Financial institutions play a critical role in society. Through the products and services they provide, financial institutions are uniquely placed to influence economic growth, and importantly, by including environmental, social and governance issues in decision-making, ensure long-term sustainable growth.

Yet, despite this, few African financial institutions currently include sustainability criteria in their lending business activities and credit risk approaches.

Over the course of 2006, we surveyed South African and Nigerian banks on their approaches to environmental, social and governance issues in credit risk policies. This was done in an effort to identify best practice and formulate guidance for African financial institutions.

This report details the outcomes of these surveys and provides practical sustainability credit risk guidance complemented by key findings and recommendations.

Guidance and findings should be of interest to financial institutions, legislators, civil society, central banks and financial sector policy makers throughout Africa.
Banking on Value: A New Approach to Credit Risk in Africa

This report was commissioned by
United Nations Environment Programme Finance Initiative (UNEP FI)
African Task Force (ATF)

Prepared in partnership with the University of South Africa
Center for Corporate Citizenship (UNISA CCC)
# Table of contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>4</td>
</tr>
<tr>
<td>Introduction from the Chairs</td>
<td>5</td>
</tr>
<tr>
<td>Introduction and Background</td>
<td>6</td>
</tr>
<tr>
<td>Methodology</td>
<td>8</td>
</tr>
<tr>
<td>Desktop research</td>
<td>8</td>
</tr>
<tr>
<td>Interviews</td>
<td>8</td>
</tr>
<tr>
<td>Workshops</td>
<td>9</td>
</tr>
<tr>
<td>Research Chronology</td>
<td>10</td>
</tr>
<tr>
<td>Key Findings and Recommendations</td>
<td>11</td>
</tr>
<tr>
<td>Key Findings</td>
<td>11</td>
</tr>
<tr>
<td>Recommendations</td>
<td>12</td>
</tr>
<tr>
<td>Sustainability Credit Risk Assessment Guidance</td>
<td>13</td>
</tr>
<tr>
<td>Policy making</td>
<td>14</td>
</tr>
<tr>
<td>Policy implementation and credit risk assessment procedures</td>
<td>15</td>
</tr>
<tr>
<td>Managing and monitoring policy</td>
<td>19</td>
</tr>
<tr>
<td>Communicating and reporting on policy</td>
<td>19</td>
</tr>
<tr>
<td>Desktop Research</td>
<td>20</td>
</tr>
<tr>
<td>Elements Shaping the South African financial sector</td>
<td>20</td>
</tr>
<tr>
<td>Elements Shaping the Nigerian Financial Sector</td>
<td>22</td>
</tr>
<tr>
<td>Interview Findings</td>
<td>25</td>
</tr>
<tr>
<td>South Africa</td>
<td>26</td>
</tr>
<tr>
<td>South Africa Summary</td>
<td>31</td>
</tr>
<tr>
<td>Nigeria</td>
<td>32</td>
</tr>
<tr>
<td>Nigeria Summary</td>
<td>35</td>
</tr>
<tr>
<td>Appendix</td>
<td>37</td>
</tr>
<tr>
<td>1.0 Research Questionnaire</td>
<td>37</td>
</tr>
<tr>
<td>2.0 Sustainable Banking</td>
<td>41</td>
</tr>
<tr>
<td>3.0 Equator Principles</td>
<td>42</td>
</tr>
<tr>
<td>3.1 Application of the Equator Principles</td>
<td>43</td>
</tr>
<tr>
<td>4.0 King II</td>
<td>44</td>
</tr>
<tr>
<td>5.0 Nigerian Banking Sector Reforms</td>
<td>45</td>
</tr>
<tr>
<td>6.0 Broad Based Black Economic Empowerment</td>
<td>45</td>
</tr>
<tr>
<td>7.0 Financial Sector Charter</td>
<td>46</td>
</tr>
<tr>
<td>8.0 South African Legislation</td>
<td>46</td>
</tr>
<tr>
<td>Participating Institutions</td>
<td>48</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>49</td>
</tr>
</tbody>
</table>
Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATF</td>
<td>African Task Force</td>
</tr>
<tr>
<td>BASA</td>
<td>Banking Association of South Africa</td>
</tr>
<tr>
<td>BBBEE</td>
<td>Broad Based Black Economic Empowerment</td>
</tr>
<tr>
<td>ECRA</td>
<td>Environmental Credit Risk Assessment</td>
</tr>
<tr>
<td>EIA</td>
<td>Environmental Impact Assessment</td>
</tr>
<tr>
<td>ESG</td>
<td>Environmental, Social and Governance</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FEPA</td>
<td>Federal Environmental Protection Agency (Nigeria)</td>
</tr>
<tr>
<td>FMO</td>
<td>The Netherlands Development Finance Company</td>
</tr>
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<td>FSC</td>
<td>Financial Sector Charter (South Africa)</td>
</tr>
<tr>
<td>GAAP</td>
<td>General Accepted Accounting Principles</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GRI</td>
<td>Global Reporting Initiative</td>
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<tr>
<td>IDA</td>
<td>International Development Association</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IoD</td>
<td>Institute of Directors</td>
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<tr>
<td>JSE</td>
<td>Johannesburg Securities Exchange</td>
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<tr>
<td>NEMA</td>
<td>National Environmental Management Act (South Africa)</td>
</tr>
<tr>
<td>PFMA</td>
<td>Public Finance Management Act (South Africa)</td>
</tr>
<tr>
<td>RIMAN</td>
<td>Risk Managers Association of Nigeria. Formally known as CRIMA</td>
</tr>
<tr>
<td>SCRA</td>
<td>Sustainability Credit Risk Assessment</td>
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<tr>
<td>SRI</td>
<td>Socially Responsible Investment</td>
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<tr>
<td>UNEP FI</td>
<td>United Nations Environment Programme Finance Initiative</td>
</tr>
<tr>
<td>WBG</td>
<td>World Bank Group</td>
</tr>
</tbody>
</table>
Introduction from the Chairs

An increasing number of financial institutions are embracing sustainability and in particular environmental, social and governance (ESG) issues in decision-making processes. While international frameworks such as the Equator Principles have pioneered these concepts – especially in the context of project finance – these issues generally receive little consideration in the credit decisions made by banks when providing loans to small businesses and individuals. Furthermore, many banks are faced by a lack of practical guidance for implementation of ESG issues into credit risk processes.

As part of our mandate to extend sustainable banking practices in Africa, the United Nations Environment Programme Finance Initiative (UNEP FI) African Task Force (ATF) commissioned this study to provide an assessment of how leading financial institutions in Africa’s largest financial centres – South Africa and Nigeria – currently integrate ESG issues in their financing activities. We aim to provide practical guidance for African institutions seeking to include these issues in their financing activities, through formal sustainability credit risk assessment (SCRA) policies.

More than 25 financial institutions and supporting stakeholders were interviewed and have contributed to this study. While interviews are limited to South Africa and Nigeria, we provide this study and its findings to assist financial institutions, throughout the continent, in embedding ESG issues in their management structures and lending practices.

We believe that this practice can create the conditions that lead to sustainable growth in Africa, and new opportunities for financial institutions.

It is our view that embracing sustainability at the heart of decision-making in Africa can offer the clearest opportunity for people, planet and prosperity.

