Observatoire sur la Responsabilité Sociétale des Entreprises

How to integrate ESG risks into the financial sector's operational risk management methods

Guide

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Observatoire de la Responsabilité Sociétale des Entreprises
25 rue du Charolais - 75012 Paris - Tel. : +33 1 43 46 02 22 - Fax : + 33 1 43 46 86 99
Courriel : contact@orse.org - Site : www.orse.org

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[1] The ISO 26000 standard is described later in this document. For more information, see: http://www.iso.org/iso/iso_catalogue/management_and_leadership_standards/social_responsibility/sr_discovering_iso26000.htm or http://www.ifan.org/ifanportal/livelink/fetch/2000/2035/36282/394607/social_responsibility/index-sr.html

Foreword

The Finance Club at the French Study Centre for Corporate Social Responsibility (ORSE) set up a working group with its members – including representatives of sustainable development departments and risk management departments (banks, insurance and asset management) – to consider how environmental, social and governance (ESG) risks can improve our understanding of operational risks.

Its work has culminated in this guide presenting the interactions between these two risk categories and where they converge and diverge.

The guide was written by a working group headed by La Banque Postale with representatives of:

- Amundi
- Banque Neuflize OBC
- BNP Paribas
- Caisse des Dépôts
- CNP Assurances
- Crédit Agricole
- Crédit Coopératif
- Dexia
- Fédéris Gestion d'Actifs - Malakoff Médéric
- Groupama
- Humanis
- La Banque Postale
- Macif Gestion

The quality of ORSE's work stems from the strong commitment of its Finance Club members and experience sharing with experts from a wide range of sectors.

Our acknowledgements to all those who helped develop this guide, especially:

- The members of the working group for contributing their expertise on these subjects;
- The editorial team:
  - Nicholas Vantreese, Sustainable Development Manager;
  - Sophie Bayle, Sustainable Development and Diversity Manager, La Banque Postale;
  - Stéphane Audrand, Adviser on Governance & Processes to the CSR Delegation, BNP Paribas;
  - Jérôme Courcier, CSR Manager, Crédit Agricole SA;
  - Michel Laviale, Chair of the Finance Club;
  - Patricia Lavaud, Head of the Finance Club;
- The ORSE team, with Catherine Delettang on layout and editing.

Background

Risk is intrinsic to banking, and risk management is a key priority for the sector and its sustainability. The banks traditionally manage three major categories of risks:

- Credit and counterparty risks found in potential losses due to counterparty default;
- Market and balance sheet risks caused by interest rate fluctuations, a drop in share prices, etc.;
- And operational risk, which is the risk of direct or indirect losses resulting from inadequate or failed internal processes, people and systems, or from external events.

The common thread running through these three risk categories is that they all concern the impacts of the risk on the company itself.

With the development of CSR, we are seeing **the emergence of a new risk category, called ESG (*Environmental, Social and Governance*) risks**. The main characteristic of these risks is the potential impact of stakeholders (*customers, staff, suppliers, natural environment, etc.*) on the company and, conversely, the risks to which the company exposes its stakeholders and environment due to its business.

Although risk management departments clearly identify and steer operational risks on the basis of regulatory measures such as Basel II[2], ESG risks are not yet covered.

ORSE's Finance Club put together a working group of representatives from sustainable development departments and risk management departments to compare their understanding of these two risk categories and develop a common analytic grid.

Our work has culminated in the writing of this guide for the banking sector's social and environmental responsibility and sustainable development practitioners and, more especially, for:

- Risk management departments, and
- Non-financial analysts and non-financial rating agencies.

This guide makes two important contributions. First, it builds on the standards used by risk management departments by shedding new light on ESG considerations. Second, it improves upon the approach taken by non-financial rating agencies and analysts, which do not systematically cover operational risk issues.

[2] The Basel II standards are described later in this guide and in its appendices. For more information, see the Banque de France Prudential Supervision Authority (ACP) website: http://www.acp.banque-france.fr/international/les-grands-enjeux/les-accords-de-bale/bale-ii.html

I. Purpose, standards and definitions

A. Purpose

The financial sector (banks and insurance firms) is a player in the financing of the French and global economy. As such, it is aware of its responsibility and the rigour called for in the management of its operational risks if it is to sustain the sector and continue to provide services to its customers.
This guide is a product of the think tank held by the Operational Risks and ESG working group formed by the French Study Centre for Corporate Social Responsibility (ORSE) Finance Club. It is designed to help factor in new CSR-related risks and understand how CSR practices can improve on current operational risk management methods and their associated decision-making processes.

This guide:
- Compares the Basel II standards (types of incidents, operational risks (level 1 and 2)) with CSR standards (see below);
- Shows where these standards converge and diverge;
- And builds on and improves the "operational risk" approach.

The guide has been put together to improve the steering of non-financial performance and provide a broader base to help optimise overall risk management.

The Solvency II[3] standards are the insurance sector's equivalent of Basel II. The working group that produced this guide made some preliminary comparisons between these standards and the ESG risks to which insurers are exposed. These comparisons revealed certain similarities with the banking sector observations. This comparison work will continue with the aim of drawing up a complete map.

B. Chosen standards

- **The Basel II standards** are the benchmark standards for operational risks in banks (see the benchmark regulation to date, Order of 20 February 2007).

- **ISO 26000** are consensus standards that provide quite a comprehensive approach to the CSR issues to be addressed along with examples of practices for businesses. Yet these standards are geared towards the industrial sector, which means they have certain limitations for the financial institutions, especially in terms of the indirect impacts of financing and investment. They nonetheless provide a useful framework on "what to do" in CSR.

- **GRI (Global Reporting Initiative)**[4] offers organisations a sustainability reporting framework with precise economic, environmental and social indicators. GRI includes a financial services sector supplement, which gives all the financial institutions the steering tools they need to measure the impact of the main ISO 26000 concerns and ESG risks.

[3] For more information on the Solvency II standards, see the Financial Services Authority (FSA) website: http://www.fsa.gov.uk/solvency2
[4] For more information on GRI, see: www.globalreporting.org

- **EFFAS (European Federation of Financial Analysts Societies)**[5] has developed key performance indicators (KPIs) over the course of three years based on input from analysts and investors. The federation has validated them with users so as to integrate environmental, social and corporate governance issues into the presentation of reports to financial market representatives. The STOXX index provider was one of the first applications to use the EFFAS KPIs as a basis for a new range of ESG indices launched on the market in April 2011.

C. Definitions

Operational risk

Basel II and the French Banking and Finance Regulatory Commission[6] define operational risk as *the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.* This definition excludes strategic risks, but includes the notion of risks of non-compliance, which are operational risk subgroups.

The Basel II additional Second Pillar guidelines (supervisory review process)[7] also include the notion of **reputational risk** (or **image risk**) in the risk measurement. This can be interpreted as the loss of business value following a risk-induced incident.[8] Loss of value is potentially greater with the growth in ESG risks, which are also generators of image risks. This provides another reason for operational risk management departments to step up their diligence in business process management.

ESG risk

An ESG risk is an **environmental, social or corporate governance risk**. It is caused by not properly factoring in corporate social and environmental responsibility considerations. In additional to the banking institutions' finance and investment activities in non-financial areas (especially since the introduction of the Equator Principles[9]), ESG risks are intrinsic to all the other banking sector activities (retail banks, international trade transactions and services).

ESG risks need to be taken into consideration in the finance sector's relations with **all its stakeholders:** customers, staff, shareholders, suppliers and civil society, with its greater voice developed by the NGOs.

