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ECO:FACT QUARTERLY

The briefing for E&S risk experts

ECO:FACT CELEBRATING 20 YEARS

Editorial

If your time to you
Is worth savin'
Then you better start swimmin'
Or you'll sink like a stone
For the times they are a-changin' (Bob Dylan)

December is a good time to look back at how the sustainable finance debate has evolved in 2018. It has definitely been an interesting and eventful year. We would like to point to four aspects that are highly relevant for 2019, all of them linked to the dimension of time:

- Both the speed and breadth of regulatory change pertaining to sustainable finance are unprecedented. A web of intertwined soft and hard law standards addresses topics across the board, from the business and human rights agenda to gender and diversity issues, and – predominantly – climate change. Such regulatory action is not a coincidence. It is the result of growing concerns about severe societal and economic challenges. Unfortunately for the financial sector, it seems that regulators – and even many sustainability experts – find it wiser or easier to regulate financial institutions than the real economy.
- In his most recent speech, Mark Carney detailed the risks of a delayed response to climate change. While he highlighted recent achievements, such as the broad response to the TCFD recommendations, he also pointed to challenges. One of them is the fact that the financial risks stemming from climate change tend to be beyond financial institutions' planning horizons ("the tragedy of the horizon"). This makes it very difficult for them to develop a comprehensive understanding of the related financial risks.
- This is not only a problem for the financial sector, but also, ironically, for policymakers. The Paris Agreement defined an overall target, but does not include an agreement on policy changes. Each country provides its own national climate plan. As today's national climate plans, even collectively, will in no way suffice to meet the target of the Paris Agreement, they make it almost impossible for financial institutions to provide reliable predictions of the transition risks for individual sectors. As a result, financial institutions come to the conclusion that climate change will not become financially material for their operations in the next few years. However, the IPCC has recently called for much stronger mitigation efforts, which would have severe implications for policy over the next ten years. For financial institutions, such changes in policy remain intangible, as it is unclear whether they will actually occur.
- The central topic of the Sustainable Finance Working Group of the International Institute of Finance (IIF)'s recent meeting was the urgent need for the financial sector to demonstrate leadership in the sustainable finance debate. There was broad concern that the financial sector was behind the curve, and that there is a need for it to approach sustainable finance in a more meaningful way. This should happen very soon, as groundbreaking developments are expected in 2019.

We believe that one important message the IIF and financial institutions could convey to regulators is the need for policy roadmaps that will enable them to understand and manage transition risks. Such information would also help to make the case for investment opportunities, and would allow financial institutions to provide better support for the transition to a low-carbon economy.

Olivier Jaeggi

International standards

Updates on cross-sector environmental and social standards which might be relevant as a benchmark for risk assessments.
Scope: key developments related to the most important international environmental and social standards.

→ Public consultation launched for UNEP FI's Principles for Responsible Banking

The UN Environment Programme Finance Initiative (UNEP FI) is accepting public input on the Principles for Responsible Banking until May 31, 2019. Officially supported by 28 banks and 12 civil society organizations, the proposed framework is designed to help the finance industry align business objectives with the Sustainable Development Goals (SDGs), UN Guiding Principles on Business and Human Rights, and the Paris Climate Agreement. Intended as a global sustainability standard, the principles focus on six areas: 1) alignment; 2) impact; 3) clients and customers; 4) stakeholders; 5) governance and target setting; and 6) transparency and accountability. November 26, 2018.

Read more (1) → Read more (2) → The principles →

→ Breakthrough blue economy sustainability framework launched

The blue economy is expected to double in size by 2030, even though the world's oceans are already at crisis point due to over-fishing, pollution, habitat destruction, global warming and acidification. In response, a global framework for sustainable ocean finance was launched at the Our Ocean global summit. The Sustainable Blue Economy Finance Principles have been developed by the European Commission in collaboration with the WWF, the World Resources Institute (WRI), and the European Investment Bank (EIB), in order to promote sustainable enterprise practices in industries such as shipping, fisheries, tourism, aquaculture, energy, and biotechnology. As part of this initiative, an IT tool is being developed that will allow investment managers to assess whether a particular strategy matches UN guidelines on oceans, seas and marine life. October 29, 2018.

Read more → The principles →

→ Consultation draft of impact investing operating principles launched

Together with policymakers and leading global investors, IFC has launched a consultation draft entitled *Investing for Impact: Operating Principles for Impact Managers.* The draft principles describe "the essential features of managing investment funds with the intent to contribute to measurable positive social, economic, or environmental impact, alongside financial returns." The principles are intended as fit for purpose for a range of funds and institutions. IFC is asking for feedback on the consultation draft of the principles to be submitted by the end of December 2018. October 12, 2018.

Read more → Draft principles →

Coming soon:	Expected by:
Equator Principles (EP): Targeted review	May – August 2019: Finalization and launch of the EP4
World Bank Group Environmental, Health, and Safety (EHS) Guidelines	Revision ongoing Revised guidelines on some industry sectors available Second consultation on general EHS Guidelines planned
Principles for Responsible Banking	Consultation open until May 31, 2019

High-risk sectors

Developments relevant to six specific high-risk sectors, such as news on risk factors and trends, the relevant regulations, and best practices. The table below contains an update on controversies, and comments on the corresponding reputational risk for financial institutions.