Cas Coovadia  
Managing Director  
The Banking Association of South Africa  
Co-Chair  
UNEP FI African Task Force

Justin Smith  
Head of Governance & Sustainability  
Nedbank  
Co-Chair  
UNEP FI African Task Force
Introduction and Background

Financial institutions play a critical role in society. Through the products and services they provide, financial institutions are uniquely placed to influence the direction and pace of a country’s economic development and by default, its long-term sustainability.

Finance in Africa is complex. The severity of poverty\(^1\) poses an enormous challenge for African countries and contributes to a cycle of dependence on finances provided by multilateral lending institutions\(^2\). Sub-Saharan countries receive the largest share of International Development Association (IDA) lending of any region in the world\(^3\), and the World Bank Group (WBG) continues to play a significant role in shaping policy and directing investments, through structural adjustment lending, poverty reduction strategies, and support for direct investments.

Nevertheless, local financial institutions and banks have a pivotal role to play in the future of Africa’s development. Their ability, and importantly, the manner in which they provide capital, has the potential to encourage Africa’s development trajectory. Indeed, it is an awareness of this role, and the need for a sensitive approach to the acute environmental, social and governance issues on the continent, that is increasingly bringing leading financial institutions in Africa to embrace the concepts of sustainable banking and finance\(^4\).

African banks provide credit and loans to thousands of businesses and individuals throughout the continent, and, ultimately credit risk managers, financiers and loan officers are the lifeline to businesses and the gatekeepers to capital. It in this context that financial institutions can significantly influence the economic growth and development of societies, and potentially bring about change. By including ESG issues in credit risk management\(^5\), banks can allocate finance in a manner that mitigates the negative impact of corruption, poor governance, and other issues detrimental to the African social and environmental fabric. If financial institutions are successful in this, they could help to both lift African business to a new level of growth, based on accountability and transparency, and influence business to responsibly manage environmental and social issues.

The links between ESG issues, company value and risk are increasingly being documented\(^6\) and the receptivity of the financial community to these issues is growing. Analysts, asset managers and investors are beginning to understand the potential consequences of these risks on long-term investment value and are increasingly committing to include ESG issues in investment processes. These issues have also grown in importance to the project finance community, especially in the context of the potential environmental and social impacts of infrastructure and extractive industry projects. When turning to the world of credit, financing and loans, which is traditionally risk adverse, it would therefore seem natural that banks would consistently integrate ESG issues in their policies to protect value and minimise risks. After all, an over-riding objective of credit risk management is to avoid bad debt\(^7\).

---

1. 34 of the world’s 48 poorest countries are found in Africa. Source: Bank Information Centre USA. http://www.bicusa.org
2. Such as the World Bank Group (WBG)
4. For an overview of Sustainability Banking and the challenges to implementing sustainable banking in Africa please see Appendix 2.0.
5. Credit Risk Management is the process by which banks attempt to limit the risk that those owing money to the bank will not repay.
6. To view reports produced by a partnership between the UN and asset managers see “Materiality Research” on http://www.unepfi.org/. Other emerging market specific research is available on the IFC’s website, see http://www.ifc.org/. Finally, the Enhanced Analytics Initiative, an incentive driven collaboration between asset owners and asset managers aimed at encouraging better investment research, and in particular, research that takes account of the impact of extra-financial issues on long-term investment, also documents ESG links, see http://www.enhanced-analytics.com/
7. The Principles for Responsible Investment (PRI), launched by UN secretary-general Kofi Annan together with global investors at the New York Stock Exchange in April 2006, are a major commitment by signatory institutional investors and asset managers to integrate ESG issues into decision-making processes and provide a significant platform for their inclusion in mainstream investment practice. More than USD 4.5 trillion in assets under management have committed to the PRI, a figure rapidly approaching 10% of global capital markets, estimated at $50 trillion. For more information see http://www.unpri.org
8. The Equator Principles are a benchmark for the financial industry to manage social and environmental issues in project financing. These Equator Principles have consequently become the standard for assessing and managing environmental and social risk in project financing. This has helped accelerate momentum in other areas of environmental and social responsibility in the financial industry. For more on the Equator Principles see the Appendix 3.0 or visit http://www.equator-principles.com/
9. A debt that is not collectable and therefore worthless to the creditor.
The objective of this study is to firstly assess the extent to which ESG issues feature in South African and Nigerian credit risk assessment policies; and secondly, to provide guidance for implementing environmental, social and governance issues, or sustainability issues, in credit risk assessments.

This study is expected to serve as guidance for financial institutions seeking to define sustainability policies in the field of credit risk management. Furthermore, it is hoped that by providing insight to the opportunities presented by embracing sustainability in the financial sector, it allows financial institutions throughout Africa to identify their relative strengths and weaknesses, and assist in improvement.
Methodology

This section includes a description of the methodology used, and research undertaken in this study. The ISIS Asset Management Benchmarking Study undertaken in 2002 “Environmental Credit Risk Factors in the Pan European Banking Sector”\textsuperscript{10} was a key reference point in formulating a research approach to ESG credit risk practices in financial institutions.

**Desktop research**

Desktop research was conducted to understand sustainable banking practices in Africa, and the factors currently shaping the South African and Nigerian financial sectors. This was done in an effort to specifically define elements that can influence the receptivity to sustainability issues, of one region over another.

**Interviews**

Interviews were conducted to understand the depth and range of current ESG policies currently used in South African and Nigerian financial institutions. The interview process involved a series of structured one-hour interviews with senior credit risk officials, investor relationship managers and sustainability managers. 10 South African and 12 Nigerian financial institutions participated, these are listed below:

<table>
<thead>
<tr>
<th>South African financial institutions</th>
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<tbody>
<tr>
<td>ABSA</td>
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<tr>
<td>Barclays South Africa</td>
</tr>
<tr>
<td>Investec</td>
</tr>
<tr>
<td>Development Bank of South Africa</td>
</tr>
<tr>
<td>Standard Bank</td>
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<tr>
<td>Industrial Development Corporation</td>
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<tr>
<td>Citigroup South Africa</td>
</tr>
<tr>
<td>Nedbank</td>
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<tr>
<td>First National Bank (First Rand Group)</td>
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<tr>
<td>Standard Chartered</td>
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</tbody>
</table>

\textsuperscript{10} ISIS Asset Management commissioned the study in 2002 to benchmark the Environmental Credit Risk Assessment (ECRA) of participating European financial institutions. The study examines the origins of the banks’ ECRA policies and their drivers, the ways in which these policies are applied in practice and their impact on business performance and shareholder value. ISIS and F&C Group merged in 2004 and a new company, F&C Asset Management plc (F&C), was created.
A standardised questionnaire was used for the interviews; however some deviation from this was allowed in order to enhance the quality of discussion. The questionnaire was structured into the following three key areas:

**Policy:** Financial institutions were asked to describe the extent and nature of their ESG policies, to indicate if the policies are formally reviewed, who has ownership of the policy, if the policy is publicly available and to what extent it references other policies within the bank.

**Formalised Systems:** Financial institutions were assessed on the extent to which they translated their policies into formalised and functional procedures, management tools and auditable systems.

**Monitoring and reporting:** Financial institutions were questioned on the ESG training they provide to credit officers, the level of internal reporting and the extent to which their activities are publicly disclosed.

Interviews were conducted in English and where possible recorded for review purposes. All financial institutions were provided with a confidentiality note, indicating that individual institutions and participants would not be linked to research findings, and details of individual feedback would remain confidential.

