Environmental & Social Credit Risks in Korea

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Jee-In Jang, Chung-Ang Univ.
Environmental and Social Risks

- Primary Losses
  - Responsibility to recover env./social accidents
  - Penalty or shutdown due to the legal violation
  - Costs to prevent environmental accidents
  - Harder import and export authorization

- Secondary Losses
  - Market losses and investment losses
  - Damages to brand image
  - Damages to employees’ morale
  - Damages to political status of leadership

- Financial Risks
- Regulatory Risks
- Reputational Risks
Significance of Environmental Risks

Strengthened Global Environmental Regulations

Results

More Risks for Korean Companies to Encounter Environmental Troubles

- Risks of import or export restriction
- Risks of unintended violation of environmental regulation

- Recycling of Electronic Wastes
- Prohibition of toxic substances

- Propositions 65
- Ozone Protection
- Recycling
- RoHS
- WEEE
- EuP
- REACH

Recall
Monetary Penalties
Brand Damage
Significance of Environmental Risks

Climate Change and Effectuations of Obligatory Carbon Reduction from 2013

Potential Loss of GDP in case of little preparation

- For 5% reduction of GHG from 2012 compared to the level of 1995, KRW 11,300 billion of GDP losses are expected (Korea Energy Economy Institutes, 2005)

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<thead>
<tr>
<th>Industry</th>
<th>Short-term forecast</th>
<th>Long-term forecast</th>
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<td>Semiconductor</td>
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<td>Electronics</td>
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<td>Generation</td>
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<td>Construction</td>
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Short-term: '05 ~ '07
Long-term: '08 ~
▲ Improvement
- Little impact
▼ Damage
▼▼ Serious Damage
Significance of Environmental Risks

Increasing Environmental Disputes of Companies

Annual number of the case of the environmental disputes of National Environmental Dispute Resolution Commission
Cases of Environmental Risk and Damages

Mattel
- Lead(Pb) was detected in their products
- Recalled 21 million products

SK-II
- Heavy metals detected in cosmetic products (within allowance level)
- Stopped selling in some area in 2006

A Japanese T-shirts import company
- Toxic substances were detected in T-shirts for infants
- 100 thousand sheets of the shirt were disposed
Cases of Environmental Risk and Damages

The Case of Sustainability Risks in Korea: Samsung Heavy Industries

Social Risks
Disclosure of Slush Funds 29 October 2007

Environmental Risks
Tae-an Oil Spill 7 December 2007

Heavy Fall in Stock Prices

Disclosure of Slush Funds
29 October 2007

Tae-an Oil Spill
7 December 2007
## Sustainability Risk Management of Various Countries

<table>
<thead>
<tr>
<th>Region</th>
<th>Country</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia Pacific</td>
<td>Korea</td>
<td>✓ Environmental risks are partly reflected in credit evaluation checklists; however, the impacts are weak (less than 4%) and the processes are unsystematic.</td>
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<tr>
<td></td>
<td>Japan</td>
<td>✓ Development Bank of Japan’s loan system considering environmental grade (2004)</td>
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<td>✓ Lower interest rate (max. 0.6% cheaper than market interest rate) for companies which encounter environmental risks well</td>
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<td>Australia</td>
<td>✓ Environmental risk assessment rate: 17% daily, 40% periodically, 30% in case of requirement</td>
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<td>China &amp; Indonesia</td>
<td>✓ China: Greenwatch program, Indonesia: PROPER program</td>
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<td>✓ Corporate environmental management program led by government and banks activities linked to loan management</td>
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<tr>
<td>Europe</td>
<td>U.K</td>
<td>✓ 60% banks performed environmental risk analysis on their lending decision (sample No. 57)</td>
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<tr>
<td>North America</td>
<td>Canada</td>
<td>✓ Bank of Montreal: Published the guideline of environmental risk evaluation,</td>
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<td>✓ National Bank of Canada: Integrated credit policy and environmental criteria</td>
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<td></td>
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<td>✓ Royal Bank of Canada: Risk diagnosis and mitigation service</td>
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<td>✓ Scotiabank: Managing the pool of 250 environmental consultants</td>
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※ US: 1980, CERCLA(The Comprehensive Environmental Response, Compensation, and Liability Act) came into effect
※ EU: 1996, Similar proposal (Directive on Integrated Pollution Prevention and Control)
Efforts of the Ministry of Environment, Korea

**Opening Corporate Environmental Information to Public**

- **Project to develop ‘Environmental Reporting Guidelines’**
  - 1st: 2001
  - 2nd: 2002
  - 3rd: 2003
  - 4th: 2004

