Marsh

Risk Trend Reporting Across the Energy and Power Industry

June 2024

Introduction

Marsh's Advisory solutions team has analyzed data and information contained in the annual reports of prominent energy and power companies listed on global stock exchanges to assess the key risk reporting trends related to enterprise risk management, as well as environmental, social, governance (ESG) disclosures.

Unique analysis has been developed from the risk information in the annual reports and accounts of over 60 global companies. Headquartered in 16 countries, members of this group represent approximately $6 trillion in market capitalization across the energy industry. The report summarizes over 1,500 risks extracted from companies listed on the various market exchanges, including FTSE 100, CAC 40, S&P 500, Tadawul, and Hang Seng.

This research explores information contained in annual reports covering the reporting period 2021-2022. Published risk data was benchmarked against the 2023 World Economic Forum's Global Risk Report to compare results and trends. In addition, the research incorporated a risk governance and management survey completed by a cross section of risk and insurance professionals within Marsh's Energy & Power client base.

In this report, we will review how the reporting period was marked by a number of global and economic dynamics, including the COVID-19 pandemic and the onset of the Russia-Ukraine conflict. We will also explore how it represents a time when ESG and climate action had risen high on the agenda for governments, communities, and the business world.

While time has passed between our research and this public paper, risk reporting remains much the same. Our hope is to guide energy and power organizations to deliver a deeper, richer conversation moving forward that creates a transparent view of risks and strategies for all stakeholders.

Trend 1: Risk governance.

Lack of comprehensive reporting on risk appetite statements, particularly outside of FTSE 100.

Only 15% of the companies researched made reference to their risk appetite statement within their annual report. While no company listed on the CAC 40, Hang Seng, or S&P 500 included a risk appetite statement, all of the FTSE 100-listed companies included such a statement mentioned their risk appetite statements.

The risk appetite statement is a key indicator of how integrated the risk framework is into a company's strategy.

The energy and power industry is experiencing a period of uncertainty and disruption driven by global commitments and urgency to transition to clean energy sources; the growing demand for energy from developed and emerging economies; and the critical need for energy security and safeguarding of energy infrastructure. As such, it is paramount that risks are understood and integrated appropriately into strategic goals and objectives. Businesses can then determine what are acceptable or unacceptable levels of risk; what controls are working; and how well risk transfer, financial reserving, and insurance provisions are performing.

While many companies likely have risk appetite statements, not outlining key risk decision-making in an annual report could signal room to improve reporting processes or better inform stakeholders. That is likely to change as even more emphasis is placed on transparency.

In 2019, the UK Corporate Governance Code required companies to make statements in their reporting that illustrated their risk approach and perspective but did not require them to disclose confidential governance information or jeopardize any competitive advantage.

In the age of increasing transparency amid heightened public scrutiny and expectations, other trading exchanges will likely follow the path laid out by the FTSE 100 and may require more in depth, transparent statements on risk and strategy.

Companies should consider the benefit to stakeholders — including clients and investors — when sharing information regarding their risk appetite statements. An opaque approach may miss the opportunity to provide these stakeholders with assurance that there is sufficient interconnectivity between strategic goals and objectives and the risk framework, including the company's risk appetite. Proactive disclosure can help to build confidence for shareholders.

Trend 2: Principal risks.

Stronger focus on short-term risks than longer-term emerging risk themes.

Principal risks tend to have a two- or three-year horizon and are usually considered to be the threats that could have a fundamental impact on a company's business. This is the timeframe that most corporate governance codes will focus on for annual reporting. Companies are expected to disclose their top "here and now" risks and how they are being addressed, especially at the director or leadership level.

Emerging risks are far less tangible and there is less data available to assess the impacts of these types of risks. While principal risks are more event-specific, emerging risks are viewed in a more thematic way. For these risks, companies need to demonstrate a good awareness of the overarching themes and a clear assessment of the potential impact of these risks on their businesses.

