot of potentially useful information externally but it is challenging to filter and interpret

### Potential accelerators and enablers

- With greater disclosure, access to relevant and meaningful data will become more challenging – consider the development of AI tools that will help maintain awareness of trends and material ESG factors



# ERS themes in more detail

5

## Need for improved metrics and indicators

- It can be challenging to keep up with the external context – how do you ensure you are measuring and assessing the right metrics?
- There is a common desire to provide business areas with ERS performance information but a lack of agreement on common/standardised metrics and KPIs
- Challenges to ERS can greatly depend on understanding what signals we should be paying attention to in advance – or learning from for the future

### Potential accelerators and enablers

- Global convergence of ESG reporting obligations – work in progress!

6

## Supply chain management is a core focus

- Supply chain vulnerabilities and demands for improved transparency have been highlighted in the pandemic
- SC-related operational, reputational and litigative risks have increasing prominence internally and externally
- Tools to robustly collate and assess SC performance data are required

### Potential accelerators and enablers

- Don't limit assessment to materiality factors and peer group. Use tools to incorporate supply chain risks
- Consider supply chain as a business opportunity

# ERS themes in more detail

7

## Limited use of tools or models

- Current approaches are largely manual and qualitative/judgment led
- In some instances an ESG database is available, but generally analysis and reporting remains reliant on manual processes or is piecemeal/tactical
- Some use is made of ESG ratings (e.g., MSCI) in terms of reporting, but there is limited use in day-to-day decisioning
- Having subject matter teams in place that are capable of handling complex data sets is important – e.g., to monitor a complex supply chain for responsible sourcing of materials

### Potential accelerators and enablers

- See previous discussion of the development of technology tools, including AI

8

## Need to assess risks at different granularities and dimensions

- Stakeholder requirements can vary significantly – strategically, an agile, scalable and multi-dimensional approach is required
- Assessing risks (qualitatively) in terms of reputational impacts is a common starting point for a number of organizations
- Important to identify factors that trigger multiple risks and connected risks across the business

### Potential accelerators and enablers

- Integrate ESG into ERM assessment and align the ESG team with the requirements of the ERM process

