ESG RISK QUARTERLY

ECOFACT's briefing for risk experts

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ECO:FACT

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Editorial

Understanding Corporate Sustainability

To establish "a truly global common language of sustainability-related financial disclosures," the International Sustainability Standards Board recently articulated its understanding of the relationship between sustainability and financial value creation as follows:

> *"Sustainability will be described (…) as the ability for a company to sustainably maintain resources and relationships with and manage its dependencies and impacts within its whole business ecosystem over the short, medium and long term."*

This definition raises several concerns. **It doesn't actually define what sustainability is**. It just describes what reasonable companies are already doing. In fact, as a definition, it is meaningless.

The intention may be to use this "definition" as a framework that businesses can understand. But it **neglects what corporate sustainability is really about: value creation and responsible business conduct**. Well-executed corporate sustainability creates value for a company, but it also requires investments of both time and cash. Let's not forget that sustainability matters would be a non-issue for corporates if addressing them always generated revenue. Economic externalities and regulatory gaps cause sustainability challenges, so unsustainable business practices can still pay off. While there is no doubt that some companies will profit from sustainability-related business opportunities, many others still stand to gain from business as usual. The transition to sustainable business practices will require significant effort.

Finally, **this definition will be of little use when explaining to senior management what the company should be doing.** It doesn't help them to gain a reasonable understanding of what is expected.

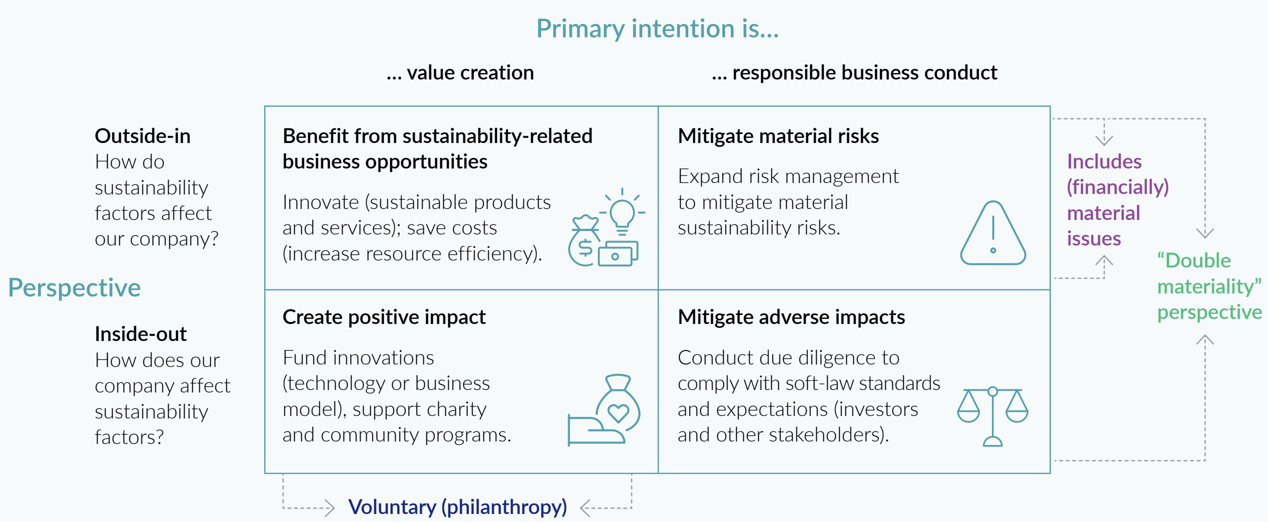
I remember how a lecturer at the Harvard Business School made a joke about how every human issue can be organized into a 2x2 matrix. He went on to show us how this simple tool was helpful in structuring thoughts. In this case, **the 2x2 matrix (see figure below) may indeed help management understand the following:**

- Corporate sustainability is about value creation, but also about responsible business conduct. The latter requires improved risk management and aims for compliance with relevant soft-law standards.
- Benefiting from innovative sustainability-related business opportunities — while avoiding potential greenwashing allegations — is a challenging journey which will take time.
- Solely focusing on (financially) material issues is not enough. Companies are expected to adopt a double materiality approach, by also taking their actual and potential adverse impacts on society and the environment into account (the inside-out perspective). This is where sustainability strategies become challenging: what does our company consider appropriate business practice?
- Contrary to popular belief, corporate sustainability is not about philanthropy. Philanthropy is just one — and probably the least significant — element of corporate sustainability.

by Olivier Jaeggi

Corporate Sustainability in a 2x2 Matrix

Corporate sustainability is as much about value creation as it is about responsible business conduct.
Impactful corporate sustainability involves all of this matrix's elements, which in some cases are interrelated.



