GREENING BANKS

Highlights of 2012 International Green Credit Forum

International Finance Corporation
World Bank Group

Foreword

Over the course of 2012, IFC joined hands with bank regulators from Asia, Africa and Latin America to launch a powerful new platform for the development of national environmental and social risk-management guidelines for financial institutions. The Sustainable Banking Network is facilitating innovation and regulatory advances by sharing knowledge and technical resources.

The momentum for this important initiative came from the first International Green Credit Forum hosted by IFC and the China Banking Regulatory Commission (CBRC) in Beijing in May 2012. Regulators from ten emerging markets, supported by senior banking executives from China and elsewhere, confirmed a growing consensus that sustainable banking practices are sound business practices.

As the largest multilateral source of debt and equity finance for private enterprises in emerging markets, IFC, part of the World Bank Group, is also a leader in applying environmental, social and governance (ESG) sustainability standards to ensure the profitability and integrity of our investments. Through our sustainable finance journey over almost two decades, IFC has worked actively with financial institutions in emerging markets to create business opportunities and strengthen lending portfolios through sustainable banking practices.

We have found time and again that sustainable banking protects banks' assets and opens up new financial product areas and markets. It also improves resilience during tough economic times. Reducing the use of non-renewable resources and avoiding negative impacts on the environment are just some of the strategies that also yield financial returns.

However, banks require a level playing field before they can make the leap to new practices and management systems. If done right, the returns to banks and society could significantly enhance the competitiveness of emerging market economies.

A few bank regulators have taken the lead to create appropriate frameworks and incentives to support adoption by local banks. China and Bangladesh have issued groundbreaking sustainable finance polices in recent years. Brazil has a rich array of policies in place and many lessons to share. It is very clear from the early pioneers that there is no one-size-fits-all approach. But there is much to be learned from a community of peers, sharing their experiences and offering tools and strategies that have worked.

With that in mind, IFC is committed to sharing what we've learned and to facilitate the exchange of knowledge and innovative approaches among emerging market bank regulators. We are proud to play a coordinating role and support the Sustainable Banking Network to help build capacity and partnerships.

This eBook provides an exciting snap shotp of how regulators are already engaging with the new frontier of sustainable banking and developing nationally appropriate models. It is among the first of many tools to facilitate knowledge sharing and collaborative learning.

Karin Finkelston
Asia Pacific Vice President, IFC

Video: Highlights of the 1st International Green Credit Forum, Beijing, 2012

To watch the video on YouTube, click here.

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1. About this eBook

On May 16-17, 2012, the Chinese Banking Regulatory Commission (CBRC) and IFC, a member of the World Bank Group, jointly hosted the first International Green Credit Forum in Beijing. It was the first time high-level representatives of banking regulators from emerging markets had gathered to discuss good practices in sustainable finance.

The event attracted around 300 participants from 16 countries, including Bangladesh, Brazil, China, Canada, India, Indonesia, Japan, Korea, Laos, Malaysia, Mongolia, Nigeria, South Africa, Russia, Thailand, and Vietnam. Among them were senior representatives of banking regulators from 10 countries, senior executives from the top 25 Chinese banks, heads of 36 local branches of the CBRC, and 13 banks from 10 countries outside China.

Through this eBook, IFC and CBRC aim to provide an overview of the presentations and discussions that comprised the two-day event and to share thoughts on the next steps for banking regulators. We have also included some notable highlights of national regulatory initiatives subsequent to the Forum.

With more than a decade of experience providing technical assistance to emerging market banks and regulators, IFC addresses sustainability issues through a dual approach: i) seeking investment opportunities, and ii) creating robust risk management systems. IFC's support to CBRC and China's Ministry of Environmental Protection was the first example where IFC's Performance Standards and the World Bank Group Environmental, Health, and Safety Guidelines served as international references for national policy development in an emerging market.

"Sustainable finance" and "green banking" are terms that describe the integration of environmental and social (E&S) considerations into mainstream banking practices. Such integration reduces both reputational and credit risk in banks' lending portfolios. It also opens up new lending opportunities that benefit the environment and society.

The first International Green Credit Forum explored efforts by China and other emerging markets to promote "green" economies through banking policies, regulations, and capacity building for banks. Participants agreed that sustainability is both a business challenge and opportunity for the financial sector.

Through this eBook, we hope to support ongoing sustainable banking efforts by emerging market regulators and inspire similar initiatives in other countries. This publication is one of the first knowledge products to support the newly established **Sustainable Banking Network for Regulators**. ***(See "Resources" section for more information)***

"Successful businesses will be the ones which can adapt to the changing business environment – specifically by adopting the belief that business success and environmental and social well-being go hand-in-hand."

Karin Finkelston, Vice President, IFC

2. Context and Key Messages

2.1. THE BUSINESS CASE FOR SUSTAINABLE FINANCE

A growing number of financial institutions worldwide are adopting policies, systems and lending practices to reduce negative private sector impacts on the environment and society. They are doing so to ensure that economic development does not come at the cost of human well-being, natural resources and vital ecosystems. They are also protecting their lending portfolios from business risks and identifying new business opportunities offered by the green economy.

A number of global challenges have reinforced the urgency for the financial sector to play a proactive role. As each of the conference keynote speakers pointed out, the effects of climate change, natural resource constraints, severe pollution, growing populations, and threats to food security are just some of the converging pressures affecting national economies. These challenges require a change in how the private sector plans and collaborates to develop solutions for the coming decades.

As capital providers, banks are ideally placed to help the private sector respond to sustainability risks sooner and more effectively. This in turn reduces losses in banks' own lending portfolios due to failure of businesses to adapt to new economic realities, manage stakeholder relationships, and comply with regulations.

Maintaining good environmental and social (E&S) management systems can therefore help protect the assets of financial institutions. It can also help them navigate difficult economic conditions.

