ESG RISK QUARTERLY

ECOFACT's briefing for risk experts

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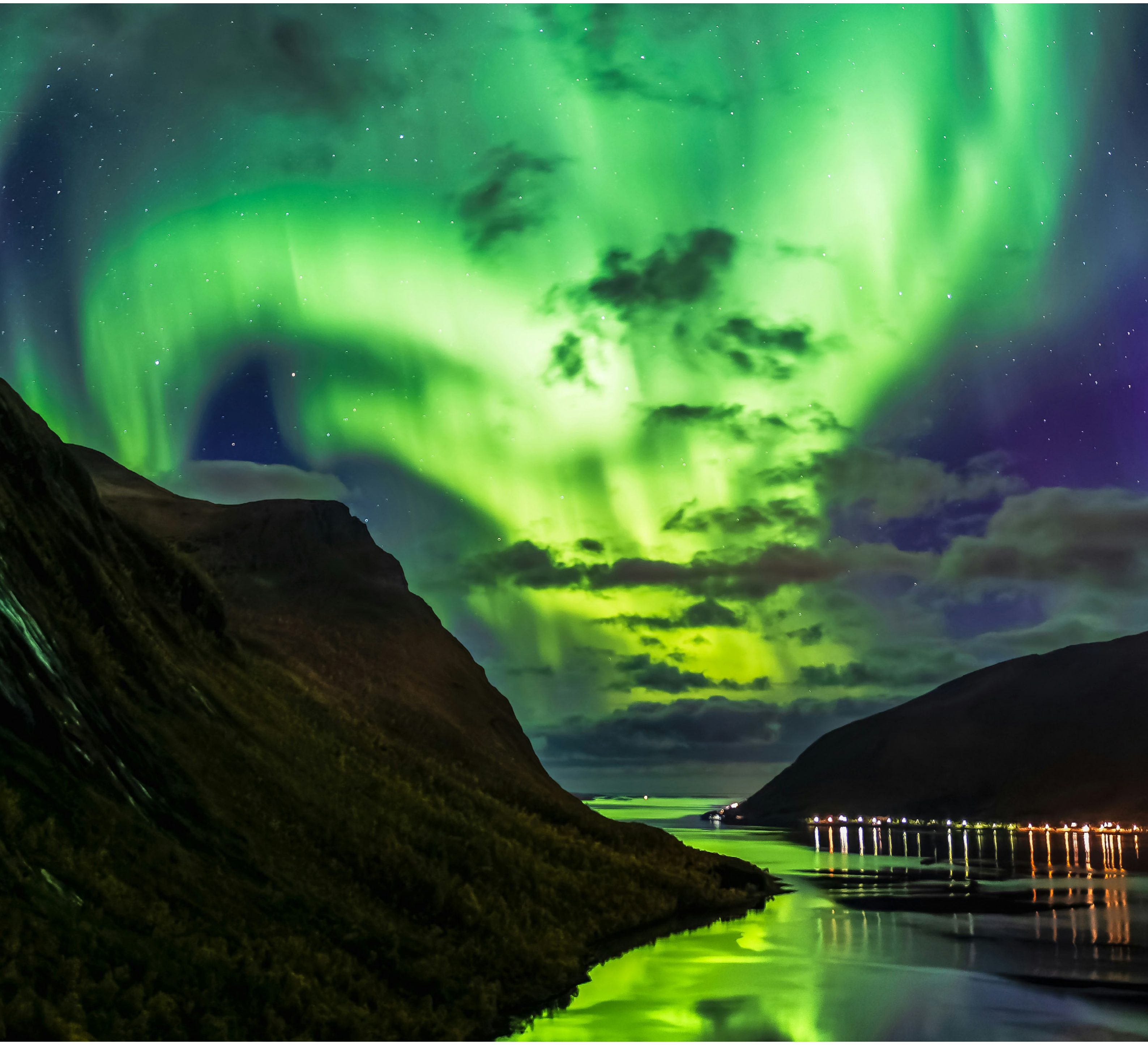

ECO:FACT

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Editorial

Risky business: why companies need to pay attention to adverse impacts

If I could make one wish about sustainability regulations for 2025, it would be for them to become less complex and focus on what truly matters in the short term: reducing harmful ("adverse") impacts.