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.

➔ Sustainability-related disclosure: proposed standards are progressing

While a Carbon Tracker **report** reveals that carbon-exposed companies are not doing a great job at integrating material climate matters into their financial statements, the International Sustainability Standards Board (ISSB) is coming closer to finalizing its first two standards (IFRS S1 and S2) by making **decisions** such as requiring companies to report their scope-1, -2, and -3 greenhouse gas emissions. As prominent standards approach finalization, **research** confirms the importance of information governance in sustainable finance and disclosures. This **briefing** compares the EU's Corporate Sustainability Reporting Directive, the ISSB framework, and Form 10-K climate disclosures proposed by the US Security and Exchange Commission. Meanwhile, the Financial Stability Board has published a **progress report** on climate-related disclosures around the world as well as a **report** on supervisory and regulatory approaches to climate-related risks. December 22, 2022

Read more (1) ➔ Read more (2) ➔ Read more (3) ➔

➔ Basel Committee clarifies its framework for capturing climate-related financial risk in evolving markets

The Basel Committee on Banking Supervision (BCBS) has published responses to **frequently asked questions** to clarify how emerging climate-related financial risks may be captured in the existing Pillar 1 standards for regulated banks. To help promote consistent interpretation of the current framework amid evolving reporting contexts, the BCBS answers questions about the following: the relevance of climate-related financial risks to property valuations, "investment grade" definitions, creditworthiness (of covered bonds and counterparties), recommended ways of reflecting these risks in supervisory slotting criteria, and the considerations relevant to risk weights and ratings. It also addresses recommended error margins, ways of identifying potential losses, and optimum stress-testing approaches, among other topics. December 8, 2022

Read more ➔

What we're watching

Here are a few **anticipated actions revealed by our Policy Outlook research**. ECOFACT's team of legal analysts monitor regulatory developments related to sustainable finance and corporate responsibility in more than 50 jurisdictions, including the EU, and those of financial sector regulators, stock market authorities, and multilateral organizations. Please **contact us** for more information on regulatory trends.

Jurisdiction	What's on our radar	Date of next expected development
Net-Zero Insurance Alliance (NZIA), Science Based Targets initiative (SBTi)	The NZIA and SBTi plan to release a net-zero target-setting protocol for the insurance sector. **Read more** (for Policy Outlook subscribers) ➔	Q1 2023
International Sustainability Standards Board (ISSB)	The ISSB is to finalize its general requirements for disclosing sustainability-related financial information (IFRS S1) and the climate-related disclosures standard (IFRS S2). **Read more** (for Policy Outlook subscribers) ➔	Q2 2023

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: biodiversity needs finance, and finance needs biodiversity

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.

➔ We are in the midst of the "sixth mass extinction event." Because our economy relies on the ecosystem services provided by a disproportionately small percentage of land and waterbodies, it has been estimated that a mere 30 percent of land and 24 percent of waterbodies need to be conserved in order to sustain 90 percent of these critical services.

This sounds like a straightforward solution. However, animal populations continue to decrease rapidly, as does global biodiversity, due to causes that are challenging to address. The Convention on Biological Diversity's 15th Conference of the Parties (COP15) in Montreal in December resulted in a "historic deal" to protect nature and restore degraded areas. This agreement could signal that governments are committed to confronting nature loss with an urgency similar to that advocated for climate change.

Why we think it matters

The UN Environment Programme states that investment in nature needs to be double current levels, reaching USD 384 billion annually by 2025, in order to address biodiversity loss in a meaningful way. Some have identified this as an opportunity that makes "commercial sense." Yet most of Europe's largest banks neither have biodiversity strategies nor systematically consider biodiversity-related risk.

"Nature-positive" is a catch phrase (like net zero) for actions that protect and regenerate ecosystems. Nature-positive claims and biodiversity policies are likely to see the same type of scrutiny that net-zero commitments are increasingly facing. These claims (both nature-positive and net zero) risk being labelled as greenwashing. As the Taskforce on Nature-related Financial Disclosures works to finalize its reporting framework, there is criticism that its approach will facilitate rather than prevent greenwashing.

