Striking a balance ahead of Rio+20 in 2012

Sustainable Finance: Achievements, Challenges, Outlook

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Context

The *Earth Summit* in 1992 made history. The United Nations Conference on Environment and Development (UNCED) on 3 – 14 June 1992 in Rio de Janeiro was a breakthrough for the concept of sustainable development, a joint umbrella for economic, social and environmental dimensions of development as well as a multi-generational perspective.

A *global effort* followed the 1992 Earth Summit to translate the vision of sustainability into practice. This effort included all stakeholders: governments, multilateral organisations, the private sector, and civil society. However, two decades later, there is a big gap between what has been achieved, the initial ambitions of 1992, and what needs to be done to offer everybody a life in dignity and to preserve the planet for future generations.

The forthcoming *Rio + 20* event, the United Nations Conference on Sustainable Development (UNCSD) will take place from 14 – 16 May 2012 in Brazil and aims at (1) securing renewed political commitment for sustainable development, (2) assessing progress and gaps, and (3) identifying and addressing emerging challenges.

In the preparatory process of Rio+20 the "*green economy*" in the context of sustainable development and poverty eradication was identified as concept to unite the whole range of economic policies relevant to sustainable development. This includes approaches such as using market tools, getting prices right or ecological tax reform. It is essential that the concept of the green economy is not a one-dimensional, environmental substitute for sustainable development but includes equity concerns as well.

The *financial sector* occupies a prominent place in the economy, and there is no leeway to bypass banking and finance when heading towards a paradigm shift. The conceptual differences – if any – between sustainable development and a green economy are not yet clear. However, both approaches have to address in appropriate forms governmental policies as well as private sector operations.

The financial sector

Sustainable finance is frequently defined as addressing environmental, social, and governance (ESG) impacts of financial services. In addition, the sustainability concept includes a longer term financial dimension and an ethical dimension. The concrete meaning of sustainability for the financial sector is an issue of controversial debate and continues to be evolving.

The sustainability approach is challenging the *core business of the financial industry* (governance, products, processes, operations and logistics). Philanthropy and corporate social responsibility are just a limited part of that picture. The providers of financial services (banks, intermediaries, etc.) increasingly realize that sustainable practices in the sector have a positive potential: sustainable approaches may save costs, increase revenues, reduce risks, develop human capital and improve access to capital.[2] Moreover, ignoring the issue of sustainability is increasing their exposure to compliance and reputational risks. The sustainability approach is about engaging with environmental, social and financial opportunities and risks in a systematic way while complying with regulation and voluntary standards as well as observing good practices in ethics and governance. The sustainability approach to banking can be summarised as a cube:

