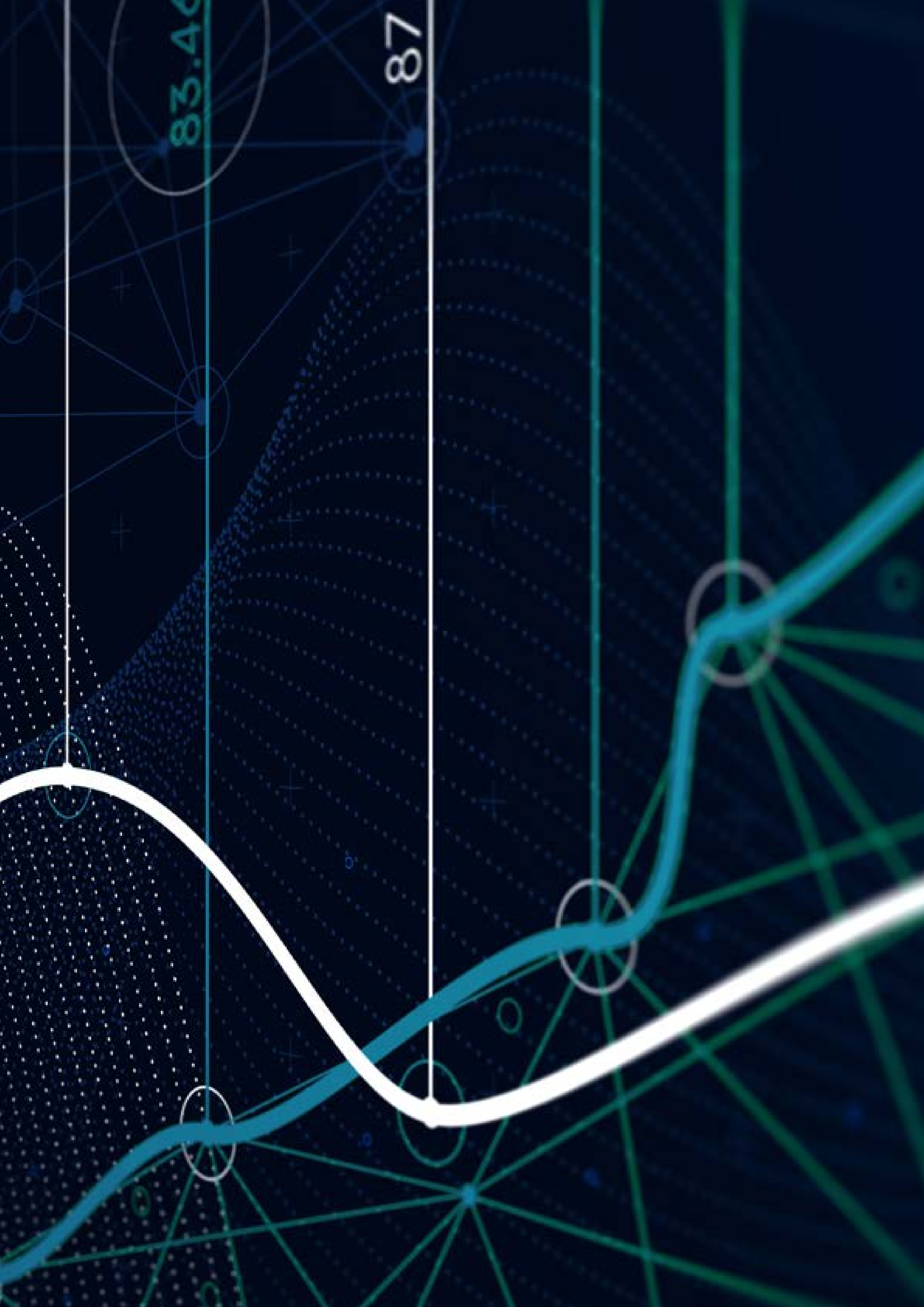
Marsh

Evaluating ESG and pandemic risk reporting trends

FTSE 100 and global exchanges risk analysis 2021

February 2022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Preface

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Many parallels have been drawn between the lack of global preparedness for the COVID-19 pandemic and the environmental, social, and governance (ESG) risks that confront the world. As COVID-19 took hold in early 2020, some speculated that it was a "rehearsal" for the type of calamity the world could face as a result of climate change. It has proven to be more than simply a rehearsal for anything, and businesses and governments are actively applying lessons learned to date while still managing the ongoing risk.

Over the past two years, the pandemic has brought into sharp focus social risks, such as those relating to employee wellbeing, health and safety, labor laws, and human rights. At the same time, governance risks — associated with compliance, disclosure, reputation, and ethical standards — have gained increased attention and are now also at the fore. The questions are increasingly being asked: Is ESG risk the new pandemic risk? Will the world be equally unprepared?