IFC's 15-year engagement with emerging market financial institutions has identified the following key benefits when banks adopt E&S management systems[1]:

- Lower cost of capital
- Improved quality of loan portfolio
- New business opportunities (e.g. renewable energy, clean technology, underserved markets)
- Better terms of insurance
- Better ratings by analysts
- Attracting funds or international finance institutions that support E&S activities
- Recognition and awards
- Improved brand value

2.2. A ROLE FOR BANKING REGULATORS

Banking regulators at the first International Green Credit Forum agreed sustainability is a global trend and sustainable finance a business imperative. Sustainable finance was recognized as both a risk management and business opportunity. Case studies and experiences shared by banks and regulators confirmed that:

- Sustainability adds measurable value to banks' portfolios

[1] IFC, (March 2007), "Banking on Sustainability – Financing Environmental and Social Opportunities in Emerging Markets"

- Sustainability protects banks and economies against risks and losses

Yet financial institutions face numerous obstacles to adopting sustainable finance practices. Among these is the need for a level-playing field for bank competition. Banking regulators therefore play a vital role in guiding and supporting banks to adopt new and innovative practices. In collaboration with other regulatory agencies, they can create i) a sound policy context, and ii) an effective implementation framework to help local financial institutions prepare for the transition to sustainable banking practices.

Several emerging markets have been first-movers in sustainable finance. China, Brazil and Bangladesh, in particular, provided detailed descriptions of their experiences and lessons learned. Vietnam, Indonesia and Nigeria are also in the process of establishing green credit frameworks for their national economies. Subsequent to the Forum, Nigeria launched the Nigeria Sustainable Banking Principles.

The participating regulators identified the following **success factors** to develop effective policies and implementation frameworks for sustainability finance:

- Establish a legal system and supervision mechanism in coordination with other regulating agencies
- Oversee the implementation of green credit and provide capacity building for banks
- Develop guidelines or principles for green banking, including sector-specific guidelines.
- Establish monitoring and supervision mechanisms to ensure consistency
- Provide economic incentives to promote lending to sustainable projects and businesses
- Create an environment for collective learning among stakeholders in the green financial sector

They also identified **challenges** and **opportunities** going forward:

- Improve availability and access to information about the E&S performance of borrowers
- Continue to build the capacity of banks around E&S management
- Ensure ongoing regulatory drive to support a national transition to sustainable finance
- Develop technical resources to support banks
- Agree on definitions of types of sustainable finance
- Provide more information on opportunities and business models for sustainable finance
- Measure the impact of green credit application in terms of banks' portfolios and contributions to the economy

The participating regulators identified a need for common standards or themes that could guide them in policy development and implementation. Three themes were explored in greater depth:

I) DATA COLLECTION

One of the main barriers for implementing green credit policy is that the banks have little or no access to companies' E&S performance information. Most countries have not built the necessary database of companies' environmental and social records, thus the current information is too limited for banks to analyze the borrower's E&S risks or regulation violations.

II) MEASURING IMPACT

After implementing sustainable finance policies, it is necessary to measure the impact of implementation and strengthen its influence. Regulators should assess the influence and range of the policy, the experience learned during the implementation, and ways to improve. For the commercial banks adopting the green credit policy, regulators should measure the extent, capability and outcome of implementation, and analyze good practices as well as problems exposed during the process.

III) PROVIDING MARKET INCENTIVES

Some commercial banks pointed out that if they reject polluting companies, they may lose certain "premier" customers in the short term and reduce revenue. Moreover, most companies in the environmental-protection industries are small and medium enterprises and start-ups with fewer assets to use as leverage. Banks usually do not grant loans to these businesses due to the high risk and low return on investment. Therefore, governments should continue to discuss how to encourage commercial banks to implement sustainable finance practices through market incentives and mechanisms.

2.5. OUTCOMES AND NEXT STEPS

The first International Green Credit Forum demonstrated the value of shared learning and the participating regulators from emerging markets called for the creation of a Sustainable Banking Network for Regulators to assist them in:

- Sharing experiences
- Building partnerships
- Developing common resources

IFC supports the Network as a strategic and technical partner. An initial Steering Committee for the Network has been formed, consisting of IFC, CBRC and Bangladesh Bank, with a view to rotating Steering Committee members and involving other emerging market regulators. The Network's goal is to reduce the learning curve for regulators and help them more quickly design systems that work. It was also agreed that members of the Network would collaborate on developing knowledge products, with this eBook being the first of such products.

Bangladesh Bank formally offered to host the next international Forum. Other regulators welcomed the proposal and the establishment of an annual forum. **The next Forum will take place in Dhaka, the capital of Bangladesh, in early 2013**.

3. Overview of Emerging Market Regulatory Initiatives

implementation of sustainable finance policies, regulations, and capacity building for local financial institutions. The following section provides an overview of the various national initiatives, including some notable highlights subsequent to the Forum.

3.1. BANGLADESH

Bangladesh has developed a national Environmental Risk Management (ERM) Policy and Strategy Framework, which Bangladesh Bank, the country's central bank, made mandatory for the financial sector in 2011.

The Policy is being implemented in three phases between 2011 and end of 2013. Phase I (2011) included a focus on promoting governance and policy, incorporating ERM in core risk management, creating a Climate Risk Fund, and supporting training, marketing and reporting activities. Phase II (2012), which is being implemented, includes developing sector-specific environmental policies, Green Strategic Planning, setting up Green Branches, and delivering programs to educate bank clients and improve bank disclosure and reporting.

Bangladesh Bank has particularly emphasized the need to manage or "treat" risk rather than tolerate or transfer risk. Sustainable banking is seen as an opportunity to move to resource-efficient and low-carbon industries, including green industry and green economy in general.

Implementation of the ERM Policy will include a Policy for Preferential Treatments for Compliant Banks. Bangladesh Bank publishes the names of the top 10 banks that are most compliant in an effort to encourage nationwide compliance. Compliant banks will be given priority to open new branches and receive licenses. For instance, Bangladesh Bank will give permission for establishing a small and medium enterprise branch subject to installation of solar panels.

