



WWF

REPORT

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An aerial photograph showing a large area of deforestation. A winding road or path cuts through a dense green forest. In the lower right, there is a large, irregularly shaped pond or reservoir. The sky is filled with white clouds.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE INTEGRATION FOR BANKS: A GUIDE TO STARTING IMPLEMENTATION



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WWF is one of the world's largest and most experienced independent conservation organizations, with over 5 million supporters and a global network active in more than 100 countries. WWF's mission is to stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.

WWF's International Finance Programme seeks to support this vision by engaging directly with banks, asset managers and other financial institutions. It helps strengthen lending and investment criteria for key industry sectors, provides insights and data on environmental and social risks, fulfils critical research gaps and helps unlock innovation breakthroughs in sustainable financial products.

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It is solely intended to provide general guidance on matters of interest. It does not, in any way, constitute professional advice. Readers should not rely on the information contained in the Guide without obtaining relevant professional advice. Each bank has to consider its own legal and regulatory environment and the necessary requirements specific to itself.

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FOREWORD

**WELL MANAGED
BANKS SHOULD
FOCUS ON BOTH
THE RISKS AND
OPPORTUNITIES, AND
IN SO DOING
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FROM BUSINESS-
AS-USUAL TO A
SUSTAINABLE
FUTURE**

We have clearly entered the anthropogenic era where human activity has profound impacts on biodiversity, natural resources and the climate. The 2012 WWF Living Planet Report indicates that humanity's ecological footprint exceeded the Earth's regenerative capacity by 50 per cent in 2008 and will exceed it by 100 per cent in 2030 under a business-as-usual scenario. That means humanity would need the equivalent of two planet Earths in 2030 to meet its needs unless business-as-usual changes significantly.

Banks understand that consuming capital as opposed to income is not sustainable. It is the same with the Earth's regenerative capacity. Business-as-usual is no longer acceptable and change to a more sustainable global economy is necessary. This requires banks to integrate Environmental, Social and Governance (ESG) matters into their activities.

The anthropogenic era poses risks and opportunities for banks. There are credit risks which could result from more severe weather patterns impacting infrastructure or agricultural production. Water stress could affect production activities in numerous sectors. Regulations could reduce the value of carbon assets or carbon-related infrastructure. There is also the potential for reputational risk impacting brand value, which could be critical for banks funding themselves with retail deposits.

In addition to the risks, the anthropogenic era creates numerous opportunities for banks. The transition to a carbon-constrained economy creates financing needs in renewable energy and energy efficiency. Sustainable transportation infrastructure

will need to be built and supported. Water management systems will become more important. Financial inclusion for the base of the pyramid is another opportunity and can be combined with low-emission household energy solutions or locally-controlled forest regeneration activities, which also have positive environmental benefits.

Well managed banks should focus on both the risks and opportunities, and in so doing they can become key leverage points to move from business-as-usual to a sustainable future. They can do this by engaging with their clients on ESG matters, shifting capital flows to more sustainable activities and creating new products which have ESG-related features.

Some banks are only at the beginning of their ESG journey and WWF welcomes the opportunity to contribute to progress on this front. We would like to thank Credit Suisse for their support as a sponsor of this Guide. We hope this Guide will enable banks to take their first steps on what will be a continuing journey of improvement to eventually attaining the highest standards of ESG performance.

Now is the time for every institution to get on board.

1. INTRODUCTION TO THE GUIDE

China is already the world's largest emitter of CO₂, but still builds a new coal fired power station every week and has huge reserves of coal, much of which is very low grade and highly polluting.



1. INTRODUCTION TO THE GUIDE

This Guide aims to give you practical guidance to help you integrate Environmental, Social and Governance (ESG) into your banking practices. It focuses mainly on the environmental and social aspects of ESG.

This guide has been developed by WWF, with support from Credit Suisse and from KPMG as knowledge advisers, and offers a structured approach to building an ESG strategy and implementation framework. This guide is intended for banks that are beginning their ESG journey but could also assist banks that have already embarked upon their journey in further refining their framework.

WWF has interviewed four banks to gain good insight into ESG integration practices currently employed by the banking industry. In the case of ANZ, information has been taken from publicly available materials and explanatory interviews were conducted to assist in the understanding of these materials. In the case of Credit Suisse, FMO and Rabobank, information has been taken from both publicly available materials and materials shared during the interview process. WWF also received some materials from Standard Chartered Bank, but did not interview them. WWF is very grateful to these banks for their input.

It should be noted that the practical examples contained in this document do not represent an endorsement of any institution's performance on ESG matters.

The Guide will help you to:

- Appreciate that integrating ESG can be a value driver for new business and stronger client relationships;
- Define your ESG ambition and strategy;
- Assess your existing ESG risk position and determine your ESG risk appetite;
- Develop an ESG policy framework;
- Develop an operating model to implement your ESG strategy;
- Create a system to monitor and report on your performance.

1.1 WHO IS THE GUIDE FOR?

The Guide is primarily for representatives from banks in the early stages of their ESG journey, who are looking to create and implement an ESG strategy. However, it is also relevant for bank representatives who are in the process of executing their ESG strategy.

The Guide should interest:

- Senior managers and executives involved in risk management, strategy development and sustainability;
- Members of risk, sustainability or ethical committees and working groups.

The Guide may also interest:

- Regulatory stakeholders interested in ensuring that ESG regulatory changes and demands are achievable and in line with international best practice;
- Anyone interested in understanding the issues and processes of ESG within the banking industry, for example, corporate clients of banks, shareholders and investment analysts covering the sector.

1.2 WHAT ARE THE GUIDE'S OBJECTIVES?

This Guide aims to:

- Inform your fundamental views on ESG;
- Improve your awareness of the impacts of ESG factors on your core business;
- Show that ESG integration can:
 - Promote value creation opportunities through product innovation and better anticipation of future trends;
 - Facilitate better risk management and more optimal capital allocation based on an appreciation of ESG issues such as constraints on natural and social capital;
 - Catalyse organizational change;
- Enable you to begin assessing your current risks and opportunities around ESG issues in your core businesses, with a focus on lending, equity capital markets (ECM), debt capital markets (DCM) and advisory;
- Help you to define your long-term strategic ESG ambition and manage the increasing reputational issues associated with poor ESG practices;
- Provide a step-by-step guide to help you achieve your ESG ambition through strategy and framework development, and implementation across core business lines;
- Highlight existing good practices from major international banks, demonstrating the level of action banks are already undertaking globally. As has been noted, mentions of existing practices by such banks are in no way an endorsement of any bank's performance on ESG matters. Since the understanding of critical ESG issues continues to grow, there is always room to improve existing standards.

1.3 SCOPE OF THE GUIDE

The Guide focuses on providing a practical implementation framework, governance structure and supporting information to help you manage your indirect ESG impacts. Indirect ESG impacts occur when the products and services you provide, such as loans, ECM, DCM and advisory services, facilitate your clients' operations, which in turn have ESG impacts. The Guide focuses more on the environmental and social aspects of ESG for banking rather than the corporate governance aspect as the latter is already thoroughly covered in the existing public literature.

Asset management and investment activities are not included in the scope of this Guide. However, the Guide contains screening tools and procedures for client review and due diligence which you could modify and apply to these activities.

A man in a black and white t-shirt and blue jeans is using a machete to clear land in a forest. He is standing in a field of tall grass and brush, with a dense forest in the background. The image has a blue tint.

2. THE BUSINESS CASE FOR ESG IN BANKING

Deforestation to clear areas to grow commodities like palm oil not only causes devastating climate change, but threatens the livelihoods and wellbeing of millions of people, like the woman below in Sumatra, Indonesia.



2. THE BUSINESS CASE FOR ESG IN BANKING

2.1 WHAT IS ESG?

Environmental, Social and Governance (ESG) is a term and concept first proposed in June 2004 by the UN Global Compact's "Who Cares Wins" initiative to focus mainstream investors and analysts on the materiality of and interplay between environmental, social and governance issues. Investors and analysts consider ESG performance in their fundamental analysis of companies with the underlying premise that companies that proactively manage ESG issues are better placed than their competitors to generate long-term tangible and intangible results.

(Source: www.unglobalcompact.org/Issues/financial_markets/)

ESG issues can cover:

- Environmental: Greenhouse gas (GHG) emissions, biodiversity loss, pollution and contamination, carbon regulation exposure, renewable energy;
- Social: Labour practices, community displacement, human rights, health and safety, financial inclusion;
- Governance: Corruption and bribery, reputation, management effectiveness.

2.2 WHY IS ESG RELEVANT TO BANKS?

To ensure global long-term financial stability and economic development, the banking sector needs to significantly change its attitudes and actions to promote more responsible and sustainable business practices. Leading companies, the UN, OECD, G20 and certain regulators and investors share the position that environmental and social issues need to be factored into investment decisions and corporate decision-making processes, alongside traditional financial metrics.

The private and public sectors need to more urgently acknowledge and take meaningful action on significant global ESG challenges or "sustainability megaforges", such as climate change, population growth and resource scarcity. These ESG challenges have profound implications for businesses, the economy and society at large, representing both risks and opportunities that must be addressed if long-term economic and social growth and stability are to be maintained.

These ESG challenges have particular relevance to banks in relation to their role as financial intermediaries and as capital raising agents. Banks are significant catalysts

ALL BANKS NEED TO UNDERSTAND THAT INCIDENTS RELATING TO NEGATIVE ESG OUTCOMES CAUSED BY THEIR LENDING, CLIENT RELATIONSHIPS AND ADVISORY DECISIONS CAN AFFECT THEM

in promoting economic development. This role needs to include the promotion of sustainable business practices, failing which, banks will end up facilitating practices which have significant negative environmental and social impacts and will miss opportunities to create new products and services that capitalize on ESG issues. Banks can do this through timely and strategic integration of ESG into their business practices and processes.

RobecoSAM says in its Sustainability Yearbook 2013: “As banks work to restore their credibility and contribute to stable financial systems, leadership and accountability are key factors in building a competitive advantage. Adherence to international best practices in corporate governance, risk management and compliance standards remains a necessity. Regulation, political and stakeholder pressure, demographic shifts and climate change will continue to have an impact on the business environment. Leading banks are integrating environmental and social factors into their long-term strategies and performance reviews.”

(Source: <https://www.kpmg.com/BE/en/IssuesAndInsights/ArticlesPublications/Documents/sustainability-yearbook-2013.pdf>)



Figure 1: 10 ESG challenges impacting organizational business models

Source: KPMG International. 2011. Expect the Unexpected: Business Value in a Changing World. See online at: <http://www.kpmg.com/global/en/issuesandinsights/articlespublications/sustainable-insight/pages/sustainable-insight-expect-the-unexpected.aspx> (last accessed 14.05.14)

All banks need to understand that incidents relating to negative ESG outcomes caused by their lending, client relationships and advisory decisions can affect them. These incidents may cause reputational and brand damage. In addition, they may potentially have direct financial impacts, such as:

- Increased non-performing loans due to credit/default issues and client inability to comply with loan agreements;
- Increased risk of litigation due to lack of appropriate disclosure on ESG risks for equity and debt issuance activities;
- Higher cost of capital for the bank itself, related to:
 - Equity and debt holders requiring higher returns due to perceived poor risk management ability and quality of loan book;
 - Loss of a low cost patient source of capital for banks with retail operations if depositors shift their funds away due to concerns about the bank’s ESG impacts.

Introducing an ESG “mindset” into your bank and developing an ESG strategy for integration may mitigate these factors.

2.3 ESG IN EMERGING MARKETS

Many banks operate in, or increasingly focus on, emerging markets as drivers for development and growth. These emerging markets are home to the fastest growing economies and populations in the world and many hold substantial natural resources. As such, they represent significant risks and opportunities to banks. ESG issues and risks may be more prevalent in some of these markets for reasons such as less mature, comprehensive and robust regulations; weaker enforcement; lower levels of external scrutiny (for example from civil society/NGOs); and lower awareness and capacity within banks, and in turn from their clients, regarding ESG issues.

However, ESG-related business opportunities (such as loans for energy efficiency or environmental protection projects and microfinancing) are more numerous given the significant need for investment activity due to the greater exposure emerging markets may have to ESG megafactors such as population growth, water scarcity and urbanization.

2.4 DRIVERS FOR ESG INTEGRATION

The main business case for integrating ESG is twofold: it can help you to manage risks and it can help you to capitalize on opportunities. Understanding the main ESG drivers that come under these two tenets can help you establish a clear business case for developing and implementing an ESG strategy.

At the end of this section, you can find links to examples of how financial institutions developed their business cases in publications from organizations including the United Nations Environment Programme Finance Initiative (UNEP FI), the International Finance Corporation (IFC), Principles for Responsible Investment (PRI), CDC (a UK development finance institution) and the CFA Institute.

For example, the CDC approach links risks and opportunities to financial impacts, innovation, reputation and access to capital and markets.

Figure 2: CDC ESG value drivers

Source: CDC. 2010. Toolkit on ESG for Fund Managers: Adding Value through Effective Environmental, Social and Governance (ESG) Management. See online at: <http://isresponsible.ca/wp-content/uploads/cdctoolkitforfundmanagers20101.pdf> (last accessed 14.05.14)



Four key drivers

Below we list four key drivers for ESG integration. This is not a complete or exhaustive list, and the business case for each bank will come from a combination of many drivers. We encourage you to access all the referenced publications to understand more fully how to build a business case that is most relevant to your bank.

1. Increasing regulatory expectations

ESG-related regulation and compliance is a constantly evolving process. Environmental and social regulation can be aimed at the broad company level, and more specifically at the banking and finance sector. Issues are defined by international agreements and standards, government policy, regulatory action and standard setting bodies.

Consequences of non-compliance for you and your clients can include:

- Fines and/or legal risks;
- Non-financial sanctions and reputational damage, such as loss of access to markets or the real or perceived licence to operate.

Examples of regulatory development for financial institutions include:

China

The China Banking Regulatory Commission has:

- Requested that banks assess environmental risks in loan applications and integrate environmental considerations into bank investment choices (2007);
- Launched the Green Credit Guidelines, specifying how banks should integrate sustainability into their lending practices, both in domestic and overseas financing (2012);
- Published the Green Credit Guidelines Statistical System in 2013, requiring Chinese banking institutions to report loan balances in 12 green sectors, including sustainable forestry, sustainable agriculture, and overseas lending based on international sustainability standards.

STAKEHOLDERS ARE DEMANDING THAT YOU UNDERSTAND AND MANAGE THE MORE INTANGIBLE FACTORS ASSOCIATED WITH YOUR OPERATIONS BY ADDRESSING ESG FACTORS

Brazil

FEBRABAN, the Brazilian Federation of Banks, signed the Green Protocol in 2009 with the Brazilian Ministry of Environment. Through the Protocol banks make voluntary commitments to:

- Provide financial credit lines and programmes that promote quality of life, sustainable use of natural resources and environmental protection;
- Consider the impacts and environmental costs in managing their assets and analyse customer risk and investment projects, based on the National Policy on the Environment;
- Promote conscious consumption of natural resources and materials derived from such resources;
- Inform, sensitize and continuously engage interested associates in policy and sustainable practice;
- Promote cooperation and integration of efforts among the signatories to the Protocol.

Banks, the government and NGOs jointly developed a set of indicators to monitor compliance with the Protocol and banks are now reporting on this.

In May 2014, the Central Bank of Brazil published Resolution No. 4,327, which requires all financial institutions authorized to operate by the Central Bank to draft and execute a Socio-Environmental Liability Policy (SELP) by 2015. The main aim of the SELP is to prevent losses stemming from environmental damage caused by the activities of the financial institutions as well as their clients.

The SELP will encompass systems, routines and procedures by the financial institutions to classify, evaluate, monitor, mitigate and control the socio-environmental risk of their activities and operations. Under this policy, financial institutions will also have to conduct a preliminary evaluation of the potential socio-environmental impacts of new types of products and services, including reputational risks.

2. Reputation management and licence to operate from shareholders and other stakeholders

Diverse stakeholder interests and expectations and their growing awareness of ESG issues ensure that your licence to operate does not just mean meeting regulatory licences, permits and compliance expectations.

Stakeholders are demanding that you understand and manage the more intangible factors associated with your operations by addressing ESG factors. Reputation may affect the perceived and real value of your bank and improve or destroy brand image. Poor management of ESG issues may also impact long-term profitability, financial stability and both “hard” and “soft” licences to operate (for example, legal permits as well as customer and investor relationships).

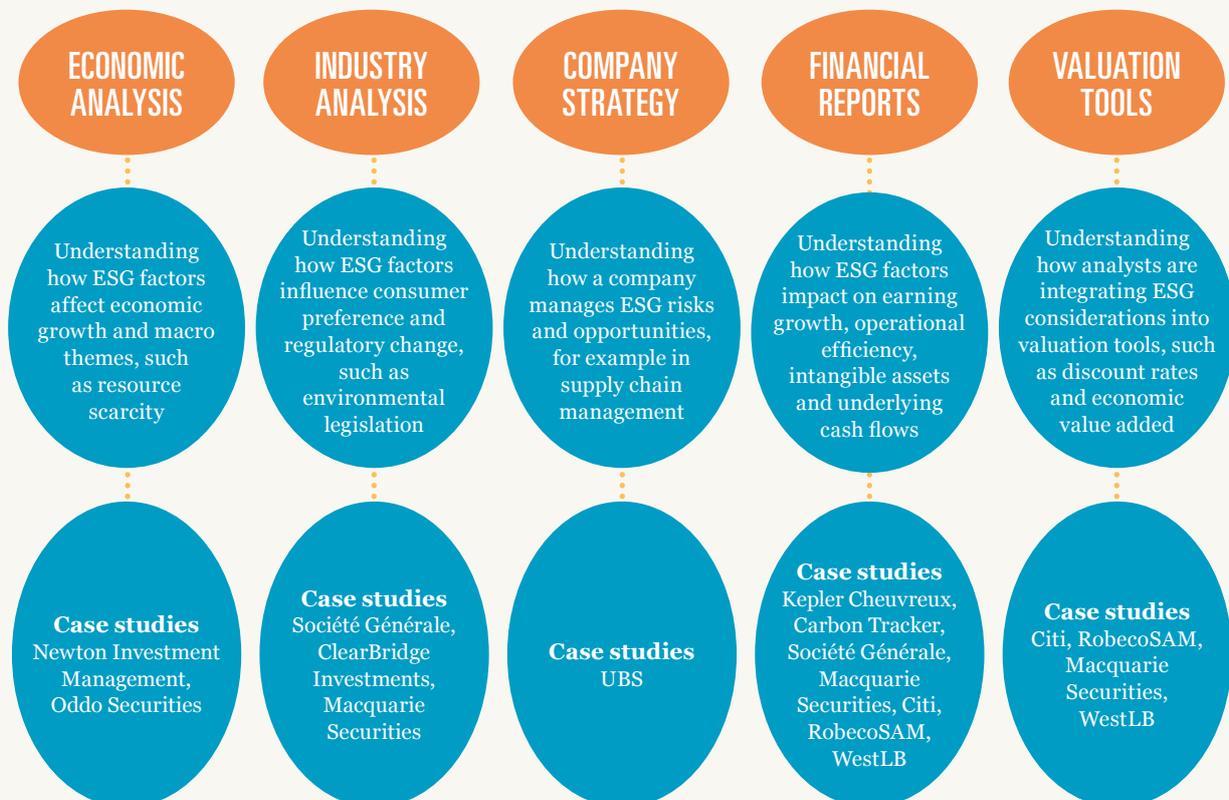
More directly, investors have ramped up the inclusion of ESG indicators in their investment decisions. According to the PRI website (accessed 17.03.14) as of April 2013, signatories to PRI had grown to 1,188 from over 50 countries representing over US\$34 trillion under management. This represents approximately 15 per cent of the world's investable assets and most of them (94 per cent) have adopted responsible investment policies which take into account ESG issues.

As this type of analysis increases, investors will consider your ESG strategy and the indirect ESG impact of your bank's activities when they assess your institution. As such, your ability to integrate ESG may impact the demand for your shares, potentially influencing your ability to raise capital, or affecting the cost of capital you can access and deploy.

In 2013, PRI published a series of case studies showing how financial institutions factor ESG into their assessment of companies. This trend reinforces the importance of integrating ESG into your activities.

Figure 3: ESG analysis is increasingly used by financial institutions

Source: PRI. 2013. Integrated Analysis: How Investors are Addressing Environmental, Social and Governance Factors in Fundamental Equity Valuation. See online at: http://www.unpri.org/viewer/?file=wp-content/uploads/Integrated_Analysis_2013.pdf (last accessed 14.05.14)



3. Enhanced risk management

It makes good commercial sense to analyse a broad range of risks and integrate their potential impacts into any business strategy. Given the growing presence of more uncertain systemic risks, such as climate change, which could impact entire economies and multiple geographies, risk assessment criteria have to move beyond traditional financial issues.

You need to consider a full range of direct and indirect risks, including those driven by environmental and social issues, via your own operations and your client relationships. For example, this is the approach taken by the Greenhouse Gas Protocol, which is the most widely used accounting tool by governments and businesses to quantify and monitor GHG emissions for the purpose of managing climate change risk. Its calculation of emissions includes both direct and indirect emissions. Indirect emissions are defined as emissions that are a consequence of the activities of the reporting entity, but occur at sources owned or controlled by another entity.