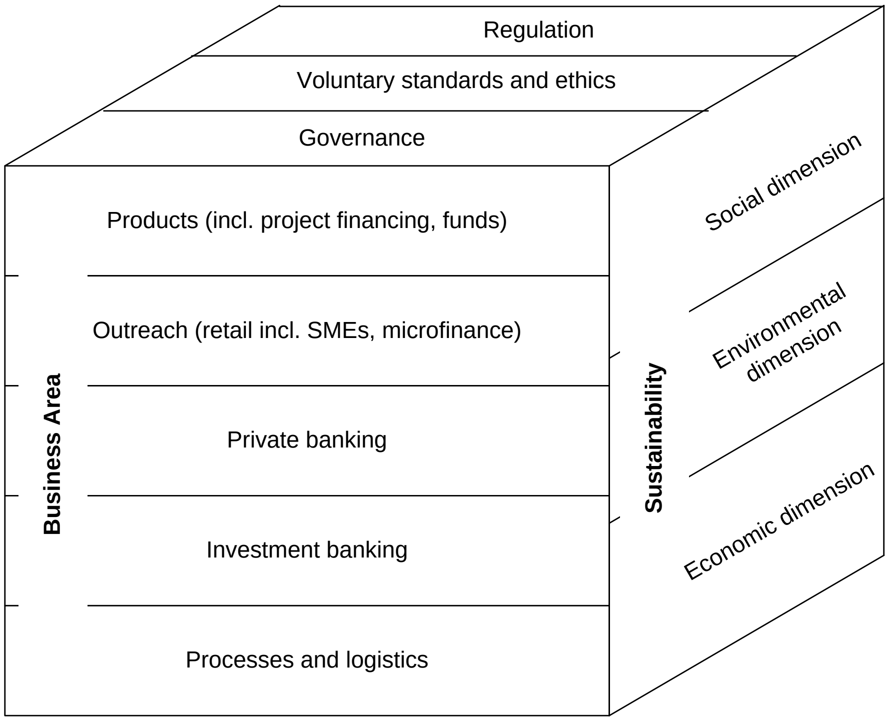

Fig. 1: The Sustainable Banking Cube

Financial services are also provided by *public institutions*, such as the International Financial Institutions (IFIs) like the World Bank Group (including the International Finance Corporation, IFC) or the Regional Development Banks, and national banks with government ownership. Their strategies are usually designed to promote development and include some considerations of sustainability. It is becoming more and more common to use public finance to mobilise additional private financial resources. It is in the hands of the governments involved in public finance to leverage this instrument as an incentive to progress along the sustainability agenda. The IFI's exposure and influence is shrinking to the same extant that the benefitting countries advance economically.

The *financial crisis* demonstrated that the financial industry is part of the problem or even at the origin of instability and non-sustainable economies. It exposed fundamental market failures and weaknesses of the widely practiced business models in the financial sector, which are based on a non-transparent risk structure, ill-priced risk premiums, dysfunctional compensation schemes, inadequate governance structures, and an erosion of solid business values. Widespread bail-

[2] SustainAbility/IFC/Ethos, Developing Value. The business case for sustainability in emerging markets, 2002, p. 4, see http://www.sustainability.com/library/developing-value; similarly based on case studies, SustainAbility/IFC, Market Movers. Lessons from a Frontier of Innovation, 2007, http://www.sustainability.com/library/market-movers

outs of private banks using taxpayers' money were one of the consequences. Two years after the acute phase of the financial crisis it is essential to learn the lessons at all levels. In December 2010 the Basel Committee on Global Banking Supervision issued "A global regulatory framework for more resilient banks and banking systems" (Basel III). It is a matter of controversy to what extent Basel III is addressing the root causes of the financial crisis.[3] However, the ideas of sustainability and a green economy are not taken explicitly care of at this level. But they should become an integral part of a global response and of national, contextualised responses to the financial crisis in order to prevent its recurrence, while leading towards a sustainable paradigm for the financial sector.

The idea to *integrate sustainability concerns into the financial sector* is driven by the vision to make it part of the solution: a stable financial system serving a sustainable footprint of mankind on earth. The global – albeit fragmentary – efforts include countless initiatives. Three of them are particularly noteworthy at the multilateral, the business and the civil society levels:

- The financial initiative of the UN's Environmental Programme (UNEP FI)[4], together with a range of partner organisations and key stakeholders worldwide, has pioneered the UN's work with the global financial sector, comprising investment firms, insurance companies and banks, to integrate ESG factors into fundamental financial analysis, decision-making and reporting processes since 1992;
- The World Business Council for Sustainable Development (WBCSD)[5] is running a Vision 2050 project and works with its membership of leading global companies on corporate best practice and the advancement of sustainability reporting. The WBCSD has also developed a number of tools, such as the Greenhouse Gas (GHG) Protocol, to help companies measure and report their management of sustainability issues.
- A global coalition of non-governmental organisations (NGOs) including WWF-UK, the Berne Declaration, Friends of the Earth, and the Rainforest Action Network, joined forces to promote sustainable finance in the business sector. Based on the shared vision for a sustainable financial sector, this informal network subsequently evolved into BankTrack[6].

Achievements

The implications of sustainability for the financial sector have been translated from different perspectives into principles of sustainable banking. Among a plethora of individual and institutional initiatives, the most remarkable examples are:

- The *Principles for Responsible Investment* (2006, see annex 2), a UN backed investors initiative in partnership with UNEP FI and the UN Global Compact. At present 862 individuals signed this voluntary framework to incorporate ESG issues into their decision-making and ownership practices;

[3] See e.g. Third World Network, Largest banks fall short of meeting Basel III capital rules, 23.12. 2010, at http://www.twnside.org.sg/title2/finance/2010/finance101203.htm
[4] http://www.unepfi.org/
[5] http://www.wbcsd.org/
[6] http://www.banktrack.org/

- The *Equator Principles* (2006, see annex 3) for funding of projects exceeding USD 10 mio. They are based on the environmental and social standards of the World Bank Group's IFC, and were adopted by 70 financial institutes;
- The *Colleveccio Declaration* (2003, see annex 4) which were endorsed by 200 civil society organisations: It identifies six fundamental commitments for the entire financial industry.