In *Evaluating ESG and pandemic risk reporting trends*, Marsh presents research and analysis regarding risk trends based on annual reports from a selection of companies listed on global stock exchanges, covering the July 2020 to July 2021 reporting period. The report summarizes over 1,100 combined risks extracted from the annual reports of companies on the Financial Times Stock Exchange 100 Index (FTSE 100) and provides cross-industry analysis on risk section maturity and corporate governance alignment.

The reporting period we analyzed is unique, with the continuing impact of COVID-19 on society and businesses globally combined with the rising prominence of ESG risks, particularly climate and sustainability.

We also compared 60 companies listed on the Hong Kong Stock Exchange (HKSE), New York Stock Exchange (NYSE), and Euronext, and their collective 200 risks, providing insight into the reporting of ESG risks of significance for all companies.

Executive summary

Marsh, assisted by Cranfield University, analyzed key words in the risk sections of annual reports for a set of companies listed on the world's four leading stock exchanges to gain insight into how businesses evaluate ESG risks. We previously used this method to analyze views of risk among FTSE 100 companies within the 2018 to 2019 reporting period. However, this is the first time the approach has been applied to assess risk across global stock exchanges. Given the research occurred over the course of 2021, the study presents a unique assessment of global risk as the pandemic receded somewhat and the focus shifted to ESG issues.

It's worth noting that respondents in the World Economic Forum's *Global Risks Report* in 2022 signaled environmental and societal risks as the most concerning. However, over a 10-year horizon, the health of the planet dominates concerns: environmental risks are perceived to be the five most critical long-term threats to the world as well as the most potentially damaging to people and planet, with "climate action failure", "extreme weather", and "biodiversity loss" ranking as the top three most severe risks. The current Marsh analysis reveals a more nuanced picture of pandemic and ESG risk. For example, the outlook on both risks was found to vary according to location. Greater importance was placed on ESG risk in regions where there has been more action and more discussion aimed at addressing the issues. However, when quantifying the financial impact of climate-related risks and establishing relevant metrics for evaluation and mitigation of the hazards, some alarming gaps emerged.

For example, the study found that only 30% of FTSE 100 companies showed evidence of a standalone report on climate change risk in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Set up in 2015 to promote more targeted and standardized climate-related reporting, the UK has made the TCFD's framework mandatory, with disclosure by some organizations required as early as next year. Given that a company ideally would be reporting according to TCFD recommendations for several years before the disclosures became compulsory, such a finding suggests a potentially widespread lack of readiness.

Other risks — related to information technology, the regulatory and legislative environment, health and safety, and geopolitics — were also found to be top of mind at companies across the exchanges. The predominance of these concerns raises the question of whether companies need to consider further the effectiveness of their risk management frameworks, in both measuring and mitigating these risks.

Global views on ESG risk

Concerning ESG risk across the global exchanges, 90% of the Euronext companies sampled named it as a top risk, compared to 21% of all companies listed on the FTSE 100 (see Figure 1).

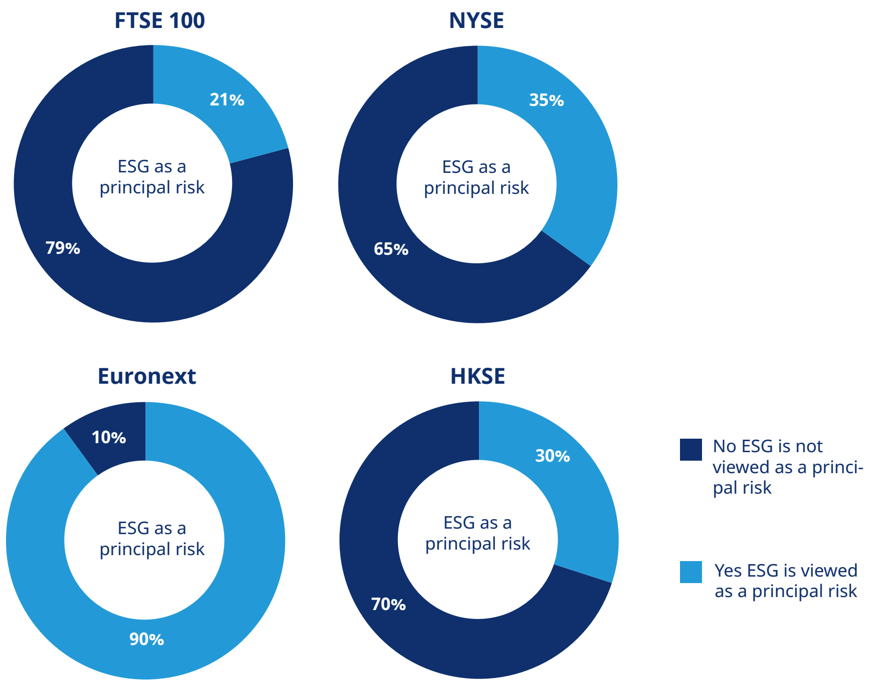
On the NYSE, 35% regarded ESG as a principal risk, while among HKSE companies the total dropped to 30%. While the FTSE 100 figure appears to be low for a standalone ESG principal risk, our analysis shows that key words such as environmental and climate appear in 94% and 62% of all reports, respectively.