Going forward, Bangladesh Bank has identified the following priorities: to build capacity among staff; to apply Green Banking and use the ERM guideline efficiently; to develop a culture within the organization based on environmental governance; to replicate global and local best practices; to share knowledge and technical know-how with peer groups; to achieve further integration with Credit Risk Management; to apply a quantitative approach for Environmental Risk Rating; and to develop a database for technical support.

3.2. BRAZIL

The regulatory framework for sustainable banking in Brazil is characterized by a combination of self-regulation by banks and regulations introduced by the Central Bank of Brazil (BCB) and relevant sectoral ministries. Since 2004, four Brazilian banks have signed the Equator Principles: Itaú Unibanco (2004), Banco Bradesco S.A. (2006), Banco do Brasil S.A. (2006), and CAIXA Economica Federal (2009).

In the mid-1990s, the first Green Protocol was launched. Through this framework, public banks committed themselves not to finance environmentally degrading undertakings and to provide support to sustainable productive systems. To achieve this, the banks adapted their procedures for analysis and concession of credit. In 2009, Brazil's banking association (Febraban) and the Ministry for Environment introduced the second **Green Protocol**, which establishes sustainability standards for commercial financial institutions. The Ministry for Environment and Brazilian Central Bank also established a **technical cooperation** agreement to monitor social and environmental actions and practices in the financial system.

Since 2008, several regulations have been introduced, which affect financial institutions operating in the different natural biomes of Brazil:

Resolution 3.545/2008 was introduced for rural credit and applies to the Amazon Biome. It requires financial institutions to request from borrowers, i) documentation to ensure compliance with environmental laws and regulations, and ii) environmental licenses and permits.

Resolution 3.813/2009 aims to avoid deforestation and prohibits the production of sugarcane crops to produce ethanol and other biofuels in new areas. This resolution applies in the Pantanal and Amazon biomes and Upper Paraguay River Basin, among other areas.

Resolution 3.876/2010 prohibits the concession of rural credit to people or companies that maintain workers in slavery conditions according to a list published by the Ministry of Labor. The resolution applies to the whole country.

Resolution 3.896/2010 establishes a program to reduce emissions of greenhouse gases in agriculture, and is supported by resources from the National Bank of Economic and Social Development.

In 2011, the Central Bank of Brazil introduced a regulation establishing procedures for the internal capital adequacy assessment process. **Circular 3.547 ICAAP** applies to financial institutions with total assets greater than 100 billion Reais. Banks also need to explain how they consider the social and environmental damages in their business activities when they evaluate and calculate their required capital.

Going forward, Brazil aims to establish minimum standards of sustainability through proposed rules or guidelines and apply them to all financial institutions. The main challenges are to determine i) to what extent should social and environmental issues be incorporated into financial institutions' policies and strategies, risk management and daily operations; and ii) the appropriate combination of rules and guidelines.

3.3. CHINA

In July 2007, the China Banking Regulatory Commission (CBRC), the Ministry of Environmental Protection and the People's Bank of China jointly launched the **Green Credit Policy**. This high-level policy declaration demonstrates political will to encourage Chinese banks to reduce lending to enterprises with high levels of pollution and energy consumption and to increase lending to those that promote energy efficiency and emissions reduction.

In December 2007, CBRC introduced the **Credit Guidance on Energy Efficiency and Emission Reduction Lending**. This guidance note was CBRC's immediate follow-up to the Green Credit Policy to translate high-level political will into bank-level implementation.

In February 2012, CBRC introduced the **Green Credit Guidelines**, outlining the three pillars for banks' implementation as (i) environmental and social risk management, (ii) identifying related business opportunities; and (iii) managing banks' own footprints.

Going forward, CBRC plans to develop a robust monitoring and evaluation system to improve clarity and consistency in policy implementation. Specifically, a set of key performance indicators will be developed and launched. Sector-specific technical guidelines are also required to assist banks in understanding E&S risks, particularly for high-risk sectors.

3.4. INDONESIA

In 2010, the Governor of Bank Indonesia and the State Minister of Environment signed a joint agreement on "Coordinating the Increased Role of Banking in Environmental Conservation and Management." In July 2011, Bank Indonesia, Green Radio and IFC jointly organized the first Green Banking Conference in Indonesia.

Going forward, Bank Indonesia plans to launch a Green Banking Policy in 2012 to improve the competitiveness of banks associated with green finance; enable a level-playing field; increase the loan portfolio of green sectors; enhance banking regulation and supervision related to environmental protection; and to develop effective incentive schemes, coordination, and gradual implementation of the Green Banking Policy.

3.5. KOREA

Korea has introduced a Framework Act on Low Carbon Green Growth and a Five-Year Plan to implement the nation's green growth strategy. These measures allow the government to regulate the market with taxes, penalties and incentives, and encourage banks to provide low-cost loans to companies with green projects. They also cover green finance and promote a carbon-trading system and infrastructure for green finance.

Going forward, public funds will be allocated to start-ups and SMEs, and private funds will be targeted towards larger companies. Korea also aims to increase the size of green loans by policy banks; to ease the listing criteria of its stock exchange, KOSDAQ, for green companies; to facilitate the issuance of green primary collateralized bond obligations (P-CBOs), thereby helping to finance SMEs; and to improve the educational program to train experts. A challenge cited is that some financial institutions are hesitant to finance green projects. It is also difficult to evaluate green technology and products.

3.6. NIGERIA

The Central Bank and CEOs of all major financial institutions signed a joint commitment statement. Two Nigerian banks have adopted the Equator Principles: Access Bank PLC (2009) and Aterios Capital (2012).