Addressing sustainability challenges effectively requires action on two key fronts: fostering innovation and reducing the company's adverse impacts. Innovation is crucial because it drives fundamental changes in how we produce and consume. However, innovation takes time and significant investment to scale. In the meantime, reducing adverse impacts – limiting the harm done – is what we can do right here, right now. For example, regulations that cut emissions, halt deforestation, and reduce waste protect natural resources and prevent irreversible damage. This action often relies on existing technologies and policies, making it faster to implement. It stabilizes systems and buys us the time needed for long-term solutions.

Take plastic pollution as an example. Improving waste management and recycling systems is essential, but these efforts are costly and often ineffective, especially in low and middle-income countries. Meanwhile, plastic is breaking down into microplastics, and biodegradable plastics are no different under normal conditions. Increased plastic production only adds to this problem, undermining waste management efforts and causing a **rapid rise** in microplastics in **freshwater systems**, **food, and even the human body**. (**Here's** a brief article on this issue.) The only effective solution to reduce harm today is to cut the production of virgin plastic.

This shift will undoubtedly challenge many established companies, but it will also open doors for businesses that can already provide alternative products today, and those that can develop innovative materials in the future. By phasing out outdated industries, resources like financial and human capital will be redirected to support emerging sectors. This process, known as Schumpeter's "**creative destruction**," highlights the transformative power of capitalism. It will eventually drive the economy toward more sustainable and forward-thinking pathways.

Reducing adverse impacts should therefore be at the core of sustainability regulations. The European Union has begun to demonstrate this in the Corporate Sustainability Reporting Directive and the Corporate Sustainability Due Diligence Directive. Limiting harm is the most critical ingredient in sustainable development.

So, what does this mean for companies? While they need to bring innovative ideas to market and scale them, the most **important step** today is to examine their current value chain. Senior leaders must analyze their operations, supply chains, and the harmful impacts linked to their products and services. Tools such as life-cycle assessments, technology evaluations, and scenario analysis are well established but still underused.

When presenting the idea for the UN Global Compact at Davos in 1999, then-UN Secretary-General Kofi Annan urged businesses to embrace a set of core values in human rights, labor standards, and environmental practices. He believed that businesses could drive meaningful change. Today, companies must also recognize that **failing to identify, disclose, and address harmful impacts** is not just an oversight – it is a source of reputational, legal, and liability risks.

Olivier Jaeggi
ECOFACT Managing Director

CSDDD Support Package

If you know an organization that could use some help implementing the EU Directive on Corporate Sustainability Due Diligence (CSDDD), send them our way. We can help you, your clients or suppliers with our CSDDD Support Package. This is composed of a summary presentation that provides an overview of the directive and key concepts, and a rule map that sets out easy-to-follow action items for implementing the requirements, as well as highlighting links to other key frameworks in the EU and globally. Support calls are also included. The CSDDD Support Package will be continually updated as the directive is transposed into national law by member states across Europe.

Perhaps you'd like to leverage our expertise to develop a guide to CSDDD implementation that you can share with your own clients or suppliers?

Please contact **Shane Murphy**, Head of Product & Operations: **shane.murphy@ecofact.com**; +41 58 520 20 08.

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.

→ Researchers assess impact of HREDD laws on corporate due diligence practices

The British Institute of International and Comparative Law has released a **study** on how businesses are changing their practices in response to human rights and environmental due diligence (HREDD) laws. Juxtaposing HREDD laws in France and Germany with the upcoming requirements of the EU's Corporate Sustainability Due Diligence Directive (CSDDD), the study highlights gaps in corporate HREDD practices, calling for greater progress with regard to grievance mechanisms and recommending steps that policymakers can take to improve the design and implementation of HREDD legislation. October 15, 2024

Why we think it matters: This study may help investors to anticipate how companies could be affected by the CSDDD. EU member states must transpose the CSDDD into national law by July 26, 2026. However, the EU Commission may propose an "omnibus" regulation to streamline overlapping requirements of the CSDDD and other regulations. (Policy Outlook subscribers can read more **here**.)

Read more →

What we're watching – and open consultations tables

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

Authority	What's on our radar	Date of next expected development
European Union	The European Artificial Intelligence Act will start to apply. It is the world's first legal framework to address the risks of AI technologies. The provisions will be phased in between 2025 and 2028. **Read more** (for Policy Outlook subscribers) →	February 2, 2025

Open consultations

Our **Policy Outlook database tracks open consultations** that are relevant both to the wider financial and insurance industries and to corporate actors. Organizations and governments solicit structured feedback from stakeholders during these events. Interested parties can comment on the materials that are issued to promote dialogue. Please **contact us** for more information about open consultations.

