Sustainability Management and Reporting

Benefits for Financial Institutions in Developing and Emerging Economies

A Document of the UNEP Finance Initiative Sustainability Management and Reporting Project

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Contents

Foreword

The United Nations Environment Programme greatly welcomes the publication of the UNEP Finance Initiative Sustainability Management and Reporting guidance with its focus on the needs of financial institutions in developing and emerging economies. It is becoming increasingly apparent that full disclosure and transparent reporting around environmental, social and governance issues – in fact the whole spectrum of issues that make up sustainability – is a key differentiating factor between those institutions that are leading and those which are reactive in this complex area.

Well-tailored sustainability reporting also makes sense from the standpoint of "good business." Those financial companies that are active in regional and global capital markets will derive a clear advantage from reporting, which sets them apart as a leader on sustainability issues.

At the global level we have the Global Reporting Initiative (GRI) reporting guidelines, strengthened by the recent release of the new G3 reporting framework, and this is certainly the best practice approach that any institution can strive towards. The critical issue, however, is that a financial institution begins on the journey of sustainability reporting in a manner that makes sense to them, their clients, broader stakeholders and the environment. A steady progression from the earliest of reports covering basic internal environmental issues right up to fully GRI-compliant reports creates learning inside an organisation which is invaluable in every respect: performance; staff attitude; reputation; and a connectivity to the broader community which enables institutions to understand their clients needs more fully and identify new markets more readily.

This guidance document really does provide the "how to" for financial institutions that wish to either commence their environmental and sustainability reporting or for those, already started on the journey that wish to take their next annual report to a new level. The heavy focus on case studies also gives a clear lead from industry peers in different parts of the world, which is essential if institutions undertaking their first reports are not to reinvent the wheel.

The guidance will be an invaluable tool for both UNEP FI members and those who have not yet joined this unique public-private partnership between the United Nations and the global financial services sector. We wish you good reading and a fruitful journey towards meaningful sustainability reporting.

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Executive Summary

The take up of Sustainability Management and Reporting (SMR) by financial institutions especially in developing and emerging economies is still low whilst the financial sector plays an important role in sustainable development as intermediaries to the allocation of capital. The report assumes lack of awareness and capacity as the two main barriers hindering many financial institutions to implement SMR. It aims to serve as an initial tool to overcome these barriers by raising awareness of the benefits it can entail. Additionally, it hopes to offer CEOs and board members ideas and strategic approaches towards SMR.

The report identifies four primary ways in which implementing SMR can provide benefits to financial institutions: revenue growth, risk management, access to capital, and cost savings and efficiency. Fifteen case studies illustrate each of these benefits through financial institutions' interaction with its stakeholders: suppliers, employees, clients and shareholders, society and the environment as follows:

Revenue growth: SMR may be used as a framework to develop new products and services and drive revenue growth through i) early market entry into new socio-environmental business opportunities, ii) enhancing reputational advantage in a new and growing market and iii) by SMR displaying the institution's commitment towards sustainability, an important factor in attracting socio-environmental business.

Risk management: SMR can also be a risk management tool not just in building and maintaining the capacity to understand the risk of new socio-environmental businesses. In a world where new regulations and expectations of the social responsibility of financial institutions are growing, SMR assists in appropriately assessing these risks within the institution's overall credit risk analysis and other financial decision-makings.

Access to capital: Many financial institutions especially in developing and emerging economies also have found that SMR improves its access to both public and private capital and in assisting the organisation in meeting its stock exchange listing requirements.

Cost savings and efficiency: Lastly, introduction of SMR provides internal benefits. While an SMR system cannot be 'plugged' into an organisation and will often represent a fundamental shift in how all facets of the organisation operate, if installed systematically and consequently embraced across all company divisions it should lead to a better-managed organisation.

It is hoped that this report will encourage more financial institutions in developing and emerging markets to take up SMR. As these leading institutions realise the benefits and gain experience in addressing adverse risks and top-line opportunities, others will follow and soon SMR may become common practice.

Sustainability Management and Reporting (SMR)

When this report refers to sustainability management, a sustainability management system, or sustainability management and reporting (SMR), the term "sustainability" is used generally as a framework under which "extra-financial" environmental, social, and governance (ESG) issues are addressed in conjunction with economic and financial matters.

Most of the banks featured in this report first began addressing environmental issues due to mandates of multilateral and bilateral financial institutions such as IFC, EBRD, DEG, FMO, CAF, IDB, and IIC. Environmental risk management remains at the core of bank programmes today; however, we find the term "sustainability" becoming the premier word or concept within the lexicon utilised globally by multinational environmental players and civil society or NGOs.

1 Introduction

1.1 Why this document

Through their role as intermediaries of capital, financial organisations play an extremely important role in shaping the economy and driving sustainable development. Financial institutions are increasingly expected to take on this social responsibility, and hence there is a growing recognition of the importance of sustainability management and reporting (SMR) systems in this sector.

While SMR is becoming more mainstream in the financial sector of the developed world, this is not yet the case in developing economies (➲ see Section 2). Two key reasons have been identified.

1. Lack of awareness of the issues
2. Lack of capacity to deal with these issues

This document serves as a tool to overcome the first barrier by focusing on the benefits of SMR for financial institutions, especially banks, in developing and emerging economies. It aims to stimulate interest in the take up of SMR by financial institutions by raising awareness of the benefits it can entail. Additionally, it hopes to offer CEOs and board members ideas and strategic approaches towards SMR.

1.2 What this report is about and who it is for

i) Who it is for

This report is designed to be of use to chief executives, board members and managers of financial institutions who are interested in SMR. It especially targets domestic financial institutions in developing and emerging economies.

ii) Structure

This report uses case studies from financial institutions in developing and emerging economies to highlight systematically identified benefits of implementing SMR through its interaction between its stakeholders.

iii) What this report is and is not

This report is not a manual to set up SMR and does not contain step-by-step instructions.

What is sustainability management and reporting (SMR)?

The most commonly used definition of **sustainable development** is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." [1]

From a more focussed business perspective, **corporate sustainability** can be defined as "a business approach that creates long-term shareholder value by embracing opportunities and managing risks derived from economic, environmental and social developments."[2]

Sustainability management is a generic term for environmental and social management and corporate governance. It refers to the processes or structures that an organisation uses to meet its sustainability goals and objectives while transforming inputs into a product or service.

Sustainability reporting is a generic term for corporate extra-financial reporting. It refers to the account an organisation gives to describe its performance on a number of sustainability dimensions such as economic, environmental, social and corporate governance performances. Reports can be either internal or external; within this document the term 'sustainability reporting' refers to external or public reporting.

2 Benefits of SMR: an Overview

The deregulation and liberalisation of financial markets has contributed to growing international competition amongst financial institutions. In addition, economic volatility and increasing social, environmental and governance legislation means that financial institutions need to take a dynamic attitude to change. SMR is an important mechanism for improving corporate sustainability performance. It can generate business value through measurement and management of sustainability risks and opportunities. In addition, reporting this information responds to the growing expectations of the organisation's stakeholders.

This report addresses the interaction between financial institutions and four broad groups of stakeholders.

1. Suppliers
2. Internal (employees)
3. Clients and shareholders
4. Society and the environment

In addition, this report identifies four primary ways in which implementing SMR can provide benefits to financial institutions especially in emerging and developing economies.

i. Revenue growth
ii. Risk management
iii. Access to capital
iv. Cost savings and efficiency

The report examines each benefit across each of the stakeholder groups. The summary of these benefits are shown in the table below. In the following sections, each benefit is described and where possible illustrated with a case study or case studies.

Table 1 **Matrix of SMR drivers**

Stakeholders → / Benefits ↓	A. Suppliers	B. Internal		C. Clients & Shareholders	D. Society/ Environment
i. Revenue growth	Opportunities for new business developments	Improve competitiveness and business		New products and services	Boost local economic growth
ii. Risk management	Reduce risk of supply chain reputational damage	Governance – improve compliance and transparency		Manage environmental risk	Manage reputational risks
iii. Access to capital				Improve access to finance	Meet stock exchange listing requirements
iv. Cost savings & efficiency	Build better relationships	Reduce waste	Motivate workforce	Build better relationships	

Trends in SMR

Scope of sustainability reporting

Traditionally sustainability reporting has focused on environmental performance. Today many extra-financial reports integrate economic, environmental, social and corporate governance performances within the scope of corporate sustainability and corporate social responsibility/ corporate citizenship.

Types of sustainability reporting

Traditionally sustainability reports have been standalone publications. In addition to the growing use of web-based reporting, we are seeing new annual reports which integrate both financial and extra-financial performances.

