1. E&S in FIs

- Why FIs should consider E&S
  The need to incorporate E&S considerations into the operations and activities of FIs is becoming evidentially more important. For example over the last decade, risk trends captured annually by the World Economic Forum evolved from issues such as financial failure and fiscal imbalances to themes such as climate change, infectious diseases and livelihood crises. Despite the growing evidence of the escalation of E&S risks and its materiality on an FI's activities, its integration into an FI's lending and operations is sometimes met with resistance. Some of the reasons cited (as discussed in the working with management section) include the resource implications of developing and implementing an E&S Management Systems (ESMSs); perceived fear of losing market share to competitors with less rigorous standards and lack of foresight of the immediate benefits of E&S risk management.

  This section focuses on the business case and value proposition of integrating E&S risks into an FI's operations. It provides evidence on why sound E&S practices should form a key part of business strategy and risk management framework by using case studies of FIs in emerging markets. It can be used as reference material, alongside other sections of this Toolkit, to develop training and the baseline to engage both internal and external stakeholders on the importance of the E&S business case for FIs.

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- Linking E&S to fiduciary duty and Investment Returns

  Although the definition of fiduciary duty and legal interpretations varies from country to country; they mostly share key principles. Fiduciary obligations exist to ensure that those who manage other people's money act responsibly in the interests of savers (clients or beneficiaries), rather than serving their own interests. There is growing recognition that E&S performance is part of an FI's fiduciary responsibility (for example the EU Sustainable Finance Disclosure Regulations) and that integrating E&S considerations into credit analysis to predict financial performance more reliably is permissible within fiduciary duty. This has already been codified in some countries, including emerging markets.

The Sustainable Banking Network Report identifies a wide range of countries in emerging markets where central banks have requirements for FIs to formalise their ESMS's and their performance is monitored through periodic reporting. The list includes countries such as Bangladesh, Nigeria, Kenya and Nepal (regulators in countries such as Egypt and India are also actively working on developing industry level E&S-related guidelines). It is expected that the list will continue to grow as commitments to climate change, green financial products and links to other systemic E&S issues (e.g. modern slavery) become clearer. This signpost the growing awareness of the industry's regulator on the need for E&S regulations and guidelines into what is often considered as the traditional banking system.

As regards to investment returns, there is increased evidence that sound E&S practices do not conflict with positive investment returns. In a report initiated by the Global Alliance for Banking on Values (GABV), of 100 FIs sampled, it was observed that the pursuit of E&S priorities did not conflict with strong performance in terms of profitability. FIs that scored high on having systems in place to address material E&S issues also delivered high risk-adjusted returns in comparison to their counterparts who performed poorly on the same parameters.

CLICK TO VIEW DIAGRAM

Sustainability Banking Progression Matrix (source IFC: 2019)

2. Value drivers – from risk to reward

Enhanced E&S performance provides an opportunity for FIs to create value for the clients. However, it is important to ensure robust E&S risk management framework to address the inherent risks evidenced in the client's business should underpin such advisory support. This is because through lending activities, FIs become exposed to the E&S risks of their clients which can result in credit/collateral risks, reputational risks and liability risks for them, ultimately affecting their bottom-line. Therefore, this should be done in advance or concurrently with E&S value creation work (see the Transaction Cycle section of the Toolkit for further details on integrating E&S risk management into the transaction cycle).

Opportunities for E&S focused value creation are specific to each company and sector. The

Sector profiles section of the Toolkit identifies sector-specific opportunities to help FIs add value to companies and should form a part of the ESDD process. Broad E&S factors which have proved to be closely correlated with value-creation include improvements in labour practices, efficient use of resources (especially energy and water use) and reduced cost of doing business by eliminating bribes and facilitation payments. Identifying areas to help the FI's clients improve efficiency and reduce costs in their operations may be considered as part of the value-add proposition which clients benefit from in comparison to an FI's competitors, possibly setting them apart from the counterparts who may focus solely on the credit performance of the client's business. This may help strengthen the FI's relationship with the client as they may be perceived more as a partner rather than just a lender.

Each investment will have different E&S risks and opportunities depending on its country, sector and specific characteristics. Unlocking opportunities may not always be self-evident; therefore, FI's may benefit from preparing a country/region-sector matrix to help them identify and develop E&S value-add propositions to their clients.

The sections below provides guidance to FIs on the business case for E&S within the FI itself, using emerging market case studies where possible.

- Risk management - improving E&S and BI management systems

  In most FIs, there will be opportunities to improve how they manage E&S risks. Although this may involve some investment in the early stages, it can add overall value to the business in the medium-long term. There will also be opportunities to improve the way an FI manages business integrity risks. Supporting the development of new or stronger anti-corruption and whistleblowing systems can help strengthen their internal controls, reduce fraud and the cost of doing business in the long run.