		Information based on RepRisk data		Analysis based on RepRisk data, combined with insights gained in ECOFACT's consulting practice	
		RepRisk runs the most comprehensive database on environmental, social and governance (ESG) risk. RepRisk systematically collects and analyzes negative incidents, criticism, and controversies about companies and projects worldwide, and offers information on activities related to human rights violations, breaches of labor standards, corruption, environmental damage, and violations of international standards. www.reprisk.com		The grades take into consideration the degree of reputational risk to financial institutions that is associated with investments in the subsectors mentioned. **An "A" indicates that transactions related to this topic present comparably low reputational risk, while an "E" indicates high reputational risks.**	
		Level of controversies # of RepRisk risk incidents per quarter and trend of the last three months† DJF MAM JJA SON	**FI exposure** Share of news criticizing banks and / or insurers	**ECOFACT summary**	**ECOFACT risk rating**
Agriculture	Mono-cultures	-17%	20%	Deforestation, loss of biodiversity, excessive pesticide use, genetically modified crops, negative effects on the livelihoods of local communities, violations of indigenous peoples' rights, land-grabbing, and child labor are some of the issues with which large monocultures of such commodities as tea, cocoa, rubber, soy, sugar, and other biofuels are often associated. Projects not complying with best sustainability practices may expose FIs involved with monocultures to high reputational risks.	C
Agriculture	Palm oil	-39%	39%	The palm oil sector is the subject of severe criticism owing to issues such as deforestation, threats to endangered species, and poor working conditions. NGOs, and even companies, increasingly deem the Roundtable on Sustainable Palm Oil's (RSPO) current certification scheme to be insufficient. It remains to be seen if recently adopted changes, such as zero deforestation requirements and a ban on peat removal, will strengthen the framework and increase acceptance by NGOs. FIs involved with palm oil companies perceived as non-compliant with best practices face considerable reputational risks.	D
Defense	Cluster munitions	N/A	33%	Many FIs have policies stating that they do not offer financial services to manufacturers of cluster munitions. Regulations banning investments in cluster munitions manufacturers have been implemented in some countries and are being discussed in others. FIs that do not have such policies or fail to implement them thoroughly are subject to major reputational risks.	D
Forestry	Pulp and paper	-16%	0%	The overuse and contamination of water, environmental pollution, and the ensuing health risks for local communities are some of the concerns faced by pulp and paper companies. In addition, the sector's supply chain is frequently associated with unsustainable practices, including deforestation and land-grabbing. Sustainability certification schemes are often criticized for being inadequate or lacking enforcement mechanisms. FIs linked to companies engaged in operations viewed as unsustainable face significant reputational risks.	C
Mining	MTR mining	0%	0%	While few coal mining companies still engage in mountaintop removal (MTR) mining in the United States, the MTR method continues to face opposition from NGOs and locals owing to its severe impact on the environment and communities' health. Many FIs have either excluded MTR companies from their portfolios or committed themselves to phasing out their involvement. FIs failing to pursue such an approach expose themselves to high reputational risks.	D
Mining	Seabed mining	0%	0%	With rights granted for growing numbers of seabed mining projects, the sector seems to be gaining momentum. While the International Seabed Authority (ISA) is working on regulations to manage deep-sea mining, these are deemed insufficient by the International Unions for Conservations of Nature (IUCN). Scientists, environmentalists, and industry representatives are highly concerned about the unknown consequences seabed mining could have for marine ecosystems. NGOs have already warned FIs against involvement in such projects, and some countries have imposed temporary moratoria. Any FI associated with seabed mining companies or projects will thus face considerable reputational risks.	D
Oil and gas	Arctic drilling	-50%	0%	Environmentalists maintain that Arctic drilling is too risky for oil and gas development, and local communities are concerned about the impact the practice may have on their livelihoods. The Trump administration has initiated the process of opening the national Arctic wildlife refuge to oil and gas drilling. Increasing numbers of FIs are explicitly excluding involvement in Arctic drilling projects. Any institutions that do not pursue an exclusion policy or are associated with companies engaged in Arctic drilling will be exposed to high reputational risks.	D
Oil and gas	Deep sea drilling	-100%	0%	NGOs are concerned about the risks of accidents and oil spills from offshore drilling and their consequences for surrounding ecosystems. Opposition from NGOs and local communities is particularly strong in ecologically or economically valuable areas. New projects launched in such zones will involve reputational risks for FIs.	C
Oil and gas	Hydraulic fracturing	-14%	0%	Oil and gas companies continue to face criticism for the impact of fracking activities, such as excessive water consumption, the risk of ground-water contamination, and a suggested link between fracking and increased seismic activity. The practice is opposed by communities in large parts of Europe, where some countries have introduced temporary bans. Some banks have announced that they will limit their associations with fracking companies. FIs involved in fracking and related infrastructure projects face reputational risks.	D
Oil and gas	Oil sands	-58%	80%	The development of oil sands and oil pipeline projects continues to be opposed by communities and civil society groups owing to concerns about their environmental and social impact, including climate change, pipeline safety, and their effect on indigenous peoples' rights. FIs involved with oil sands producers or related pipeline projects face significant reputational risks. Moreover, some FIs partially exclude oil sand projects and/or companies from their portfolios.	E
Utilities	Coal-fired power	-26%	14%	Coal-fired power remains highly controversial due to its impact on human health and the environment, and particularly to its contribution to climate change. FIs involved in financing coal-fired power plants or associated companies are often targeted by NGOs. Increasing numbers of FIs are distancing themselves from coal-fired power projects and companies.	E
Utilities	Large dams	-43%	9%	Large-scale resettlements, severe impacts on ecosystems and the livelihood of local communities, including indigenous peoples, are some of the concerns associated with large-scale hydropower projects. If located in sensitive areas, projects often face strong opposition from communities and NGOs. FIs, especially development finance institutions, are regularly implicated in criticism of such projects.	D
Utilities	Nuclear power	0%	5%	Nuclear power remains a highly controversial sector, the subject of concerns regarding safety risks, radioactive contamination, and the management of nuclear waste in the absence of permanent disposal facilities. These concerns are not restricted to areas of limited regulatory supervision, and FIs involved in new nuclear power plants face reputational risks, regardless of project location.	E

†The green / red arrows mean that the number of RepRisk risk incidents has fallen or risen by more than three risk incidents in the last three months, whereas the orange arrow means that the change in the number of RepRisk risk incidents in the last three months has been smaller than three.

High-risk sectors

Oil & Gas · Mining · Forestry · Agriculture · Utilities · Chemicals · Other

Risk factor

US safety rules on oil rigs repealed

The Trump administration has rescinded offshore drilling safety regulations put in place after the Deepwater Horizon oil rig disaster in 2010 that killed 11 people and caused the worst oil spill in American history. The US Department of the Interior's Bureau of Safety and Environmental Enforcement (established to regulate offshore drilling after the spill in the Gulf of Mexico) has completed a proposal to ease these regulations, as part of efforts to relieve fossil fuel companies of "unnecessary burdens" and to boost domestic energy production. The changes promise to maintain safety standards. Advocacy groups such as Oceana counter that these new relaxed regulations amount to a self-policing mandate that will give a green light for those who prioritize profits over safety, creating a direct threat to coastal communities and marine life most at risk from devastating oil spills. September 27, 2018.

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Risk factor / Best practice

Are green resources fueling conflict in the transition to low carbon?