Have sustainability concerns *arrived at the top level* of financial companies? McKinsey's[7] 2010 Global Survey of 1749 companies across sectors reveals that sustainability is considered by more than 50 percent of executives as "very" or "extremely" important. However, only a quarter of executives say it is a top-three priority on their CEO's agenda, and an even smaller number of companies embark on a proactive approach in implementation. In comparison to the overall average, the financial sector attaches a lower priority to sustainability issues, and in particular a markedly lower rating than manufacturing or energy. Being the aftermath of the financial crisis a number of banks are still operating in survival mode. However, over time sustainable strategies are gaining ground also in the financial industry. They are increasingly seen as a source of competitive advantage and are on the way into mainstream practices. In the initial phase, sustainable finance had to respond to sceptical questions regarding performance. Now the most pertinent queries address the question of what difference the ESG criteria make in terms of impact on the environment and the well-being of citizens.

Box: Sustainable finance in Switzerland

"Switzerland is one of Europe's leading countries for Sustainable and Responsible Investment", writes Eurosif in its Sustainable and Responsible Investment (SRI) 2010 study. Indeed, it is well positioned to become a hub of sustainable finance. In 2009, the Swiss Government jointly with the UN Global Compact and IFC co-sponsored a report on embedding ESG issues in investment markets, including a summary of the lessons learned (see annex 5) regarding the relevance of ESG issues and their integration into investment decisions ("Who Cares Who Wins Initiative 2004 - 2008"). In a remarkable contrast to the financial crisis of 2007/08 sustainable finance has regained its position of a fast growing segment in Switzerland's financial sector:

- *Funds*: With € 23 billion assets under management the Swiss SRI market has reached a historical all time high in 2009. Equity is the predominant asset class, and retail investors account for the majority of SRI investments. The share of SRI in the overall assets under management is estimated at 3.8%.
- *Research*: FINRISK, a National Centre of Competence in Financial Research, managed by the University of Zurich, initiated a research program "Finance and Society" focusing on sustainability issues. Since 2001, FINRISK has developed into a renowned academic forum for research, education and knowledge transfer.
- *Training*: Partnering with institutions and experts of the financial community, WWF[8] Switzerland is piloting in 2011 a vocational training course on sustainable finance for middle level cadres of banks and other companies of the financial

[7] McKinsey, Global Survey results: How companies manage sustainability, March 2010, see: https://www.mckinseyquarterly.com/How_companies_manage_sustainability_McKinsey_Global_Survey_results__2558

[8] http://www.wwf.ch/de/newsundservice/service/bildungsangebot/kursangebot/zertifikatskurs_finance/

sector. Also the Swiss Banking Institute[9] of the University of Zurich offers a sustainability related training course, however limited on socially responsible investments.

- *Communication*: The Sustainability Forum Zurich (TSF)[10], an independent platform of business, science and public authorities, focuses on sustainable finance, and hosts regular public dialogue events.

Disclosure of information on sustainability efforts and their strengths and weaknesses are a prerequisite to trace impact, and so are voluntary guidelines in these areas to advance global reporting and disclosure. Most noteworthy efforts in this direction are: the Global Reporting Initiative (GRI)[11], the International Organization for Standardization (ISO)[12], and the Carbon Disclosure Project (CDP)[13]. At the national level countries like Denmark, France, Sweden and the United Kingdom are pioneering mandatory non-financial reporting by companies.[14] However, the quality of these efforts varies. Therefore, the European Commission started to explore the needs for a common European disclosure regime for non-financial information.[15] All these efforts strengthen the accountability of the private sector to the shareholders as well as to a wider range of stakeholders.