Relatively new but growing business practice

Sustainability reporting first appeared in the early 1990s. Since then it has spread quickly worldwide mainly amongst big corporations and especially in Europe and Japan. Today, although only approximately 2,000

3 Revenue Growth as a Benefit of SMR

Implementing SMR can provide opportunities for revenue growth. SMR may assist financial institutions in the following ways.
1. Assist in the identification, creation and winning of new products and services
2. Strategically assist local economic growth and poverty reduction, thereby enriching the market in which the financial institution operates
3. increasing competitiveness

This section looks into each of the above points in more detail along with case studies.

3.1 Increase revenue by developing new products and services

Stakeholders → / Benefits ↓	C. Clients and Shareholders
i. Revenue growth	New products and services

SMR may be used as a framework to develop new products and services and drive revenue growth. Its benefits are identified as follows:

• **Early market entry:** SMR helps identify new socio-environmental business opportunities. More importantly, it can help establish the financial institution's presence in a new and growing market at an early stage.

• **Reputational advantage:** SMR displays the institution's commitment towards sustainability, an important factor in attracting socio-environmental business.

• **Managing the new business:** SMR assists in building and maintaining capacity to understand the new market and appropriately assess socio-environmental risks within credit risk analysis and other financial decision making.

Boosting reputation and market share

A general association with SMR can provide many benefits for financial institutions in terms of reputation. In an increasingly commoditised market, SMR may provide the point of differentiation that enables a financial institution to increase market share. This is especially the case where companies integrate into the community through such means as local recruitment and philanthropy.

companies worldwide produce sustainability reports[3], they include 52 per cent of the world's top 250 companies[4].

Financial sector reporting

In the past few years, the financial sector has seen fastest growth in the take up of sustainability reporting. Reporting amongst financial institutions in the world's top 250 companies doubled from 24 percent in 2002 to 57 percent in 2005[4].

1. World Commission on Environment and Development (WCED). Our common future. Oxford: Oxford University Press, 1987 p. 43.

2. Dow Jones Sustainability Indexes (http://www.sustainability-indexes.com/htmle/sustainability/corpsustainability.html)

3. CorporateRegister.com (http://www.corporateregister.com/charts/byformat.htm)

4. KPMG International Survey of Corporate Responsibility Reporting 2005 (http://www.us.kpmg.com/jnet/English/KPMG_Int_Survey_Corp_Respons.asp)

Case Study 1

Financing the Renewable Energy Sector (Unibanco SA, Brazil)

The global growth of environmental business provides an increasing number of new opportunities for financial institutions to do business with "green" firms and projects. For example, in 2004 an estimated $30 billion – about one-fifth of total global investment in conventional power sector – was invested in renewable energy. Within the next decade, this investment is expected to reach $85 billion annually.

The example of Unibanco SA

Unibanco is the oldest and the third largest private sector bank in Brazil. Its stock is listed as Level 1 on the Bolsa de Valores de São Paulo (Bovespa) and on the New York Stock Exchange (NYSE).

Sustainability Management

As part of Unibanco's business vision, the bank strives to respond to national development needs by establishing sustainable business practices. An environmental management system (EMS) was established in 2002 in conjunction with a credit line from the International Finance Corporation (IFC). Accompanied by a sustainability policy, the bank's EMS was developed with assistance from the IFC and required certain subprojects to adhere to IFC's then environmental and social policies and guidelines (which also met DEG requirements). As staff awareness and experience increased and additional financing was sought from the Inter-American Development Bank (IDB) Unibanco expanded the breadth and coverage of the EMS in line with its stated objectives and began to integrate socio-environmental risk analysis within the bank's overall credit risk analysis.

Building Competitive Advantage in Renewable Energy

In 2003, the Project Finance division developed a pioneer project with a natural gas plant that generates energy using methane gas extracted from a landfill. A total of US$16 million was invested in the 22MW power plant that provides energy for 200,000 inhabitants of São Paulo. The bank leases the facility to another company and utilises the energy generated. The plant was the first of its kind in Brazil and the largest at the time in the world. The project illustrates how sustainable business practice can bring benefit for both society and the company: Aside from the benefits from cost reduction (energy costs of the bank's office buildings in São Paulo city fell 35 percent), the project has tremendous environmental benefits: Not only is energy generated from a renewable source; but also the release of methane – a greenhouse gas, with a warming potential about 20 times greater than carbon dioxide – into the atmosphere is prevented and the project will generate 7.4 million tons of carbon credit equivalents in a time horizon of seven years.

Furthermore, the bank has consolidated its knowledge of the renewable energy sector and established a leadership position in structuring finance for energy projects, such as small hydropower plants and, most notably, sugar-cane bagasse cogeneration – Unibanco acted as financial advisor for projects amounting to over 290 MW of cogeneration capacity. Overall this has reinforced its reputation as a responsible business actor.

Case Study 2

Green Markets for the Environment (Bank Ochrony Srodowiska S.A., Poland)

Many businesses in Eastern Europe have strong business ties with Western European and international companies. Such relationships often require compliance with high environmental and social standards and can thus promote investments in cleaner technology and recycling. Additionally, the market for green investments, such as renewable energies, organic agriculture and nature conservation offers good growth potential. Banks can harness this business potential by promoting the creation of green markets and developing tailored products and services.

The example of Bank Ochrony Srodowiska S.A.

Bank Ochrony Srodowiska S.A. (BOS), established in 1991, is a leading Polish commercial bank specialising in environmental protection investments, and the only bank in Poland with this focus. The two largest shareholders are the Swedish capital group Scandinaviska Enskilda Banken and the National Fund for Environmental Protection and Water Management.

Sustainability Management and Reporting

BOS has included sustainability management in its operations from the beginning and is continuously working to develop this area further. The bank's development strategy for 2003-2007 states that environmental protection is a major institutional goal, its annual report includes a section on environmental activities, and in addition the bank publishes an annual environmental report.

Sustainability Products and Services

BOS has developed a number of tailored environmental products as follows:

Environmental credits account for over 20 percent of the bank's total portfolio . While the initial growth of this credit area was facilitated by cooperation with donor institutions in Poland and the EU, the bank expects the demand to grow further and is prepared to handle a much larger number of environmental credits.

For individual customers, the bank offers endangered species deposits that help funding the protection of endangered animal species in Poland, while still yielding a fair interest rate.

For environmental investments, the bank offers "ecological credits" with preferential interest rates. These credits, which have become a standard in the bank's portfolio, can be applied in a wide range of areas, including waste and sewage management, energy efficiency, cleaner production, noise reduction, construction of bicycle routes, and emissions reductions from municipal public transport vehicles, among others. The preferential interest rate can be granted thanks to the collaboration with the National Environmental Protection and Water Management Funds.

Additional offers to corporate customers include tailored packages for distributors of environmental products, as well as car salvage facilities, garages and other recycling businesses.

Drivers and Benefits of SMR

By establishing a sustainability management system, BOS was more easily able to develop new products and services for its diverse customers. Having an environmental credit risk management approach not only enabled the bank to reduce the risk linked to providing loans, but also allowed it to co-operate more easily with a range of international banks and institutions. Many clients are attracted to the bank because of its environmental orientation and thus the bank has found a profitable niche. According to BOS, providing loans for environmental protection projects is now the most profitable area of the bank's activities.

Case Study 3

Becoming a Regional Competitor (Siauliu Bankas, Lithuania)

The example of Siauliu Bankas

Siauliu Bankas (SB) is a Lithuanian bank established in 1992 in the provincial town of Siauliai. It offers a range of banking products (leasing, investment management, factoring and investment in land and real estate) but its strength lies in credit lines for small and medium enterprises (SMEs) and female entrepreneurs.

Niche market development as a result of social and environmental focus

Operating in a market where all competitors are internationally owned, SB had to find its niche: the bank operates several specialised credit lines for SMEs, green business or environmental investments and female entrepreneurs. The credit lines for environmental investments are funded by the Lithuanian Environmental Investment Fund (LAAIF) and the Investment Guarantee Fund, and offers below market interest rates for environmental projects in energy efficiency, waste recycling, renewable energy, and hazardous waste management. In 2003 the bank was awarded an EU-European Bank for Reconstruction and Development (EBRD) award for 'Best performance in an established programme by a niche bank'.

Business benefits

Establishing itself as a niche market leader has helped SB to compete on a national level. According to SB management, the focus on SMEs, green investments and women entrepreneurs has improved the bank's competitiveness on a national level. Furthermore, the specialised focus has greatly facilitated access to external funds (see page 20).

Partly as a result of communicating its sustainability practices, SB has been able to build a positive image for itself. It has won a reputation for being a reliable, stable, constantly growing bank, focusing on the needs of small and medium-sized enterprises. Additionally, the bank's involvement in sustainability management has increased staff morale and all of the bank employees receive training to identify environmental risks in credit applications.

Moreover, the bank is provided with LTL 15 million from State funds to grant micro-credits to small and medium-sized enterprises with a main preference towards micro-companies that have less than 10 employees.

In the UK, the Co-operative Bank is doing innovative work investigating the link between ethical policies and the bank's overall profitability. During the reporting year 2000, 15 to 18 percent of the bank's pre-tax profits were attributed to the Co-operative Bank's brand and reputation.