The tools set to promote a low-carbon economy, such as wind turbines and solar panels, still require substantial amounts of minerals and metals to function, and unless an alternative technological breakthrough is imminent, these resources must come from traditional mining. According to the International Institute for Sustainable Development (IISD)'s 2018 report entitled Green Conflict Minerals: The fuels of conflict in the transition to a low-carbon economy, this demand will threaten the fragile quest for peaceful, sustainable development in countries with strategic reserves. There is a real danger that mineral extraction will cause conflict, so it is essential that steps be taken now to develop a competent, transparent mining supply chain. Drawing on mapping analyses, stakeholder consultation, case studies, and prior mineral supply chain governance mechanisms, the IISD advises that civil society, the private sector and governments take concerted action. August 2018.

Read more | The report

Risk factor

NGOs to World Diamond Council: human rights obligations should not be voluntary

The World Diamond Council (WDC) is promoting its recent consensus on planned reforms to the Kimberly Process (KP), an initiative to certify diamonds as conflict-free, and their System of Warranties (SoW) Guidelines, a self-regulated consumer assurance of responsibly obtained and processed diamonds. The WDC intends to expand its KP definition of conflict diamonds to incorporate "human security and environmental concerns" and has also adopted reforms to its SoW. However, several NGOs have pointed out that the SoW directly states that companies should respect human rights in a "voluntary" manner, and this directly contradicts international standards such as the OECD standard for responsible sourcing and trading of minerals. The groups were critical of the WDC, calling the revisions a "token attempt" to address criticism. November 12, 2018.

Read more (1) | Read more (2)

Risk factor

Investor Alliance for Human Rights calls for tougher jewelry industry standards

Following the level of supply chain abuse reported by Human Rights Watch in February 2018, the Investor Alliance for Human Rights has called for an industry-wide review of policies and practices. The Alliance asks that the Responsible Jewellery Council set higher quality protocols on responsible sourcing within the jewelry supply chain in order to match UN Guiding Principles on Business and Human Rights and OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. September 25, 2018.

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Risk factor

If Brazil removes protection of the Amazon, asset managers may hold the key to influencing the rate of degradation

Brazil's incoming president, Jair Bolsonaro, has suggested the removal of legal environmental protection for the Amazon. It remains to be seen if he will follow through on this proposal. However, if protection is eliminated, agriculture could consume additional forested areas. A study published in Global Environmental Change pointed out that "Financial Giants", through ownership, could influence economic activities as well as collaborate to have a potential impact on climate change. BlackRock, State Street, and Vanguard were identified as having "major holdings" in Brazil's soy and beef industry. These US funds could steer corporate behavior through engagement, voting, and divestment. According to Victor Galaz, Deputy Director and Associate Professor at Stockholm University's Resilience Centre, "Considering the political situation in Brazil, finance will become a very important aspect in trying to protect the Amazon." November 8, 2018.

Read more | Paper

Risk factor

New report lifts the lid on animal abuse in farms across Europe

A landmark report has called for the immediate end to abusive farming in Europe. The report, entitled Animal welfare in the EU: closing the gap between ambitious

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goals and practical implementation, was prepared by the European Court of Auditors (ECA) and highlights the widespread maltreatment of animals in rural Europe. Intensive farming methods that place profit above animal welfare squeeze high volumes of animals into close quarters. Such overcrowding causes excessive pecking, cannibalism, aggression and biting. Rather than reduce numbers, farmers perform painful physical alterations like beak trimming, tail docking, castration and teeth clipping. They also engage in brutal slaughterhouse and live animal transport management. With 40 percent of smaller EU farms excluded from regulatory control, the report calls for stronger enforcement and compliance. The European Commission has accepted most recommendations, and legislative actions may follow. November 15, 2018.

Why we think it matters: Slaughter-houses are not only criticized for animal mistreatment but have also been linked to psychological and physical effects on their workforce. Apparently, slaughterhouse work has been linked to post-traumatic stress disorder, with undercover video evidence gathered by workers revealing animal cruelty. Worker-related domestic violence is prevalent, as is alcohol and drug abuse. Finally, there's the physical toll. The UK Health and Safety Executive has cited the slaughter industry as having the highest injury rates in all UK jobs. In their six-year study, the UK Health and Safety Executive found that 800 UK abattoir workers had suffered serious injury, with 78 requiring amputations and four dying at work.

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Best practice

RSPO adopts full ban on palm oil deforestation

The Roundtable on Sustainable Palm Oil (RSPO) has adopted new, global standards for zero deforestation, banning its member companies from clearing any forest in areas required to maintain or enhance High Conservation Values (HCVs). The new standards also introduce a ban on new planting on peat, regardless of depth, after November 2018. Previously, RSPO-certified companies could clear secondary forests and peat forests with a peat layer no deeper than three meters. While certain institutional investors have pushed for a blanket ban, environmental activists remain wary, noting that enforcement of the certification body's standards has historically been lax. November 16, 2018.

Why we think it matters: Strict enforcement of the new zero-deforestation standard will be key to enabling financial institutions and other stakeholders to continue to use RSPO as their benchmark for sustainable palm oil amid a consumer and commercial backlash against palm oil. This is particularly important, as existing zero-deforestation pledges have been criticized in the Zoological Society of London's analysis of palm oil companies – using SPOTT, its Sustainability Policy Transparency Toolkit – as being either shortsighted or not checked, let alone enforced. Furthermore, companies define deforestation in a variety of ways. This means that more than half of zero-deforestation commitments have been ignored in certain types of intact or secondary forests.

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Risk factor

Launch of SPOTT rubber, an online transparency tracker

A new Sustainability Policy Transparency Toolkit (SPOTT) designed to evaluate natural rubber production is being developed by the Zoological Society of London (ZSL) and is to be launched in the fall of 2019. Whereas the small-scale plantation ecosystem that has been prevalent in the natural rubber industry is thought to have lower social and environmental impact, poor management of rubber crop chemical processing can nevertheless cause pollution, health problems, and poverty. Moreover, the rapid expansion of large-scale natural rubber monocultures in southeast Asia in the past three decades has resulted in the loss and degradation of biodiversity. To respond to these social and environmental impacts, greater industry transparency is needed to bring about effective change. As yet, there is no overarching sustainability certification standard applied specifically to natural rubber. SPOTT Rubber will begin by targeting those that pose the most risk – private-sector companies with large-scale rubber plantations. October 24, 2018.