In order to further substantiate the information collected in the interviews, all publicly available documentation relating to the participating financial institutions’ sustainability and environmental policies was reviewed.

Following the interviews, a selection of local environmental experts was consulted to assess the maturity of local environmental legislation, and the nature of sustainability issues in the local banking sectors.

It should be noted, financial institution participants indicated that actual processes for assigning a risk weighting to ESG issues are critical to competitive advantage, and therefore confidential. For this reason, detailed risk weighting processes were not discussed.

**Workshops**

Feedback workshops were held with the research participants in South Africa and Nigeria. The workshops were designed to discuss findings and elicit feedback to formulate appropriate guidance for implementing sustainability credit risk assessment (SCRA) in the banking communities of the respective countries and their peers in Africa.

The methodology of this study was developed with an objective of firstly assessing how ESG issues currently feature in South African and Nigerian credit risk assessment policies. Secondly to identify best
practice. Thirdly to give shape to appropriate sustainability credit risk assessment (SCRA) guidance structure, based on the approaches to credit risk provided by the leading South African and Nigerian financial institutions interviewed.

**Research Chronology**

<table>
<thead>
<tr>
<th>Date</th>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2005</td>
<td>Initial South African stakeholders discussion</td>
</tr>
<tr>
<td>October 2005</td>
<td>South African interviews. The 10 participating financial institutions were interviewed from the 3rd to the 7th of October 2005</td>
</tr>
<tr>
<td>January 2006</td>
<td>South African feedback workshop. The one day event took place on Friday 27 January 2006</td>
</tr>
<tr>
<td>March 2006</td>
<td>Nigerian Interviews. The 12 participating Nigerian financial institutions were interviewed from the 6th to the 10th March 2006</td>
</tr>
<tr>
<td>April 2006</td>
<td>Nigerian feedback workshop. The workshop took place at the Credit Risk Managers Association of Nigeria annual conference. The conference was held from the 19th to the 21st of April 2006 in Lagos</td>
</tr>
<tr>
<td>Sept. - Nov. 2006</td>
<td>Report writing and finalisation</td>
</tr>
</tbody>
</table>
Key Findings and Recommendations

“Banks in Africa have a crucial part to play in the sustainable development of the region. Considering sustainability factors in the assessment of credit risk on commercial loans will push the sustainability agenda ahead, allowing for balanced and healthy economic development in African nations.”

Cas Coovadia
Managing Director, The Banking Association of South Africa

This section summarises the key findings and recommendations following desktop research, interviews and feedback from workshops. The results are described in more detail in the following sections of the report.

Key Findings

1 Leading financial institutions in South Africa, and to a lesser extent Nigeria, are beginning to embrace sustainability at the heart of their operations. Yet in both countries many financial institutions have yet to fully realise their potential to contribute to sustainable development.

Our research finds there is a range of sustainability leaders and laggards in both the South African and Nigerian financial sectors. We find that while leaders are championing sustainability and committing to embrace it at the core of their operations, many are new to the sustainability concept, especially in the context of financing and lending activities.

2 Significantly more financial institutions conduct sustainability credit risk assessments in South Africa, than in Nigeria.

We find that, compared to Nigerian financial institutions, South African financial institutions are more actively integrating environmental, social and governance issues in financing decisions, carrying out sustainability credit risk assessments (SCRA) and committing to international frameworks such as the Equator Principles. Yet, we also find that South African institutions could make significant improvements in terms of formal SCRA practices and reporting. Furthermore, we believe that while the Nigerian financial sector is currently comparatively weaker in terms of sustainability issues, the recent local financial sector reforms provide an excellent opportunity to formally integrate SCRA policies into credit risk practices, on a sector wide basis.

3 Reputational opportunity – rather than lender liability risk – is a major driver for formally including environmental, social and governance issues in credit risk assessment practices in South African and Nigerian financial institutions.

Lender liability does not appear to be the main driver of SCRA practices in South Africa and Nigeria. Rather, it appears that the primary issues driving the sustainability agenda, are the potential reputational benefits that can result. The main drivers appeared to be a combination of the following:

— Opportunity to enhance reputation and build relationships with international banks,
— Opportunity to access “on-lending” opportunities from foreign banks,
— Opportunity to increase access to syndicated loan opportunities.

12 “On-lending” is the process whereby bulk loans are provided by multilateral development banks to “local” banks for use in specific sectors such as oil and gas, agriculture etc.
4 Local stakeholders have a key role to play in driving and shaping the sustainability agenda and receptivity of the financial sector to this agenda.

We find that local governments, policy makers, industry associations and civil society have a critical role to play in advancing the receptivity of financial institutions to sustainability issues. Furthermore, we find certain key elements can have a role to play in the receptivity of a country’s banking sector towards sustainability issues. These elements include:

— The maturity, transparency and legitimacy of the financial sector and its charters, norms and regulations. Size and listing requirements of the local stock exchange also have an effect.
— The extent and enforcement of environmental legislation and regulation.
— The presence and activities of local sustainability champions in civil society including academics, lawyers and NGOs.
— The drive of finance ministries and central banks. For example, the Nigerian Central Bank is currently playing a pivotal role in shaping good practice in the Nigerian Banking sector, through the publication of directives and policies pertaining to good governance and risk management.

5 International finance organisations, multinational banks and other international organisations are playing a key role in advancing the sustainability agenda and sustainability credit risk assessment practices of African financial institutions.

Our findings show that international finance organisations such as the IFC or FMO and related international organisations such as the UN are playing a key role in educating and promoting sustainability in local financing activities. Furthermore, multinational banks with commitments to cross-regional international frameworks such as the Equator Principles, have provided a proxy for local African financial institutions to embrace sustainability.

Recommendations

1 In order to support the uptake of ESG credit practices in Africa, local country level sustainability champions need to be identified and involved in capacity building and awareness raising campaigns.

2 To further encourage the uptake of sustainable banking, SCRA practices and commitments to internationally established frameworks, it is recommended that international finance institutions and international organisations continue a process of education and outreach that is aligned to regions and the local capacity of African countries.

3 Local policy makers, Ministries of Finance and Central Banks have a role to play in encouraging sustainability banking and its incorporation into credit risk processes, in a coordinated effort with international finance institutions, organisations and local stakeholders.
“We strongly support the inclusion of social and environmental risk analysis in the credit process of all African banks to ensure that the sector is playing its role in ensuring that Africa’s growth and development takes place in a sustainable manner, thereby preserving the unique natural resources of the continent, and benefiting all its people.”

Justin Smith
Senior Manager Governance and Sustainability, Nedbank

This section provides general guidance for African financial institutions with extensive lending activities. The guidance in this section provides a platform from which African financial institutions can undertake policy refinements that integrate environmental, social and governance, or sustainability, issues into credit risk assessments, and towards requirements of multilateral lending institutes. The guidance provided is the result of desktop research, interviews and stakeholder meetings in South Africa and Nigeria.

Details on specific environmental, social and governance standards are not provided. The guidance provided, is rather designed to ensure a standardised and efficient approach to embedding sustainability issues in financing and lending practices. Overall objectives are to:

- Assist relationship and risk managers in identifying, mitigating and monitoring environmental, social and governance (ESG) risks in their business activities,
- Support financial institutions in developing policies to limit the ESG risks associated with their lending operations,
- Assist financial institutions with ESG disclosure in their annual sustainability reports,
- Enable financial institutions to enhance their company sustainability and corporate governance performance.

