

# INTRODUCTION TO ESG RISK MANAGEMENT

Vital Information for  
your Impact Fund





## — Understanding ESG Risk Management

The financial implications of **environmental, social, and governance (ESG) risks**, coupled with a growing number of global regulations mandating ESG risk assessment, underscore the need for companies and financial institutions to understand and address these risks.

Despite the growing recognition, the complexity of defining ESG risks and the challenge of securing reliable data for their identification persist.

**In impact investing, the stakes for ESG risk management are particularly high.** Fund managers are tasked with the dual responsibility of generating positive outcomes through their investments and meticulously evaluating and mitigating potential negative impacts.

This dual focus amplifies the necessity for an effective ESG risk management framework, positioning it as a cornerstone for impact investing, distinct from traditional investment approaches.

Effective management of ESG risks safeguards against harm and can uncover ethical and sustainable investment opportunities.

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**Innpact guides fund managers** in crucial ESG risk management with strategies and tools to effectively manage such risks.

This ensures investments **aim for positive impacts** as well as **minimize adverse effects**.

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### What is an ESG Risk?

ESG risk refers to the **potential negative impacts on an organization's financial performance and sustainability** arising from environmental, social, and governance factors. These risks can stem from a company's own practices or from broader systemic issues within the markets and communities they operate.

**These risks can significantly impact an organization's performance, and can lead to legal issues.** Managing these risks effectively is crucial for sustainable success and long-term viability.



#### Environmental Risk

The potential for financial loss or reputational damage a company faces due to its **environmental impact**, such as pollution, resource depletion, and climate change.



#### Social Risk

Refers to the potential for financial loss or reputational harm arising from a **company's relationships with its employees, customers, and the communities in which it operates**, including labor practices and human rights issues.



#### Governance Risk

The risk of financial or reputational loss resulting from inadequate internal **governance structures and practices**, including management, and ethical standards, as well as regulation compliance.



## Examples of ESG Risks and Mitigation Strategies

| Microfinance Fund |  |                                      | Renewable Energy Fund |   |   |
|-------------------|--|--------------------------------------|-----------------------|---|---|
|                   | Risk   | Mitigation                           |                       | Risk  | Mitigation                                    |
| Environmental     | Vulnerability to climate impacts (droughts, floods)      | Environmental risk assessments       | Environmental         | Natural disaster risks, climate change impact | Site selection to minimize ecological impact  |
|                   | Negative environmental impacts from supported industries | Support for eco-friendly practices   |                       | Projects in fragile ecosystems                | Climate resilience planning                   |
| Social            | Labor rights issues (forced labor, child labor)          | Strict labor standards for borrowers | Social                | Negative impacts on local communities         | Community engagement and benefit-sharing      |
|                   | Negative social impacts from supported industries        | Social impact monitoring             |                       | Reputational risks from social impacts        | Labor rights compliance in projects           |
| Governance        | Fraud, corruption, conflicts of interest                 | Enhanced governance structures       | Governance            | Project governance issues                     | Transparent project governance                |
|                   | Regulatory non-compliance                                | Compliance training and audits       |                       | Regulatory non-compliance risks               | Adherence to regulatory and ethical standards |

| Agribusiness Fund |  |  |
|-------------------|--|--|
|                   | Risk   | Mitigation                                   |
| Environmental     | Soil, water, biodiversity degradation                | Sustainable farming practices                |
|                   | Climate change impacts on productivity               | Water management and soil conservation       |
| Social            | Labor practices and workers' rights                  | Fair labor practices and safety measures     |
|                   | Impact on food security and community livelihoods    | Support for local food systems               |
| Governance        | Improper land usage and lack of ethical supply chain | Ethical land use and supply chain management |
|                   | Agricultural regulations compliance                  | Regulatory compliance and transparency       |

### Who needs to conduct ESG Risk Assessments?

ESG Risk Management is vital throughout the whole investment chain to protect and increase value.

#### Impact Fund Managers

Need to perform ESG risk assessments to identify sustainable investment strategies that align with clients' financial goals and values.

#### Asset Managers

Use ESG risk assessments to identify risks and opportunities in investment portfolios and develop sustainable investment strategies aligned with their clients' values.