"The Triple Bottom Line, does it all add up?", edited by Henriques and Richardson, 2004

3.2 Increase revenue by assisting local economic growth and poverty reduction

Stakeholders → / Benefits ↓	**D. Society / Environment**
i. Revenue growth	Boost local economic growth

SMR assists in the efficient and strategic design, implementation and monitoring of financial institutions' contribution to community development. By assisting in local economic growth and poverty reduction, financial institutions benefit from a wealthier market environment for its clients. In addition, there is a growing thought that philanthropy and socially responsible business operations are required as a "licence to operate" for business.

This section examines how SMR can assist financial institutions to increase revenue and also benefit the local community at the same time through the following activities:

Microfinance: The indirect effects of offering credit to under-served segments of the community should not be discounted. As micro entrepreneurs grow, the rest of the community is likely to become more prosperous. Overall the financial institution is expected to benefit from increased business from all sections of the community.

Using local suppliers: In addition to targeting clients within the local community, if the bank directly uses local suppliers this leads to a boost in general economic growth.

Community investment: Community investing is capital from investors that is directed to communities under-served by traditional financial services. Community investing includes providing financial services to low-income individuals, and to supply capital for small businesses and vital community services. All of these factors will boost overall community productivity and increase the customer base of the financial institution.

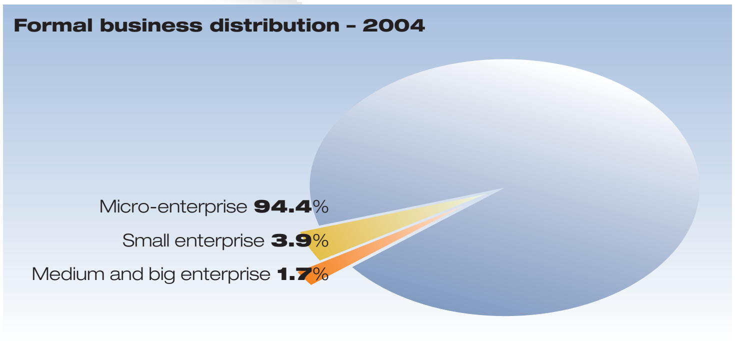
Case Study 4

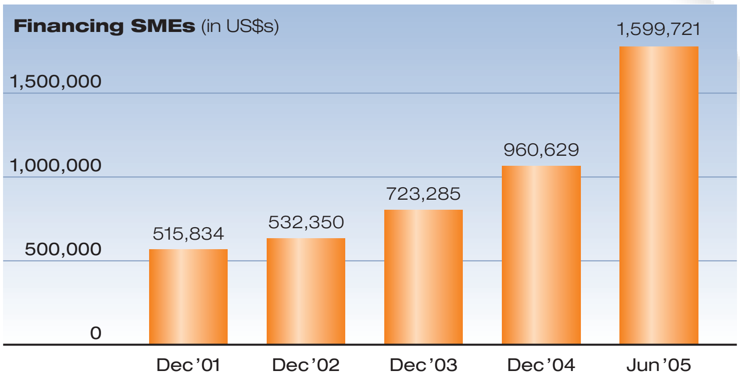
Developing New Markets in Microfinance (MIBANCO, Peru)

In many communities the poor and those in the informal economy lack access to credit. The concept of microfinance – the extension of small loans to entrepreneurs too poor to qualify for traditional collateral based loans – was initiated by the Grameen Bank in Bangladesh, and it has shown that financial institutions can service this segment of society profitably while at the same time providing considerable social benefits.

Traditionally, most micro-enterprises in Peru have operated outside the country's formal economy because of the high cost of establishing a formal business. These enterprises often do not have credit track records and their business practices and needs are very different from other private sector participants. According to SUNAT, the Peruvian Tax Administration Authority, of the 659,000 registered companies in Peru, the majority are SMEs.

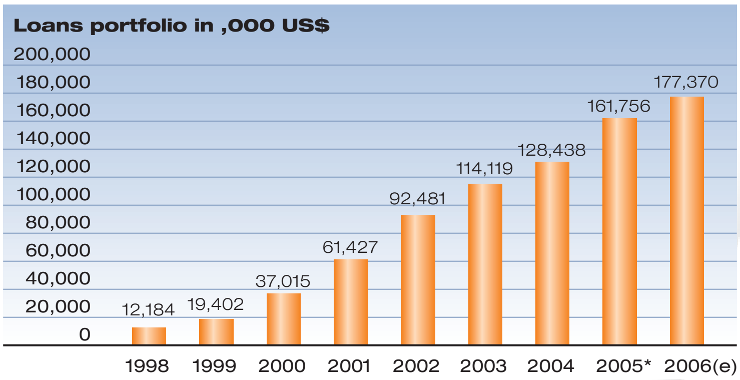
Traditional financial institutions have rarely offered products and services tailored to the needs of such SMEs. However, the Peruvian Banking and Insurance regulator, SBS, report an increasing number of institutions providing services to SMEs and micro-entrepreneurs in Peru (banks, municipal and rural savings banks, Small and medium enterprise development banks and capital providers).





The example of MIBANCO: Revenue Growth and Social Benefits

MIBANCO is a pioneer of micro-finance activities in Peru. It provides commercial banking services to the Small and Micro-Enterprise (sme) sector. It has successfully tapped into this underdeveloped market helped by a sustainability management system and specialist knowledge and experience in the microfinance sector. It serves the Peruvian society by empowering small entrepreneurs and reducing their exposure to the risks and challenges associated with an informal economy such as poverty, crime, and poor environmental quality. The evolution of its loan portfolio from 1998 to 2005 shows a continuous growth based on additional branches, new products and a reputation of credibility in the SME sector. Also, its profits show a solid growth trend between 1998 and 2005, based on the bank's particular expertise in micro finance and its sound risk management strategies.



Risk Management

Sustainability management plays an important role for MIBANCO. The bank's credit risk assessment includes sustainability criteria rarely seen in traditional microfinance credit assessments. The bank supports its clients in their business management, which includes awareness raising in environmental and social compliance (environmental licences from the municipality or other local authorities). As customers realise that sustainability management creates value for their company and helps to prevent problems with local authorities, they appreciate the training and support provided. The application of social and environmental standards has led to the rejection of some credit applications that do not meet sustainability criteria, and the bank at times foregoes the business opportunities. At the same time, it is clear that the introduction of a sustainability management system have enabled the bank's staff to attain a high level of risk assessments skills in micro finance decision making, reducing the bank's overall risk exposure. MIBANCO has the best credit performance amongst all financial institutions in Peru.

Case Study 5

High Performance with a Social Mission (Fundación Social, Colombia)

A company that operates with a corporate citizenship approach and is able to communicate its social responsibility ethic can gain in financial terms. The reputation of being a trusted partner will help to attract and retain customers as well as build positive relationships with regulators; investment in underserved segments of society will expand the company's market, and employees that identify with the company's values will generally perform better and remain longer in the company.

The example of Fundación Social

Fundación Social is the owner of an entrepreneurial group as well as a non-governmental organisation (NGO) in Colombia. It owns several financial institutions, which together rank as the 5th biggest financial group in the country, with a share of about 6 percent of the banking market. As part of its social mission, it works "to contribute to overcoming the structural causes of poverty in Colombia through the building of a more humane, prosperous and fair society". The pursuit of this mission is achieved through its entrepreneurial group and through direct social programmes with poor communities. Since its founding it has tried to 'expand' commercially viable financial services to the poor as a way to help them improve their welfare, with positive impacts over local markets.

Sustainability Management and Reporting Practices in Fundación Social

Fundación Social saw the use of a sustainability management system as almost a natural evolution linked to the culture of social responsibility in the organisation. Next to social programmes with marginalised communities, the activities of Fundación's socially responsible entrepreneurial group are seen as a principal means of fulfilling the organisation's mission of contributing to human development in Colombia. In implementing social responsibility practices throughout its companies, the development of systems to co-ordinate efforts and to target, measure and optimise social impact had to be developed, which formed the basis of Fundación's SMR.

The formal sustainability management system was established in 1992, and expands across a range of policy areas related to both clients and employees. For example, all enterprises which form part of the Fundación Social provide salaries that adequately satisfy a family's basic needs, as well as training and strategic human resource administration. Regarding its client focus, Fundación Social targets commercial activities at working-class markets, paying special attention to the number, profile, and regional distribution of these clients, in addition to the social impact of services and products. For example the provision of microfinance loans is considered a commercial activity with positive social impacts.

In terms of environmental management, the credit risk policy of the Group's bank excludes financing projects or enterprises with a significant negative environmental impact. Fundación is additionally considering to include the assessment and promotion of social and environmental responsibility among its clients as part of its corporate policy.

