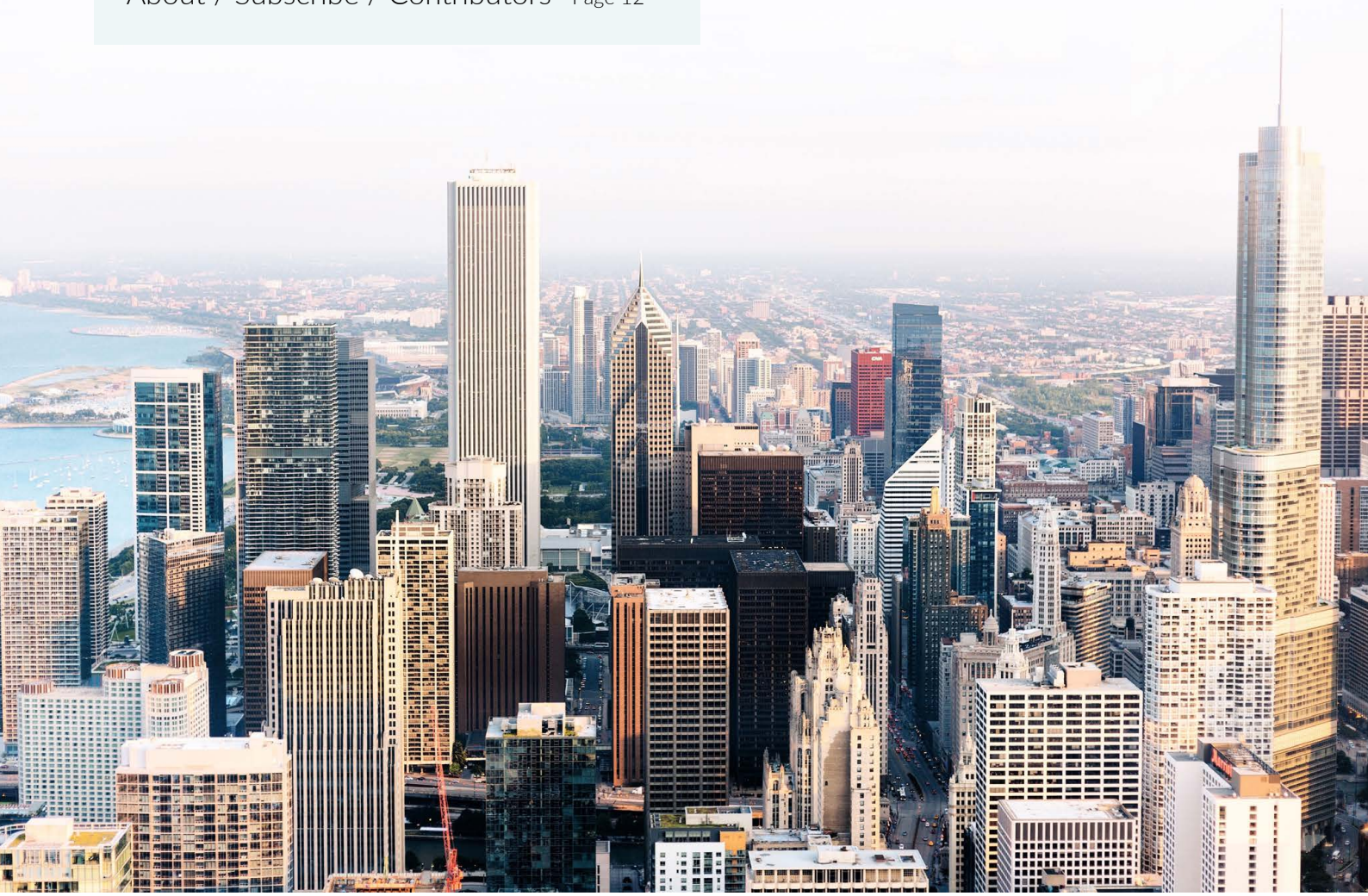
ESG RISK QUARTERLY

ECOFACT's briefing for risk experts

JULY 2022 | ISSUE #41

ECO:FACT

Table of contents



Editorial

Leaders from the insurance industry intend to pave the way to net zero

As far back as 2013, in an **article** for MIT Sloan's sustainability blog, ECOFACT pondered why the insurance industry's sustainability actions (at the level of their corporate-client business) was lagging behind those of the banking sector. In a follow-up **article** two years later, we noted that the industry was stepping up its game. However, at that point, most action was being taken by a few trailblazing market leaders.