  In IFC's Banking on Sustainability report, most of the commercial banks interviewed considered E&S issues, either by managing risks or developing new business opportunities, beneficial to their business. FIs highlighted that integrating E&S risk management led to a risk reduction alongside tangible benefits such as such as new lines of business, greater access to financing, increased shareholder value and improved reputation and goodwill. This was deemed valuable for FIs in emerging markets given the fact that they often compete for international investments alongside their peers, and the development and implementation of ESMSs are one of the key requirements to access funding from Development Financial Institutions and other private investors.

Case study: This case study demonstrates the value of investing in formal environmental and social management systems.

Commercial International Bank Egypt (CIB)

CIB was established in 1975 and has since then distinguished itself as Egypt's leading private sector bank with a network of 207 branches and banking units, workforce of 6,900 employees and client base of over 1.4 million customers. Also, as at 2018, it was ranked number 1 among all Egyptian private-sector banks in terms of revenues, net worth, total assets and deposits. The FI has embedded creating shared value as one of its core business strategy, understanding the need to foster and prioritise the collective good of all above individuality. According to its 2019 Sustainability Report, this philosophy has impacted its policies and operations across the organisation with the two-pronged benefit of being Egypt's leading private sector bank and enhancement of its risk management framework to build resilience against evolving risk areas. The FI commenced its journey of responsible banking since 2013 and has developed an ESMS policy and has a team tasked with its implementation which is overseen by a Corporate Sustainability Task Force chaired by one of its Non-Executive Directors. Its ESMS is aligned to international standards such as the IFC Performance Standards, EBRD Performance Standards and Equator Principles. CIB is also one of the founding signatories of the United Nations Environment Program Financial Initiative (UNEP-FI) Principles for Responsible Banking and is a member of the governance body which oversees the implementation of the Principles. According to IFC's Sustainability Banking Country Report on Egypt, the Principles are currently being adopted by the Central Bank of Egypt as part of the country's sustainable finance framework and CIB has been involved its development. The FI is also the first bank in Egypt to join the Task Force on Climate-related Financial Disclosures (TCFD) to further enhance its risk management framework to mitigate against risks related to climate change.

Standard Bank Group

Standard Bank is also one of the founding signatories of the UNEP FI Principles. In its 2020 Environmental, Social and Governance Report, the FI highlights ESG risk management as a key part of its enterprise risk management framework and recently included ESG management as part of the considerations in the assessment of the performance of its executives.

Regarding implementing its ESMS, the FI screens all new lending activities for compliance with its relevant policies and where required, applies the IFC performance standards and Equator Principles. This is done by the Group environmental and social risk (GESR) team to ensure that E&S risks, including climate-related risks, are correctly identified, evaluated and managed at transactional level with transactions rated as high E&S risk requiring a sign-off from the head of GESR prior to credit approval. Part of its E&S process also includes screening for human rights risks such as forced labour, child labour, freedom of collective bargaining and where these are unmitigable, may lead to declining the deal. Furthermore, Standard Bank has identified climate risk as a material risk and is working towards aligning with the principles of TCFD to demonstrate its commitment to being on the forefront of emerging E&S risks.

According to a report culled by African Business which analyses performance based on capital, reserves and retained earnings, both FIs in this case study ranked amongst top performing FIs in Africa. This demonstrates that FIs in emerging economies can deliver on the triple bottom-line proposition – profitability in tandem with good environmental and social performance.

Source: Standard Bank Group Environmental, Social and Governance Report (2020); Sustainability Banking Network Flagship Report: Country Progress Report: Egypt; CIB: The Journey of Responsible Banking

- Accessing new markets

FIs operate in competitive environments with counterparts offering similar products and services with the comparable pricing, terms and conditions. To distinguish themselves, there is a need to strategically design new products and services to access untapped business opportunities and customer segments. For example, FIs have been developing agent banking models and digital platforms to deepen financial inclusion and facilitate financial literacy for underbanked populations. By doing so, they are meeting the appetite of some investors with mandates on financial inclusion, contributing to sustainable development and accessing new markets segments concurrently.

