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# ECO:FACT QUARTERLY

The briefing for E&S risk experts

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The ECOFACT Quarterly is a briefing on environmental and social risks relevant for the financial sector. This sample report includes the editorial, excerpts from three tables, and a limited selection of 11 news items from the 43 items featured in the full report. For information on subscribing to the ECOFACT Quarterly, go to the last page.

## Editorial

# OECD Specifies RBC Due Diligence Requirements

### **There are widespread misconceptions about the role that due diligence has to play in investment decisions.**

In asset management, responsible business conduct (RBC) is often seen as just one of several potential ESG strategies, such as best-in-class or impact investment.

However, none of these alternative ESG strategies ensures compliance with the OECD's due diligence guidelines,<sup>1</sup> under which **due diligence has a specific meaning for investors.**<sup>2</sup> It is defined as "a process for identifying, preventing, mitigating and accounting for so-called adverse impacts" related to "human and labor rights, the environment, and corruption" in investors' portfolios. Due diligence "should be **continuous and ongoing** and aimed at avoiding and responding to risks related to issues covered in the OECD Guidelines."

**The OECD expects investors to** a) implement due diligence for RBC, regardless of their ESG approach, and even if they have no ESG strategy at all; b) address adverse impacts, which requires them to go beyond simply mitigating risk in their portfolios; and c) implement appropriate systems within their institutions<sup>3</sup> in order to identify, prevent, mitigate and account for such impacts from any business activity that might be associated with those impacts in any way.

**The first RBC guidelines produced by the OECD for the financial sector address institutional investors. A second guide, currently in production, will focus on corporate lending and corporate finance.** The first expert working session for the new guide took place on March 13, 2018, in New York.<sup>4</sup>

While this type of OECD guidance is not legally binding, it does provide an important point of reference. The more granular the guidance that is created today, the easier it will be for the OECD's National Contact Points (NCPs) to assess financial institutions' business practices.<sup>5</sup> That guidance might also be used by regulators and courts as a benchmark for expected business practices in the future. **As in other areas, non-compliance with OECD guidelines will pose significant risks,** and might be seen as a deliberate decision, since both actions and omissions are considered to be "activities" in this context.

Aligning investment portfolios with OECD standards is therefore not merely a question of unlocking long-term value, but also a process that is essential to protect investors from risks. Due diligence for responsible business conduct is thus a requirement, and should not be taken lightly.

*Olivier Jaeggi*

#### References:

1. For details, see our article for the blog of the MIT Sloan Management Review (2016): What New OECD Standards Mean for Investors <https://sloanreview.mit.edu/article/investors-required-by-oecd-to-broaden-due-diligence/>
2. OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>
3. Merely defining policies and standards with which suppliers and business partners must comply is not sufficient to meet RBC requirements. The OECD has adopted an inward-looking approach, requiring institutions to implement due diligence to support their own decision-making.
4. We are honored to support this work; if you are interested in the process, please contact us at [info@ecofact.com](mailto:info@ecofact.com), and we will put you in touch with the OECD secretariat.
5. Financial institutions currently facing NCP complaints include Credit Suisse and ING.

# ECO:FACT QUARTERLY

The briefing for E&S risk experts

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**Commerzbank**

## 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.

### → First OECD expert working session on RBC guidance for corporate lending and corporate finance



On March 13, 2018, an OECD Expert Working Session on Responsible Business Conduct (RBC) took place in New York with the aim of working towards new RBC guidance for corporate lending and corporate underwriting. The meeting explored banks' practices in relation to the OECD Guidelines for Multinational Enterprises. Experts in finance and sustainability, human rights and environmental, social and governance (ESG) risk management were invited to share their knowledge and develop good practices that will be integrated into the OECD's work on Responsible Business Conduct in the financial sector. In particular, the sessions explored how leverage, severity of harm, complexities of various financing strategies, client characteristics, legal, policy and market contexts can affect banks' ESG due diligence processes in the context of corporate lending and underwriting transactions.

If you would like to know more about the project, please contact us at [info@ecofact.com](mailto:info@ecofact.com) and we will put you in touch with the OECD Secretary.

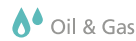
Coming soon:	Expected by:
World Bank: Environmental and Social Framework (ESF)	2018 (exact date to be determined)
OECD Due Diligence Guidance for Responsible Business Conduct	Scheduled for completion in 2018 Draft guidance available

## 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. <a href="http://www.reprisk.com">www.reprisk.com</a>	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*	FI exposure Share of news criticizing banks and / or insurers	ECOFACT summary	ECOFACT risk rating
		MAM JJA SON DJF			
Oil and gas	Oil sands		78%	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, and some FIs have already excluded oil sand projects and/or companies from their portfolios.	E
	Coal-fired power		15%	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 are often targeted by NGOs, irrespective of the location of such projects. Coal-fired power is also the focus of the fossil fuel divestment movement, and some FIs have announced that they will distance themselves from coal-fired power projects and companies.	E

## High-risk sectors



Risk factor



### LME to determine if child-mined cobalt may be traded on the exchange

In view of complaints that cobalt mined using child labor is being traded on the London Mineral Exchange (LME), the group is looking into the claims and has directed all suppliers to detail how they assure the “responsible sourcing” of all traded commodities. Cobalt, particularly if mined in the Democratic Republic of Congo (DRC), has been linked to child labor, with children as young as seven observed in active mines. Cobalt, used in the manufacture of batteries and other electronics, has seen growing demand and an increase in value. More than half the world’s cobalt supply comes from the DRC, which is known for its vast deposits and contentious human rights and labor issues. November 23, 2017.