The emphasis European and UK governments and the private sector in these jurisdictions have put on ESG factors may go some way in explaining the results. For example, the EU is implementing compulsory reporting of climate-related risk via the Non-Financial Reporting Directive (NFRD), supplemented in 2021 with the Corporate Sustainability Reporting Directive (CSRD). Meanwhile, the UK will be one of the first countries to require mandatory climate risk reporting in line with recommendations of the TCFD. (Some UK companies will need to report according to the framework from April 2022).

The Securities and Future Commission of Hong Kong announced a later date of 2025 for TCFD framework compliance (although disclosures in some sectors will become mandatory earlier), while the US is yet to make a formal statement on which climate reporting framework they will follow.

As the TCFD recommendations gain traction around the world, and compulsory reporting of climate-related issues becomes commonplace, companies will have to take a more proactive and methodical approach to these stipulations. Building a profile of a company's climate-related risks is perhaps the most difficult component of the TCFD recommendations. An oversight in this regard could lead to companies having their climate change exposure modeled by another party, possibly to their disadvantage. It is therefore advisable to tackle the problematic aspects of this task early on and start managing the risk through an enterprise risk management (ERM) framework approach.

01| ESG overview for the global stock exchanges



Source: *Marsh*

Beyond the "E" of ESG

Marsh's research broke down further the ESG risks noted in annual reports to see whether more emphasis was placed on any one of the environmental, governance, or social risk areas. This was achieved by conducting a word analysis across a survey set of 60 companies on the exchanges. Mention of environmental risk was found to be most common. In the food and beverages, mining, and utilities sectors, the word appeared in all company report risk sections. The words "social responsibility" appeared frequently in reporting; "diversity", "wellbeing", and "net-zero" were seen significantly less.

The same analysis was carried out on the annual reports of FTSE 100 companies. Consistent with their peers on the other global exchanges, almost all of FTSE 100 businesses used the word "environmental" in their principal risk sections, but mention of "social responsibility" was low by comparison, with the travel and leisure sector using them the most, in 17% of annual reports reviewed.

These results point to a concentration across all exchanges on the environmental aspect of ESG evaluation, and worryingly scant attention to its social and governance facets. It is vital that companies' strategies to mitigate ESG risks consider social and governance as well as environmental factors to ensure their long-term value and resilience.

Social criteria are increasingly gaining attention, especially among younger generations. These include how a company treats and values its employees and surrounding communities. Companies are also judged on commitment to inclusion and diversity strategies as a way of fundamentally improving the business, and the labor standards of suppliers.

Governance criteria generally assess a company's corporate governance practices, such as board structure, and in particular board diversity, audit quality and transparency, and issues surrounding remuneration, including executive pay. The United Nations Framework Convention on Climate Change's (UNFCCC) new Finance Climate Action Pathway 2021 has called for board, executive, and client-facing staff remuneration to be aligned with net-zero targets and climate risk management and resilience.

FTSE 100 — ESG versus pandemic risk

During 2020 and 2021, pandemic trumped ESG risk as a principal hazard for FTSE 100 companies, with 51% including COVID-19 as the most significant risk cause category within their annual reports.

Of the businesses surveyed, 34% named pandemic risk as a top hazard, while 21% of companies regarded ESG risks as their main concern.

Sectors ranking ESG most commonly as a principal risk included retailers, mining, and travel and leisure, with the financial sector most regularly not recognizing it as a top concern.

FTSE 100 risk controls

For the FTSE 100, we analyzed how different industries use key words to outline risk controls. The words "policy", "continuity", "planning", and "monitoring" were the most frequently used words to describe risk control measures.

The word "insurance" appeared in 41% of annual report risk sections. However, the use of the word "transfer" was seen in 37% of annual reports, suggesting increasingly wider discussion of risk mitigation issues.

In the construction and real estate sector, 75% of annual reports included the word "insurance." The support service and aerospace/industrials sectors also more commonly referred to insurance in their reporting, with the word appearing in 71% and 70% of reports, respectively.

There was no mention of insurance by the media and food and beverages companies surveyed, while the word only appeared in the annual reporting of 17% of travel and leisure and electronic/technology company reports. The lack of conversation around insurance in companies, and in sectors as a whole, suggests potential protection gaps or inadequate risk reporting.