After only a few years, market leaders significantly stepped up. In 2019, AXA **committed** to phasing out coal completely, both in underwriting and investments. Two years ago, Christian Mumenthaler, Swiss Re's Group CEO, **urged** businesses to "chart a course out of the climate crisis." Since then, insurers have been making stronger statements and more robust commitments. Although everyone appears to have realized this work will be more challenging than initially envisioned, it is clear that the insurance industry has accepted it is on as a mission that must not fail.

Last month, the **Principles for Sustainable Insurance (PSI)** Initiative held a **three-day meeting** at the Swiss Re Centre for Global Dialogue to celebrate its 10-year anniversary. The event was livestreamed to connect participants worldwide. Intriguingly, it was a very different atmosphere from earlier meetings I had attended: the PSI initiative exhibited a growing membership that is a broadening representation of the insurance industry. There were more industry leaders with seniority in attendance, and the call to action was compelling and unanimous.

Echoing Mumenthaler's 2020 sentiments, Mary Shapiro, vice chair of both global public policy at Bloomberg and the **Glasgow Financial Alliance for Net Zero**, remarked that working to advert the climate crisis would be the most impactful thing meeting attendees would do in their lives. In her view, the insurance industry must step in where governments have not, and she emphasized that "we" will need to do the work ourselves.

The next key step will be carbon accounting. During a panel discussion, it was pointed out that the industry faces challenges measuring the carbon footprint of their insurance portfolios, making it difficult for insurers to act on their net-zero commitments. The **Net-Zero Insurance Alliance** is advocating for science-based targets and reporting to support the decarbonization of insurance portfolios, and the **Partnership for Carbon Accounting Financials (PCAF)** is working on a standard to harmonize greenhouse gas accounting in the insurance sector. In 2022, PCAF published its **Insurance-Associated Emissions Scoping Document** for public consultation.

Reflecting on the meeting, despite the challenges identified, one thing is certain: PSI's members have the momentum required to back the transition to a more sustainable economy. Their efforts place society's resilience front and center. And this matters greatly. As alluded to above, governments may find it difficult to prioritize climate policies given the current political and economic turbulence. The insurance industry's role is therefore crucial.

Olivier Jaeggi

International standards

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

→ Financial advisers unprepared for the EU's new know-your-client requirements

Undercover **research** by the 2° Investing Initiative has revealed that only 25 percent of European financial advisers are asking clients about their environmental or social objectives during client profile assessments. Half of the mystery shoppers were either not offered products suited to their sustainability preferences or they did not understand how an offered product met their ESG investment objectives. May 1, 2022

Why we think it matters: As of August 2, 2022, the European Securities and Markets Authority will be able to police the client sustainability preference requirements of the MiFID II Delegated Act. Firms need to be ready to demonstrate that they are fulfilling their many obligations, including training their sales and customer relations teams and updating IT systems and all internal documentation. (Policy Outlook subscribers can access more information **here**.)

Read more →

→ Basel Committee publishes climate risk management principles

The Basel Committee on Banking Supervision has issued finalized **principles** for robust climate-related risk management and supervision. The 18 principles cover corporate governance, internal controls, risk assessment, management, and reporting. The result of a 2020 consultation, the principles are designed to strengthen the regulation and supervision practices of banks worldwide and enhance financial stability. Seeking to balance the improvement of practices with the provision of a common baseline for internationally active banks, the principles promote flexibility given the degree of heterogeneity and evolving practices in this area. The principles can be adapted to a diverse range of banking systems in a proportional manner. June 15, 2022

Read more →

What we're watching

ECOFACT's team of legal analysts monitor regulatory developments related to sustainable finance and corporate responsibility in more than 50 jurisdictions. Please **contact us** for more information on regulatory trends.

