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ECO:FACT QUARTERLY

The briefing for E&S risk experts

30TH ISSUE

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 41 items featured in the full report. For information on subscribing to the ECOFACT Quarterly, go to the **last page.**

Editorial

Norm-based screening may not be what you think it is

Almost two years ago, I **drew your attention** to a widespread misconception about the role of due diligence for responsible business conduct in investment decisions. At the time, I noted that most investors appeared to believe that due diligence for responsible business conduct was just one of several potential ESG strategies, and pointed out that this was not the case. This misconception remains the popular view, and a similar misconception persists with regard to norm-based screening.

To illustrate this, let me paraphrase a statement heard at the PRI in Person Conference held in Paris in mid-September: "Norm-based screenings are about values. We don't like that. We prefer to focus on ESG risks." The term "ESG risks" can be substituted by almost anything: SDGs, impact, best-in-class strategies… We come across such statements time and again. Putting it bluntly, many investors see norm-based screening as a slightly more sophisticated version of stone-age exclusion strategies, or as a Scandinavian tradition.

The general philosophy behind norm-based exclusion is about much more than institutional or national values, although such values can supplement screening strategies: norm-based exclusion aims to ensure compliance with relevant standards. "Norm" is a broad concept. What matters here is that, among other important things, norms establish acceptable and unacceptable standards of behavior, including rules for private transactions.

Norm-based exclusion builds on international standards that encompass such norms. Private-sector companies, including financial institutions, should take international standards seriously, as they provide useful, and not surprisingly, internationally recognized minimum standards for business conduct.

International standards are approved or adopted by governments and multinational organizations. From a risk or legal perspective, compliance with such norms is a baseline expectation all over the world. Norms are therefore particularly relevant in court.

The belief that norm-based screening belongs in the "value corner" also ignores the dynamics of the relevant frameworks:

- Many international standards are evolving – some rapidly, such as human rights-related due diligence requirements – and are more commonly incorporated in national regulations.
- The OECD is constantly expanding its set of guidelines on **due diligence for responsible business conduct** (RBC), and builds on a broad set of norms. We are often surprised at how little attention this work receives, as the OECD guidelines detail government-backed due diligence expectations. The OECD has already produced guidance for **investors**, will publish a version for commercial banks and investment banks in **late October**, and start working on a third document soon afterwards (scope to be determined). The OECD guidelines go significantly beyond norm based screening in terms of both scope and operational expectations.
- The scope of sustainability issues in the current public draft of the **EU Disclosures relating to sustainable investments and sustainability risks** is practically identical to the RBC scope of the OECD. Many investors may ignore the OECD, but lawmakers do not.

In short, it is no coincidence that the term is not value-based screening. In our view, it is essential that investors conduct due diligence for RBC (or extended norm-based screenings) across their portfolios if they wish to meet international due diligence expectations.

Olivier Jaeggi

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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.

→ New global convention on workplace violence and harassment

The International Labour Organization (ILO), the global body responsible for drawing up and overseeing international labor standards, has adopted a new *Convention and Recommendation on Violence and Harassment at Work*. At the 108th session of the International Labour Conference (ILC), the ILO stated that everyone – regardless of gender or employment status – has the right to be free from violence and harassment in all work-related activities. The new international standard defines violence and harassment as behavior, practices or threats "that aim at, result in, or are likely to result in physical, psychological, sexual or economic harm." The legally binding Convention, which calls on governments to adopt a zero-tolerance policy towards workplace violence and harassment, will enter into force twelve months after at least two member states have ratified it. June 21, 2019

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Coming soon:	Expected by:
Equator Principles (EP): Targeted review	Draft EP4 available Late 2019: Finalization and launch

High-risk sectors

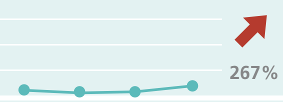
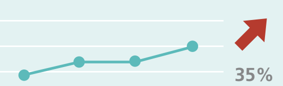
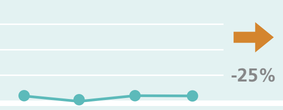
Developments relevant to six specific high-risk sectors, such as news on risk factors and trends, the relevant regulations, and best practices.
The table below contains an update on controversies, and comments on the corresponding reputational risk for financial institutions.