When it comes down to it, it is up to *asset owners* to demand sustainable services and products. Committed individual as well as institutional investors increasingly practice an active shareholder role to strengthen sustainable finance, dialoguing with the companies' management as well as influencing decisions of the annual general assembly. Examples are ACTARES[16], Shareholders for a Sustainable Economy, giving individual shareholders a voice and Ethos[17], the Swiss Foundation for Sustainable Development, speaking on behalf of institutional investors. Through pension funds, asset ownership is broad based in many countries. Typically, the main drivers of the SRI market are institutional investors. It is difficult to get solid information on the outreach and impact of sustainable finance. In a number of specific segments of the financial markets figures are available and demonstrate how sustainability concerns have been gaining ground:

- At the end of 2010, the above mentioned "Principles of Responsible Investing (PRI)" had 855 signatories from 45 countries that control USD 22,000 billion of assets under management – almost 10 percent of the global capital market;[18]
- In 2007, USD 53 billion of USD 75 billion officially granted in loans for major projects in developing and emerging economies complied with the "Equator Principles", according to the Infrastructure Journal[19];

[9] http://www.finance-weiterbildung.uzh.ch/programme/courses/socialinvest/overview
[10] http://www.sustainability-zurich.org/
[11] http://www.globalreporting.org/Home
[12] http://www.iso.org/iso/home.html
[13] https://www.cdproject.net/en-US/Pages/HomePage.aspx
[14] See Eurosif (2011), pp. 4-5, http://www.enviroreporting.com/detail_press.phtml?act_id=1081
[15] http://ec.europa.eu/internal_market/consultations/2010/non-financial_reporting_en.htm; for Eurosif's response see http://www.enviroreporting.com/detail_press.phtml?act_id=1081
[16] http://www.actares.ch/
[17] http://www.ethosfund.ch/e/ethos-foundation/ethos-foundation.asp
[18] Institutional Investor, 24 January 2011,
[19] ENDS report 12-2008, http://www.equator-principles.com/documents/ENDSReport12-08English.pdf

- Eurosif's 2010 SRI study reveals a strong expansion of the European market of SRI despite the financial crisis, now totalling approximately € 5,000 billion assets under management. € 1,200 billion of it is based on core SRI criteria, consisting of norms and value based exclusions and different types of positive screens; the remaining € 3,800 is based on broad SRI criteria encompassing simple exclusion, engagement and integration approaches.

However, these encouraging figures have to be put into a *broader context*: A new PRI/UN study[20] calculated the annual cost of environmental damage caused by the world's 3000 largest publicly-listed companies for 2008 at USD 2,150 billion. A list[21] of the most environmentally and socially controversial multinational companies in 2010 demonstrates what is at stake for the society as well as the investor, with the lead of Transocean and BP being responsible for the oil spill in the Gulf of Mexico. Sustainable finance – in terms of market shares – still makes up for a small percentage only. The Bank for International Settlements (BIS) estimates the global turnover in over-the-counter transactions in currencies and derivatives at US$ 4,000 billion per day (2010). The finance turnover of four days exceeds the annual trading volume of the productive economy in goods and services (US$ 15,500 billion in 2009, according to the WTO International Trade Statistics)[22]. These huge volumes of financial transactions are mainly linked to short term, speculative capital, which often enhances market volatility and encourages market participants to look for short term profits instead of pursuing long term sustainability goals. The beneficial impact of a more sustainable financial sector is immense and will be felt across the globe in all economies.

Considering the long way still ahead it is encouraging to take note of the numerous *business initiatives* to take the concern of sustainability forward. At the global level the already mentioned WBCSD Vision 2050 and the Global Compact[23] framed in the UN are the most outstanding examples. In view of the World Economic Forum (WEF) Annual Meeting 2011 in Davos, Switzerland, the WEF as a leading discussion platform has prepared a report on sustainable credit. The guiding spirit was to "rethink, redesign and rebuild the institutions and practices that made the financial crisis possible" write the WEF representatives in their preface.[24] The report does not cover all dimensions of sustainability and it is limited to credit. However, the WEF analysis has a clear focus on how to prevent excessive lending in future, and on inclusive growth to address credit blockages faced by small enterprises particularly in developing countries. The recommendations to regulators, policy-makers and financial institutions are to be milestones on the way to sustainable credit and fewer crises (see annex 6).