Read more

Risk factor / Regulation

EU supports France's bid to ban deforestation imports by 2030

Following France's initiative to ban the import of soy, palm oil, beef, wood and other products linked to deforestation by 2030, the European Parliament has committed itself to a new suite of clean energy laws designed to help sever Europe's economic ties to unsustainable agriculture practice worldwide. According to the initiative, Europe's agricultural import trade is responsible for more than a third of global deforestation. Plans to address this legacy include a commitment to increasing the EU's use of renewable energy and to banning the sale of high-emission biofuels. Frameworks are being developed to help European companies ensure that their trade is free from violations of land tenure rights and that it does not contribute to a decline in biodiversity. November 14, 2018.

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High-risk sectors

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Risk factor

Environmentalists slam the EPA's support for Trump's controversial wood power policy

Environmentalists are concerned that the Trump administration has endorsed burning trees and other biomass products, despite scientific evidence that this practice is even more destructive than coal. Allied with US Energy and Agriculture, the Environmental Protection Agency has sent a letter to Congress encouraging biomass. Their rationale is that wood-burning power plants are carbon-neutral when partnered with managed regrowth programs. The EPA also defends biomass power as promoting growth in US farm jobs as well as air quality. Utilities credits have been proposed for producers swapping coal for biomass, easing an Obama-era halt on emissions from electricity. Environmentalists challenge this, saying it takes decades, even centuries, for the biomass lifecycle to release carbon dioxide formerly caught inside plants. Even the EPA's own scientific advisors warn that it is dangerous to assume that biomass power is carbon-neutral. November 2, 2018.

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Risk factor

Polish energy company faces world's first court action for climate risk

In a world first, Polish energy company Enea is facing a legal challenge for pushing ahead with a controversial coal power plant despite warnings that the power plant is unsustainable and will be unprofitable NGO ClientEarth (a minority shareholder in Enea) has challenged the company for failing to manage material climate-related financial risk when making a major investment decision. Action focuses on monetary risks posed by the decision to build the EUR 1.2bn, 1GW Ostrołęka C coal power plant despite rising carbon prices, the availability of cost-effective renewables, and EU energy reform. November 2, 2018.

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Risk factor

Southeast Asia fossil-fuel power plants incompatible with UN climate goals

Most of Southeast Asia's fossil-fuel plants emit too much carbon. A new study by the University of Oxford analyzes the amount of carbon expected to be emitted over the lifespan of the plants. Those estimates are then compared to how much carbon can be released without the planet reaching catastrophic temperatures. According to these rigorous evaluations, mass closures are required even if they hamper efforts to bring power to developing nations. Furthermore, the report warns that at least half of planned fossil fuel power plants in Southeast Asia also fail to meet the emissions thresholds. October 18, 2018.

Read more → The report →

Risk factor

Renewable energy sector fails to protect human rights

Only five of 59 major solar, bioenergy and geothermal companies have basic measures in place to protect communities and workers within their projects. Nearly 50 percent have no basic protection, according to analysis by the Business & Human Rights Resource Centre (Resource Centre). This finding follows similar analysis of the wind and hydropower sectors, which also fails to provide adequate mechanisms for human rights risk management, community consultation, labor rights, grievance mechanisms, and supply chain monitoring. The Resource Centre believes that the transition to renewable energy will be possible only if suppliers act responsibly. Its latest research shows that failure to consider human rights risks is causing project delays, legal issues, higher costs, and increased risk to investor capital. September 5, 2018.

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Risk factor

Warnings of inadequate digital risk management

The information and communication technology (ICT) sector has faced intense scrutiny over its poor global record on human rights. A recent ICT sector briefing prepared by the Business & Human Rights Resource Centre notes issues regarding violence and the local repression of community expression, arbitrary detention, torture, killings, political intimidation, and threats, as well as possible infringements of privacy, labor and land rights, poor working conditions, and displacement. Similarly, the 2018 Ranking Digital Rights survey identifies poor disclosure as an ongoing risk indicator in the ICT sector. Few firms conduct risk assessments that consider the potential negative impacts of their activities. In view of these concerns, the Corporate Human Rights Benchmark (CHRB) has launched a new online consultation service that sets a benchmark for human rights risk management in the ICT sector. October 30, 2018.

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Risk factor

Energy cost of "mining" bitcoin over double that of copper or gold

New research from the Oak Ridge Institute in Cincinnati, Ohio, shows that crypto-currencies require more electricity use per dollar "mined" than the cost of mining the same value of copper, gold or platinum. Institute researchers rate the energy required for mining copper, gold and platinum as four, five and seven megajoules for every dollar spent, whereas it takes 17 megajoules of energy to mine one dollar's worth of bitcoin. A new paper, entitled *Quantification of energy and carbon costs for mining cryptocurrencies* by researchers Max J. Krause and Thabet Tolaymat, theorizes that virtual costs central to bitcoin, ethereum and similar projects are more akin to real mining than initially realized. November 16, 2018.

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High-risk sectors

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Risk factor

Thousands of ships could dump pollutants at sea to bypass dirty fuel ban

Industry analysis shows that in the rush to meet a 2020 deadline to use cleaner (lower-sulfur-content) shipping fuel set by the International Maritime Organization (IMO), thousands of ships are fitting an exhaust gas cleaning system known as a scrubber instead of buying higher-cost clean fuel. Scrubbers allow maritime operators to continue to purchase cheaper high-sulfur fuel, which is then washed onboard. A commonly used system, known as open-loop, dumps the waste water at sea. October 29, 2018.

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Best practice

Financial task force backs Duke of Cambridge's wildlife trade embargo

Key financial institutions have co-signed a pact – the Mansion House Declaration – with the Duke of Cambridge to disrupt the illegal trade in wildlife products. Signatories agree to share resources and intelligence aimed at disrupting any illegal income created from poached animal products such as elephant tusks, rhino horn and pangolin scales. Illegal wildlife trade (IWT) is a global racket worth an estimated USD 23 billion annually, connected to money laundering, corruption, extreme violence, illicit drugs, and, weapons trafficking. The declaration is a commitment to "not knowingly facilitate or tolerate financial flows derived from IWT and associated corruption." The task force convened by His Royal Highness (via his charity United for Wildlife, as run by The Royal Foundation), will feature an initial cluster of 30 global banks and financial organizations, including Standard Chartered, HSBC, RBS and Bank of America, as well as agencies and regulatory bodies such as TRAFFIC and RUSI. October 10, 2018.