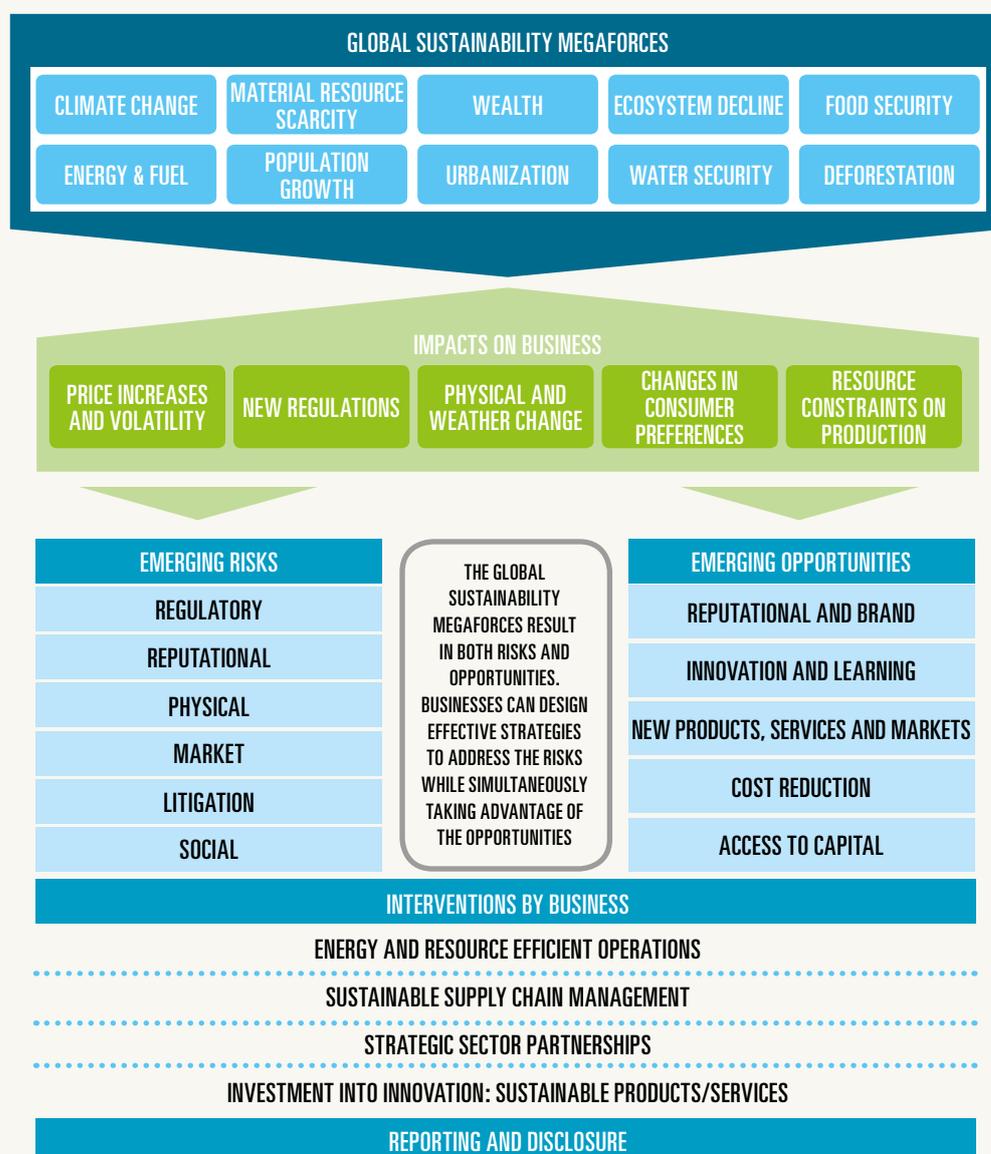
In the same way, you should consider the ESG risks that arise as a consequence of financing the operations of your clients, not least because these ESG risks have implications for the viability and credit worthiness of your clients. Understanding how well your clients mitigate and capitalize on their potential exposure to ESG issues also helps you to develop deeper insights into their business strategy and planning procedures.

By incorporating ESG criteria, you can develop a more comprehensive approach to risk management. Addressing and potentially lowering or mitigating ESG risks increases your ability to understand the scope and significance of ESG issues and identify areas underserved by current products.

You can also gain insight for your budgeting and capital allocation process in terms of new business opportunities as well as portfolio weightings. With more comprehensive information, you can make better business management decisions. Leading global banks have tried to achieve better risk management, in part by better identifying, understanding and managing ESG issues. Figure 4 shows an example of how both you and your clients can respond to ESG issues.

Figure 4: ESG process flow from sustainability megaforges to ESG responses

Source: KPMG International. 2011. Expect the Unexpected: Building Business Value in a Changing World. See online at: <http://www.kpmg.com/global/en/issuesandinsights/articlespublications/sustainable-insight/pages/sustainable-insight-expect-the-unexpected.aspx> (last accessed 14.05.14)



4. Value creation for the bank

As ESG challenges such as climate change, water scarcity, deforestation, displacement of indigenous communities and labour rights trickle down through value chains, new trends and pressures will continue to emerge. The result of you taking on your role as a catalyst for sustainable development could be new opportunities, stronger client relationships and potential revenue streams.

Value may be created and sustained by:

- Differentiating through innovation on existing products;
- Identifying and creating new products and services in line with the new and emergent requirements of markets and society;

- Adopting ESG governance systems and management processes to reduce the cost of doing business by optimizing the use of information, reducing risks and maintaining compliance;
- Helping clients improve their ESG performance through deep understanding and proactive management and advice, which can deepen your client relationships and also improve the quality of your client portfolio;
- Aligning with employee expectations in terms of social values, ensuring a better rate of attraction and retention for core human resources;
- Having an enhanced reputation as a leader in managing ESG issues, driving competitive positioning and potentially increased market share.

More information

- CDC. 2010. CDC Toolkit on ESG for Fund Managers: Adding Value Through Effective Environmental, Social and Governance (ESG) Management. See online at: <http://www.cdcgroup.com/PageFiles/147/finalcdctoolkitforfundmanagers20101.pdf> (last accessed 01.04.14)

This gives some interesting insights into the business case for integrating ESG as well as insight into the perspectives of investors.

- CFA Institute. 2008. Environmental, Social, and Governance Factors at Listed Companies: A Manual for Investors. See online at: <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2008.n2.1> (last accessed 01.04.14)

This manual will help investment professionals identify and properly evaluate the risks and opportunities that ESG issues present.

- IFC. 2012. IFC Sustainability Framework. See online at: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework (last accessed 01.04.14)
- PRI. 2013. Integrated Analysis: How Investors are Addressing Environmental, Social and Governance Factors in Fundamental Equity Valuation. See online at: http://www.unpri.org/viewer/?file=wp-content/uploads/Integrated_Analysis_2013.pdf (last accessed 01.04.14)
- UNEP FI. 2011. Guide to Banking & Sustainability. See online at: http://www.unepfi.org/fileadmin/documents/guide_banking_statements.pdf (last accessed 01.04.14)
- The UNEP FI, IFC and PRI have a range of other useful publications, which you can find on their websites:
 - www.ifc.org
 - www.unpri.org/publications
 - www.unepfi.org

3. DEVELOPING YOUR ESG STRATEGY

Climate change is already leading to severe flooding and drought in Asia, costing billions to economies and ruining lives.



3. DEVELOPING YOUR ESG STRATEGY

This section will help you decide the “right” level of ambition and commitment to ESG integration for your bank, explore the ESG risks you face, and develop an ESG strategy.

It will cover:

- 3.1 Establishing your ESG ambition level
- 3.2 Understanding your risk exposure and your current level of integration
- 3.3 Determining your ESG risk appetite
- 3.4 Responding to ESG risks
- 3.5 Developing your ESG policy framework and finalizing your ESG strategy

Developing an ESG strategy is an ongoing and evolving process. Your first commitment or “strategy” may well be a simple set of goals to get things started. The most important factor is to begin the ESG integration journey.

Each bank’s initial ambition level and pace of integration will differ. The quicker the pace of integration, the faster the benefits will be gained. Ultimately, all banks need to move toward full integration. Inaction is not an option if the bank’s business model is to be robust in the medium and long term due to megaforges and regulatory trends.

International institutions and publications, external consultants and civil society can provide a significant degree of help to overcome any hurdles that may slow down the pace of integration.

Getting started

You may already have a well defined strategy development process which you can use to develop your ESG strategy.

Ideally you should form an ESG committee to oversee the development of your ESG strategy, bringing together representatives from relevant business lines and business activities. Your ESG strategy has to align with your wider corporate mission and strategy. To show your commitment to the process, it is important that a member of the board or someone in an executive-level role leads the committee. It is also important to nominate a competent manager(s) with the mandate and authority to drive the process internally and to draw upon the support of other stakeholders when necessary.

Participation from diverse internal stakeholders, including front-office, operations, risk management, corporate strategy and human resources, is vital to generate ideas, garner support during implementation and eventually to successfully integrate and embed ESG into your daily activities.

**THE FIRST THING
YOU NEED TO DO IN
THE WHOLE PROCESS
OF INTEGRATING ESG
IS TO DECIDE
WHAT LEVEL OF
AMBITION YOU
ASPIRE TO**

3.1 ESTABLISHING YOUR ESG AMBITION LEVEL

The first thing you need to do in the whole process of integrating ESG is to decide what level of ambition you aspire to. As you go through the ESG strategy development process, attitudes on your level of ambition may change and you may wish to revisit this step.

Start by answering the following questions:

- What type of bank do you want to be when it comes to managing ESG issues?
- What does sustainable banking mean for you? How do you want to define sustainable banking?
- What are the ESG value drivers and societal trends that will shape your growth prospects over the next 10 years?
- What is the value (or business case) of ESG for your bank? (see page 14: Drivers)
- What role do you want to play in the transition toward a more sustainable economy and society – regionally and globally? What is your role in society?
- What strategy do you need to capitalize on ESG opportunities and mitigate ESG risks?
- What are you good at and how does this relate to ESG issues?
- How do you want others to see you?
- How does ESG integration link to your corporate strategy?

Some factors that could influence your initial ESG ambition level include:

- Your current understanding of ESG and your vision on where you would like to be in three to five years' time;
- The current regulatory environment in which you operate;
- Your current ESG profile – you may need to do an assessment to determine this (see the portfolio heat map exercise below);
- Alignment toward and support for ESG in your wider corporate vision, mission, strategies and objectives;
- Your current reputation, benchmarking and peer/competitor analysis results (if available);
- Opinions and positions of your stakeholders, including major shareholders, board members, clients, employees and others, such as civil society.

Determining and formalizing your ESG ambition level

After completing the steps above, you can formalize your ambition level using the ESG maturity grid (see figure 5) as a guide. This should involve discussions, endorsement and support from senior management and your board of directors.

At this point it would be useful to produce an ESG vision and/or mission statement to communicate the ambition level you have decided on.

This may only be an internal or informal message at this stage, but it may be useful to make sure everyone in your bank understands and can commit to the aims you have established. However, you could produce a more formal positioning statement, publicly committing to future goals.

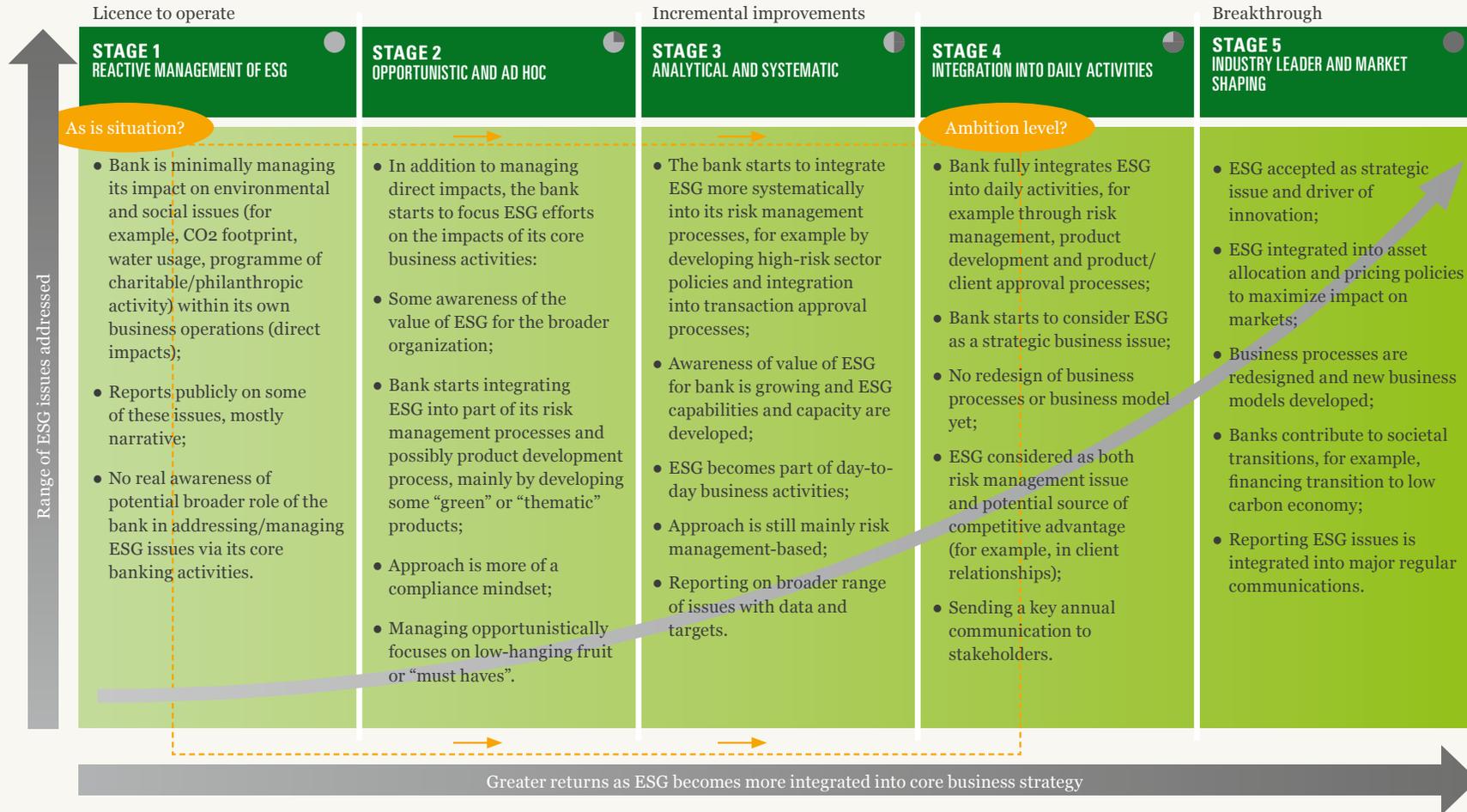
Your statement may reflect a range of positions:

- Minimal ESG development beyond compliance with the current regulatory environment based on identified ESG-related issues;
- Limitations and reduction of impacts of ESG factors based on your own activities (direct exposure);
- Limitations and mitigation of impacts of ESG factors based on the activities of your clients (indirect exposure);
- Development of proactive systems of advanced risk management and opportunity identification;
- Use of ESG as a strategic/competitive initiative (for example, developing new or enhanced business products, deeper client relationships, leadership in certain sectors or on certain ESG themes);
- Contribution to the transition to a more sustainable economy through ESG leadership.

Your statement can also include your position on the extent of monitoring and transparent reporting to which you aspire.

Figure 5: ESG maturity grid model

Source: MIT Sloan Review. 2009. ESG Maturity Grid.
Adapted by WWF and KPMG for the banking industry.



**Practical example:
How Standard
Chartered
determined and
formalized its ESG
ambition level**

Standard Chartered Bank introduced a formal Environmental and Social Risk Policy in 1997 to help govern its lending activities. This process has continually evolved over the subsequent years to reflect changing economic and risk environments and indeed developing social expectations.

In 2009, the bank introduced 14 Position Statements for a variety of higher-risk industry sectors to support its environmental and social risk management process. These 14 Position Statements were subsequently revised and increased to 20 in 2013, reflecting the development of new industry-wide benchmarks to manage environmental and social risks in additional sectors. In addition to sector-specific commitments, each statement includes the broad, generic commitment that: “The Position Statements guide our approach by outlining the standards we encourage or expect of our clients. The Position Statements are applied through our internal Policies and Procedures and reference appropriate industry-wide benchmarks such as the IFC Performance Standards and Equator Principles.”

As part of its positioning, or ambition level, the bank makes the comments below, and also incorporates them into each industry sector statement:

**IN 2009, THE
BANK INTRODUCED
14 POSITION
STATEMENTS FOR
A VARIETY OF
HIGHER-RISK
INDUSTRY SECTORS
TO SUPPORT ITS
ENVIRONMENTAL
AND SOCIAL RISK
MANAGEMENT
PROCESS**

- “For us, sustainability is about creating long-term value for our shareholders, working in partnership with our clients to make a positive economic and social contribution in the markets where we operate. We recognize that our success as a bank is linked intrinsically to the health and prosperity of these markets. The biggest impact we have is through the businesses we finance. By providing finance efficiently and responsibly, we can generate value for our shareholders while creating value more broadly for society.”
- “We want to be a force for good by working with our clients to improve their sustainability performance. We believe this approach will further strengthen and develop our long-term relationships with our clients, contributing to their competitive advantage and promoting sustainable economic growth in our communities.”
- “While the Group voluntarily adheres to these non-legally binding Position Statements, they reflect our aspiration to apply these principles consistently and to conduct our business with the highest standard of ethics and integrity. All staff are required to adhere to the Position Statements and endeavour to achieve these goals in line with our Group Code of Conduct and to live up to our brand promise of Here for good.”

Source: Standard Chartered Bank. ESG Performance Standards and Policies. See online at: <https://www.sc.com/en/sustainability/performance-and-policies/standards-and-policies.html> (last accessed 01.04.14)

**Practical example:
Credit Suisse’s
mission statement**

Credit Suisse’s Statement on Sustainability is based on the bank’s Code of Conduct and shows the bank’s ESG ambition level. It includes the following:

- “At Credit Suisse, we believe that our responsible approach to business is a decisive factor determining the long-term success of our bank. Our vision is to become the world’s most admired bank. To realize this vision, we uphold high ethical values and professional standards in order to maintain and strengthen our reputation for integrity, fair dealing and measured risk-taking.”

- “We conduct our business with a view toward long-term environmental and social sustainability. Therefore, we consider potential environmental and social impacts when making business decisions and when managing our resources and infrastructure.”
- “Economic, environmental and social issues, including climate change and human rights, matter in the communities and markets where we do business. We are integrating such considerations into our activities in order to meet the expectations of our diverse stakeholders, to appropriately manage our workplace and supply chain, to pursue business opportunities by developing products and services, and to understand and assess risks in our business transactions.”

Source: Credit Suisse. Sustainability Commitments. See online at: <https://www.credit-suisse.com/ch/en/about-us/corporate-responsibility/banking/sustainability-policy.html> (last accessed 01.04.14)

3.2 UNDERSTANDING YOUR RISK EXPOSURE AND YOUR CURRENT LEVEL OF INTEGRATION

A vital part of developing an effective ESG strategy and control framework is determining and understanding the ESG risk exposure of your portfolios, as well as the industry-specific ESG issues impacting your clients. You should also understand your current level of ESG integration, so as to put the risk exposure into perspective.

Getting started

Your first step should be to undertake an initial assessment of your ESG risk exposure by mapping business line activities to industry sectors, scoring them on their known ESG risk profiles in a portfolio heat map. This will help you develop a broad overview of the ESG risk exposure of your business lines, to help managers:

- Understand the proportion of your portfolio exposed to industries most susceptible to ESG risks;
- Map out the potential evolution of your ESG risk profile in relation to your current corporate strategy (for example, target expansion of the activities for a business line to a new region or industry sector);
- Prioritize which industry sectors should be examined in more detail in terms of ESG issues.

A number of parameters can impact your portfolio’s ESG risk profile, including the type and size of transactions, geographic location, internal exposure limits you impose and the ESG management capacity of individual clients. A critical factor is the sensitivity of the industry sector to ESG issues. For example:

- Water scarcity caused by weather pattern changes or climate change could impact the beverage industry in some regions resulting in temporary or permanent closure of a production facility;
- Banks that provide significant numbers of loans to oil and gas companies or large, complex infrastructure projects are more exposed to a variety of ESG risks than banks that provide loans to media companies;

- Reputation risks are high when financing a company operating in a controversial industry such as palm oil or mining.

How to create a portfolio heat map

Start by identifying and mapping the size of each industry sector in each of your portfolios.

To classify sectors, you could look at broad sectors, for example mining or agriculture, or drill down to, for example, coal and minerals or specific soft commodities such as palm oil and timber. Alternatively, you could look at super-sector or sector classifications such as FTSE International’s Industry Classification Benchmark, or MSCI and Standard & Poor’s Global Industry Classification System.

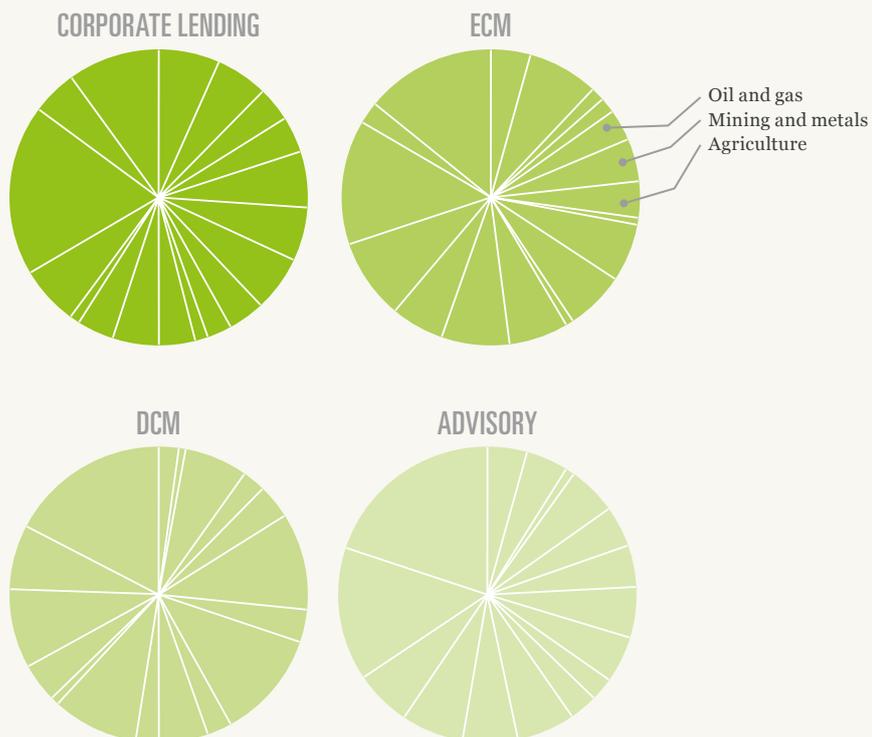
You could use the following criteria to map the size of each sector:

- **Corporate lending:** The nominal amount of outstanding loans and unfunded commitments (letters of credit or committed but unused credit lines) as a percentage of the total size of the lending portfolio;
- **ECM/DCM/advisory:** The size of the mandates executed or fee revenue as a percentage of total mandates.

You can determine the significance of each industry sector for each business line. One approach could be to generate a series of pie charts, as presented in figures 6-9. To do this, begin by identifying the industry sectors in each of your portfolios, and map them on to a chart, showing their relative sizes:

Figure 6: Business line portfolios classified by industry sectors

Source: Developed by WWF



The next step is to categorize the industry sectors you have identified according to their ESG risks.

You should produce a reference table that puts industry sectors into high/medium/low ESG risk exposure categories. This should focus on high-level categorization and should not necessarily incorporate detailed issues such as geographical areas of operations or the level of ESG preparedness for the sector, since this is a global mapping exercise.

To help you categorize, you could use publicly available research reports or buy sector reports from specialized ESG rating and research companies (MSCI, Bloomberg or Sustainalytics, for example, provide company-level and/or sector-level ESG reports). You could also bring in external experts or NGOs to help, or draw upon information resources from IFC.