[20] See http://www.unpri.org/files/6728_ES_report_environmental_externalities.pdf
[21] http://www.reprisk.com/downloads/innews/86/RepRisk%20Names%20Most%20Environmentally%20and%20Socially%20Controversial%20Companies%20of%202010.pdf
[22] WTO, http://www.wto.org/english/news_e/pres10_e/pr598_e.htm
[23] http://www.unglobalcompact.org/
[24] WEF (2010), p. 5

Challenges

The challenges are evident in all three dimensions of sustainability. The following section refers to the specific challenges of the financial sector only. These challenges have to be met in order to make relevant contributions to addressing global concerns such as a stable financial system, pro-poor growth or the transition to a low carbon economy. It is disturbing to note that leading senior bankers – recently at the WEF Annual Meeting in Davos – seem to prefer to return to business as usual rather than addressing the challenges and promoting radical reforms in the financial sector.[25]

The *regulation of the financial sector* does neither sufficiently discourage non-sustainable business models nor reward sustainable business practices which take into account adequate ethical standards which should go beyond the legal minimum. This does not necessarily mean that more but better regulation is required. Improving regulation includes many controversial issues at the technical level. However, the key challenge to improve regulation will be to win support of taxpayers and governments in order to overcome political resistance.

Beyond regulation an *effective implementation of agreed voluntary standards and principles* for sustainable finance by individual banks and service providers is a key challenge. Many financial institutions sign sustainability declarations to secure their reputation but are neglecting implementation. Good governance, determined leadership, ambitious policies, appropriate incentives, effective accountability, and transparency at all levels matter and are a prerequisite for a real change.

An institutionalised *independent monitoring and evaluation* is missing to enhance the effectiveness and credibility of sustainability criteria and principles. Part of these processes may be assumed by the formal banking supervision of the national authorities. However, beyond the supervision credible monitoring and reporting of the implementation of agreed sustainability principles is needed. What counts in future is demonstration of impact.

The *soft areas of values and culture* beyond law, regulation and principles shape the corporate behaviour and integrity to a large extent. Financial literacy at the management level needs to be re-directed towards sustainability. In order to perceive sustainability as a business opportunity sustainability factors need to be systematically linked to business success factors.[26] The inclusion of sustainability in the corporate culture of financial institutions in all its facets is essential to give change a chance.

Broad access to financial services (savings, credits, insurance, etc.) also at the micro level is a prerequisite for pro-poor growth. In contrast to the recent excesses in the credit markets, economic history of advanced economies tells us how sustainable finance underpins an inclusive development process.

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[25] New Rules for Global Finance, update 4 February 2011, http://www.new-rules.org/new-rules-blog/317-blog-24

[26] See the business case matrix in: SustainAbility/IFC/Ethos, Developing Value. The business case for sustainability in emerging markets, 2002, see http://www.sustainability.com/library/developing-value

Complementary service providers around the nucleus of the banking sector should equally adopt sustainable business practices: intermediaries of the financial markets, stock exchanges, credit rating agencies, auditing companies, etc..

Outlook: Avenues to make the financial sector more sustainable

A major networking effort will be required to implement real change and involve competent institutions and experts across the globe. Transparency and participation of interested stakeholders should guide the process. In order to meet the above mentioned challenges, the way forward should take the following five aspects into account:

- **Regulatory environment**: Developing core ingredients of a regulatory environment to prioritize sustainable finance at the international (including a Basel III assessment from a sustainability perspective, the taxation of financial transactions[27] to discourage short-term movements, being on the agenda of the G-20 presidency in 2011) and national (including the restoration of the historic 20 percent share of equity capital of total assets[28] in banking, the development of appropriate staff incentives, discouraging tax evasion by effective international cooperation) levels;
- **Good practices**: Identifying and taking stock of existing private practices (including how to seize sustainability related business opportunities, how to make investment in clean technology attractive, discouraging environmentally harmful projects, and creating a conducive environment for micro-insurance) which contribute to improving sustainability in the financial sector, and assessing options of scaling them up;
- **Change of mindset**: Making efforts to take sustainable finance to the board rooms and to the corporate leaders of the financial industry, and integrating sustainability issues into the education and training curricula of finance professions, as well as developing postgraduate vocational training courses;
- **Redirect research**: Stimulating research programmes which are designed to analyse issues relevant for sustainable finance and to facilitate mainstreaming of sustainability issues in the financial sector;
- **Communication**: Media coverage and public debate on the issues, efforts and results of strengthening sustainable finance is essential to obtain acceptance of a paradigm shift by the financial community and restore the credibility of the financial sector in the public.