ESG risks do not form a risk category of their own. They build on the risks generally identified and monitored by the banking institutions. So an ESG risk may take the form of a credit risk (*problems a company has with its bank due to a poorly managed environmental or social risk*), a legal risk (*provisions for risks, court cases, convictions, fines, damages, etc.*) or most importantly an image risk *(damage to reputation, downgrading of the non-financial rating, etc.)*. **It is mainly here where ESG risks can extend and improve the operational risk approach.**

[5] For more information on EFFAS, see: www.effas-esg.com
[6] For more information on the French Banking and Finance Regulatory Commission's regulation, see http://www.banque-france.fr/cclrf/fr/pdf/CRBF97_02.pdf
[7] Basel II's second pillar addresses risks not covered by the first pillar: interest rate risk in the banking book, liquidity risk and other risks (strategic risk, reputational risk, etc.).
[8] See the References for the Basel Committee's definition of reputational risk.
[9] The Equator Principles are a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. For more information, see: http://www.equator-principles.com/resources/equator_principles_english.pdf

Examples of ESG risks

Governance: Poor risk control system management can result in positions being taken that are too risky. Some business practices may encourage risk taking and granting credit to customers incapable of paying it back (which could generate a credit risk).

Social: A human resources policy that does not properly factor in discrimination can create a legal risk and a social cohesion risk.

Environment: Insufficient consideration of environmental risks (pollution, biodiversity, resources and local communities) can lead a financed project to fall far behind schedule, lose cost effectiveness and even be shelved (resulting in a reputational risk and a financial risk).

II. Main conclusions of the comparison of the Basel II standards for operational risks and the ISO 26000 standards for ESG risks

The comparison of operational risks and ESG risks turns up three major findings:

1. A better understanding of the risks already addressed by Basel II

The ESG approach takes a new angle on the risks identified by the Basel II approach, especially in the areas of business ethics, the environment and human rights (see box on page 11).

2. Broader scope and greater weight for the risks already addressed by Basel II

The classic operational risk analysis approach concentrates on the organisation's processes and seeks mainly to identify impacts on this organisation.
See Figure 1

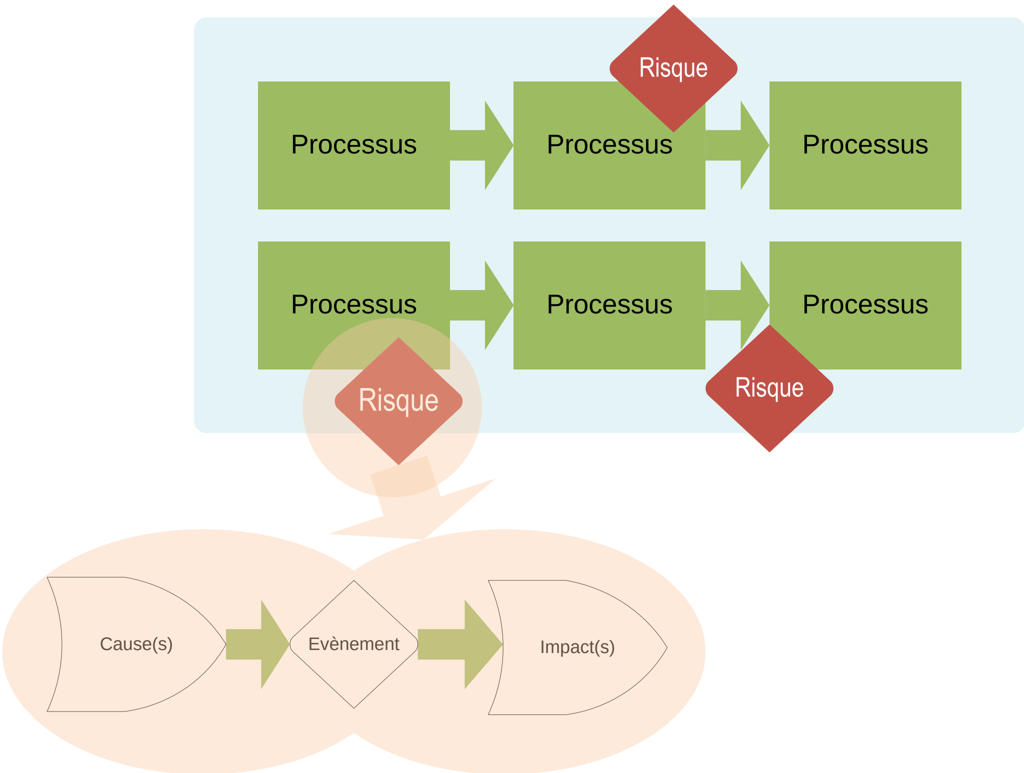

Figure 1 ***– Classic operational risk analysis framework: the risk analysis concentrates on the organisation's processes and only seeks to identify impacts on this organisation.***

The consideration of "ESG risks" places operational risk management in a system that transcends the institution itself. Management then focuses on the risks to which the institution exposes its stakeholders and environment due to its business (customers, shareholders, staff, suppliers and natural environment). These are **direct risks**[10] **– See 1. of Fig. 2**

[10] **Direct risks** have an impact on the company.

These risks can in turn have "retroactive" adverse effects on the financial institution that the traditional methods cannot identify or do not identify well. These are called **indirect or induced risks**[11]**– See 2. of Fig. 2.**

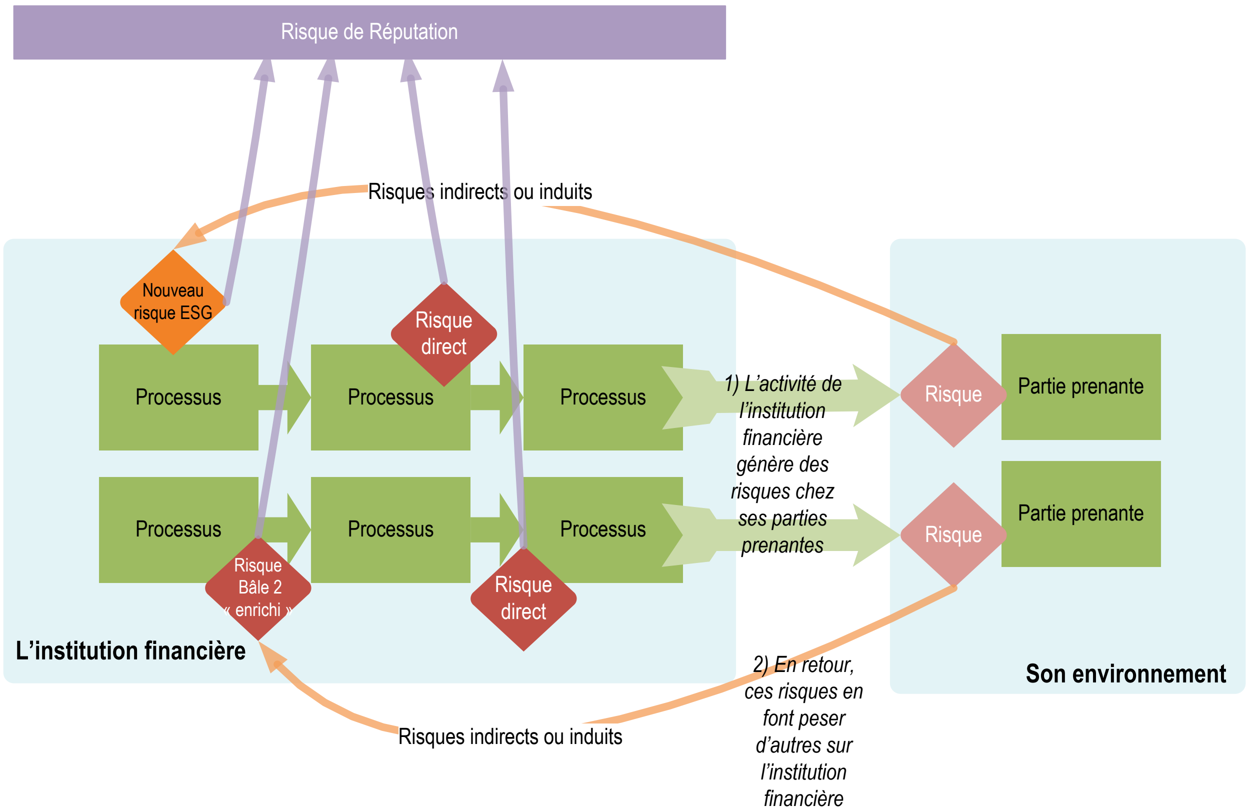

Figure 2 *– **Analysis of ESG risks: Consideration of ESG risks induced by the financial institution's business places the institution in a "retroactive" system where the stakeholders expose the institution to a risk on the scale of that which the institution induces.***

