A4S CFO LEADERSHIP NETWORK

MANAGING ESG-RELATED RISKS AND OPPORTUNITIES

Practical example: Royal DSM

THE PRINCE OF WALES'S CHARITABLE FUND

DSM

WHAT?

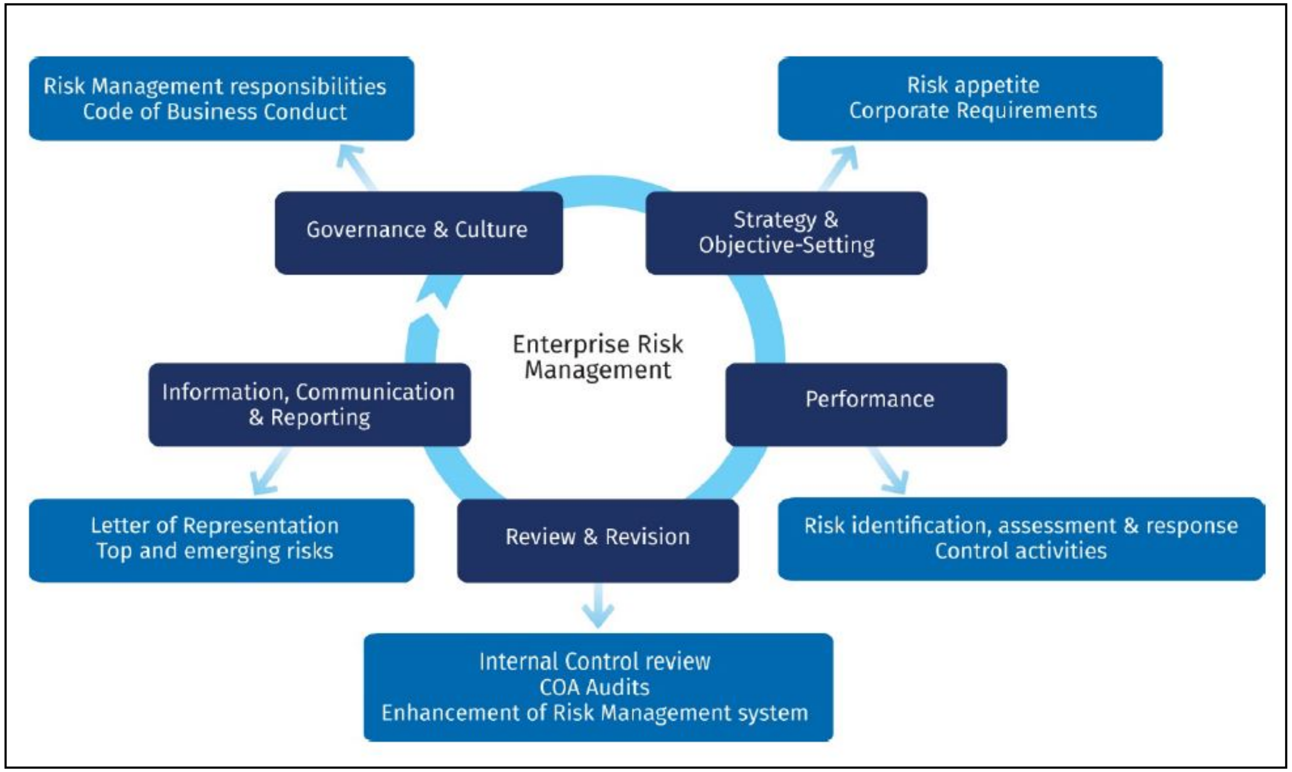
Royal DSM is a global, Health, Nutrition and Bioscience company, applying science to improve the health of people, animals and the planet. We are a purpose-led company committed to sustainability, and recognise the importance of embedding environmental, social and governance (ESG) risks into our risk management framework. This enables us to take decisions that will prepare us better for the future. To manage risks in line with our risk appetite, our comprehensive risk management process enables us to identify, assess and manage short-term as well as emerging risks and we have fully embedded environmental, social and governance (ESG) risks into this framework.

WHY?

We believe that companies have a key role in achieving the UN Sustainable Development Goals (SDGs). With our unique science-based capabilities and growing portfolio of nutrition and health solutions, we are focused on addressing the urgent societal and environmental challenges linked to the way the world produces and consumes food. While we aim to capture the opportunities of achieving the SDGs, we also have to improve our own environmental and social footprint and manage related risks accordingly. Only then can we continue to provide value for all our stakeholders across the three dimensions of our People, Planet and Profit ambitions.