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Emerging risks

Risks that may become material in the near future or are relevant when looking into a company's business model, but are not yet considered as highly significant risks from a financial institution's reputational risk perspective, or are not related to a high-risk sector.

Climate Change

→ No G20 country achieving climate targets; action needed before 2030

In the *Brown to Green Report,* Climate Transparency compares G20 countries to each other, as well as collectively, against 1.5°-C and 2°-C benchmark climate change scenarios. Emissions around the world need to be halved by 2030 to meet the 1.5°C objective. Only India has set targets that would, in theory, keep temperatures below 2°C. Jointly, G20 countries continue to use fossil fuels for 82 percent of energy needs. Based on current efforts, the planet is heading for a 3.2°-C temperature rise. The Intergovernmental Panel on Climate Change (IPCC) issued a special report on global warming of 1.5°C that warns of the increased risk of extreme drought, fire, flood, and shortages of water and food as soon as 2030. Despite high-level commitments to change, the window for action is "closing rapidly" and will require increasingly radical and urgent tactics. November 14, 2018.

Why we think it matters: The Principles for Responsible Investment (PRI) is warning investors and governments that significant negative effects on the "global economy, societies and investment portfolios" can be expected if more action is not taken to meet the 2-degree goal. The longer it takes for adequate policy response, the more disruptive and "forceful" the actions will need to be; this is predicted to cause large-scale volatility in capital markets.

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→ OECD cautions: Current carbon prices too low to have an impact

An Organisation for Economic Co-operation and Development (OECD) report highlights the finding that countries are failing to price carbon high enough to affect climate change. Most industrial, residential, and commercial emissions are underpriced. In Effective Carbon Rates 2018: Pricing Carbon Emissions through Taxes and Emissions Trading, the group compares actual carbon prices from 42 countries to real climate costs. It finds that, at current rates, the slowly rising prices will not meet real cost until 2095 – which is insufficient to meet targets. September 18, 2018.

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Expect more litigation on climate change, says lawyer

Highlighting the Intergovernmental Panel on Climate Change (IPCC)'s special report on global warming, lawyers are warning governments that they should expect to see increased litigation aiming to hold them accountable for damage caused by climate change. Reportedly, there are more than 1,000 cases of this nature filed worldwide, with 20 of them directly naming companies as defendants. Many plaintiffs are farmers whose livelihoods are threatened by extreme weather events and rising sea levels. One highlighted landmark case was filed against the EU on behalf of 11 families in May 2018. The interesting aspect of the case is the fact that the plaintiffs are not seeking financial compensation, but are instead asking the EU to cancel its emission trading scheme directive, effort-sharing regulation, and the regulations governing land use, land use change and forestry, as they "violate the plaintiffs' rights and are not in line with higher-ranking law […]. They want the EU to adjust its climate target." October 25. 2018.

Read more → IPCC report →

Air pollution

Serious air pollution health threat requires action, says WHO

The World Health Organisation (WHO) warned that at least 7 million people die annually from exposure to toxic air and that the damage caused is particularly harmful to children. Global death rates from air pollution have overtaken those of tobacco. With more than 90 percent of the world's population exposed to air pollution, the "epidemic of needless, preventable deaths and disability" requires immediate action, says Dr. Tedros Adhanom Ghebreyesus, WHO's Director-General. The World Bank has reported that the economic cost of this problem probably amounts to USD 5 trillion per year. In addition to the established connection between air quality, heart attacks and lung disease, new research has found links between poor air quality and diabetes as well as lowered intelligence. Pollution particulate matter has also recently been discovered in the placenta tissue of mothers. Given the cost of this problem, it has been pointed out that a lack of political action will be harshly judged by future generations. October 27, 2018.

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Business case

Information that underlines the business case for environmental and social risk management in financial institutions.

Tobacco-free commitments paying off

Global tobacco-related deaths have been pegged at more than 7 million per year, and the industry is being criticized for its impact on the environment. Launched by the UNEP FI in September 2018, the Tobacco Free Finance Pledge has already garnered 130 signatories. It aims to encourage "comprehensive global tobacco control efforts" through financing pathways (lending, insurance, investment). Supporters include AP4, BNP Paribas, Natixis, AXA, Robeco, and the UN Joint Staff Pension Fund. Since 2016, tobacco stocks have underperformed by 40 percent, and Swedish pension group AP4 reported that it was pleased with the improved performance of its holdings since its divestment of tobacco stocks in 2016. "By participating in this initiative, we hope to prove to others that it is profitable to integrate sustainability aspects into investments," said Niklas Ekvall, AP4's Chief Executive. November 13, 2018.

Read more (1) → Read more (2) → The pledge →

New research on the environmental and social impact of sustainable investing

While investors are increasingly considering the environmental, social, and governance (ESG) performance of their investments, research on sustainable investing to date has largely focused on their financial performance. Whether sustainable investing actually has a positive environmental and social impact is a question that has only recently been addressed by researchers at the universities of Zurich and Hamburg. The results of their literature review suggest that a number of approaches can increase investors' environmental and social impact. These include intensifying engagement efforts, focusing on widely shared priority issues, and ensuring that these issues are consistently assessed. Capital allocation strategies are more likely to be effective when companies depend on external capital for growth. However, the review did not identify influencing companies indirectly through intermediaries as a promising approach. November 28, 2018.

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→ Australian NCP scolds ANZ Banking Group for violating human rights standards

Responding to a complaint against ANZ Banking Group, the Australian National Contact Point (NCP) for the OECD Guidelines issued a statement admonishing the bank for ignoring its own policies and recognized human rights standards when it loaned USD 40 million to Phnom Penh Sugar, a Cambodian sugar producer, in 2011. British media had covered the company's land grabs, forceful displacement of locals, and employment of children. ANZ maintains that it terminated its relationship with Phnom Penh Sugar in 2014 following failed attempts to stimulate change within the company. However, the bank's assertion was contested by the plaintiffs, who reported that the bank severed its financial ties only when public awareness and pressure grew. The NCP was criticized for not requiring the bank to make reparations for the harm it had caused to the 681 families named in the complaint. October 11, 2018.