Compulsory reporting

Around the world, companies increasingly face risks, as well as opportunities, resulting from regulatory and reporting requirements that focus on the ESG impacts of their operations. Mandatory reporting of climate-related risk will be required in the EU via the aforementioned Non-Financial Reporting Directive and Corporate Sustainability Reporting Directive. In the US, the Biden administration's Executive Order on Climate-Related Financial Risk, issued in 2021 and directed at federal agencies is expected to result in consideration of various climate-related regulatory initiatives.

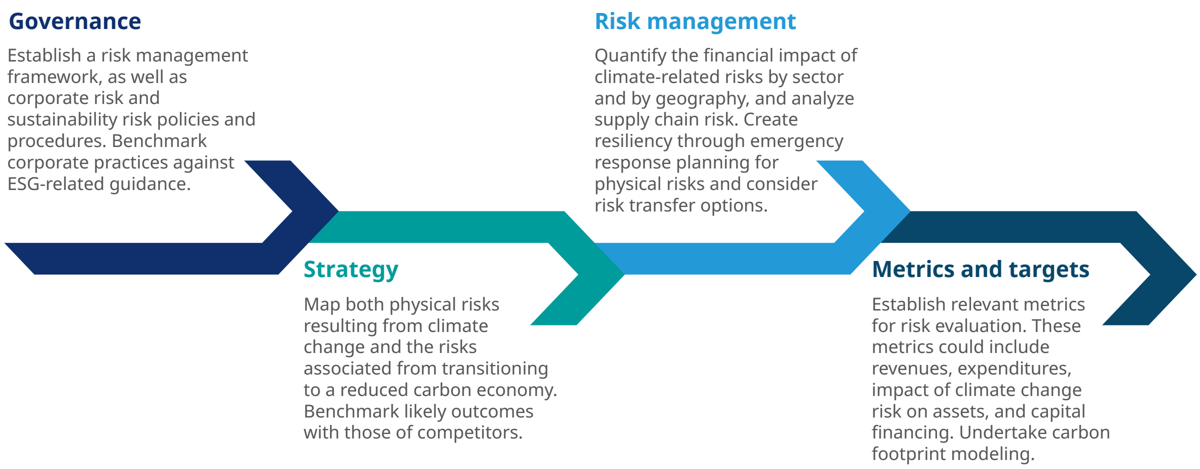
The TCFD was established in 2015 to promote more targeted and standardized climate-related reporting to enable better investment, underwriting, and credit decisions. The intention is that increased awareness of the financial implications of climate change will lead to more sustainable business models and solutions. TCFD compliance, while ultimately likely to result in long-term benefits for companies, is a significant undertaking.

The TCFD advocates making [11 recommended disclosures] around four core elements of climate-related risks (see Figure 2):

- Governance.
- Strategy.
- Risk management.
- Metrics and targets.

One of the task force's key disclosures centers on the resilience of an organization's strategy when different climate-related scenarios are taken into account. This includes a 2° C or lower scenario, where energy use and emissions are consistent with limiting the global average temperature increase to 2° C above the pre-industrial average.

02| Considerations in fulfilling the TCFD's 11 recommended disclosures



FTSE 100 reporting of climate change risk

The Marsh analysis of the FTSE 100 found only 30% of companies showed evidence of reporting climate change risk on a standalone basis in line with the TCFD (see Figure 3). This is despite the UK government's move to make the recommendations mandatory by 2025. From April 2022, disclosure will be mandatory for the 1,300 largest UK-registered companies, including traded companies, as well as private companies with over 500 employees and £500 million in turnover. The majority of UK organizations will see reporting requirements come into effect in 2023.

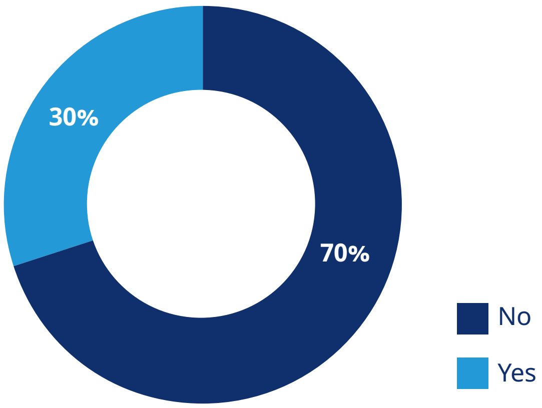
Marsh's research showed sectors differed vastly in the public disclosure of the climate change risk they face (see Figure 4). While 75% of companies in the utilities, mining, and healthcare sectors demonstrated that they had reported in accordance with the TCFD's recommendations on a standalone basis, no companies in the support services showed evidence of having done so.

A quarter of companies in the food and drinks sector had separate reports on the TCFD recommendations, while only 17% of companies in the electronics and technology, travel and leisure, and media industries reported on a standalone basis.