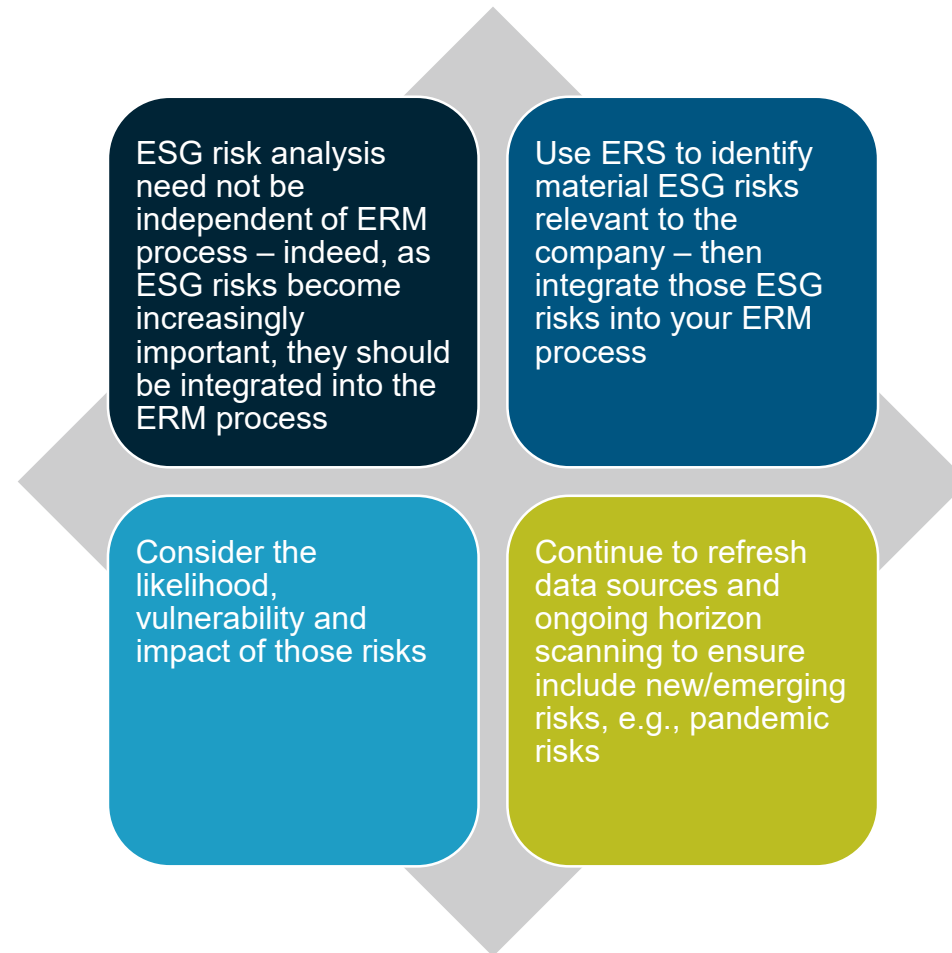




Key takeaways



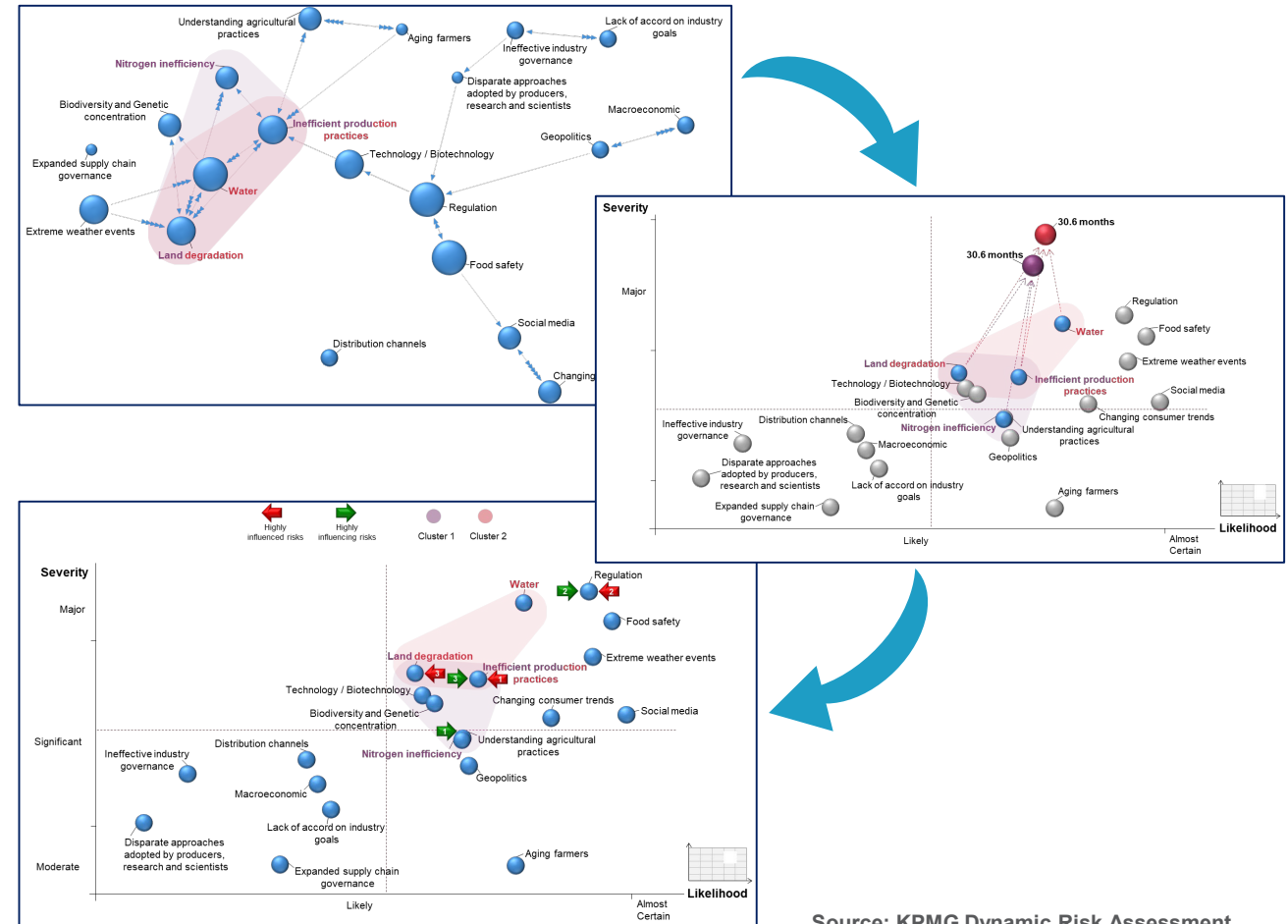
# Incorporating ESG into ERM





# Using ERS to support enhanced risk assessment

- ESG-related risks are macro, complex, multi-faceted and interconnected, and can affect the business across many dimensions (including different forms of capital and value)
- Organizations are increasingly viewing and managing risks as a connected, dynamic network - providing insight to:
  - Range of impacts of risk events
  - Speed at which risk impacts could occur
  - The clustering of types of risks and impacts
  - Identifies trigger risks and risks impacted by other risks
  - Aggregation of business impacts and vulnerabilities
  - **ERS enables organizations to review and identify the triggering of risks within the network and to inform assessment of the spread and aggregated impact of the manifestation of risks across the network**



Source: KPMG Dynamic Risk Assessment

# Integration and engagement with risk management

## How can we connect ESG risks to the broader risks?

ERS provides organizations with an additional tool to address the increasing need and expectation of the incorporation of ESG risks into institutions' business strategies and processes and internal governance arrangements.

Early identification and assessment of ESG factors encourages organizations to consider of the impacts on the long-term resilience of business models, operational practices and market opportunities.

Increasingly, organizations use ERS when reviewing the shape and effective application of their risk management framework with a specific focus on how ESG risks are embedded in or supplemental to other principal risks.

In turn, organizations are modifying risk governance arrangements to provide transparent ownership and clear responsibilities for ESG risks as drivers of strategic, financial and operational performance.

## How can we engage risk owners with ERS?

The impacts of the COVID-19 pandemic on business and society have highlighted the importance for risk managers to better understand and identify risks that may impact strategic performance assessment, corporate resiliency and vulnerability management.

