R&C risk & compliance

OCT-DEC 2021

www.riskandcompliancemagazine.com

Inside this issue:

FEATURE

Managing the risks of ransomware

EXPERT FORUM

Driving transformation in the insurance sector through trusted data and technology

HOT TOPIC

Optimising data for more effective forensic investigations

PERSPECTIVES

OVERCOMING THE REPORTING CHALLENGES FOR ESG

BY **SAMUEL K. WON**
> GRMA

Until recently, sustainability and environmental, social and governance (ESG) were of primary interest to environmentalists, liberal-leaning political action groups and non-governmental organisations.

Over the past several years, however, a confluence of major political, economic and social shifts has transformed ESG into one of the most topical business issues of our times. The term ESG has reached remarkable search-popularity on Google, hitting the maximum possible score of '100'. And major new best practice and regulatory requirements have only brought further attention and urgency to the topic of ESG.

Currently, more than a dozen major global reporting frameworks, with a dizzying array of acronyms, prescribe a host of best practice and regulatory-driven disclosure and reporting requirements. Among the most notable reporting frameworks are Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Climate Disclosure Standard Board (CDSB), Task Force on Climate-related Financial Disclosures (TCFD), UN Principles for Responsible Investing (PRI), Carbon Disclosure Project (CDP) and United Nations Sustainable Development Goals (SDGs).

On the regulatory side, in March 2021, the European Union's Sustainable Finance Disclosure Regulation (SFDR) came into effect, requiring

financial firms such as fund managers, insurers and banks that provide financial products and services to comprehensively disclose and report on their level of sustainability with regard to their investment activity. Under the SFDR, there are transparency specifications at both the entity and product levels.

The principal objective of this regulation is to provide transparency on sustainability within the financial markets, ensure that financial market participants can embed sustainability into their decision making and redirect capital flow toward sustainable finance. Another key aim of the SFDR is to prevent 'greenwashing', where some financial market participants may for marketing purposes exaggerate their environmental commitments on paper without necessarily following through on those commitments in practice.

Reporting frameworks and standards for ESG fall largely into three major categories: guidance frameworks, reporting frameworks and third-party frameworks. Each of these pose a different set of challenges because their aims differ and there is at present no harmonised definition of ESG and its content. For example, a guidance framework is intended to provide insight into how a company's operations may impact the climate, as well as the likely impact climate change may have on the company's ability to generate shareholder value.

A reporting framework, on the other hand, requires the disclosure of quantitative and qualitative information for the purposes of receiving a score and enabling comparison among peer firms.

"New and ever-changing standards mean that reporting requirements are a 'moving target', so organisations are finding it difficult to develop and maintain an up-to-date and unified approach for their ESG disclosures and reporting."

Although, there are few areas of commonality slowly emerging from several ESG harmonisation initiatives, as long as the goals of these reporting frameworks remain not only different but also continue to evolve in divergent ways, the challenges to ESG reporting participants will continue to be significant.

New and ever-changing standards mean that reporting requirements are a 'moving target', so organisations are finding it difficult to develop and maintain an up-to-date and unified approach for their ESG disclosures and reporting.

Common challenges

As a result of the wide range of ESG reporting standards and requirements that are either now fully in effect or coming due soon, we are finding that many companies and institutions, both large and small, are scrambling to figure out which reporting frameworks are applicable to them and how to meet the daunting operational challenges of complying with these numerous and complex disclosure and reporting requirements.

Some of the most common challenges are as follows. First, many companies are frustrated by the lack of relevant ESG data that is specific to their enterprise or institution. Second, they are finding that what ESG data is available to them is often not consistent, reliable or comparable. Third, the absence of a uniform definition of 'materiality' among jurisdictions and legal frameworks further complicates the challenge as to how an organisation should undertake ESG disclosures and reporting. Fourth, most companies and institutions lack the underlying infrastructure and native capabilities to perform the complex data management work necessary to do their ESG reporting.

Remarkably, a large majority of these companies and institutions that are attempting to do their ESG

reporting in-house are doing so using a primarily manually driven process that is dependent upon spreadsheets as the primary tool and infrastructure for their reporting.

Sound and repeatable ESG reporting

The drivers of a decision to do ESG reporting are varied but, from our experience, are primarily related to an organisation's mission, stakeholders and peers, as well as which reporting framework they choose to follow. In the current environment, with heightened sensitivity and scrutiny surrounding ESG-related issues, asset managers, asset owners, corporates and institutions quickly realise they need a more robust, sound and repeatable programme for ESG reporting. The motivation to have a sound reporting programme in place stems from not only the recurring requirements to do reporting, but also from the complexity, breadth and depth of the metrics, analysis and reporting that organisations must provide to both internal and external audiences. For example, many organisations are receiving more periodic, as well as ad hoc, requests from current and prospective investors asking for detailed ESG metrics and analysis about their investments and portfolio companies.

A sound ESG reporting programme should be repeatable and flexible so that it can adapt to the evolving requirements of various reporting frameworks. From our experience, there are three key prerequisites toward having a strong ESG reporting programme. In general, the development of an effective ESG reporting programme should begin by determining which of the various ESG reporting frameworks or regulatory requirements are most relevant and directly applicable.

Once this determination has been made, an inventory must be done to precisely ascertain the specific data, metrics or analysis needed to fulfil disclosure and reporting framework requirements. A second important consideration in establishing a sound programme for ESG reporting is developing a plan for the robust infrastructure and proper workflows that will be necessary to perform recurring reporting and to meet the ad hoc data and reporting requests that invariably come from having to provide ESG disclosures and reporting.

In our experience, very few organisations are equipped with the data infrastructure and processes (e.g., appropriate data warehouse, data hierarchies, data aggregation and data management capabilities), as well as reference data and qualified internal staff, to do all the complex ESG data collection and data management work necessary for a well-functioning ESG reporting process.

In most cases, with the exception of some very large organisations, we have found that, generally, it is significantly more cost-effective in both the near term and long term to have the data management and reporting done on an outsourced basis by a qualified and experienced provider – one that is

equipped to undertake this kind of investment and ESG data curation and outsourced reporting.

The third and final consideration, which is arguably a more critical and difficult aspect to develop and execute, is ensuring a reporting programme is well integrated and an effective component of the organisation's overall governance, policies and procedures, monitoring process and controls for ESG. Ultimately, regardless of whether an organisation's mission is to maximise earnings, produce 'alpha' or provide essential services as a non-profit institution, it will be judged for the quality of its transparency and by how well its 'talk and walk' for ESG are aligned. R&C

Samuel K. Won
Founder & Managing Director
GRMA
T: +1 (212) 230 1610
E: swon@grmainc.com