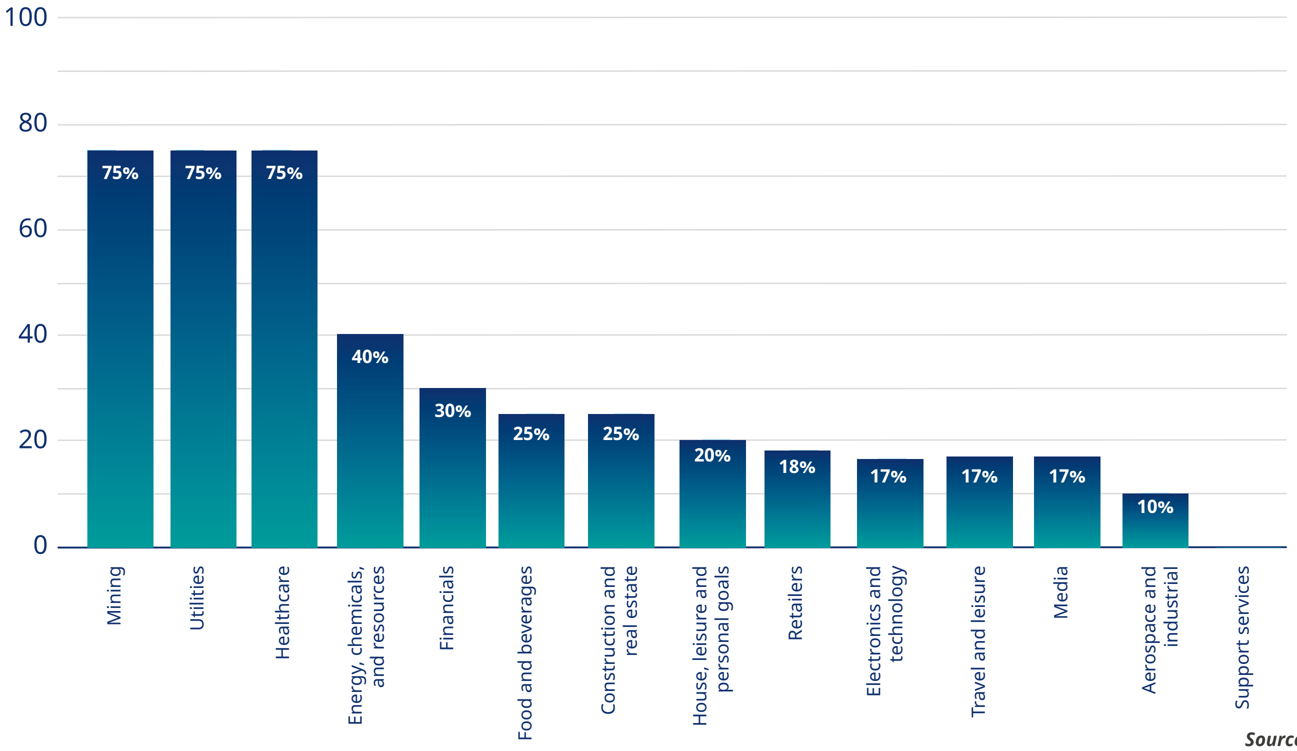
In the energy, chemicals, and resources sector, 40% of companies had separate TCFD-aligned reports. For financial companies, the total was 30%, and for construction and real estate 25%.

FTSE 100 companies are starting to report TCFD content within dedicated pages of their annual reports, a trend expected to become commonplace within the next annual reporting period. It is advisable to tackle the more difficult aspects of TCFD compliance early, for example, physical risk modeling. The Marsh Risk Resilience Diagnostic tool can be used, for instance, to analyze the impact and interrelation of emerging risks across an organization's complete value chain. It can also be useful to engage stakeholders, such as lenders, banks, and insurers, and ask what information they would like to see.

03| Most surveyed companies' annual reports show no evidence of standalone TCFD reporting



04| Evidence of standalone TCFD reporting in annual reports varies by sector



Source: *Marsh*

Global view on pandemic risk

As well as sounding the alarm over ESG-related risks, the World Economic Forum (WEF) for many years has warned about pandemic risk. In 2020, with the spread of COVID-19, the threat became an actuality. Even as the threat of COVID-19 lessens somewhat, respondents in the WEF's *Global Risks Report 2022*, identified infectious diseases as the sixth most severe risk on a global scale over the next 10 years (see Figure 5). They also noted that societal and environmental risks have worsened the most since the start of the pandemic.

