Focus on the ‘G’ in ESG:

Identifying governance risks in your third-party ecosystem

Webinar

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An LSEG Business

Before we get started

Housekeeping

- Please note that we will be recording today's session. We will share the recording, presentation slides and other relevant materials with you as soon as possible
- Try to refresh your browser if you encounter any issues or buffering

Interacting

- Submit your questions for the speakers at any time via the **Slido** panel embedded in the 'Questions' tab, found to the right of your screen
- Alternatively, you can submit your question at **slido.com** from any device and enter the code: **#focusontheg**
- If you would like to hear more about Refinitiv's solutions, submit the contact form on the 'Contact a risk specialist' tab

Our speakers

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CORPORATE CRIME & INVESTIGATIONS

G in ESG
Legal Considerations

Refinitiv Webinar

February 2023

The ‘G’ in ESG


Board governance and decision making
Corporate culture and values
Compliance with law and Regulation

Supply Chain – Governance Considerations

The Corporate Governance Road & the 3rd Party Risks

- **Corporate Governance regulations have been defined to protect the Company "corporate value" from risks arising from the Governance of the companies**
- **Throughout the years, regulations and international standards have been gradually introduced worldwide to reinforce the duties of Boards of Directors to guarantee that their actions do not cause any harm to shareholders first and stakeholders lately**
- **Latest analysis of corruption cases, as well as numerous legislations, such as money laundering or export control and sanctions, require a thorough screening of business partners risks. For example, according to Transparency International (TI), one of the most common types of channels through which bribery takes place is the use of business partners as "Intermediaries".**
- **The essential element of business partner analyses are due diligence processes, relevant for all business relationships with:**
  - agents, consultants and other similar intermediaries
  - joint ventures, controlled subsidiaries, consortium partners, collaboration agreements
  - contractors, subcontractors and suppliers

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ESG Governance Risks Framework

- **Environmental, social and governance (ESG) risks are at the heart of organisations of all types and sizes**
- **Governance Risks covers a wide range of matters affecting to the Board as responsible for adopting**
  - their own self-regulations and policies (i.e. executive compensation, bonus system, diversity policy …)
  - company targets and strategy
  - risk management system and a compliance management system
  - tax strategy
  - corporate affairs policy and relation with institutions
  - and recently, sustainability strategy and policies
- **Not only coming from the relevant Regulations but also from ESG Rating Standards and**
- **Affecting the company and its supply chain widely**

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ESG Governance Risks Management

- **Management of the Governance Risks Framework requires effort and monitoring as those indicators affects the company's intangible value (reputation and brand value)**
- **Not only for the company itself but those risks related with the activities that undertakes with its business partners, supply chain, intermediaries, agents, and all 3rd relevant parties, products or services**
- **In the management of 3rd party risks, two basic requirements needs to be addressed:**
  - Conducting reasonable due diligence process before entering into a business relationship, as well as "on an ongoing basis" to confirm the suitability of a third party
  - Undertaking appropriate measures to ensure that the third party does not engage in improper conduct
- **Under new framework set out by CSRD, new obligations are required to company in respect its supply chain:**
  - Monitor and report on adverse impacts (actual or potential) arising from the company operations including its supply chain and
  - Taking actions to prevent, mitigate, remediate and cease such potential adverse impacts

ESG Governance Legal Framework

NFRD & CSRD includes the risks associated to the supply chain

- ❑ **Non-Financial Reporting Directive (Directive 2014/95/EU – "NFRD"): disclosure of non-financial and diversity information by certain large companies**
- ❑ **Corporate Sustainability Reporting Directive ("CSRD") from the European Parliament and the Council 14 December 2022, which will amend the NFRD**
- ❑ **Taxonomy Regulation (Regulation (EU) 2020/852 – "Taxonomy") on the establishment of a framework to facilitate sustainable investments (together with Delegated Acts and amending Delegated Acts)**
- ❑ **Regulation on sustainability-related disclosures in the financial services sector (Regulation (EU) 2019/2088)**

Non-Financial Reporting Directive (2014/95/EU)