HOW?

A well-embedded risk management framework and accompanying organizational structure is in place. Our Risk Management Cycle is based on the COSO Enterprise Risk Management framework and ESG aspects are integrated in each of the stages. This is important as ESG risks often have a longer time horizon and come with higher uncertainty. Applying an ESG focus to only part of the cycle, or organizing it separately from other business risk management processes, will be a less effective way to future-proof the company. Each stage of our risk management cycle is covered in further detail on the next page.



Source: Royal DSM Integrated Annual Report 2020, p.133

GOVERNANCE AND CULTURE

The responsibility for sustainability is clearly defined throughout the company, starting at the level of our Managing Board. They are supported by an external Sustainability Advisory Board and sustainability experts in business groups across the company and at corporate level, which helps them to identify risks and opportunities. All parts of the company are responsible for managing ESG risks and opportunities and delivering on ESG-related targets.

Sustainability is at the core of who we are and is one of the elements of our Culture Compass, which sets out what we stand for and what we aspire to be. To reinforce the point, our Code of Business Conduct contains business principles covering all the dimensions of People, Planet and Profit that guide our decision making.

STRATEGY AND OBJECTIVE SETTING

To deliver upon our 'purpose-led, performance-driven' strategy, we have defined clear targets that span both financial and nonfinancial measures. Improving our sustainability performance is important for future-proofing our company by mitigating risks ('value protection') and enabling new growth opportunities ('value creation'). All our organizational units are guided in their strategy implementation by our risk appetite and our corporate requirements. Both give clear guidance on various ESG related aspects.

PERFORMANCE

We measure our progress against our sustainability targets and ambitions using different metrics, which are audited by our external audit firm to reasonable assurance standards and which are disclosed each year in our Integrated Annual Report. DSM was one of the first companies in the world to align its reporting with the Stakeholder Capitalism Metrics developed by the World Economic Forum's International Business Council, which we see as important to provide clear comparable disclosure at a global level.

All our organizational units are responsible for their own financial and sustainability performance, including short-term and emerging risk identification, assessment, and response. The number of ESG-related risks is increasing for all companies and we execute specific risk assessments to get a better understanding of likelihood and potential impact. In line with our commitment to implement the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), we also execute climate-related risk assessments, both physical and transition risks, using scenario analysis.

REVIEW AND REVISION

Our Corporate Operational Audit department provides additional assurance to the Managing Board that significant risks, including ESG-related ones, are managed and controlled effectively, efficiently, and sustainably. In addition, the effectiveness of the risk management processes are reviewed biannually and changes are implemented if needed.

INFORMATION, COMMUNICATION AND REPORTING

Supported by an open culture, different structures and communication channels are in place to make sure information on risks is communicated, discussed, and drives decision making and actions. For example, all units provide an overview of all material short-term and emerging risks and incidents to the Managing Board twice per year.

SUSTAINABILITY TARGETS

In developing our 'purpose-led, performance-driven' strategy, we looked closely at emerging global megatrends, the UN's Sustainable Development Goals, and our capabilities to identify business opportunities that will create a growth company that can make a difference.

To deepen our understanding of ESG factors that could become material for Royal DSM, we tapped into internal and external information sources to update our materiality matrix. We also used sources such as CDP, Sustainalytics, MSCI, and EcoVadis to identify the elements that they consider most relevant. We spoke to our customers and to end-consumers to understand their needs. Additionally, we engaged in dialogues with investors and analysts to get input on their expectations and challenges.

Sustainability risks and opportunities are embedded in our strategy via public targets which we established in 2018. These set out our ambitions (see image right) to improve our own societal and environmental impact.

Sustainability performance

	GHG structural improvement (vs. 2016)	Energy efficiency improvement year-on-year	Purchased renewable electricity	Employee engagement favorable score	Safety Frequency Recordable Index	Female executives	Brighter Living Solutions
2020 Realization[1]	~18%[2]	5.7%	60%	76%	0.24	21%	63%[3]
2021 / 2030 Ambitions	30% by 2030 (vs. 2016)	>1% average annually till 2030	75% by 2030	>75% by 2021	<0.25 by 2021	25% by 2021	>65% by 2021