[27] Baker, Dean, The Benefits of a Financial Transactions Tax, cepr, Washington December 2008, see http://www.cepr.net/documents/publications/financial-transactions-tax-2008-12.pdf
[28] Miles, David et al., Optimal Bank Capital, Bank of England Discussion Paper January 2011, see http://www.bankofengland.co.uk/publications/externalmpcpapers/extmpcpaper0031.pdf

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Annex 2

The UN-backed investors' initiative of Principles for Responsible Investment

The Principles for Responsible Investment are an investors initiative in partnership with UNEP FI and with UN Global Compact. The process was convened by the United Nations Secretary-General. The 862 signatories (217 asset owners, 477 investment managers, 168 professional service partners) publicly commit to adopt and implement the principles, to evaluate their effectiveness and improve the content of the principles over time. As institutional investors, the signatories have a duty to act in the best long-term interests of their beneficiaries. In this fiduciary role, they believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios. Applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with the fiduciary responsibilities, the signatories commit to the following:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses

- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

2 We will be active owners and incorporate ESG issues into our ownership policies and practices. Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest. Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

4 We will promote acceptance and implementation of the Principles within the investment industry. Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration
- Support regulatory or policy developments that enable implementation of the Principles

5 We will work together to enhance our effectiveness in implementing the Principles. Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

6 We will each report on our activities and progress towards implementing the Principles. Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a 'Comply or Explain'[1] approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders

Source: http://www.unpri.org/principles/

Annex 3

The "Equator Principles" – a financial industry benchmark

The Equator Principles serve as benchmark for determining, assessing and managing social & environmental risk in financing worldwide across industry sectors new projects with capital costs of USD 10 million or more. They serve as a common social and environmental baseline drawn from the World Bank Group. Based on the IFC's screening criteria, the projects are categorised in A (potentially significant adverse impact), B (potentially limited adverse impact), C (minimal or no adverse impacts). The Equator Principles Financing Institutions (70 EPFI signatories as at 31.12.2010) will only provide loans to projects that conform to the principles below (slightly abridged version):

Principle 1: Review and Categorisation
When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC).

Principle 2: Social and Environmental Assessment
For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment ("Assessment") process to address, as appropriate and to the EPFI's satisfaction, the relevant social and environmental impacts and risks of the proposed project. The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.

Principle 3: Applicable Social and Environmental Standards
For projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development

Indicators Database, the Assessment will refer to the then applicable IFC Performance Standards and the then applicable Industry Specific EHS Guidelines. The Assessment will establish to a participating EPFI's satisfaction the project's overall compliance with, or justified deviation from, the respective Performance Standards and EHS Guidelines. The regulatory, permitting and public comment process requirements in High-Income OECD Countries, as defined by the World Bank Development Indicators Database, generally meet or exceed the requirements of the IFC Performance Standards and EHS Guidelines. Consequently, to avoid duplication and streamline EPFI's review of these projects, successful completion of an Assessment (or its equivalent) process under and in compliance with local or national law in High-Income OECD Countries is considered to be an acceptable substitute for the IFC Performance Standards, EHS Guidelines and further requirements as detailed in Principles 4, 5 and 6 below. For these projects, however, the EPFI still categorises and reviews the project in accordance with Principles 1 and 2 above. The Assessment process in both cases should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

Principle 4: Action Plan and Management System
For all Category A and Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the borrower has prepared an Action Plan (AP) which addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable Performance Standards and EHS Guidelines, as defined in the AP. For projects located in High-Income OECD countries, EPFIs may require development of an Action Plan based on relevant permitting and regulatory requirements, and as defined by host-country law.

Principle 5: Consultation and Disclosure
For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner. For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns.

In order to accomplish this, the Assessment documentation and AP, or non-technical summaries thereof, will be made available to the public by the borrower for a reasonable minimum period in the relevant local language and in a culturally appropriate manner. The borrower will take account of and document the process and results of the consultation, including any actions agreed resulting from the consultation. For projects with adverse social or environmental impacts, disclosure should occur early in the Assessment process and in any event before the project construction commences, and on an ongoing basis.