Subsequent to the Forum, the Nigerian Bankers Committee, with support from the Central Bank, introduced the voluntary **Nigeria Sustainable Banking Principles** in July 2012, together with Guidance Notes[2]. Sector-specific guidelines have also been developed for three key sectors: oil and gas, renewable energy, and agriculture. The principles apply to all banks, discount houses and development finance institutions. The Central Bank has pledged to provide necessary incentives to institutions taking concrete measures to embed the provisions of these principles and guidelines into their operational, enterprise risk management and other governance frameworks. Reporting requirements with guidelines will also be made available to the industry.

Going forward, Nigeria aims to develop lasting local capacity to manage emerging E&S risks and opportunities within banks' internal operations, as well as in relevant financial-sector government agencies, learning institutions, and service providers.

3.7. THAILAND

In 2011 and 2012, IFC and the Thai Bankers' Association organized two E&S Risk Management Workshops for Thai banks to raise awareness of sustainable banking. The second one focused on Lao hydropower investments. IFC facilitated CBRC and China Industrial Bank's participation in the workshops to enable south-south knowledge sharing.

3.8. VIETNAM

In March 2009, State Bank of Vietnam (SBV), the Vietnam Bankers Association and IFC jointly organized the country's first sustainable finance workshop. The workshop featured international good practices in E&S risk management, including IFC's Performance Standards, the Equator Principles, and south-south knowledge shared by China's CBRC and Industrial Bank.

In August 2009, in partnership with the SBV and CBRC, IFC facilitated a study tour by seven Vietnamese government agencies and four Vietnamese banks to China to exchange views with Chinese banking and regulatory counterparts and review experiences in implementing the Green Credit Policy.

In June 2012, following a multi-ministry dialogue process, SBV received confirmation to develop E&S risk management guidelines, which are expected to be launched in 2013.

[2] Central Bank of Nigeria, Circular to all Banks, Discount Houses and development Finance Institutions in Nigeria, September 24, 2012 www.cenbank.org/Out/2012/CCD/Circular-NSBP.pdf

4. China's Regulatory Experience with the Green Credit Policy

4.1. AN OVERARCHING NATIONAL STRATEGY

In China, the drive toward sustainable finance is greatly influenced by the need to balance continued economic growth against resources and environmental constraints. Sustainable development, or the green economy, is a core theme of China's national strategy. This is reflected in China's 12th Five-Year Plan, under which the government is determined to change the way the economy grows, emphasizing greater energy efficiency and emission reduction.

Bank financing remains the main source of funding in China and therefore a powerful tool for stimulating the green economy. Sustainable banking practices can help improve risk management capability, while also helping to establish an environmentally friendly society to achieve both societal and economic returns.

The introduction of green credit has happened in three main stages:

1. ***Green Credit Policy*** launched jointly in 2007 by CBRC, the Ministry of Environmental Protection and the People's Bank of China.
2. ***Credit Guidance on Energy Efficiency and Emission Reduction Lending*** published in December 2007 by CBRC.

Green and sustainable development has become the trend in today's world. The financial regulatory authorities and financial institutions of emerging-market countries should promote social and economic 'green' development along the following five aspects:

1. **Integrate green development policies into national policy and strategy.**
2. **Develop green credit policies for banks.**
3. **Use effective incentives and mechanisms to guide the allocation of financial resources.**
4. **Incorporate social responsibility into a green credit culture.**
5. **Set up a legal system and supervision mechanism to oversee green credit mechanisms.**

WANG Zhaoxing, Vice Chairman, China Banking Regulatory Commission

"We have developed an information exchange channel with CBRC, under which CBRC provides information on environmental non-compliance and clean production information to banks to use as reference in making credit decisions.

MEP will be supporting the Green Credit Policy in three ways:

- **Providing environmental information to support banks' implementation of the Green Credit Policy**
- **Supporting CBRC in developing sector-specific guidelines**
- **Developing a rating system on businesses' environmental performances. "**

BIE Tao, Deputy Director-General, Department of Policies and Regulations, Ministry of Environmental Protection

3. ***Green Credit Guidelines*** introduced by CBRC in February 2012, with technical support from IFC.

4.2. INTERAGENCY COLLABORATION

An important characteristic of China's approach has been extensive interagency collaboration. The Chinese banking regulator has taken the lead to develop Green Credit Guidelines. These efforts included extensive engagement between banking and environmental regulators, particularly the Ministry of Environmental Protection (MEP) and the Ministry of Finance, to promote access to businesses' environmental compliance information and E&S management expertise.

The Green Credit Guidelines define the Green Credit Policy along three pillars:

1. Business Opportunities – increased support for the green, low-carbon and recycling economies
2. Risk Management – mitigate and reduce environmental and social risks
3. Footprint management – manage banks' own environmental and social footprin

MEP has been a key player in devising the Green Credit Guidelines as part of the agency's broader policy to achieve positive environmental impacts while supporting economic benefits and outcomes. MEP has also been instrumental in contributing best practices in managing E&S issues.

In 2008, MEP translated and introduced the World Bank Group EHS Guidelines as international best practice to support Green Credit Policy implementation by banks. MEP also provides technical expertise for continued development of technical tools to support banks' E&S risk management, and shares information on businesses' environmental compliance.

The Ministry of Finance and MEP further collaborated with four other government agencies to establish the China Clean Development Mechanism (CDM) Fund. In November 2007, the Ministry of Finance and the National Development and Reform Commission jointly launched the CDM Fund, which offers grants and investments to support activities in climate-related capacity building, as well as promotion of public awareness.

4.3. PROVINCIAL REGULATORY EXPERIENCES

CBRC's provincial branches have played an important role in implementing the Green Credit Policy. Four local CBRC branches, from **Yunnan**, **Shanxi**, **Shandong** and **Fujian** provinces, shared their experiences at the International Green Credit Forum.