Benefits of Fundación Social's Social Management and Reporting

Fundación Social considers the positive bottom-line and the success of its individual companies as a benefit of the strong social management system, and as a business case for the same. To give an example, Fundación's BCSC is a local leader in financial services for micro and small companies, with a return on equity (ROE) and return on assets (ROA) above the industry average and with an outstanding reputation and client fidelity.

3.3 Improve Competitiveness against National and International Competitors

Stakeholders → / Benefits ↓	B. Internal
i. Revenue growth	Improve competitiveness

SMR provides a level of internal rigour that allows an organisation to meet the standards set by international competitors. In particular, two benefits are identified as follows:

Strengthen internal controls: Many developing and emerging economies have undergone relaxation of its financial regulation, which has led to greater competition within the finance sector. SMR strengthens internal controls for a financial institution and has the potential to make improvements in all operational areas. These productivity gains can be converted into revenue opportunities.

Improve business management: A UNEP FI survey carried out amongst development financing institutions in the Asia Pacific revealed many undertake some form of sustainability activities but few yet integrate it into a comprehensive management system. This is a lost opportunity as sustainability management enables efficient and strategic management of the organisations' sustainability activities. In addition, sustainability reporting enables effective communication of an organisation's sustainability efforts and assists in improving its stakeholder relations.

Case Study 6

Improved Competitiveness with SMR (Bulbank, Bulgaria)

The example of Bulbank

Bulbank is one of the largest banks in Bulgaria. It was established in 1964 as a 100 percent state owned bank and was privatised in 2000. It has since worked on improving overall management as well as introducing sustainability management. Unicredit Group is its majority shareholder.The bank is now in a process of merger with 2 Bulgarian banks as a result of the acquisition of HVB by UniCredit in 2005. The new combined entity will become the largest bank in Bulgaria holding more than 20 percent of the market.

Corporate governance and management systems

As part of an effort to mainstream Unicredit Group's values to all of its subsidiary banks in Central and Eastern Europe, the group has committed Bulbank's board members to improving SMR. This has created a motivation in Bulbank to follow best practice in SMR and commercial activities have been aligned with corporate social responsibility activities. As a result, Bulbank became a pre-eligible member of the UN Global Compact and follows its nine principles. The requirements to become a member include social action, visibility and reporting.

In line with best corporate practices, Bulbank is implementing strict environmental procedures and does not finance projects with adverse environmental impact. Criteria for the assessment of credit risk include compliance with environmental, industry, and safety in the workplace regulation, and the analysis of specific risk factors correlated to environmental risks. The bank provides finance to companies that upgrade their environmental performance in order to meet EU standards, while it excludes any project or company linked to arms production or trade.

Bulbank reports widely on the sustainability aspects of its management. There is no separate CSR report but some of the issues are included in the bank's annual report. It regularly seeks contact with the media and the general audience through press conferences and publications on its company web site. External communications focus on investments towards local communities, environmental efforts and anti-money laundering practices.

Business benefits

Following strict procedures for environmental compliance and anti money laundering procedures, Bulbank has been able to reduce credit risk. This represents an additional driver to further invest into staff training related to this issue. The bank is developing staff capacities through training, including covering MBA expenses for future top management members. The opportunities for education and the possibilities to participate in social activities increase staff morale and staff loyalty to the bank. Returned MBA graduates are better able to improve the bank's management.

The bank was able to attract European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB) resources, some of which are invested in major environmental projects. It has increased its revenue and profit through the management of these funds. And while its business success cannot be attributed to its improved sustainability management alone, it is an indication that the two will often go hand in hand.

Importance of making specific resources responsible for the company's sustainability programme

Support from the board and senior management has been identified as the most important condition for the successful introduction of SMR. Their support must be transparent and tangible, and must demonstrate a willingness to adopt SMR with a long-term commitment to the programme. SMR must not be seen as another passing management fad. Key resources need to be assigned to the programme and significant awareness must be created and maintained. This includes consistent and continued commitment to both financial and human resource support.

Examples of Board Commitment to SMR

Fundación Social

The implementation of Fundación Social's SMR system was based on long-term commitment from the board and senior management to build, maintain and improve on such a system. This also ensured the necessary financial commitment to support the process. The responsibilities for SMR follow the responsibility structure of the regular business lines. That is, the guidelines are set by the Corporate Vice-President, and are approved by the President and Boards, and the logistics and development of SMR are supported by the Planning Department.

Suleasing

Started in 1999, the company's SMR was initiated in response to International Finance Corporation (IFC) and Andean Development Corporation (CAF) shareholder requirements. It opened the company up to new lines of credit with the IFC and the Interamerican Investment Corporation (IIC). Additionally, the then President of Suleasing, Francisco Gómez, required clients to operate according to those aspects of Colombia's environmental and social regulation that went beyond IFC and CAF requirements. Continuous support from the three board members (IFC, CAF, and the President) regarding the company's new environmental and social policy was essential in making SMR an integral part of its business strategy.

Bank Ochrony Srodowiska S.A.

BOS received full commitment from the Board towards SMR as environmental protection is in line with the bank's mission. This commitment is reflected in the staff composition. There is one Vice-Director who is involved principally in the environmental protection operations. Similarly, up to 50 percent of the Executive Director's time is spent on environmental protection activities. The bank also has a position of the Chief Ecologist who works full time on environmental protection and cooperation with municipalities. As at 2004, there were 60 environmental specialists working for the Bank.

4 Improve Risk Management through SMR

Increasingly stringent environmental regulation and public awareness, especially from NGOs, can represent real bottom-line risks for financial institutions. For example, environmental opposition can increase project completion risk, major fines can impair a borrower's ability to repay and foreclosure on contaminated property can create a risk of lender liability.

A sustainability management system assists an organisation in the management of these new risks as listed below.
1. Management of and reduction in environmental credit risks in lending
2. Managing reputational risks
3. Improving compliance and transparency

This section looks into each of the above points in more detail and with case studies.

4.1 Manage and Reduce Environmental Lending/Credit Risk through Sustainability Management

Stakeholders → / Benefits ↓	**C. Clients and Shareholders**
ii. Risk management	Manage environmental risk

A sustainability management system forms the basis for integrated environmental credit risk management. Sustainability issues are increasingly regarded as part of a financial organisation's risk management because of the direct and indirect environmental risks that can arise in the institution's lending activities.

Direct Risk

The direct credit risk is the risk of a financier becoming legally responsible to pay for the clean-up of the environment (eg. land, water etc) which has been contaminated by a customer. The clean-up cost is not only costly to the organisation but history tells us that the value of the underlying real estate never recovers thus reducing the ability to sell and recoup the losses.

In Colombia, the environmental ministry held a bank responsible for cleanup after the bank received a site from the National Federation of Cotton Growers in payment of a loan. The property was contaminated with agrochemicals. Under an agreement with the ministry, the bank committed to clean up onsite contamination and monitor the remedy for 20 years. The ministry also ordered the bank to suspend financing for housing near the site.

Gracer: "Green risks on the rise", LatinFinance September 2000

Indirect Risk

Clients who run into environmental problems may have a reduced capacity to repay loans. Unexpected payments for fines or cleanup costs serves to increase credit risk within the bank's portfolio. Avoiding lending to such clients and/or contributing to improve their behaviour are the simplest ways to minimise risk.

The environmental authorities of the department of Cundinamaraca in Colombia shut down 59 tanneries along the Río Bogotá in January 2005, because of non-compliance with a norm issued by the authorities in 2004. Tanneries use a number of toxic substances in their production process and the wastewater discharged into the river includes chrome and sulphur, both of which can have serious effects on human and ecosystem health.

Of the 59 tanneries, 13 were completely shut down because they were located in the 30 meter protected zone along the river and did not comply with the environmental norm. The other 46 were closed temporarily, until the presentation of an acceptable environmental management plan, or the relocation of any installation within the 30 meter protected zone. The environmental authorities propose to close a total of 194 tanneries in the department, as none of them, according to the authorities, comply with the required environmental standards.

El Tiempo, January 2005

The above examples clearly demonstrate that the bank needs to know its customer and the way it transacts its business, the underlying rules of the country and the attitude of the authorities in dealing with those who do not follow the rules – this is basic banking but because it has an environmental or social "tag" to it is seen as having a mystique. Implementing SMR and working with clients to help them comply with increasingly demanding legislation is the simplest way to avoid issues arising in the future.

Case Study 7

Building Trust through SMR (Suleasing Internacional S.A., Colombia)

Implementing improved risk management procedures for evaluating client projects can offer multiple financial gains. As Suleasing International has demonstrated, its risk management policy has helped to reduce the risk of client default, opened the bank to new credit lines, and brought in increased business through the reputation of a trusted business partner.

The example of Suleasing

Suleasing International S.A. was founded in 1993, specializing in financial cross-border leasing to companies in Central America, the Caribbean, the Andean Region and Brazil. The company's principal products are standard and structured leasing.