Read more → NCP statement →

→ EU passes "historic" due diligence requirements for financial investment

The EU Parliament's cross-party acceptance of the proposed regulation, *Disclosures relating to sustainable investments and sustainability risks,* indicates widespread support for increased transparency and communication with regard to environmental, social, and governance (ESG) risks in investment. Promoted as a way of encouraging ethical behavior in finance by reorienting private capital, the initiative follows guidelines set in the OECD's Due Diligence for Institutional Investors. If accepted by member states, investors and investment services would have to identify, avoid or mitigate, account for, and communicate ESG risks, whether actual or potential. Acceptance of the initiative at parliamentary level signals acknowledgement of the need for better due diligence and a framework to support it. November 5, 2018.

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ECOFACT Policy Outlook users can find additional information **here**

Policy Outlook, a monitoring and implementation package, covers regulatory change pertaining to ESG and corporate responsibility issues. Click **here** for further information.

→ UK: Banks and insurers will have to account for impact on climate change

A pair of papers published by the Bank of England's Prudential Regulation Authority (PRA) and the Uk's Financial Conduct Authority (FCA) each look at the risks of climate change and the opportunities offered by green finance. In the FCA discussion paper, the group solicits public and institutional opinions on the development of climate risk reporting requirements, the growth of green finance, and the types of information that should be provided to investors about the financial impact of climate change. The FCA also plans to start consultations on climate-related rules for contract-based, defined-contribution pension schemes in early 2019. The PRA consultation paper presents a draft supervisory statement (SS) on "banks' and insurers' approaches to managing the financial risks from climate change." Expecting firms to understand how climate change will affect their business, the PRA is asking for feedback on what kind of risk measurement and public disclosure should be implemented. October 16, 2018.

Read more (1) → Read more (2) → Read more (3) → Read more (4) → FCA paper → PRA paper →

Peer approach

New sector and issue policies that financial institutions have recently adopted. The table below gives an overview of the number of sector and issue policies produced by financial institutions.

→ IFC position statement condemns reprisals by clients against those who voice opinions

Human rights groups have applauded a position statement released by the International Finance Corporation (IFC). The statement represents a formal refusal to tolerate reprisals, including "threats, intimidation, harassment, or violence," by clients of the IFC against individuals and/or communities that speak out against IFC-related projects or activities. NGOs have called for the next step to involve comprehensive, proactive engagement protocols. It has been noted that development banks are beginning to respond to the occurrence of targeted attacks on human rights defenders opposed to development projects. One NGO spokesperson suggested that financers will have to "reconfigure their development models and modes of stakeholder engagement" to tackle power imbalances. November 12, 2018.

Read more (1) → Position statement →

→ Five principles for a responsible civilian firearms industry

Developed by an alliance of institutional and private investors with combined assets of more than USD 4.83 trillion, the Principles for a Responsible Civilian Firearms Industry is a pragmatic framework that is attempting to engage firearm-affiliated companies with regard to gun safety and risk management from a financial perspective. "This is not a political statement about constitutional rights; it is a joint assertion by all of the involved signatories that investors have a stake in advancing public safety," said California State Teachers' Retirement System's Chief Investment Officer, Christopher Ailman. Described as an "engagement solution to divestment and meant to stimulate productive dialogue," the principles are voluntary in nature and open to any investor who wishes to become a signatory. November 14, 2018.

Read more (1) → Read more (2) →

→ UNEP FI to develop risk assessment tools for insurance industry

In order to integrate the Financial Stability Board (FSB)'s Task Force recommendations on Climate-related Disclosures (TCFD), the United Nations Environment Programme Finance Initiative (UNEP FI) has announced its intention of developing analytical tools for the insurance industry's climate risk disclosures. "An uninsurable world is a price that society could not afford," said UN Environment chief, Erik Solheim. The tools will be built using scenario analysis, assessment of physical and transition risks, and refer to the most recent findings in climate science. This set of tools will focus on core insurance portfolios and products. November 13, 2018.

Read more →

→ ING institutes "Terra approach" to measure portfolios and steer lending to support climate change action

In partnership with 2° Investing Initiative (2°ii), ING has developed an open-source, science-based methodology for setting and measuring the extent to which portfolios can have an impact on the climate. Built over several years, the "Terra approach" aims to help all banks finance the kind of change needed to move towards a low-carbon economy and meet the Paris Agreement goals. It will enable the sector to adopt a customized approach, and will focus on those sectors that emit the highest levels of greenhouse gases (energy, including oil, gas, renewables and conventional power; automotive, shipping, and aviation; steel, cement, residential mortgages, and commercial real estate). By delivering information on "what needs to shift, [by] how much and by when," the bank's EUR 600 billion lending portfolio will be evaluated and steered towards financing technologies that will have an impact. The approach relies on data collated from global databases that track public and private-sector companies. September 14, 2018.

Read more (1) → Read more (2) → Read more (3) →

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➔ Sector and issue policies adopted by insurers

(A) indicates the number of insurers among the 9 Systematically Important Insurers which have adopted a policy, guideline, or commitment addressing the corresponding sector or issue for their investments. (B) indicates the number of insurers which have adopted a policy, guideline, or commitment addressing the corresponding sector or issue in underwriting. Only the sectors or issues covered by policies are included in the table.

Sector policies	A	B
Agriculture	2	1
Palm oil	2	1
Tobacco	2	2
Forestry	2	1
Infrastructure	1	1
Defense	3	1
Cluster munitions	5	1
Metals and mining	1	1
Coal mining	3	2
Oil and gas	1	1
Arctic drilling	1	1
Oil sands	1	1
Utilities	-	-
Hydropower	1	1
Nuclear power	1	1
Coal-fired power	3	2

Issue policies	A	B
Climate change	5	4
Agricultural commodities	2	1
Human rights	5	5
Child labor	2	1
Forced labor	2	1
Indigenous peoples' rights	1	1

This table includes the 9 global systemically important insurers (G-SIIs) according to the Financial Stability Board: Aegon N.V., Allianz SE, American International Group, Inc., Aviva plc, Axa S.A., MetLife, Inc., Ping An Insurance (Group) Company of China, Ltd., Prudential Financial, Inc., Prudential plc. Source: **fsb.org**

➔ Sector and issue policies adopted by banks

(C) indicates the number of banks among the 29 Systematically Important Financial Institutions which have adopted a policy, guideline, or commitment addressing the corresponding sector or issue and disclose its content. (D) indicates the number of banks which disclose that they have adopted a policy, guideline, or commitment, but do not disclose the corresponding content.