It is essential that companies begin to talk more about emerging risk themes; an openness about the understanding of emerging risk will be needed for a collaborative approach to a transitioning future and the achievement of international goals, such as those outlined in the Paris Agreement.

Furthermore, insight within an annual report expressing how a company is addressing emerging risk is demonstrative of a company's long-term strategic view of risk and resilience.

Acknowledging the current level of uncertainty within the sector and highlighting the techniques available within the company to assess emerging risks and their potential impact on strategy is useful insight for stakeholders highlighting a company's longer-term approach. This can be done without giving away any intellectual property or sensitive information, as the insight refers to the approach, techniques, and tools that could be used to address emerging risk themes rather than specific activities.

Once again, companies listed on the FTSE 100 are ahead in this regard, including high level reference to financial quantification, as part of their viability statement requirement.

A viability statement expresses the directors' views about the longer-term viability of the company with reference to the company's current position and the longer-term risks that could threaten the business.

Across all companies, the analysis shows that there was a stronger focus on shorter-term, principal risks, rather than on the more thematic emerging risks.

Energy companies are experiencing unprecedented change, from regulatory reforms to geopolitical dynamics affecting multinational locations. Some of this change is also self-driven, for example technological evolution and infrastructure improvement relating to energy transition. In recent years, near-term uncertainty has led to a need for a focus on principal risks and a more tactical approach to risk — the crisis response to COVID-19 being a prime example. However, the current wave of uncertainty has a much longer tail and is more rooted in emerging risk. Companies would do well to consider and demonstrate their understanding of emerging risk in a more in-depth way through their reporting.

Trend 3: Risk control.

The language used for risk control represents an opportunity for improved strategic positioning for risk in annual reporting.

The annual reports were scanned for key risk control words to assess their willingness to discuss their risk control activities. Omissions were also indicative of the assumption that readers would intrinsically know what is being done despite lack of articulation.

This may have been acceptable in the past when annual reports were targeted specifically towards knowledgeable shareholders. However, companies increasingly need to consider their broader stakeholders — and the practical industry and risk knowledge of this expanding group may be less mature, requiring companies to be more explicit.

When reviewing the risk control language in these annual reports, words like “contingency” and “planning” were rarely used. Nearly all companies, however, mentioned key words like “contract”, “monitor”, “security”, and “policy”. This suggested a level of comfort in reporting on risk control in a tactical way, but companies are still shying away from discussing their strategic activities.

There were also observed differences among sub-industries with regard to their willingness to discuss risk controls in a meaningful way.

Only one of three oil & gas storage & transportation companies used any of the key risk control words we analyzed; the one key word used by this single company was “security”.

In contrast, all three fertilizer & agricultural chemicals companies mentioned every single key word.

Not all of the key words analyzed represented the hard measures associated with risk management. “Culture”, for example, plays a significant role in risk management. Having the right culture in place in an organization can help foster good performance and the right risk taking; conversely, a poor risk culture can leave a company overly exposed. Roughly 16% of the companies analyzed spoke about “culture” when outlining risk controls.

This represents an opportunity for companies to include not only the things that can go wrong with risk controls, but also to discuss the measures that can be implemented to improve a company’s risk profile.

Findings in detail

An effective risk management governance framework typically incorporates direction and guidance on risk appetite, financial viability, emerging risk, and risk management committees. All of the global exchanges required listed companies to provide risk governance information, with the UK Corporate Governance Code (applying to the FTSE 100 organizations) being the most extensive in its requirements. The table below compares the information available for companies included in the research. Based on the annual report risks sections, specialty chemicals and electric utility companies ranked highest across the board in terms of general corporate risk governance best practice.

Across annual reports, companies were most comfortable with reporting on emerging risk identification and their risk management committee provision. However, while several sub-industries demonstrated that all of their companies had risk management committees, the outputs associated with these committees — such as the risk appetite statement, viability statement, and outline of principal emerging risk — have not been articulated.