Authority	Consultation topic	Deadline for input
Switzerland	The Swiss Federal Council is looking for feedback on proposed **amendments** to the Ordinance on Climate Disclosures. The revisions would introduce mandatory sustainability reporting in 2026 that must be aligned either with an internationally recognized standard or the European Sustainability Reporting Standards. Minimum requirements for financial institutions' transitions plans are also proposed. **Read more** (for Policy Outlook subscribers) →	March 21, 2025

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: Transition plans

➔ As we strive for a more sustainable future, the financial sector is playing an important role in **financing** the requisite technological advances. According to a **climate scenario analysis** released by the European supervisory authorities and the European Central Bank in November 2024, the combination of transition risks and macroeconomic shocks could undermine the financial sector's ability to finance the green transition. Understanding transition risks and developing a preemptive response to address them is a critical task for all stakeholders in the economy.

Transition plans communicate an organization's actions, strategy, and goals with regard to managing risks associated with the economy's green transition. These plans describe how an organization intends to meet its strategic climate or nature-related commitments and targets. Financial institutions can benefit from developing their own transition plans and analyzing their clients' and portfolio entities' transition plans (*see Figure 1*).

What are transition risks?

Transition risks are about change. They are potential (direct and indirect) threats to an organization that arise from the economy's or an organization's dependencies and impacts on nature and from moving toward low-carbon goals. These risks may be:

- **Policy risks:** changes in policy context or enforcement
- **Technology risks:** old systems displaced by new ones
- **Market risks:** changes in supply and demand

Figure 1. The value of transition plans for financial institutions and insurers

Transition plans of others...

Analyze the transition plans of...

Clients + Portfolio entities

Some resources on what to look for:

- Investor Expectations for Corporate Just Transition Planning (Investors Group on Climate Change)

Own transition plans...

Develop and disclose climate and nature-related transition plans that support emission reduction, manage risks and opportunities, and enable support of economy-wide transition activities.

Some resources to help you do this:

- Disclosure Framework and sector guidance (banks, asset managers, asset owners) from the Transition Plan Taskforce

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

Assessing the state, health, and economic risks of Europe's water

A European Securities and Markets Authority report asserts that the most prominent risks for EU funds are related to water. Using different methods to proactively assess exposure to physical climate risk, the report shows that indirect and direct water risks, such as flooding and supply-and-demand imbalances, can and should be considered. In its report on the health of Europe's surface water, the European Environment Agency confirms that the risk of water-related exposures is growing. Primarily due to the impact of chemicals, pesticides, air pollution, water overuse, and habitat degradation, exacerbated by climate change – only one-third of Europe's rivers, lakes, coastal waterbodies, and related ecosystems are cited as being in good health. The report warns that unless measures are taken to improve the resilience and sustainability of freshwater supplies, Europe could face serious water security challenges. October 15, 2024

Read more (1) → Read more (2) →

Risk factor

Traceability software could expose risks in food-sector supply chains

A Planet Tracker case-study report on supply-chain traceability shows how external players could tap publicly available supply-chain data to estimate companies' environmental footprints. Planet Tracker used supply-chain traceability software to integrate Nestlé's supply-chain disclosures with geospatial data to reveal the environmental impacts of the company's coffee, cocoa, fresh milk, and palm oil supply chains. The report urges companies to invest in advanced traceability tools to help them identify supply-chain risks and meet due diligence obligations. October 16, 2024

Why we think it matters: Tools such as this demonstrate how publicly available data could be leveraged to inform investment decisions and meet regulatory requirements.

Read more →

Investor resource

How investors can shape the mining industry's future

Investors play a key role in shaping the mining industry as it gears up to meet the resource requirements of the green transition. The Global Investor Commission on Mining 2030, an investment group, has identified ways in which investors can help to increase the benefits of mining while reducing its negative impact. These strategies include allocating capital directly to companies exhibiting best practices and actively monitoring investee mining companies in terms of ESG expectations. Additionally, investors should also adopt an active stewardship role with companies throughout the mining sector's value chain. Beyond mining companies and customers, investors can engage with banks and stock exchanges to pursue high environmental and social standards, and they can also encourage governments and regulators to develop policies to promote responsible mining. October 8, 2024