Given the scope of issues that can constitute a business liability, integrating ESG issues in credit risk management is a thorough undertaking. This guidance is designed accordingly and should help financial institutions, especially those new to this area, to:

- Formalise credit risk assessments through the development of ESG credit risk policy,
- Define systems that ensure ESG policy is implemented,
- Ensure ESG policies and procedures are updated and used,
- Appropriately report on ESG issues.

There are four areas that can be considered as fundamental to the application of ESG issues in credit risk. These relate to ESG policy content, management, implementation and ESG credit risk assessment reporting.

In accordance with this, and for practicality, the guidance below is broken up into the following four areas:

- Policy-making,
- Policy implementation and credit risk assessment procedures,
- Managing and monitoring policy,
- Communicating and reporting on policy.

The guidance provided is not intended to be a template solution. Individual financial institutions will

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13 Examples are institutes such as the IFC, European Development Bank, FMO, Asian Development Bank, European Bank For Reconstruction and Development and the African Development Bank.

14 Generally the IFC and WBG social and environmental Performance Standards are accepted and used as the reference point for the majority of financial institutions internationally.
need to modify the guidance provided to suit their products, management culture, tolerance for risk, and sectors of involvement.

**Policy making**

Clear unambiguous in-house policy forms the front end of a well-structured sustainability credit risk process. Policy making of this nature is best driven from the board level through consultation with senior credit risk committees and other key stakeholders.

The following table outlines the key elements for consideration in formulating a sustainability credit risk policy:

<table>
<thead>
<tr>
<th>Formulating Sustainability Credit Risk Policies</th>
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<tbody>
<tr>
<td><strong>1</strong> In developing a sustainability policy, a financial institution should draw on industry stakeholders and experts in order to understand the broad-based ESG issues affecting its practices. Engagement of this nature is critical, as it forms the basis against which future reporting and feedback can be undertaken.</td>
</tr>
<tr>
<td><strong>2</strong> The policy should be defined to reflect the company value system, tolerance for risk and management culture.</td>
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<td><strong>3</strong> A short company rationale for the development of the policy, as well as aims and objectives is recommended.</td>
</tr>
<tr>
<td><strong>4</strong> Specific ESG credit risk assessment policies should reside as a defined sub-clause within the overall credit risk management policy. These policies should be cross-referenced to the financial institution’s broader social and environmental objectives.</td>
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<tr>
<td><strong>5</strong> The preamble to the policy should indicate who has responsibility for ensuring the maintenance and implementation of the ESG credit risk policy. This typically falls to the bank board of directors.</td>
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<tr>
<td><strong>6</strong> The policy should be developed centrally, but described in a way that allows further refinement, through input from internal and external stakeholders.</td>
</tr>
<tr>
<td><strong>7</strong> The policy should make clear the exact extent of its applicability in terms of the financial institution’s product range. In addition, the policy should be clear regarding the bank’s approach to syndicated loans, recourse loans, non-recourse, secure and un-secured loans.</td>
</tr>
<tr>
<td><strong>8</strong> The policy should be specific in terms of its geographical applicability.</td>
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<tr>
<td><strong>9</strong> The policy should be publicly available and widely communicated both internally and externally.</td>
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<tr>
<td><strong>10</strong> The ESG credit policy should account for issues such as the potential for reputation damage and the issues associated with changing ESG norms and legislation.</td>
</tr>
<tr>
<td><strong>11</strong> The policy should be worded in a clear and unambiguous way, and provide direction on the financial institution’s approach to credit provision and ESG issues. The policy should include reference to a standard against which the performance of clients will be assessed, for example the World Bank Group’s Environmental, Social and Health standards.</td>
</tr>
<tr>
<td><strong>12</strong> The policy should make specific reference to the kind of projects that may not be funded as a result of their negative impact on society and /or the environment.</td>
</tr>
<tr>
<td><strong>13</strong> The front-end policy and preamble should not be a lengthy wordy document, but rather succinct and to the point. Generally two to three pages suffice.</td>
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</table>
Policy implementation and credit risk assessment procedures

In order to ensure that ESG policies come alive in the day to day operations of the bank, it is critical that pragmatic steps are undertaken to ensure ownership of these policies. This section outlines some of the steps that can be taken to ensure that ESG policies are translated into actionable procedures.

Translating Sustainability Credit Risk Policies into Actionable Procedures

1. Ensure that all lending officers are contractually bound to implement the institution’s ESG credit policies - ensure that they have Key Performance indicators that relate to the application of ESG credit risk policies.

2. Ensure that all credit officers are fully aware of the definition of ESG issues and what constitutes an ESG risk. A proposed outline is provided below.

**Environmental issues:**
- Compliance with environmental legislation
- Air emissions and responses to climate change
- Energy and resource consumption
- Ecological footprint
- Environmental impacts associated with products and services
- Environmental behaviour of major suppliers
- Approaches to toxic releases and waste
- Potential for new regulations to expand the boundaries of environmental liabilities or to affect the social acceptability of products and or services
- Potential new markets for environmental services and environmentally friendly products

**Social issues:**
- Workplace health and safety
- Employment conditions
- The use of forced or child labour
- Community relations
- Human rights/Freedom of association issues at company and suppliers/contractors premises
- Consideration of major social agenda of government
- Forced relocations and removals
- Government and community relations in the context of operations in developing countries

**Governance issues:**
- Transparency of board structure and accountability
- Transparency of share allocations & executive compensation
- Non-executive directors
- Accountability and disclosure practices in terms of ESG issues
- Disclosure of government relations practices and payment
- Audit committee structure and independence of auditors
- Management of corruption and bribery
Financial risks:
Loss of investment due to involvement in environmentally sensitive sectors
Loss of investment value due to environmental damage/negative publicity for the company and/or its products
Potential for default on loan repayments due or project profitability
Unforeseen increases in project costs due to environmental clean up costs or due to project delay as a result of improper procedure

Legal risks:
Potential to incur environmental liabilities in the event that investments are found to be contaminated, or the cause of other environmental damage.
Potential to incur environmental liabilities in loan default situations
The possibility for international settlements (for example Cape Asbestos Plc)

Reputational risks:
Damage through association with environmentally or socially damaging activities
Damage through association with companies that cause, or are perceived to cause environmental or social damage
Community backlash for non-engagement
Shareholder activism

3 Develop and make available practical guidance tools for lending offices that explain how best to undertake an ESG review. This should include a process flow chart that describes the three phases of ESG assessment:
   Phase 1: Desktop reviews,
   Phase 2: In-depth interviews,
   Phase 3: Detailed investigations.
A detailed “ESG Risk Process” flow chart is included at the end of this section.

4 In addition to a risk process flow chart, credit officers should be provided with legal registers, check lists, questionnaires and risk matrices in order to establish a comprehensive picture of applicable ESG risks. A useful categorization is the one used by the IFC, which groups projects into three main areas:
   A: High Impact
   B: Medium impact
   C: Low Impact
It is useful to supply company credit officers with lists and supporting examples of projects that fall into categories A, B and C.
Immediate priority should be given to high-risk sectors. Details of these sectors should be provided, as well as examples of high-risk projects in each sector.
Credit officers should be alerted to the potential for risk, based on the physical geographic location of the borrower, the country risk and supply chain responsibilities (i.e. does the company's viability depend on a single large customer whose business could be threatened as a result of poor ESG performance?).