3. A broader view of image and reputational risk

Reputational and image risk emerges as a factor found in all the Basel risks. The ESG approach paints a broader picture of the potential image risk to the reputation of the banking institutions. It extends the scope of their responsibility beyond their core business, sometimes as far as their licence to operate.

The CSR approaches conducted by the financial institutions improve their targeting of the potential impacts of their activities on their stakeholders (customers, staff, suppliers, etc.) and their environment (ecological disaster, health problem, financial scandal, etc.) and identify the levers for action to be developed to manage and reduce these impacts.

There are two categories of levers for action:
- The first is *a "defensive" approach*, which consists of protecting the organisation from the causes of risk by limiting their impact on the organisation (*exclusion of certain types of finance and termination of certain lines of business*);
- The second is *a "proactive" approach* used to systemically limit the risk by acting precisely on the "retroactive" effects that impact the company.
  This approach drives practices forward to be able to improve the satisfaction of stakeholder needs and even anticipate them *(inclusion of social and environmental risks in*

[11] **Indirect risks** affect the company's stakeholders (customers, staff, suppliers, etc.). **Induced risks** affect the company's environment.

project financing, introduction of internal codes of conduct, definition of a "human rights" policy, implementation of a diversity promotion approach, commitments in the customer's interest, consideration of climate change in building damage, inclusion of the geographic coverage notion in the service supply, signing purchasing charters, etc.).

CSR approaches therefore have the "knock-on effect" of improving the management of the operational risks to which the financial institutions are exposed. They assess banking risks from a different angle and, in this way, consistently address common risk factors (by properly gauging the means provided). These approaches are designed to alleviate adverse situations, i.e. negative events generated by customers, staff, suppliers and the natural environment (ecological disasters, health problems, financial scandals, etc.) - **see box.**

CSR is in step with the classic long-run profit maximisation rationale and is also particularly well suited to the new business strategies designed to maximise competitive advantage in a competitive environment.[12]

The following box illustrates the main conclusions of our work.

The main conclusions drawn from the comparison of the Basel II and ISO 26000 standards

There are three major conclusions to be drawn from the comparison of operational risks and ESG risks:

1. A better understanding of the risks already addressed by Basel II

- Categories 1 (**internal fraud**) and 2 (**external fraud**), as defined by Basel II, might seem vague to certain professional managers *(the causes and aggravating factors of fraudulent behaviour are hard to explain).* → **The CSR standards identify these categories more clearly. They place greater emphasis on anti-corruption and fair practices** and go further than purely the financial risks and the legal concept of fraud. Codes of conduct on governance and business ethics have grown in keeping with this development.

- Category 5 (**damage to physical assets**) already took into account notions associated with natural disasters and their impacts on business premises and computer centres, etc. → The ESG standards clarify these notions. They focus corporate attention more particularly on climate change considerations and provide a broader reading of the **natural disaster risks that have stepped up the need for ad-hoc adaptation plans to deal with these factors**. The notion of corporate community investment also comes within this category.

2. Broader scope and greater weight for the risks already addressed by Basel II

Operational risks are classically found essentially in the organisation's processes and operational risk analysis seeks mainly to identify impacts on this organisation. The inclusion of "ESG risks" places operational risk management in a system that transcends the organisation itself with the notion of impact on others.

- Category 3 (**employment practices and workplace safety**) concerns mainly compliance with labour laws and regulations and related litigation. → **The ESG angle covers issues connected with the promotion of diversity, gender equality at work and, more generally, compliance with international standards** (*human rights, International Labour Organization, etc.*), which takes operational shape in "human rights" policies, diversity promotion approaches, commitments to respect ILO conventions, etc.

- Category 4 (**clients and business practices**) addresses the notions of fair practices (aggressive sales, information provided to customers, etc.) and product quality → **The CSR standards support this interpretation by stepping up the importance of customer**

[12] See the references at the end of this guide for the theories put forward by Milton Friedman and Michael Porter

information, voice and protection as seen, for example, in service commitment charters, ombudsman systems, and closer co-operation with consumer associations.

Also concerned in this category is **financing for sectors considered to be sensitive** (*armaments, energy, etc.*) → The granting of this financing is increasingly conditioned by compliance with a certain number of social and environmental impact criteria. The Equator Principles[13] form one such example in project financing.

- Category 6 (**business disruption and system failures**) takes an exclusively technical approach to these issues under Basel II. → **The ESG approach establishes the "essential services" notion**, which concerns the capacity to ensure the continuity of this service over time (e.g. 24/7 ATM availability) and the supply of basic banking services and their accessibility for all.

- In Category 7 (**execution, delivery and process management**), the ESG approach enhances interactions between the company and its external stakeholders (*counterparties, suppliers, etc.*). → **Dissemination of the CSR principles in the value chain** guards against unsuitable practices by certain suppliers that could ricochet back on the company. It also compels companies to adopt responsible purchasing practices (*responsibility in the customer/supplier relationship*). In this regard, the banks propose purchasing charters to their suppliers and conduct audit processes. Some even rate their suppliers on their non-financial performance.

3. A broader view of image and reputational risk

The ESG approach ultimately makes for **a broader picture of the potential image risk to the reputation of the banking institutions. It extends the scope of their responsibility beyond their core business**, sometimes as far as their licence to operate.

The image risk has expanded considerably, due to civil society pressure in particular, and now cuts across all the "Basel" risk categories. Reputation and customer confidence have become major assets for banking institutions. This means that the banking institutions have to protect their reputation like a strategic tool. The somewhat subjective notion of image makes it complicated to understand and quantify the associated risks.

[13] The Equator Principles are a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. For more information, see: http://www.equator-principles.com/resources/equator_principles_english.pdf

III. Detailed conclusions of the comparison of the Basel II/ISO 2600 standards and GRI-EFFAS indicators

Summary of the approach

The following table presents a summary of the Basel II level 2 and 3 operational risks and compares them with the ISO 26000 principles and selected GRI and EFFAS indicators. Note that this list of indicators is merely indicative.