Figure 7: ESG risk exposure by industry sectors

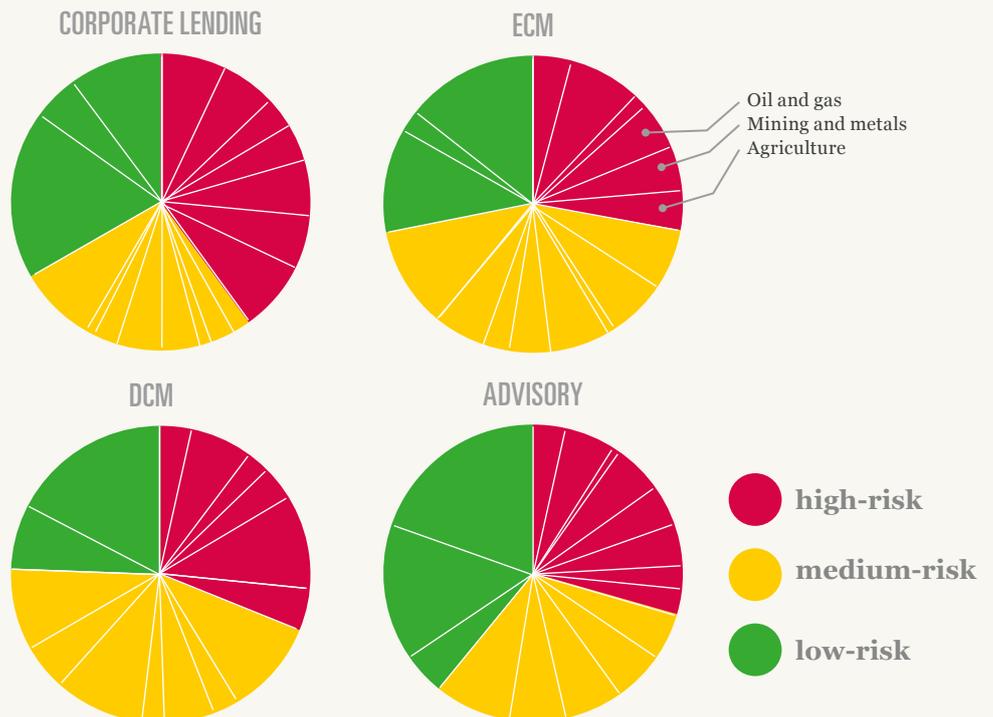
Source: Developed by WWF

ESG risk exposure by industry sectors		
LOW	MEDIUM	HIGH
Sector 1 Sector 2	Sector 3 Sector 4 Sector 5 Sector 6 Sector 7 Sector 8	Sector 9 Sector 10 Sector 11 Sector 12

The final step is to generate a baseline overview of the current ESG risk profile of your business lines by creating a pie chart showing the size of each industry sector and its level of risk as determined in the prior two steps.

Figure 8: Business line exposure to ESG risks based on industry sector categorization

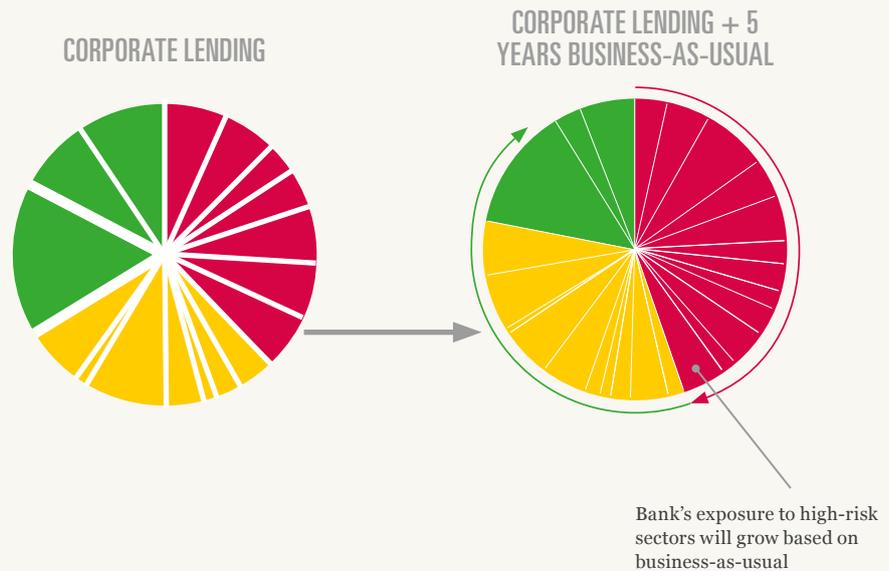
Source: Developed by WWF



Taking this information one step further, you could apply your current corporate strategy to your ESG business line profile and develop further insight on how your ESG risk profile, based on business-as-usual, could be impacted in the future as a result of, for example, growth targets for specific lines of business, industry sectors or geographies.

Figure 9: Future business lines exposure to ESG risks

Source: Developed by WWF



More information

- FIRST for Sustainability, Financial Institutions: Resources, Solutions and Tools, www.firstforsustainability.org (last accessed 01.04.14)

FIRST for Sustainability is a portal that provides a number of resources to help financial institutions understand sustainability in the context of the finance industry. It provides insight into general and sector-specific environmental and social risks and opportunities. It looks at how to manage these risks, and identify environmental business opportunities across business lines and sectors. FIRST also introduces users to financing/investing in environmental business opportunities with traditional financial/investment products.

- KPMG. 2012. Expect the Unexpected: Building Business Value in a Changing World. See online at: http://www.kpmg.com/dutchcaribbean/en/Documents/KPMG%20Expect_the_Unexpected_ExtctveSmmry_FINAL_WebAccessible.pdf (last accessed 01.04.14)

In this report KPMG identifies and analyses 10 sustainability megaforges that will potentially impact all businesses globally over the next 20 years. The report aims to help business leaders begin the process of understanding these forces; assess the implications for their own organizations; and devise strategies for managing risks and harnessing opportunities. It also provides an analysis of the ESG risk and opportunity exposure of a number of industry sectors.

- World Resources Institute, www.wri.org (last accessed 01.04.14)

WRI has produced a number of reports which include information on general ESG risks and also risks in specific sectors:

- Bradley, R. et al. 2005. *Growing in the Greenhouse: Protecting the Climate by Putting Development First.*
- Krechowicz, D. and Fernando, H. 2009. *Undisclosed Risk: Corporate Environmental and Social Reporting in Emerging Asia.*
- Krechowicz, D. and Fernando, H. 2009. *Emerging Risks: Impacts of Key Environmental Trends in Emerging Asia.*
- Krechowicz, D., Venugopal, S. and Sauer, A. 2010. *Weeding Risk: Financial Impacts of Climate Change and Water Scarcity on Asia's Food and Beverage Sector.*
- Sauer, A. and Miranda, M. 2010. *Mine the Gap: Connecting Water Risks and Disclosure in the Mining Sector.*
- Yang, A. 2012. *Global Coal Risk Assessment: Data Analysis and Market Research.*

Make a comprehensive list of ESG issues you could face

Once you have completed your portfolio heat map, you will need to focus on the thematic ESG issues, such as climate change caused by GHG emissions, that can pose risks throughout your portfolio, for example through the impact of carbon pricing on your clients' credit profile or through reputational risk to your bank. You should also be aware of how your bank's activities can contribute to these ESG issues. For example, if you are lending to a company in the agriculture sector that engages in rampant deforestation, your financing would facilitate greater GHG emissions.

You need to identify a comprehensive list of ESG issues you could be exposed to when providing financing and services to each of the medium- and high-risk industry sectors you have identified in the previous section.

A broad range of ESG issues can impact each industry sector. You need to use a consistent set of criteria to assess these, so you can prioritize the most relevant issues and deal with them accordingly. You can use publicly available research reports, sector reports or seek external expert help to develop your comprehensive list, creating a table like figure 10.

Figure 10: ESG issues that banks may consider (example)

Source: Developed by WWF and KPMG

Industry sector	ESG risk exposure	List of most relevant ESG issues	
Beverages	High	1. Water use 2. Packaging 3. Social issues of alcohol	4. Sustainable raw materials, for example sugar 5. Community relations
Agriculture/ food producers (for example, palm oil)	High	1. GHG emissions 2. Deforestation 3. Water use and pollution	4. Community relations 5. Habitat/ecosystem destruction 6. Severe weather events
Oil and gas	High	1. Health and safety 2. Impact on biodiversity 3. GHG emissions	4. Lack of proper labour contracts 5. Risk of corruption
Forestry	High	1. Habitat alteration 2. Community relations 3. Deforestation	4. Unsafe/prohibited pesticide/ herbicide 5. Illegal operations 6. Severe weather events
Chemicals	Medium	1. Chemical security 2. Employee health and safety 3. Impact on biodiversity	4. Air and water pollution 5. GHG emissions

Ask yourself the following questions:

- Which ESG issues does the industry in question have most impact or influence on? For example, the mining industry can impact biodiversity, GHG emissions, occupational health and safety standards, and corruption, among others.
- Which ESG issues is the industry most dependent upon? For example, the food and beverage industry may list water scarcity and availability of sustainable agricultural raw materials.

You should base your list on:

- The issues you are most likely to be exposed to, given the exposure of your various business lines to each industry sector;
- The potential impact of the issues on the performance of your clients and as such on your risk profile;
- The relevance/importance of the issues to external stakeholders, including clients, regulators, shareholders, civil society and society at large.

To create your list you could use your annual review process or do a more detailed analysis of a sample of transactions and clients in the medium- and high-risk sectors to further detail the specific issues you are exposed to over time.

Listing issues will help you to:

- Provide inputs to the process of classifying and approving clients and transactions and managing the performance of individual clients by contractually agreed (remedial) actions or client engagement strategies;
- Determine your exposure to thematic ESG issues, such as the risk of stranded carbon assets, and your organizational vulnerabilities. This could lead you to create global exposure limits across various industry segments impacted by those issues (such as fossil fuel energy generation, coal mining, coal transportation infrastructure and unconventional oil extraction).

It is important to recognize the inter-linkages and cause/effect relationship between different issues. Some simple examples of ESG issues cutting across different sectors are:

- Energy and its efficient use is almost a universal issue across sectors and along value chains.
- Water efficiency is a critical issue for the beverage and semi-conductor industries, but not as crucial to the delivery of telecommunications services. However, this often depends on where the boundaries of the value chain are drawn as there is obviously considerable use of semi-conductors in all telecommunications products.
- Land-use change/forest clearing is a particularly relevant issue for forestry and agriculture, for example, the soy and palm oil sectors. Forest clearing has environmental impacts through loss of biodiversity and climate change. But it also has social impacts as local communities dependent on the forest for food, fuel and medicine lose access to their traditional livelihoods.
- Labour conditions (rights, salary levels and health and safety conditions, for example) impact multiple sectors and should be a primary concern for banks given the threat of work stoppages, reputational risk and risk to operating margins due to unsustainable product price points based on unsustainably low wages.

Assessing your current level of ESG integration

After creating your portfolio heat map and list of ESG issues, you should assess the current status of your ESG integration. This will help you to understand which aspects of your internal framework and processes require strengthening for effective ESG integration.

Some of the criteria you could use for this include:

- **Risk control framework:** Do you have adequate policies or practices to manage your indirect sustainability risks or impacts? For example, is ESG included in client and transaction risk processes and do you have the procedures and technology to do so?
- **Governance:** Can your overall governance framework identify and manage sustainability risks and opportunities throughout the organization?
- **Human resource capacity:** Do you have the skills, knowledge, expertise and resources needed? Do you have access to information?

THIS EXERCISE OF UNDERSTANDING YOUR RISK EXPOSURE AND ASSESSING YOUR LEVEL OF ESG INTEGRATION SHOULD BE REPEATED ON AN ONGOING BASIS, AT LEAST ANNUALLY

- Products and services: Is there evidence of any integration of environmental and social factors into your mainstream product development? This could be through specialized “green” or “socially responsible” products and services to capitalize on market opportunities and decrease your portfolio’s ESG footprint.

You could develop a scoring table to rank/assess your current level of ESG integration. Criteria could include:

- Scope of application
- Level of integration
- Level of development
- Type of controls
- Resources applied

You could score each element from, for example, non-existent to best practice. You could do your own assessment or bring in a qualified third party.

You could also consider benchmarking your current status against your competitors/peers to add to the richness and depth of information available to make decisions.

This exercise of understanding your risk exposure and assessing your level of ESG integration should be repeated on an ongoing basis, at least annually. Such reviews assess relevant and material ESG risks and the adequacy of internal controls. The approach you take to managing ESG risks and influencing client behaviour may evolve due to development of ESG issues within sectors, inter-linkages of ESG issues and change in your focus geographies and industries over time.

More information

- Financial Times/IFC. 2013. Sustainable Finance Award Criteria. See online at: https://www.eiseverywhere.com/file_uploads/759a7483046a15411da34b628681ca58_SFA2013-Criteria.pdf (last accessed 01.04.14)
- Global Reporting Initiative. Sustainability Topics for Sectors. See online at: <https://www.globalreporting.org/resource/library/sustainability-topics.pdf> (last accessed 01.04.14)

This website provides lists of relevant sustainability topics for different industry activities, identified by five stakeholder groups – business associations, labour representatives, civil society organizations, information users and experts.

- IFC. Sustainability Framework and Environmental, Health and Safety Guidelines. See online at: www.ifc.org/ehsguidelines (last accessed 01.04.14)
- WWF and Credit Suisse. 2012. Decarbonizing Swiss Real Estate. See online at: https://www.credit-suisse.com/ch/real_estate/doc/Nachhaltigkeit/study_decarbonizing_swiss_real_estate_eng.pdf (last accessed 14.05.14)

- WWF and Credit Suisse. 2012. Environmental Performance of Swiss Banks: Shifting Gears Toward Next Generation Banking. See online at: http://assets.wwf.ch/downloads/environmental_performance_of_swiss_banks___shifting_gears_towards_next_generation_ban.pdf (last accessed 04.04.14)

This report looks at the interaction between environmental challenges and the business model of Swiss banking. It provides a framework which banks can use to benchmark their level of integration of environmental issues against their peers, identifying leading practices as well as the level of ambition that stakeholders expect in the future.

- WWF. 2012. The 2050 Criteria: Guide to Responsible Investment in Agricultural, Forest, and Seafood Commodities. See online at: http://awsassets.panda.org/downloads/the_2050_criteria_report.pdf (last accessed 01.04.14)

This guidance is designed to help a variety of stakeholders, including companies, banks and investors, to incorporate sector environmental and social key performance indicators (KPIs) into their business processes. It addresses 10 major global commodity sectors: aquaculture, beef, cotton, dairy, palm oil, soy, sugar, timber, pulp and paper, and wild caught seafood. WWF identifies these industries as high priority due to their current impacts on global biodiversity, overall GHG emissions and water use.

- WWF. The Water Risk Filter. See online at: <http://waterriskfilter.panda.org/> (last accessed 01.04.14)

This tool allows companies and investors/creditors to quantify water-related risks for all industries in all countries. It provides a highly structured set of risk indicators, covering physical risks, regulatory risks and reputational risks. The tool uses the best available data with global coverage, as well as company specific information provided by the user, to analyse and compute all relevant indicators of water risk. These are determined by the location (watershed) in which the company is located and the performance and behaviour of that specific company.

3.3 DETERMINING YOUR ESG RISK APPETITE

You can now determine your risk appetite on ESG issues and put together your ESG risk appetite statement. This should show the level of risk you are willing to accept in pursuing your business objectives and could impact your pricing considerations. It should give clear insights into the trade-off between considerations relating to ESG risks and profitability.

To decide your risk appetite, you will need to take into account your specific ESG risk profile, corporate strategy and other related business objectives.

Criteria for risk appetite statements

Your ESG risk appetite statement should be compliant with your criteria for risk appetite statements, as well as international guidelines and regulatory requirements (see “More information” below).

It should:

- Provide a clear insight into your risk tolerance in relation to your corporate strategy;
- Consider the balance between profitability and risk;
- Include qualitative and quantitative elements (principles and leading indicators and/or risk limits).

Key considerations

In determining your ESG risk appetite, you should consider the following factors:

- Your corporate strategy and business objectives (annual and long-term plan);
- Your stakeholders' expectations and reputational concerns;
- The key risks and issues identified and assessed as material in previous sections of the Guide;
- The potential impact on achieving business objectives if ESG risks materialize;
- The capacity required to manage ESG risks throughout your organization;
- Alignment of selected principles and indicators with external reporting requirements (for example, the Global Reporting Initiative (GRI)).

Examples

You can formulate ESG risk principles and indicators on multiple levels, depending on the complexity of your activities, your risk profile and the outcome of other key considerations.

As a minimum, your ESG risk appetite statement should include your limits for key risks identified and assessed as material in section 3.2. Examples of this approach include:

- Targeted distribution of ESG ratings or risk categories across portfolios, such as targets or caps on medium- and high-risk categories;
- Maximum exposure limits across portfolios for the medium- and high-risk sectors you have identified previously, as well as cross-sectoral risks;
- Statements on key risk indicators related to identified cross-sectoral risks, such as:
 - Potentially stranded fossil fuel assets;
 - Water and waste intensity metrics;
- Statements on minimum compliance with international standards (for example, Equator Principles for project finance, sector-specific standards developed by industry associations or organizations such as NGOs, the United Nations Global Compact or the International Labour Organization (ILO));
- Exclusion lists that could be sector- and/or activity-related, for example, gambling, child labour or deforestation.

Figure 11 shows a range of KPIs to monitor ESG risk appetite from both the risk and control perspective:

Figure 11: Potential risk indicators Source: Developed by WWF and KPMG

#	Risk indicator	Limit	Unit of measurement
1	% of high-risk transactions in portfolio	maximum	%
2	% of medium- and high-risk transactions in portfolio	maximum	%
3	Sector limits (reflective of ESG risk level)	maximum	%, nominal amount
4	Project finance as % of total portfolio	maximum	%
5	% of remedial actions concluded on time	minimum	%
6	Financed carbon emissions – scope 1 and 2	maximum	metric tonne CO ₂ /year
7	Net water withdrawals financed	maximum	megalitre/year
8	% of transactions in water-stressed regions	maximum	%
9	% of transactions facing specific environmental issues	maximum	%
10	% of transactions facing specific social issues	maximum	%

#	Risk control indicator	Unit of measurement
1	# of sector policies for medium-/high-risk sectors (in relation to sector exposure)	#
2	# of issue policies (in relation to exposure)	#
3	% of portfolio covered by sector policies	%
4	% of transactions screened on ESG risks	%
5	% of transactions escalated to ESG specialists	%
6	% of project finance transactions covered by Equator Principles	%
7	# of client engagements	#
8	Coverage and frequency of internal audits on ESG risk control framework	
9	ESG management training (in terms of \$/hours spend/# of employees trained)	

**Practical example:
Westpac’s Principles
for Doing Business**

Westpac states that its Principles for Doing Business underpin its commitment to sustainable business practice and community involvement. The Principles outline the framework against which it aims to achieve that – by embedding sustainability throughout its business in the areas of: governance and ethics; customer practices; employee practices; care for the environment; community involvement; and supply chain management. The Principles apply across the entire Westpac Group.

The Westpac Group’s lending and investment policies are guided by these Principles which set out commitments governing its response to ethical issues, such as respecting human rights, preventing financial crimes and the management of environmental risks.

Its Environmental Lending Policy seeks to identify and mitigate environmental risks when evaluating lending proposals. This helps to avoid environmental harm and unacceptable credit risk, in accordance with environmental law and regulation in every jurisdiction in which it undertakes business activities.

Westpac's Environmental Lending Policy forms part of a comprehensive framework to manage the ESG impacts of its business activities. This ESG Risk Management Framework articulates its approach to managing ESG risks in all aspects of its operations, including lending and investment. The Framework includes:

- Adopting of the Equator Principles, a framework for assessing social and environmental risks in project finance;
- Signatory to the UN PRI. These Principles commit institutional investors to incorporate ESG considerations into investment analysis, decision-making and ownership priorities;
- Offering a range of environmentally-linked products and services.

Source: Westpac. Sustainability & Community. See online at: <http://www.westpac.com.au/about-westpac/sustainability-and-community/> (last accessed 01.04.14)

**Practical example:
Standard
Chartered's risk
position statements**

Standard Chartered Bank has 20 position statements to help its clients understand Standard Chartered's environmental and social standards. They clearly communicate Standard Chartered's approach to providing financial services to clients who face specific issues or operate in sectors associated with specific environmental and social risks. They also give clients guidance on sound environmental and social management practices.

The statements cover 17 sectors and three issues:

- Agribusiness
- Biofuels
- Chemicals and manufacturing
- Dams and hydropower
- Forestry
- Palm oil
- Fisheries
- Fossil fuel power generation
- Gaming and gambling
- Infrastructure
- Mining and metals
- Nuclear power generation
- Renewable energy
- Oil and gas
- Ship breaking
- Tobacco
- Transportation
- Climate change
- Children's rights
- Water

To ensure its position statements match its exposure to sectors with specific risks, Standard Chartered tracks and monitors them regularly and applies them across its Commercial and Institutional, Commercial and Retail (business clients) segments. The Bank's internal policies and procedures, together with the Equator Principles, serve as a "compass" for Standard Chartered's financing decisions and form the bedrock of its sustainability risk management approach.

Source: Standard Chartered. Our Standards and Policies. See online at: <https://www.sc.com/en/sustainability/performance-and-policies/standards-and-policies.html> (last accessed 01.04.14)

More information

- KPMG. 2008. Understanding and Articulating Risk Appetite. See online at: <https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/documents/Risk-appetite-O-200806.pdf> (last accessed 01.04.14)
- The Equator Principles, www.equator-principles.com (last accessed 14.07.14)

These are a credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions. At present, 80 financial institutions in 34 countries have officially adopted the Equator Principles, covering over 70 per cent of international project finance debt in emerging markets.

3.4 RESPONDING TO ESG RISKS

Now that you have identified your ESG risks, you need to decide how to deal with them based on your level of risk appetite and your ESG ambition level.

Your first response may be to mitigate risks. However, identifying ESG risks can also be a starting point to generate new business opportunities.

You must recognize the tools and options you have available to respond to and manage ESG risks. Understanding where the greatest opportunities are within your portfolio and how to establish influence will be a key factor in successfully integrating ESG into your daily operations.

Influence of business lines and other factors

Your capability to respond to and manage ESG risks is influenced not only by the industry sector, but the business line itself, your risk control framework and the types of products and services you offer.

Examples of responses to different business lines include:

- A bank is often more able to manage ESG risks through its lending portfolio due to factors such as the long-term nature of relationships and lending agreements, the ability to negotiate and include risk-mitigating clauses and covenants in loan documentation, and the ability to work with clients to improve their practices. Leading banks are already engaging with their laggard lending clients to improve their sustainability performance.

- In capital raising transactions such as bond issues or initial public offerings, the options to influence are perhaps less direct in current products. Applying ESG-related assessment criteria in the decision to underwrite an issue, or requiring additional disclosure in the risk section in a transaction prospectus addressing ESG risk exposure and mitigating actions are possible responses, although these are more difficult to measure, monitor and act upon.

Some example questions you could answer to determine how you respond to ESG risks include:

- Do you go ahead with a transaction, even knowing the risks?