15 Following a House of Lords' ruling in 2000, British companies operating overseas are open to litigation, in English courts, by foreign plaintiffs injured by their overseas operations. This meant that Cape Asbestos Plc was open to liability, under UK law, for asbestos poisoning suffered by its former workers in South African mines. The duty of care owed by an employer to safeguard its employees was higher under UK law, than under South African law, at the time the workers were put at risk. Further information is available on the following website: http://www.btinternet.com/~ibas/lka_lords.htm
In undertaking an in-depth review, credit officers should identify all the ESG risks associated with the products and or business processes. Breaking down risk exposures into common categories will allow the bank to aggregate risk exposure across its business lines and in addition, will speed up the assessment process of future clients.

Credit officers should be provided with case studies and guidelines that highlight the types of covenants, indemnifications, guarantees and waivers the bank uses for its protection - for example, obliging the borrower to inform the bank of all major environmental incidents.

Critical to this process is knowledge management. Financial institutions should ensure that their existing systems provide for the inclusion of ESG credit risk information.

Once the documentation is prepared for consideration by the risk committee, the following questions should form part of the decision-making process:

• Are all ESG risks considered?
• Have key stakeholders been engaged?
• What other risks does this pose to the bank (reputation, credit or otherwise?)

In approving a credit of this nature the credit committee should consider the following points:

• The way in which ESG performance would be monitored, both by the client and internally by the financial institution,
• The way in which ESG covenants would be included in the loan documentation,
• Any liability that would be shared,
• Any insurances that would be required,
• The extra loan conditions that would be required.

Roles and responsibilities should be clearly allocated, with clear boundaries drawn between what is expected of internal investment officers and external consultants.
**Summarised Generic ESG Risk Process Flow Chart**

(this may vary from bank to bank depending on structures, roles and responsibilities)

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**Loan application**

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**Phase 1: Desk Top review**

- Review of client’s approach to ESG issues
- Does the project fall into any exclusionary categories specified in credit by the bank policy (i.e. armaments)?
- Does the project fall into a high risk sector or geographical location?
- Does the project involve a high risk sector?

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**Phase 2: In-depth Interviews Review**

- Rough assessment of potential impacts including scale and extent
- Overviews of technology being used
- Details of mitigation processes
- History of client and project area
- Types of contamination
- Types of Environmental & Social Management Systems used
- Legal compliance
- Types of standards being used

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**Phase 3: In-depth Investigation**

- Detailed due diligence or environmental and social impact assessment
- Development of appropriate social and environmental covenants
- Development of decommissioning plan
- Use of technical experts

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**Phase 4: On going monitoring**

- On going monitoring of key social and environmental performance indicators
- Eventual / possible decommissioning

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No risks, account officer makes note on client file and proceeds with credit application.

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Environmental and social risks can be effectively managed through a detailed Environmental & Social Impact Assessment (ESIA) and Environmental & Social Management Plan (ESMP), developed by client appointed consultant. ESIA and ESMP reviewed by technical expert and potentially included as a covenant in load agreement.

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Pending the outcome of independent expert review of the ESIA, ESMP and decommissioning plan, risk quantified, specific loan covenants agreed and presented to the credit committee.

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Client to supply accounts officer with regular monitoring reports on the ESMP and ultimately with a decommissioning report.

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Account officer to undertake this review using bank sector / country ESG risk screens. Based on assessment a short impact report should be provided to the Company Credit Department.

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Investment officer to categorises the project (i.e. using the World Bank Classifications Category A, B or C) and provides a detailed note to Accounts Officer who if required liaises with the client about further environmental/social studies required and the appropriate standards to be used.
Managing and monitoring policy

In order to ensure that the ESG credit practices are being implemented on a day-to-day basis, it is critical that a financial institution builds an internal mechanism to constantly review performance and behaviour. This section provides a short overview of best practice pertaining to the implementation of ESG credit policies.

Implementing ESG credit risk policy

1. ESG policy should be reviewed as part of a financial institution’s internal audit procedure on an annual basis.
2. A centralized environmental credit risk support service (a team of ESG experts either in-house or external) should advise on ESG policy implementation and credit committee decisions.
3. The terms of references for all Environmental and Social Impact assessments should ideally be reviewed by the bank’s centralized environmental credit risk support services.
4. Regular ESG training sessions/workshops are required for lending officers in the financial institution’s domestic and international markets.
5. ESG training is an integral part of an employee’s career progression and performance monitoring and as such, should appear in key performance goals of senior managers in the credit department.
6. ESG policy and procedural guidelines should be made available on the financial institution’s Intranet, along with case studies and self-assessment tests.
7. Records of all ESG training should be kept.
8. Performance measures should be developed for the implementation of the ESG credit policies. Such measures could include:
   - Target dates for key ESG policy roll out,
   - Extent to which the loan portfolio has been screened against ESG issues,
   - Percentage of approved loans that do not comply with ESG policies,
   - Number of accounts officers trained in ESG credit policies.
9. Percentage value of loan portfolio exposed to ESG risks.

Communicating and reporting on policy

The final step in proactively managing ESG credit risk issues is to ensure that stakeholders, both internal and external, are consulted on a regular basis with respect to the financial institution’s key ESG credit practices. This level of transparency not only ensures a continual cycle of improvement, but is also critical for maintaining a sound reputation.

A short overview of best practice as it pertains to reporting on ESG policies is provided below:

Reporting on ESG credit risk policy

1. Public disclosure should be made of ESG implementation processes and guidelines (not including commercially sensitive operational procedures).
2. Annual ESG forward implementation targets should be publicised.
3. Annual results against ESG implementation targets should be disclosed.
4. Financial institutions should engage with stakeholders regarding concerns related to ESG issues associated with the provision of credit. Stakeholders include employee’s, government, business, labour and civil society.
5. Emergency communications strategies should be developed, pertaining to ESG risks associated with each project.
6. ESG issues should be included within a broader sustainability report.
7. Key learning should be regularly communicated internally, using the financial institution’s intranet and illustrated by case studies.
Desktop Research

“I am curiously looking forward to the day when all banks and indeed financial institutions operating in Africa will fully embrace the triple bottom line approach as a core business strategy and practice.”

Emmanuel Kalu
Fidelity Bank

Desktop research was conducted to understand the range of influencing factors that have shaped the extent to which sustainability issues are embraced by the South African and Nigerian banking sectors. Influencing drivers range from the shape and size of the banking sector, to the listing requirements of the securities exchange, through to the effectiveness of environmental legislation. Influencing drivers are summarized in the section below.

Elements Shaping the South African financial sector

Economy: South Africa has the largest economy in Africa and most advanced banking system on the continent. South Africa is the economic powerhouse of Africa, with a gross domestic product (GDP) comprising around 25% of that of the entire continent. South Africa is host to the five biggest banks in Africa.

Financial institutions: Currently, there are 38 registered banks in South Africa. This number consists of 15 South African controlled banks, 6 non-resident controlled banks, 15 local branches of international banks, and two mutual banks. In addition, 44 international banks have authorised representative offices in South Africa.

Financial sector regulation: Within South Africa, the Financial Services Board oversees the regulation of financial markets and institutions, including insurers, fund managers and broking operations, but excluding banks, which fall under the South African Reserve Bank. The Banks Act is primarily based on similar legislation in the United Kingdom, Australia and Canada. The South African Banking sector is purported to compare favourably with industrialised countries in terms of the strength of its banking systems, legislation, central bank and the overall structure of the sector. Investment and merchant banking remains the most competitive front in the industry, with many major South African banks competing for business throughout Africa. While not a direct driver the relative size and sophistication of the South African Banking Sector implies that it has a critical leadership role to play in forwarding the sustainability agenda in the banking industry across Africa.