#### Companies

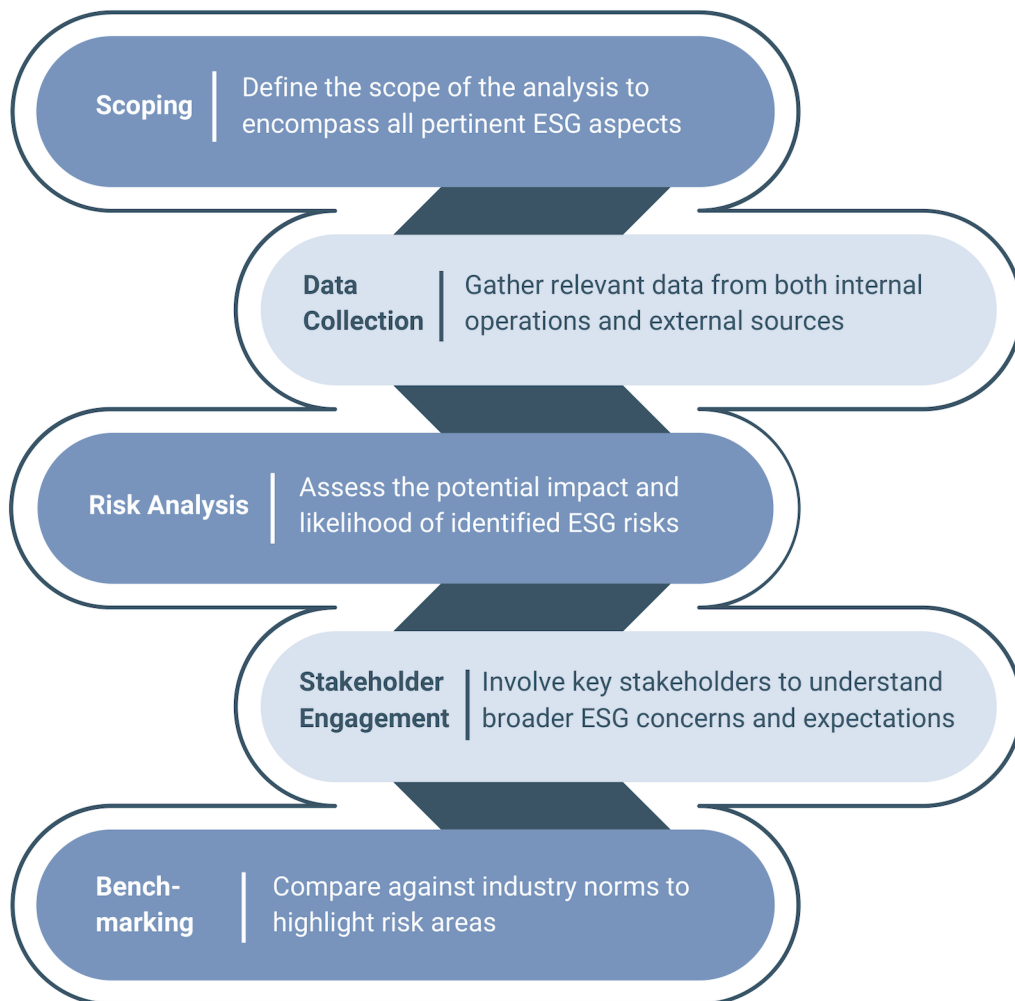
Conduct ESG risk assessments to identify operational and supply chain risks and opportunities and establish sustainable practices for long-term success.



## — ESG Risk Identification Process

ESG risk identification is the process of detecting, analyzing, and prioritizing potential environmental, social, and governance-related risks that could affect an organization's operational performance, reputation, or sustainability objectives.

This process involves:



## — Innpact can help you every step of the way

Innpact advises impact funds on ESG risk management for all **UN Sustainable Development Goals (SDGs)**. We cover various financial instruments, including private equity, debt, and carbon credits, globally.

Our comprehensive ESG risk management strategy combines ESG risk scores with qualitative information. Let us help you assess and manage ESG risks in your fund using quantitative metrics and qualitative insights.



## — Comprehensive ESG Risk Management Services

### ESG Risk Assessment:

- Identifying and Assessing ESG Risks
- Specialized ESG Analysis
- Developing ESG Risk Management Frameworks
- Optimizing Value Creation

### Impact Measurement, Monitoring and Reporting Services:

- Measuring Social and Environmental Impact
- Impact Measurement Tools and Methodologies
- Comprehensive Reporting Frameworks

### ESG Due Diligence and Engagement Support:

- Conducting ESG Due Diligence
- Specialized ESG Analysis and Due Diligence Frameworks
- Supporting ESG Engagement with Investee Companies

### Capacity Building in ESG Risk Management:

- Building Capacity in ESG Risk Management
- Training and Education on ESG Concepts and Tools
- Best Practices in ESG Risk Management

### Global Data Integration and ESG Risk Collaboration:

- Integrating Global ESG Data
- Collaborating with ESG Risk Rating Providers
- Ensuring Comprehensive and Reliable ESG Risk Data



## Contact our ESG and Impact Experts



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**Innpact is a leading impact finance specialist providing advisory and third-party fund management services.**

With experts based in Luxembourg and Mauritius, our team boasts unrivalled expertise in designing and structuring impact investment funds and blended finance vehicles.

We work with fund managers, sponsors and investors worldwide on impact investing projects totalling over 8 USD billion that directly address the sustainability challenges outlined by the UN Sustainable Development Goals.

Committed to excellence, we provide our services with enthusiasm and dedication, remaining faithful to our mission and values.



**Dedicated to Impact Finance.**



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