I want to prevent a risk referenced in Basel II		I'm carrying out a measure referenced in ISO 26000		I'm following indicators referenced in the GRI or EFFAS
Basel II Category	**I wish to prevent a potential loss caused by**	**N° ISO 26000**	**What my measure is for**	**What I publish (or not) Réf. GRI/EFFAS**
1. Internal fraud	*acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party*	**6.6**	**Fair operating practices**	**10 indicators**
2. External fraud	*acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party*			
3. Employment practices and workplace safety	*acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity / discrimination events*	**6.3** **6.4**	**Human rights** **Labour practices**	**30 indicators**
4. Clients, products & business practices	*an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.*	**6.7**	**Consumer issues**	**26 indicators**
5. Dammage to physical assets	*loss or damage to physical assets from natural disaster or other events.*	**6.5** **6.8**	**The environment** **Community involvement and development**	**8 indicators**
6. Business disruption and system failures	*disruption of business or system failures*			**2 indicators**
7. Execution, delivery & process management	*failed transaction processing or process management, from relations with trade counterparties and vendors*			**20 indicators**

Note on the standards chosen:
1. The **Basel II** standards are the benchmark standards for operational risks in banks.
2. The **ISO 26000** "standard" identifies major CSR action levels and has achieved international consensus.
3. The **GRI and EFFAS guidelines**[14] provide a list of indicators to monitor the effectiveness of ESG risk management actions.

A. Method and objectives

Each Basel II level 2 event type was compared with the ESG risks identified by the chosen standards (ISO 26000, GRI and EFFAS). This exercise, illustrated by concrete examples of incidents, turns up points of diligence that vary depending on the sensitivity of the subject specific to each establishment. Where appropriate, we draw the reader's attention to types of events or ESG risks that are not well covered at present or are likely to grow quickly in coming years, and which could significantly affect the outlook for establishments that have chosen the AMA model.[15]

The CSR standards also have implications that could represent a strategic risk to the establishments concerned if they are not properly covered. Although strategic risks do not concern the operational risk practices in the Basel II scenarios, they nonetheless need to be highlighted since their importance will be decisive for companies in coming years.

The chosen GRI/EFFAS indicators:
Can be roughly classed in two categories, which correspond to two macro-categories of stakeholders with distinct needs *(see the definition given in the MiddleNext guide entitled* SRI and Sustainable Development for Midcaps[16]*).*

1. **Key Performance Indicators**
   These **KPIs** are management indicators designed for inclusion in the corporate steering and control systems to meet the needs of managers and economic stakeholders, in the shape of investors (shareholders). They measure ESG impacts and their effect on overall performance.
   The German Sustainability Code[17] proposes **a list of key performance indicators (KPIs)** based on GRI and EFFAS.

2. **Indicators connected with the "social licence to operate"** (state indicators)
   These indicators reflect the social demand made of economic players (businesses).
   They provide information on areas that stakeholders other than the investors feel should be taken into account by the economic players. Their main purpose is to broadly inform internally and externally on ESG impacts and the extent of control of these impacts (progress approach).

   This guide proposes an **indicative** list of indicators in these two categories. **The KPIs used are taken from the German Sustainable Development Code. They are followed by * and are printed in bold type in the right-hand column of the following table.**

   It is obviously up to each company to draw up its own list.

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[14] For more information on the EFFAS/DVFA standards and the guideline for the integration of ESG into corporate reporting, see: http://www.reportingrse.org/force_document.php?fichier=document_513.pdf&fichier_old=KPIs_ESG_FINAL[1].pdf Financials chapter.

[15] AMA: Advanced Measurement Approach - http://www.bis.org/publ/arpdf/ar2011e.pdf p. 128.

[16] Source Guide, *L'ISR et le Développement Durable pour les Valeurs Moyennes* published by MiddleNext in March 2011, available only in French.

[17] The German Sustainability Code was adopted in late 2011 following consultations with a large number of stakeholders. It is a standard for transparency in corporate sustainability performance. Its application is voluntary and it may be used by businesses of different sizes. To comply with the German Sustainability Code, companies publish a declaration of conformity on their website. Declarations can also be published in their annual or sustainability reports. In the declaration of conformity, companies report on whether they have satisfied the Code criteria (comply) or outline the reasons for deviating from them (explain). Comprehensive reporting following the stringent reporting standards of the GRI (A+) or EFFAS (Level III) equates to compliance with the Code.
http://www.reportingrse.org/force_document.php?fichier=document_752.pdf&fichier_old=RNE_Octobre_2011_-_Code_du_developpement_durable_allemand.pdf

B. Comparative table on the Basel II/ISO 26000/GRI-EFFAS indicators

Event-type 1: Internal fraud

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
1.1 Unauthorised Activity, Mismarking of position	6.6.5 Fair competition	**SO7 Total number of legal actions for anticompetitive behavior, anti-trust, and monopoly practices and their outcomes. ***
1.2 Theft (credit fraud / worthless deposits) and Fraud (extortion/ embezzlement / robbery)	6.6.3 Anti–corruption 6.6.4 Responsible political involvement (*i.e. lobbying actions for instance*)	**SO2 Percentage and total number of business units analyzed for risks related to corruption.*** SO3 Percentage of employees trained in organization's anti-corruption policies and procedures. SO4 Actions taken in response to incidents of corruption. SO5 Public policy positions and participation in public policy development and lobbying. SO6 Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country. **SO8 Monetary value of significant fines and total number of non-monetary sanctions for noncompliance with laws and regulations.*** **EFFAS V01-01 Expenses and fines on filings, law suits related to anti-competitive behavior, anti-trust and monopoly practices*** **EFFAS V02-01 Percentage of revenues in regions with Transparency International corruption index below 6.0. ***

CSR and fair practices: The CSR standards place a great deal of emphasis on anti-corruption and fair practices. Far from being restricted to environmental and social issues, these standards promote new "business ethics" in responsible governance that are particularly important to the financial institutions. The accent is placed on identifying corruption risks, training, model management and establishing codes of conduct. The French financial institutions are well prepared in all of these areas.

Event-type 2: External fraud

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
2.1 Theft and Fraud, Forgery, Check Kiting 2.2 Systems Security, Hacking damage, Theft of information	6.7.7 Consumer data protection and privacy	PR8 Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.

CSR and external fraud: Type 2 events are not really addressed as such in the CSR standards in that they are risks to the business due to external actions. This event type concerns the corporate responsibility to protect consumer data and privacy. It is an issue that is becoming increasingly important in these days of the all-digital era and the cloud computing revolution.[18] The loss or corruption of consumer data from external fraud is a highly significant ESG risk for the financial institutions.

It is important for the financial institutions' forward-looking scenarios to take more account of consumer data protection and privacy, and for the physical and digital security processes to be robust enough to withstand any malicious act that could occur at any stage, from accessing an ATM to decommissioning IT equipment and direct and indirect attacks on the Internet (hacking and phishing)

Event-type 3: Employment practices and workplace safety

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
3.1 Employee Relations	6.3.10 Fundamental principles and rights at work 6.4.3 Employment and employment relationships 6.4.4 Conditions of work and social protection 6.4.5 Social dialogue 6.4.7 Human development and training in the workplace	HR7 Operations identified as having significant risk for incidents of forced or compulsory labor, and measures to contribute to the elimination of forced or compulsory labor. LA1 Total workforce by employment type, employment contract, and region. LA2 Total number and rate of employee turnover by age group, gender, and region. LA3 Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations. **LA10 Average hours of training per year per employee by employee category. *** LA11 Programs for skills management and lifelong learning that support the continued employability of employees and assist them