New biodiversity resources

Title	Description	Published by
Act now! The why and how of biodiversity integration by financial institutions	Practical guidance on how to integrate biodiversity into financial institutions' financing activities and decision-making, including how to start measuring impact and setting targets.	Finance for Biodiversity Foundation
Biodiversity Finance Reference Guide	The guide is the "first market framework for biodiversity finance." It provides a list of investment projects, activities, and components that help to protect, maintain, or enhance biodiversity and ecosystem services, as well as promote the sustainable management of natural resources.	International Finance Corporation

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

EU's new law requires deforestation-free commodities; new database helps investors to exclude deforestation from their portfolios

The EU Council has approved the final text of a new regulation that prevents certain commodities and products associated with deforestation and forest degradation from being sold on the EU market. From its earliest days, this new law appears to have influenced behavior. In the past, Indonesia's timber was exempted from due diligence because its verification system (SVLK) was certified by the EU. Indonesia is adding sustainability components to the SVLK in the hope that its producers will comply with the EU's new expectations. Forest IQ, a new database from the Zoological Society of London's SPOTT, offers investors information on companies' links to deforestation, conversion of nature, and human rights abuses. This should help investors to better understand their exposure to commodity supply and value chains responsible for deforestation. December 21, 2022

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

Risk factor

BNP Paribas may face climate litigation over fossil fuel investments

Three French NGOs — Oxfam France, Friends of the Earth France, and Notre Affaire à Tous — have threatened to take legal action against BNP Paribas under the corporate duty of vigilance law. This pioneering legislation obliges French multinationals to identify and prevent serious violations of human rights and to minimize any risks to human health and safety as well as the environment linked to their international activities. BNP Paribas argues that it is on track to achieve its carbon neutrality targets by 2050. However, a letter from the NGOs demands that the company comply with the law within three months and withdraw its support — both direct and indirect — for new fossil fuel projects, protesting that, as the primary European funder of fossil fuel expansion, BNP Paribas' efforts remain far too limited. October 28, 2022

Read more (1) → Read more (2) →

Risk factor

Increased carbon emissions from buildings and construction threaten net-zero targets across the sector

Despite increasing investment in energy efficiency, carbon emissions from buildings and the construction sector are surging above pre-pandemic levels. Growth in floor space has outpaced efficiency efforts, leaving the sector increasingly off track to achieve decarbonization by 2050. This is the conclusion of the *2022 Global Status Report for Buildings and Construction* published by the Global Alliance for Buildings and Construction. With volatile energy prices worldwide and rising interest rates expected to continue to hamper investment in decarbonization, urgent recommendations include government incentives for zero-carbon building activities, coalitions to promote sustainable targets, mandatory green building codes, and commitments to construct more efficient buildings along the sector's entire value chain. November 9, 2022

Read more →

Risk factor

Who will pay the price of plastics?

Microplastics have been found in human breastmilk and airborne microplastics recorded in high concentrations in New Zealand: it is estimated that plastic pollution costs people and communities USD 100 billion a year worldwide. This could mean that plastic producers in the US alone may face legal costs of USD 20 billion over the next eight years due to litigation on the grounds of physical harm, water contamination, property damage, breaches of consumer protection laws, and greenwashing. Meanwhile, jurisdictions are moving to address plastic pollution at source. In California, the Plastic Pollution Prevention and Packaging Producer Responsibility Act would require most packaging used in the state to be recyclable or compostable by 2032. Internationally, the UN is developing a binding treaty seeking to prevent single-use plastic pollution as of 2025. November 22, 2022

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

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 Q4	2022 Q1	Q2	Q3	Q4	FI exposure: % share of NGO actions criticizing FIs (SIGWATCH data)	ECOFACT risk rating	Noteworthy news
Oil & Gas	Pipelines	25	25	26	29	19	23%		Shell agrees to pay Nigerian farmers USD 16 million in damages due to leaks in its oil pipelines. Read more
Oil & Gas	Oil sands	6	5	6	3	5	4%		Despite record profits, oil sands companies are under fire for not reinvesting to address environmental liabilities. Read more
Oil & Gas	Liquefied natural gas (LNG)	59	43	73	44	57	26%		Analysis of International Gas Union strategy documents reveals plan to frame natural gas as an eco-conscious fuel. Read more
Utilities	Gas-fired power	126	140	145	90	95	13%		Number of gas-fired power plants in Asia increasing; expected to surpass number in North America. Read more
Utilities	Hydropower	18	16	14	9	9	17%		Extreme weather (drought and heatwaves) threatens dam viability worldwide. Read more
Utilities	Nuclear power	37	34	35	35	33	6%		After the Fukushima disaster, some Japanese are questioning government plans to bring 17 nuclear power plants back online. 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.