Information based on RepRisk data

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

Analysis based on RepRisk data, combined with insights gained in ECOFACT's consulting practice

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† SON DJF MAM JJA	**FI exposure** Share of news criticizing banks / or insurers	**ECOFACT summary**	**ECOFACT risk rating**
Agriculture	Mono-cultures	 267%	9%	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
	Palm oil	 35%	16%	The palm oil sector is associated with issues such as deforestation, threats to endangered species, and poor working conditions. While, "No Deforestation, Peat, Exploitation" (NDPE) commitments by RSPO members have been criticized for a lack of on-the-ground-verification, FIs are urged to request NDPE commitments from their clients and monitor compliance. FIs lacking stringent palm oil policies or involved with companies that do not adhere to best practices face considerable reputational risks.	D
Defense	Cluster munitions	 -25%	67%	Many FIs have policies stating that they do not offer financial services to manufacturers of cluster munitions. FIs that do not have such policies or fail to implement them thoroughly are subject to major reputational risks. Regulations banning investments in cluster munitions manufacturers have been implemented in some countries and are being discussed in others.	D

†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. *Indicates a change in the ECOFACT risk rating compared to the previous quarter.

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High-risk sectors

Oil & Gas Mining Forestry Agriculture Utilities Chemicals Other

Risk factor

First complaint filed against a bank for contributing to harm done by its palm oil clients

A group of NGOs has filed a complaint against ING Group with the Dutch National Contact Point (NCP) based on allegations that it has breached the Organisation for Economic Co-operation and Development (OECD) Guidelines in its business relationships with three palm oil clients – Bolloré Group / Socfin Group S.A., Noble Group Ltd., and Wilmar International Ltd. – or their subsidiaries. It is allegedly the first such complaint brought by NGOs against a bank for this reason. The plaintiffs are arguing that despite the foreseeably harmful impact of these companies' operations, ING Group has continued to issue significant loans to these companies and failed to take mitigative measures, thus becoming a contributor to human rights, labor, and environmental abuses. The NGOs have called for the bank to divest from these companies as well as the palm oil sector. In its posted response, ING Group has pointed out that an IUCN Task Force stated that a ban on palm oil would only lead to other, more resource-intensive crops taking its place, that the bank has taken no new palm oil clients since September 2018, and is committed to actively engaging with the ones it already has. July 5, 2019.

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ING respoonse →

Risk factor

IIGGC outlines climate contribution expectations for construction materials and cement producers

Together with the Global Investor Coalition on Climate Change, the Institutional Investors Group on Climate Change (IIGCC) has issued a report for producers of construction materials outlining its expectations of the sector's climate strategy. *Investor Expectations of Companies in the Construction Materials Sector* examines the exposure to "significant transition and physical risk" that climate change places on the industry. It also presents actionable steps investors expect in order to mitigate risk, lower emissions, and transition to a low-carbon economy. The IIGCC has also specifically called out the cement industry for its high emissions – which account for seven percent of all man-made carbon emissions worldwide. July 22, 2019.

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Report →

Risk factor

Shipping industry may not meet climate targets, but if the world does, demand for vessels could decrease by a third

In *A Sea Change*, its first report on the shipping sector, CDP ranks the 18 largest shipping companies in terms of their preparation for the transition to a low-carbon economy. The 17 key findings include the observation that large shipping companies are not investing in new technology to reduce or eliminate emissions. This could translate into the sector not meeting the target of a 50-percent reduction by 2050. Even though shipping companies are facing growing pressure from their customers as they seek to decrease emissions in their supply chains, insufficient innovation and investment in alternative fuels and new types of vessels is impeding real change. If the world does manage to meet the 2050 Paris Agreement targets, demand for vessels would decrease by one-third due to an assumed lower demand for fossil fuel and coal transportation. If this transpires, "implications are pretty bleak," as a global swing to clean energy would result in large amounts of capital being "wipe[d] out." Investors are advised to put their money in efficient ships and think about divesting from fossil fuel carriers. July 18, 2019.