Read more (1)



Read more (2)



Read more (3)



Read more (4)



Best practice



### Aluminum value chain certification program launched

With a view to promoting the responsible

production, sourcing, and stewardship of aluminum, the Aluminium Stewardship Initiative (ASI) has introduced a program of certification that covers all aspects of the value chain and is measured against the group’s standards, which include a Performance Standard and a Chain of Custody Standard. The fifty-eight members of the non-profit, multi-stakeholder organization can now apply for certification, which is awarded after consideration of such sustainability issues as greenhouse gas emissions, waste management, material stewardship, biodiversity, and human rights. Growing demand for the highly recyclable metal is being fueled by the construction, electronics, packaging, and transport industries. The first ASI-certified aluminum is expected in late 2018 or 2019. December 15, 2017.

Read more



ASI Standards



Risk factor



### Financial industry asked to set rules for gun sales in the USA

With the student movement against gun violence gaining traction after the recent school shooting in Parkland, Florida, and the Trump administration showing no

intention of changing US gun laws, it is now incumbent on the business community to assume responsibility and step into the void. While some businesses announced years ago that they would not allow their services to be used to sell firearms, the financial industry is now being asked “to step off the sidelines and take a stand” – since it is seen as having “more leverage over the gun industry than any lawmaker.” The financial industry in the USA is, indeed, reacting: Bank of America has stated that it will ask gun manufacturers how they can help to end mass shootings, BlackRock has announced that it will contact gun companies to “understand their response to recent events,” and the First National Bank of Omaha will not renew a contract for a Visa card that is branded with the National Rifle Association (NRA) logo. February 19, 2018.

Read more (1)



Read more (2)



Read more (3)



## 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

### → Globally, lawsuits involving climate change predicted to multiply in 2018

A March 2017 survey by UN Environment and Columbia Law School found 900 climate change-related legal cases in 24 countries, and the number is expected to grow in 2018. Organizations and individuals are increasingly turning to the courts to hold governments and businesses to account for climate-change issues. Depending on outcomes, the rulings have the potential to “reshape the roles and responsibilities of governments and businesses in tackling climate change,” as well as to release a surge in similar claims. Judges around the world have apparently displayed a strong interest in hearing arguments that governments and companies are responsible for climate change, and should reduce – and pay – for its impact. December 28, 2017.

Read more (1)



Read more (2)



Read more (3)



## Business case

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

### → New sustainable finance roadmap released by group in the European Commission

The European Commission's High-Level Expert Group on Sustainable Finance (HLEG) recently released a new report that sets out to support sustainable investments by outlining strategic recommendations for financial systems. The European Commission will complete its strategy on sustainable finance based on the recommendations, and hopes to use the plan to promote the transition to a low-carbon economy and reduce the risks financial institutions face from climate change. Some NGOs, such as Global Witness, ActionAid, and Friends of the Earth, have stated that while these steps are important, they believe the European Commission needs to take other regulatory action in order to ensure that Europe's financial sector has regulatory safeguards. January 31, 2018.

[Read more \(1\)](#) → [Read more \(2\)](#) → [The report](#) →

### → Research shows ESG characteristics contribute to financial value in a variety of ways

The Applied Equity Research department of research company MSCI has looked at the influence of environmental, social, and governance (ESG) characteristics on stock performance. Noting that "correlation does not imply causation," the group was interested in the relationship between corporate financial performance and the strength of a company's ESG qualities. They investigated "how ESG information embedded within stocks is transmitted to the equity market." The group found that ESG factors affect valuation and performance through systemic risk profiles and idiosyncratic risk profiles. ESG ratings were seen to have a longer influence than other factors (several years), which may indicate that they would be appropriate to use "in the asset allocation process and [as] policy benchmarks." November 29, 2017.

[Read more](#) →

## 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.*

### → The World Bank will cease to fund oil and gas extraction after 2019

In an attempt to support the transition to a low-carbon economy and implement the Paris Agreement's goals, the World Bank has announced that it will cease to finance upstream oil and gas as of 2019, unless exceptional circumstances dictate otherwise. Having halted coal plant lending in 2010, the bank experienced continuous pressure to cut the USD 1 billion – equivalent to roughly two percent of its portfolio – it lent annually to developing nations for oil and gas extraction. As of 2018, the bank will also start to publish the greenhouse gas emissions of projects in key sectors. December 12, 2017.