Manage and reduce credit risk through sustainability management

Integrated in the credit risk department, Suleasing's sustainability management system (SMS) extends across all products. The process is based on the IFC exclusion list and divides projects into categories of type A, B, or C according to the project's environmental impact. In obtaining approval, certain projects must undergo site visits by Suleasing staff, and all projects must take into account local and/or national environmental legislation. As a testament to its risk analysis, its client default rate is 0 percent, compared to that of 1 percent before SMS adoption, and only two cases of environmental infringement have been recorded according to subsequent monitoring of client operations.

Boost corporate reputation through SMR

In implementing sustainability management practices, the main benefit to Suleasing has been to its overall reputation and brand value. With an SMS in place, the company has been able to better access credit lines from international and regional financial institutions and Export Credit Agencies. By having an already implemented SMS, it makes a smoother 'entry' with these institutions and provides an easier due diligence process. Additionally, the integration of an SMS has made the firm more competitive by contributing to a more integrated risk management approach. In their experience a positive correlation exists between competitiveness and good environmental and social practices. Approving loans and leases for companies that demonstrate inadequate environmental safeguards represents not only a financial risk, but also a potential to damage the company's reputation which may limit their access to financing from multilateral financial institutions.

Reduce compliance failures and build trust through SMR

Furthermore, Suleasing has found that stringent social and environmental safeguards can attract business. Helping clients to strengthen the integration of sustainability considerations into their operations makes the client feel that the company is equally vested in the project's success. When problems arise, the company invests considerable time and energy to engage with the client, as well as external consultants, to support the development of a mitigation plan, the fulfilment of which is also monitored. Based on Suleasing's successful example, other Andean banks have sought the company's advice on SMS and staff training. Suleasing's guidance and support in handling bureaucratic compliance processes, and in assisting clients to correct infringements, are factors that bind clients to the company.

"There is a definite correlation between companies that have serious social and environmental (S&E) problems and those that present financial problems or lack of transparency. The bank discovered tangible credit risk issues in addition to reputational risk issues."

Christopher Wells, ABN AMRO Real Brazil SRI manager,
commenting after completion of an SRI screening initiative.

Case Study 8

Adopting the Equator Principles (Unibanco SA, Brazil)

The Equator Principles

Many banks have internal policies and procedures covering the recognition of environmental and social risk in lending. To address the compound significant risks often encountered by financiers of large ticket projects in emerging markets, a number of leading private sector banks set out in 2002 to develop and agree to a framework eventually named The Equator Principles. Launched in June 2003 and revised in July 2006 following IFC's revision of standards upon which they are based, the Equator Principles "are intended to serve as a common baseline and framework for the implementation by each Equator Principles Financial Institution [EPFI] of its own internal social and environmental policies, procedures and standards related to its project financing activities."

While most private sector banks rooted in emerging markets are not engaged in large scale transactions that the Equator Principles were initially designed to capture, the Principles nevertheless may serve as a sound reference for all banks on assessment, structuring and supervision in a similar fashion as the Global Reporting Initiative's guidelines can serve as a point of departure on sustainability reporting. The revised Principles offer process, elements, and standards. And for banks or funds engaged in financing of infrastructure, extractive industries, or development projects, the Principles can serve as a foundation for risk management and sustainability leadership.

To date, Brazil is the only emerging market to have domestically rooted banks adopt the Equator Principles. Unibanco adopted the Equator Principles in June 2004 and was followed shortly thereafter by Banco Bradesco, Banco Itau, Itau BBA, and later state-owned Banco do Brasil.

Benefits

Apart from what some Equator banks perceive as an improved and more comprehensive risk management process, additional benefits of the Principles' adoption include access to funding, improved reputation and the ability to attract skilled and motivated employees. For example, a recent brand study showed that in the first three months since the adoption of the Equator Principles, Unibanco's brand recognition as a socially responsible bank improved seven fold.

Contrary to its initial analysis, the integration of additional and more demanding criteria for assessing projects, which went beyond those of competitors, did not result in a loss of competitiveness or client demand. Instead, new demand has been created by clients whose project needs are addressed by the bank's social and environmental considerations.

Preamble to the Equator Principles

Project financing plays an important role in financing development throughout the world. In providing financing, particularly in emerging markets, project financiers often encounter environmental and social policy issues. We recognize that our role as financiers affords us significant opportunities to promote responsible environmental stewardship and socially responsible development.

In adopting these principles, we undertake to review carefully all proposals for which our customers request project financing. We will not provide loans directly to projects where the borrower will not or is unable to comply with our environmental and social policies and processes.

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

4.2 Manage Corporate Reputation Risk through SMR

Stakeholders → / Benefits ↓	D. Society / Environment
ii. Risk management	Manage reputational risk

One key benefit of SMR implementation can be the protection of the reputation and operations of the firm. SMR helps to maintain existing reputation by helping to make the right decisions.

Case Study 9

Earning the Reputation of a Good Corporate Citizen (Nedbank Group, South Africa)

Transparency, stakeholder engagement and an open ear for criticism help companies establish the reputation of being serious about their responsibility towards communities and the environment. A company that is getting these principles right will more easily earn the rank of an accountable corporate citizen in the eyes of customers, investors and regulators.

Nedbank Group, South Africa

Nedbank Group Limited is one of the four largest banking groups in South Africa. The group offers a wide range of banking services, the principal ones being corporate and retail banking, property finance, investment banking, private banking, and foreign exchange and securities trading. Nedbank also operates in a number of other Sub-Saharan jurisdictions, and the United Kingdom.

Nedbank's Aspirations in Corporate Responsibility

The Nedbank Group's vision is to become Southern Africa's most highly rated and respected bank by staff, clients, shareholders, regulators and communities. Sustainability, good governance, transparency and comprehensive reporting are integral to its strategy for building credibility with investors and analysts.

Creating Management Oversight Structures

The responsibility for SMR was assigned to the Enterprise Governance Division, where dedicated employees were appointed for this purpose. Furthermore a Group Transformation and Sustainability Board Committee was constituted, and at management level a Group Corporate Citizenship Committee was established.

Sustainability Management and Reporting

While Nedbank has had a comprehensive sustainability management system in place since 2003, this case study focuses on Nedbank's sustainability reporting and the related stakeholder process.

The bank has produced comprehensive sustainability reports since the 2003 financial year. Since 2004, the report uses the GRI standards as the guiding principles together with sector specific guidance – the SPI social indicators for the finance sector and the UNEP/GRI environmental reporting indicators.

It goes to great lengths to achieve the highest possible credibility of its sustainability report among stakeholders: The report goes through a thorough stakeholder feedback process, including three stakeholder meetings across South Africa. Furthermore the report is subjected to a full audit by internal auditors and is also independently assessed by an academic institution, (UNISA's Centre for Corporate Citizenship), and a non-profit organisation, World Wildlife Foundation SA (WWF-SA).

Business Benefits

Putting the systems in place to undertake sustainability reporting has assisted tremendously with the level of management information available, as well as sensitising both management and employees to the issues involved in sustainability. It has assisted the bank in improving its transparency in reporting, thereby improving its reputation amongst analysts and media, and strengthening the brand. Additional business benefits include the development of new products and services; improved risk management; building trust with regulators; cost savings and efficiency; improving human resource management and staff morale; and building positive relationships with customers, suppliers, NGOs and local communities.

Recognition

Nedbank believes that it is thanks to these efforts to achieve the highest standards in good governance, transparency and comprehensive reporting that the Group has been awarded numerous credentials which establish it as a CSR leader in the Southern African region for example:

- Member of the Dow Jones World Sustainability Indices and is ranked in the top 20 percent of the Johannesburg Securities Exchange SRI index.
- Chosen the "Emerging Markets Corporate Social Responsibility Bank of the Year" at the 2005 Banker Awards in London.
- Ernst & Young award for second place in the 2005 Excellence in Sustainability Reporting Survey awards in South Africa.

Engaging all stakeholders

By understanding the perspectives of all stakeholders, business is likely to be better positioned to minimise risk. Transparency and community engagement allow a corporation to manage environmental and social expectations and therefore reduce the chance of adverse surprises.

"Corporate leaders recognise that it's not just the economy that's globalised -- information and civil society are globalised, too. Companies need to protect their brands, and their global right to operate"

Jonathan Lash, President of the World Resources Institute
"Corporate Green", Washington Post, 11 May 2005

Shareholder and NGO activism

There have been a number of recent cases where financial institutions have been targeted by activists with regard to their lending policies. This trend is only likely to continue leading many financial institutions to implement policies to manage such risks more effectively.

Increasing pressure on financial institutions

Since 2000, Rainforest Action Network, a US based NGO, has been running the Global Finance Campaign urging financial institutions to recognise environmental and social responsibility in their lending. Through this campaign, the three largest private banks in USA, Citigroup, Bank of America and JP Morgan Chase have adopted comprehensive environmental policies including signing the UNEP FI Statements. Recently, Goldman Sachs became the first investment bank to adopt environmental policies.