Case study: This case study demonstrates the value of how an FIs alignment with a sustainable development need can facilitate access to new clients.
RBL Bank (RBL) is one of India's fastest growing private sector banks which provides services to over 9.63 million customers through a network of 429 branches, 1,365 business correspondent branches and 412 ATMs spread across 28 Indian states and Union Territories. The FI has a dedicated Development Banking and Financial Inclusion segment which ensures that rural unbanked and under-banked customers access basic banking services through its branches and business correspondents. According to its 2019 – 2020 sustainability report, RBL had a network of 1,099 financial inclusion branches through which it provides financial products and services of which women empowerment is one of its key focus areas. This strategy has been effective in driving female entrepreneurship, women's engagement in household financial decisions and their entry into the formal banking system.
The Bank has also developed a financial literacy programme which is deployed through classrooms and covers a broad range of topics ranging from importance of saving, responsibilities and rights of customers, over indebtedness etc. As at March 2020, the programme has trained a total of 195,066 women. The impact of accessing new markets has not only contributed to positive development impact but growth in the FI's business. From the 2018/19 to 2019/20 Financial year the number of active borrowers increased by 21% and number of loans by 15.29%. In 2021, the Bank won the Asia Money Award for its Financial Inclusion and the provision literacy programmes which have already been mentioned.
Sources: RBL Bank Sustainability report 2019-20; Asia Money Awards: India's Best Bank for CSR 2021.

- Identifying cost savings

Substantial cost savings can be made through the adoption of resource use efficiency measures. The importance of using energy, water and other resources efficiently will continue to increase as climate change, environmental degradation and resource scarcity grow. Although this is particularly relevant in the case in energy and/or water-intensive activities such as manufacturing businesses and other real sector activities, FIs with large footprints and branch networks may benefit from introducing energy efficiency initiatives in their operations.

Case study: This case study demonstrates how FIs can make significant savings through better in house environmental management and advisory support to portfolio companies.
In a progress report on Nigerian Sustainable Banking Principles, FIs stated that managing their own environmental footprint resulted in cost reduction. The FIs cited initiatives such as the deployment of online document management systems to manage processes led to a reduction in paper consumption and the installation of LED lighting and use of alternate sources such as solar power at branches and Automated Teller Machines (ATMs) helped reduce their emission profiles and manage operational costs better. As new innovations around document management, digital finance platforms and energy efficiency technologies evolve, FIs will have continuous opportunities to leverage on these and further reduce their footprint and costs concurrently.
In its 2019 Sustainability Report, Access Bank Nigeria was able to reduce its fuel consumption by 23.5% percent through introducing early shutdown policies across its branch network. It also reduced its electricity consumption by 31% by introducing motion-sensitive lights, branches powered by hybrid energy and deploying 605 solar-powered ATMS nationwide. To reduce its paper consumption, the FI introduced 'No Paper Initiative' which included activities such as automaton of various processes, disseminating paper saving tips via internal communication and introduced the use of Diligent BoardBook to reduce the number of documents printed for Board meetings.
Opportunities to support clients are covered in sector-specific guidelines and Resource efficiency and the circular economy section of the Toolkit.
Source: Sustainability in the Nigeria Banking Industry: The Journey So Far. A Review of the Nigerian Sustainable Banking Principles (2012 – 2018).

- Looking for opportunities to innovate

As highlighted in the accessing new markets section above, the financial services industry is characterized by high levels of competition. Leading FIs recognise that sustainability-related products and services can grow their portfolios, distinguish them from their peers and enhance reputation among stakeholders. According to the Banking on Sustainability report, this has led to increased uptake of specialist bankers focused on sustainable finance and mandated to develop innovative products and solutions which address significant sustainable development challenges (e.g. food security and water scarcity) alongside meeting the FI's profit targets. One key area which has garnered attention in recent years is Climate Change and the Paris Agreement which requires a multi stakeholder-oriented approach towards achieving net zero emissions by 2050 poses an opportunity for FIs to be innovative through their products and services. This will lead to simultaneous growth of climate-resilient portfolios and position themselves as a market leader before the space of green financing becomes saturated.

Case study: This case study demonstrates how FIs seek and use value-add opportunities to innovate and develop new products to address emerging E&S risk themes.

Bank of Africa (BMCE)

BMCE was founded more than 60 years ago for the purpose of developing Morocco's foreign trade. Since inception, it has evolved and emerged as a major financial player in Africa. BMCE's values and underlying commitment to respecting human rights and the environment underpins its ESMS which was established in 2008 based on the IFC Performance Standards. The FI also adopted the Equator Principles. Its ESMS has been incorporated within the Group Management Policy and deploys a blend of questionnaires, matrix analysis, summary files to determine its clients' E&S risk profile. Furthermore, it provides training to all business and account managers and helps managers carry out E&S risk and impact analysis of their projects and has an ESG committee which periodically meets to discuss its ESMS and impact strategy implementation.

Arguably, one of the positive benefits of developing and implementing a robust ESMS has been the FI's ability identify and work with various investors to develop products that generate positive impact products in the Blue Economy, Circular Economy and Green Financing in collaboration with various DFIs such as the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD) and the Dutch Development Bank (FMO). It also pioneered the first socially responsible funds within the MENA region and issued a green bond to develop, finance, build, maintain and operate the Khalladi wind farm which generated 258 gwh of clean energy in 2018 and saved 131 335t of Co2 emissions in the same year.