How feasible is it to say “no”, knowing the risks that have been highlighted as a result of ESG screening? Setting basic parameters for accepting transaction risk is one of the first steps you should take.

- Do you proceed with high ESG risk transactions because they have a short tenure?

Does your organization take higher ESG risks for short-term transactions because you do not believe the risk will materialize in the short term? Or do you believe the ultimate refinancing risk on some short-term transactions (that are not self-liquidating) means that ESG risks should still be taken fully into account in your lending decisions?

- What are your core business lines and what type of financial products and services do you offer clients?

Your ability to directly address risk and inform behaviour may be greater for longer-term loans and project finance than for ECM/DCM and advisory services, although this will ultimately depend on the depth of the relationship with the client.

- What is the level of your sector expertise?

The impact a bank with relevant sector expertise could make on the sustainability performance in that sector is much greater compared to a bank which has less sector expertise. This does not mean that such banks should not respond to identified risks. On the contrary, banks with less sector expertise are likely to be more exposed due to the lack of internal capacity to understand and address such risks and should perhaps consider a more conservative risk appetite.

- Who are your clients? What type of clients do you have?

Large multinationals and international companies typically have their own sustainability targets and may welcome new products, services and ongoing advice to help them achieve their goals. Smaller and domestic companies without an established sustainability strategy are likely to require more engagement from you to help them understand and manage their ESG risks, and this is an opportunity to provide value-added services to your clients.

**YOU SHOULD
CONSIDER
EVALUATING HOW
ANTICIPATED
ENVIRONMENTAL
AND SOCIAL
CHANGES ARE
LIKELY TO IMPACT
YOUR EXISTING
PRODUCTS AND
SERVICES**

- Which geographical areas are you operating in?

Banks operating in geographical areas where ESG is more business-as-usual (and clients/investors are more aware of it due to rules from government or exchanges) may find it easier to influence clients' behaviour than banks operating in markets that are currently less experienced and have less understanding of ESG issues. In these latter markets, it is crucial for banks to address the risks and engage more closely with their clients who are likely to have higher ESG risk profiles.

Having a good understanding of your ability to respond to ESG risks will impact:

- Your understanding of which ESG risk controls you can use and which ESG risks will require a different approach, such as lobbying, engagement or external partnerships with other organizations;
- How you develop the ESG risk control framework later in this guide (for example, by sector, client type, line of business or geographical area);
- Products and services within your business line portfolio that are offered to mitigate risks or create new business opportunities.

**Ways to deliver
and develop your
responses to
ESG risk**

You can use the following means to develop your responses to ESG risk, develop internal systems and controls, and inform client behaviour:

- Setting basic transaction acceptance parameters (basic screening) and rejection procedures;
- Developing and imposing client acceptance and transaction approval guidelines;
- Indirect client engagement, for example by disclosing how you approach ESG risk management (including policy statements), research publications, thought leadership, collective industry activism and partnership programmes;
- Direct client engagement, either relationship driven (i.e. constructive, cooperative) or risk driven (i.e. critical and with consequences);
- Enforcing specific actions through transaction documentation (for example, representations, reporting and disclosure requirements and covenants);
- New or revamped products and services geared toward ESG integration.

**Tailoring your
current products
and services**

You should consider evaluating how anticipated environmental and social changes are likely to impact your existing products and services, and how you can tailor them to enable better outcomes and lower impacts on critical ESG issues.

The table below shows some examples of products and services banks have developed, allowing them to signal their responses to ESG risks externally, while influencing ESG issues in their portfolio. How you implement these products or services may also allow better management of ESG issues in some cases.

Figure 12: Innovative services and products

Source: UNEP FI. 2007. Green Financial Products and Services: Current Trends and Future Opportunities in North America, adapted by WWF and KPMG

BUSINESS LINES	INNOVATIVE PRODUCTS AND SERVICES BUSINESS LINES COULD USE TO MANAGE ESG ISSUES IN THEIR PORTFOLIOS
CORPORATE LENDING	<ul style="list-style-type: none"> • “Green” finance/credit focusing on alternative/renewable energy, clean technology, energy saving or environmental protection financing across key industry sectors and projects; • Innovative impact financing for key sectors or focus areas – for example community development and inclusion, public financing and micro-financing; • Range of credit services to low carbon clients or projects; • Leasing for energy efficiency/low carbon projects.
ECM/DCM	<ul style="list-style-type: none"> • Initial public offering support to environmental firms and carbon credit developers; • Developing markets for sustainability and green bonds; • Establishing a capital base for climate mitigation projects; • Corporate bond index that favours climate-friendly companies; • Weather derivatives; • Exchange-traded catastrophe options; • Higher access to capital and credit ratings: “green” mortgage-backed securities.
ADVISORY	<ul style="list-style-type: none"> • Developing specific and focused teams, including emissions trading desks, sustainable finance teams and portfolios and equity research teams; • Developing expertise in the carbon finance space; • Providing carbon custodian services; • Services to help clients identify and manage environmental and social risk, including research and structuring advice.

More information

- UNEP FI. 2007. Green Financial Products and Services: Current Trends and Future Opportunities in North America. See online at: http://www.unepfi.org/fileadmin/documents/greenprods_01.pdf (last accessed 02.04.14)

This report provides a good overview of the trends and demand for “green” products, outlines the numerous “green” financial products and services that were available at the time of publication across a range of business lines, and shows the opportunities for future development in the space.



Traffic jam and smog in Beijing's central business district, emitting massive pollution and causing thousands of hours of lost work.

**YOUR ESG STRATEGY
MUST BE DESIGNED
TO ALIGN WITH AND
SUPPORT
YOUR WIDER
CORPORATE VISION,
MISSION AND
STRATEGY**

3.5 DEVELOPING YOUR ESG POLICY FRAMEWORK AND FINALIZING YOUR ESG STRATEGY

Your ESG strategy should indicate how you translate your stated ambition level into practice. To establish and finalize your strategy, your ESG committee should use the information gleaned during the risk exposure exercise, plus:

- Develop four to six key topics/themes that give substance to your ESG ambition level. They will form the building blocks of your strategy and could relate to, for example:
 - Higher-risk sectors such as extractives, infrastructure, food or agriculture;
 - Specific/thematic ESG issues, such as climate change or water;
 - Management practices such as ESG integration into mainstream risk management, new product development or remuneration schemes of executive management;
- Develop objectives supporting each of the four to six key topics/themes. Objectives should fall into three categories:
 - Objectives related to the ESG risk control framework: to identify risks within existing and new transactions/projects and operations, and the processes to address and manage your strategy and associated risks. These objectives should reflect the level of risk you are willing to take to achieve your ESG ambition level and strategy;
 - Objectives related to the opportunities identified: within the existing activities/products or in creating new ones, and how you will manage these opportunities;
 - Objectives related to social and ethical activity: showing how you intend to manage your interactions and contribution to the society in which you operate, either through finance, expertise, influence or time.

To complete your strategy, you should formulate guidelines and an action plan for each topic/theme to incorporate these objectives into your core business activities. It is important to note that your ESG strategy must be designed to align with and support your wider corporate vision, mission and strategy.

To execute your strategy and achieve your objectives, you will need to develop an ESG policy framework.

ESG policies translate your ESG risk identification and assessment and risk appetite into operational guidelines for approval and acceptance processes and into the day-to-day conduct of your business. The policy framework will allow you to control your ESG risk profile and ensure it stays within formulated boundaries.

Proper implementation and monitoring systems and processes need to back up any policy you introduce. Policies are only useful if you use them bank-wide and embed them into your daily operations.

A general ESG policy should describe your view on ESG, provide targets, guidelines and minimum standards and describe the governance of ESG risks. Depending on the complexity of your bank, these elements could be split into several documents which may include:

- A policy defining your overall view;
- A document describing the minimum standards required (which you may also use to develop decentralized policies);
- A charter describing governance in terms of your target operating model;
- The roles of the three lines of defence (business, second line risk management and audit).

If you are exposed to medium- and high-risk sectors, you may consider developing specific sector policies in addition to a general ESG policy. These specific policies will detail the minimum requirements for risk acceptance for transactions and clients operating in these sectors. Such policies can also help clients understand what is expected from them in terms of performance on certain ESG issues.

Minimum requirements for your general ESG policy

Your policy should:

- Clearly articulate your view on and approach to dealing with ESG issues;
- Have sufficient scope and ideally provide coverage over all products and services and geographies;
- Detail the procedure for identification, assessment and classification of ESG risks in new business and minimum standards and acceptance criteria relating to ESG risks;
- Detail the procedure for rejecting a business opportunity or client, including feedback to the prospective client;
- Detail the subsequent treatment of ESG risks, including mitigation, monitoring and reporting of both exposures and mitigating actions;
- Detail ownership and procedures for implementation and monitoring of adherence to the policy;
- Identify staff who are responsible, trained and accountable for the policy's delivery and management, including guidance to members of the bank where required;
- Be regularly reviewed and updated to:
 - Reflect changes in macro and micro factors both internal and external;
 - Ensure it continues to meet stakeholder expectations in light of the evolving nature of ESG issues;
 - Address direct, indirect and cumulative impacts (including those related to your clients' third party providers or supply chains), even if not directly financed;
- Be incorporated in your overarching risk management and policy framework;

- Include a summary that could be released into the public domain, particularly for shareholders, but also for other interested stakeholders;
- Specify targets that allow for credible monitoring and reporting on implementation; you could make public disclosures against these targets.

These criteria can also be applied to sector policies.

Other policy framework elements

Besides a general ESG policy, your policy framework could include:

- **Sector policies:** These can say which activities you will and will not finance within a particular sector, specify conditions under which you will provide finance, and set out the ESG requirements for clients and transactions. Sector policies should specify types of investments, loans and other products and services that the policies apply to. See figure 13 below.
- **Thematic policies:** These policies relate to certain groups of ESG issues, for example human rights, climate change, water or biofuels. Such policies will have similar content to sector policies and could also be developed using the tools in this document. Both sector and thematic risk policies can use the IFC Performance Standards as a baseline.
- **Exclusion policy/list:** These policies prohibit establishing business relationships if certain parameters/conditions exist. Examples could include production/activities involving forced or child labour, deforestation, financing of cluster munitions or activities that negatively impact World Heritage Sites. You can use the IFC Environmental and Social Review Procedures Manual and its exclusion list as a reference guide.

Resources to develop your policies

- **Local laws and regulations:** Policies should as a minimum adhere to local laws and regulations.
- **Voluntary international and industry best practice standards and principles:** You can base your sector-specific policies/guidelines on several generally agreed ESG standards such as the IFC Performance Standards, the Equator Principles for project finance, international treaties and initiatives, and certification standards such as the Roundtable on Sustainable Palm Oil (RSPO), the Forest Stewardship Council (FSC) and the Marine Stewardship Council (MSC) (i.e. voluntary standards issued by multistakeholder groups which often require third party audits for certification).

Figure 13 summarizes the building blocks for the creation of sector policies:

Figure 13: Developing sector-specific policies

Source: Developed by WWF and KPMG

TYPE OF SECTOR POLICIES	INPUTS	BUILDING BLOCKS	NEXT STEPS
<p>EXAMPLES OF HIGH-RISK INDUSTRIES:</p> <ul style="list-style-type: none"> • Defence • Forestry and palm oil • Mining and metals • Oil and gas • Hydropower • Fossil-fuelled power generation • Gaming and gambling • Nuclear • Agriculture • Chemicals 	<p>INPUTS FOR DEVELOPING SECTOR POLICIES:</p> <ul style="list-style-type: none"> • Relevant international, regional and national law and regulation; • Broadly accepted international treaties and conventions (for example on banned weapons, UN treaties such as UNESCO World Heritage Sites, wetlands on the Ramsar list); • Voluntary initiatives developed by financial institutions (for example IFC Performance Standards, IFC Environmental, Health and Safety Guidelines and the Equator Principles); • International good practice standards within industry (for example Global Forest and Trade Network, multistakeholder initiatives such as RSPO, FSC, MSC); • NGO research, insight and expertise; • Outcome of engagements with sector and expert stakeholders (stakeholder mapping will need to be undertaken perhaps with external adviser input). 	<p>A SECTOR POLICY COULD CONTAIN THE FOLLOWING ELEMENTS:</p> <ul style="list-style-type: none"> • Scope of policy in terms of: coverage of financial products and services, geographical reach, coverage of sector activities, applications in cases of partial/ indirect links to sector; • Policy prohibitions – minimally, your policy should clearly state the ESG conditions your bank places on its investments in, and financial services to, the sector; • Other policy restrictions and guidance, for example best practices, certification standards within sector; • Implementation and compliance – this is where banks should expect the barriers and difficulties to be. Planning and managing expectations are absolutely key to successful ESG implementation. 	<p>ONGOING COMMITMENTS:</p> <ul style="list-style-type: none"> • Develop set of procedures for implementing policy; • Manage internal roll-out and upkeep of policy and procedures (for example develop communication programme, e-learning programmes); • Manage communication with external stakeholders; • Set up monitoring and reporting system (including performance indicators) to manage implementation policy.

- Engagement with sector and expert stakeholders (for example NGOs, research institutes) is essential to develop a sector policy that meets stakeholder expectations;
 - Which sector policies are relevant depends on your business model.

Input for policy development – thematic policies

Issues covered by thematic policies typically apply across all industry sectors and include:

Environment issues

- Pollution and pollution abatement;
- Impacts on water quality and quantity, particularly where this affects downstream communities and ecosystems, plus activities that have a high water demand or occur in areas of water shortage or uncertainty;
- Air emissions, including GHGs and hazardous or toxic gases;
- Solid and other waste streams, including hazardous toxic materials and other harmful materials;
- Impacts of land-use change, including loss of biodiversity, impacts on natural habitats and endangered species, and GHG emissions;
- Resource use efficiency, including a set of commitments around maximizing the efficiency of resource use in relation to energy, water and the reuse and recycling of materials;
- Ecosystem services (for example, freshwater, climate regulation, pollination of crops and provision of food). There are growing commitments to address ecosystem service risks and issues. These include emerging international standards and initiatives such as the Natural Capital Declaration, which calls on the private and public sectors to work together to create the conditions necessary to maintain and enhance natural capital as a critical economic, ecological and social asset. See www.naturalcapitaldeclaration.org for more information.

Social and human rights issues

- Labour and worker rights, including compliance with ILO core labour standards and basic international health and safety norms that cut across sectors and the supply chain;
- Community health and safety, including the capacity and commitment to manage risks to local communities generated by clients or as a result of a transaction. These could include risks derived from explosions, vehicle and transport impacts or infrastructure failures, for example;
- Consultation processes (for example, free informed prior consent by local communities on activities that impact them) and agreements on any resettlement (physical or economic) that may be required as a result of a transaction;
- Impacts on indigenous peoples, local communities, minorities, women, and other vulnerable groups which may be directly or indirectly affected by your clients' business;
- Impacts on cultural and religious heritage (including tangible and intangible heritage).

**Practical example:
ANZ's group-wide
policies**

Presented below are a range of ANZ's group-wide policies that support their code of conduct, including corporate, sector and general policies:

- Generic environmental policy: ANZ's approach to the environment
- ANZ Climate Change Position Statement
- Sensitive sector-specific social and environmental lending policies, including:
 - ANZ Forests Policy
 - ANZ Energy Policy
 - ANZ Water Policy
 - ANZ Extractive Industries Policy
 - ANZ Hydroelectric Power Policy
- Global Sourcing Policy
- Health and Safety Policy
- ANZ Military Equipment Policy
- Respecting People and Communities: ANZ's Approach to Business and Human rights
- Stakeholder Engagement Policy Summary
- Political Donations Policy Summary
- ANZ Equal Opportunity, Bullying and Harassment Policy Summary
- ANZ Global Product Management Policy
- ANZ Continuous Disclosure Policy

Governance-related policies to support ESG risk management:

- ANZ Compliance Risk Appetite and Compliance Framework
- ANZ Global Reputation Risk Policy

Source: ANZ Group. ESG Policies. See online at: <http://www.anz.com/about-us/corporate-responsibility/more-mike/group-wide-policies/> (last accessed 14.05.14)

**Practical example:
WWF's metrics**

Below are some of the criteria WWF uses to assess the scope of banks' sector policies:

- Does the bank have a specific sector policy?
- Has the policy been approved or is it just a draft document?
- Is the policy public?
- Is there a clear commitment to periodically review the policy?
- Does the policy have global or regional application?
- Does the policy apply to all scales of lending?

- Does the policy apply both to lending and asset management?
- Is there a clear commitment to track clients' performance?
- Is there a commitment to have clients report on performance annually?
- Are clients required to report using credible sustainability standards (GRI or equivalent)?
- Does the policy have clear performance requirements?
- Are there clearly laid out engagement standard operating procedures in case of violation of policy clauses?

WWF assesses the strength of banks' sector policies based on the extent to which these policies include key performance criteria listed in WWF's 2050 Criteria Report. These criteria are applied to assess how well a company is dealing with the ESG risks in each of the sectors and can be used as input into your sector policies.

For each soft commodity sector, the report outlines:

- Key features of the global market, including trade data and dynamics;
- Primary environmental and social risks;
- Key performance criteria for managing environmental and social risks;
- Leading third party certifications;
- Major trends and opportunities;
- Links for additional tools and resources.

More information

- IFC. Environmental and Social Review Procedures Manual. See online at: <http://www.ifc.org/wps/wcm/connect/190d25804886582fb47ef66a6515bb18/ESRP+Manual.pdf?MOD=AJPERES> (last accessed 02.04.14)
- IFC. Exclusion List. See online at: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework/IFC+Exclusion+List/ (last accessed 02.04.14)
- IFC. 2012. Performance Standards on Environmental and Social Sustainability. See online at: http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_handbook_pps (last accessed 02.04.14)

This publication defines IFC clients' responsibilities for managing their environmental and social risks, providing guidance on how to identify risks and impacts. It is designed to help avoid, mitigate and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations of the client in relation to project-level activities. These standards, along with IFC's Access to Information Policy, form

the IFC Sustainability Framework, which articulates its strategic commitment to sustainable development.

- WWF. Responsible Palm Oil Financing and Investment. See online at: http://wwf.panda.org/what_we_do/footprint/agriculture/palm_oil/solutions/responsible_financing/ (last accessed 02.04.14)
- WWF. 2012. The 2050 Criteria: Guide to Responsible Investment in Agricultural, Forest, and Seafood Commodities. See online at: http://wwf.panda.org/what_we_do/how_we_work/businesses/transforming_markets/solutions/commodity_financing/2050_criteria/ (last accessed 02.04.14)

4. IMPLEMENTING YOUR ESG STRATEGY

Unsustainable manufacturing operations can lead to devastating environmental effects on surrounding areas, including severe water and air pollution.



4. IMPLEMENTING YOUR ESG STRATEGY

As soon as you have your ESG strategy you can start integrating it into business processes such as product development and capital allocation.

This section deals with:

- 4.1 Creating an operating model and organizational structure
- 4.2 Soft controls
- 4.3 Integrating ESG into your budgeting and capital allocation processes
- 4.4 Client and transaction approval – lending
- 4.5 Integrating ESG in ECM, DCM business activities
- 4.6 Client engagement

4.1 CREATING AN OPERATING MODEL AND ORGANIZATIONAL STRUCTURE

To execute your ESG strategy and implement, operate and govern the ESG risk controls you have developed in previous steps, you should now create an operating model commensurate with the size and complexity of your bank.

- The first pillar of your operating model should be a sound organizational structure (hard controls), with the roles and responsibilities of your various business and staff units in your first and second line clearly articulated. The third line internal audit function should test the functioning of these units and their respective roles and responsibilities from time to time.
- The second pillar of your operating model should be a set of soft controls to complement your ESG risk control framework (typically enforcing hard controls) in terms of incentives, facilitation, rewards and desired behaviour to create an enabling environment for sound ESG risk management.

You already have a clear operating model for the management of other risk categories, particularly related to managing credit risk, transaction approval and client acceptance. Your operating model to manage ESG risk should align closely to these.

To put your operating model into practice effectively, you will need suitably qualified staff, working either in specialized units or integrated into your existing departments and functions. You will also need to make sure designated staff take clear ownership of the ongoing development, periodic review and updating of your ESG risk controls.

Some common dilemmas you may face when integrating the management of ESG risks include:

- Should you assign responsibility for your ESG strategy and your ESG risk control framework to a single unit or to separate specialized units?
- What should you use ESG specialists for, and what tasks should you assign to your credit officers and relationship managers?
- Should you integrate ESG specialists into your relevant business lines or centralize ESG risk management in a specialized unit?
- In the case of specialized units, do you organize single reviews of ESG risks by specialists or use a four-eye principle (review by more than one person)?
- Do you organize ESG risk approvals in regular credit risk committees or build in additional steps with specialized ESG committees?

The size and complexity of your bank, as well as the ESG risk profile of your activities, will guide your answers to these questions.

Requirements for a sound organizational structure

To design a sound organizational structure, you will need to consider the following factors:

- The senior executive responsible for your ESG risk control framework (executive board-level);
- Existing groups and divisions that will need to weave ESG considerations into their daily activities;
- Creation of new business functions/positions dedicated to driving and managing your ESG strategy and implementing and operating your ESG risk control framework at the corporate- and business line-level;
- Appointment of ESG specialists in your second line review function to monitor ESG exposures and the performance of first line risk mitigation, as well as to provide guidance and support to other areas of your bank (you do not want to create silos but rather ensure capability and expertise as integration is gradually embedded);
- Independent review and advice on the approval of ESG risks in new and existing business, including a four-eye principle on material risks and complex subject matters;
- Appointment of ownership over ESG risk controls and responsibility for periodic review and updating of existing controls;
- Ongoing identification and assessment of emerging ESG risks and the development of adequate ESG risk controls;
- Creation of a specialized committee for the supervision of your ESG risk control framework and ESG risk approval with sufficient authority to instruct you on ESG issues;
- Human resources to support the development process and ensure that the performance of your staff is aligned with ESG requirements.

Guiding questions

The following questions can help you resolve some of the dilemmas around centralized or decentralized management of ESG risks and the appropriate level of expertise and independent review you need to organize:

- Are you exposed to ESG risk in one/a few/many business lines?
- Are you exposed to ESG risk in one/a few/many medium- or high-risk sectors or industries?
- What level of medium- and high-risk transactions are you engaged in that require specialized review of ESG risks and the performance of mitigating actions and controls?
- What range and spread of ESG issues have you identified?
- How complex are the ESG issues of the industries you work with?
- What level of sector expertise do your independent credit review officers have?
- What level of expertise do you need to be able to review and approve the ESG risk profile of new transactions? Can existing risk approval functions and committees provide this expertise? Do you need new staff or training from external experts?

Figure 14: Example role descriptions for ESG policies and procedures

Source: Developed by WWF and KPMG

It is imperative that you clearly define roles and responsibilities for implementing ESG policies and procedures. Figures 14-16 below show examples of how you could distribute roles and responsibilities. This is not a complete or exhaustive list, and depending on your structure different entities may perform some of the roles.