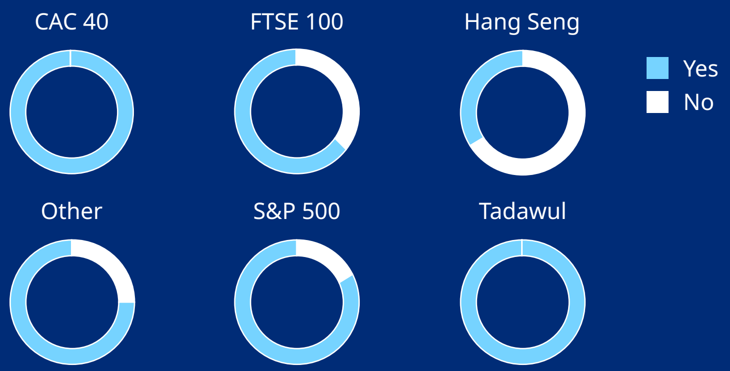
A risk management committee will typically have specific responsibilities that include oversight of risk analysis, controls, and treatment plans, and approval of the organization's overall enterprise risk management framework. The majority of companies (77%) have disclosed the existence of a risk management committee. The most common name of the board level risk committee is the *Audit Committee* (37 entries), whereas the majority of organizations (39 entries) did not name an executive level risk committee, suggesting it was not in place. Marsh recommends that energy and power organizations create both board and executive or management level risk committees to provide sufficient oversight and ownership. Of those 22 organizations that did name a committee at this level the most common name was the *Corporate Risk Management Committee*.

A risk appetite statement outlines the amount and type of risk that an organization is willing to take to meet its strategic objectives. Across the 61 companies analyzed, only 9 (15%) noted risk appetite statements within their annual report. None of these were listed within CAC 40, Hang Seng, and S&P 500. In contrast, 100% of companies listed on the FTSE 100 note the existence of their risk appetite statement.

GICS Sub-Industry Name	#	Risk Appetite Statement	Viability Statement	Emerging Risk Identification	Risk Mgmt. Committee	Principal Emerging Risks
Integrated Oil & Gas	13	23%	15%	69%	69%	8%
Industrial Gases	3			33%	67%	
Muti-Utilities	7	14%	14%	71%	86%	
Specialty Chemicals	5	20%	20%	60%	100%	20%
Oil & Gas Exploration & Production	8	25%	13%	88%	50%	
Electric Utilities	9	22%	11%	78%	100%	11%
Diversified Chemicals	1			100%	100%	
Oil & Gas Storage & Transportation	3			67%	67%	
Oil & Gas Refining & Marketing	4			50%	100%	
Fertilizers & Agricultural Chemicals	3			33%	67%	
Oil & Gas Equipment & Services	3			67%	67%	
Commodity Chemicals	2			50%	50%	

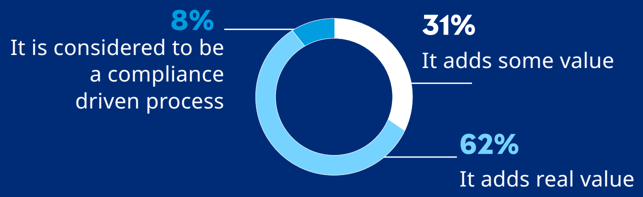
In Q3 2022 Marsh conducted a voluntary survey of energy and power clients, to assess their risk management function. The following insights help illustrate a view into their risk approach and annual review involvement.

01| Reports listing risk management committees



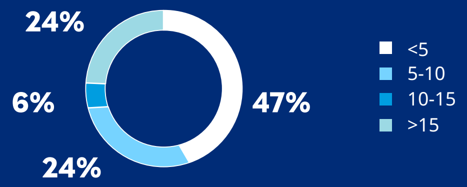
The client pulse questionnaire asked respondents how risk management is perceived within their organizations. Nearly two thirds (62%) felt that the risk management process added real value in supporting decision making, and that it was embedded across the organization. However, it is worth noting that 8% felt that it is instead a compliance-driven process and used it as a tool to communicate to stakeholders that the company is managing risk.