Banking Association: The Banking Association of South Africa (BASA) is an additional non-statutory body that is charged with ensuring responsible, competitive and profitable performance of the banking sector. BASA was instrumental in developing the financial sector charter.

Stock exchange: The Johannesburg Securities Exchange (JSE) is the 18th largest exchange in the world by market capitalisation. With approximately 400 listed companies, Listings requirements for the JSE are aligned with international best practice. They aim to improve company reporting practices through the adoption of various Statements of General Accepted Accounting Principles (GAAP). In terms of sustainability, the JSE requires listed companies to comply with the second King

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16 See http://www.southafrica.info/
17 See the African Business annual survey (October 2005) of Africa’s top 100 banks, http://www.africasia.co.uk/
18 The Bank Supervision Department of the South African Reserve Bank maintains a list of registered banks, branches and representative offices. See http://www.fintforum.co.za/
19 For more information on the South Africa Financial Services Board, the South African Reserve Bank and The Banks Act, see: http://www.fsbb.co.za and http://www.reservebank.co.za/
20 For more information see: http://www.banking.org.za
21 R3.5 billion as of 2005, see: http://www.jse.co.za/
22 See: http://www.jse.co.za/
23 Generally Accepted Accounting Principles (GAAP) is the standard framework of guidelines for financial accounting. It includes the standards, conventions, and rules accountants follow in recording and summarizing transactions, and in the preparation of financial statements.
Report on Corporate Governance, which necessitates adherence to Global Reporting Initiative (GRI) guidelines for integrated sustainability reporting. In May 2004 the JSE launched the Socially Responsible Investment (SRI) Index. The SRI index comprises a list of companies from the JSE All Share Index who voluntarily participate in a screening process that aims to assess the extent to which they comply with a series of triple bottom line performance criteria. The index was the first of its kind in an emerging market and the first of its kind in Africa.

**Codes of Corporate Governance:** Corporate governance is a well-developed concept in South Africa, with the King Committee on Corporate Governance publishing the first King report on Corporate Governance in 1994. The King Code was published through the efforts of the Institute of Directors (IoD). The King Committee issued its second report in March 2002 (King II). King II advocates principles of openness, integrity and accountability. It identifies seven primary characteristics of good governance, namely discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Further information on King II is provided in Appendix 4.0.

**Broad Based Black Economic Empowerment:** Broad Based Black Economic Empowerment (BBBEE) has been a policy of the Government since 1994. The government has identified BBBEE as a critical component of social transformation necessary for the sustainable socio-economic development of South Africa. In 2004, the government took this policy forward with the enactment of the Broad Based Black Economic Empowerment Act. The Act houses the legislative framework for broad based BBBEE by defining the policy, outlining the mechanisms for the regulation and measurement of BBBEE, and establishing the Black Economic Empowerment Advisory Council. Further information on BBBEE is provided in the Appendix 6.0.

**Financial Sector Charter:** The Financial Sector Charter (FSC) is the outcome of negotiations between 11 industry associations representing the South African financial services sector. The aim of the Charter is to address the following key areas:

- Increased access to financial services for the un-banked
- Agricultural development
- Low-income housing finance
- Financing of small and medium black businesses
- Black ownership, control and management
- Skills development
- Procurement from black-owned businesses
- Creation and development of BEE companies.

The Charter applies to the South African operations of the financial sector, and the targets contained apply from 1 January 2004 to 31 December 2008, with a review in 2008, including the setting of targets to 2014. Further information on the Charter is provided in the Appendix 7.0.

**Environmental and Governance Legislation:** The Bill of Rights under South Africa’s Constitution, entitles all South Africans to the right to an environment that is not harmful to human health or well-being and to have the environment protected for the benefit of present and future generations. As a result, the legal tools now exist for the public to enforce environmental laws through class actions.

The following four major Acts presently account for the bulk of environmental regulation in South Africa:

- Environmental Conservation Act, 1989 (the ECA)
- National Environmental Management Act, 1998 (NEMA)
- National Water Act, 1998

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24 To access the report, visit the South African Chapter of the Institute of Directors (IoD) homepage: http://www.iodsa.co.za/
25 For more information see: http://www.globalreporting.org/
26 For more information see: http://www.jse.co.za/sri/
27 IoD - The IoD is a voluntary membership organization that was established in South Africa in the 1940’s to promote director professionalism and interests. It is affiliated, loosely, to the IoD in the United Kingdom and enjoys a close affiliation with its well-established counterparts in Australia and New Zealand as well. Over 2 000 directors and professionals are members of the IoD in South Africa. For more information see http://www.iodsa.co.za/
28 For more information on the formulation of the Black Economic Empowerment Act visit http://www.info.gov.za/
29 For more information on the Financial Services Sector Charter see: http://www.treasury.gov.za/
30 For more information on South African environmental regulation, see the homepage of the South African Department of Environmental Affairs and Tourism http://www.environment.gov.za/

The following four major Acts presently account for the bulk of government governance regulation in South Africa:

• Public Finance Management Act 1 of 1999
• Promotion of Access to Information Act 2 of 2000
• Protected Disclosures Act of 2000
• Financial Intelligence Centre Act of 2001

Further information on South African environmental and governance related legislation is provided in the Appendix 8.0.

Other Influencing Factors:

• The Basel II Accord proposes that banks disclose their operational risk in order to accurately determine their capital adequacy requirements. The Accord considers the management of ESG risks as an integral part of operational risk management. Through the advanced risk assessment process provided for in Basel II, banks are able to operate with lower capital adequacy if they can effectively account for the manner in which they manage operational risk. While the Basel II does provide a small incentive for the management of ESG issues, this is not seen as a major driver of sustainable management in the banking sector in South Africa.

• The requirements of multilateral banks are forcing local banks to reconsider their approaches to credit risk assessments.

• A growing awareness amongst the local banks of voluntary industry agreements, such as:
  1. UNEP Statement by Financial Institutions on the Environment and Sustainable Development
  2. UN Global Compact’s Financial Institutions Initiative
  3. The Equator Principles
  4. Collevecchio Declaration on Financial Institutions and Sustainability
  5. The United Nations Principles for Responsible Investment.

Elements Shaping the Nigerian Financial Sector

Economy: Nigeria is Africa’s most populous country and as such is seen as one of the most promising markets for international companies. FDI in 2001 totalled US$1.1 billion. In 2005, Nigeria had a GDP of US$132.9 billion. GDP rose by 5.6% in real terms over the previous year. GDP per capita was about US$1,000, using the purchasing power parity method. About 57% of the population lives on less than US$1.00 per day. In 2005, the GDP was composed of the following sectors: agriculture, 26.8%; industry, 48.8%; and services, 24.4%.

Sovereign Rating: Nigeria was accorded a BB sovereign rating by international rating agencies in January 2006. Although this is not considered as an investment grade rating, the effect has been significant on the Nigerian economy, which has seen a huge increase in foreign investment and a reduction in foreign loan interest rates.

While not a direct driver of sustainable banking practices, the sovereign rating has increased the levels of awareness of ESG issues in local banks. This is primarily as a result of the fact that many leading foreign banks now require lending partners to have ESG credit risk practices in place. This awareness is driven from both the supply and demand side, as Nigerian Banks seek lending opportunities and foreign banks seek access to new markets.