05| "Identify the most severe risks on a global scale over the next 10 years"

1st	Climate action failure	6th	Infectious diseases
2nd	Extreme weather	7th	Human environmental damage
3rd	Biodiversity loss	8th	Natural resource crises
4th	Social cohesion erosion	9th	Debt crises
5th	Livelihood crises	10th	Geoeconomic confrontation

Economic Environmental Geopolitical Societal Technological

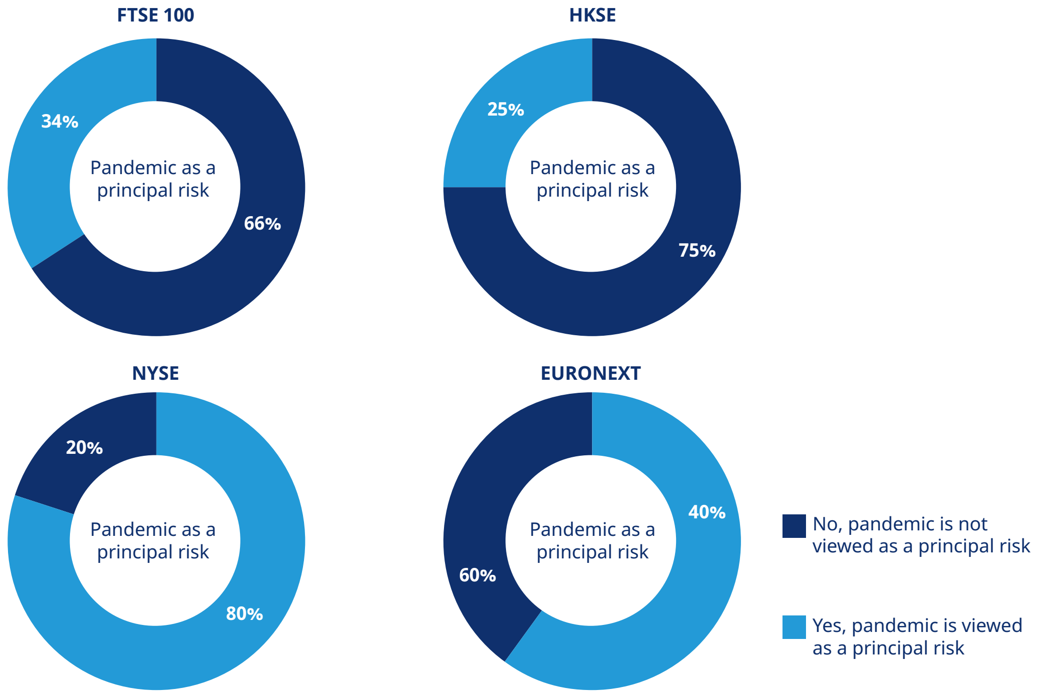
Source: *World Economic Forum Global Risks Perception Survey 2021-2022*

When Marsh analyzed the view on pandemic risk of companies listed on the world's four leading stock exchanges, a far from uniform view emerged (see Figure 6). How companies regarded the hazard depended, to some degree, on location.

Of the Euronext companies surveyed, 40% rated the pandemic as a principal risk in 2021. Among HKSE and FTSE 100 companies, 25% and 34%, respectively, named pandemic as a top threat. While the minority of companies rated the pandemic as a principal risk across these exchanges, it was more commonplace to cite it as a cause of principal risks, alluding to the lack of control that many organizations felt.

A much higher 80% of NYSE companies analyzed perceived the pandemic as the predominant threat in 2021.

06| Consideration of pandemic risk varies by location of reporting companies



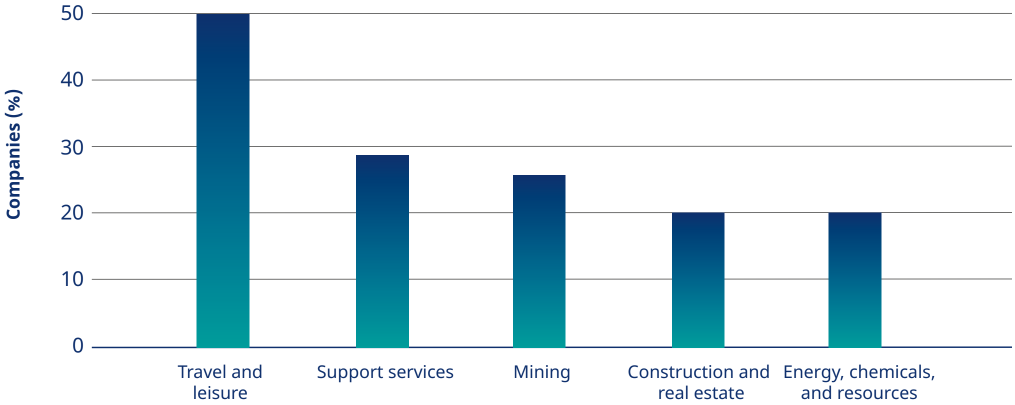
Source: *Marsh*

FTSE 100 and pandemic risk

Taking a deeper dive into the 1,100 risks reported in the FTSE 100 company annual reports, the travel and leisure; support services; mining, construction and real estate; and energy, chemicals, and resources sectors identified the pandemic most highly as a principal risk (see Figure 7). By contrast, the financial sector ranked it the lowest.