Read more →

Risk factor | Investor resource

Financial sector's role in deforestation spurs call for stricter regulation

Investment in commodity sectors linked to tropical deforestation is rising, according to the Banking on Biodiversity Collapse report issued by the Forests & Finance coalition. The report states that investment in the beef, palm oil, pulp and paper, rubber, soy, and timber industries has grown by 7 percent since September 2023. Credit in these sectors is also up, despite voluntary banking initiatives promoting sustainability practices. The report asks governments to strengthen financial-sector regulations to take biodiversity factors into account. The coalition has released a second report, titled Regulating Finance for Biodiversity, which recommends steps countries can take in this regard. Moreover, to help financial institutions integrate deforestation risks into climate- and nature-related financial disclosures, the Forest Risk Consortium has released a workbook and training webinar to complement its recent guide to deforestation disclosure. December 5, 2024

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 2023 Q4	2024 Q1	Q2	Q3	Q4	FI exposure: % share of NGO actions criticizing FIs (SIGWATCH data)	ECOFACT risk rating	Noteworthy news
Oil & Gas	Pipelines	36	18	36	19	28	15%	Orange	The US Transportation Security Administration has proposed requiring certain pipeline and rail operators to meet cyber risk management requirements. Read more
Oil & Gas	Oil sands	5	5	8	4	3	12%	Red	The oil sands regulator of Alberta, Canada has been accused of withholding information because it failed to publish annual reports on the environmental monitoring program for five years. Read more
Oil & Gas	Liquefied natural gas (LNG)	49	69	74	58	63	15%	Yellow	As LNG development intensifies, big banks and investors are being called out for having net-zero targets yet not excluding or limiting financing for LNG projects. Read more
Utilities	Gas-fired power	81	77	81	101	101	15%	Orange	Gas-fired power generation in Germany was increased by 79% in November 2024 to fill an energy gap because wind speeds were slow. Read more
Utilities	Hydropower	9	16	14	10	12	16%	Yellow	Despite supporting only one new large-scale hydro project in the last decade due to environmental risks, the World Bank seems likely to finance five new major dams in the first half of 2025. Read more
Utilities	Nuclear power	31	44	36	28	30	5%	Orange	More uranium will be needed if nuclear power plants are brought online to meet energy needs. However, uranium mining poses risks to groundwater. 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.

➔ Greenwashing seems to be on the wane; most investors prioritize short-term gains rather than sustainability

RepRisk's annual **review** of greenwashing noted a 12 percent decline in greenwashing cases in 2024 (year-on-year) – the first fall in six years – although high-risk incidents surged over 30 percent. While this reflects more stringent rules in place, particularly in the EU, the report also warns that such rules may encourage "greenhushing" – when companies avoid discussing sustainability initiatives to avoid legal risk. Meanwhile, an EY **survey** has found that while 88 percent of investors say that their firms use ESG information when investing, 92 percent would not sacrifice short-term performance for ESG benefits. Two-thirds of respondents believe that ESG investments will be less important in future, even though nine out of ten assert that greenwashing is a growing issue. December 10, 2024

Read more (1) ➔ Read more (2) ➔

➔ Flaws in MiFID II sustainability preference regime

A survey of European banks that are required to comply with the sustainability reporting rules of the Markets in Financial Instruments Directive (MiFID II) has found a large disparity between the number of investors who state a sustainability preference (only 5 percent of clients) and those who hold sustainable investments (40 percent of clients). This suggests that MiFID II's requirement to record sustainability preferences may neither precisely reflect investor preferences nor drive new investments toward sustainable investments. To achieve these goals, banks should carefully design their processes to capture preferences accurately. EU regulators should also assess the regulatory structure, while market participants should be cautious about statistics that indicate investors do not want sustainable investments. October 2024

Read more ➔

➔ Are insurers ready for climate change?

Climate change is becoming increasingly expensive for the insurance industry, **accounting** for one-third of insured weather losses in the last 25 years. To help insurers manage climate-related risks, the European Insurance and Occupational Pensions Authority **recommends** increasing the capital requirements for fossil-fuel-related stocks and bonds held by insurers. Carbon Tracker, meanwhile, **argues** that economists and consultants have systematically under-priced global warming compared to decarbonization, convincing the financial

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.