[Read more \(1\)](#) → [Read more \(2\)](#) →

### → French banks strengthen their fossil fuel policies

In December 2017, Crédit Agricole, Natixis, and Société Générale announced stricter fossil fuel policies. All three will exclude oil sand production and Arctic drilling. Crédit Agricole will also exclude shale gas and oil production involving excessive flaring or venting, as well as infrastructure developed mainly for projects related to oil sands, Arctic drilling, or fracking. Société Générale will only support oil and gas companies with implemented or planned measures to limit flaring and gas losses. December 2017.

[Crédit Agricole](#) → [Société Générale](#) → [Natixis](#) →

## ECOFACT News

The 7th Roundtable on Reputational Risk Management in Banking took place on January 25 and 26, 2018, at Santander Group's headquarters in Madrid. The Roundtable (formerly "Forum") was established in 2008 to provide a platform for dialog and knowledge-sharing with regard to common and best practices in reputational risk management. This year's Roundtable was hosted by Santander and moderated by ECOFACT. Highlights included inputs by Santander's CEO, Group Chief Compliance Officer, and Chief Information Security Officer – who highlighted the role of emerging technologies as a significant source of reputational risk. January 26, 2018.

### → 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	Issue policies	A	B
Agriculture	2	1	Climate change	5	3
Palm oil	2	1	Agricultural commodities	2	1
Forestry	2	1	Human rights	5	5

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](http://fsb.org)

### → Sector and issue policies adopted by banks

(C) indicates the number of banks among the 30 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	Issue policies	C	D
Agriculture (general)	9	5	Biodiversity	1	3
Biofuels	3	2	UNESCO World Heritage Sites	13	2
Palm oil	14	2	Human rights	19	5

This table includes the 30 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](http://fsb.org)

## New tools and databases

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

### → WWF and Gold Standard launch best-practice guide for business action on SDGs

A new report by WWF and Gold Standard looks at key opportunities and challenges that businesses have faced when addressing the United Nations' Sustainable Development Goals (SDGs). The report also provides information on lessons learned and gives recommendations on how companies can improve current practices and mitigate risk in order to make a credible, meaningful contribution towards achieving the SDGs. February 25, 2018.

[Read more](#)



[The report](#)



### → Insufficiently addressed deforestation risks may lead to stranded assets, CDP issues guidance

According to a report published in November 2017 by CDP entitled *From risk to revenue: The investment opportunity in addressing corporate deforestation*, 87% of companies identify deforestation risk and 32% are already experiencing the impact of such risks, such as disruption or reduction of supply, or reputational damage. Failing to act on the challenges of producing forest-risk commodities could turn the affected investments into stranded assets. While investors are increasingly asking for information on deforestation risks from companies, only 23% of those companies approached in 2017 responded. Such information is important for investors to assess risks, but also to identify opportunities in the growing market for deforestation-free commodities. According to the Tropical Forest Alliance 2020, investment opportunities for such commodities will total roughly USD 200 billion annually by 2020. In line with these findings, CDP, together with the Global Canopy Programme, issued guidance for financial institutions with regard to engaging on deforestation risk with companies in soft commodity supply chains. November 21, 2017.

[Read more](#)



[The report](#)



[Guidance document](#)





## 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.

## About ECOFACT

ECOFACT is a signatory to the United Nations Global Compact



We have been helping our clients to understand environmental and human rights risks in their relationships with other companies since 1998. Our client base consists of universal banks, insurers, private banks, asset owners, investment managers, and governmental agencies. We understand their practices, needs, and the importance of confidentiality.

Relationships with controversial companies, projects, sectors, and investments may cause financial loss, reputational damage, compliance and liability risks to financial institutions. We support our clients in **assessing business transactions** from an environmental and social risk perspective on a day-to-day basis. We also help our clients to develop **risk management solutions**, new policies, guidelines, and screening tools, and assist them in reviewing, designing, and implementing assessment and escalation processes.

Complementing and supporting this hands-on approach is the second pillar of our work: **research**. In addition to the **ECOFACT Quarterly**, we help the financial sector to understand regulatory developments in corporate responsibility and sustainability. Originally commissioned by UBS, the **ECOFACT Policy Outlook tool** is used by banks and insurance companies alike. Working together, UBS and ECOFACT have also established the **Policy Outlook platform** for discussion and collaboration on these topics.

ECOFACT facilitates two additional knowledge-sharing platforms, in which many of the world's leading financial institutions participate: the **Forum on Reputational Risk Management in Banking**, established in 2008 [[www.ecofact.com/forum](http://www.ecofact.com/forum)] and the **Roundtable on Environmental & Social Risk Management**, established in 2011 [[www.ecofact.com/roundtable](http://www.ecofact.com/roundtable)].

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