In order to ensure the Green Credit Policy's effective implementation, CBRC branches needed to develop provincial work plans enabling and requiring local banks to align with China's industrial strategy and to do so in a way that would reinforce their business competitiveness. Implementation also required better coordination within the local branches to ensure effective monitoring and engagement with banks. Each branch developed mechanisms and strategies within three main areas:

1. Promoting risk management
2. Promoting innovation
3. Establishing effective monitoring and enforcement

4.3.1. PROMOTING RISK MANAGEMENT

The first major effort has focused on promoting green credit and international standards among banks and society. CBRC branches motivated banks to establish green credit strategies and risk management systems so that environmental considerations are considered by management teams. For instance, guidelines are needed for dealing with high pollution, high energy consumption, and high-emission businesses. Banks also needed to establish green thresholds for lending and post-loan management to classify different types of green credit. There has been a focus on continuous improvement of management systems.

4.3.2. PROMOTING INNOVATION

Green credit enables and requires innovation and improvement of financial products and services to accommodate different needs. For instance, banks have been encouraged to initiate loans for small and micro businesses and to ensure that preferential treatment is given to energy-reducing projects. CBRC branches have focused on increasing green credit lending and optimizing the banks' lending structures, such as by supporting clean- and renewable-energy projects, biodiversity protection and improvement in specific areas, and supporting forest- and water-facilitation projects.

4.3.3. ESTABLISHING EFFECTIVE MONITORING AND ENFORCEMENT

An important adjustment for the local CBRC branches has been to establish systems for monitoring banks' practices, such as through surveys, inspections and reviews. Gate-keeping and warning mechanisms have also been put in place to ensure that businesses not in line with energy-reduction requirements won't be issued loans. This further requires coordination between different agencies to ensure appropriate fines and penalties are being enforced.

Specific data systems have been established for energy-emission reduction. Examples include monitoring systems for key sectors. These efforts have highlighted the need for environmental information-sharing platforms to facilitate the work and coordination among multiple agencies. More efficient monitoring and assessment mechanisms would in turn streamline the allocation of green credit by local banks.

4.3.4. MAIN CHALLENGES

The local CBRC branches identified several challenges they currently face in implementing the Green Credit Policy, including:

- Accessing environmental information without government support
- Difficulty launching voluntary emission-reduction projects
- Stopping lending to traditional high-pollution and high- emission sectors such as coal power stations or the oil sector immediately
- Lack of evidence for the business case

4.4. INNOVATION BY BANKS

Chinese banks have taken the lead in innovation around green lending products. Green credit is expected to increasingly gain government policy support in the future. This is motivating many banks to align themselves with the national policy and further enhance their green credit offerings.

For instance, the investment volume during the Five-Year Plan for energy-efficiency and emission-reduction projects will be almost 2.4 trillion yuan, and green credit can take up a large portion of the investment. First movers will be better prepared to offer services and gain clients in the green-credit sectors.

However, there is still a need and opportunity for regulators to provide more guidance to banks on sustainable finance and help financial institutions build up core capacity. Only China's Industrial Bank has adopted the Equator Principles to date. Some banks have already begun self-reporting the size of their green credit lending, but a standardized approach is need to accurately calculate the extent of green-credit adoption. With this in mind, CRBC is partnering with IFC on capacity building for Chinese banks.

It is expected that banks will adopt green credit practices according to the following steps:

1. Adopt a vision and policy on environmental protection and social development. This should be aligned with the bank's own image and include implementation and accountability, targets, processes, and responsibilities. Banks should identify the major industries they are restricting or supporting.

2. Build internal capacity.

3. Integrate process management, due diligence, and support from qualified independent third parties when necessary.

"Green credit opens huge market opportunities. It would transform and define the future banking industry."

LI Renjie, President, China Industrial Bank

The following Chinese banks shared their experiences at the International Green Credit Forum in Beijing:

4.4.1. CHINA DEVELOPMENT BANK

China Development Bank (CDB) is a state-owned bank providing mid-to-long-term financing to large-scale infrastructure projects in and outside China. By the end of 2011, CDB reported that it has disbursed 228.1 billion yuan of lending (US$ 36.2 billion) in support of energy-conservation, emission-reduction and environment-protection, with an outstanding balance of RMB 658.3 billion yuan (US$104.5 billion), up by 33% year-on-year. Priority business focuses are urban waste and urban-waste-water treatment, industrial waste water, clean production, energy efficiency, and clean energy.

CDB set up an internal task force on the Equator Principles (EP) in 2008 and introduced EP practices into business processes. The bank has deepened its relationship with government departments, including an agreement with MEP to support key environmental projects. The bank will also plan project strategy in line with the 12th Five-Year Plan.

With support from MEP, performance evaluation systems have been set up to monitor environmental benefits and quantify the emission reductions in 13 categories of environmentally friendly lending.

4.4.2. AGRICULTURAL BANK OF CHINA (ABC)

Developed from one of China's four wholly state-owned banks, ABC focuses on rural financing. As of end of 2011, ABC reported that its environmentally friendly and energy- efficiency lending portfolio exceeded 88.168 billion yuan ($14 billion). According to ABC's 2011 Corporate Social Responsibility Report, the bank also reportedly rejected 106 credit applications totaling 4.157 billion yuan.

ABC has developed more than 20 sector-specific guidelines covering all major polluting and energy-intensive industries. Environmental governance has been integrated into the management system and responsibilities allocated to the relevant departments: The credit department has responsibility for policy development and oversight; the operational department for green products innovation; and the risk management department is responsible for E&S performance ratings.

In order to control exposure to sectors with high environmental impacts, high energy consumption, and surplus capacity, all new borrowers in these sectors need approval by the ABC head office. There is a credit ceiling given to heavy industries like iron, steel, and paper producers. ABC also provides consulting services to customers on clean energy innovation.

4.4.3. SHANGHAI PUDONG DEVELOPMENT BANK (SPDB)

A joint-stock bank headquartered in Shanghai, SPDB is a leader in green-finance products and services innovation. Green credit has become part of SPDB's business strategy and is viewed as bringing in green-lending business opportunities rather than simply a corporate social responsibility. SPDB has extended more than 100 billion yuan ($ 16 billion) to the green sector.