18 For more information on cloud computing, see: http://en.wikipedia.org/wiki/Cloud_computing

		in managing career endings. LA12 Percentage of employees receiving regular performance and career development reviews. **LA13 Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other indicators of diversity.*** LA14 Ratio of basic salary of men to women by employee category. EC5 Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation. HR5 Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights. LA5 Minimum notice period(s) regarding operational changes, including whether it is specified in collective agreements.
3.2 Safe Environment, Employee health & safety rules events	6.4.6 Health and safety at work 6.5.3 Prevention of pollution 6.5.6 Protection of the environment, biodiversity and restoration of natural habitats	HR8 Percentage of security personnel trained in the organization's policies or procedures concerning aspects of human rights that are relevant to operations. LA6 Percentage of total workforce represented in formal joint management–worker health and safety committees that help monitor and advise on occupational health and safety programs. **LA7 Rates of injury, occupational diseases, lost days, and absenteeism, and number of work related fatalities by region. *** **LA8 Education, training, counseling, prevention, and risk-control programs in**

		place to assist workforce members, their families, or community members regarding serious diseases.* LA9 Health and safety topics covered in formal agreements with trade unions. EN11 Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas. EN25 Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organization's discharges of water and runoff. EN28 Monetary value of significant fines and total number of non-monetary sanctions for noncompliance with environmental laws and regulations.
3.3 Diversity & Discrimination	6.3.7 Discrimination and vulnerable groups	HR1 Percentage and total number of significant investment agreements that include human rights clauses or that have undergone human rights screening. HR3 Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained. **HR4 Total number of incidents of discrimination and actions taken.*** HR7 Operations identified as having significant risk for incidents of forced or compulsory labor, and measures to contribute to the elimination of forced or compulsory labor. LA13 Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other

		indicators of diversity. LA14 Ratio of basic salary of men to women by employee category.
		EFFAS S03-01 Age structure/distribution (number of FTEs per age group, 10-year intervals)* **EFFAS S10-01 Percentage of female employees in relation to total employees. *** **EFFAS S10-02 Percentage of female FTEs in senior positions in relation to total FTEs in senior positions. *** **EFFAS S02-02 Average expenses on training per FTE p.a ***

CSR and conditions of work: Staff, along with customers, are one of the most important stakeholders for companies in terms of CSR: they directly condition the company's performance and sustainability.

3.1 ***Employment contract litigation*****:** The traditional practice of managing employment contract risks in the financial institutions has to do first and foremost with compliance with national legislation. This legalistic approach has come up against its limits with the development of CSR issues. It constitutes a risk, particularly for establishments working in emerging countries that do not have the same level of labour regulations as the OECD countries. The CSR standards and stakeholders active in this field (leading NGOs and the United Nations) have driven the emergence of a "global minimum" in labour law, more in line with OECD region levels. So companies are expected to give their staff the guarantee that they will comply with the basic ILO conventions, even in countries that are not signatories, and to guarantee and promote the freedom of association, the freedom to form unions, the right to collective bargaining, and so on.

The CSR standards and the stakeholders concerned have compelled corporate practices to progress towards such developments as a higher proportion of women in management positions.

3.2 ***Health and safety at work, pollution and occupational injury:*** This point might be thought to be fairly minor for financial institutions compared with manufacturers in the most exposed sectors (oil sector, chemical industry, etc.). However, growing concerns over constant exposure to certain molecules form a risk for all businesses irrespective of their sector. The asbestos scandals could well be overshadowed in coming years by indoor air pollution and endocrine disrupters (Bisphenol A, used in thermal paper in electronic payment terminals and ATMs). Here again, risk management plans need to evolve to cover these emerging concerns. Psychosocial risks form another area to be examined.

3.3 ***Discrimination:*** Issues surrounding discrimination against "vulnerable groups" are also a highly significant source of risk for the company's reputation and a source of direct (fines) and indirect (loss of value) financial risk. Here again, practices are evolving to create de facto standards that go further than mere compliance with national legislation. Companies are expected to be committed players in combating discrimination.
The CSR standards and practices provide keys to improve the management of these risks: continuous, proactive consultations with stakeholders (especially trade unions),

participation in workgroups and exchanges of best practices can all make for a better command of these three types of operational risks by considerably improving on the traditional approaches with their focus on French labour law alone.

Event-type 4: Clients and business practices

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
4.1 Suitability, Disclosure & Fiduciary ; Breach of privacy ; Misuse of confidential information	6.7.3 Fair marketing, factual and unbiased information and fair contractual practices 6.7.5 Sustainable consumption 6.7.7 Consumer data protection and privacy	PR3 Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements. PR4 Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes. PR5 Practices related to customer satisfaction, including results of surveys measuring customer satisfaction. PR6 Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship. PR7 Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes. PR8 Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data. EN26 Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.
4.2 Improper Business or Market Practices	6.3.7 Discrimination and vulnerable groups 6.6.3 Anti–corruption 6.6.7 Respect for property rights 6.7.3 Fair marketing, factual	**HR4 Total number of incidents of discrimination and actions taken.*** **SO7 Total number of legal actions for anticompetitive behavior, anti-trust, and**

	and unbiased information and fair contractual practices	**monopoly practices and their outcomes. *** **SO8 Monetary value of significant fines and total number of non-monetary sanctions for noncompliance with laws and regulations. *** PR3 Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements. PR4 Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes. PR6 Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship. PR7 Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.
4.3 Product Flaws	6.7.3 Fair marketing, factual and unbiased information and fair contractual practices 6.7.5 Sustainable consumption	FS15 Policies for the fair design and sale of financial products and services. PR3 Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements. PR4 Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes.

4.4 Selection, Sponsorship & Exposure		
4.5 Advisory Activities ; Disputes over performance of advisory activities	6.4.7 Human development and training in the workplace (ie: staff training) 6.7.3 Fair marketing, factual and unbiased information and fair contractual practices 6.7.5 Sustainable consumption 6.7.9 Education and awareness	FS16 Initiatives to enhance financial literacy by type of beneficiary. **LA10 Average hours of training per year per employee by employee category. *** LA12 Percentage of employees receiving regular performance and career development reviews. PR3 Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements. PR4 Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes. PR5 Practices related to customer satisfaction, including results of surveys measuring customer satisfaction. PR6 Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship. PR7 Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.

CSR and business practices: In business practices and customer relations, Basel II and the CSR standards agree on one fundamental point: financial profitability cannot be the only driver for a company's action in its customer relations. Fair practices (aggressive sales, insufficient information provided to the customer, etc.), respecting and protecting the customer's interest, and diligent, fair practice are all common points among the standards compared here.

The CSR standards and practices ramp up action in certain areas that extend beyond the traditional frameworks and speak to the financial institutions, which have been especially exposed to these concerns since the start of the financial crisis.

ISO 26000 has been hugely influenced by developments in management standards over the last 20 years, with the main model being ISO 9001. In this respect, ISO 26000 is “customer-centric” with the customer as the company’s “central” stakeholder. The company has to factor in CSR imperatives at all stages of the customer relationship. For the financial institutions, this entails getting to know their private customers better to be able to offer them products and services to suit their profiles, needs and long-term interests. Business practices in the retail networks are supervised by CSR stakeholders such as consumer associations. This also implies “no discrimination” and offering “financial inclusion” to atypical and vulnerable populations (pensioners, victims of illness, erratic careers, etc.) and participating in their “financial education”.

The image risks are great, but so are the financial risks as consumers get organised and bring class actions before the authorities.

The due diligence practice is a good example of what CSR standards have improved in terms of corporate clientele. Over the last three or so years, many leading NGOs (Greenpeace, WWF, Friends of the Earth, etc.) have started asking that the banks be accountable for the financing of certain sensitive sectors in terms of the environment and human rights (nuclear industry, oil and gas, mining, and armaments). Traditionally, the banks’ due diligence only went so far as to the check the strict legality of the transactions concerned. Yet the NGOs’ weight and lobbying power form a major reputational risk and, given their sometimes considerable local influence, can even threaten the establishment’s licence to operate.[19] This can lead to the cancellation or nationalisation of certain projects and raise the risk of counterparty default. A practice is emerging of seeking responsibility upstream in the event of a loss, right up to the donor, in an extension of the polluter-pays principle. What the Americans call “deep pocket” – a practice that consists of disentangling the financial transactions upstream of a loss in order to determine who is ultimately responsible for it (and therefore who ultimately pays) – looks set to become a growing practice, although the European establishments probably still have some time left before they have to face this prospect.