Jurisdiction	What's on our radar	Date of next expected development
Net-Zero Banking Alliance (NZBA)	Many members of the NZBA will be submitting their first round of interim 2030 targets. Before the end of 2022, the NZBA plans to release its first guidance document for sector-specific decarbonization and implementation pathways. Read more (for Policy Outlook subscribers) →	Q3 and Q4 2022

Open consultations

Our **Policy Outlook database tracks open consultations** that are relevant to the wider financial and insurance industries as well as corporate actors. Please **contact us** for more information on open consultations.

Authority	Consultation topic	Deadline for input
International Sustainability Standards Board (ISSB) ISSB	The ISSB **requests feedback** on how the International Financial Reporting Standards Foundation should develop a sustainability disclosure taxonomy for digital reporting. Read more (for Policy Outlook subscribers) →	September 30, 2022

Source: ECOFACT's Policy Outlook, a database of in-depth analyses of sustainable finance and corporate responsibility regulatory initiatives across the globe. More information: **https://www.ecofact.com/policyoutlook/**

Spotlight: Engagement

A deeper dive into news, issues, or developments that have received significant attention in the past quarter. We also explain why we think the topic is important to your work.

➔ **Is engaging with investee companies a zero-sum game?** There are several common ways in which ESG risks associated with investee companies are managed. Engagement and stewardship are often promoted as critical to affecting change. The threat of divestment is also placed on the table from time to time. In reality, engagement rarely ends in a hard stop. It is more of an evolving combination of pressuring actions in responsible investors' toolboxes.

However, the conversation continues to evolve. Asset managers are thinking of creative new ways to make an impact and deliver what clients are asking for: positive change in the world. They are engaging with their clients *and* investees.

Some asset managers are exploring client-led voting, and some investors assert their proxy voting rights to support or protest executive remuneration and other climate or ESG goals/inaction. All are wondering about how to reliably measure and report the impact of their efforts.

During this past quarter, we have noted several interesting publications that promote engagement.

Why we think it matters?

Investors are increasingly expecting asset managers to deliver more than just returns on their investment. Some investors want their money to advance climate action, protect the environment, and promote a just world.

However, simple exclusions and net-zero pledges are at risk of being perceived as greenwashing. These actions do not meaningfully contribute to decarbonizing the real economy. Thorough climate transition plans and detailed short-, medium-, and long-term targets are important aspects of creating value for investors and companies.

Engagement resources made available in the second quarter of 2022

Resource	Offered by	Description
Enhancing Investor Engagement	Accounting for Sustainability	A free webinar targeting investor relations teams. Presents a conversation about practical concepts, tools, and case studies related to engaging investors on sustainability. Read more
Finance for Biodiversity – Guide on engagement with companies	Finance for Biodiversity Foundation	Accompanied by a webinar recording, templates, and examples of collaborative engagements, the guide helps financial institutions to engage with companies on several aspects of biodiversity. Read more

High-risk sectors

News on risk factors and trends, regulations, and best practices associated with key high-risk sectors.

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

Risk factor

Almost USD 80 billion at risk due to deforestation

Timber, cattle, and palm oil enterprises are failing to meet their deforestation commitments made at COP26, finds a joint CDP/Accountability Framework Initiative (AFI) report. Primary rainforests lost the equivalent of 10 football pitches every minute during 2021, posing enormous risks. Over 200 disclosing companies have identified more than USD 79.2 billion at stake. According to the report, mitigation would cost less than a tenth of that amount, yet only 36 percent of disclosing companies have public deforestation policies. The majority have insufficient traceability (77 percent) or monitoring systems (74 percent) throughout their supply chains. CDP/AFI urge companies to scale up rigorous accountability frameworks quickly. A report by the independent think tank International Institute for Sustainable Development (IISD) 2022 recommends voluntary sustainability standards to motivate investors. May 24, 2022