- **Large listed companies, banks and insurance companies with more than 500 employees are required to publish reports on the policies related to:**
  - Social responsibility and treatment of employees
  - Respect for human rights
  - Anti-corruption and bribery policies
  - Diversity on company boards (age, gender, educational and professional background)
  - Business models, policies, outcomes, risks and risk management and KPIs related to the business
- NFRD introduced the so-called "**double materiality" effect**, whereby companies are obliged to
  - **Outside-in risks** or how sustainability issues may affect the company and
  - **Inside-out risks** or how the company affects society and the environment
- And to prove and explain that **the company applies appropriate due diligence process** when dealing with the monitoring of such risks

Corporate Sustainability Directive (2022/2464/EU)

Introduce new Governance factors, such as:

- **The role of the company administrative, management and supervisory bodies, with regard to sustainability matters, and their composition; and their expertise and skills to fulfil this role or access to such expertise and skills**
- **Information about any incentive schemes offered to members of the administrative, management and supervisory bodies which are linked to sustainability matters**
- **Business ethics and corporate culture, including anti-corruption and anti-bribery, the protection of whistle-blowers and animal welfare**
- **The undertaking's engagement to exert its political influence, including its lobbying activities**
- **The management and quality of relationships with customers, suppliers and communities affected by the company activities, including payment practices; and**
- **Main features of the undertaking's internal control and risk management systems, in relation to the sustainability reporting process**
- **Due diligence processed implemented by the company with regard to sustainability matters, and to conduct due diligence processes**

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Corporate Sustainability Directive (2022/2464/EU)

- **Due diligence processed implemented by the company with regard to sustainability matters, and to conduct due diligence processes**
- **Adverse impacts (actual or potential) connected with the company own operations and its value chain and actions taken to identify and monitor those impacts**
  - products and services
  - business relationships and supply chain
- **Actions taken by the company to prevent, mitigate, remediate or bring an end to actual or potential adverse impacts, and the result of such actions;**

Corporate Sustainability Directive (2022/2464/EU)

Apply new disclosure rules to:

- all large companies, whether listed or not (removing the current 500-employee threshold) and to listed small and medium-sized enterprises (SMEs) (other than listed micro-enterprises);
- to non-EU companies which generate a net turnover of more than €150m in the EU and have at least one subsidiary or branch in the EU;

- **Require reporting in line with mandatory EU sustainability reporting standards;**
- **Require that the sustainability information is subject to a limited level of audit assurance;**
- **Require companies to prepare their management reports in an electronic reporting format and to tag the sustainability information.**

Third Party Risk Management and Due Diligence Process

- The establishment of processes, systems and controls to ensure compliance with ESG disclosure regulatory requirements in Human Rights and Environment is going to be a key element of all RMS:
  - Approach, code of conduct and Due Diligence processes
- A robust risk-based Due Diligence Process Map affecting the supply chain, amongst other relevant parties, should be developed and implemented, which address at least:
  - The Scope of Third Parties
  - Third Parties risk assessment to discover adverse effects (actual or potential)
  - Due Diligence Process
  - Approval processes and Risk mitigation measures
  - Monitoring processes of the Due Diligence Processes effectiveness
- Appropriate whistleblowing channels
- Communication campaigns on the Due Diligence Processes

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Challenges for the near future

- **Identify the relevant functions** within the company to lead the implementation of the new obligations:
  - Consider the role of Legal, Compliance, Procurement Departments?
- **Operationalizing an ESG reporting function**
  - Updating of standardization bodies
  - Integration of KPIs (regulatory –coming from NFRD and CSRD- and ESG rating KPIs)
  - Bear in mind that CSRD introduce a general EU-wide audit requirement for reported sustainability information
- **ESG Third Party Due Diligence**
  - Update or approve adapted Code of Conduct, policies, Due Diligence Processes, prevention and mitigation measures
  - Design and implement Due Diligence Process covering all new requirements
  - Set out whistleblowing channels and procedures with dealing with hints
  - Design communication plan and activities

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What are some of the best practices and tools available to help companies identify potential governance risks in their third-party ecosystem?

How to manage Third-Party Governance Risk?