Source: http://ran.org/what_we_do/global_finance

4.3 Manage Regulatory Compliance Developments in Corporate Governance

Stakeholders → **B. Internal**

Benefits ↓ **ii. Risk management** — Governance — improve compliance and transparency

Stakeholders → **D. Society / Environment**

Benefits ↓ **iii. Access to capital** — Meet stock exchange listing requirements

In 10 years time, Kenya might only have half the number of banks, largely as a result of improved governance mechanisms. The surviving banks will be those that manage to implement sound governance procedures.

John Wanyela, Executive Director, Kenya Bankers Association
"CEO briefing: Sustainability Banking in Africa", UNEP Finance Initiative

Internationally, corporate governance requirements are increasing with the advent of regulations such as Basel II, and the Sarbanes-Oxley Act. In addition, disclosure and reporting regulations such as the International Accounting Standards (IAS) 39 has placed an increasing burden on companies to disclose ‘material’ business related issues. The management and reporting of material environmental and social risks for financial institutions are therefore increasingly becoming compulsory.

Stock Exchange Listing Requirements on Corporate Governance in Emerging Markets

International developments in corporate governance are also changing stock exchange listing requirements or legally mandated disclosures around the world. Further, there are many more recommendations and best practice codes that are not legally binding but increasingly relevant. These developments are leading to the tightening and convergence towards international standards. Examples of stock exchanges in emerging markets with corporate governance listing requirements and mandatory disclosures are introduced below.

Code of Corporate Governance for Listed Companies in China

China Securities Regulatory Commission requires all listed companies in the People’s Republic of China to embody the code when it formulates or amends their articles of association or rules of governance.

Source: www.csrc.gov.cn

Malaysian Code on Corporate Governance

Bursa Malaysia (Kuala Lumpur Stock Exchange) uses the code as a listing requirement. The Code requires listed companies to produces a narrative statement in their annual report as to whether the company has applied the principles of the Code and a statement on the extent of compliance specifically identify and give reasons for any areas of non-compliance, if any.

Source: www.klse.com.my/website/listing/pn20019.htm

“From a global perspective, corporate governance is now even seen as contributing to systemic stability in the capital markets, providing a form of early warning mechanism”

Dato' Mohd Azlan Hashim, Executive Chairman of Kuala Lumpur Stock Exchange (KLSE)

29 October 2002 (www.klse.com.my/website/mediacentre/mr/2002/20021029a.htm)

Pakistani Code of Corporate Governance

The Securities and Exchange Commission of Pakistan directs all stock exchanges to insert the code in their respective listing regulations. It requires listed companies to publish and circulate a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance code.

Source: www.secp.gov.pk/news/code_corporate(revised).htm

Johannesburg Securities Exchange (JSE)

Uses the code of corporate practices and conduct (based on the “King Report on Corporate Governance”) as a listing requirement. It requires listed companies to deal, in their annual report, with governance structures, internal control, committees (audit, remuneration, group management, risk management, compliance, and others where applicable) and requires companies to tell stakeholders where the Code is not being followed.

Source: www.jse.co.za

5 Access to Capital

Improved risk management and disclosure has been shown to provide better access to capital and hence reduce the cost of capital. Through SMR, financial institutions are able to provide confidence to investors that sustainability risks are managed and appropriate governance structures are in place.

SMR assists an organisation in improving access to capital in the following ways:
1. Improving access to both public and private capital
2. Assisting the organisation in meeting its stock exchange listing requirements

Point 2 has already been covered in Section 4.3 above. Hence this section looks into Point 1 in more detail and with case studies

Stakeholders → / Benefits ↓	**C. Clients and Shareholders**
iii. Access to capital	Improve access to finance

"Companies that can manage their environmental risks better ... can position themselves as leaders in the market and in terms of gaining access to capital ...If you are a good performer, you want to know how you will be rewarded for that. If you are managing your risks better, then you should get access to financing that guys who aren't managing their risks can't ... But in very short order, those banks [using the Equator Principles] started seeing a competitive advantage. They could attract good risk businesses by managing these issues better and now some of the leading Equator banks are using environmental and social corporate governance factors to assess their clients and asking whether they want to be the banker for this company and how it needs to improve"

Rachel Kyte, Environmental and Social Director of the IFC, Financial Times, 21 March 2005

5.1 Improved Access to Public Capital

Investments of public funds made by multilateral institutions, bilateral donors and other public development agencies are often channelled through financial intermediaries. However many public financing institutions have in place environment funding policies which require them to conduct stringent environmental due diligence on the intermediary institution. Typically, public financiers assess existing environmental policies and procedures, sustainability risks of operations and portfolios and capacity to respond to the financier's environmental requirements. SMR enables the potential financial intermediary to respond to these requirements of the public financing institutions and so offers a competitive advantage against others seeking public finance.

Case Study 10

Attracting Niche Market Investments (Siauliu Bankas, Lithuania)

For background on Siauliu Bankas (SB), see page 7.

Access to specialised multilateral funds

SB has attracted investment from several multilateral institutions to operate specialised credit lines. For the bank's focus on female entrepreneurs, investment has come from the EBRD and the Nordic Investment Bank. For SME development, investment is from the Council of Europe Development Bank and the World Bank. Access to this kind of capital has been much easier because of the bank's environmental and social credentials.

SB also has credit lines with the Lithuanian Environmental Investment Fund (LAAIF) and the Investment Guarantee Fund to support environmental investments. Both funds have been providing below market interest rates for environmental projects in energy efficiency, waste recycling, renewable energy, and hazardous waste management as of July 2004.

Business benefits

Following successful cooperation with the EBRD, the latter has decided to become a shareholder in SB and now holds just over 16 percent of SB's capital shares. Because of SB's reputation and standing, it has also been included in a special committee in the Lithuanian Ministry of Economy to promote SMEs. Due to its excellent track record on work with SMEs and with the accession of Lithuania to the European Union, SB hopes to be involved in the management of some of the EU SME development funds.

Case Study 11

Joint Operations with Foreign Partners (Microinvest SA, Brazil)

According to the data from the Central Bank of Brazil, the microcredit industry has the potential to influence over 14 million small businesses. Currently 171 institutions (principally NGOs) are reaching a mere 300,000 clients with loans. Unibanco, a bank with a functioning SMR in place has been successful in attracting a foreign partner to enter into this untapped market together.

Unibanco operates in this segment through Microinvest, a pioneer in the offer of financing to low-income entrepreneurs. Created in October 2003 through a joint-venture between Unibanco and the International Finance Corporation (IF, Microinvest has since funded over 1,800 credit operations, for R$3.7 million (approx. US$1.8 million).

5.2 Improve Access to Private Finance

"Investors will not purchase securities if they lack confidence in the reliability of the information they receive concerning those securities. Markets will not attach attractive values to listed companies in the absence of a climate of trust."

Robert Monks, founder of Institutional Shareholder Services and LENS investment fund letter to Harvard University, 2 October 2003 (www.ragm.com)

"Credibility and high governance standards are essential factors in a company's efforts to attract and retain investors in global capital markets."

Leo C. O'Neill, President of Standard & Poor's, 15 October 2002

Both price and volume of available capital can be impacted by the implementation of SMR.

Price of capital

The cost of capital is closely related to the risk perception of a company. SMR and strong corporate governance can assist in assuring investors of the quality of management of the company. This can lead to greater equity valuation for the company and relatively predictable returns for the financier. As a result, SMR forms an important part of cheaper access to capital from both debt and equity markets.

Volume of capital in socially responsible investment (SRI)

According to a 2003 research, only 0.1 percent (or $2.7 billion), of the global SRI is held in emerging markets (of which, about $1.5 billion held by developed-country investors and about $1.2 billion by emerging-market investors) . However there is great potential demand for SRI in emerging markets from both external and internal investors. For example, among U.S. social investors it has been suggested there could be as much as $4.5 billion demand in high-risk emerging-market investment. One of the popular SRI portfolio selection strategies is "positive screening". Positive screening shows preference towards sustainable companies. And as above, SMR is an effective management and reporting system that ensures the company maintains environmental, social or community leadership. This therefore means the financial institution with an effective SMR is more likely to receive a higher rating or screening from an SRI fund.

The First SRI Fund in Emerging Markets – ABN AMRO Fundo Ethical

ABN AMRO Asset Management in Brazil pioneered the first emerging market SRI equity fund in 2001. The ABN AMRO Fundo Ethical now has in excess of US$ 35 million in net assets. The fund invests in listed shares of Brazilian companies that have a leadership position in their sector in terms of the integration of sustainability into their business strategies, applying both negative and positive screening. Positive screening includes assessing the policies and practices of social, environmental and corporate governance activities of each eligible company. The fund has displayed a solid performance since its inception in November 2001, posting a return of 174.6 percent in US dollars until June 2005, while its benchmark – the Bovespa Index – yielded 128.2 percent in the same period. The fund was awarded best performing SRI fund since inception out of 221 SRI funds tracked by Bloomberg. According to Bloomberg, these figures put the fund as the best performing SRI equity fund in US dollars terms in 2003, 2004, and since their inception, out of a total of 210 funds tracked by the system worldwide.