Stock Exchange: The Nigerian Stock Exchange (NSE) was established in 1960 and currently has some 282 listed companies with a total market capitalisation on 18 August 2006 of about N4 trillion (US$31.5 billion). All listings are included in the only index, the Nigerian Stock Exchange All Shares Index.

See http://www.bis.org/
See http://www.unepfi.org/
See http://www.unglobalcompact.org/
See http://www.equator-principles.com/
See http://www.foe.org/camps/intl/declaration.html
See http://www.unpri.org/
See http://www.cia.gov/
Standards and Poor, http://www2.standardandpoors.com/
Environmental Legislation: The bulk of Nigerian environmental legislation is encompassed in the two following Acts:

- The Federal Environmental Protection Agency Act 1988. This Act established the Federal Environmental Protection Agency (FEPA), in recognition of the importance given, by the Nigerian Government, to addressing the problem of environmental degradation.\(^{40}\)
- The Environmental Impact Assessment (EIA) Act 1992 was subsequently passed, to ensure that the FEPA is empowered to manage environmental issues. The EIA Act reaffirmed the powers of the FEPA and defined the minimum requirements for an environmental impact assessment.\(^{41}\) This Act makes Nigeria one of the few developing countries to have legally entrenched the EIA tool.\(^{42}\)

Furthermore, the law provides for environmental litigation, which has been tested in a court ruling against Shell, a major oil and gas corporation, for major pollution incidents.\(^{43}\)

While not a key driver of sustainable banking in Nigeria, the environmental legislation provides an important minimum set of expectations from the government on how companies should behave, in regards to environmental issues. Nigeria, like many other African countries, is struck with the challenge of implementing environmental law and driving economic growth. Often these two factors are seen as opposing forces. The result is that in many African countries, the need to drive economic growth has resulted in higher levels of tolerance for environmental degradation.

Financial sector Regulation and Consolidation: Beginning in 2004, the Central Bank of Nigeria, headed by Governor Charles Soludo, began a drive to consolidate the banking sector in Nigeria. The Central Bank set a deadline of December 2005 for all commercial and merchant banks to hold US$182 million in shareholder funds and reserves. This represented a twelve-fold increase in the previous minimum capital requirements of US$14.6 million. From January 2006, only those banks that were able to confirm these funds were able to hold a banking licence. The result was a series of mergers, acquisitions and liquidations, which saw Nigeria’s 89 banks consolidated into 25 larger banks.\(^{44}\)

The result of the consolidation process is that the Nigerian Banking sector is now concentrated into a more robust core set of larger players. Nevertheless, the sector is still relatively small.

Further information on the Nigerian banking sector consolidation is provided in the Appendix 5.0.

Codes of Corporate Governance: In the last five years, corporate governance has become one of the most debated corporate issues in Nigeria. In 2001, the Securities and Exchange Commission of Nigeria set up a committee to produce a Code of Best Practice for Public Companies in Nigeria. This code was published in 2003 and although voluntary, all public companies are expected to comply and report on non-compliance.

Recognising the risk that the consolidation process poses to the banking sector, the Central Bank issued a revised code of corporate governance for banks in Nigeria. Compliance with this code, and annual reporting based on its provisions, is mandatory for all banks. The code aims to tackle issues such as transparency, board composition, remuneration and risk management. Although relatively new, the Code is a positive step forward for the banking sector, which is expected to provide a strong leadership role for the broader Nigerian economy.

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\(^{40}\) FEPA’s duties include: The management and monitoring of environmental standards; devising policies for the protection of the environment (biodiversity, conservation); the sustainable development of Nigeria’s natural resources and the development and operation of procedures for conducting environmental impact assessments for all development projects, of the accuracy of the environmental assessment of a project; and determination of the effectiveness of any measures taken to mitigate the adverse effects of any project.

\(^{41}\) The EIA Act empowers the Agency to ensure the implementation of mitigation measures and follow-up programmes such as the elimination, reduction, or control of the adverse environmental effects of any project; the restitution of any damage caused by such effects, through replacement, restoration, compensation or any other means; verification of the accuracy of the environmental assessment of a project; and determination of the effectiveness of any measures taken to mitigate the adverse effects of any project.

\(^{42}\) Further information on the EIA Act and its effect can be found in: “Environmental Impact Assessment as a Tool for Sustainable Development: The Nigerian Experience”, Ifeanyi ANAGO, FIG (International Federation of Surveyors) XXII International Congress Washington, D.C, USA, April 19-26 2002: http://www.fig.net/

\(^{43}\) In February 2006, the Nigerian Senate ordered oil giant Shell and its partners to pay $1.5 billion to Ljaw communities of the Bayelsa State region of the Niger Delta. The Ljaw had been fighting since 2000 for compensation for environmental degradation in the oil-rich region. Further information: http://www.foei.org/climate/news/june2004-02.html

\(^{44}\) For further information, see: http://www.cenbank.org/
Other influencing factors:

- The requirements of multilateral banks are forcing local banks to reconsider their approaches to credit risk assessments.

- The IFC is one of the main sustainable banking organisations active in Nigeria. The IFC has delivered training to representatives of several Nigerian Banks and has extended credit lines to some local banks. The influence of the IFC on the practices of local banks is evident from the interviews in which they participated. Many banks have begun the process of developing ESG policies and procedures that are in line with those of the IFC. In addition to the IFC, the Dutch FMO, and the African Development Bank, to name a few, are also having an influence on the ESG practices of local banks.

- At a local level, the Risk Managers Association of Nigeria (RIMAN), formally known as Credit Risk Managers Association (CRIMA), provides an important knowledge hub for local bankers. RIMAN held its annual conference in March 2006, with a focus on the three main areas of risk management: Market Risk, Operational Risk and Credit Risk (as per the Basel II Accord). The organisation is central to capacity building in the Nigerian Banking Sector, in regards to best practice and risk management. RIMAN has recently become a strong advocate of the inclusion of ESG issues in credit risk assessments and has broadened its mandate to include all forms of risk, not just credit risk.

- The Basel II Accord. While the Basel II Accord does provide a small incentive for the management of ESG issues, this is not seen as a major driver of sustainable management in the banking sector in Nigeria.

- In December 2005, the Central Bank of Nigeria published a Framework for Risk Based Supervision for Banks in Nigeria. The document presents an overview of the Central Bank’s approach to risk based supervision, as well as a guideline for risk management systems. Importantly the document requires that banks submit a copy of their Risk Management Process to the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation for appraisal and review. The document has focused the Nigerian Banking industry on the importance of effective risk management processes and systems.
Interview Findings

“We grasp reality by integrating sustainability issues in our risk assessment. We do so because we believe that information on sustainability issues improves our strategic and project decision making as we foresee financial institutions and banks playing an important role to engender sustainable development of our African continent!”

Elsa Kruger-Cloete
Development Bank of Southern Africa

In this section the South African and then Nigerian interview findings are presented:

■ 10 banks participated in the South African leg of the research – five local banks, two development banks and three branches of foreign banks.†

■ 12 banks participated in the Nigerian focused research. Participating institutions included 10 local banks, one trade bank and one foreign bank.‡

Interviews were conducted with a range of senior personnel in the banks, including investor relationship managers, credit managers and sustainability managers. The findings have been aggregated to provide a general picture of how the participating banks include ESG issues in credit risk assessments and policies.

