



# TECC 2022

WS 2

Environmental, Social and Governance Issues

September 2022

Monika Dissen

# What do we mean by ESG?



## Environmental

Conservation of the natural world

- Climate change and carbon emissions
- Air, water and soil pollution
- Biodiversity & ecosystems
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity
- Circular economy

## Social

Consideration of people & relationships

- Human rights & modern slavery
- Health & safety
- Client & employee satisfaction
- Equal opportunities & Diversity
- Data protection and privacy

## Governance

Standards for running a company

- Board composition & independence
- Shareholder rights
- Management compensation
- Prevention of money laundering, corruption, and bribery
- Political contributions
- Tax compliance
- 
-

# ESG Risks and Drivers



Risk	Regulation & Supervision	Products, Services, Corporate Commitments
<ul style="list-style-type: none"><li>• Regulatory</li><li>• Reputational</li><li>• Conduct</li><li>• Transition</li><li>• Physical</li></ul>	<ul style="list-style-type: none"><li>• Global regulatory landscape rapidly evolving</li><li>• Central Banks agreed to advance ESG supervision*</li><li>• ESMA's Sustainable Finance Roadmap 2022-2024</li></ul>	<ul style="list-style-type: none"><li>• Fast growing product and services suite</li><li>• Corporates, incl. Banks, continue to make commitments, join initiatives and speaks up</li></ul>

# Compliance areas impacted



# Embedding ESG in Compliance mandate (1/2)



"The compliance function and the risk management function play a key role in the approval of new products, e.g. environmentally sustainable credit facilities, or significant changes to existing products, processes and systems."

*EBA Report on Management and Supervision of ESG Risks for Credit Institutions and Investment Firms, June 2021*

1

## Regulatory Tracking

- Capture and anticipate regulatory change
- ESG regulations repository
- Assessment of regulatory change
- Industry best practice

2

## Policies & Procedures

- Embed ESG risk management aspects, including risk management requirements, in policies and procedures
- Reflect new and amend rules and regulation in policies and procedures

3

## Knowledge, Expertise & Training

- Staff to be trained on ESG regulatory landscape, regulators' expectations and internal governance
- Collaboration between 2<sup>nd</sup> LoD functions
- Remain up-to-date on market trends and product innovation

4

## Internal Governance

- Compliance to fulfil its general role as assigned by law and meeting regulators' expectations
- Representation on internal committees, fora and working groups
- Other? Depending on organisational setup

"The compliance function should include the legal requirements regarding sustainability for financial sector entities when carrying out its duties [...]"

*BaFin Guidance Note on Dealing with Sustainability Risks, January 2020*

"Rapid changes in the prices of green and emissions-intensive assets could lead to market instability. The rush for green investment could create green asset bubbles and increase the risk of sudden price corrections, especially if greater demand for such investments incentivises greenwashing."

*Bank of England, April 2022*

# Embedding ESG in Compliance mandate (2/2)



“The compliance function should advise the management body on measures to be taken to ensure compliance with applicable laws, rules, regulations and standards, and should assess the possible impact of any changes in the legal or regulatory environment on the institution’s activities and compliance framework.

As rules and standards on sustainability may change over time, institutions may increasingly face compliance-related risks, such as liability, litigation and/or reputational risks, stemming from climate-related and environmental issues.”

*ECB Guide on Climate-related and Environmental Risks, November 2020*

5

## Advisory

- Advise on controls, live situations
- Party in product governance process
- Advise on implementation of regulatory changes
- Support remediation

6

## Risk Assessments

- Risk types to reflect ESG-specific risk as required
- Risk scenarios for ESG risk
- ESG risk as an integral part of annual Compliance risk assessment

7

## Surveillance, Monitoring & Testing

- Develop meaningful attributes and scenarios, update lexica etc.
- Focus on specific risks, e.g. greenwashing
- Monitoring of key controls
- Testing of ESG-specific processes

8

## MI & Others

- Identify needs for MI
- Automate reporting on ESG metrics
- Embed MI in escalation process

“Let me be clear: there is no complacency from the part of ESMA or any national regulator, who remain vigilant when it comes to misleading communication on sustainable investing or other forms of greenwashing when advising or offering products to investors.”

*Verena Ross, Chair of ESMA, Speech Nov 2021*

“[...] where compliance personnel were integrated into firms’ ESG-related processes and more knowledgeable about firms’ ESG approaches and practices, firms were more likely to avoid materially misleading claims in their ESG-related marketing materials and other client/investor-facing documents”

*SEC Risk Alert, Review of ESG Investing, April 2021*