02| Perception on the importance of risk management



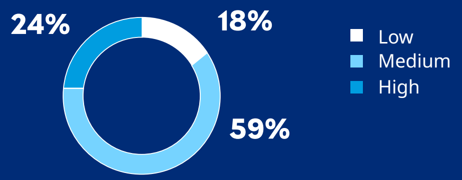
The questionnaire also asked respondents to provide information on the size of their risk function, with results revealing that a significant number of survey participants have a relatively small risk management function of fewer than five employees. In the cases of smaller companies, this may be sufficient; however, for larger energy and power companies, a greater number of resources assigned to the leadership and management of risk would be expected.

03| Size of risk management function



An interesting finding from the client pulse questionnaire was the level of involvement of the risk function in the production of the annual report section. Only 24% of respondents stating they had a high level of involvement in producing the report, and the majority (59%) noted a medium contribution. A potential "silo trap" was also noted in response to the question "What level of interaction do you have between risk functions e.g. Enterprise Risk Management, Insurance, Business Continuity Management, Cyber, Health & Safety?". The vast majority of respondents (82%) stated that it was either low or medium.

04| How involved is your team in the production of your organization's Annual Report risk section?



When asked: "What are the biggest performance gaps in your organization's risk management structure?" the results from respondents indicated a greater need for cross theme-collaboration, educating staff members, and the need for innovation. This may help improve these factors as well as provide greater insight and foresight to inform decision making.

05| Biggest performance gaps in your organization's risk management structure

1	Lack of cross-organization collaboration / cultural implementation issues	6	Managing supply chain performance
2	Educating other (non-risk) employees on key risk management practices	7	Determination/assessment of emerging risks
3	Timely adoption of new/innovative solutions	8	Connection to the C-suite and board
4	Implementation of a formalized enterprise risk management program	9	Connectivity with business continuity and crisis management
5	Integrating risk activities with ESG and sustainability goals	10	Managing incidents and claims

Incongruence with key risks identified in the World Economic Forum's Global Risks Report

Analysis of the risks that companies articulated in their annual reports identified some differences to the most primary risks detailed in the Global Risks Report, which is considered the prominent global risk survey.

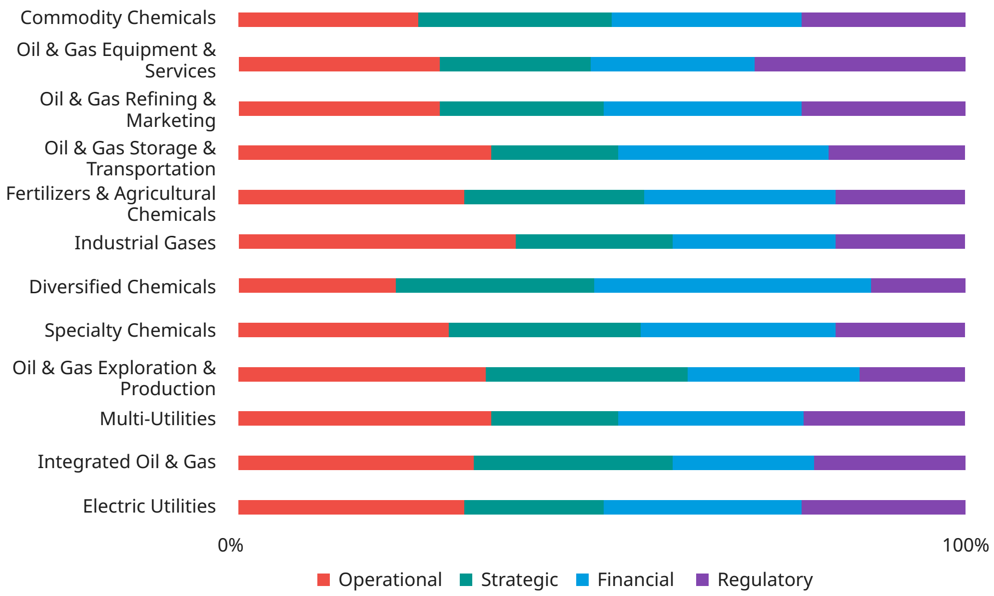
In the 2023 report, there is a clear emphasis on environmental risks, with four of the top five risks falling into this category. This is likely due to the multi-industry nature of the report's respondents. Also, the scope of the report is not as heavily influenced by the underlying regulatory drivers that feature with energy & power industry organizations. Furthermore, the macro nature of the report and the incorporation of perspectives from a broad group of global stakeholders provides thematic trends which are broader in nature.