Tree planting not enough to fight climate change

While tree planting is touted as a simple solution to climate change, a **study** has found there is not enough land on earth to achieve the world's cumulative tree-planting goals. Tree-planting-based climate pledges rely on "unrealistic amounts" of land-based carbon removal that could not be achieved without negatively affecting communities (especially Indigenous peoples), ecosystems, and food security. Instead, countries need to make much deeper cuts in emissions and preserve their existing forests to achieve net-zero goals. Another **analysis** of tree-planting programs has found that forest restoration is often unsuccessful, as many of the trees die from lack of maintenance or unsuitable sites. Such programs are not effectively audited or analyzed, meaning that tree-planting risks becoming a "junk offset" used to greenwash burgeoning national and corporate emissions. November 21, 2022

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

From greenwash to "green hush"

One in four businesses with ambitious net-zero targets plan to keep them quiet, according a **net-zero report** from climate consultancy South Pole. Reviewing the net-zero progress of more than 1,200 private companies in 12 countries and 15 sectors, South Pole has found that despite increasingly ambitious targets, the stigma of greenwashing (i.e., when a company exaggerates its green credentials) is so feared that executives would rather say nothing than risk being accused of overstatement. Being labeled a greenwasher brings reputational harm, financial damage, and often the **scrutiny** of regulators. Greenwashing is increasingly being replaced by what South Pole has dubbed green hushing, a level of discretion that South Pole warns could silence inspirational change leaders. December 14, 2022

Read more →

Amid planetary crises, antimicrobial resistance is an equally pressing issue

The World Health Organization **expects** up to an additional 10 million deaths yearly by 2050 if a proactive, aggressive approach to antimicrobial resistance (AMR) is not taken. For its part, the World Bank **believes** that AMR might cause the loss of up to 3.8 percent of global gross domestic product by 2050. Although some high-level **commitments and targets** were established at the Third Global High-Level Ministerial Conference on Antimicrobial Resistance, climate change, biodiversity loss, and AMR have complex interrelationships that require coordinated policies and action to lower systemic risk and lessen financial implications. For this reason, Aviva Investors and Legal & General Investment Management want AMR risks under the banner of sustainable finance and included in the sustainability disclosure frameworks currently under development. November 25, 2022

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

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.

➔ Accelerated net-zero efforts needed

While the six major US banks have pledged to achieve net-zero financed emissions by 2050, all need to end support for new fossil-fuel projects, according to the Sierra Club. The G20 Sustainable Finance Working Group has also urged governments and the financial sector to accelerate the development of transition finance to address climate change, and to use independent third-party assurance to ensure transition accountability. Likewise, the Glasgow Financial Alliance for Net Zero (GFANZ) has called on G20 countries to bridge the gap between their Paris commitments and their actual emissions by using all possible "policy levers" for ambitious emission reduction. To help companies do their part, GFANZ has also launched a new framework for financial sector net-zero planning and a pan-sector guide to portfolio alignment to help financial institutions measure their emissions. November 1, 2022

Read more (1) ➔ Read more (2) ➔

➔ Over 200 investors sign up to "Advance," the world's largest collaborative stewardship initiative on human rights

Some 220 investors representing USD 30 trillion in assets under management, including Norges Bank Investment Management, Schroders, and JPMorgan AM, are collaborating to promote investor engagement with human-rights issues by joining Advance, a major collaborative stewardship initiative launched by the Principles for Responsible Investment. Participants in the five-year group initiative pledge to enhance their own human rights policies and due diligence processes while also using their collective influence as investors to drive positive change. Half of the members will initially engage with 40 focus companies from two sectors: metals and mining, and renewables. Named focus companies include Anglo American, Nippon Steel, Goldfields, NextEra, Rio Tinto, and RWE. December 1, 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	Q4 2022	
	I	U
Agriculture	**1**	**1**
Agricultural commodities	2	0
Animal welfare	1	1
Palm oil	3	2
Forestry	2	2
Tobacco	5	3
Fisheries	1	1

Sector policy	Q4 2022	
	I	U
Utilities	**1**	**1**
Nuclear power	1	1
Coal-fired power	8	3
Hydropower	0	1
Human rights	**7**	**5**
Large-scale resettlement	1	1
Indigenous rights	2	1