ENTITY	EXAMPLE ROLE DESCRIPTIONS
EXECUTIVE BOARD	<ul style="list-style-type: none"> • Overall responsibility for execution of ESG strategy and functioning of ESG risk control framework; • Ultimate oversight and responsibility for implementation of ESG integration process.
SUSTAINABILITY DEPARTMENT (STAFF DEPARTMENT)	<ul style="list-style-type: none"> • Development and implementation of the overall ESG strategy and general sustainability policies (and perhaps the management of sector policies) of the bank (both direct and indirect impacts); • Internal and external sustainability reporting and stakeholder engagement and communication; • Development and monitoring of ESG activities, including training and capacity building; • All internal ESG issues, reporting, etc.
FIRST LINE (BUSINESS UNITS, CLIENT TEAMS ETC.)	<ul style="list-style-type: none"> • Following the procedures of ESG policy framework at the transaction level; • Performing client acceptance procedures; • Conducting initial ESG screening (quick scan) to identify potential ESG risks and apply ESG sector policies; • Timely escalation to specialized ESG units for ESG due diligence and risk review; • Monitoring and reviewing client performance on ESG issues and executing or initiating client engagement activities; • Identifying ESG-related new business opportunities and initiating product approval procedures.

ENTITY	EXAMPLE ROLE DESCRIPTIONS
<p>FIRST LINE SUPPORT (FOR EXAMPLE, TRANSACTION PROCESSING, LEGAL DEPARTMENT)</p>	<ul style="list-style-type: none"> • Ensuring that the bank's ESG mitigating measures/performance improvement measures/disclosure requirements are incorporated into legal documentation for the transaction (for example, loan documentation, prospectus, offering memorandum); • Monitoring ongoing client obligations under loan documentation, for example, timely reporting and deadlines for agreed remedial actions in environmental and social action plans.
<p>SECOND LINE (RISK MANAGEMENT DEPARTMENTS, SPECIALIST ESG ADVISERS)</p>	<ul style="list-style-type: none"> • Designing, developing and reviewing ESG policy framework and risk controls; • Integrating operational oversight for ESG policy and risk control framework; • Due diligence and independent review of ESG risks in case of escalation by first line; • Providing ESG advice to transaction approval authority, for example the credit committee; • Assessing ESG impact of new business and overall portfolio risk assessment; • Appointing external consultants to conduct in-depth risk assessment (due diligence) in case of a high-risk transaction; • Engaging with risk, credit or deal teams as needed on potentially high-risk clients or transactions where material reputation or ESG issues exist, to provide guidance and recommendations; • Recognizing challenges for relationship managers and deal teams and helping find solutions in projects; • Engaging with the sustainability team in developing general sustainability policies.
<p>RISK APPROVAL AUTHORITIES (FOR EXAMPLE, CREDIT COMMITTEE, ESG COMMITTEE, BUSINESS SELECTION COMMITTEE)</p>	<ul style="list-style-type: none"> • Taking decisions or advising the management board on proposed transactions (depending on authority levels and governance structure of the bank); • Ensuring compliance with the ESG risk appetite and ESG policy framework; • Advising on minimum standards, acceptance criteria and policy development; • Approving new product proposals, business activities and changes to the operating model in relation to ESG issues.
<p>THIRD LINE (INTERNAL AUDIT DEPARTMENT)</p>	<ul style="list-style-type: none"> • Monitoring of compliance with and the effectiveness of the ESG risk control framework; • Supporting operational risk assessments of the ESG function (including first and second line departments and units).
<p>EXTERNAL ADVISERS</p>	<ul style="list-style-type: none"> • Engaging with consultants, civil society etc. to get expert views and alternative perspectives on ESG issues; • Providing specialist support for specific tasks (for example, due diligence or strategy review); • Providing third party verification.

Practical examples

Figure 15: Standard Chartered’s allocation of responsibility for ESG assessment process (example of a central/separate approach)

Source: Provided by Standard Chartered to WWF (2014)

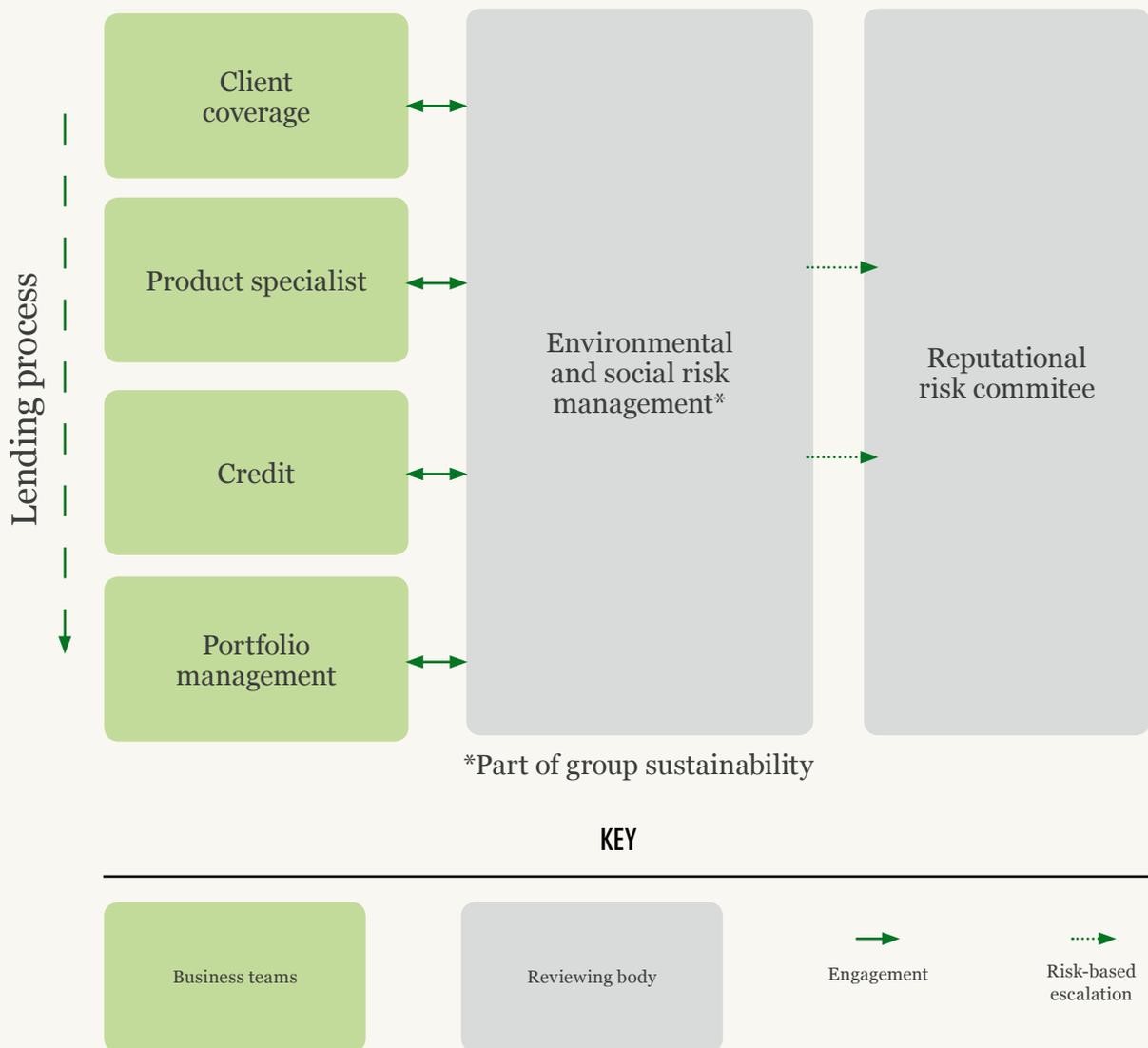
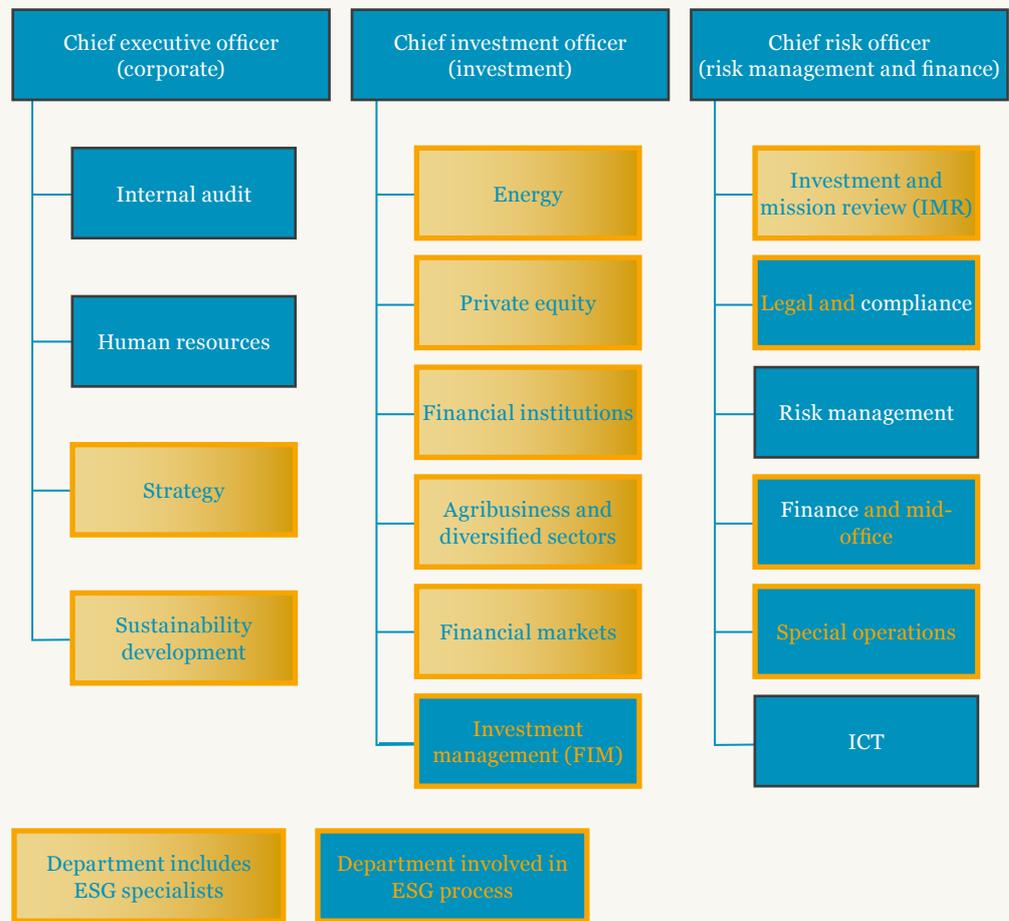


Figure 16: FMO's organizational structure (example of an integrated approach)

Source: Provided by FMO to WWF (2014)



More information

- EIRIS. Forum on Responsible Banking and Best Practice for ESG Teams. See online at: www.eiris.org (last accessed 02.04.14)
- UNEP FI. 2013. Online Guide to Banking and Sustainability. See online at: <http://www.unepfi.org/bankingguide/> (last accessed 02.04.14)

This guide shows how all roles and departments within a bank need to take action to address the cross-cutting nature of sustainability issues.

4.2 SOFT CONTROLS

Your ESG strategy, policy framework and risk controls alone will not ensure you can properly manage ESG risks and opportunities. You must also develop soft controls, including clear values and performance standards, senior management support, appropriate incentive structures, and adequate training and facilitation of the staff who are part of the ESG risk management function.

Staff can often face interpretation issues and dilemmas when assessing ESG risks and client performance. Environmental and social issues are prone to subjective judgements, and cannot often be expressed in terms of numerical compliance with rules and guidelines.

Developing a framework of soft controls will help you facilitate an open, learning environment where your staff can debate issues and you can build on your experience to sharpen your views, approaches and policies toward management of ESG risks and opportunities.

Key soft controls to consider

Key soft controls to contemplate include:

- Incorporation of ESG considerations in your corporate vision and mission;
- Clear definitions and communication of your performance standards and values;
- Senior leadership commitment setting the tone at the top and acting as role models;
- A compensation structure aligned to drive ESG performance, for example linking compensation to the longer-term success of transactions rather than only to fees for closing deals;
- Appropriate information systems and tools to facilitate business processes, risk management, internal control, compliance review, audit, monitoring and reporting;
- Access to information on your ESG strategy and your ESG risk control framework for your employees involved in ESG risk management;
- Training to develop the ESG skills and capacity of staff. You can use third party advisers for this. NGOs can also provide insight and expertise on ESG issues – for example, WWF works with banks/regulators globally to provide capacity building/training;
- Appropriate training for all levels on ESG policies and controls such as integration in your client and transaction approval processes;
- Recruitment and training of specialized staff for dedicated roles;
- Internal and external communications programmes to create awareness of your activities.

The five elements of soft control capacity

Below are the five elements of soft control capacity you should have, according to the 2013 PRI report Building the Capacity of Investment Actors to use Environmental, Social and Governance Information (<http://www.unpri.org/introducing-responsible-investment/> (last accessed 31.07.14)). These elements are applicable to banks in their lending, ECM, DCM and advisory roles:

1. Attitudes, values and belief systems, specifically that individuals and organizations recognize the importance of ESG issues to companies and to investors, and accept that they have a responsibility for company or investor performance and action on these issues;
2. Skills, knowledge and expertise, specifically that individuals and organizations have sufficient knowledge and expertise to analyse the ESG information that is available, to make sense of this information in the context of their roles and their organization's goals, and to make informed decisions about the actions that they should take;
3. Resources, specifically that individuals and organizations have sufficient human resources, financial resources and organizational/institutional support to take appropriate action on the ESG issues that are relevant to them;
4. Access to information, specifically that individuals and organizations have access to the tools, data and information that they need to deliver on their ESG-related goals;
5. An enabling environment, specifically that approaches to investment focus on long-term financial returns and the factors – including ESG – that will deliver them.

Practical example: Rabobank's soft controls

To help employees deal with ethical dilemmas they encounter in the course of their jobs, Rabobank Group has introduced an ethics office.

The ethics office gives advice based on previous cases and can provide support to interpret Rabobank's policies. The ethics committee discusses new cases and advises the entire Rabobank Group on ethical dilemmas, including ESG-related issues such as controversial weapons, land grabbing, food speculation, shale gas and sustainability in livestock farming.

If a client relationship manager or ESG specialist within the bank struggles with an ESG-related dilemma, they can take this issue to the ethics office for advice. Any conclusions or advice given by the committee is communicated to relevant people throughout the organization who may face similar types of issues. Rabobank tries to align the behaviour of its staff on ESG-related issues using this model.

The ethics committee meets four to six times a year. In addition to the CEO acting as committee chair, all relevant departments are represented, including risk management, sustainability/ESG, corporate communications and legal.

Besides managing the organization of the ethics committee, another task of the ethics office is to provide training and awareness sessions on ethics management at all levels of the bank. For example, the office regularly organizes workshops on ethics management for local supervisory boards and makes videos to increase awareness of ethical questions and dilemmas.

Source: Rabobank International. Interview with Thomas Ursem, Sustainable Supply Chain Manager, October 2012, reconfirmed June 2014

**Practical example:
Credit Suisse's
soft controls**

Reviewing transactions for ESG risks is an integral part of risk management at Credit Suisse. While in principle identifying such risks is the responsibility of all bank employees, the necessary in-house expertise to enable this responsibility lies within the corporate-level Sustainability Affairs team, which has expert representation in all global regions.

The Sustainability Affairs team contributes to ESG risk management in various ways, by:

- Helping to assess whether a client relationship and/or a transaction should be submitted into the formal Reputational Risk Review Process;
- Conducting analysis of the ESG risk involved in a particular client relationship/ transaction;
- Providing specialist assistance to relationship managers in dealing with ESG risks;
- Providing guidance on tools to assist with ESG risk investigations;
- Providing training to internal business and complementary risk management units to help them understand, identify and assess ESG risks;
- Reviewing the internal processes used to identify, assess and manage ESG risks and, where necessary, providing improvements or adjustments.

A challenge faced by clients everywhere, but particularly by those in emerging markets, is that of translating company aspiration around ESG into sustainable action. For this reason, and as a natural complement to ESG risk management support, Credit Suisse's Sustainability Affairs team also offers clients a range of ESG business advisory services that can help shape client commitment and support them in developing the necessary human and systems capacity to identify and manage ESG issues over the longer term.

Source: Credit Suisse Risk Assessment. See online at: https://www.credit-suisse.com/responsibility/en/banking/risk_review.jsp (last accessed 02.04.14), and (non-public) Credit Suisse Intranet, Sustainability Risk Management section (updated 31.05.13, last accessed 25.03.14)

More information

- IFC. Sustainability Training and E-Learning Programme (STEP). See online at: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Training+Resources/#STEP (last accessed 02.04.14)

This programme is designed for managers and staff of financial institutions to better understand sustainable finance and environmental and social risk management and to explore sustainability-related business opportunities.

- PRI. 2013. Building the Capacity of Investment Actors to Use Environmental, Social And Governance (ESG) Information. See online at: <http://www.unpri.org/publications/building-the-capacity-of-investment-actors-to-use-environmental-social-and-governance-esg-information/> (last accessed 02.04.14)

This report assesses and clarifies the capacity needs of key investment actors (including institutional investors, investment banks, ESG research providers, companies, business schools, policy-makers and NGOs) to analyse and use ESG information.

**BY INCORPORATING
ESG CRITERIA,
YOU CAN IDENTIFY
AND POTENTIALLY
CREATE
OPPORTUNITIES
WHILE HELPING TO
MINIMIZE YOUR RISK
EXPOSURE**

- UNEP FI. Sustainable Finance Training. See online at: <http://www.unepfi.org/training> (last accessed 02.04.14)

This training aims to raise awareness and to build capacity in sustainable finance among UNEP FI signatories and other financial institutions, as well as relevant stakeholders in governments, NGOs and academia, especially in developing countries and emerging markets.

4.3 INTEGRATING ESG INTO YOUR BUDGETING AND CAPITAL ALLOCATION PROCESSES

ESG issues are risk factors, but they can also provide a good set of criteria to apply in your process of setting the annual budget and the allocation of capital to certain business lines or products. By incorporating ESG criteria, you can identify and potentially create opportunities while helping to minimize your risk exposure.

You should aim to ensure you can incorporate ESG factors into your current budgeting and capital allocation systems and processes rather than developing new ones.

By shifting the parameters of decision-making to include ESG issues, you may refocus allocation of capital to particular sub-sectors and away from others, or into a completely new area or product.

Examples include:

- Lending or project finance:
 - Increasing allocation of capital available for energy efficiency/low carbon projects and related infrastructure;
 - Reducing target allocations for sectors with large environmental footprints which cannot be mitigated;
- ECM, DCM and advisory:
 - Building an expert team to help grow your activities in targeted sub-sectors such as renewable energy or sustainable commodity supply chains.

Integrating ESG into mainstream product development

By integrating ESG factors into your development process for new and existing products and services, you may:

- Create opportunities for additional/new revenue streams through innovative products that include ESG factors and considerations;
- Meet increasing expectations from ESG-savvy clients and companies;
- Distinguish and “reward” clients and sectors who better manage their own ESG risks and opportunities;
- Reduce risk exposure at organization and transaction level.

Getting started

You could develop decision-making tools relating to ESG issues. These may be linked to target revenue levels from new business/products you have identified and introduced or exposure limits to certain industry sectors. You can also develop portfolio monitoring tools to track exposure to thematic ESG risk issues, such as the quantum of assets that could be challenged in a carbon-constrained environment.

Individual business lines will set potential ESG targets, guided by your overall strategy for ESG. You will include these in your annual budgeting cycle. The ESG targets could, in line with your usual target setting process, relate to:

- Output targets for different business lines;
- Sector targets or exposure limits (involving single or multiple business lines) reflecting ESG issues inherent in the specific sector;
- Number of new products which reflect ESG issues.

These targets could be based/categorized around the following examples:

- Commercial lending: Supply chain finance products to support sustainable commodity production or energy efficiency loans or reduction in loan exposure to sectors or clients with high environmental footprints;
- ECM, DCM: Green bonds or social impact bonds (to encourage sustainable or social development) or underwriting targets for high environmental performance sectors or clients;
- Advisory: Environmental and social research offered to clients, assessment tools for clients.

In formulating any of the above related targets, you should follow your internal procedures and guidelines for budgeting, allocation of capital and adherence to risk parameters.

Practical example: ANZ integrating ESG considerations into its asset allocation processes

ANZ has taken steps to integrate ESG-related factors into its asset allocation process.

To reduce the ESG impact of its lending portfolio in the energy sector, ANZ has formulated a target for its renewable energy lending activities. The bank aims to increase its lower-carbon gas and renewable power generation lending in its Project Finance business by 15-20 per cent by 2020.

In addition, as of December 2013, almost 5,000 business lending employees have completed the online Social and Environmental Risk training, which is mandatory for all International and Institutional Business and Commercial employees who have approval to make credit decisions.

Source: ANZ. Corporate Responsibility Targets. See online at: <http://www.anz.com.au/about-us/corporate-responsibility/reporting-performance/targets/> (last accessed 02.04.14). Also: 2013 Corporate Sustainability Review. See online at: http://www.anz.com/resources/e/2/e29f5bf3-8b7e-456f-a3a3-f381b46a99f8/ANZ_Sustainability_Review_FY13.pdf (last accessed 14.05.14)

Practical example: ING's Sustainable Lending Team

In 2012 ING created a Sustainable Lending Team (SLT) to encourage and initiate viable commercial opportunities for the commercial banking division in the area of sustainability/ESG.

The team has a global mandate, and acts on behalf of all lending services and business units. Its challenge is to identify and promote growth areas in the sustainability arena. Its objectives include:

- To develop a scorecard to identify clients with progressive sustainability agendas;
- At the deal level, to promote transactions in sustainable sectors, such as renewable energy, energy efficiency and sub-sectors like waste and water management;
- To work closely with other specialist teams within ING Bank and ING Lending Services to contribute to the bank's understanding of sustainability issues and the business opportunities that could arise from them.

Source: ING Group. Sustainability Report 2012. See online at: <http://www.ing.com/ING-in-Society/Sustainability/Data-center/Sustainability-reports-archive.htm> (last accessed 01.04.14)

4.4 CLIENT AND TRANSACTION APPROVAL - LENDING

Having detailed minimum standards and acceptance criteria for ESG risks, you can now integrate ESG criteria into client and transaction approval procedures by developing an ESG screening/assessment and management process.

This will provide guidance to your staff, including risk managers and client relationship managers, before making business decisions on loans.

Below we cover the steps you will need to perform within a client and transaction acceptance process, including:

- ESG screening/assessment of your client as a result of their activities in identified sectors;
- ESG screening/assessment of the corporate activity specifically financed by the loan, i.e. the transaction);
- ESG due diligence to support the decision;
- Contracting and monitoring ESG performance on objectives agreed to as part of provision of the loan.