Principal risk analysis

Across all analyzed annual reports, an average of 24 risks were reported, with the industrial gases sub-industry having the lowest average number at 18 risks and the oil, gas storage & transportation sector having the highest at an average 35 risks. The 1,500+ risks across all reports were classified into the four macro categories of operational, strategic, financial, and regulatory. As shown below, across all sub-sectors operational risks make up the highest proportion (33%); which is significant as we would usually expect the number of strategic risks to rank highly. Interestingly, while 'regulatory and legislative environment' is ranked as the top risk across all sub-industries in terms of occurrence, risks categorized as regulatory only make up 19% of the risks identified. Strategic and financial risks make up 23% and 25% of total risks respectively. However, the distribution of risks does vary across industries. For the energy equipment and services sector, regulatory-related risks occur with the greatest frequency (31%).

This points to a focus on shorter-term risks relating to operational challenges and regulatory reporting. Given the macro-economic and geopolitical turbulence during the reporting timeframe, the trend is understandable. Many companies were impacted to varying degrees by the Russia-Ukraine conflict and were also in survival mode during the COVID-19 pandemic — a doubling down on operational risk may have felt like a logical approach.

06| Breakdown by industry sub-sector



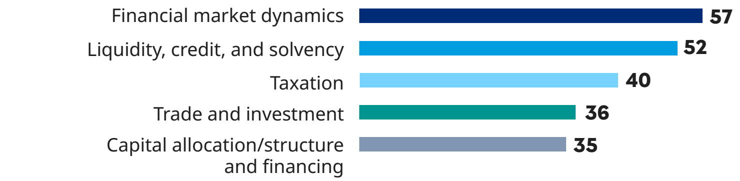
The results below show the abstracted risks that were sub-categorized into 70 risk classes within the four macro categories.

Financial market dynamics ranked top across financial risks identified across all exchanges, with major hazard/natural catastrophe risks ranking highest for those categorized as operational. Within the operational risk category, sustainability and environment was in second place, closely followed by information technology in third.

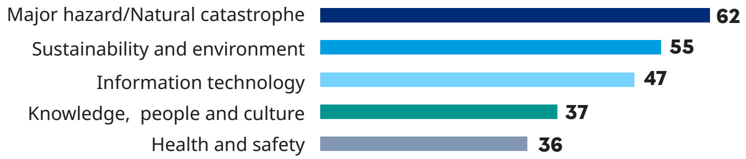
ESG-related risks ranked top across strategic risks identified across all exchanges, with regulatory and legislative environment ranking highest for those categorized as regulatory and across all categories. Geopolitical risk was ranked second lowest within the strategic risk category, despite considerable global issues and threat vectors. Contract risk, within the regulatory category, was ranked lowest across all risk categories.

The results of the count ranking across all risk classes, as indicated below, showed that the most common risk was regulatory and legislative environment followed by major hazard natural catastrophe.