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

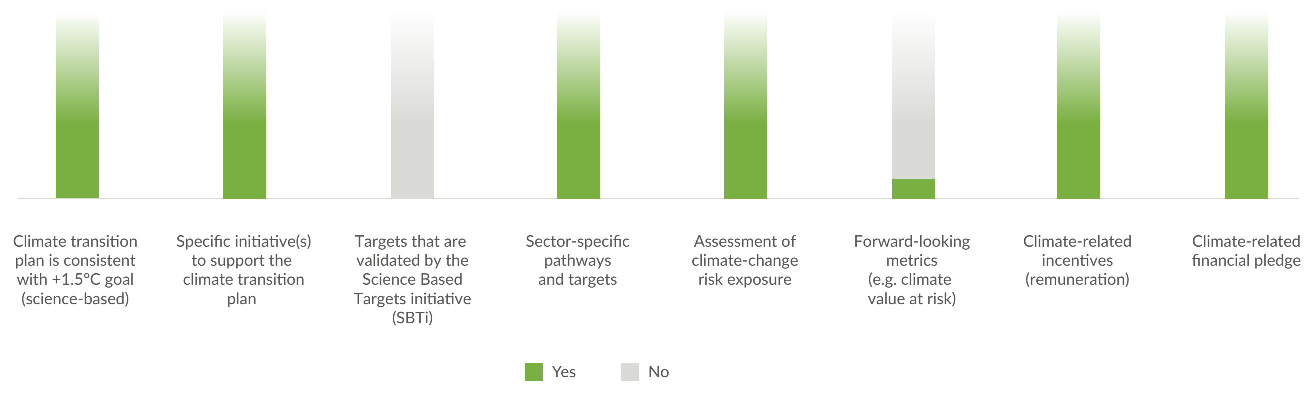
Policy sector in focus: climate transition plans

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

➔ Prior to the 27th Conference of the Parties (COP27) meeting in Egypt in November 2022, many organizations released reports urging action to address climate change. For example, a Climate Action Tracker progress report, an Energy Transitions Commission report, and a policy briefing from the Institute and Faculty of Actuaries all point out that the delay in lowering greenhouse gas emissions is destabilizing the climate (and human societies) more quickly than expected. This is moving the Paris Agreement goal of 1.5°C warming almost out of reach. Although COP27 failed to produce an agreement on phasing down fossil fuels, an agreement to develop a "loss and damage" fund is being heralded as "climate justice."

➔ **Why we think it matters:** While companies appear increasingly to be identifying risks and opportunities related to climate change, the world of finance remains out of step with climate-change goals. Financial institutions are developing climate transition plans that detail (to varying degrees, see the chart below) how they will adjust their own operations, portfolios, and policies to contribute to the net-zero transition. However, there is room for improvement. For example, other high-emitting sectors (not just fossil fuels)

What is being mentioned in financial institutions' climate transition plans



*Graph based on data from ECOFACT's Monitoring Peer Policies, a comprehensive analysis of environmental and social policies and frameworks of a variety of leading banks and insurers.

New resources

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

➔ New guide to responsible investment in the renewable energy sector

Concerned by evidence of links to modern slavery in the clean energy sector, the Business & Human Rights Resource Centre has published a new guide to responsible investment in renewables. In line with a recent report published by the Clean Energy Council, *Addressing Modern Slavery in the Clean Energy Sector*, which urges investors to proactively engage on these issues, the guide outlines critical steps that renewable industries can take to strengthen accountability: 1) create a culture of awareness; 2) conduct supplier due diligence; 3) use influence to drive change; 4) develop robust remediation frameworks for adverse human rights impacts; and 5) seek (or create) opportunities to work collaboratively toward solutions. November 29, 2022

Read more (1) ➔ Read more (2) ➔

➔ New Just Transition finance tool and guidance for investors

The need for a net-zero transition that is inclusive, fair, and green (i.e., a Just Transition) is recognized in the Paris Agreement. The newly released Just Transition Finance Tool gives practical "entry points" to institutions looking to embed these goals across their operations. Developed by the International Labour Organization and the London School of Economics' Grantham Research Institute, the tool explains how to integrate social aspects into existing and emerging sustainability alignment strategies. Complementary guidance from the corporate sustainability initiative UN Global Compact recommends an integrated approach across four core elements of operations – strategy, governance, risk management, and metrics and targets – as well as engagement with policymakers to support an enabling environment, particularly with regard to fiscal policies. December 15, 2022

Read more (1) ➔ Read more (2) ➔

➔ New template for easier Swiss Climate Scores application

The Swiss Climate Scores, developed by Swiss Sustainable Finance (SSF), Swiss Bankers Association, and the Asset Management Association Switzerland (AMAS), were designed to provide investors with information about companies and portfolios' greenhouse gas (GHG) emissions, fossil fuel exposure, net-zero commitments, and other climate-related data. After consulting experts in the field, AMAS and SSF released the first version of a template that makes it easier for companies and investors to calculate and display their Swiss Climate Scores indicators, including a company/portfolio's GHG emissions intensity and footprint as well as verified commitments to net-zero targets. The new template, which includes definitions and calculations, is intended as a starting point for industry testing. The Swiss Federal Council recommends that all Swiss financial market actors apply the climate scores to their assets and portfolios. October 5, 2022

Read more ➔

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