Five product lines have been developed as part of business innovation in response to the Green Credit Policy. These include energy-efficiency financing, clean energy financing, environmental financing, carbon finance, and environmental-equipment supply chain financing. SPDB's Green Credit Products also have a special focus on supporting SMEs, such as through energy-efficiency financing, emissions trading, and providing new forms of financing to small businesses.

In order to build capacity of staff around green credit, two annual bank-wide trainings have been developed specifically focusing on green credit policy and implementation.

4.4.4. CHINA INDUSTRIAL BANK (IB)

A joint-stock bank headquartered in Fuzhou, IB began partnering with IFC to pioneer energy-efficiency lending in 2006. In October 2008, IB adopted the Equator Principles, becoming the first Equator Bank in China and among Asia's emerging markets. As of August 2012, IB reported it has accumulatively extended lending of almost 200 billion yuan ($32 billion) to nearly 4,000 green finance projects. As of Q1 2012, 37 loans applying the Equator Principles were disbursed by 18 branches.

IB has identified two main benefits of green credit. Implementation has optimized credit processes and improved overall risk management. It has driven business innovation in new areas such as energy efficiency, carbon finance and environmental finance, resulting in the launch of a series of green-finance products and services under a specific green-finance brand.

IB has developed a corporate policy on sustainable finance and integrated it into its operations. A professional team was established to deal with green-finance operations and the bank improved its internal E&S risk management system drawing from international experiences.

Several important shifts have occurred. IB shifted from passively following lending restrictions to proactively seeking business opportunities. Emission-reduction services and implementation of the Equator Principles have been recognized as tools for achieving competitive advantage and new business opportunities. IB's business goals have also aligned with China's national goals and societal needs.

4.4.5. EXPORT-IMPORT BANK OF CHINA (EXIM BANK)

China Exim Bank is the country's state-owned export credit agency. The bank has developed E&S Risk Assessment Guidelines to cover both domestic and international financing, with reference to international good practices.

Green credit has been fully integrated into Exim bank's lending processes, including due diligence, credit review and portfolio management. Borrowers' environmental compliance records are fully reviewed. Any environmental non-compliance leads to vetoing of the loan application.

4.4.6. INDUSTRIAL AND COMMERCIAL BANK OF CHINA (ICBC)

ICBC is the world's largest bank by market capitalization and has the largest green credit portfolio in China. As of June 2012, ICBC reported that its total outstanding loans to green companies stood at 590 billion yuan ($94 billion).

ICBC has 43 industrial credit-granting policies, including steel and cement industrial standards. It has developed an E&S risk rating system with four levels and 12 sub-categories. The four levels are Friendly, Pass, Observation, and Correction. The 12 categories include Friendly I (ecological protection), Friendly II (clean energy), Friendly III (energy-savings, emission-reduction), Friendly IV (resource utilization), Pass I-III, Observation I-III, and Correction I-III.

4.4.7. BANK OF BEIJING

Bank of Beijing is a commercial bank headquartered in Beijing with a business focus on SME lending. Green credit generates new opportunities for SME lending, such as through the development of an energy-efficiency lending platform for SMEs. Bank of Beijing is one of IFC's partner banks in China for energy-efficiency loans.

Bank of Beijing has also benefited from international expertise. It has worked with IFC and international investors to establish an understanding of green credit, including tools and management, which further promote SME green-financing business. IFC's cooperation has helped lay a solid foundation with future SME borrowers.

"Green concepts take time to shape, but we need to be dedicated to promoting green credit. ICBC has done this by establishing procedures and processes. But most importantly, we have to establish a green culture top-down. Education and communication of green concepts from the top will allow every employee to incorporate green culture into their lives."

YIN Hong, ICBC

5. Equator Bank Experiences

Speakers from three emerging-market Equator Banks shared practical experiences on implementing sustainable finance. They were Banco Itau **BBA (Brazil)**, **Standard Bank (South Africa)** and **China Industrial Bank (IB)**, East Asia's only signatory to the Equator Principles.

5.1. ABOUT THE EQUATOR PRINCIPLES

The Equator Principles are a voluntary credit-risk management framework for determining, assessing and managing environmental and social risk in project finance transactions. They are adopted by financial institutions and applied where total project capital costs exceed $10 million.

Since 2006, the Equator Principles have been based on the IFC Performance Standards for Environmental and Social Sustainability and on the World Bank Group Environmental, Health, and Safety Guidelines. Equator Principles Financial Institutions (EPFIs) commit to not providing loans to projects where the borrower is unable to or will not comply with their respective E&S policies and procedures.

The Equator Principles have become the industry standard for E&S risk management. Currently, 77 financial institutions (74 EPFIs and three associates) in 32 countries have officially adopted the principles, covering more than 70 percent of international project finance debt in emerging markets.

5.2. ITAU BBA BANK, BRAZIL

Roberto Dumas Damas, Head of Social and Environment Risk at Itau BBA, presented his bank's experience in implementing the Equator Principles. He also represented the EPFI Steering Committee and explained how the principles add value to banks doing business in emerging markets.

He emphasized that the principles are a matter of monitoring and leveraging strengths rather than overhauling how banks do business. The principles are a framework for enhanced credit analysis, which becomes a core part of an institution's way of operating. E&S factors are incorporated into the credit analysis and decision framework throughout the Itau-Unibanco group.

According to Damas, the following are some key success factors when implementing the Equator Principles and managing E&S issues:

1. It must be a top-down approach: Top management must be aware of how important

"There are several stakeholders who can impair your project, cash flow and reputation if you don't manage E&S issues effectively. These include NGOs, other commercial and development banks, and the media.

Investment in E&S issues should be part of your business plan from an early stage. This is fundamentally about credit enhancement."