Sector policies	C	D
Agriculture (general)	8	5
Biofuels	3	2
Palm oil	14	2
Soy	7	3
Tobacco	2	-
Fisheries	5	2
Chemicals	4	3
Defense (general)	10	2
Cluster munitions	13	1
Nuclear weapons	10	2
Forestry (general)	15	3
Metals and mining (general)	10	5
Coal mining	12	4
Mountaintop removal mining	16	1
Oil and gas (general)	10	6
Arctic drilling	5	8
Fracking	7	5
Oil sands	8	8
Utilities (general)	10	5
Coal-fired power	13	2
Hydropower	13	1
Nuclear power	12	2

Issue policies	C	D
Biodiversity	1	3
UNESCO World Heritage Sites	14	1
Human rights	18	4
Indigenous peoples' rights	10	-
Water	2	2

This table includes the 29 Systematically Important Financial Institutions (SIFIs) according to the Financial Stability Board: Agricultural Bank of China, Bank of America, Bank of China, Bank of New York Mellon, Barclays, BNP Paribas, China Construction Bank, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, Groupe Crédit Agricole, HSBC, Industrial and Commercial Bank of China Limited, ING Bank, JP Morgan Chase, Mitsubishi UFJ FG, Mizuho FG, Morgan Stanley, Nordea, Royal Bank of Canada, Royal Bank of Scotland, Santander, Société Générale, Standard Chartered, State Street, Sumitomo Mitsui FG, UBS, Unicredit Group, Wells Fargo. Source: **fsb.org**

New tools and databases

This section presents new tools and databases that can help to identify or manage environmental and social risks.

→ New web tool identifies natural capital risks

The Natural Capital Finance Alliance (NCFA) has launched a pioneering tool to link environmental change with economic consequences. The online tool, called ENCORE (Exploring Natural Capital Opportunities, Risks and Exposure), will help global investors to rapidly identify the potential economic impact of environmental degradation. The tool frames the environment as a form of natural capital, a way of thinking about nature as a stock that provides a flow of benefits, including "ecosystem services" such as flowing water and clean air, to people and the economy. Assessment of the FTSE 100, one of the world's highest-profile indices, using ENCORE found that 13 of the 18 sectors that make up the index have a high (or very high) material dependence on nature. The three sectors most materially dependent on nature are agriculture, aquaculture and fisheries, and forest products. November 26, 2018.

Read more → Report → The tool →

→ Financial institutions join forces to develop methodology for biodiversity impact

ACTIAM, ASN Bank, and CDC Biodiversité, supported by Finance in Motion, have measured the impact of their loans and investments on biodiversity with a view to identifying common rules or concepts as starting points for any financial institution interested in assessing its biodiversity footprint. The researchers found that there is a great deal of common ground among the methodologies available, and have now shared their findings in a new report entitled *Common ground in biodiversity footprint methodologies for the financial sector.* Among other things, the group agrees that four steps are required to calculate a biodiversity footprint: (1) analyze the focus of the investment, (2) assess the pressures on biodiversity as well as (3) the impact on biodiversity, and (4) interpret the footprint results. November 18, 2018.

Read more → The report →

→ SASB releases sustainability accounting standards six years in the making

Called "an important milestone for capital markets," the Sustainability Accounting Standards Board (SASB) announced the publication of 77 standards that address specific industries from a financial materiality perspective. The first such standards of their kind, they are designed to be compatible with other sustainability frameworks such as the EU's directive on non-financial disclosures. Drafted over six years of consultation, the information the standards help to deliver is intended to facilitate decision-making for investors. November 7, 2018.

Read more (1) → Read more (2) → The standards →

→ Database of world's 120 top coal developers launched by NGOs

The Coal Plant Developers List (CPDL) has been updated for 2018, and the NGOs responsible for the list are raising the alarm about a 33-percent increase in coal plant development that would add 672,124 megawatts (MW) to global coal power production. Worldwide, 1,380 new coal plants are planned in 59 countries. The top three developers are China's National Energy Investment Group (NEI), China Huadian Corporation, and India's National Thermal Power Corporation (NTPC). The list is based on the quantity of planned megawatts (MW) of coal power, ownership based on equity, and is also weighted geographically to include all countries with projects over 300 MW. According to Heffa Schuecking, Director of German environmental NGO Urgewald, the list names the top companies that investors and banks should avoid if they are committed to limiting the rise in global temperatures. October 4, 2018.

Read more → Database →

→ Corporate Human Rights Benchmark releases 2018 rankings – average score is 27%

For the second year in succession, Corporate Human Rights Benchmark (CHRB) has evaluated 101 publicly traded companies in terms of human rights "policies, process, and practices." Companies from the apparel, agricultural product, and extractive sectors were measured against 100 indicators specified in the UN Guiding Principles on Human Rights. Applauding a small group of emerging leaders such as top scorers Adidas, Rio Tinto, and BHP Billiton, CHRB observes that "leading companies are beginning to gain greater access to cheaper capital, based on their lower human rights risks," and applying pressure to governments to raise the bar for corporate behavior. However, a quarter of companies scored under ten percent and two-thirds under 30 percent, indicating a large discrepancy between the few taking action and the many that are not making noticeable progress. November 12, 2018.

Read more (1) → Read more (2) → The benchmark →

→ Thailand publishes list of fishing vessels to combat illegal fishing, human rights abuses, and support regulation

In an attempt to make its fishery more transparent, Thailand has for the first time published a list of all vessels that are registered and licensed, providing registration numbers, owners' names, and ports of registration. This includes a "watchlist" of boats that have been sold to out-of-country buyers, are prohibited from fishing, and/or have been sunk or damaged. Thailand is the first Southeast Asian country to make this information publicly available. The fishing industry as a whole is known for its secrecy, which facilitates illegal fishing and human rights abuses. NGO Environmental Justice Foundation praised Thailand for this "progressive step." September 25, 2018.