Read more →

Risk factor

Aviation misses its own emission targets

The global aviation industry has missed almost all its self-imposed greenhouse gas (GHG) emissions targets since 2000, says environmental charity Possible. The charity's report claims that the sector's targets were primarily greenwashing, and that they were not defined, monitored, or reported. A Greenpeace publication states that none of Europe's seven largest airlines (responsible for more emissions than Norway, Sweden, Denmark, and Finland combined) have committed to cutting enough GHG by 2040 to meet the Paris Agreement's 1.5°C target. Both organizations called on governments to reduce the aviation industry's flight numbers. Meanwhile, six global banks have pledged to build a finance framework to help decarbonize aviation, and a member of the European Parliament has proposed amending EU fuel laws to include non-CO2 effects that have a greater warming impact than carbon emissions. May 10, 2022

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

Risk factor

Responsibly sourced mineral certifications compromised, leaving supply chains in doubt

An international certification scheme intended to weed out conflict minerals from Africa's mining supply chains is failing, reports the international watchdog Global Witness (GW). GW warns that many minerals, such as tin, tantalum, and tungsten (3T metals), although certified as conflict-free under the International Tin Supply Chain Initiative (ITSCI) in countries such as the Democratic Republic of Congo, Rwanda, Burundi, and Uganda, in fact come from compromised mines controlled by militia or from locations where human-rights abuses take place. Although major companies such as Apple, Intel, and Tesla use ITSCI to identify responsibly sourced minerals, "ITSCI's minimal field staff and lack of oversight make it easy for miners and traders to launder minerals." April 27, 2022

Read more →

Risk factor

The dodgy disposal practices of accountability-free shipping

Many of the world's ships end up in cheap but notoriously hazardous ship-breaking yards in South Asia. In the third quarter of 2021 alone, seven people died in ship-breaking yards in Bangladesh. Recognizing this, the EU passed legislation in 2018 to ensure that EU-registered ships could be scrapped only in EU-approved facilities. However, as journalist Paul Tullis reports, in the "murky world" of international shipping, these regulations are regularly dodged by the sale of aging vessels to offshore intermediaries. Ships land in South Asia via "flags of convenience," which allows ship re-registration in countries that disregard these regulations. With re-flagging deals rife, advocates for change are calling for stronger financial incentives and a safe recycling reward scheme. May 3, 2022

Read more →

High-risk sector controversies

This table shares SIGWATCH data on NGO campaigns and financial institutions' exposure to criticism from NGOs. It also provides ECOFACT-curated links to sector-related controversies from the last quarter as well as our risk rating.

Sector & subsector		Level of controversy: Number of NGO campaigning actions per quarter in the last five quarters (2021 Q2, Q3, Q4; 2022 Q1, Q2)	FI exposure: % share of NGO actions criticizing FIs (SIGWATCH data) / ECOFACT risk rating	Noteworthy news
Forestry	Logging and plantations	104, 130, 122, 85, 73	12%	Government audit reveals that forestry laws have been repeatedly violated in Democratic Republic of Congo; illegal contracts suspended Read more
Mining	Coal mining	47, 40, 39, 26, 24	22%	Asset managers with net-zero commitments rebuked for not requiring portfolio companies to end new coal development Read more
Mining	Mining impact on Indigenous people	40, 24, 21, 19, 24	19%	Survey of 130 Brazilian mining companies shows, for first time in decades, that none have current applications for mining in Indigenous territories Read more
Agriculture	Palm oil	29, 27, 23, 27, 24	12%	Italian chocolatier Ferrero Group refuses to purchase palm oil from company linked to forced labor Read more
Agriculture	Livestock agriculture	195, 183, 194, 173, 137	7%	Satellite used to pinpoint the source of a methane plume to a single farm, most precise independent monitoring yet Read more
Agriculture	Deforestation by agriculture	75, 66, 81, 46, 47	14%	Banks called out for continuing to fund deforestation and human-rights violations in forest-risk commodity supply chains Read more

ECOFACT risk rating

After weighting the level of controversy associated with each subsector, ECOFACT assigns a risk rating of either **red** (high risk), **orange** (enhanced risk), or **yellow** (moderate risk). The rating reflects our assessment of the degree of reputational risk that financial institutions (FIs) face when investing in the sector.