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CDP report summary →

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.

Water

→ World Bank flags a water crisis

We face an invisible water quality crisis that will cause economic growth in polluted countries to drop by one-third, posing a direct threat to human and environmental health, warns the World Bank. Its report, entitled *Quality Unknown: The Invisible Water Crisis,* shows that a combination of bacteria, salinity, sewage, nitrates, as well as plastics and other chemicals is sucking oxygen from water and poisoning vital water supplies for people and ecosystems alike. To highlight these concerns, the Bank has assembled the world's largest database on water quality, which accesses its information via monitoring stations, remote sensing technology, and machine learning. August 20, 2019.

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Climate change

→ Climate change litigation is increasingly targeting governments and companies

In *Global trends in climate change litigation: 2019 snapshot,* the Grantham Research Institute on Climate Change and the Environment and the Centre for Climate Change Economics and Policy report that climate change litigation cases are increasing in number and geographical spread. Lawsuits have been filed in countries such as India, Pakistan, Columbia, and Indonesia, expanding beyond Australia, the United States, EU countries, and Canada. Cases are either "pro" climate action and brought forward by individuals, NGOS, or corporations against governments, or classified as "hindering," filed by companies and organizations seeking to contest environmental regulation. Governments are the defendants in 80 percent of all cases. Human rights-based arguments were noted in several important cases, signaling this approach's probable integration into future cases. Fossil fuel and cement companies are more often targets due to their greenhouse gas emissions. In terms of investor involvement, companies such as Shell (sued for failing to incorporate climate risk in its investments), and ExxonMobil (sued for misleading investors about climate change risks to assets) have been targeted. Lawsuits claiming insufficient disclosure of climate risks to shareholders have also been filed. July 4, 2019.

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Business case

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

→ Improved environmental, social, and governance disclosure reduces legal risk

Businesses are increasingly disclosing their ESG practices. Whether of their own accord or under external pressure, according to a recent research study, *Managing Legal Risks From ESG Disclosures,* issuers are publishing their ESG commitments through lodgments with the US Securities and Exchange Commission (SEC), web pages, printed materials, presentations to investors, and otherwise. Current disclosures to the SEC are voluntary, creating goodwill with customers, investors, and the public, particularly when the issuer can demonstrate a positive influence in community and industry. Issuers may nevertheless be liable under US securities case law if a disclosure is false or misleading. In order to minimize litigation risks, issuers must consider who owns a specific ESG disclosure and improve disclosures via ongoing company auditing. This involves using appropriate language or approximations, hedging or disclaiming where possible, identifying context, as well as accounting for any associated insurance or liability. August 12, 2019.

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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.

→ Chubb's coal ban leads the way for major US insurers

Chubb has announced that it will no longer create new debt or equity for new coal-fired power plants. Nor will it sell new policies to companies that generate more than 30 percent of their revenues from thermal coal mining. While US-based insurers have so far resisted the current European drive to stop backing coal-based power plants and mines due to their environmental impact, Chubb's decision pioneers a more environmentally conscious approach. Key provisions of Chubb's future policy on coal cover new coal plant construction and operation, coal mining, utilities, and investments. July 1, 2019.

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Banks

Banks to factor carbon emissions into maritime investments

Key shipping banks will henceforth factor climate considerations into their lending plans in order to help cut carbon emissions in the maritime shipping industries. Banks involved in the historic Poseidon Principles initiative representing USD 100 billion in maritime industry values include Citigroup, Société Générale, ING, DNB, and Crédit Agricole CIB. The new maritime sustainability framework measures carbon use with related finance portfolios. This establishes a benchmark to test whether lending portfolios are aligned with the UN International Maritime Organisation's 2050 climate target to reduce the global carbon footprint by 50 percent. Bankers will now be more selective about which ships to include in a given portfolio. Global shipping currently accounts for 2.2 percent of combined carbon dioxide emissions. June 18, 2019.

