



RISK MITIGATION AND THE PIVOTAL ROLE OF ESG

The far-reaching consequences of Covid-19 have forever changed the risk landscape, and rising levels of third-party risk now demand urgent attention. Persistent gaps in formal due diligence must clearly be addressed, but a broader sea change is needed: both financial institutions (FIs) and corporates need to adopt a more holistic approach to risk management – one that incorporates environmental, social and governance (ESG) considerations as a fundamental tenet of the risk mitigation process, rather than as a separate silo.





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The 2021 risk landscape

A 2021 global survey, commissioned by Refinitiv, collated responses from more than 2,900 managers in large companies across 30 geographies¹, and found – unsurprisingly – that Covid-19 had changed business focus. A substantial 73% of respondents revealed that they found themselves under extreme or significant pressure to increase turnover in the wake of the pandemic.

The reality of this increasing pressure is that 65% of those who participated agree that Covid-19 forced them to take shortcuts with their know your customer (KYC) and due diligence checks in order to cope with the impact of the pandemic. These shortcuts have directly contributed to rising levels of risk.

Encouragingly, there is evidence that many organisations continue to adopt a proactive attitude to detecting and preventing third-party risks, but nonetheless the due diligence gap has widened since our last survey in 2019. Just 44% of third-party relationships are now subject to due diligence checks, down from 49% two years ago.

It is precisely third-party due diligence gaps such as these that can allow heightened risk individuals and entities to slip through the net within often vast, global supply chains and perpetuate a range of crimes (including fraud, money laundering, theft, bribery and corruption, cybercrime and modern slavery), the consequences of which are far-reaching, impacting organisations, individuals and societies in immeasurable ways.

Further complicating this situation is the persistent problem of lack of access to reliable data – respondents revealed that they had only been able to obtain 46% of the required data and legal documentation needed to conduct checks.

Respondents are acutely aware of the potential fallout from financial crime, with our survey finding that they considered employees and the economy to be the chief victims of such crime. On top of this, it is well-documented that any organisation linked to any form of financial crime can face serious consequences, ranging from significant financial penalties through to often irreparable reputational damage.

¹ All respondents were knowledgeable about or involved in regulatory compliance and practices.



ESG: moving to centre stage

“Disillusioned ESG investors no longer want surface-level intelligence. They require more in-depth analytics. ESG investing is moving toward a place that reflects innovation and corporate leadership more transparently.”

Refinitiv playbook

Top ESG trends for 2021:
Stability and sustainability in the investment community.

Alongside this changing risk landscape, the convergence of risk and sustainable finance is accelerating, with ESG considerations moving more and more towards global centre stage.

This trend is being driven by a host of factors, including a growing need to address a broader range of risks than has been standard in the past, as well as increasing regulatory pressure, which continues unabated – upcoming regulations include the EU’s Directive on Mandatory Environmental and Human Rights Due Diligence and Germany’s Corporate Due Diligence Act. Both will raise the bar with respect to the due diligence obligations and reporting that organisations face, and we expect regulatory interventions to continue to accelerate.

The good news is that respondents appear to be well aware of the increasing importance of ESG considerations, partly as a result of the pandemic. Our survey delved into respondents’ views on this topic, and found that 66% believed overall ESG considerations had increased in importance for their organisations as a result of Covid-19.

In terms of future developments, we expect to see the continued emergence of the ‘S’ in ESG – while the environmental agenda has been given the greatest focus to date, there is a growing awareness of the connection between social and environmental factors. Social factors will also increasingly impact organisational supply chains, in that companies will look to adopt frameworks that can evaluate how their suppliers rate in terms of critical issues like diversity and inclusion.

Additional Refinitiv research into the top ESG investing trends in 2021 reveals that both transparency and the proactive integration of ESG considerations will become more significant, again boosted by the ‘sustained and profound impact’ of Covid-19 on attitudes to social responsibility.

Our research further highlights that, whilst 2020 saw record inflows into ESG funds, the substantial intergenerational wealth transfer that will unfold over the next decade will add further impetus to this trend, as millennials, who are typically more tuned to the importance of sustainability and ESG investing, take over the reins from older generations.

Millennials are much more likely to make investment decisions based on broad-based criteria, rather than purely on the potential for profit. They are generally more focussed on factors such as equality and accountability. In line with this, ESG considerations have become indispensable in investment decision making.

Green crime, a key component of the sustainability agenda

Green crime forms a fundamental part of the environmental considerations embodied within the concept of ESG. These crimes are systematically contributing to significant biodiversity loss across the globe, and are often closely linked to financial crimes enabled by heightened-risk individuals and entities hiding within complex third-party networks.

Refinitiv research reveals that biodiversity loss continues to increase across the globe, with serious implications for both livelihoods and economies, and we predict that from 2021 onwards, this will be a growing area of concern for companies.

These greater levels of awareness are reflected in our survey findings, with over half (52%) of respondents confirming that they consider green crime (including illegal fishing, logging, wildlife trade and waste dumping) to be a priority. Unfortunately, the same respondents also revealed that currently green crime receives just 8% of overall company efforts (cost and time) allocated to preventing financial crime, a situation that urgently needs to change. Whilst companies with environmental records that do not meet evolving standards are not necessarily committing a crime, heightened awareness of green crime across all networks will be to the benefit all stakeholders.

