In the face of emerging regulatory requirements related to environmental, social, and governance (ESG) disclosure and pressure from a wide range of stakeholders, the financial services industry is now looking closer at how to best identify and address the material risks and impacts of their operations and value chains. This is a marked difference from previous ESG materiality approaches, which largely focus on financial risks to the business alone.

In order to meet the wave of regulatory developments and stakeholder expectations, BSR has developed a range of innovative tools, such as double materiality assessments, to help companies account for both impacts inward (financially material ESG topics for enterprise value) and impacts outward (material impacts on people, the environment, and the economy).

The Double Materiality Matrix

For multiple stakeholders: Considers the company’s impacts outwards and uses the GRI definition: “topics that reflect its most significant impacts on the economy, environment and people, including impacts on human rights.”

For investors, lenders, and other creditors: Considers the company’s impacts inwards and uses the SASB definition: “expected to influence investment or lending decisions that users make on the basis of their assessments of short-, medium-, and long-term financial performance and enterprise value.”
Survey Insights

» Many financial institutions that participated in the survey consider financial risk and risk to people and planet when determining material issues and find double materiality assessments as beneficial.

When asked which criteria they consider when determining material risk, all survey respondents chose financial risk. Nearly 85 percent shared that their companies also consider risk to people and planet, although the criteria and standards to assess these risks are not clear based on the survey results.

Forty-five percent of respondents agree that double materiality assessments positively impact their company’s business success, with 18 percent saying that they “strongly agree.”

» Financial institutions regularly conduct double materiality and other assessments to identify ESG risks and impacts.

When asked what type of assessments they conduct to identify priority ESG issues, the survey found that they conduct a range of assessments, with a majority undertaking a double materiality assessment (62 percent).

Respondents also indicated that their companies conduct human rights risk and/or impact assessments (54 percent) and environmental and social risk assessments (46 percent), although survey results did not reveal the methodology, scope, or frameworks used for these assessments.

While further research is required to understand the drivers behind these numbers, they could partly be due to European regulations, such as the Sustainable Finance Disclosure Regulation, that require disclosures by certain financial market participants and advisers based on the double materiality approach.

Although the frequency of when respondents update or plan to update materiality assessments and matrices varies, the survey revealed that almost half (46 percent) plan an update every two years. None of the respondents indicated a frequency of over four years.

» Respondents identified a variety of ESG issues that they see as material today and in the future.

Multiple respondents identified the following ESG issues as material today based on their impacts on business value, people, and the planet, as well as those that they expect to become material in the future:

Respondent perceptions of material ESG issues for financial institutions, people, and planet today

<table>
<thead>
<tr>
<th>Business ethics</th>
<th>Customers</th>
<th>Data and technology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lobbying and public policy, responsible tax practices, corruption, and money laundering</td>
<td>Consumer protection, financial inclusion, and local economic impacts of financial products and services</td>
<td>Disruptive financial technologies, cryptocurrency, and data security and management</td>
</tr>
</tbody>
</table>
**Employees and workplace:** Diversity, equity, and inclusion (DEI), employee health and wellbeing, fair wages, and talent attraction and retention

**Environment:** Climate change, including the issues related to financing the transition to a low-carbon economy, environmental justice, and inclusive development. Natural resource management, biodiversity, and ocean protection

**Products and services:** Environmental and human rights impacts of lending, financing, investment banking, and asset management activities, including impacts of customers, clients, and portfolio companies

**Vulnerable and marginalized populations:** Issues related to child rights, migration, and those stemming from gender, racial, and other forms of discrimination that arise in the provision of financial products and services

**Respondent perceptions of material ESG issues for financial institutions, people, and planet in the next 5 to 10 years**

**Access to remedy:** Pressures to provide access to remedy and address adverse human rights impacts within own operations and value chain, including those that are closely linked to climate change

**Data and automation:** Machine learning, the acceleration of automation, and responsible data management within own operations and value chain

**Geopolitical and economic instability:** Geopolitical dynamics, including country-level and conflict risks, resource dependencies, supply chain disruptions, and human rights implications

**Nature and natural resources:** Biodiversity loss, access to food, energy, and water, and forced migration due to the depletion of natural resources and climate change

> Respondents face challenges with reporting requirements and expressed uncertainty around the role of ESG data providers.

When asked about challenges that existing and emerging reporting requirements and frameworks pose for the respondents’ companies, almost 80 percent found that the “reporting landscape is ever changing and it’s hard to keep up.” Another challenge may be linked to the accuracy of data that companies use to assess material risks and impacts. Several respondents either “disagreed” or “neither agreed nor disagreed” that external ESG data providers, rating agencies, and benchmarks provide an accurate assessment of what is happening in practice. One respondent remarked that “ESG data providers present an accurate assessment of what companies are saying they are doing – but that is not always the same as what is happening in practice.”
Respondents consult a variety of sources to inform double materiality assessments.

For respondents that conduct double materiality assessments, they consider input from various internal and external sources, including shareholders, peers, thought leaders, academics, trade unions, and civil society. However, few respondents indicated that they consider rightsholders’ perspectives to inform assessments, which reveals a potential blind spot in determining accurate risks and impacts and understanding how to address them.

How Can Financial Institutions Effectively Capture and Address Risks and Impacts?

As companies continue to refresh their materiality assessments and look to apply and refine the lens of double materiality for future assessments, the following recommendations should be considered:

- **Build internal capacity and awareness.** While internal human rights, environmental, and social teams may be more accustomed to assessing outward impacts, business risk teams may not be equipped to consider risks to people and planet. Establishing a clear and shared understanding of double materiality early on is essential for assessment and subsequent ESG strategies and disclosure to be effective.
- **Align with impact materiality assessment criteria.** When conducting double materiality assessments, move away from stakeholder perception-based approaches to approaches focused on impacts, specifically assessing their likelihood and severity. This approach aligns with the expectations set out by the UN Guiding Principles on Business and Human Rights (UNGPs). (See BSR’s blog on Impact-Based Materiality for further information).
- **Ensure effective stakeholder engagement.** Engaging stakeholders to identify inward and outward risks to the business, people, and environment should involve reaching out to rightsholders (or their representatives, e.g., civil society, trade unions) who may be currently or potentially affected by impacts associated with the business. It is important to include critical voices as opposed to only those who are close to the business, as this offers an opportunity to gain valuable insights that can inform subsequent action.
- **Employ various approaches to assess impacts.** A high-level double materiality assessment may uncover enterprise-wide risks and opportunities. However, meaningfully capturing inward and outward impacts will require taking deeper dives, such as conducting portfolio-level and supply chain assessments. Consider multiple data sources of information that provide further insights into impacts on people and planet (over business risk) to inform your assessments (e.g., in addition to ESG indices, look at human rights benchmarks and reports). Adopt a forward-looking approach to prepare for emerging trends and scenarios that can alter potential risks and impacts to people and the planet (e.g., dynamic materiality, BSR Sustainable Futures Lab, etc.).
- **Evaluate issues and company performance against global standards and frameworks of responsible business conduct.** Global standards such as the Universal Declaration on Human Rights, the ILO Core Conventions, and Paris Climate Accord, provide the standards of achievement that should guide and define what issues are assessed. In turn, process-based frameworks such as the UNGPs and the OECD Guidelines lay out expectations for responsible business conduct and offer valuable guidance for what actions companies can take to address adverse impacts on ESG issues connected to their operations and value chains.

BSR offers a variety of resources for companies looking to undertake practical and effective materiality assessments (e.g., our blog series on materiality, Human Rights Roadmap for Transforming Finance and many others.). To learn more about our approach, please contact us.
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