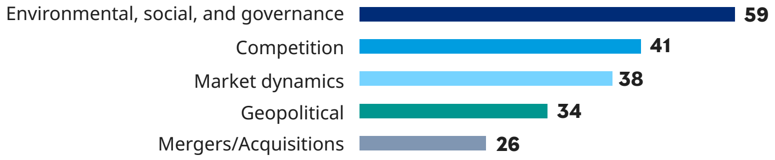
07| Top 5 Financial risks by occurrence



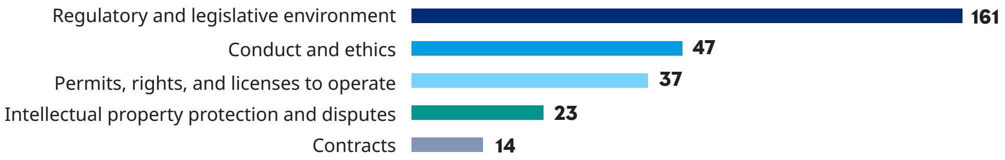
08| Top 5 Operational risks by occurrence



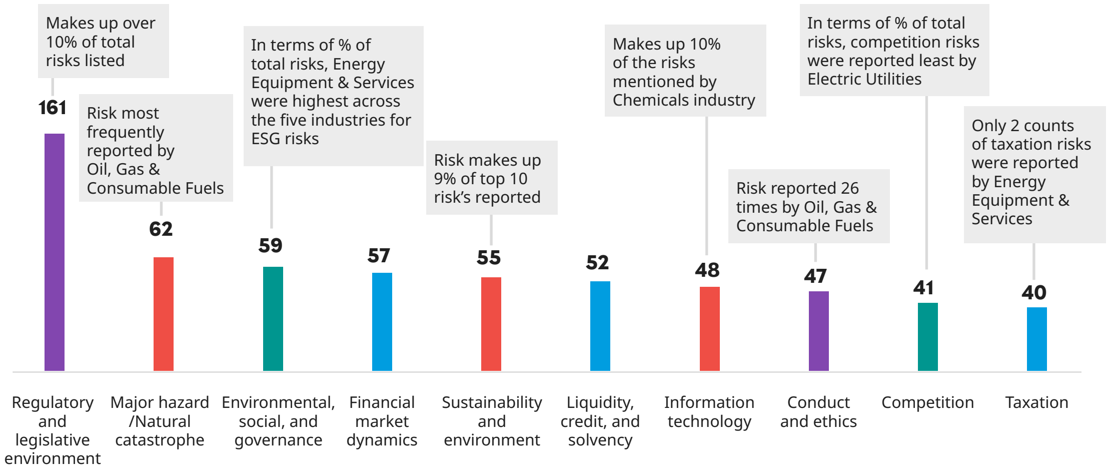
09| Top 5 Strategic risks by occurrence



10| Top 5 Regulatory risks by occurrence



11| Count ranking across all risk classes



Conclusions and recommendations for businesses

Now is the time for energy and power organizations to utilize their annual reports as a way to provide a deep or transparent picture of risk and to reflect an understanding of the interconnectivity of risk and stratgy.

Sharing information on the impact of emerging risk themes, and how these themes play into strategic plans, demonstrates both understanding and the intention to future-proof for resilience.

Sharing more insights about current risk management approaches and practices would give the ever-growing list of stakeholder groups greater confidence in the sector at a time of significant uncertainty. Articulating that the interconnectivity of risk and strategic objectives are well aligned will also provide stakeholders greater assurance and may open the door to future collaboration with relevant entities.

This level of transparency has been mandated by FTSE 100 and the difference in reporting between this exchange and others is considerable. Companies should note that in the future other exchanges will likely require enhanced disclosures. An opportunity exists for companies to proactively adopt greater transparency before mandated reporting requirements are introduced.

Methodology

The headquartered location of the 61 participating companies, across the five industries[1] and 12 sub-industries[2] (based on the Global Industry Classification Standard (GICS)) are shown in the diagram below. Most of these organizations published their annual reports and accounts during February to April, with February being the predominant month for S&P listed organizations, and March for FTSE and CAC listed organizations. Companies were listed on the following exchanges: FTSE 100, CAC 40, S&P 500, Tadawul, and Hang Seng.