Principle 6: Grievance Mechanism

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure that the mechanism addresses concerns promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.

Principle 7: Independent Review

For all Category A projects and, as appropriate, for Category B projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

Principle 8: Covenants

An important strength of the Principles is the incorporation of covenants linked to compliance. For Category A and B projects, the borrower will covenant in financing documentation:

a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;

b) to comply with the AP (where applicable) during the construction and operation of the project in all material respects;

c) to provide periodic reports in a format agreed with EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and

d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate.

Principle 9: Independent Monitoring and Reporting

To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, for all Category A projects, and as appropriate, for Category B projects, require appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.

Principle 10: EPFI Reporting
Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience,

Source: http://www.equator-principles.com/index.shtml

Annex 4:

Civil Society Principles for Sustainable Banking ("Collevecchio Declaration")

The "Collevecchio Declaration" was launched in January 2003, endorsed by over 200 civil society organisations. It outlines the unique role and responsibility the financial sector has in advancing sustainability. The commitments in an abridged version:

Commitment to Sustainability:
Financial institutions must expand their missions from ones that prioritize profit maximization to a vision of social and environmental sustainability. A commitment to sustainability would require financial institutions to fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting and advising), to put sustainability objectives on an equal footing to shareholder maximization and client satisfaction, and to actively strive to finance transactions that promote sustainability.

Commitment to 'Do No Harm":
Financial institutions should commit to do no harm by preventing and minimizing the environmentally and/or socially detrimental impacts of their portfolios and their operations. Financial institutions should create policies, procedures and standards based on the Precautionary Principle to minimize environmental and social harm, improve social and environmental conditions where they and their clients operate, and avoid involvement in transactions that undermine sustainability.

Commitment to Responsibility:
Financial institutions should bear full responsibility for the environmental and social impacts of their transactions. They must also pay their full and fair share of the risks they accept and create. This includes financial risks, as well as social and environmental costs that are borne by communities.

Commitment to Accountability:
Financial institutions must be accountable to their stakeholders, particularly those that are affected by the companies and activities they finance. Accountability means that stakeholders must have an influential voice in financial decisions that affect the quality of their environments and their lives -- both through ensuring that stakeholders' rights are protected by law, and through practices and procedures adopted by financial institutions themselves.

Commitment to Transparency:
Financial institutions must be transparent to stakeholders, not only through robust, regular and standardized disclosure, but also by being responsive to stakeholder needs for specialized information on financial institutions' policies, procedures and transactions. Commercial confidentiality should not be used as an excuse deny stakeholders information.

Commitment to Sustainable Markets and Governance:
Financial institutions should ensure that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms which facilitate sustainability and that foster the full cost accounting of social and environmental externalities.

Source:
http://www.banktrack.org/download/collevechio_declaration/030401_collevecchio_declaration_with_signatories.pdf

Annex 5

Ten recommendations to kick-start the next phase in ESG integration in financial markets

Who Cares Wins aimed to support the financial industry's efforts to integrate ESG issues into mainstream investment decision-making and ownership practices. In the light of the 2007–2008 financial crisis the need to refocus the investment system on the long term and on a more holistic assessment of risk is more important than ever. The conclusions of the Who Cares Wins initiative — a roadmap to markets that are more 'future proof' — are captured by the following set of ten recommendations for different investment market actors:

1. All investment actors: mobilise top management. CEO / CIO leadership is needed to unblock stalled situations between different actors and agree on how to share the costs of further market-building efforts

2. Regulators and governments: require greater transparency on ESG performance / integration from companies and investors. Engage in an open dialogue with the financial industry on this issue, and support neutral platforms aimed at fostering that dialogue. 'Walk the talk' in terms of the way you invest your own capital. Help the industry's integration efforts by giving a price to public goods, thereby internalising external environmental and social costs

3. Asset owners: make ESG inclusion a specific criterion in new asset management mandates. Commit to evaluating ESG capabilities systematically when formulating mandates and selecting managers. Professional staff: increase the awareness and knowledge of trustees in this area

4. Investment consultants: develop and communicate a house view on the integration of ESG issues. Be explicit about how that position is reflected in your services (e.g.