SRI indexes

In order to help SRI fund managers select the companies that make up their investment portfolios, some stock indexes include sustainability criteria in their selection process. These are called sustainability indexes and include the Dow Jones Sustainability Indexes, FTSE4GOOD and Ethibel Sustainability Index. The Johannesburg Stock Exchange's (JSE) Socially Responsible Investment Index, which was launched in May 2004, is the first of its kind in an emerging market. The São Paulo Stock Exchange (BOVESPA) in Brazil followed suit and launched Bovespa Corporate Sustainability Index (Índice de Sustentabilidade Empresarial – ISE), which was developed by Fundação Getulio Vargas Centro de Estudos em Sustentabilidade, in December 2005. The index tracks the economic, financial, corporate governance, environmental and social performance of leading companies listed in the São Paulo Stock Exchange.

Dow Jones Sustainability Indexes

Launched in 1999, the Dow Jones Sustainability Indexes (DJSI) are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide. The Dow Jones Sustainability World Indexes (DJSI World), which is a group of indexes in the DJSI family, consist of more than 300 companies from 58 sectors in 24 countries. The total market capitalisation of DJSI World was USD 7.8 trillion as at August 2005.

Source: DJSI website (www.sustainability-indexes.com)

Case Study 12

Inclusion in the Dow Jones Sustainability World Index (Banco Itaú Holding Financeira, Brazil)

Banco Itaú Holding Financeira S.A. ("Itaú") operates as a universal bank and oversees the activities of Banco Itaú, which services private individuals and companies, and Banco Itaú-BBA which specialises in large corporate clients. The risk control, audit and treasury areas of these banks are strategically coordinated. It is the largest Brazilian and Latin American financial institution in terms of market value and the second largest private bank in Brazil. Its shares are traded on the São Paulo, Buenos Aires and New York stock exchanges.

Inclusion in the Dow Jones Sustainability Index

At Itaú, systematic sustainability management was triggered by the bank's involvement in the Dow Jones Sustainability Index (DJSI). In 1999, at the invitation of DJSI, the bank participated in a sustainability questionnaire. The exercise showed that it already had a number of 'sustainability practices' in place and that the collection and systematisation of those activities would give the bank an advantage in this new market.

Itaú has been a part of the DJSI World for the sixth consecutive year and continues to be the only Latin American bank to be included on the list. Being part of the Dow Jones has provided the bank with a strategic sustainability orientation as well as suggestions for best practice, which have guided the bank's efforts in improving sustainability performance. Resulting initiatives have included the creation of an environmental commission within the bank, the signing up to the Equator Principles for Project Finance, and the launch of a comprehensive internal regulation covering environmental assessment of middle market companies (companies with annual sales ranging from R$ 10 million to R$ 100 million). In addition, the participation in the Dow Jones has led to a reformulation of the bank's Ethics Code, following international codes such as the Global Compact, the UN Declaration of Human Rights and others. The new text, which is being consolidated internally with the involvement of all areas, is key to the sustainability-driven long-term strategy of the bank.

Sustainability Management and Reporting

Itaú does not have a centralised management system for its sustainability strategy. Instead, it operates through a committee system (composed of senior executives) responsible for discussing and then deciding on appropriate policies and implementation. The company's main sustainable practices can be divided into three major aspects: corporate governance, project finance and corporate philanthropy. As to the former, the activities are guided by a commitment to the global best corporate governance practices. The bank meets the Bovespa's (São Paulo Stock Exchange) level I Corporate Governance listing requirements regarding transparency and respect for minority shareholders. It is also listed on the New York Stock Exchange's Level II American Depositary Receipts (ADRs), which requires compliance with NYSE and SEC requirements regarding disclosure of financial statements under US GAAP format, as well as the Sarbanes-Oxley Act.

Itaú believes that its comprehensive approach to sustainability, driven by the inclusion in the Dow Jones Index, has enabled the bank to strengthen its competitive edge, based on best sustainability practice. This is reflected in the bank's consistent receipt of corporate governance awards in recent years. For example in 2005, the bank was awarded the IR Magazine Brazil Award for Best Corporate Governance which surveyed over 600 Brazilian analysts, asset managers and investors.

Responsible investment as mainstream practice

Facilitated by UNEP Finance Initiative and the Global Compact, the UN together with major institutional investors around the world have developed a set of Principles for Responsible Investment that define best-practice responsible investment. Indeed, socially responsible investment and sustainability practices and strategies are increasingly brought into mainstream asset management practices. A 2006 survey found that 13 percent of investment managers expected increased client demand for the integration of environment, social and corporate governance (ESG) analysis into mainstream investment processes in the coming year, and rising to 38 percent over the next three years. This follows a previous survey in 2005 in which almost three-quarters (seventy three percent) of the managers surveyed predicted that ESG performance indicators would become mainstream investment considerations within ten years.

Access to other financial sources

i) **Access to special segment of the stock exchange**

The São Paulo Stock Exchange (BOVESPA), Brazil, have introduced the Novo Mercado, a listing segment designed for the trading of shares issued by companies that voluntarily undertake to abide by corporate governance practices and disclosure requirements in addition to those already requested by the Brazilian legislation. Other stock exchanges in developing and emerging economies may follow suit in order to raise corporate governance standards voluntarily. Companies that undertake SMR, with good governance will have additional access to capital through such special segments of the stock exchange.

ii) **Corporate governance ratings**

Corporate governance is fast becoming part of the criteria for corporate ratings. For example, Fitch Ratings evaluates the quality of corporate governance in its credit ratings process whilst Standard & Poor's provides company ratings just on corporate governance. These developments show how corporate governance evaluations are a tool for today's creditors and investors, and so provide another competitive advantage to companies that undertake SMR with good governance.

iii) **Microfinance institution credit ratings**

There are agencies that provide credit ratings of microfinance institutions. Good ratings provide better access for microfinance institutions to loan funds or equity investments from commercial banks, development banks or other types of apex financial institutions. Donors use rating information not only as a lending or investment decision tool but also to benchmark microfinance institutions. An example of an institution that specialises in specialises in rating microfinance institutions is Micro Credit Ratings International Ltd (M-CRIL) based in India.

Case Study 13

Attracting Private Capital with SMR (MIBANCO, Peru)

MIBANCO shares are listed on the Peruvian stock exchange. Its shareholders are international and over 25 percent are financial institutions focused on microfinance (Action International, the Dutch NGO HIVOS and Triodos Bank).

MIBANCO's capital providers (shareholders, business partners, creditors) requested a general environmental management system (EMS). The EMS was critical in having access to new capital providers such as the IFC (US$ 5 million) and FMO, the Netherlands Development Finance Company (US$ 5 million), as well as shareholders such as Triodos, HIVOS and CAF.

6 Make Cost Savings and Efficiency Improvements through SMR

Introduction of SMR provides internal benefits for both the environment and social development of suppliers, employees, customers, local communities, etc. While an SMR system cannot be 'plugged' into an organisation and will often represent a fundamental shift in how all facets of the organisation operate, if installed systematically and consequently embraced across all company divisions it should lead to a better managed organisation. Analysis of a series of questionnaires and interviews conducted by UNEP Finance Initiative shows that involvement of the board, senior management and employees in deciding to implement SMR is critical.

Sustainability management system assists an organisation in making cost savings and efficiency improvements as listed below.
1. Through suppliers
2. Through operational management
3. Through relationships with clients and shareholders

This section looks into each of the above points in more detail and with case studies

6.1 Cost Savings and Efficiency through Building Better Relationships with Suppliers

Stakeholders → / Benefits ↓	A. Suppliers
iv. Cost savings & efficiency	Building better relationships

SMR forces transparency of operations that can make links with suppliers more effective. Firstly, sustainable procurement creates effective demand for sustainable products which will reduce price and increase the product range. In addition, supply chain efficiencies can also reduce waste and lead-time, both of which influence cost. It allows flexibility as well as the possibility that the supplier can make cost saving suggestions.

6.2 Make Savings on Costs through Operational Management

Stakeholders → / Benefits ↓	B. Internal	
iv. Cost savings & efficiency	Reduce energy, paper, waste etc.	Motivated workforce

A critical part of successful SMR implementation is commitment from employees. A variety of steps must be undertaken for this to occur.