About SIGWATCH

SIGWATCH scans the messaging of more than 10,000 NGOs around the world every day, identifying active and emerging campaigns and issues, and tracking the criticism (and occasional praise) of corporations and industry sectors. This qualitative and quantitative data offers unique insights into NGO concerns and gives early warning of the problems that companies and investors will have to manage in the months ahead.

Emerging risks

Risks that could be relevant when looking into a company's business model. These issues may not yet be considered highly significant, but they have the potential to be.

Environmental risks forecast to devastate currencies and sovereign credit ratings

Mass biodiversity loss could devastate world economies, fueling a global national debt crisis by 2030, according to the first major **study** of the impact of nature loss on sovereign credit ratings. A team of economists led by the Bennett Institute for Public Policy outline various scenarios, including one in which a partial collapse of key ecosystems upends nature-dependent industries such as farming and fishing, causing debt crises and sending borrowing costs soaring. Separately, analysts at Barclays Plc. have published an emissions model as well as forecasts for the USD 6.6 trillion-a-day foreign exchange market from now until 2070. In the most extreme case, they predict that the Chinese yuan and Japanese yen could fall by more than 50 percent. June 23, 2022

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

Could hackers sabotage the global food supply?

Smart technology is increasingly being used to help feed the world's growing population. It can make farms more efficient and productive. However, **research** from the University of Cambridge warns that using new artificial intelligence technologies at scale poses enormous risks that require more forethought. Automatic crop sprayers, drones, and robotic harvesters are easily hacked. US producers JBS and AGCO have already suffered ransomware attacks, and the FBI warns that the threat of cyberattacks is growing. Researchers recommend employing hackers to check security, and they also emphasize the importance of inclusive development to ensure that environmental impacts are factored into efficiency drives. Furthermore, open-data co-operatives are encouraged to ensure that the benefits of agricultural revolution are shared with subsistence growers. May 20, 2022

Read more (1) → Read more (2) →

Some US state governments are legally obstructing investors' ESG exclusions

In some US states, the way investors are managing risk has become a risk itself. Texas has a **law** that requires the state to divest from and not contract companies that meet the state's definition of boycotting fossil fuels. Bills in **West Virginia** and **Idaho** would prohibit firms from banking contracts with their state governments if they do not conduct business with coal, natural gas, or oil companies. Financial institutions' public statements are being evaluated to make this determination. June 14, 2022

Why we think it matters: Phased-in fossil-fuel exclusions are common policies for net-zero financial institutions. While it may be counterintuitive, efforts to make the world cleaner and more resilient are being perceived as damaging by some politicians, particularly in states that count fossil fuels among the top sectors for revenue and job generation. However, anti-ESG laws may have unacknowledged costs; a recent **study** predicted that Texas entities will face higher borrowing costs for at least eight months after ESG-limiting laws were put in place. How the laws will be enforced remains to be seen.

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

Peer approach

A selection of new sector and issue policies that have recently been adopted or that are receiving attention. This section includes announcements of peer alliances and collaboration.

→ Race to Zero and GFANZ ramp up net-zero commitments with transition plan and other requirements

The Race to Zero campaign has strengthened its **criteria**, requiring all members to phase out unabated fossil fuels. Members must also publish a public transition plan within a year of joining, among other prerequisites. The Glasgow Financial Alliance for Net Zero (GFANZ) has collected input on a draft of its ***Net-zero Transition Plan framework*** that aims to help financial institutions develop credible transition-related financing plans. It will also enable standardized comparison of these plans. June 15, 2022

Why we think it matters: Initiatives like GFANZ and the Race to Zero have mobilized hundreds of companies in all sectors to meaningfully tackle the climate crisis. As these groups continuously tighten their criteria, asking for more effective actions from members, **critics** note that the actions are neither fast nor ambitious enough, especially considering that global energy-related emissions were the highest ever on record in 2021.

