Environmental Credit Risk Management

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What risks do environmental issues create for financial institutions?

- Every business activity has some inherent potential to cause damage to people and property (environmental, health & safety risks)
- If clients don't properly manage those inherent environmental health & safety risks, they can incur unexpected environmentally derived financial, legal and reputational liabilities
- If you don't manage the bank's exposure to those risks and liabilities, they can also become unexpected financial, legal and reputational risks and liabilities for the bank.

Environmental Risks for the Customer

- Unexpected environmental costs (eg, capital investments, increased operating costs, fines)
- Disruption or cessation of operations
- Legal liability for clean-up
- Damage to their reputation by association with environmentally controversial activities

Policy

Planning:
- Significant Environmental Aspects
- Environmental Requirements
- Objectives and Targets

Implementation:
- Roles and Responsibilities
- Procedures
- Use of Consultants
- Risk control/supervision
- Training
- Document Control

Monitoring:
- Measurement
- Non-conformities
- Records
- Audits
- Reports to IFC

Management Review

Core elements to manage environmental issues and risks

- High level Policy commitment to promote sustainable development
  - Consider HSE issues in its business and operations in accordance with EMS (eg. in Policy statement, founding charter, investment policy, by signing the UNEP Statement).

Structure of the EMS

Policy & Commitment

-Formulate vision & policy
-Define long term objectives
-Communicate vision
-Express commitment

Plan

-Set specific targets
-Select projects & programs

Do

-Execute projects & programs
-Develop and apply procedures
-Provide training
-Adjust organizational structure

Check

-Monitor progress
-Take corrective measures
-Evaluate EMS; audits

Review

-Review EMS & objectives
-Decision on reporting
-Prepare decision making
on expansion EMS

Core Elements – Environmental Review Procedure

- Documented
- Broken down into key stages:
  - screening
  - appraisal
  - approval
  - supervision
- Integrated with core procedures (credit manual, investment procedure)
- Outputs should be documented on sub-project file

Core Elements - ERP

Adoption and Implementation of Environmental Review Procedure

- Screening:
  - this helps determine (1) applicable environmental standards (b) what appraisal action is needed
- Appraisal:
  - eg: desk-top review of environmental permits; Environmental Audit Environmental Impact Assessment
- **Approval** - including environmental risk mitigation if required
- **Supervision** - continued compliance; implementation of agreed mitigation measures

Core Elements – Contd.

- Appointment of at least one employee to conduct, co-ordinate environmental due diligence on transactions.
- Designation of one member of senior management with ultimate responsibility for implementation of the EMS
- Setting specific performance indicators and targets for the implementation of the FI's Policy commitment and review procedures.
- Provision of regular training of staff in the application of the Policy and Procedures

Core Elements - Monitoring

- Regular monitoring and reporting on the implementation of the EMS, in particular of key performance areas against targets, in order to advise the Board and stakeholders where policies and procedures are working well and where improvements are required.

Core Elements – Objectives and Targets

- Re-definition of objectives and targets based on the outcome of monitoring activities.
  – Reputational - "we will be the best"
  – Operational - "EMS will be implemented in Head Office by Year 1, major branches by Year 2 and all branches by Year 3"
  – Value-creation - "measured improvement in portfolio quality due to enhanced risk management"
  – Growth - "develop new products such as finance leasing for environmental pollution control technology"

Expanding the scope of the EMS

Integrate sustainability in products and services

- include social aspects in loan appraisal process
- activities related to energy-efficiency and renewable energy
- development and introduction of:
  - eco-efficiency or sustainability funds
  - new insurance products
  - leasing of renewable energy products
  - etc,.

Expanding the scope of the EMS

Improve monitoring and EMS efficiency

- from monitoring progess of individual projects to a set of key performance indicators
- improvement of the efficiency of the EMS as a whole

Expanding the scope of the EMS
include cost and benefit analysis during review

- Comprehensive assessment of value added of environment related activities
- Including recommendations on:
  - adjustment of vision and policy
  - areas to be covered by next improvement cycle

Concluding remarks

- The implementation of such a system can yield multiple benefits:
  - management of environment related business risks
  - new business opportunities (Renewable Energy)
  - stronger position of the financial institution as a corporate citizen and in relation with stakeholders