- **Environmental Information Support System for Companies**
  - 2007

**Facilitation of Financial Institutions’ Assessment of Environmental Risks**

- **Project to develop ‘Environmental Risk Analysis Guidelines’**
  - 1st: 2003
  - 2nd: 2004
  - 3rd: 2005

- **Environmental analysis guidelines for Project Finance**
  - 2006

- **Environmental Information Support System for Bank Loan**
  - 2007
Efforts of the Ministry of Environment, Korea

Environmental Risk Assessment Guideline (the 3rd edition, 2006)

<table>
<thead>
<tr>
<th>General Steps</th>
<th>Checklists of the step 2</th>
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<tbody>
<tr>
<td>STEP 1. Review and Categorization</td>
<td>1. Environmental strategy</td>
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<td>2. Execution system</td>
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<tr>
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<td>4. Products env. mgt.</td>
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<td>7. Risk management</td>
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<td>8. Soil pollution mgt.</td>
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<td>9. Local community mgt.</td>
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</tbody>
</table>
Still in low level but started to recognize the significances

- Domestic banks think that there was no case of damage from environmental accidents
- Portion of financial criteria: non-financial criteria = 6:4 ~ 8:2, env'tal criteria is less than 2%

### Importance of env'tal risks in loan

- Not important: 14%
- Average: 29%
- Will be important in future: 57%

(14 interviewees from 8 domestic banks, 2007)

### Portion of env’tal risks in loan (Bank ‘A’)

<table>
<thead>
<tr>
<th>Class</th>
<th>Environmental Assessment Item</th>
<th>Weight</th>
<th>Check Points</th>
</tr>
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<tbody>
<tr>
<td>Reliability</td>
<td>Social Responsibility</td>
<td>4%</td>
<td>Environmental accidents, lawsuits, deferred payments, etc. (Gives the very low score, if the normal operation was ever stuck by violating environmental regulations)</td>
</tr>
</tbody>
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(14 interviewees from 8 domestic banks, 2007)
Banks in Korea: Social Risk Perspective

- **Reflect 10% of ethic management index when evaluating corporate credit level**
- **Reflect anti-pollution facility, compliance of regulations, environment protection activities**

**Introduced in 2004**
Actual portion of reflection: 4%

**Introduced in 2003**
Actual portion of reflection 4%

- **Distinguish financial/nonfinancial criteria when evaluating corporate credit level**
- **Reflect ethic management and environmental management considering non-financial criteria**
- **Companies with excellent ethics are benefited with loan capacity and interest**

- **Period**: 6 May ~ 31 June 2003
- **Evaluated Companies**: 1,209

Jee-In Jang
Voices of the Banks in Korea

**Banks' profitability perspective**
- The value over the cost of the information and the firm relationship with profit are important
- Banks' loan competitive capabilities are vulnerable: potential customer churn
- Clear cases of the damage from environmental risks are required

**Facilitators**
- Database of the environmental information of business sites or companies
- Positive approach using additional points are readily and voluntarily usable by banks
- Deciding reflection timing and weight of environmental risk is important. Banks' joint efforts are desirable.

**Obstacles**
- Due to the SMEs’ low level of environmental management, it is hard to present appropriate environmental information
- Cost of environmental risk assessment might be imputed to companies
- If regulation or financial supervisory services do not force the adoption, banks will hardly adopt the environmental risk assessment
## Alternatives to Resolve Obstacles

### Opening Environmental Information to Public

- **Target**: Public Companies & Corporations, Business Sites
- **Information Provider**: Companies, Government
- **Subjects using the information (Related Financial Institutions)**:
  - Non-experts can use the information (Securities and asset management)
  - Risk assessment experts are needed (Banks and Insurances)
- **Data Comparability**:
  - Hard to Compare Various formats
  - Easy to Compare Standardized format
- **Similar systems**:
  - Law for the facilitation of environmental care, Japan
  - EPA, United States

### Building up Database of the Environmental Information of Business Sites

- **Target**: Public Companies & Corporations, Business Sites
- **Information Provider**: Companies, Government
- **Subjects using the information (Related Financial Institutions)**:
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Building a Sustainable Finance Network

Joint efforts of financial institutions and government are required

- Integration and opening of the environmental information system
- Supporting education and promotion in order to facilitate the recognition of sustainability risk

Financial Institutions

- Examination of sustainability risk assessment model for the context of Korea
- Examination of the utility of the sustainability risk assessment: reduction of credit risks, strategic importance, etc.

Government for Financial issues

- Development of Sustainability risk roadmap reflecting Basel II
- Facilitating financial institutions’ voluntary sustainability risk management

Government for ESG issues

Council of Sustainable Finance

Jee-In Jang
Thank You