ERS provides an additional tool for risk managers to utilize when exploring the emergence of identified risks but importantly also to consider signals of the emergence of new, additional risks or risks that have not been prioritized by the business – e.g., do not appear in the high impact/high likelihood quadrant of their risk matrix.

As risk managers are requested to extend assessments and more explicitly assess ESG factors, business agility and corporate responsiveness (e.g., to focus on the “what if” questions), effective ERS will contribute to a deeper and wider risk management input to key business areas such as the continuity of business, operational effectiveness and long-term strategic resilience.



# Conclusions

- It is an essential part of business planning to engage in ERM – and, increasingly, apply ERS to ESG factors and to broader risks that are being integrated into ERM
- Undertaking ERS can help with the identification of sector-, geographic- and company-specific risks. However, this is dependent on:
  - Resources dedicated to screening
  - Availability of data and use of technology
  - Integration of ERS into broader ERM processes, and bringing along relevant stakeholders
- Successful integration of ERS and ESG into ERM can result in:
  - Future-proofing business and building resilience
  - Demonstrating to investors that ESG issues are being considered and addressed
  - Informing continuity and crisis management plans
- Given the volume and complexity of data (which will only increase), technology tools including AI will increasingly be key to enabling businesses to manage these issues efficiently and effectively

# Helpful resources

- [ESG Litigation Roadmap](#)
- [Aligning enterprise risk management with ESG-related risks](#)
- [An enhanced assessment of risks impacting the Food & Agriculture sector](#)
- [Diagnostic tool for assessing the level of integration of ESG-related risks](#)
- [Modernizing governance: key recommendations for boards to ensure business resilience](#)
- [WBCSD Board Director Resources](#)





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