Read more →

→ FAIRR Protein Producers Index helps identify best in class for meat, fish, and dairy

With an eye on sustainability issues, the new Coller Farm Animal Investment Risk and Return (FAIRR) Protein Producers Index has measured 60 intensive farming companies against nine risk factors aligned with the UN Sustainable Development Goals. Sixty percent of companies were found to be "high-risk" in terms of their overall management of sustainability. The best managed risk factor was waste management, while the worst was antibiotic management. The "worrying lack of ESG [environmental, social and governance] data availability and disclosure" from the sector is described as "a cause for concern". Aquaculture producers display the best reporting on critical sustainability risks. Greenhouse gas emissions reporting is "inadequate, unstandardized and unverified" across the sector, "putting the implementation of the Paris Agreement in jeopardy." Of the Asia-based companies examined, 94 percent are not managing risks or disclosing basic information. June 4, 2018.

Read more (1) → Read more (2) → Read more (3) → Read more (4) →

→ PRI guide to investing in the "just transition"

Climate change and the just transition: a guide for investor action was published by Principles for Responsible Investment (PRI) to help investors develop a strategic approach to investing that links environmental, social, and governance issues to responsible investment decisions. The term "just transition" used in the Paris Agreement indicates that the switch to a low-carbon economy needs to prioritize social inclusion, yet also happen rapidly. This document makes the case for investor action and suggests five things investors can do to ensure that a "just transition" becomes part of their core operating practices. Key priority steps are also proposed to "bring the just transition to life." October 11, 2018.

Read more (1) → Read more (2) →

→ Carbon Tracker develops way to estimate capacity of coal-fired plants in areas lacking data

The current distribution of satellites in space is capable of producing an image of anywhere on the planet to a resolution of 30 cm. A report from Carbon Tracker reveals findings from a new process that harnesses public and private satellite images and machine learning to estimate the capacity and utilization of coal plants. This information is of particular interest to investors and policymakers, as it illuminates areas in which this data did not previously exist, such as outside the EU and US. Hoping to facilitate more informed asset-level decision-making, Carbon Tracker notes that its model has close to 90 percent accuracy and could deliver insight on when coal plants should be decommissioned and the risk of becoming stranded assets. Using the satellite information, the group has taken a closer look at China's coal power situation, predicting that by 2021 it will be less expensive for China to build and operate onshore wind farms than run coal plants. The profitability of coal power will continue to fall in China, with the potential for that country to see a loss of USD 390 billion by 2040 if plants are not retired. October 11, 2018.

Read more →

→ Three new tools to help assess investments' climate risk

A trio of tools targeting investment decision-makers and climate risk has been issued. The first, a joint project between Principles for Responsible Investment (PRI) and California Insurance Commissioner Dave Jones, aims to reveal the extent of the gap between an investor's current portfolio holdings and the 2°C benchmark. The free, confidential, online tool is called the Paris Agreement Capital Transition Assessment (PACTA). Users can access multi-scenario analyses that show the transition risk exposure of their fixed income and equity portfolios. Confidential, custom reports can be generated that will enable users to tailor output by sector, region, climate scenario, and other indicators.

Read more → PACTA tool →

The Institutional Investors Group on Climate Change (IIGCC) has published a guide to help investors close the knowledge gap with regard to the analysis of climate change scenarios as it relates to their portfolio. Scenario analysis is one of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). While scenario analysis is an accepted risk management tool, its application to climate change is fairly new. *Navigating climate scenario analysis* presents a five-step framework, includes case studies, and could be useful in identifying risks and opportunities.

Read more → IIGCC analysis →

In *Addressing Climate Risks and Opportunities in the Investment Process,* the IIGCC has delivered a "comprehensive guide" for pension fund trustees and board members that encourages them to embrace current and forthcoming regulatory requirements mandating them to report on the impact of climate change on their investments. The majority of pension funds "have been shown to be unprepared," and this guide aims to maneuver senior decision-makers towards the advantages of low-carbon investments. November 22, 2018.

Read more → IIGCC risk report →

About this report

This briefing is tailored to the needs of individuals and teams in charge of assessing and controlling environmental and social risks in corporate banking, investment banking, and commercial insurance. It aims to provide an update on risks, standards, tools, and best practices that are relevant primarily from a reputational risk perspective.

The content is organized into four levels: each item of information is headed by a title which allows the reader to digest the report in less than five minutes. Subsequently, a brief abstract summarizes the key facts. Additionally, if appropriate, a short comment illustrates why this information might matter and, finally, a link to the original source allows the reader to drill down further into the subject.

Our research process consists of four steps: firstly, ECOFACT collects information from international newspapers and specialized periodicals. Secondly, the websites of the most relevant NGOs, international organizations, private and academic research centers, environmental and sustainability think-tanks, and government agencies are visited regularly. Thirdly, specialized newsletters to which we subscribe are screened, and finally, organizations in charge of international environmental and social standards are contacted.

Selection criteria for the content of the briefing: a) information on environmental and social risks that b) was published (in most cases) over the past quarter, and c) is relevant from the reputational risk perspective of a financial institution. The scope covers the ten principles of the UN Global Compact.

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ECOFACT has addressed the risks and opportunities that environmental, social and governance issues present to the financial sector since 1998. We work primarily for banks, insurers, institutional investors, and international standard-setters.

We help our clients to improve their understanding of credit, reputational, compliance and liability risks in the context of sustainability, ESG and responsible business conduct.

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We assist our clients in designing processes and conducting due diligence:

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ECOFACT hosts three events that facilitate knowledge sharing among peers and experts:

- The *Policy Outlook Conference* gives you the chance to join peers and experts from the fields of public policy, legal & compliance, corporate responsibility and sustainability in exploring how financial firms are addressing corporate responsibility regulations.
- The *Environmental and Social Risk (ESR) Roundtable* provides an opportunity for peers to discuss the challenges that arise as environmental and social issues are further integrated into financial institutions' business with corporate clients.
- The *Reputational Risk Management (RRM) Roundtable* is a platform for dialog and knowledge sharing on common and best practices in reputational risk management in the financial sector.

ECOFACT is a signatory to the *United Nations Global Compact* and the *Principles for Responsible Investment,* and a member of *Swiss Sustainable Finance.*

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Produced and distributed by ECOFACT AG, Stampfenbachstrasse 42, 8006 Zurich, Switzerland.
Tel: **+41 44 350 6060** | Fax: **+41 44 350 6020** | **contact@ecofact.com** | **www.ecofact.com**