A sound understanding of client risk is a necessary first step in this process. If your client has past incidences of, or a perceived lack of control relating to, ESG impacts of its business activities, this should lead to higher-risk classification, even if the activity to be financed (i.e. the transaction itself) has a low ESG risk profile.

For example, a client that has engaged in deforestation of high conservation value areas in the past should not have a loan approved for financing a waste to energy plant without significant requirements for improved ESG performance in its overall

business activities. Ongoing monitoring of emerging and new risks (for example, as the client's business profile evolves) and a sound process to flag changes will help ensure information is kept up-to-date.

In circumstances where, for example, your client has had a loan approved in exchange for improving its environmental performance ("ESG covenants"), these covenants could be incorporated into the loan contract. You may define them in an environmental and social action plan (ESAP) that provides a summary of actions to be undertaken against a timeline and with specific accountabilities identified.

Minimum requirements for screening/new business

Procedures and tools for screening/assessing new clients (and any specific corporate activities which are being financed) on ESG risks could contain the following key elements:

- Guidelines for first line officers to identify ESG risks when engaging with clients on new business;
- Escalation procedures ensuring timely consultation and involvement of ESG specialists;
- Guidance on ESG due diligence (for example, client visits, independent third party consultation and review, application of minimum standards);
- Guidance on the application of minimum standards in loans where multiple providers are included (for example, club deals, loan syndicates);
- Guidance on ESG risk classification of clients and their proposed transactions (in accordance with minimum standards and acceptance criteria);
- Guidance for reviewing ESG risks and independent second line ESG risk advice to the relevant client approval authority of your bank (for example, the credit committee);
- Guidance on negotiation of ESG loan covenants and clauses (for example, involvement of ESG specialists, client interaction guidelines);
- Minimum standards of inclusion of covenants and clauses in loan documentation relating to ESG risks (for example, reporting requirements, remedial actions agreed in ESAP);
- Guidelines for monitoring and reporting of ESG risks and compliance with covenants and clauses;
- Procedures for allocating portfolio limits on thematic ESG risks, such as the amount of risk your institution is willing to accept on assets that could become vulnerable in a carbon-constrained environment.

Risk classification

As noted above, you can classify the level of ESG risk exposure for a client (and a transaction) through basic screening/assessment based on:

- The direct ESG risk exposure of your client's existing business operations referenced to the industry sector's material ESG issues;
- The ESG exposure of the activity for which your client is seeking financing, referenced to that particular industry sector's material ESG issues.

However, for detailed and specific insight into the ESG performance of your client, other factors to consider include:

- Countries and locations where your client operates: For example, high-risk countries could entail ESG risks such as water stress and health and safety. There may also be limited capacity to implement relevant environmental and social laws and regulations, and evidence of poor practice in specific industry sectors.
- The position of your client in the supply chain: In certain industries, for example, fast moving consumer goods, companies have direct relationships with end consumers through their marketing and branding and are more vulnerable to ESG risks than companies operating further downstream in the supply chain, where reputational risk is potentially lower (for example, the point of sale retailer).
- Scale of controversial activities: What is the material risk from a credit risk perspective where thresholds may be applied? For example, is the client's direct exposure from fossil fuels to a carbon-constrained environment applicable to only 5 or 10 per cent of its revenue, profits or assets? Alternatively, certain matters could represent a reputational risk for banks, such as if they are financing a new coal power plant, even if it represents only a small portion of the client's business.
- Past performance: For example, whether your client has been involved in any serious incidents; received material fines related to ESG issues involving its operations during the past two to five years (depending on the nature of the issues); or received negative NGO attention or publicity for ESG-related reasons in your chosen review period. Is there evidence of legal action in relation to ESG performance? For more information, the IFC environmental and social management system gives clear guidance on the most relevant issues you should consider when scoring transactions.
- The responsiveness or capacity of your client in addressing ESG issues: For example, their internal ESG capacity and standards should correspond to their level of ESG risk exposure.
 - Clients' ESG capacity is often overlooked – are they able to ensure compliance with your policies?
 - Is there accountability for ESG at board-/executive-level?
 - What is the quality and scope of their ESG systems and commitments?
 - Do they have dedicated sustainability staff/capability?

- Are they members of, and do they comply with, the requirements of industry ESG initiatives such as the RSPO or MSC?
- Do they have a policy to disclose information and report publicly on ESG issues?

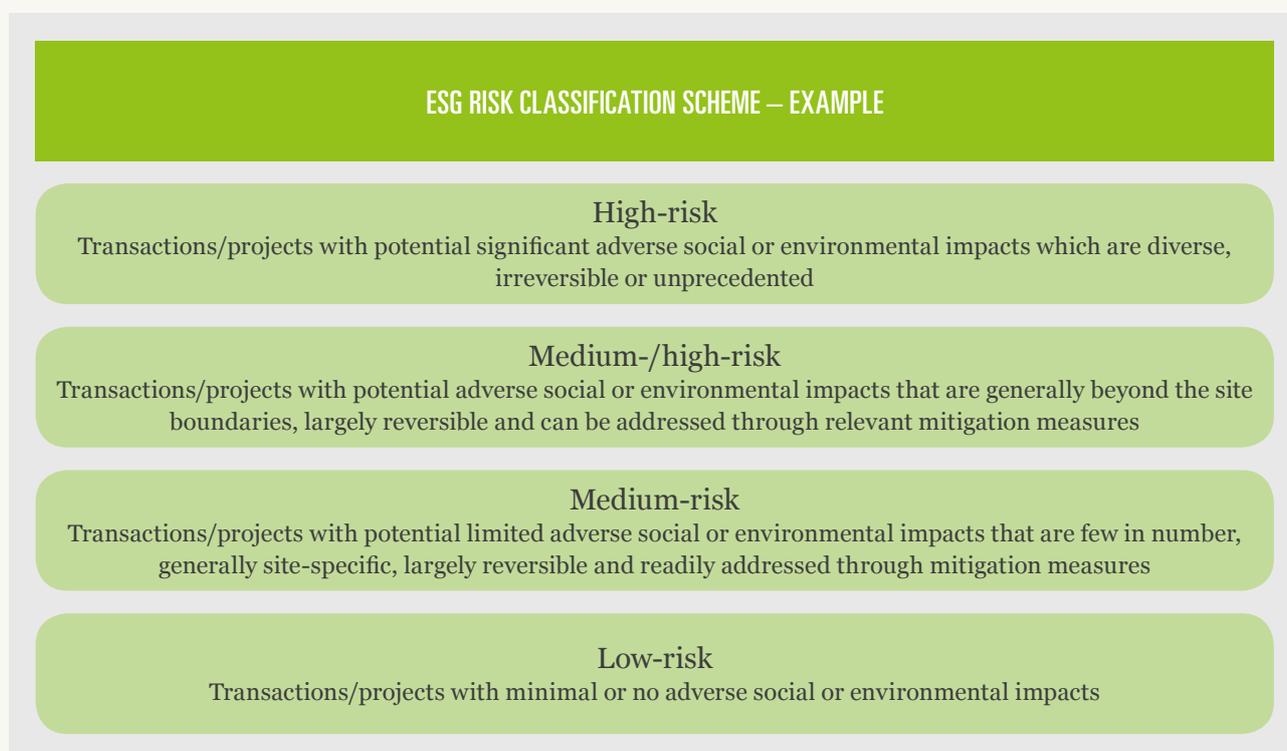
Classifying clients and transactions

Based on the outcome of your screening/assessment, you could classify a client’s ESG risk as, for example, high-, medium/high-, medium- or low-risk. It is up to you to determine the thresholds per risk category, the number of risk categories and how to label the categories.

It is also important to understand what risks you are already exposed to for outstanding loans in your existing portfolios. You may want to focus on historic transactions in the medium- and high-risk sectors identified in the portfolio heat map exercise as you may still have the opportunity to engage with and flag issues to these clients.

Figure 17: ESG risk classification scheme

Source: Developed by WWF, adapted from IFC (http://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2/components-of-an-esms/risk-categorization-and-managing-portfolio/) (last accessed 27.07.14)



**Practical example:
IFC's checklist**

Checklists can be a convenient tool to support first line credit officers and relationship managers in assessing the ESG risk level of new clients, or to classify the risk of new activities undertaken by clients.

IFC has developed a good example of a checklist to follow and steps to cover to perform an efficient ESG screening/assessment for project finance transactions. This checklist can easily be adapted to be used to assess corporate clients and many banks have developed proprietary checklists based on this IFC tool.

**Figure 18:
Environmental
and social aspects
screening checklist**

Source: IFC. See online at: <http://firstforsustainability.org/media/IFC%20ESMS%20101%20Presentation.pdf> (last accessed 02.04.14)

This checklist is just a starting point and should not restrict your bank's thinking. For example, this checklist does not contain any references or guidance on biodiversity and ecosystem services. It can serve as a template that can be adjusted to ensure that it is comprehensive and relevant.

ENVIRONMENTAL AND SOCIAL ASPECTS SCREENING CHECKLIST	
Transaction name:	Location:
Lending amount (\$m) and financial purpose:	
Industry sector:	Brief project description:
Site visit date:	Additional technical review required:
Reviewed by:	<input type="checkbox"/> Yes
	<input type="checkbox"/> No
COMPLIANCE WITH APPLICABLE REQUIREMENTS – CHECK ALL THAT APPLY:	
<input type="checkbox"/> Exclusion list	
<input type="checkbox"/> National regulatory requirements	
<input type="checkbox"/> Environmental, health and safety permits granted	
<input type="checkbox"/> Injuries and fatalities have occurred (how and when:.....)	
<input type="checkbox"/> Labour-related fines (when and why:.....)	
<input type="checkbox"/> Environmental incidents and fines (when and why:.....)	

MANAGEMENT SYSTEMS – CHECK ALL THAT APPLY:

- No written environmental and social policy
- No written human resources policy (for example, employee rights/non-discrimination)
- No written fire/safety plan or emergency prevention/preparedness/response plan
- No environmental, health and safety training for employees
- No procedures for managing environmental and social risks
- No designated person in charge of environmental and social issues
- No internal process for sharing information

PROJECT SITE – CHECK ALL THAT APPLY:

- Non-urban/undeveloped land
- Proximity to river/stream/pond/lake/sea
- Proximity to protected area (for example, forest/endangered species)/ecologically sensitive area
(for example, wetland/breeding grounds)
- Proximity to culturally sensitive/indigenous area

ENVIRONMENTAL ISSUES – CHECK ALL THAT APPLY:

Air emissions

- Boilers
- Generators
- Vehicles and equipment
- Furnaces and incinerators
- Welding and soldering
- On-site burning
- Use of solvents
- Use of fumigation
- Evaporation of chemicals
- Refrigeration plant
- Use of exhaust ventilation

Solid and hazardous wastes

- Waste generated
- Types of waste:.....
.....

- Hazardous waste (for example, waste oils, pesticide washings, solvents, clinical waste, asbestos)

Waste disposed to:.....

Resource consumption

Materials used:
.....
.....

Use of renewable natural resources

Use of tools and equipment

Water source:

Energy source:

Waste water

- Waste water discharged to: Drains and grates
- Oil separators Separation tanks or filters Reed beds Cut-off valves Foul sewers and septic tanks
- Water treatment units Cleaning operations Spraying operations De-watering/water pump out

Hazardous chemicals, fuels and pesticides

- On-site chemicals or fuels storage Protective measures against leaks/spills Signs of leaks/spills
- On-site spill clean up equipment Protective measures against rain
- Signs of corrosion on tanks/containers Secured storage areas against theft
- Training on proper handling of chemicals and fuels Pesticide use and management

Nuisance

- Dust Noise Odours Fumes Vibrations Traffic congestion and obstructions

COMMUNITY INTERACTIONS – CHECK ALL THAT APPLY:

- No designated person in charge of responding to questions from the community
- No procedures for managing community complaints
- Use of security personnel

SOCIAL ISSUES – CHECK ALL THAT APPLY:

- Land acquisition required Displacement/resettlement of local settlements
- Impact on local settlements/livelihoods Impact on indigenous peoples
- Complaints from neighbours/communities On or adjacent to site of cultural/archaeological importance

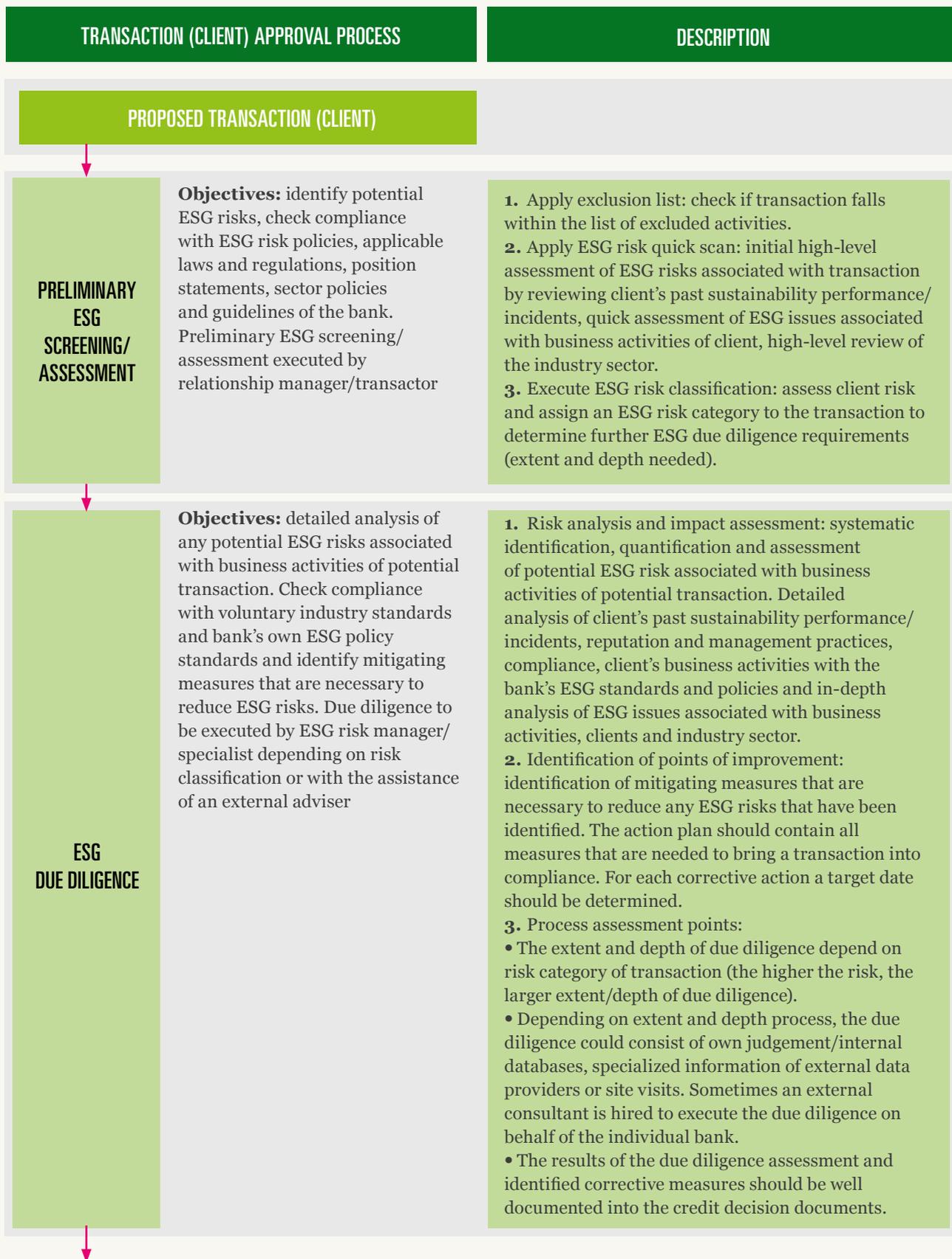
LABOUR ISSUES – CHECK ALL THAT APPLY:

- No personal protective equipment provided (for example, safety goggles/hard hat/protective gloves)
- Inadequate employee health and safety measures (for example, fall prevention/ventilation)
- Inadequate working conditions (for example, air quality/lighting/confined spaces/on-site hygiene)
- Inadequate terms of employment (for example, working hours/rest breaks/time off/overtime pay)
- Unequal employment opportunities (for example, discrimination against gender/ethnic group/age)
- Payment below minimum wage Employees below minimum age
- Child or forced labour No process for employees to voice complaints
- No recognition of employee organizations/labour unions

The figure below demonstrates the client and transaction approval process that banks can apply starting from the initial ESG screening through to ongoing monitoring throughout the life of the loan:

Figure 19: Transaction (client) approval and monitoring process

Source: Developed by WWF and KPMG



TRANSACTION (CLIENT) APPROVAL PROCESS	DESCRIPTION
<p style="text-align: center;">PROPOSED TRANSACTION (CLIENT)</p>	
<p style="text-align: center;">RECOMMENDATION AND DECISION</p>	<p>Objectives: advise on ESG risks and mitigation recommendations by ESG risk management and transaction approval from credit department. Recommendation given by ESG risk manager/ specialist. Final decision normally made by independent credit risk officer or credit committee</p> <ol style="list-style-type: none"> 1. Advice and final decision depend on outcomes of due diligence. Options: <ul style="list-style-type: none"> • Approval of transaction; • Approval with conditions; • Rejection or termination of transaction; • Escalate transaction to next level (depending on level of risk, other body than credit department may be consulted for final decision on transaction, etc.).
<p style="text-align: center;">CONTRACTING</p>	<p>Objectives: set up contract and include ESG clauses and corrective action plan if necessary</p> <ol style="list-style-type: none"> 1. Record the decision taken. 2. Incorporate ESG contract clauses and corrective action plan in loan documentation and contractual agreements. 3. Link agreed corrective action plan to a database to be able to monitor progress.
<p style="text-align: center;">MONITORING AND REPORTING</p>	<p>Objectives: monitor client risk rating and compliance with contractual agreements, evaluate progress on any ESG commitments made with clients</p> <ol style="list-style-type: none"> 1. ESG annual client review: monitor and measure client compliance with and progress in meeting the bank's ESG conditions included in loan documentation and ESG standards. 2. ESG annual progress reporting. 3. Managing non-compliance: non-compliance could be considered as "event of default" depending on the terms of the loan agreement. 4. For each transaction a record of supporting documentation of ESG reviews needs to be maintained.

Examples of clauses and covenants in loan documentation

Examples of potential ESG covenants in loan documentation and their benefits include:

- Reporting requirements, detailing the content, standard and frequency of reports clients should provide (for example, requiring clients to report to the Carbon Disclosure Project and/or in line with the GRI framework);
- Requirements for independent third party review (for example, when applying the Equator Principles for high-risk project finance transactions);
- Implementing an environmental and social management system to understand, monitor and manage a range of environmental and social impacts of your client's business;
- Meeting time-bound ESG milestones such as becoming members of, and adhering to, the principles and criteria of certification standards such as the RSPO (for example, HSBC Agricultural Commodities Policy in relation to customers in the palm oil sector).

Practical example: Standard Chartered's environmental and social risk management process

Environmental and social risk management is an important part of the credit and lending process of Standard Chartered Bank.

Frontline staff are provided with environmental and social risk assessment (ESRA) tools. Staff are supported by Standard Chartered's Environmental and Social Risk Management (ESRM) team, who provide technical advice, training, site visits and assistance to ensure compliance with Standard Chartered's standards. The team is made up of technical specialists from various industries blended with fast track bankers on rotation from the front line roles.

There are three stages to Standard Chartered's lending and environmental and social risk management processes:

1. **Assessment and due diligence:** In performing its due diligence, front line teams use the Bank's tools, including its ESRA templates, to gauge clients' and transactions' alignment against the Bank's standards as set out in the Position Statements. As applicable, the Equator Principles, or other applicable standards and guidelines are applied.

Where specific risks or impacts are identified as part of this process, the client or transaction may be escalated to the ESRM team for further guidance including a decision on whether to refer the transaction to the Business Responsibility and Reputational Risk Committee (BRRRC).

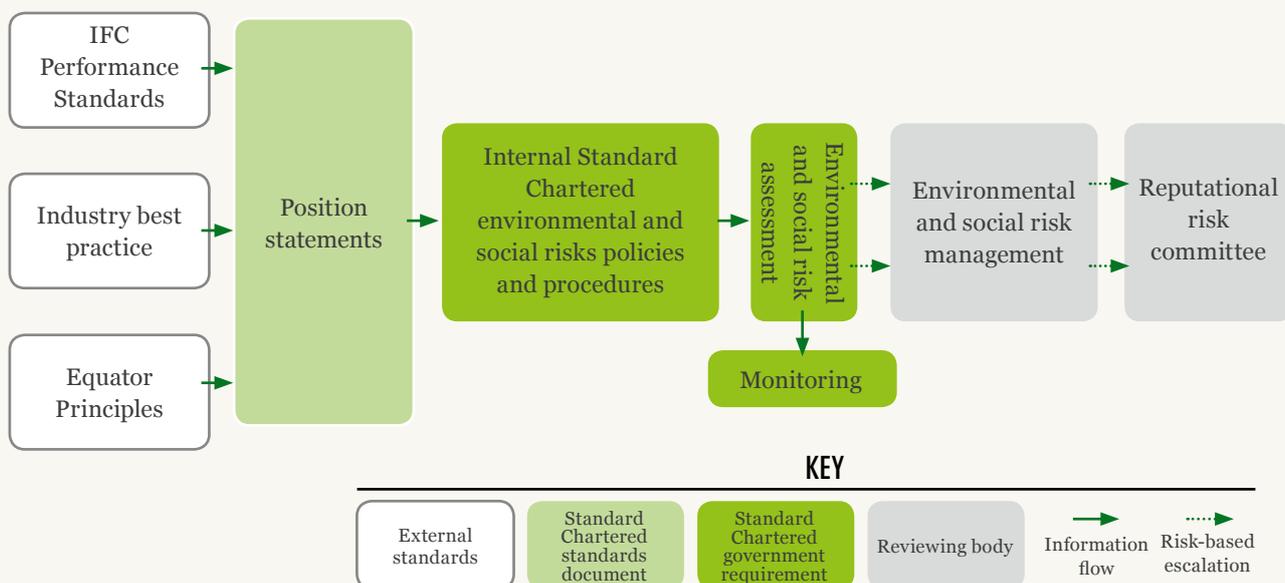
Where required, external consultants may also be engaged to perform detailed due diligence and recommend an action plan to mitigate any associated risks. Circumstances in which this is likely include: where required by the Equator Principles; where specific risks are identified; where specialist skills are required; and/or in situations where the Bank is highly reliant on an asset or project for the repayment of a loan. The ESRM team is available to guide business teams through this process where required.

2. **Approval:** All lending transactions require approval from Standard Chartered's credit department. Client relationships and specific transactions that require further scrutiny are escalated to the BRRRC*.
3. **Monitoring:** If necessary, ESG conditions are included in loan documentation, and clients are required to comply with a time-bound action plan to meet these conditions. For project finance, Standard Chartered's Portfolio Monitoring team is responsible for ensuring client compliance with any agreed action plans. Any material deviation against the action plan is referred back to ESRM and where required the BRRRC.