investment strategy, asset-liability management / asset allocation and manager selection)

5. Asset managers (senior mgt): lead ESG integration by communicating clear goals and providing appropriate incentives for employees and service providers (e.g. sell-side research). Involve human resources / compensation managers in your planning

6. Asset managers: pro-actively develop and distribute investment strategies and services that focus on ESG as a tool for improving risk-adjusted return. Design integrated methodologies for ESG that go beyond simple screening approaches

7. Asset owners, asset managers and research providers: enter a dialogue with companies to explain how ESG issues drive investment decision-making and to request improved reporting on ESG performance

8. Asset owners, asset managers and research providers: improve the quality and coverage of country-specific ESG research in emerging markets. Include ESG issues in regular company meetings and engagement activities. Consider collaborating with other investors in requiring minimum ESG disclosure standards from emerging markets legislators and exchanges

9. Research providers: leverage the knowledge of analysts covering industries with a high degree of ESG integration, and expand the quality and scope of ESG inclusive research to include other sectors, regions (including emerging and frontier markets) and asset classes

10. Rating agencies: improve and communicate your efforts to integrate ESG issues into rating methodologies

Source: IFC/FDFA/UN Global Compact (2009), Future Proof? Embedding environmental, social and governance issues in investment markets, 2009, p. 11, http://www.unglobalcompact.org/docs/news_events/8.1/who_cares_wins_29Jan09webversion.pdf

Annex 6

The World Economic Forum's (WEF) Recommendations for Decision-Makers on Sustainable Credit

The study recommends eight actions that financial institutions, regulators and policy-makers can take today to ensure sustainable credit levels for the future.

a. Integrate the concepts of sustainable credit into the regulatory agenda. New liquidity and funding regulation can help reduce the frequency and intensity of credit hotspots and should be supported. However, decision-makers should guard against the risk that such regulation limits sustainable global credit growth or creates new credit coldspots.

b. Create standardized government accounting practices to increase transparency and accurately assess sovereign finances. Governments should adopt uniform accounting standards so that a complete and transparent picture of each country's financial resources and obligations is available. The challenge of creating and agreeing on such standards should be made part of the G20 agenda.

c. Encourage responsible borrowing through financial education. An international, government-led initiative should undertake an impact study of existing financial education programmes worldwide, and then bring together government officials, education leaders and financial institutions to agree on an approach and implementation plan for improving financial literacy.

d. Encourage financing of local coldspots through targeted mechanisms. Governments and banks should create targeted mechanisms to solve the well-documented problem of lending to SMEs in developing markets. In developed markets, they should establish a robust fact base on the extent to which SME lending is constrained, and develop innovative solutions to improve both the supply and the demand side.

e. Task a single agency with monitoring global credit levels and system-wide credit sustainability. A single organization should be tasked with monitoring global credit levels so that the risks to financial institutions are accurately assessed. This organization should build on the credit sustainability metrics presented in this report and combine them with the Early Warning Exercise methodology developed by the FSB and IMF.

f. Align banks' risk appetite with sustainable credit criteria. Banks should ensure that their contribution to systemic risk is considered at the level of day-to-day credit and lending decisions. Regulators and supervisory bodies should recognize the contributions made to financial stability by banks that are aligned with sustainable credit principles.

g. Drive innovation by financial institutions, developing new mechanisms that can safely meet future global credit needs. Governments could help kick-start securitization markets with targeted mechanisms such as a government-subsidized programme to securitize SME loans. Financial institutions should develop further mechanisms to grow balance sheet capacity safely and meet future worldwide credit needs – including measures to strengthen housing and environmental finance, and to integrate the unbanked into the banking system.

h. Establish goals for efficient and deep capital markets by 2020 in developing economies. Governments, international agencies and the G20 should promote the strengthening of capital markets in developing countries by institutionalizing two fundamental capital market development goals: improving infrastructure to broaden participation by foreign firms and investors, and creating a sound institutional environment.

Source: WEF (2010), More Credit with Fewer Crises: Responsibly Meeting the World's Growing Demand for Credit, World Economic Forum, Geneva 2010, p.17, http://www3.weforum.org/docs/WEF_NR_More_credit_fewer_crises_2011.pdf