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

Bank of America will no longer fund private prisons and detention centers

Keen to distance itself from a sector marked by protests over the Trump administration's immigration policies, Bank of America Corp. has stated that it will no longer finance private prisons and detention centers. Earlier this year, industry peers JPMorgan Chase & Co. and Wells Fargo & Co. made similar commitments to stop investing in private prison companies. This decision accompanies the recent rise in activism against private prison funding amid concerns over reported detention conditions and tighter immigration policies under US President Donald Trump. S&P Global Ratings estimates that in 2018 alone, private detention centers accounted for nearly 70 percent of all persons incarcerated by US Immigration and Customs Enforcement. June 26, 2019.

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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	3	2

Issue policies	A	B
Climate change	6	4
Agricultural commodities	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**

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
Agriculture (general)	8	5
Biofuels	3	2
Palm oil	17	2

Issue policies	C	D
Biodiversity	1	3
UNESCO World Heritage Sites	18	1
Human rights	19	3

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**

ECOFACT News

ECOFACT has just launched a new research product that will provide financial institutions with a coordinated analysis of ESG policies based on a neutral, sound, and transparent methodology. Scope and methodology will be informed by the needs of the participating institutions. The research will combine AI technologies with analysis by ECOFACT experts. The output will include:

- **High-level summaries that provide a bird's-eye view of policies addressing controversial sectors and issues (incl. qualitative and quantitative data);**
- **Granular tables that include details such as original wording and an assessment thereof (files that enable you to easily sort and filter information to generate tailored reports), as well as links to all underlying sources and documents.**

To learn more about this new product, contact us at **info@ecofact.com** or **+41 44 350 60 60.**

New tools and databases

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

→ Checklist published to help companies respect indigenous peoples' rights

Developed under the Indigenous Navigator initiative, the Danish Institute of Human Rights published *Respecting the Rights of Indigenous Peoples: A Due Diligence Checklist for Companies.* It offers operational guidance by aligning the recommendations of the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) and International Labour Organization (ILO) Convention No. 169. The checklist focuses on assessing human rights impact (real and anticipated) as well as monitoring and remedying such impact, and is structured in four steps: (1) screening; (2) impact assessment; (3) consultation; and (4) implementation and monitoring. The initiative also offers several online tools, resources, and indicators to monitor indigenous peoples' rights in greater detail. June 28, 2019.

Read more → Checklist → Tools →

→ Green investment guide to help tackle climate change: an EU pathway

In a push to generate more investment funds for green businesses, the European Commission (EC) has published updated guidelines for "environmentally friendly" investment status ratings. To cut emissions by 2030, many sectors, such as manufacturing or energy, will require annual investments of EUR 180 billion. To achieve zero emissions by 2050 will require an even greater cash flow. Central to the Commission's 414-page report is its effort to create new investments, repurpose existing funds, and achieve overall emissions targets. Many investors want to back sustainable businesses to help stop climate change. Judging business activities appropriate for fighting climate change has been a challenge. The EC's report therefore provides a formula to help determine whether an investment is green or not. Separate guidelines are available on what amounts to a "green" bond, as well as climate-related benchmarks for company reporting. June 18, 2019.

Read more (1) → Read more (2) →

→ **ECOFACT Policy Outlook** users can find additional information on the EU sustainability taxonomy **here.** Policy Outlook, a monitoring and implementation package, covers regulatory change pertaining to ESG and corporate responsibility issues. Click **here** for further information.

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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 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.

Due Diligence

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

We provide solutions for issue monitoring, policy development, portfolio screening, individual risk assessment, and engagement services.

Research Products

In addition to the *ECOFACT Quarterly,* ECOFACT also produces the *Policy Outlook.* The *Policy Outlook* covers regulatory change pertaining to ESG and corporate responsibility issues. It a monitoring and implementation package that consists of an online tool and provides access to a network of peers.

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Knowledge Sharing

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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