All five market exchanges studied require companies to provide information on principal risks, risk management, controls, and governance within annual reports. Regarding ESG and climate risks (collectively referred to here as ESG), while this was not mandatory for all exchanges during the reporting period, it is increasing in both regulatory requirements and board direction.

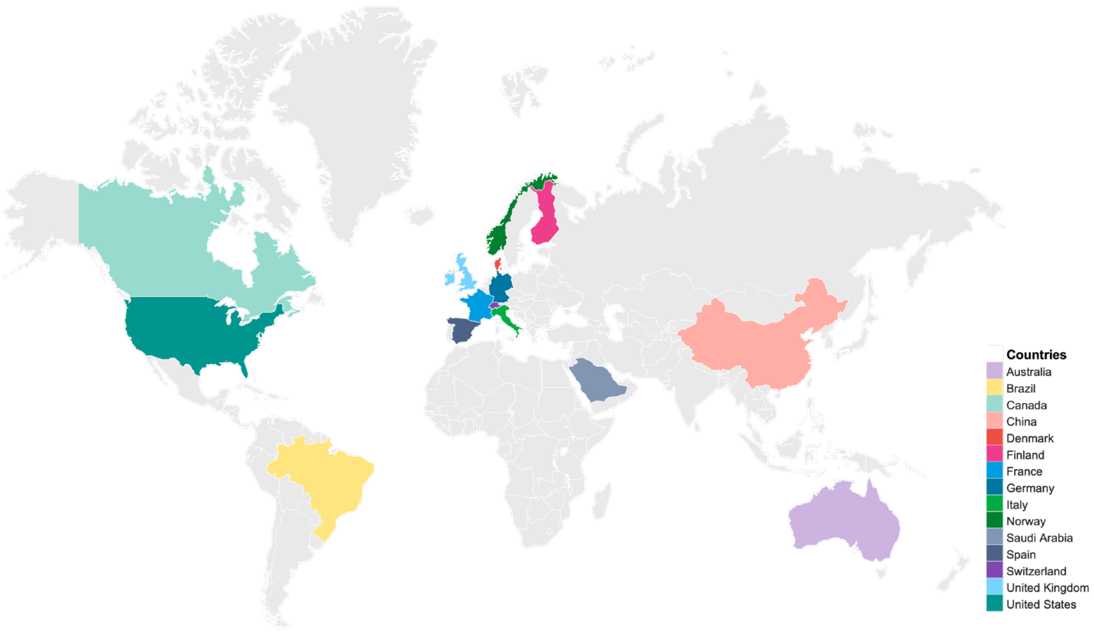
The level of risk and ESG information required differs over the various corporate governance codes studied, with the FTSE100 and CAC40 requiring most information.

Over the course of 2022, Marsh in conjunction with Cranfield University, examined the reporting of risks and risk management information. We extracted and analyzed over 1,500 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.

The risk information analyzed was solely extracted from publicly available content published by energy and power listed companies within their annual report and accounts / 10-K (collectively referred to as 'annual reports') from July 2021 to July 2022.

Company selection in the 2022 research project was driven by company market capitalization, the availability and accessibility of annual reports, and broad representation of the global energy and power industry. Marsh's Advisory solutions team undertook similar analysis in 2021 across all industries and sectors within the FTSE 100 index, and an additional 60 companies from other global exchanges.

12| **Country distribution**
Overview of location of company headquarters



[1]Chemicals | Electric Utilities | Multi-Utilities | Oil, Gas & Consumable Fuels | Energy Equipment & Services

[2]Integrated Oil & Gas | Industrial Gases | Multi-Utilities | Specialty Chemicals | Oil & Gas Exploration & Production | Electric Utilities | Diversified Chemicals | Oil & Gas Storage & Transportation | Oil & Gas Refining & Marketing | Fertilizers & Agricultural Chemicals | Oil & Gas Equipment & Services | Commodity Chemicals

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