Event-type 5: Damage to physical assets

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
5.1 Disasters and other events, Natural disaster losses; Human losses from external sources (terrorism, vandalism)	6.5.5 Climate change mitigation and adaptation 6.7.4 Protecting consumers’ health and safety 6.8.9 Social investment (i.e. local involvement)	EC2 Financial implications and other risks and opportunities for the organization’s activities due to climate change. **EN16 Total direct and indirect greenhouse gas emissions by weight.*** EN17 Other relevant indirect greenhouse gas emissions by weight. **EN18 Initiatives to reduce greenhouse gas emissions and reductions achieved.***

[19] Informal authorisation to operate a business activity given tacitly/indirectly by the company’s stakeholders affected by this activity.

		EN19 Emissions of ozone-depleting substances by weight. EN29 Significant environmental impacts of transporting products and other goods and materials used for the organization's operations, and transporting members of the workforce. **EC1 Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.*** EC8 Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in kind, or pro bono engagement.

Climate change, corporate community investment and operational risk: Basel event-type 5 is generally perceived in terms of a loss associated with physical premises, with the case of a fire at a company's head office (see the case of Crédit Lyonnais) being a classic example.
The CSR standards build on this approach by pointing up new risks and ways of managing them.

As regards natural disasters, CSR focuses corporate attention more particularly on climate change considerations. Basically, the increased frequency and impact of climate-related natural disasters (floods, storms, fires and drought) have sharpened the need for a review of risk management action plans and scenarios. Adaptation to climate change doubtless calls for changes to be made to business premises, from the agency and data centre through to head office. This is especially true in coastal areas and countries most exposed to extreme weather events.

With respect to vandalism, the CSR standards stress the importance of the company's engagement in the geographic areas in which it operates. The company cannot be an "ivory tower" operating separately from its immediate social environment. It has to be involved locally, take positive action and be a fully-fledged civil society player. This holds true as much for developing countries where establishments are located (avoid "isolation" from the local populations, instead demonstrating the corporate contribution to local development) as for poor suburbs, underprivileged urban areas and rural exodus areas. An establishment that "invests" in the local fabric is much less likely to be vandalised than an establishment perceived as a foreign body to the social structure.

Event-type 6: Business disruption and system failures

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
6.1 Systems, Utility outage / disruptions 6.2 Public services	6.7.8 Access to essential services	FS13 Access points in low-populated or economically disadvantaged areas by type. FS14 Initiatives to improve access to financial services for disadvantaged people. (Note: these indicators only covert one part of the concept of essential services. The list of indicators given in this document is not exhaustive).

The notion of "essential services": It may seem surprising, at first glance, to consider a break in service due to a computer incident to be a CSR issue. Yet this needs to be viewed from the angle of providing an "essential service". When the company supplies a service deemed essential to society, it is its social responsibility to ensure the availability, soundness and continuity of this service.

Although water and electricity supply establishments and major infrastructure operators are top of the list (and alone mentioned in the ISO 26000), banking and financial services form an absolutely essential everyday service for the entire population. The responsibilities of ensuring the availability of ATMs, platforms and e-banking, transfer services, and means of payment will no doubt become increasingly important as the information technologies develop and we enter the "all-digital" era.

The notion of essential services also takes in another aspect to do with an establishment's duty to provide a basic banking service (right to hold a bank account, etc.) and guarantee access for all. This raises the question of banking accessibility and admission of fragile and/or excluded customers (financial inclusion). This essential services notion can extend to the establishments' capacity to provide sufficient geographic coverage (rural areas, underprivileged districts, etc.).

Event-type 7: Execution, delivery and process management

The indicators in bold type followed by * are key performance indicators (KPIs) proposed by the German Sustainability Code.

Basel II	ISO 26000	GRI / EFFAS indicators
7.1 Transaction Capture, Execution & Maintenance 7.2 Monitoring and Reporting; Failed mandatory reporting obligation	6.2 Organizational governance	
7.3 Customer Intake and Documentation	6.6.3 Anti–corruption	**SO2 Percentage and total number of business units analyzed for risks related to corruption.*** SO3 Percentage of employees trained in organization's anti-corruption policies and procedures. SO4 Actions taken in response to incidents of corruption.

7.4. Customer / Client Account Management	6.7.6 Consumer service, support, and complaint and dispute resolution	PR5 Practices related to customer satisfaction, including results of surveys measuring customer satisfaction. PR9 Monetary value of significant fines for noncompliance with laws and regulations concerning the provision and use of products and services.
7.5 Trade Counterparties	6.6.6 Promoting social responsibility in the value chain (i.e. especially in client/supplyer relationships)	HR8 Percentage of security personnel trained in the organization's policies or procedures concerning aspects of human rights that are relevant to operations. EC6 Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation. EC9 Understanding and describing significant indirect economic impacts, including the extent of impacts.
7.6 Vendors & Suppliers	6.3.7 Discrimination and vulnerable groups 6.8.7 Wealth and income creation	**HR2 Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.*** **HR4 Total number of incidents of discrimination and actions taken.*** HR6 Operations identified as having significant risk for incidents of child labor, and measures taken to contribute to the elimination of child labor. HR7 Operations identified as having significant risk for incidents of forced or compulsory labor, and measures to contribute to the elimination of forced or compulsory labor. HR9 Total number of incidents of violations involving rights of indigenous people and actions taken. SO1 Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting. SO8 Monetary value of significant fines and total number of non-monetary sanctions for

		noncompliance with laws and regulations. **EC1 Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.*** EC5 Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation. EC6 Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation. EC7 Procedures for local hiring and proportion of senior management hired from the local community at locations of significant operation. **EFFAS S07-02 II Percentage of total facilities certificated according to SA 8000 standard.***

CSR and the company's internal processes: The CSR standards have strong process and corporate governance requirements. The ESG approach addresses a social issue, an environmental issue and looks at how the company is run.

There is obviously a change of paradigm here: beyond the regulatory framework, the company is no longer "free" to decide on its own organization and governance. The CSR standards promote a model deemed virtuous, ethical and responsible. They call for transparent, sound, high-quality business processes.

These points are extremely important in terms of internal control and they will certainly be factored into the financial institutions' ongoing control plans in the very near future.

CSR and suppliers: The promotion of CSR in the value chain is an important element found in all the CSR standards. In addition to "respecting" the principles, the company is expected to be an enthusiastic CSR player.

In a world where many activities are outsourced (ESP and non-ESP[20]), supplier relations constitute a very high ESG risk element. The CSR standards require companies to work with suppliers that respect the same ESG criteria as those to which the company is itself subject: respect for human rights and rights at work, respect for the environment, etc. These issues are especially complicated to understand as the chain of subcontractors gets longer and reaches into the emerging countries.

Here again, supplier-related risk management plans can no longer merely ensure the continuity of services and compliance with contractual commitments. Companies need to do more wherever they can, conducting a policy to both promote CSR and actively audit their

[20] ESP: Essential Service Provision as defined by Banking and Finance Regulatory Commission Regulation CRBF 97-02.

suppliers' practices. The image risk is very high and no longer concerns just those manufacturers that relocate their production to emerging countries. A financial institution working in the OECD region with suppliers that employ illegal immigrants or do not respect the environment would be exposed to the same risks. So responsibility in the customer/supplier relationship is another aspect to be considered. This notion calls for companies to adopt responsible purchasing practices.