Agriculture and Climate Risk Ltd (ACRE)

Although not a conventional FI, ACRE works with local insurers and other stakeholders in the agricultural value chain to undertake risks assessment and develop insurance products for smallholders farmers across Africa. Their products have protected rural farmers against weather risks such as droughts, storms, flood etc. To date, ACRE has partnered with 10 FIs across Africa to facilitate access to climate-related microinsurance products in Kenya, Rwanda and Tanzania.

A high-level introduction on gender-smart investing and green financing is covered in the Value-Add section of the Toolkit.

Source: BMCE Group Sustainability Report (2019); Banking on Sustainability (IFC:2007).

- Improving productivity

a) Improving productivity by upholding good E&S standards

As highlighted in the cost saving section, FIs can improve efficiency and productivity by introducing environmental management measures such as energy and water efficiency measures. Furthermore, well-established human resource management practices can lead to a motivated workforce and invariably boost productivity in the organisation. Being a service-oriented sector, this is particularly important for FIs because its people are mostly responsible for managing risks and relationships with clients. Employee satisfaction is likely to result in dedication and commitment towards the FI meeting its goals and objectives.

FIs aligned with good labour practices including the IFC Performance Standards on Labour and Working Conditions and ILO Conventions have policies that recognize equal opportunities, rights to collectively bargain or join association, open engagement with management and platforms to raise concerns about work-related challenges. Having the right policies and procedures in place to manage and grow human capital can result in acquiring the right talent, lower attrition rates, loyalty to the organisation and its values and increased employee satisfaction. This can boost productivity of employees and dedication to deliver on the FI’s mandate.

b) Improving productivity by making supply chains more efficient

An FIs supply chain typically comprises of IT, third party contract workers in functions such security, cleaning, call centre operators, energy, facility management etc. and other vendors providing services such as data storage. Although FIs are not traditionally regarded as forerunners in sustainable supply chains in comparison to other sectors such as manufacturing and agriculture, the topic is becoming more relevant to FIs. This is because, supply of these goods and services are material to the FI’s business continuity. Therefore, ensuring sound E&S practices in the FIs supply chain is imperative as it can pose direct risks if not properly managed. Some material supply chain risks in the FI’s include:

  - Data privacy and security: IT vendors often manage data storage on behalf of FIs and not having sufficient systems to protect sensitive data of FIs clients from privacy intrusion, cyber-attacks and fraud can lead to both financial and reputational issues for the FI.

  - E-Waste Management: FIs rely on IT hardware to facilitate their operations and it is important for them to ensure that these are adequately disposed to reduce impact of the FI's e-waste footprint which is not only hazardous but may also end in landfills with high occurrences of forced and child labour.

  - Security is particularly needed in FIs to protect employees or facilitate the transfer of funds and usually contracted to third parties. This may introduce additional risks for FIs therefore the need to make sure contractors have adequate procedures in training security personnel deployed to their institutions.

To manage risks in their supply chains, FIs are advised to develop Code of Conduct for Suppliers, Screen IT suppliers have take-back programs to properly re-use, donate or dispose of equipment after its end of life etc. For guidance on how FIs can manage E&S supply chain risks in transactions financed, see the E&S Topics Section of the Toolkit.

Source: Supply Chain Sustainability in the Financial Sector. BSR (2015).

- Enhancing the FI's Reputation and Brand Value
More FIs are proactively and positively addressing the E&S impacts of their business. A reputation for sustainable business practices can help build brand which appeals to employees and a broader range of stakeholders including investors. The same applies to FIs with strong governance and business integrity practices. It can foster brand loyalty, improve the company's reputation and generate goodwill among clients and other stakeholders. Premised on the importance of credibility and trust in the financial services sector, enhanced brand reputation is important to bolster the FI's social license and distinguish it from its peers. Conversely, operating unsustainably and without integrity can lead to bad publicity and boycotts.

As demonstrated over the section using case studies of FIs in emerging markets, a commitment to building and implementing ESMSs not only address E&S risks but maximise opportunities such as cost reduction, development of innovative products leads to recognition and enhanced brand imagery both locally and internationally, distinguishing FIs with sound E&S practices from their counterparts. The FIs mentioned have won awards such as the Karlsruhe Sustainability Awards (Access Bank), Global Finance's Best Global Investment Bank for Sustainable Finance (Standard Bank Group), Asia Money's India best bank for CSR (RBL). Beyond the bragging rights, recognition of an FI’s work in the space of E&S risk management and sustainable finance can lead to benefits such as more capital inflow, willingness of foreign investors to partner with the FI on financing specific impact-related themes, attracting and retaining highly-skilled and passionate professionals seeking to align with reputable FIs etc. Given the rapid evolution of the sector and more broadly, global economic landscape, good E&S practice will continue to be materially important to an FIs growth and sustainability in the short to medium term.