1) Internal communication
   - Generate firm-wide awareness of the programme
2) Balance human resource requirements
   - Train existing staff. Utilise existing skills and commit appropriate time and resources to developing and upgrading skills.
   - Recruit new staff. Identify skill gaps and target qualified personnel.
   - Outsource the parts of the programme where skill gaps still exist.
3) Employee participation

Training Initiatives related to SMR

Suleasing

Suleasing's SMR began modestly. Initially, a consultant advised the company on the nuances of Colombia's social and environmental legislation to better evaluate client risk, and staff were trained using IFC and World Bank guidelines. The training was first limited to the risk department and was later extended to the commercial force. Incorporating the latter ensured that staff could effectively communicate to clients environmental impacts as part of the risk management process.

Fundación Social

Fundación implemented its SMR system without external support. Formally no staff had to be re-trained, as the issue of social responsibility has a strong tradition in the organisation. However, the organisation undertakes permanent capacity building in order to keep staff informed of new developments related to indicators and SMR – especially since the concept has gained such prominence, both nationally and internationally.

Itaú

According to Itaú's Investor Relations manager, internal culture is the most difficult factor for the implementation of sustainable policies. "We have to prove to our staff why the implementation of a sustainability project is important to the bank now, which requires a lot of discussions…." The Investor Relations manager believes that one of the most important factors for driving sustainable results within a financial institution is to improve compliance and controls (measurement), which means identification and clear definition of the risks and implementation of controls and management systems.

Environmental cost savings through SMR

The direct environmental impact of the financial services sector may be small relative to other industries but environmental assessment by financial institutions often reveal surprising room for cost savings and efficiency improvements. Improved operational management can lead to 'eco-efficiencies' such as reductions in energy, fuel, paper, water and waste costs for the financial institution. An environmental audit is a useful first step for identifying potential sources of cost saving.

Case Study 14

Cost Savings through Reductions in Social and Environmental Impact (Bulbank, Bulgaria)

For background on Bulbank, see page 11

Bulbank has several internal policies targeted at reducing its environmental impact. The bank has recorded related cost savings on travel and paper. For the latter, a new information system has been developed which significantly decreases the amount of paper used by switching to double-sided printing throughout the bank, using recycled paper forms and having shredded paper recycled.

Building & maintaining a motivated workforce through SMR

The ethics and values associated with SMR can lead to increased productivity and morale. Outcomes such as lower turnover and absenteeism reduce operating costs.

Environmental Cost-saving Examples from Global Members of UNEP FI

Westpac Banking Corporation, Australia

Their energy conservation program reduced the electricity bill of the company by A$4.04 million within two years, recouping the A$ 2.9 million investment in the programme. The programme revolved around simple, good housekeeping measures: such as switching off unused lights and computers, setting appropriate room temperatures and centralising electricity payment procedures. In addition to the economic benefit, the environmental benefit was the reduction in greenhouse gas emissions measuring 23,000 tonnes per year.

(Source: The Department of the Environment and Heritage, Australian Government)

Deutsche Bank, Germany

Between 2001 and 2004 a broad range of measures helped to push Deutsche Bank's energy consumption in Germany down by about 16 percent (80.5 million kwh). This is equivalent to the annual energy consumption of about 17,350 four-person households in Germany.

During the same time Deutsche Bank reduced water consumption by about 20 percent (166,650 m^2).

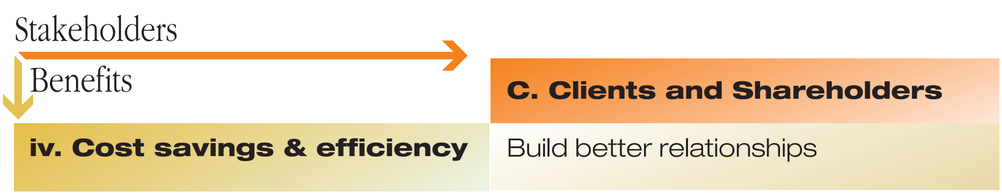
Paper consumption was slashed by 535 tons between 2001 and 2004. As a result, 642 tons of wood, 6,000 m^2 of water and more than 3 million kwh of energy were saved. Reducing paper consumption by one sheet per employee a day means that more than 500 trees will not be cut down.

In 2004, 95,898,212 km were travelled for business purposes. This is a reduction by about 336,000 km from 2001.

More information about DB's sustainability, visit www.umwelt.deutsche-bank.de/en

6.3 Make Savings on Costs through Relationships with Clients and Shareholders

According to the Millennium Poll on Corporate Social Responsibility conducted in 1999, the majority of 25,000 people interviewed in 23 countries want companies to contribute to society beyond making a profit.



Source: The Millennium Poll on Corporate Social Responsibility
(www.iblf.org/csr/csrwebassist.nsf/content/f1d2a3b4c5a6.html)

Although SMR emphasises the importance of communication, publication of statements, brochures, reports and other materials to clients and shareholders can be expensive. Cost reductions and environmental improvements can be simultaneously driven by changes such as encouraging internet banking and switching from glossy brochures to electronic reports.

Case Study 15

Training Signals Staff Value and Solidifies Programs (Exim Bank, Tanzania)

Exim Bank (Tanzania) Limited is a privately owned, mid-cap commercial bank specialising in pre-export crop financing as well as trade and financial services to small and medium enterprises. The bank has benefited from technical assistance provided by external partners and conducts ongoing internal training programmes. Exim believes its competitive edge and successful move toward sustainability is due in part to its dedication to training employees at all levels.

The Local Context

Tanzania is among the poorest countries in the world. A relatively saturated urban market of financial services has caused a strategic shift of financial services to rural centers with banks opening branches in rural or semi-urban centers. With increased competition, banks have been compelled to improve services and pricing, have been driven towards standardisation of procedures, and have become more accountable and transparent to the global market.

Training and Achievement

In 2003, Exim Bank received financing from IFC and PROPARCO. As part of the financing package, the bank received technical assistance aimed at training local staff and management on best practice SME banking skills. Staff at all levels participated in a two-week training programme on credit appraisal, portfolio management, and administration. This was coupled with an intense review of procedures leading to Exim's revision and overhaul of its credit manual where environmental issues are now addressed. This was facilitated by the general manager and a senior credit officer participating in IFC's Competitive Business Advantage workshop, which presents the rationale for environmental and social management. In addition to donor funded or subsidised technical assistance, a training arrangement was set up with Rabobank, which is known for its strength in agricultural lending.

As for ongoing training, all Exim staff receive refresher training every one to two years on new laws, rules, and best practices in banking and their specific field of work. In addition, Exim sends staff to training at local colleges and at the Tanzanian Institute of Bankers, and to courses in venues such as Johannesburg. Further, Exim's senior management has attended executive management programs at Harvard and Stanford geared to corporate governance and administration.

Exim has introduced new products aimed at spurring saving and reaching the small or underserved. These include an investment plan designed for parents to save for children and the provision of crop financing against warehouse receipts. Due to strength in appraisal and portfolio management, other notable achievements include HSBC Bank – USA's extension of a credit line for crop-oriented letters of credit and PTA Bank's (Kenya) approval for a large US dollar facility for confirmation of credit.

Building Commitment to Sustainable Business

Sustainability management and reporting can drive fresh thinking and point to improved practices and new products benefiting banks and its customers. At Exim Bank, training has reinforced and validated existing programs consistent with sustainability principles. This will allow for the recasting or alignment of these activities in the sustainability vein. With the commitment of management and employees, training and capacity building at Exim is leading to products and operations geared to sustainability in the African context.

See *Banking on Responsibility*. Freshfields Bruckhaus Deringer. July 2005.
Equator Principles, Revised. www.equator-principles.com

7 Conclusion

This report concludes that there are benefits of implementing SMR such as revenue growth, risk management, access to capital, and cost savings and efficiency which have not been sufficiently explored amongst the majority of financial institutions in developing and emerging economies. Further, the case studies illustrate many other additional benefits that come as a result of SMR practices.

Once the benefits are understood, the next step is to understand how to build capacity for SMR application. The text box below summarises some key lessons for successful SMR application. Although it is based on the experience of one financial institution, many of the points also appear repeatedly in the case studies throughout the report and are common experiences of institutions taking up SMR.

Key lessons for successful SMR application

Several lessons are important in a financial institution's decision to adopt a sustainability management system. These include:

- Start simple, but start. While there is a tendency to operate with a sophisticated system from the beginning, this is difficult and much of the value comes from learning how best to apply a system geared specifically towards your organisation
- Win support from upper management (President, Board of Directors).
- Integrate SMR into risk management
- Communicate to the employees and get them involved
- Take care in informing clients, so as not to jeopardise the commercial relationship. Clients must see the institution as a partner that is helping them to become more competitive.

Compiled from Suleasing's experience
(For background on Suleasing, see page 14)

It is hoped that this report will encourage more financial institutions in developing and emerging markets to take up SMR. As it becomes common practice, the knowledge of benefits and experience in implementation quickly expands and the cost of implementation will fall. At the same time, early adopters do have their unique benefits as demonstrated in some of the case studies. CEOs and board members will therefore need to take a strategic approach towards SMR implementation.

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