IV. Example of a method to integrate indirect or induced ESG risks into operational risk management

Basel II is designed for banking institutions to manage their operational risks. Integration of the ESG approach introduces a fundamental difference. Establishments can use this methodological approach to **consider the effects of risks to stakeholders external to the financial institution managing its own operational risk**.

This makes the ESG risk management approach fully the social and environmental responsibility of the company, which has to address its business risks to the environment, society and its stakeholders.

This approach raises two major problems:
- Firstly, the identification of the stakeholders concerned and their impact;
- Secondly, the setting of a limit on responsibility, since the major corporations' sphere of influence is *potentially* unlimited.

The solution to the first problem necessarily involves ongoing dialogue with the main stakeholders (customers, staff and staff representatives, shareholders, suppliers, NGOs, governments and regulators) to improve the targeting of the risks generated by the company's activities. This vital element feeds into the corporate ESG standards dynamic.

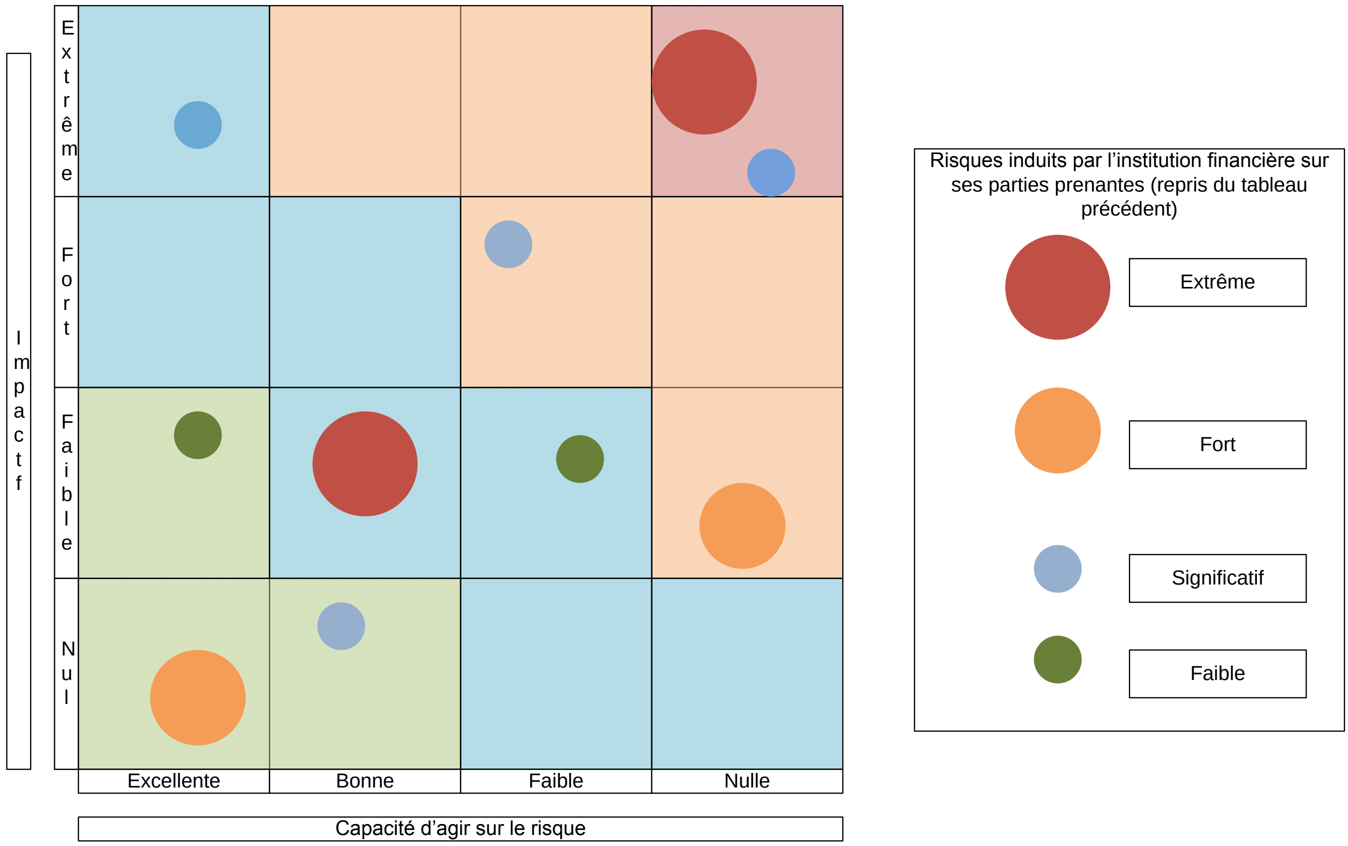
The second problem can be addressed by making leverage and the impact on the company itself decision-making criteria for handling induced risks to third parties, once these risks have been mapped.

Management process:

Determination of the entity affected by the risk:

a. The company: the risk is managed using the "traditional" Basel II method. This document provides information on the "new ESG risks", which have a particular impact on the establishment.
b. The company's sphere of influence: the risk is managed using a two-stage analysis: i) a classic impact/frequency map, which provides a risk weight (e.g. from 1 to 6 on scales with four levels), and ii) the plotting of these risks on an "impact on the company vs. company capacity for action" diagram in order to prioritise them.

Proba/Impact	Weak	Medium	Strong	Extreme
Improbable	1	2	3	4
Possible	2	4	6	8
Very probable	3	6	9	12
Almost certain	4	8	12	16



This process is a decision-making assistance mechanism for management. It can be incorporated into the operational risk departments' classic mechanisms in the financial institutions. ESG risk management actually needs to be integrated into the operational risk management action plans and processes for the approach to remain consistent and effective.

The iterative risk management process using action plans is designed to allow for risk handling feedback from stakeholders in addition to the organisation concerned. The term ***"participatory continuous improvement"*** could be used here.

V. Conclusion

The exercise of Corporate Social and Environmental Responsibility builds on and extends the foundations of operational risk management, such as it is practiced by banking institutions in keeping with the Basel II standards.

The introduction of Environmental, Social and Governance (ESG) criteria into operational risk management scales up this risk management with the addition of two strands:

- First, it brings into the equation new risks to the financial institutions, especially the impact of (indirect or induced) risks on other stakeholders and their effect on the organization's overall performance, using dedicated measurement indicators;
- Second, it sheds new light on the risks defined in the traditional standards.

Managing the "ESG" risk to the company should not be a separate issue to operational risk management dealt with by a service other than the operational risk department, since it is ultimately the financial institution that stands to suffer the losses.
The ways of managing these risks, prudential capital requirements aside, are definitely to be found in the operational processes that the operational risk management departments supervise and audit. This increases these departments' credibility.

The inclusion of ESG criteria in risk management takes us a step further on the road to integrating CSR into organization management assistance approaches, and better image and reputational risk management. Alongside the quality approaches, business process management[21], Lean[22] and other decision-making methods, CSR provides new keys for good corporate management. The ESG risk integration mechanics we have defined are intended to help management make informed decisions. The vital condition is obviously their inclusion in the consequently improved risk management process.

[21] Dennis I. Dickstein and Robert H. Flast, *No Excuses: A Business Process Approach to Managing Operational Risk*, 2008

[22] For more information on Lean, see: http://en.wikipedia.org/wiki/Lean_manufacturing

Annexes

CSR and reporting guidelines

- **The United Nations Global Compact** is an international initiative which aims to create a network of large companies, UN agencies, labor representatives and civil society in order to promote ten principles in the areas of environment, human rights, rights at work and anti-corruption. Its main objective is to promote the values of the United Nations by inviting companies to adopt, support and enact these principles within their sphere of influence.