* Transactions with significant ESG risks are escalated to Standard Chartered's BRRRC, chaired by the Deputy Group Chief Executive. The committee includes representatives from the Banking Leadership team and the Group Head of Sustainability. The BRRRC meets monthly and on an ad hoc basis where necessary.

Figure 20: Standard Chartered's process

Source: Provided by Standard Chartered to WWF (2014)

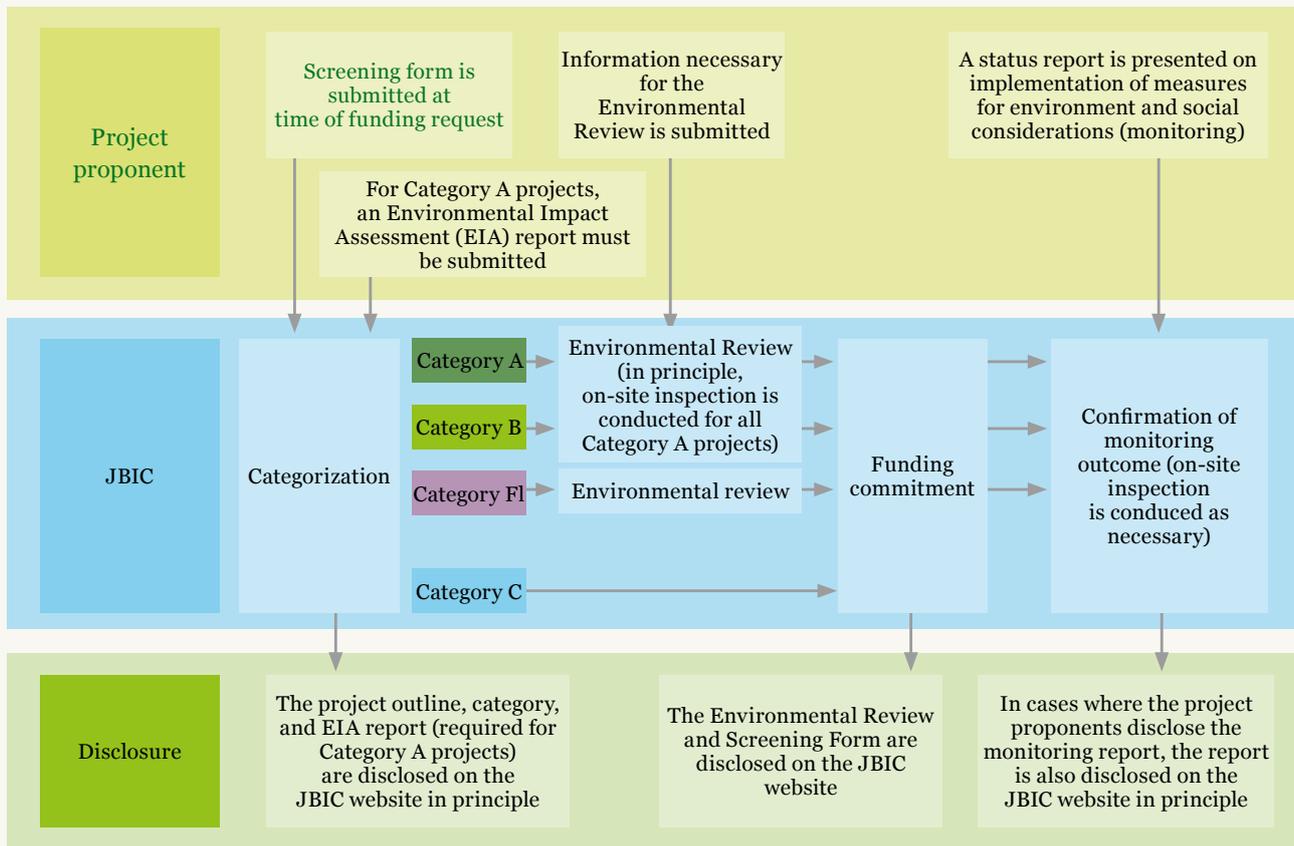


Practical example: JBIC loan process

Japan Bank for International Cooperation's (JBIC) loan process has an established order of procedures that are followed for the implementation of its Environmental Guidelines. Having a clear process flow ensures that ESG risks are adequately factored into the loan approval process, along with suitable risk monitoring and reporting requirements.

Figure 21: Procedural flow for confirmation of environmental and social considerations

Source: JBIC. 2013. Activities for Environmental Sustainability. See online at: https://www.jbic.go.jp/wp-content/uploads/page/2013/08/20397/env_2013.pdf (last accessed 15.06.14)



* For Category FI projects, JBIC confirms through the financial intermediary that proper environmental and social considerations indicated in its environmental guidelines have been followed for the project.

**Practical example:
Credit Suisse's
transaction approval
process**

Reviewing the sustainability impacts of a company's business activities is an integral part of risk management at Credit Suisse.

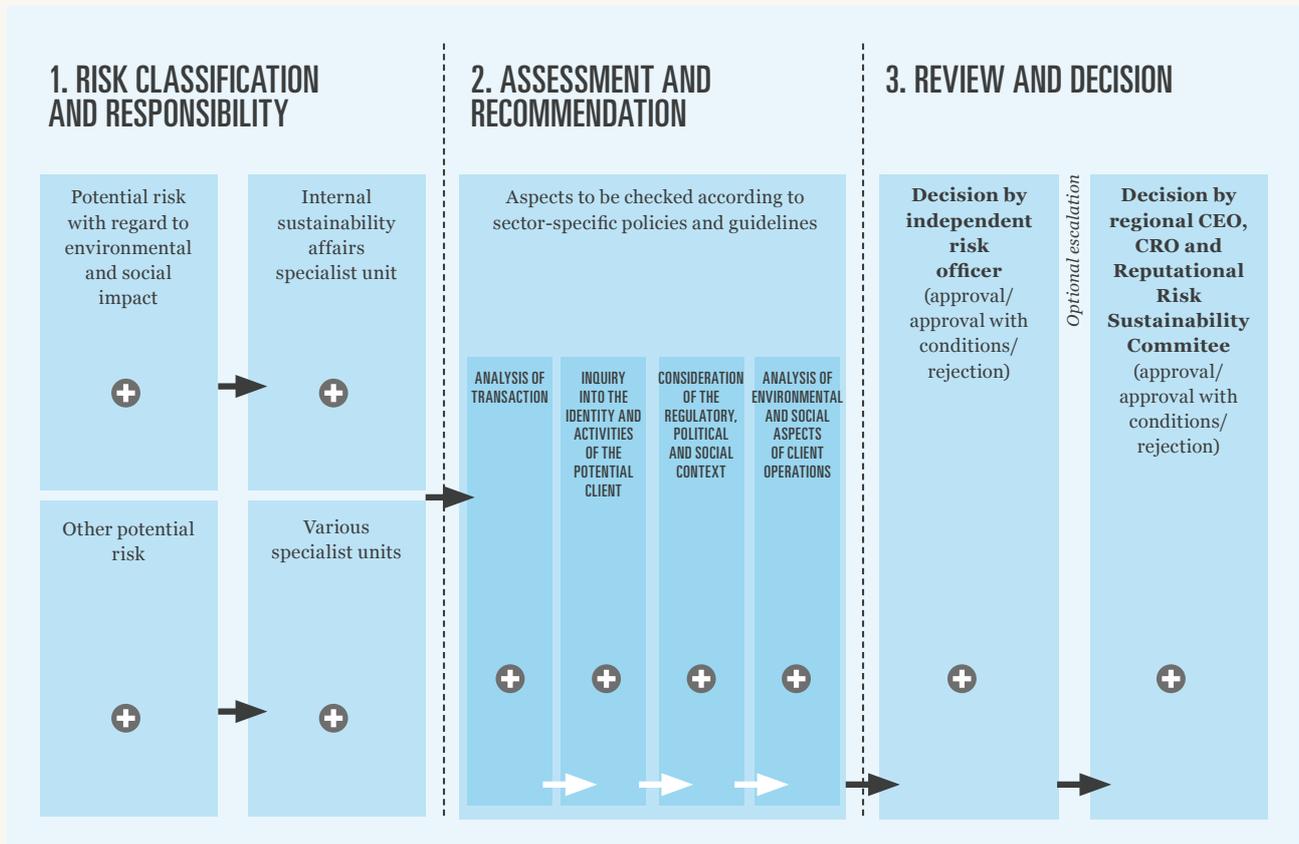
A dedicated team of environmental and social risk specialists identifies and assesses baseline information on sustainability issues relevant to the client's industry and assets with reference to various databases and, as appropriate, site audits.

The identified sustainability issues are evaluated for compliance with internal sector-specific policies and guidelines and for their adherence to applicable voluntary industry standards, following which a judgement is made to proceed or not, and with or without conditions.

If a transaction is likely to lead to reputational risk, then an independent risk officer must consider whether all relevant issue experts have provided an assessment and make a decision about the proposed transaction.

Figure 22: Credit Suisse’s transaction approval process

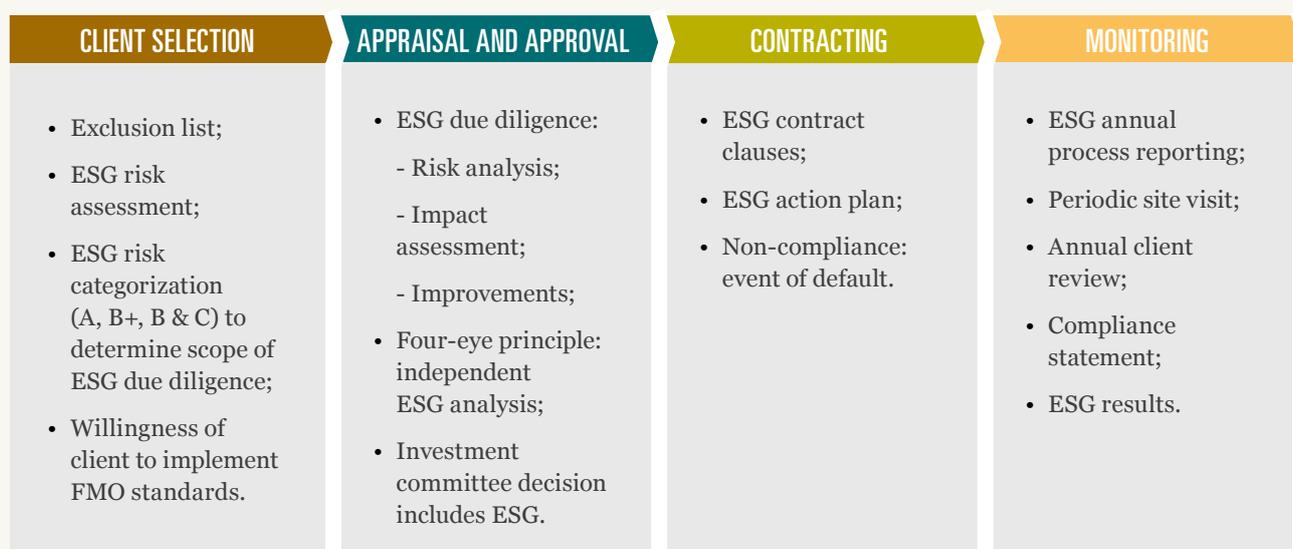
Source: Provided by Credit Suisse to WWF. See online at: https://www.credit-suisse.com/responsibility/en/banking/risk_review.jsp (last accessed 15.08.14)



Practical example: FMO's transaction approval process

Figure 23: FMO's transaction approval process

Source: FMO. Integrating Sustainability. See online at <http://www.fmo.nl/integrating-sustainability> (last accessed 02.04.14)



ESG due diligence related to financial transactions with a B and C risk level are executed by the FMO credit analyst itself. However, in case of a financial transaction with an A or B+ risk level, a four-eye principle is applied by FMO. This four-eye principle means that the ESG due diligence is executed by the FMO credit analyst and reviewed by an independent environmental and social specialist from the credit department.

For more information on FMO's transaction approval process, see: <http://www.fmo.nl/integrating-sustainability>

More information

- IFC. 2008. Environmental and Social Management System 101, A Framework for Environmental and Social Risk Management. See online at: <http://firstforsustainability.org/media/IFC%20ESMS%20101%20Presentation.pdf> (last accessed 02.04.14)

4.5 INTEGRATING ESG IN ECM, DCM BUSINESS ACTIVITIES

Equity capital markets (ECM) and debt capital markets (DCM) business is different from lending in that the banks perform an intermediary role between the issuing client and the investors in a given transaction, rather than being the direct lender or investor. There may be circumstances where in an underwritten transaction for example, a shortfall in demand from investors may result in the bank taking on a position as a principal, which it may subsequently sell.

Furthermore, ECM transactions, unlike bank lending, are typically not characterized by covenants and customized loan obligations, but rather by uniformity in terms and conditions to promote the liquidity of the transaction in the secondary market. Depending on the credit quality of the underlying issuer and the structure of the debt instrument, DCM transactions may feature covenants, for example, a covenant whereby the issuer agrees to maintain certain leverage or debt service cover ratios.

As a result, your ability to integrate ESG considerations in ECM, DCM business will differ substantially from the lending business. Examples in this area are currently modest at best.

Your ability will be limited to:

- Integrating ESG considerations in client acceptance process;
- Providing guidance to the issuing client with regard to ESG-related disclosures in the prospectus or offering memorandum of the transaction.

Client acceptance

In executing ECM and DCM business, signing a mandate letter with the client for a given transaction will generally bind you to provide certain services, although mandate letters are not always signed. Instead, the parties will proceed directly to a purchase or underwriting agreement. It is typical for mandate letters to stipulate that the offering remains subject to satisfaction of certain conditions precedent, including satisfactory due diligence being undertaken as well as receipt of all requisite approvals and mutually acceptable documentation.

Accepting business by means of a signed mandate letter should be based, among other matters, on confirmation and acceptance that the issuing client is one you are prepared to sponsor and therefore robust client identification processes are essential. In accepting the client, you agree to perform certain services and to facilitate interaction between the issuing client and potential investors. You could be exposed to reputational damage if you choose to provide services to clients associated with adverse environmental and social practices. As such, integrating ESG considerations in client identification/acceptance procedures serves to protect your reputation. You can use the same client and transaction ESG approval processes in place for your lending business.

Disclosure requirements

There is currently no common agreement on which specific ESG risk factors should be included in the prospectus or offering memorandum, but there is a general requirement to ensure that disclosure is complete and accurate, and not misleading or deceptive (whether by omission or otherwise). However, setting disclosure requirements for potential clients could be a powerful instrument for integrating ESG in the ECM, DCM business, for several reasons:

- Increasingly, there appears to be a direct correlation between the ESG performances of companies and their long-term value. This is the case in a growing number of industries. In other words, the financial success of companies depends partly on how extensively they integrate ESG into their business strategy and practices (see “More information” section for further details).

Consequently, you should consider asking ECM, DCM clients to include in the diligence investigation and process, their ESG-related business practices and performance and to include relevant disclosure in their information memoranda (or investment memoranda/offering memoranda). If they do not, you may run the risk of claims being made as to inadequate disclosure and potentially complaints and litigation on the basis that your clients may not have provided all material information to potential investors.

If an ESG issue is material to the longer-term value of the company, you must ensure your ECM, DCM client discloses this in its offering documents provided to potential investors.

Requirements to assess and disclose ESG-related issues in information memoranda will create discussions in the boardroom and throughout the client organization. This could lead to improvements in the client performance on material ESG-related issues, and improved overall ESG performance.

- By integrating ESG disclosure requirements into client approval processes for ECM, DCM business lines, you will be in a better position to anticipate the broader move toward Integrated Reporting and non-financial reporting. Investors are looking for more relevant information on company performance and potential risks companies are exposed to across an enterprise.

Disclosure requirements in ECM, DCM documentation

What type of information and level of transparency in respect of ESG matters might be relevant from potential clients?

You could request that your clients consider including the following in their offering documents:

- An assessment of potential ESG risks/opportunities to which the business model is exposed to, in the short, medium and long term;
- ESG strategies/policies in place to manage certain material ESG issues;
- Details of management systems and controls in place to minimize and monitor impact of business activities on material ESG issues;

- Details of ESG-related performance metrics that demonstrate concrete company performance on material ESG issues, such as:
 - Using best practice reporting standards such as GRI to help formulate and report on key metrics;
 - Existing membership of and degree of adherence to multistakeholder standards.

**Practical example:
Rabobank’s client
approval process**

Rabobank Group has a proprietary customer assessment system in place, called GAIA, for all its corporate clients. It is an IT system that supports client relationship managers in its individual business units to assess and review/update on an annual basis, the ESG risk and opportunity profile of new and existing clients as part of the transaction approval processes.

GAIA consists of several tools:

- Country scan: This shows the client relationship manager all relevant ESG issues per country in which a client is active;
- Sector scan: This provides an overview of all Rabobank Group’s sector policies that are applicable to the client;
- Web-based search engine: This proprietary search engine enables the client relationship manager to search for relevant public information about the ESG performance and approach of clients, for example, if the client is involved in any ESG-related lawsuits.

GAIA enables Rabobank Group to gather a broad range of discussion points on ESG issues in its role as an engagement partner for clients, and to respond to risks in accordance with internal policies.

Source: Rabobank International, Interview with Thomas Ursem, Sustainable Supply Chain Manager, October 2012, reconfirmed June 2014

**Practical example:
Hong Kong Stock
Exchange ESG
recommendations**

In 2012, the Hong Kong Stock Exchange (HKEx) published a set of recommendations on ESG reporting. In January 2013, HKEx advised that it was best practice to follow these recommendations. Subject to consultation, the HKEx plans to raise the obligation level of the guidelines to “comply or explain” by 2015.

The recommendations identify a broad set of parameters around the process of preparing an ESG report and list around 30 specific KPIs that companies are encouraged to consider in their reporting. The parameters and KPIs cover four areas: workplace quality, environmental protection, operating practices and community involvement. HKEx expects companies to be able to provide insight into their strategy and management of these issues as well as concrete, measured performance across their company operations.

For more information, visit www.hkex.com.hk (last accessed 02.04.14) and search for Hong Kong Stock Exchange ESG Reporting Guide and Toolkit.

Practical example: Johannesburg Stock Exchange Integrated Reporting requirement

The Johannesburg Stock Exchange's Listings Requirements have a provision that listed companies must comply with the King Code of Governance for South Africa (King III which came into place in March 2010), including the Integrated Reporting requirement, or explain why not. The King Code is a set of corporate governance principles and recommended practices for South African companies and other entities. The Code, which is on an “apply or explain” basis, addresses issues such as board responsibilities, ethical leadership and corporate citizenship, stakeholder relationships, and Integrated Reporting and disclosure.

To read the King III narrative, Johannesburg Stock Exchange listing requirements, visit: http://www.jsereporting.co.za/ar2013/download_pdf/jse_king3.pdf (last accessed 02.04.14)

More information

- Eccles, R.G., Ioannou, I., and Serafeim, G. 2011. (Harvard Business School) The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance. See online at: <http://hbswk.hbs.edu/item/6865.html> (last accessed 02.04.14)
 - Hoepner, A.G.F. and Nilsson, M. (Centre for Responsible Banking & Finance). 2013. ESG Data: Can it Enhance Returns and Reduce Risks? See online at: [http://www.fno.no/pagefiles/48546/presentasjoner/andreas%20og%20f%20hoepner%20og%20marcus%20nilsson%20-%20environmental,%20social%20and%20governance%20\(esg\)%20data.pdf](http://www.fno.no/pagefiles/48546/presentasjoner/andreas%20og%20f%20hoepner%20og%20marcus%20nilsson%20-%20environmental,%20social%20and%20governance%20(esg)%20data.pdf) (last accessed 02.04.14)
 - JANA. 2012. ESG Integration – A Survey of Global Equity Managers. See online at: <http://www.jana.com.au/esg-integration-a-survey-of-global-equity-managers/> (last accessed 02.04.14)
 - International Integrated Reporting Council. 2013. Consultation Draft of the International Framework. See online at: <http://www.theiirc.org/consultationdraft2013> (last accessed 02.04.14)
 - PRI. 2012. Responsible Investment and Investment Performance. See online at: http://ec.europa.eu/enterprise/policies/sustainable-business/files/reporting-disclosure/6-resinvestperformance_en.pdf (last accessed 02.04.14)
- This is a reference paper that includes major studies of ESG integration, the investment decision and company valuation.*
- RCM. 2011. Sustainability: Opportunity or Opportunity Cost? Applying ESG Factors to a Portfolio Does Not Negatively Impact Performance and May Enhance It. See online at: <https://www.allianz.com/media/responsibility/documents/rcmsustainabilitywhitepaper2011.pdf> (last accessed 02.04.14)
 - UNEP FI. Investment Work Programme publications. See online at: <http://www.unepfi.org/publications/investment/> (last accessed 02.04.14)

ENGAGING WITH CLIENTS NOT ONLY STIMULATES ADHERENCE TO SPECIFIC POLICIES AND REDUCES YOUR BANK'S ESG RISK PROFILE, BUT ALSO PROVIDES AN OPPORTUNITY TO DEEPEN TRUST AND PARTNERSHIP WITH KEY CLIENTS

4.6 CLIENT ENGAGEMENT

The success of your ESG strategy will depend not only on how implementation takes place, but also how your clients respond to new requirements.

Adherence to ESG policies is in the interest of both you and your clients. Engaging with clients not only stimulates adherence to specific policies and reduces your bank's ESG risk profile, but also provides an opportunity to deepen trust and partnership with key clients by promoting sector best practices and enhancing the value of client operations.

A challenge in ESG implementation for financial institutions is building capacity – both that of a dedicated ESG client engagement team to improve portfolio performance, and more generally among your employees. Bankers may be unwilling to discuss a subject they have limited understanding of and confidence in, so training and capacity building are an important part of integration. Many NGOs such as WWF provide capacity building workshops as part of their engagement activities with the finance sector and can share their in-depth knowledge of important ESG issues.

Some leading banks have a formal process in place to engage with potential and existing clients on sustainability issues. They set targets, formulate action plans with clients and monitor compliance toward these agreements.

You can also suggest new opportunities to your clients to develop ESG-related projects. These could be green building retrofits, waste to energy plants, extension services to smallholders or energy efficiency projects, for example. This advice will have the dual purpose of providing additional financing opportunities, but also assisting your clients to improve their sustainability profile and performance. By providing a positive, value added service to your clients, you may expand your role as a trusted adviser. Over time, you will develop insights into ESG issues in a range of sectors.

Current banking regulations may not yet require ESG integration to inform credit decisions. However, you should anticipate changes in the future. Some regulations are already emerging in China and Brazil. In the interim period, you do not want to be in the position of competing in a race to the bottom against other banks in terms of accepting lower quality (higher ESG risk) clients.