Global recognition of the serious impact of green crime is indeed growing, and this is supported by the findings of a recent Refinitiv webinar on the subject, where 81% of participants 'absolutely' agreed that green crime is a threat to peace and security. Moreover, 84% believe that these crimes should receive the same attention as crimes relating to money laundering and terrorism financing.

Che Sidanius, Global Head of Financial Crime and Industry Affairs at Refinitiv, highlights that there needs to be more collaboration between the public and private sectors in order to make the fight against green crime more effective:

“There’s increasing evidence that habitat loss, wildlife interaction and climate change will lead to greater risks of a pandemic in the future. The unprecedented impact of Covid-19 has forced organisations to take stronger roles in combatting climate change. In some cases, seeing the fragility of the natural world and recognising our increased reliance on it has encouraged companies to adopt a more systematic approach to fostering business resilience within a green-recovery strategy.”



The importance of joining the dots

The current risk mitigation status quo largely treats ESG considerations and broad-based risk management as separate siloes, but they are directly and inextricably linked. Critical ESG factors simply must become part of every risk-related decision making.

As ESG considerations have grown in importance, they have indeed moved more to centre stage, but many organisations still view the ESG arena as a ‘nice to have’ or as a tick box exercise to be completed in addition to their mainstream risk mitigation strategies.

It is this mindset that needs to change, since ESG considerations now constitute one of the most important areas of risk that need to be addressed.

Of course, challenges still remain – specifically a lack of reliable and complete ESG data – but those organisations that move ESG up their risk mitigation agendas and take a proactive approach to modelling their risk strategies around ESG will certainly reap rewards.

For example, when firms are assessing global third-party risk, those that already actively monitor ESG factors within their supply chains will be best placed to respond to and comply with regulatory requirements around today’s pressing issues, such as eradicating modern-day slavery and monitoring carbon emissions, as well as targets for emissions reductions. Numerous other examples exist.



How Refinitiv is helping

Refinitiv remains committed to helping organisations identify and eradicate risk within even the most complex global supply networks. We are also committed to ensuring that reliable and complete ESG data is accessible, and to promoting the mainstream use of ESG criteria as part of broader risk management strategies.

Data

Refinitiv's ESG investing information covers 80% of global market cap across 76 countries and delivers over 450 key metrics. This reliable, trusted data can help with risk assessment and deliver insights into suppliers' performance in critical areas such as climate change, executive remuneration, and diversity and inclusion.

In addition, our World-Check® risk intelligence database delivers accurate and reliable information to help organisations conduct essential screening. We have hundreds of specialist researchers and analysts across the globe, adhering to the most stringent research guidelines as they collate information from reliable and reputable sources, including watch lists, government records and media searches.

Reporting

Where heightened risk is detected or suspected, our enhanced due diligence reports deliver deep insight to help organisations pinpoint risk and protect themselves from potential regulatory, reputational and financial damage.

Technology

Our Refinitiv Due Diligence Centre (RDDC) centralises your third-party risk management processes and guides stakeholders through every step of the process throughout the lifecycle of third-party relationships – from initial assessment and onboarding to ongoing monitoring, renewal or end of life.

Refinitiv has consistently focussed on developing and delivering leading-edge technology, which we believe has the ability to be game-changing in the fight against financial crime. Survey results backed this belief, with responses showing that those who use technology to prevent financial crime are almost twice as likely to have a better collaboration with law enforcement on financial crime than those who do not use this technology (58% vs. 36%).

Opinions were also strongly in favour of the use of technology for crime detection and prevention, with 86% agreeing that “innovative digital technologies have helped identify more possible financial crime”.



Collaboration

Refinitiv firmly believes that collaboration between stakeholders is one of the fundamental keys to success in dismantling financial crime networks, but also critical to furthering the global sustainability agenda. In line with this we have been instrumental in various ways, with two examples being:

- In 2020 we launched the Future of Sustainable Data Alliance (FoSDA) along with a host of global partners. FoSDA seeks to answer crucial questions around the data needed to support a shift towards more sustainable investing
- Along with a distinguished group of partner organisations, we have formed The ESG Working Group, a partnership working to emphasise the importance of the social criteria within ESG investing, and to bring together civil society, experts and the private sector





Closing thoughts

Against a backdrop of rising risk levels and an increasing due diligence gap, organisations need to take stock – urgently – of their approach to risk mitigation. By adopting a more holistic view, one that treats ESG considerations as truly fundamental to building a complete picture of risk, firms can move into a position of greater power in the ongoing fight against financial crime.

The strategic adoption of leading-edge technology can vastly improve risk mitigation outcomes, and ensuring access to clean, reliable and complete data will also transform risk management processes.

This combination of trusted data and well-considered technology, when further combined with invaluable human expertise, can offer organisations their best chance to understand complex networks and form a holistic picture of potential risk.

In addition, we need to consolidate global efforts, pool our combined resources, collaborate and share ideas in order to create the best possible environment for all stakeholders to uncover and mitigate risk.

As the concepts of risk and sustainable finance continue to converge, we have an opportunity not only to boost our success in combatting illicit financial activity, but also to join forces to proactively address some of our generation's most fundamental environmental and social challenges.

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