1. ONBOARDING PROCESS

- Implement robust and risk-based **onboarding process** for all third parties (customers, vendors, suppliers etc.)
- Include elements (e.g., **questionnaire)** to address corporate governance concerns

2. ONGOING MONITORING

- Conduct **initial** and **ongoing compliance screening** to monitor changes in third party risk profile
- Stay abreast of corporate governance and management related **controversies**

3. DUE DILIGENCE REPORT

- Perform **tailored** and **risk based due diligence searches** to inform third party risk
- As needed, conduct **stakeholder interviews** or more enhanced reviews of **governance practices**

4. ESG RISK ASSESSMENT

- Determine **third-party risk** based on due diligence **findings** and **risk appetite**
- Manage ESG **risk exposure** in the third party population and **maximise value-creation**

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Governance Risk Due Diligence – Tools and Sources

What tools and sources are available?

- Compliance Screening
- Media and Internet Searches
- Litigation Searches
- Financial Information/Bankruptcy Searches
- Regulatory Enforcement Searches
- Ownership/Relationship Mapping
- Corporate Records
- Reverse Directorship Searches
- Private Data Vendors
- Reputational Intelligence
- Site Visits

Third-Party Provided Information

Starting point for due diligence research (e.g., use provided **identifiers**) but should always be **corroborate** by **other sources**

Open-Source Intelligence (OSINT)

Method of gathering data from open sources (**covert** or **publicly available**) with the use of specific tools to **make non-obvious connections**

Databases and Data Providers

Includes official **government** and **regulatory databases**, legal databases, private data vendors and **social media sites**

Vendors and Outsourced Research

Checks that can only be performed **in-person** (e.g., record retrieval etc.) or require consultation with an **expert** or **source** close to the third party

Examples of Governance Risk findings

Risk of unidentified governance issues?

- Reputational damage
- Loss of competitive advantage
- Loss of market share
- Performance risk
- Financial loss
- Performance risk
- Supply chain disruption

Corporate governance issues may impact a third party's ability to engage in business and increase exposure to reputational damage and financial loss

Senior Executive Accountability

General Board Meeting Agenda revealed vote of no confidence against Chairman in light of allegations of money laundering and misconduct

Class Action Lawsuit

Litigation checks uncovered class action lawsuit for inaccurate reporting of financial information which resulted in a drop of share prices causing losses to shareholders

Executive Remuneration

Media searches revealed shareholders challenging senior executive compensation packages despite missing profit targets

Governance Risks in the Third-Party Ecosystem

What indicates good governance?

- Effective Board composition
- Transparent Board remuneration
- Balanced Executive remuneration
- Clear Board accountability
- Sound oversight controls
- Conflict of interest management
- Stakeholder confidence
- Defined shareholder rights
- Strong Business ethics

The "G" is foundational to the realisation of both the "E" and "S"

What indicates poor governance?

- Ineffective governance framework
- Unethical practices
- Non-compliance with regulation
- Lack of independent oversight
- Perverse incentive structures
- Contradictory lobbying activities
- Ill-equipped leadership

The "G" didn't captivate media and stakeholder immigration until we witnessed catastrophic failures

Q&A

Submit questions in the ‘Questions’ tab

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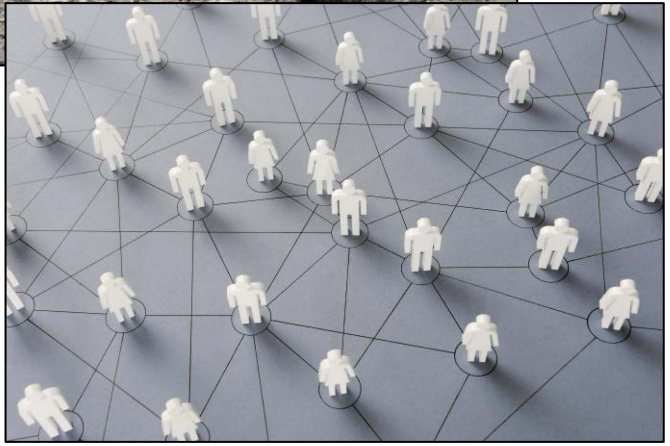
ESG and Third-Party Risk

Summary Takeaways from our three-part webinar series



1. **ESG as a third-party risk area already exists today**

2. **Third-party ESG risks are not fully defined and continue to evolve**

3. **Third-party ESG risks can already adversely impact you firm**

4. **Doing something (anything!) today is better than waiting**

5. **There are some best practices that you can implement today**

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Thank you

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