While some ESG issues may not materialize during the course of a three to five year loan, you will typically want to refinance and retain your clients at the end of their loan period. As such, it is likely that your clients will be impacted by medium-term ESG issues during the course of your relationship with them.

Requirements for client engagement

You should develop guidelines and processes to engage on ESG with your clients. These should clearly outline:

- Guidelines for client engagement, for example, via existing avenues such as client relationship managers or via separate interaction with ESG specialists;
- Instruments to enforce adherence to your relevant policies or contract conditions, where applicable, and guidelines for dealing with non-compliance. For example,

you could have a staged process for clients who fail to comply ranging from “rehabilitative” periods, guiding or helping clients back to compliance, to sanctions, and in the worst case exiting the relationship;

- Methods for ongoing performance management and opportunities for feedback to ensure you can work with your clients to help achieve stated objectives (i.e. remediation and assistance). This could include evaluating clients’ ESG performance periodically (for example, at least once a year);
- Tools and examples showing the upside of engagement, which you can use to identify and demonstrate business benefits.

Monitoring adherence

You may consider developing KPIs to monitor the progress of client engagement. Indicators could include, for example, what percentage of your clients are complying with contractual ESG agreements and remedial actions in a year and what percentage of clients have made improvements in their sustainability performance. You need to record these agreements and KPIs into your internal systems (including timeframes).

Practical example: How ANZ managed non-compliance

ANZ had a potentially significant relationship with a mining and resources customer until events that took place in 2009 and 2010. ANZ engaged with NGO stakeholders that raised concerns about a prospective project’s impact on the environment and on indigenous peoples. The issues were discussed with the client and ANZ attended a site visit in early 2010. However requests to engage independent experts were declined and an independent, client-commissioned social and environmental assessment, undertaken in 2009, was not provided to ANZ.

ANZ’s Reputational Risk governance process provided the framework for the bank to examine these issues and the client’s actions at the highest levels of the bank. As a result of this deliberation ANZ decided to exit the relationship with the customer in 2010.

Source: ANZ website (<http://www.anz.com/about-us/corporate-responsibility/customers/responsible-business-lending/> and <http://archive-au.com/page/1177353/2013-01-17/http://anz.com.au/about-us/corporate-responsibility/customers/responsible-business-lending/>) (last accessed 02.04.14)

Practical example: How Credit Suisse engages clients

A client approached Credit Suisse for advisory services in connection with the private acquisition of an oil palm plantation and mill assets. Credit Suisse’s knowledge of the client and routine screening/assessment of the acquisition did not reveal any significant concerns, and showed the target assets belonged to an RSPO member. However, there was insufficient public information on the assets for a thorough assessment.

By engaging the internal Sustainability Affairs team, Credit Suisse’s banking team was able to get more information. The Sustainability Affairs team evaluated and assessed the environmental and social attributes of the transaction against Credit Suisse’s Global Policy – Forestry & Agribusiness and complementary palm oil guidelines.

These policies dictate that Credit Suisse will only finance or advise reputable forestry and agribusiness companies with a record of responsible management in environmental and social issues. Assessments of a company's reputation and management practices are based on its ability to demonstrate that it has, in the past and can going forward, adequately address a number of key issues. Credit Suisse also requires its clients (either at parent or subsidiary level) to be (or commit to become) members of the RSPO and be certified according to its principles and criteria, or make a time-bound plan to do so.

In this case, the client supported Credit Suisse's request to engage an independent consultant to do a gap analysis audit of the assets against the RSPO's principles and criteria as a stepping stone toward certification. The audit made it clear that certain issues had to be addressed.

Credit Suisse approved the deal after agreeing with the client to develop an issue management plan and monitoring programme that would meet the Sustainability Affairs team's demands. For example, the RSPO requires members to have time-bound plans to achieve 100 per cent certification of their plantations and mills. Credit Suisse continues to engage with the client and the auditor to ensure timelines are realistic and to otherwise facilitate implementation of this.

Source: Sustainable Palm Oil Platform. Credit Suisse Case Study. See online at: <http://www.sustainablepalmoil.org/palm-oil-by-region/europe/case-studies/credit-suisse-ag/> (last accessed 02.04.14)

How HSBC manages client compliance to its policies

HSBC checks whether customers in the sensitive sectors comply with its sustainability risk policies at the outset of any relationship and monitors them annually using the same system applied to monitoring credit risk. This process is also checked through its internal audit function. HSBC assesses customers according to their level of compliance with HSBC policies and ranks them into four categories: "leader", "compliant", "near-compliant" and "non-compliant".

If HSBC finds that a customer is not complying with its policies and has the appetite to make changes, it supports them to make the necessary improvements to become compliant. This requires that the underlying impacts of the customer's business are not unacceptable and that there is an action plan in place to achieve compliance within a credible timeframe. HSBC then monitors customers to ensure commitments are carried out. If customers are unable or unwilling to improve to meet HSBC standards over a reasonable timeframe, the relationship is ended as soon as is contractually possible.

Source: HSBC. HSBC Sustainability Report 2012. See online at: www.hsbc.com/sustainability (last accessed 14.05.14)

Practical example: The Banking Environment Initiative

The Banking Environment Initiative (BEI) Soft Commodities Compact is a new commitment developed by leading banks to support the global transition to Zero Net Deforestation by 2020. The compact has thus far been signed by Barclays, BNP Paribas, Deutsche Bank, Lloyds Banking Group, RBS, Santander, UBS and Westpac, with participation open and expanding. This client-led commitment was designed to support and mirror the sustainability commitment of the Consumer Goods Forum (CGF).

In 2010, the chief executives of the CGF Board of Directors committed their 400 members, with a combined procurement power of over US\$3 trillion, to achieving Zero Net Deforestation in their supply chains by 2020. The Soft Commodities Compact is the result of two years of extensive collaboration between the CGF and the BEI banks, with guidance from WWF, to establish alignment in the banking industry with this goal.

It was endorsed by the CGF Board in late 2013, welcomed by the Obama Administration at a meeting at the White House shortly after, and used as an example of a powerful industry-to-industry partnership at a special session of the World Economic Forum's Annual Meeting in Davos in January 2014.

The BEI Soft Commodities Compact includes two commitments. First, banks will work with consumer goods companies and their supply chains to develop appropriate financing solutions that support the growth of markets producing palm oil, timber products, soy or beef without contributing to deforestation. Secondly, banks will engage clients in high-risk geographies to improve their sustainability performance in line with responsible industry practice and in line with CGF requirements.

Specifically, by 2020 all corporate and investment banking customers whose operations include significant production or processing of palm oil, timber products or soy in markets with high risk of tropical deforestation will be able to verify that these operations are consistent with Zero Net Deforestation through credible third party certification.

The first new financial product from the Soft Commodities Compact has been produced: the BEI's Sustainable Shipment Letter of Credit is a trade finance solution that can be used by banks to incentivize the international trade of sustainably produced commodities. The IFC has confirmed it will offer preferential terms to its partner banks that target this type of shipment, offering the potential to reduce the cost of capital.

Source: Banking Environment Initiative website (<http://www.cisl.cam.ac.uk/Business-Platforms/Banking-Environment-Initiative.aspx?#fragment-3>) (last accessed 27.07.14)

More information

- WWF, CDC and FMO. 2012. Profitability and Sustainability in Palm Oil Production. See online at: http://awsassets.panda.org/downloads/profitability_and_sustainability_in_palm_oil_production__update_.pdf (last accessed 02.04.14)

This study comprehensively examines the financial costs and benefits of producing sustainable palm oil under the guidelines set out by the RSPO, and demonstrates the net positive benefit of certification. The report was produced jointly by WWF; CDC, the UK's development finance institution; and FMO, the Dutch development bank.

5. MONITORING AND REPORTING ON YOUR ESG INTEGRATION

If not done responsibly, mining can cause significant environmental damage such as deforestation, habitat loss and contamination of water bodies.



5. MONITORING AND REPORTING ON YOUR ESG INTEGRATION

IT IS VITAL TO SET KPIs TO MONITOR YOUR PROGRESS DEVELOPING AND IMPLEMENTING THE ESG STRATEGY AND ITS OBJECTIVES, AND TO ASSESS THE BUSINESS IMPACT RELATED TO THIS

It is vital to set KPIs to monitor your progress developing and implementing your ESG strategy and its objectives, and to assess the business impact related to this.

You can report your progress externally in an annual sustainability report. A wide range of companies are rapidly adopting “Integrated Reporting” – which is defined by the International Integrated Reporting Council as concise reporting about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.

This section will cover:

- 5.1 Why develop KPIs?
- 5.2 Criteria for performance indicators
- 5.3 Developing an internal process
- 5.4 Sustainability reporting

5.1 WHY DEVELOP KPIs?

The main reasons for developing ESG-related KPIs are:

- **To create management information:** By developing KPIs, you are creating management information about progress on strategy implementation and the impact of strategy on business performance. You can use this information to improve decision-making processes on ESG-related issues in the future.
- **To influence policy/strategy development:** Performance measurement is vital to refining your strategy and developing fuller ESG policies in the future. Furthermore, it is not possible to effectively integrate ESG without quantifying progress and outcomes. Performance measurement also helps to identify key impact areas where you face most exposure and risk and require mitigating actions.
- **To improve transparency:** Using performance indicators creates transparency for internal and external stakeholders about your progress toward integrating ESG. They enable better reporting and communication.

5.2 CRITERIA FOR PERFORMANCE INDICATORS

KPIs should be:

- **Applicable and relevant:** They should contribute to your corporate or ESG strategy, and be linked to impact on or by business lines and stakeholders;
- **Specific:** They should be clearly defined and scoped;
- **Measurable and attainable:** They should be quantifiable, making it possible to calculate the results of different business lines. They should be based on trustworthy methodology, and realistic;
- **Understandable:** They should be well presented and easy to understand for internal and external stakeholders;
- **Time-bound:** They should have deadlines.

Impacts from direct or indirect controlled KPIs

You can have direct or indirect control of the outcomes of your KPIs.

- You will have direct control over KPIs related to, for example, the number of commercial loans you give to companies in the renewable energy sector.
- You will have indirect control over KPIs related to, for example, a palm oil producer client's compliance with the principles and criteria of the RSPO of which it is a member.

The impact of both will be lower emissions.

Target setting

For each KPI you create, you need to establish a set of meaningful and achievable short-, medium- and long-term targets. These should be both qualitative and quantitative.

Targets could include:

- Percentage of staff trained in ESG;
- Percentage of loans which are subject to ESG screening (by sector if necessary);
- The total number of environmental impact assessments you undertake on projects.

The GRI has Finance Sector Guidelines, which may be useful for reference.

Figure 24 shows KPIs that you can consider:

Figure 24: KPIs a bank could use

Source: Developed by WWF and KPMG

<p>INPUT INDICATORS</p>	<ul style="list-style-type: none"> • Total amount of money invested in ESG training programmes; • Number of studies conducted by the bank about climate change in year x (or other sustainability/ESG topics); • Budget allocated to develop the new processes or ESG-relevant products or services, for example total investments in sustainable property financing/mortgages.
<p>PROCESS/ACTIVITIES/ OUTPUT INDICATORS</p>	<ul style="list-style-type: none"> • % of staff trained in ESG; • % of staff's remuneration and bonus scheme linked to ESG components; • Number of green mortgages offered to clients; • Number of green products sold to clients in year x; • % of financial products and services incorporating ESG criteria; • Number of sector policies governing high footprint sectors which require adherence to sustainability certification standards; • Number of clients that account managers discussed ESG topics with in year x; • Number and list of clients with major ESG risks; • Number and % of credit loans that have undergone ESG screening (of overall portfolio or within specific sectors), as well as total credit value of performing loans in monetary terms; • % of loans screened on CO2 impact; • Total number and amount of financing requests rejected because of ESG criteria; • % increase in lower-carbon gas and renewable power generation lending by year x; • % of clients in high environmental footprint sectors which have signed up and adhere to sustainability certification standards; • Total corporate loans or sustainable project finance investments for large companies and SMEs operating in clean technology industry; • Total "financed emissions" across the entire lending portfolio (for example in tonnes financed CO2-eq emitted per \$ billion of finances); • Total "financed emissions" across the energy lending portfolio, mining lending portfolio or other sensitive sector portfolios (for example in tonnes financed CO2-eq emitted per \$ billion of finances); • Inclusion of sustainability performance into loan covenants; • Requirement to provide comprehensive ESG disclosure (for lending and ECM, DCM).
<p>IMPACT INDICATORS</p>	<ul style="list-style-type: none"> • Total energy saved by households with a green mortgage that would not have made energy saving investments without the green mortgage; • Total amount of people estimated to have been impacted by microfinance products of the bank; • Sustainability improvements made by corporate clients in sector x due to the bank's ESG interventions with correcting actions.

More information

- Global Reporting Initiative. Sustainability Reporting Guidelines and Financial Services Sector Supplement. See online at: www.globalreporting.org (last accessed 02.04.14)
- OECD. 2013. OECD Due Diligence Guidance for Responsible Supply Chains. Appendix III: Suggested Measures for Risk Mitigation and Indicators for Measuring Improvement. See online at: <http://www.oecd.org/daf/inv/mne/GuidanceEdition2.pdf> (last accessed 02.04.14)

5.3 DEVELOPING AN INTERNAL PROCESS

You should develop an internal process to structurally report on the progress of your ESG integration as well as the ongoing performance of your portfolio and clients on ESG-related issues to your senior management and relevant staff.

You will need to establish several reporting structures with different owners, beneficiaries and reporting frequencies. You need to report frequently on progress, exposures and risk mitigation to remain in control and create ongoing engagement and awareness with key staff.

Reporting on ESG requires clear processes (a good “control environment”) for gathering, entering and collating data. These processes must be robust and leave a clear audit trail to enable you to satisfy any requirements for internal or external audit.

Some actions you should take include:

1. Reporting ESG exposure

- Determine a specific set of KPIs for your bank, business lines or other groups to monitor and report your internal performance in line with your ESG risk appetite and risk controls;
- Determine how to report, how often (weekly or monthly) and to which internal stakeholders (for example, senior management and risk committees);
- Determine who will be responsible for reporting;
- Align ESG reporting with other forms of risk reporting (for example, credit or market risk reporting) where possible;
- Where necessary, develop systems and processes that support the collection and communication of data.

2. Reporting on client adherence to (contractual) obligations

- Upon execution of loan or other transaction documentation, collect and record all obligations and requirements on ESG-related issues in a suitable tracking system;
- Inform client teams in a timely manner of upcoming trigger dates and deadlines for client compliance;

- Review client compliance with (contractual) obligations during each (annual) credit risk review of outstanding transactions;
- Report frequently (for example, quarterly) on client compliance at the portfolio level, with a breakdown per department, line of business or client management unit as deemed relevant for promoting client engagement and compliance.

3. Reporting on operational risk and internal audit

- Include ESG risk controls (hard and soft) in the periodic review of operational risk by department managers and business line managers (in line with your internal guidelines for managing operational risk);
- Agree, report and monitor remedial actions by management to improve the control of operational risk in the execution of ESG controls (in line with your internal guidelines for managing operational risk);
- Perform a regular (preferably annual) internal audit of the functioning of your ESG risk control framework and report findings to senior management.

4. Reporting on progress toward ESG strategy implementation

- Determine the specific set of KPIs your bank, business lines or other groups need to monitor and report progress in line with your ESG strategy;
- Determine how to report, how often (for example, quarterly or monthly), and to whom (for example, senior management);
- Determine who will be responsible for reporting (for example, first and second line) and who will provide oversight for the implementation (ESG committee or management board, for example);
- Align progress reporting with regular reporting lines and management oversight, to promote the embedding of ESG management in your regular governance structure;
- Include progress reporting to a wide audience of internal stakeholders, to underline the importance of and promote support for actively managing ESG risks and opportunities among your staff.

Practical example: FMO's SusTrack monitoring system

In 2010 FMO introduced a proprietary monitoring system called SusTrack to monitor and report on progress of ESG integration into its financing processes on an operational level.

SusTrack captures all client obligations on ESG-related issues included in transaction documentation and agreed ESAPs developed by clients.

The system allows FMO to track and monitor client adherence to their ESAPs and loan covenants and clauses after the contracting phase of the transaction approval process. The bank can then intervene in a timely manner in the case of non-compliance.

Source: FMO. 2012. Annual Report. See online at: <http://www.fmo.nl/reports> (last accessed 02.04.14)

Practical example: ANZ's sustainability performance management system

ANZ states that its Sustainability Framework is about how it manages its business to take account of ESG risks and opportunities to deliver value for its customers, shareholders, people and communities.

The Sustainability Framework focuses on three Enhanced Value priority areas and five Licence to Operate areas, all of which have set targets. One of the Enhanced Value priority areas is Sustainable Development, which is defined by ANZ as integrating social and environmental considerations into its business decisions, products and services to help its customers achieve their sustainability ambitions and deliver long-term value for all its stakeholders. The 2014 targets for this priority area include the following:

- Increase employee awareness of its sustainability agenda to better equip key banking employees to engage with clients on social and environmental issues;
- Drive ongoing improvement in its decision-making by undertaking a ongoing review of its sensitive sector policies;
- Increase the proportion of lower-carbon (gas and renewables) power generation lending in its Project Finance business by 15-20 per cent by 2020;
- Pilot sustainability workshops in two Asian markets — one “developed” and one “emerging” — to better understand and support mid-size corporate customers managing social and environmental risks and opportunities.

Source: ANZ. Corporate Responsibility Targets. See online at: <http://www.anz.com/about-us/corporate-responsibility/reporting-performance/targets/> (last accessed 29.04.14)

5.4 SUSTAINABILITY REPORTING

Financial reporting alone no longer gives stakeholders a full and fair understanding of banks. Sustainability reporting provides external stakeholders with the non-financial information they need to understand the context you operate in.

Sustainability reporting should cover non-financial information on at least three different levels:

- The direct footprint of your operations in accordance with internationally accepted standards;
- The indirect footprint and impact you make through your business activities, covered by your ESG strategy and risk control framework;

- Other sustainability-related activities, through which you aim to achieve results not core to your business strategy, but use your position and abilities to contribute to the environment and the communities you operate in.

Your sustainability reporting should aim to provide information to a wider audience of stakeholders than risk management disclosures, which are for a more investor-led audience.

Sustainability reporting has become more and more important over the last decade, and is now considered a necessary element of banks' reporting suite. Sustainability reports can also undergo external assurance or verification to give both report readers and internal managers confidence in the quality of the sustainability performance data.

Guidelines for sustainability reporting

For external sustainability reporting to be useful to your stakeholders, it must meet certain minimum requirements on content and quality:

- You must determine the specific needs and expectations of your stakeholders with regard to the disclosure of sustainability-related information. This requires a good understanding of your target audience;
- Your sustainability report should provide a balanced, objective and reasonable representation of your sustainability performance, including both negative and positive contributions;
- You need to ensure that your report aligns with your long-term objectives and is consistent with previous sustainability reporting;
- Materiality determination is key to ensuring that your report covers topics and indicators that reflect ESG impacts that are both significant to you and substantively influence the assessments and decisions of your stakeholders;
- You should understand the landscape of reporting guidelines, standards, regulations and other disclosure frameworks that may affect the form and content of your sustainability reporting.

Relevant standards

Types of standards:

- Regulatory reporting requirements;
- Investment/market-driven disclosures (for example, Dow Jones Sustainability Indices, CDP);
- International reporting standards and guidelines (GRI, Global Compact, AA1000 series);
- Industry-specific frameworks/disclosure requirements (Equator principles, PRI, PSI).

Approach to sustainability reporting

Sustainability reporting is often referred to as a journey. Some of the steps you may take include:

- Developing a reporting strategy and articulating what you want to achieve from communicating non-financial results;
- Performing internal and external stakeholder analyses and reviewing applicable standards and best practices in sustainability reporting;
- Assembling potential report content, including:
 - Results of internal monitoring and reporting;
 - ESG risk management disclosures;
- Identifying additional KPIs you need to develop, for example, to comply with reporting guidelines such as the GRI's Sustainability Reporting Guidelines or the GRI Financial Services Sector Supplement;
- Reviewing your identification and assessment procedures to ensure you have identified all issues;
- Determining the materiality of issues identified;
- Reviewing the quality of data reported and the quality of reporting processes to assess the quality of content to be reported;
- Determining your sustainability reporting process, including ownership, roles and responsibilities of parties involved (for example, your sustainability department and corporate communications);
- Determining the most appropriate way to report your data, for example, within your annual report, in a stand-alone sustainability report, in your investors report, through your website or through Integrated Reporting;
- Considering external verification and assurance of your report.

More information

Examples of sustainability reports:

- Credit Suisse. 2013. Corporate Responsibility Report. See online at: https://www.credit-suisse.com/publications/annualreporting/doc/2013/csg_crr_2013_en.pdf (last accessed 15.08.14)
- Standard Bank. 2013. Sustainability Report. See online at: <http://sustainability.standardbank.com/> (last accessed 02.04.14)
- Sumitomo Mitsui Financial Group. 2013. CSR Report 2013. See online at: <http://www.smfg.co.jp/english/responsibility/> (last accessed 02.04.14)
- Westpac Banking Corp. 2013. 2013 Annual Review and Sustainability Report. See online at: http://www.westpac.com.au/docs/pdf/aw/ic/2013_Annual_Review_and_Sustainability_Report.pdf (last accessed 02.04.14)

Guidelines for reporting:

- The European Federation of Financial Analysts Societies and DVFA. KPIs for ESG. See online at: http://www.effas-esg.com/?page_id=206 (last accessed 02.04.14)
- Global Reporting Initiative. G4 Sustainability Reporting Guidelines. See online at: www.globalreporting.org (last accessed 02.04.14)
- PRI and UN Global Compact LEAD. 2012. A New Framework for Communicating ESG Value Drivers at the Company-Investor Interface. See online at: http://www.unglobalcompact.org/docs/issues_doc/Financial_markets/ESGInvestorBriefingFramework.pdf (last accessed 02.04.14)

Stock exchange reporting guidelines:

- HKEx. Hong Kong Stock Exchange Environmental, Social and Governance Reporting Guide, with related toolkit. See online at: <http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/esg/material.htm> (last accessed 02.04.14)
- Johannesburg Stock Exchange. Listing Requirements. See online at: http://www.jsereporting.co.za/ar2013/download_pdf/jse_king3.pdf (last accessed 02.04.14)
- Sustainable Stock Exchanges Initiative. See online at: www.sseinitiative.org (last accessed 02.04.14)

100%
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THE IMPORTANCE OF ESG

BIOCAPACITY

It takes 1.5 years for the Earth to regenerate the renewable resources that people use, and absorb the CO₂ waste they produce in that same year.

BIODIVERSITY

Biodiversity, ecosystems and ecosystem services – our natural capital – must be preserved as the foundation of well-being for all.



BETTER CHOICES

Living within ecological boundaries requires a global consumption and production pattern in balance with the Earth's biocapacity.

EQUITABLE SHARING

Equitable resource governance is essential to shrink and share our resource use.



Why we are here

To stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.

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