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

→ BNP Paribas first to exit Amazon oil and gas

BNP Paribas is the first major bank to adopt a financial and geographical exclusion of oil and gas investments in the Amazon rainforest, following sustained lobbying by the Exit Amazon Oil and Gas campaign. Since 2020, Indigenous leaders, Amazon Watch, and Stand.earth have demanded that financial institutions divest in order to protect the Amazon's unique biodiversity, cultural importance, and climate regulation role. BNP Paribas's "momentous move" out of Amazon (and Arctic) oil-and-gas-related enterprise is part of its 2025 plan to reduce carbon emissions across three key portfolio sectors: power generation (30 percent by 2025), oil and gas (10 percent by 2025), and automotive (25 percent by 2025), in order to achieve net zero by 2050. May 4, 2022

Read more (1) → Read more (2) →

→ Sector and issue policies adopted by insurers

This table presents the number of the **nine global systemically important insurers** that have a public policy or guideline for investing in or underwriting for the sectors listed in the left column.

Sector policy	Q1 2022		Q2 2022	
	I	U	I	U
Agriculture	**2**	**1**	**2**	**1**
Agricultural commodities	2	0	2	0
Animal welfare	1	1	1	1
Palm oil	2	1	3	2
Forestry	2	1	2	2
Tobacco	5	3	5	3
Fisheries	1	1	1	1
Defense (controversial weapons)	**6**	**2**	**6**	**2**
Cluster munitions	6	2	6	2

I = sector-related investment activities have a public policy or guideline

U = sector-related underwriting activities have a public policy or guideline

Policy sector in focus: Renewable energy

A discussion that highlights why some financial institutions have developed policies to guide their activities associated with a specific sector or concern.

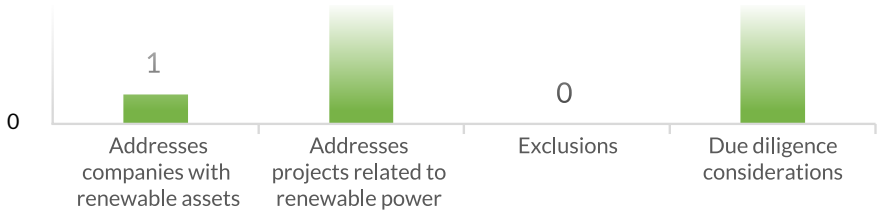
Is the road to a low-carbon world paved with worries and controversies?

National **commitments** to net-zero greenhouse gas emissions and increasing clean energy **investment** suggest that the world is starting to embrace a low-carbon future, despite the **challenges**. Harnessing **wind and sun** to feed a global renewable energy system is **critical** to the world's transition from fossil fuels, which was highlighted by the UN secretary general when he **called** renewable energy the peace plan of the 21st century and encouraged the rapid adoption of policies that facilitate these projects. Even the chief executive officer of Exxon Mobile **believes** that automobiles' combustion engines will be a thing of the past by 2040.

However, as adoption of renewables accelerates, risks are coming to light, such as these prominent issues:

- How will solar panels be **recycled**?
- Is the existing **grid** able to **handle** rapid electrification?
- Is adequate energy **storage** being developed alongside energy generation?

Some financial institutions' ESR policies mention renewable energy



Elements of ESR policies addressing renewables

Analysis by ECOFACT's **Monitoring Peer Policies** revealed four of 19 FIs consider renewables-related projects within the scope of their ESR policy. The projects are generally wind and solar infrastructure, but some FIs include biomass and biofuels.

Four FIs have due diligence considerations for renewables-related projects and clients, mainly assessing impacts on biodiversity, wildlife, and land use.