1 These data relate to DSM including discontinued operations
2 We estimate that the effect of the underlying cumulative structural improvements in absolute GHG emissions was approximately 18% in 2020, versus the 2016 baseline. The total cumulative absolute reduction was 25%, versus the 2016 baseline.
3 For a small percentage of sales (<0.6 % of sales) classified as Brighter Living Solutions, the environmental impact is considered 'best in class' together with other solutions
4 These sustainability performance statements are prepared in accordance with the reporting policies as included in the management report of DSM's Integrated Annual Report 2019

Source: Royal DSM 2020 results press release, p.14

Circumstances continuously change, so we periodically review whether our targets are still in line with the company we want to be and respond to the ESG risks and opportunities we are facing. This has led us to increase our commitments, specifically to achieve net zero greenhouse gas (GHG) emissions by 2050 and an acceleration of our absolute GHG emission reduction target to 50% by 2030 (versus the previous target of a 30% reduction).

These have been supplemented by additional targets in 2021 where we have committed to support the health of people and the planet by applying our scientific capabilities and resources to transforming the sustainability of how the world produces and consumes food.

Source: Royal DSM investor presentation

Our strategy and targets make it clear that we are committed to sustainability. Implementation is supported by clear management processes, including a solid risk management framework and the fact that the targets established in 2018 form part of the long-term incentives of the Managing Board and executives.

FINANCE'S ROLE IN DELIVERING ON OUR SUSTAINABILITY TARGETS

To support the reduction of our GHG emissions, in 2016 our finance function adjusted their capital expenditure procedure and made it mandatory to include an internal carbon price of €50/mt CO_2ᵉq. in all business cases for large investment projects. Following the update of the strategy and targets in 2018, the process became even more stringent. All large investment projects now need to be GHG neutral or better. So, in cases where an investment project would lead to an emission increase, this needs to be offset by implementing reduction measures. The additional costs and/or investments needed to offset the emission increase must be included in the business case. Furthermore, to integrate the aspect of GHG emissions in day-to-day decision making, internal carbon pricing is now also applicable for the managerial P&Ls that are used to steer the businesses.

Recently, we increased our internal carbon price from €50 to €100/mt $CO_2{}^{e}q$. This is in line with the latest external insights of forward-looking scenarios on the necessary carbon price levels to avoid exceeding 1.5°C of global warming. We use these external sources as the foundation for our scenarios of climate-related transition risk assessments so it makes sense to also use this increased level for internal steering purposes.

Integrating sustainability into financial metrics provides a strong signal throughout the company that, in order for profit to be sustainable, other elements are becoming more important. For our finance professionals it is important that they integrate ESG elements into their assessments. Cash flows today and in the future will increasingly depend on a company's environmental and social footprint. The probability of success with future growth opportunities also depends on our sustainability performance. Therefore, it is important that the finance function has a solid understanding of the sustainability targets of DSM, external ESG-related developments, and the possible impact thereof on our business.

The finance function also plays a crucial role in the reporting of our 'Brighter Living Solutions' metric. This metric was developed to measure the quality of our existing product portfolio. A solid process for data collection, review and reporting was put in place with the support of finance professionals. This is important as all sustainability disclosures are part of the reasonable assurance audit by our external auditor. With the demand for nonfinancial disclosures increasing, we leverage the experience from our finance function to design, implement and operate solid reporting processes.

TOP TIPS

GET COMMITMENT FROM THE TOP

Much of our success was because sustainability was an organizational priority. One way or another, it is essential to make sure that senior management understand why this is essential for a company's future. Improving sustainability performance is no longer 'nice to have' but is a 'must have'.

EDUCATE MANAGERS AT ALL LEVELS

It is not only about the direction set by senior management. Leaders at all levels need to understand the context, the business drivers and what is material for your organization. It is important to educate leaders throughout an organization on the full scope of emerging sustainability trends and what it means for their business and their work.

HIGHLIGHT THE OPPORTUNITIES

Risk, understandably, becomes a major focus for organizations. Managing uncertainty well, though, creates chances for you to stand out in a shifting market and create value. It can often be more motivating for staff to engage with opportunities than risks, so try not to neglect this angle.

LEARN TO DEAL WITH UNCERTAINTY

When dealing with large, uncertain risks across long-term time horizons, standard mathematical calculations and analyses are no longer enough. Finance needs to learn and implement techniques for analysing a range of possible outcomes. Factoring in the uncertainty that surrounds social and environmental risks will leave you better equipped to understand the material risks to your organization and where your focus should be. Scenario analysis can be helpful to deepen your understanding and drive better decision making.

GET IN TOUCH OR FIND OUT MORE

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