Help for banks in monitoring one another's transition progress

The low-carbon transition is still in its infancy for most banks assessed in a Transition Pathway Initiative Centre report. The banks performed weakly against Net Zero Banking Assessment Framework indicators and low-carbon scenarios. Among 26 major international banks, 85 percent remain willing to finance new coal projects. Banks seeking to benchmark their climate pledges against those of their peers can now access the World Resources Institute's Financial Institutions Net Zero Tracker, which enables comparisons of banks' performance against net-zero commitments. Meanwhile, a European Banking Authority staff paper proposes further study of a new method for assessing banks' transition risk by quantifying the implied temperature rise of their (non-SME) corporate loan books. No banks assessed this way in a pilot study were on track to meet Paris Agreement temperature targets. November 18, 2024

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

Regulation needed to address hidden emissions

The Net-Zero Asset Owner Alliance (NZAOA) has called for top-down regulatory action on scope 3 emission disclosures. Scope 3 – sometimes referred to as "hidden" – emissions, occur upstream and downstream of an organization and account for three-quarters of most companies' emissions. They are challenging to track because of insufficient accounting and disclosures, low-quality data, and

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 2024	
	I	U
Climate change	9	7
Biodiversity	6	4

Sector policy	Q4 2024	
	I	U
Medical		
Clinical trials	2	1
Animal testing	2	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: biodiversity and nature

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

➔ **Stakeholders** are growing increasingly **concerned** about the role that ecosystems play in maintaining stable and resilient financial systems. Yet companies are struggling to fully understand and manage nature risks, in part because there are significant **data challenges**, and corporate decision-makers and investors are wrestling with understanding the complexities. The International Monetary Fund **reports** that "nearly 38 percent of bank loans of the 100 largest global banks are to harmful subsidies-dependent sectors [...] and that industries most exposed to nature degradation are not well prepared to manage these risks."

Policies, disclosures, and resources

ECOFACT analyzes the public disclosures of environmental and social risk policy frameworks (including their exclusions) of several financial institutions (FIs) as part of our **Monitoring Peer Policies** service. In 2024, 62 percent of the FIs that we track had disclosed due diligence considerations for biodiversity-related risks – up from 37 percent in 2021. This shows that FIs are communicating more about how nature-related risks affect their products and services – as well as the products

Resource	Who is it for?	Issuer	What does it support? Business case	Data and metrics	Portfolio analysis	Risk management	Reporting
NatureAlign	Asset managers, asset owners, commercial banks	**NatureFinance:** Free, online app. Helps FIs align financial flows with nature-positive outcomes. Beta version of first analytica module supports baseline		✓	✓	✓	✓
Started in the Agricultural, Forestry and Mining Sectors		**Biodiversity Consultancy:** Guidance on setting targets and priority actions related to the extraction and production of commodities (bauxite, copper, cattle, wood, soy, and palm oil) from sectors with the most opportunities to mitigate nature loss.	✓			✓	

Climate risks are nature risks

The Swiss Financial Market Supervisory Authority (FINMA) is very clear that it considers climate risks to be a subcategory of nature risks. A FINMA **circular** issued in December 2024 phases in expectations of FIs and insurers in terms managing climate and nature

New resources

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

➔ Climate adaptation guidance published for financial institutions

The UK's Climate Financial Risk Forum (CFRF) has published several best-practice guides to help firms channel finance into climate adaptation activities. The **Short-term Scenarios** guide presents various use cases for short-term scenarios (covering six years or less) that can help firms to identify which activities would be good to invest in to support climate adaptation and to inform the development of climate transition plans. The **Mobilising Adaptation Finance to Build Resilience** guide details how firms can assess and price physical risks and boost investment in climate adaptation opportunities. With these guides, the CFRF aims to enhance the financial services industry's ability to manage climate-related risks and opportunities through strategic risk management and effective practice development. October 10, 2024

Read more ➔

➔ Assessing the value of physical climate resilience

The latest **discussion paper** released by the Institutional Investors Group on Climate Change (IIGCC) explores how real estate and infrastructure investors can integrate the group's Physical Climate Risk Assessment Methodology (PCRAM) into investment processes – from portfolio design to due diligence, credit and investment approval, stewardship and ongoing management. PCRAM involves evaluating assets using four steps: (1) scoping and data gathering, (2) materiality assessment, (3) resilience building, and (4) economic and financial analysis. Importantly, step 3 is designed to fully capture the value of physical risks weighed against the increased expenditures required to build resilience. This framework is also potentially useful for infrastructure and financial regulators, and to governments in general. The IIGCC is working on an updated and refined version of the PCRAM. November 18, 2024

Read more ➔

➔ Guidance published for investors on remediation of modern slavery

A **report** coauthored by the First Sentier MUFG Sustainable Investment Institute and the international human rights group Walk Free examines the role investors can play in supporting the remediation of modern slavery. Including forced labor and forced child labor, modern slavery affects more than 77 million people worldwide and occurs most often in the private economy in the services,

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