Roberto Dumas Damas, Head of Social and Environment Risk, Itau BBA these issues are for cash flow, credit analysis, reputation and image

2. You need to have an interdisciplinary team: engineers, lawyers, managers, E&S experts, bankers, etc.
3. Build sustainability with your client
4. Train your front and back office
5. Learn how to deal with client resistance

Damas emphasized the need to raise awareness among financial institutions and clients that green credit is a business and financial opportunity and is a measure to protect against risk. The Equator Principles add value by providing **one language** for classifying and describing projects. He pointed out the power of stakeholders – communities, civil society, nongovernmental organizations, and governments – who can block a project if it is not up to par with environmental, social and governance standards.

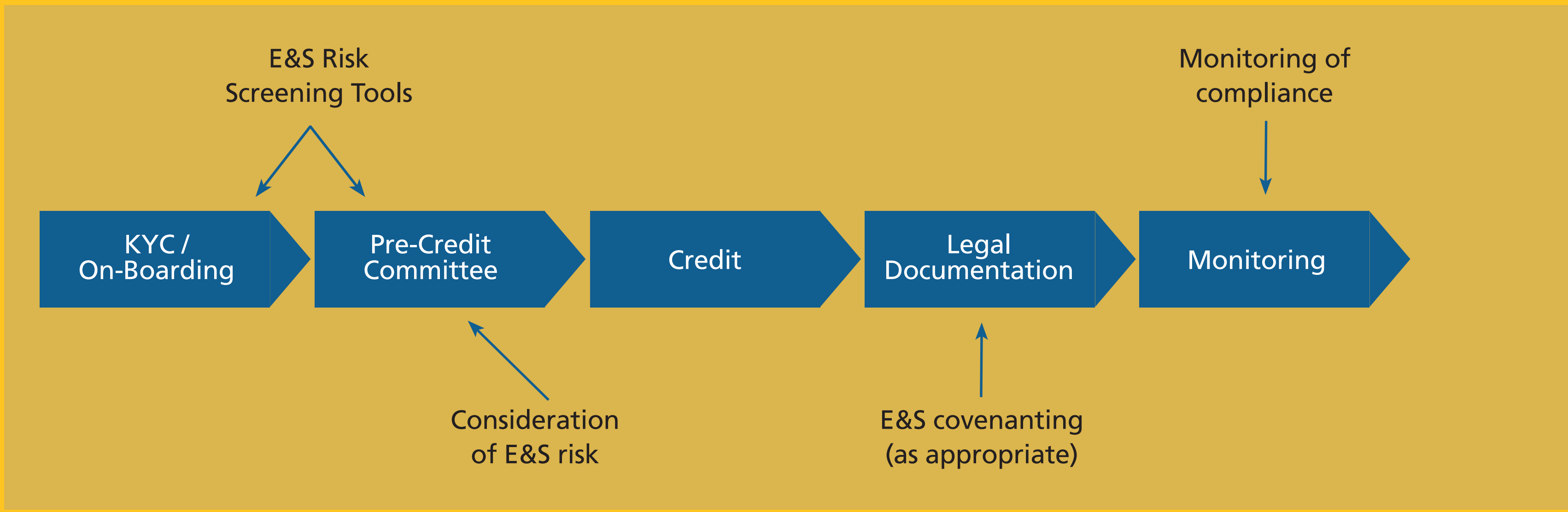
Using a uniform language helps facilitate and speed up the issuing of loans. The Equator Principles are used by banks' clients to help them address and manage E&S issues effectively. The principles enhance a financial institution's reputation among its peers, clients, central banks, and stakeholders. Analysts that evaluate EPFI stocks know there is a comprehensive system to evaluate risk.

Lack of consistency in applying the Equator Principles is more often due to lack of capacity in applying standards. The principles are designed to be applied in emerging markets, therefore the earlier the emerging markets adopt these principles, the stronger the outcome. More experiences and lessons from emerging-market financial institutions will help further develop an effective framework that can be used internationally.

5.2. STANDARD BANK, SOUTH AFRICA

Nigel Beck, Head of Environment at Standard Bank Group in South Africa, described the integrated management system the bank has developed to implement the Equator Principles.

Before granting a loan, Standard Bank evaluates the E&S risks of the project using E&S Risk Screening Tools. The bank identifies the extent of



the risks, and communicates with the clients to see if they have the capabilities of risk control.

During the loan-approval process, the bank's environmental team will conduct a technical assessment of the project, and carry out internal and external due diligence based on the risk.

E&S risk management is integrated throughout the five phases of the bank's loan process: i) on-boarding, ii) re-credit committee, iii) credit, iv) legal documentation, and v) monitoring.

5.3. CHINA INDUSTRIAL BANK

LU Biying, Deputy Manager of Sustainable Finance Division, Compliance Department, China Industrial Bank, shared some of the success factors that his bank has identified to ensure effective adoption of sustainable banking principles.

Industrial Bank adopted the Equator Principles in 2008, as the first Equator Bank in China. One of the preliminary steps to ensure compliance with the principles was the creation of an internal Equator Principles Working Group. Eight departments of the bank have been involved in this working group, including the planning and financial department and the risk management department.

Collaboration has enabled access to new business opportunities. Industrial Bank and IFC signed two cooperative agreements related to the China Utility-Based Energy Efficiency Finance Program in 2006 and 2008 respectively. By the end of September 2008, Industrial Bank had extended approximately 2.8 billion yuan energy-efficiency loans in China.

in 2006 and 2008 respectively. By the end of September 2008, Industrial Bank had extended approximately 2.8 billion yuan energy-efficiency loans in China.

"Environmental and social risk evaluation and management has improved Standard Bank's business practices and loan portfolios. It also improves the bank's reputation, and clients recognize their risk management capabilities and entrust them with more business."

Nigel Beck, Head of Environment, Standard Bank Group

"We integrate social risk management into the existing credit process. We help clients comply with the Equator Principles and find new opportunities. A top-down model is very important, as well as a full-time team to implement policies. We must continue to promote awareness among our staff."