- **The ILO fundamental conventions** [23]: These eight conventions are regarded as fundamental by the Governing Body of the ILO and are taken up by the ILO Declaration on Fundamental Principles and Rights at Work.

- **The OECD Guidelines for Multinational Enterprises**[24]: in order for the activity of multinational enterprises to be exercised in harmony with government policies and society as a whole, and all the while promoting foreign investment and sustainability, the OECD developed the "Guidelines for multinational Enterprises." This initiative comes from the "Declaration on International Investment and Multinational Enterprises" which is a set of recommendations for governments to businesses. An update of the OECD Guidelines was adopted May 25, 2011. They now provide a chapter on human rights, increased social responsibility for multinational corporations in their supply chain, and special consideration for precarious workers.

- **ISO 26000**[25]: After five years of negotiations and the international mobilization of over 500 experts from 99 countries or large organizations such as ILO and the OECD, the first international standard on social responsibility, ISO 26000, was published on the 1st of November 2010. This standard aims to provide guidelines on social responsibility for organizations taking into account existing standards of general conduct, management systems and reporting. Non-certifiable, this standard addresses the various key issues of social responsibility and present courses of action for any organization wishing to implement such an approach. One part is devoted to the communication on social responsibility.

- **The GRI (Global Reporting Initiative)** [26] provides a framework for sustainable development reporting organizations. It contains specific economic, environmental and social indicators. The GRI has a Sector-specific annex for "financial institutions". It offers each the management tools to measure the impact of major issues proposed by the ISO 26000 and ESG risks.

- Another alternative repository is the one established in 2010 by the **European Federation of Financial Analysts (EFFAS)** and **DVFA Society of Investment Professionals in Germany**, which is a revised guide on the integration of ESG criteria in company reporting. This document provides key environmental, social and governance indicators for each of the 114 sub-sectors listed in the

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[23] Pour plus d'informations sur les conventions fondamentales de l'OIT http://www.reportingrse.org/force_document.php?fichier=document_101.pdf&fichier_old=ConventionsFondamentales_OIT.pdf

[24] Pour plus d'informations sur Les Principes directeurs de l'OCDE http://www.reportingrse.org/force_document.php?fichier=document_734.pdf&fichier_old=OCDE_Ppes-directeurs_mai_2011_.pdf

[25] Pour plus d'informations sur l'ISO 26000: http://www.reportingrse.org/force_document.php?fichier=document_438.pdf&fichier_old=iso26000-en-

[26] Pour plus d'informations sur la GRI: www.globalreporting.org

"Industry Classification Benchmark (ICB)." Financial companies are among the great families of the ICB.

- Extra-financial rating agencies (Vigeo, Oekom, Sat, etc..), as well as brokers and certain asset management companies use their own repositories for CSR / ESG. Although there has been a convergence in recent years, it should be noted that there remain factors of heterogeneity (especially between the Anglo-Saxon and Continental Europe) of varying importance, depending on whether the institution being graded has offices in France, in Europe or elsewhere in the world. Moreover, their repository is more or less dependent on institutional investors, who are the most interested in the ESG rating. Depending on circumstances, consideration of one or more repositories of non-financial rating will be essential to the financial institution wishing to control its ESG risks related to changes in its extra-financial rating.

- Other than these repositories, there exist other initiatives, often led by investors, and according to which institutions can choose a « publish what you pay » approach.

- With it's **European Communication on CSR[27] published on the 25th of October 2011**, the European Commission presented a new strategy on corporate social responsibility (CSR). It argues that "To fully meet their corporate social responsibility, enterprises should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy ". The aim is both to strengthen the positive impact of companies, for example by creating new products and services that benefit society and the companies themselves, all the while reducing and preventing their negative effects. Its definition of CSR is largely inspired by the definition given by ISO 26000.

  Also, the website www.reportingrse.org was created by ORSE in 2010. It is designed to provide pedagogical support for companies in their CSR reporting.

[27] Pour plus d'informations sur Communication européenne du 25 octobre 2011 sur la RSE http://www.reportingrse.org/force_document.php?fichier=document_746.pdf&fichier_old=communication_rse_2011.pdf

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- **On the classic theory of long term profit maximization :**

« The Social Responsibility of Business is to Increase its Profits », (Milton Friedman, The New York Times Magazine, September 13, 1970. http://www.umich.edu/~thecore/doc/Friedman.pdf),

- **On company strategies to maximize their competitive advantage in a competitive environment :**

« *Companies continue to view value creation narrowly, optimizing short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success. […]Companies can create economic value by creating societal value ». (*The Big Idea: Creating Shared Value, Michael E. Porter and Mark R. Kramer, Harvard Business Review, January-February, 2011
https://archive.harvardbusiness.org/cla/web/pl/product.seam?c=8062&i=8064&cs=1b64dfac8e4d2ef4da5976b5665c5540)

- **On the consideration given to reputational risk according to the 2nd pillar of the Basel II convention :**

[...] Furthermore, in addition to a broader scope of risks covered by equity capital under Pillar 1, Basel II provides banks and supervisors with an essential tool, Pillar 2, to assess the specific risk profile of each institution and to take into account certain risks which are difficult to quantify but that can have great impact, in terms of solvency and of liquidity profile. The crisis has highlighted the need to emphasize on the management and supervision of refinancing risk (funding liquidity) and reputational risk. Thus, the liquidity crisis that affected securities on home loans (RMBS Residential Mortgage-Backed Securities) and indexed debt bonds (CDOs, Collateralised Debt Obligations) - especially for those linked to underlying home loans - has impacted banks that manage special purpose vehicles or funds holding these instruments to their credit. Aside from the acquisition of commercial paper issued by vehicles such as Structured Investment Vehicles, or in some cases their consolidation in the balance sheets, banks have also, sometimes to maintain their reputation, ensured the liquidity of funds such as UCITS (Undertakings for Collective Investment in Transferable Securities) marketed by their management companies to third parties by acquiring the assets become illiquid of these funds, or the shares held by their customers. In total, this re-intermediation has affected the banks' situation of liquidity, in some cases their credit, and has illustrated the importance of taking better account of commitments of any kind made by establishments, including under reputational risk, that is to say beyond their legal obligations. Pillar 2, which explicitly aims certain risks such as liquidity and reputational risk, allows banks, through their internal process for assessing capital adequacy (ICAAP Internal Capital Adequacy Assessment Process), as well as supervisors, through a strengthened processes of evaluation and supervision (SREP, Supervisory Review and Evaluation Process), to assess more accurately the level of such risks, the reality of their control and their coverage. [...]
Extract of « Basel II face à la crise: Quelles réformes ? » by Danièle Nouy, Secretary General of the Banking Commission and Member of Basel for France.

- "Reputational risk can be defined as the risk resulting from a negative perception on the part of customers, counterparts, shareholders, investors and regulators that may adversely affect the ability of a bank to retain or hire business relationships and access to funding sources (eg via the interbank markets and securitization). Reputational risk is multidimensional and reflects the perception of other market participants. In addition, it is present throughout the organization.

  Exposure to this risk depends on the adequacy of the bank's internal processes of risk management, but also the manner and effectiveness with which management reacts to external influences on their banking operations. "

  Extract of the Basel Committee consultation on banking control, January 2009: « Proposed enhancements to the Basel II Framework, Consultative document".

- See also the analysis on the proposed improvements to the Basel II framework, focused on operational risks:
  http://www.e-convergence.fr/ameliorations%20baleII%2016012009.pdf

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