Of the 34% of FTSE 100 companies reporting pandemic as a principal risk, most did so within the health and safety categories of their annual reports, using words relating to "pandemic" 50% more frequently than in 2019. Before COVID-19, the number of words related to "pandemic" that appeared in the risk sections was very low, and where there was mention, the focus was on the threat of flu outbreaks, which featured in 25% of reports. Given the ongoing impact of the COVID-19 pandemic, Marsh anticipates attention to this risk area to grow.

07| Travel and leisure companies most likely among FTSE 100 to report on pandemic as a principal risk



Source: *Marsh*

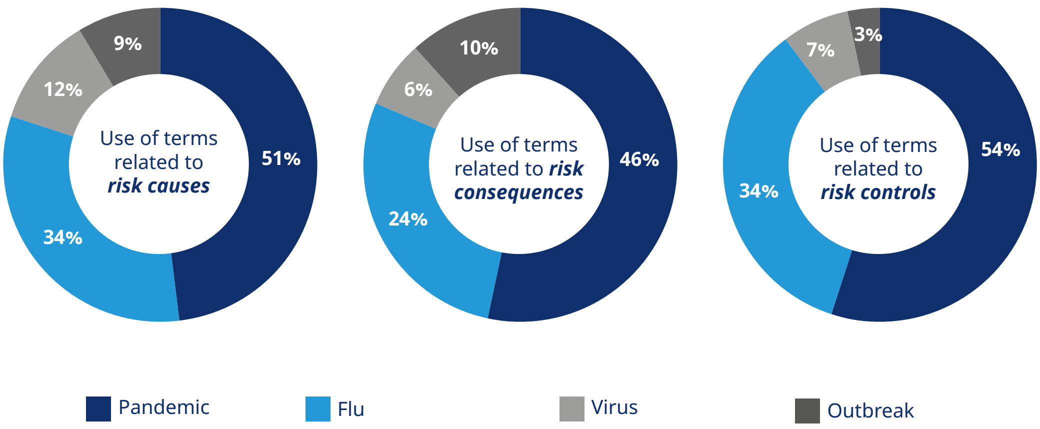
Causes, consequences, controls

Marsh broke the data down further to understand the consideration of the different aspects of pandemic risk — its causes, consequences, and controls (see Figure 8). Since 2019, we found, the use of words by FTSE 100 companies relating to the causes of pandemic risk increased by 47%, its consequences by 50%, and its controls by 57%.

The importance of the risk to companies differed between sectors. (See the appendix for a detailed industry breakdown.) For example, the significance placed on pandemic risk and its causes in the healthcare and travel/leisure industries increased 100% and 67%, respectively, since 2019. In the house, leisure, and personal goods category it rose 20%, while in media the increase was 33%.

The increase in the recognition of pandemic as a key risk indicates a need for companies to consider the effectiveness of their existing risk management frameworks and whether their risk mitigation practices need updating in light of COVID-19.

08| Use of terms related to pandemic and infectious diseases in annual reports for FTSE 100 companies increased in 2021 compared to 2019



See appendix for a detailed industry sector breakdown.

Other key risks

Risks related to health and safety, the regulatory and legislative environment, and information technology all appeared among the top five risks of companies on the global stock exchanges (see Figure 9).

IT was considered the top risk by companies on the London Stock Exchange, while Euronext companies regarded it the second-most important. It ranked as the third most important risk among NYSE companies and fifth among surveyed companies on the HKSE. On the HKSE, companies most frequently cited liquidity, credit, and solvency; regulatory and legislative; and currency risk, as leading concerns. Interestingly, liquidity, credit, and solvency risk was also cited as a top five risk by companies on the Euronext, but not by companies on the other exchanges. Currency risk only appeared in the top five risks on the HKSE.

09| Key risks across the global stock exchanges

London Stock Exchange	Euronext	Hong Kong Stock Exchange	New York Stock Exchange
Information technology	Regulatory and legislative environment	Liquidity, credit, and solvency	Regulatory and legislative environment
Regulatory and legislative environment	Information technology	Regulatory and legislative environment	Geopolitical
Health and safety	Health and safety	Business continuity management	Information technology
Staff management	Sustainability and environment	Currency	Contractor/third party management
Geopolitical	Liquidity, credit, and solvency	Information technology	Market dynamics

Operational Strategic Financial Regulatory

Conclusion

The annual reporting year from July 2020 to July 2021 was momentous with regard to global risk issues emanating from the COVID-19 pandemic, as well as for emerging risks associated with ESG, particularly, climate factors. By analyzing listed company annual reports, we found the general trend was for fuller reporting on risk management information when compared to previous research from 2019.