LU Biying, Deputy Manager of Sustainable Finance Division, Compliance Department, China Industrial Bank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6. Perspectives of International Organizations

One of the panel sessions during the Green Credit Forum focused on the perspectives of international institutions. The panelists gave their views on what they thought are major themes for sustainable finance. IFC, the United Nations Environment Programme Finance Initiative, WWF, the Equator Principles Financial Institutions Steering Committee and AFD (French Development Agency) were represented at this panel.

i. Corporate sustainability disclosure needs to improve:

According to Mengqi Cai of the United Nations Environment Programme Finance Initiative, one of the biggest challenges for sustainable finance going forward is that many corporate sustainability reports still don't disclose sufficient information on E&S performance to enable banks to make effective green-credit decisions. For instance, few companies disclose what proportion of their investments will be spent on clean energy and energy reduction.

ii. Integration of green practices into management systems still needs to improve:

Banking professionals and lending departments still lack sufficient capacity and expertise to assess environmental, social and governance impacts when issuing loans. If the banking sector does not have the ability to assess ESG impacts, they will probably ignore the related risks when making decisions. There is also a lack of capacity when it comes to effectively implementing the current international standards and principles. How can sustainable finance be incorporated from the top down so that every level in the banking system is involved?

iii. Green credit should be expanded in terms of its coverage:

Green credit is meant to prepare businesses and banks for emerging environmental and social risks. It is a strategy for competitiveness rather than just a community outreach or public-relations effort. It is also about protecting banks' lending portfolios from unsustainable consumption of natural resources. Water, agriculture, and animal protection should therefore also be covered.

iv. More active engagement with stakeholders is needed:

In its outreach to financial institutions, WWF has identified many challenges and opportunities. Among these is the need to engage stakeholders: How can the banking industry better communicate with international media and NGOs about the exact nature of a bank's ESG practices and show it is embedded in its strategy? For instance, international branches of Chinese banks must improve their communication with different stakeholders, including NGOs, local communities and the media.

v. How can banks effectively reach small businesses with green credit?

Many of the approaches to green credit and sustainable finance discussed at the Forum, such as the Equator Principles, focus on large projects and corporate finance. Participants in the session highlighted the need to serve small businesses, as these businesses can make a significant impact in achieving the goals of green credit, particularly in areas such as renewable energy. The panelists said this is an important frontier. The United Nations Environment Programme Finance Initiative and IFC provide a range of tools and resources to assist banks in aligning their green-credit lending with SMEs. Reaching SMEs also requires support from the other partner institutions involved in green credit, namely central banks and governments, which can help create the right policies and regulatory incentives, and be willing to share risk with banks.

7. Useful Resources

SUSTAINABLE BANKING NETWORK FOR REGULATORS

At the International Green Credit Forum, initiated by China Banking Regulatory Commission and IFC, banking regulator representatives from 10 countries collectively endorsed that IFC guide and contribute to an international network of banking regulators to support their collective learning and facilitate exchanges of experiences and lessons. IFC will continue to convene and support the Sustainable Banking Network for Regulators, which is hosted on IFC's eCollaborate platform: https://ifcecollaborate.ifc.org/groups/sustainable-banking-network.

IFC's Sustainability Framework – www.ifc.org/envsocstandards.

IFC's Sustainability Framework articulates a strategic commitment to sustainable development and states IFC's approach to risk management. IFC's Performance Standards are an integral part of the framework. Together with the World Bank Group EHS Guidelines, they have become a global benchmark for E&S risk management in emerging-market investments and are used as a basis for the Equator Principles.

Importantly, IFC's approach is revised periodically in consultation with stakeholders around the world. Effective on January 1, 2012, the latest updates reflect evolving good practices for sustainability and risk mitigation over the past five years. They incorporate modifications on challenging issues, including supply-chain management, resource efficiency and climate change, ecosystem services, labor practices and human rights. The framework consists of:

- **The Policy on Environmental and Social Sustainability**, which defines IFC's commitment to environmental and social sustainability.
- **The Performance Standards**, which define clients' responsibilities for managing their environmental and social risks.
- **The Access-to-Information Policy**, which articulates IFC's commitment to transparency.

FIRST Portal – www.firstforsustainability.org.

FIRST (Financial Institutions: Resources, Solutions and Tools) for Sustainability is a one-stop shop for financial institutions to get information and learn about the benefits of environmental and social risk management, and how to identify and take advantage of environmental business opportunities.

The Equator Principles – www.equator-principles.com.

The Equator Principles are a credit-risk management framework for determining, assessing and managing environmental and social risk in project finance transactions. Project finance is often used to fund the development and construction of major infrastructure and industrial projects.

The principles are adopted by financial institutions and applied where total project capital costs exceed $10 million. They are based on IFC's Sustainability Performance Standards and the World Bank Group EHS Guidelines. The principles provide a minimum standard for due diligence to support responsible risk decision-making.

UNEP Finance Initiative – www.unepfi.org.

United Nations Environment Programme Finance Initiative is a global partnership between UNEP and the financial sector. More than 200 institutions, including banks, insurers and fund managers, work with UNEP to understand the impacts of environmental and social considerations on financial performance.

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CREDITS

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Disclaimer

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OUR VISION

That people should have the opportunity to escape poverty and improve their lives.

OUR VALUES

- Excellence
- Commitment
- Integrity
- Teamwork
- Diversity

OUR PURPOSE

To create opportunity for people to escape poverty and improve their lives by catalyzing the means for inclusive and sustainable growth, through:

- Mobilizing other sources of finance for private enenterprise development
- Promoting open and competitive marketsnin developing countries
- Supporting companies and other privaten sector partners where there is a gap
- Helping generate productive jobs and deliver essential services to the poor and vulnerable

To achieve its purpose, IFC offers developmentimpact solutions through firm-level interventions (direct investments, Advisory Services, and the IFC Asset Management Company); promoting global collective action, strengthening governance and standard-setting; and business enabling environment work.

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