New resources

This section highlights tools, databases, and other information that can help you to identify, manage, disclose, and mitigate ESG risks.

➔ Scenario analysis: an A4S guide to company resilience within climate change

The Task Force on Climate-related Financial Disclosures (TCFD) recommends that organizations analyze their resilience to various climate-change scenarios. Scenario analysis is a relatively new concept for business, and consequently the least reported of recommended disclosures. The 2021 TCFD Status Report highlights this key corporate challenge. To support reporting efforts, Accounting for Sustainability (A4S) has assembled practical examples of how companies such as **Tesco**, **Unilever**, and **Verizon** are implementing the TCFD recommendations. Examples of scenario analysis are also available from **National Grid** and **Nestlé** as well as TCFD-aligned reporting examples from **ABN AMRO**, **British Land**, and **Storebrand**. A4S offers insight into how different companies model a range of scenarios, and how they evaluate their own resilience against climate possibilities. May 10, 2022

Read more →

➔ Human-rights roadmap for transforming finance: an overview for industry

Following the United Nations' calls for the finance sector to lead a sustainability and human-rights-centered transition, Business for Social Responsibility (BSR) has released the ***Human Rights Roadmap for Transforming Finance*** report. The publication clearly outlines how human rights are defined, their relevance across ESG factors, and optimum policies to ensure human-rights due diligence. Citing the confusion that arose in 2021 when companies implicated in serious human-rights abuses received high ESG ratings, the report's priority recommendations include developing clear human-rights standards and reporting frameworks. Other recommendations include innovating stakeholder engagement, providing accessible human-rights grievance mechanisms, and exploring innovative contract clauses and finance vehicles. April 20, 2022

Read more →

➔ Guide increases insurers' ESG understanding

Insurance has a vital role to play in boosting sustainability by helping individuals, businesses, and other organizations to understand and manage risk. To that end, the UN Environment Programme, together with HSBC Life, has released a **guide** to the critical ESG issues facing the life and health insurance sector. The guide is based in part on responses to a **survey** that identifies health, poverty, and climate change as the top challenges and opportunities for the sector. The guide also highlights ways insurers can evaluate and potentially mitigate risks. For instance, in the case of infectious disease, insurers can provide insurance, and they can also build their understanding of the risk and share this knowledge with their customers, as well as promote vaccines and personal hygiene. June 28, 2022

Read more (1) → Read more (2) →

About ECOFACT

Policy Outlook

Sustainable finance and corporate responsibility regulation research service

Learn more →

Regulatory Implementation

Strategic integration of sustainable finance and ESG reporting requirements

Learn more →

ESG Risk Management

Frameworks, processes, and tools for environmental and human rights due diligence

Learn more →

Monitoring Peer Policies

Analyses of leading financial institutions' ESG policies

Learn more →

Subscribe

Please submit a subscription request.

A one-year institution-wide subscription is CHF 2,000.
The ESG Risk Quarterly is published every January, April, July, and October. Contact us for more information.

ESG Risk Quarterly: ECOFACT's briefing for risk experts

Editor-in-Chief: Anna Reimann **Production:** Jenifer Guillemin, Kate Haycock, Bronwin Patrickson

Contributors: Bruno Bischoff, Robert Blood, Maria Castillo, Magdalena Forster, Olivier Jaeggi, Lana Ollier, Núria Fernández Oms, Deborah Thür, Nils Rötheli, Tennessee Soudain, Mariana Wiederkehr

Design: Edmundson Design Editing: Manuscript Language Services

Cover photo by Aditya Chinchure, Page 2 photo by Erol Ahmed, Page 5 photo by Chris Lawton – all from Unsplash

Produced and distributed by ECOFACT AG, Werdstrasse 21, PO box 8021, Zurich, Switzerland.
Tel: +41 58 520 20 00 | info@ecofact.com | www.ecofact.com

ECOFACT is signatory to the *UN Global Compact* and the *Principles for Responsible Investment*. It is also a member of *Swiss Sustainable Finance*.