Information technology along with regulatory and legislative risks dominated the top five global risk categories; sustainability and environment featured among the top five risks only for Euronext companies.

ESG trends are beginning to appear more frequently in annual reports as either a principal risk listing or, more commonly, with reference to sustainability, environment, or climate. Still, companies in the aggregate have yet to report fully on the full implications of ESG risk factors and the measures being taken to manage them.

The implications of COVID-19 featured heavily in most companies' annual reports as related to risk causes, consequences, and controls rather than as being a standalone principal risk. The exception was the NYSE, where COVID-19 featured as a principal risk in 80% of reports analyzed.

We anticipate seeing increased focus on ESG and climate-related risks within annual reports going forward, particularly as more countries legislate on climate reporting.

Methodology

FTSE 100 companies and increasingly others worldwide are required to report their principal risks within the strategic report section of their annual reports.

Over the course of 2020-2021, Marsh, in conjunction with Cranfield University, examined the reporting of FTSE 100 companies and companies listed on the Euronext, New York Stock Exchange, and Hong Kong Stock Exchange. We abstracted and analyzed over 1,300 risks from annual reports to determine trends. These risks were categorized under operational, strategic, financial, or regulatory headings and further divided into sub-classes to decode company principal risks into comparable risk types.

In the case of the FTSE 100 companies, as the analysis has been carried out during previous years, a comparison of risk trends over time was possible.

Appendix

08| Understanding how companies view pandemic risk post-COVID-19

Causes

Industry	Pandemic	Flu	Virus	Outbreak	**Mean**
Aerospace and industrials	50%	40%	0%	10%	25%
Construction and real estate	50%	25%	0%	25%	25%
Electronic and technology	50%	0%	17%	0%	17%
Energy, chemicals, and resources	60%	60%	20%	20%	40%
Financials	50%	40%	15%	5%	28%
Food and beverages	25%	25%	25%	0%	19%
Healthcare	100%	0%	0%	25%	31%
House, leisure, and personal goods	20%	0%	20%	0%	10%
Media	33%	17%	17%	17%	21%
Mining	50%	63%	13%	13%	34%
Retailers	45%	27%	9%	0%	20%
Support services	43%	43%	14%	14%	29%
Travel and leisure	67%	33%	0%	0%	25%
Utilities	75%	100%	25%	0%	50%
All sector average	**51%**	**34%**	**12%**	**9%**	**27%**

Increased since 2019 · Decreased since 2019 · Stable compared with 2019

Consequences

Industry	Pandemic ↑	Flu ↔	Virus ↑	Outbreak	Mean ↑
Aerospace and industrials	60%	30%	0%	0%	23%
Construction and real estate	75%	25%	0%	25%	31%
Electronic and technology	17%	0%	0%	0%	4%
Energy, chemicals, and resources	20%	60%	0%	0%	20%
Financials	25%	5%	0%	5%	9%
Food and beverages	0%	0%	0%	0%	0%
Healthcare	75%	25%	0%	25%	31%
House, leisure, and personal goods	80%	0%	20%	0%	25%
Media	33%	33%	0%	0%	17%
Mining	63%	50%	25%	38%	44%
Retailers	55%	36%	18%	9%	30%
Support services	14%	29%	0%	0%	11%
Travel and leisure	50%	17%	17%	33%	29%
Utilities	75%	25%	0%	0%	25%
All sector average	**46%**	**24%**	**6%**	**10%**	**21%**

Controls

Industry	Pandemic ↑	Flu ↑	Virus ↑	Outbreak	Mean
Aerospace and industrials	70%	10%	0%	10%	23%
Construction and real estate	50%	25%	0%	0%	19%
Electronic and technology	50%	17%	0%	0%	17%
Energy, chemicals, and resources	60%	80%	0%	0%	35%
Financials	40%	10%	0%	5%	14%
Food and beverages	25%	25%	0%	0%	13%
Healthcare	50%	25%	0%	0%	19%
House, leisure, and personal goods	60%	40%	0%	0%	25%
Media	67%	50%	0%	17%	33%
Mining	75%	63%	25%	0%	41%
Retailers	45%	27%	36%	9%	30%
Support services	43%	14%	14%	0%	18%
Travel and leisure	67%	17%	17%	0%	25%
Utilities	50%	75%	0%	0%	31%
All sector average	**54%**	**34%**	**7%**	**3%**	**24%**

↑ Increased since 2019 ↓ Decreased since 2019 ↔ Stable compared with 2019

Source: *Marsh*

About Marsh

Marsh is the world's leading insurance broker and risk advisor. With around 45,000 colleagues operating in 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. With annual revenue nearly $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit mmc.com, follow us on LinkedIn and Twitter or subscribe to BRINK.