In terms of the guiding sustainability frameworks at their institutions, participants indicated that policies within their organisations occurred at two broad levels: cross-functional policies and functional policies. In-depth interviews were conducted on the nature of these policies and in particular on whether specific policies relating to credit risk assessments and ESG issues existed. Where they did, participants were asked how policies are implemented and actual assessments conducted.

When talking about credit risk policies specifically, participants indicated that the responsibility of implementing credit policies resided with their senior credit risk team, which in most cases included both executive and non-executive directors. In practical terms, the actual day to day implementation of the credit policy resided with the heads of the various credit risk committees, as well as the investment officers.

Participants also indicated that the following issues were considered as critical in terms of undertaking a credit risk assessment: financial performance, economic performance and management performance. It was clear that ESG issues were considered secondary in terms of credit risk assessment processes. When they did feature, it was mostly because of the reputational risk they presented. Where sustainable functional policies pertaining to credit risk assessment existed, they occurred as sub-clauses in the bank’s main functional credit policy. All stressed that the primary focus of their credit decisions was the ability of the borrower to pay back the loan.

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† A list of participating institutions is provided on page 62.
‡ Ibid.
§ Policies exist in banks in order to provide a consistent approach to a particular issue affecting the bank.
∥ Cross-functional policies apply across all the bank’s activities and are typically a public statement of the bank’s values in terms of a particular issue, for example, a transformation policy or an environmental policy.
¶ Functional policies are product specific and often overlap with direct operational practices, for example credit policy and manuals. These types of policies are not made public as they are considered to be part of the bank’s core competitiveness.
South Africa

1 Sustainability policies

When questioned on the nature of broad sustainability policies, of the 10 participating institutions:

- All indicated that sustainability is an element of broad cross-functional policies.
- Two indicated that while cross-functional sustainability policies existed, they had not been formally endorsed or signed by the directors.
- Eight indicated that they included sustainability – more specifically ESG issues – within their credit risk assessment policies. Of these, two indicated that the sustainability sub-clauses of the credit policies had not been officially signed-off by the board.
- All indicated that defined credit risk policies existed, however, the detail of the functional credit policies varied.
- All the participating banks indicated that ESG policies are reviewed on an ongoing basis. Four banks made reference to the fact that this process is formalised and undertaken annually with the aid of specialists.
- All the banks indicated that there are no geographical boundaries to the applicability of their environmental policies and that they apply equally in both domestic and foreign markets.
- All banks indicated that operating in Africa was difficult, as in many countries local legislation is either not highly developed or not enforced and banks faced the challenge of setting ESG standards.

2 Environmental issues

When questioned on the extent to which environmental issues factor in credit risk assessment policies, participating financial institutions:

- Showed a wide variety of policies relating to the indirect and direct environmental impacts associated with their financial operations.
- Demonstrated in all cases, a stand-alone general policy concerning the particular bank’s approach to environmental issues. In some cases this was expanded to include issues of safety and health.

More specifically:

- Eight of the banks indicated that their credit policies included a specific reference to the need to consider environmental issues in credit risk assessments.
- Due to their specific product focus, foreign banks indicated that their practical experience in implementing their environmental credit policies, in South Africa, focused largely on corporate and project financing. While local banks – excluding development banks – provided a full range of products (personal loans, small business and retail, large corporate and commercial, and project financing) they indicated that their ESG credit policies tended to focus on project financing.
- South African commercial banks have been slower in relation to foreign banks in the development of comprehensive ESG credit risk policies. It would appear that the focus on Black Economic Empowerment issues, in recent years, has kept these banks’ attention focused very much on the social transformation issues of South Africa. Two banks, however, indicated that they had recently appointed attorneys to undertake extensive legal reviews of the banks’ activities in relation to environmental issues.

3 Social Issues

All participants were questioned on the extent to which social issues factor in credit risk assessment policies. Their responses are analysed below:

- All participant financial institutions had broad-ranging social policies that varied from statements committing them to provide healthy work environments, to fair employment and social transformation.
- Three institutions indicated that their credit risk assessment policies and procedures had been aligned to reflect the targets of the Financial Sector Charter (FSC).
- All indicated that the FSC commitments only applied to transactions involving South African companies and would not apply outside South Africa.
All institutions interviewed provide broad policies concerning HIV/Aids. These policies, however, did not translate into functional structures concerning credit risk assessments.

4 Governance issues

When questioned on the extent to which governance issues factor in credit risk assessment policies, there was agreement amongst participants that:

- The assessment of the management practices of companies seeking loan facilities forms a part of the traditional due diligence process followed in terms of a credit risk assessment.
- A close relationship exists between the quality of a potential client’s management team and the level of attention paid to ESG issues by that particular client (i.e. clients with strong forward thinking management teams typically have a proactive approach to the management of ESG issues).
- Unsound management and governance practices are reason enough to refuse a loan facility. Good performance against this criterion is considered non-negotiable.

However, of the participating financial institutions:

- Three indicated that no formalised policy was in place to ensure that governance issues were considered as a part of the credit risk assessment process. This was rather undertaken as a matter of good business practice.
- Seven indicated that while not explicit in their lending policies, governance issues were critical to all lending decisions.

5 ESG credit risk policy implementation

Seven banks indicated that to translate their ESG credit policies into actual practice, they provide tools to assist investment officers in the consideration of ESG issues. These tools included:

- Schematic diagrams or verbal descriptions of the process that should be followed by the investment officer, in the consideration of ESG issues. A series of prompts in these diagrams/descriptions indicate to the investment officer the most appropriate response required. Four banks used this tool.
- Questionnaires, used by the investment officer in his engagement with the borrower in order to identify any major ESG risks associated with the borrower’s activities. Five banks used this tool.
- Risk Matrices, used to help the investment officer identify, up front, the kinds of environmental and social issues relevant to each of the major business sectors. Five banks used this tool.
- Environmental, Social and Governance specialists and help desks, used by the investment officer as a source of specialist knowledge, or for assistance in drafting appropriate terms of reference for required specialist studies. Four banks used this tool. This function resided within their head offices, which in some cases, were situated outside of South Africa. This approach was favoured by the development banks that are mandated to ensure sustainability issues are factored into their lending decisions. One international bank indicated that all credit decisions required sign-off from their environmental office, prior to the credit committee making funds available.

Interviews showed the level of sophistication of these tools varied considerably, with the international banks being more advanced than local banks in this regard.

Sector classification remained the most common method of identifying the potential for environmental risk, with the sectors, in turn, being classified into risk categories. To this end, some banks relied on their sector experts to be fully aware of the environmental and social issues affecting that particular sector. Sector screening by banks also allows the banks to screen out certain sectors, in which they will not participate, that is: nuclear, armaments and so on. In addition, issues such as the physical location of the borrower, the existence of legislation and previous performance of the client, are considered by some of the banks in order to develop a risk profile for the client.

Banks had a varied approach to dealing with their clients in relation to ESG issues. Four banks preferred a more participatory approach to resolving ESG issues with their clients. This includes pointing out possible environmental problems to the client during the credit application process and providing solutions. The remaining banks preferred to have a hands-off, non-prescriptive relationship with their clients.
All the banks with credit risk procedures pointed out that, along with the standard terms of their financial agreements, the inclusion of ESG covenants and waivers is common practice. This may include, for example, the requirement that the borrower report any major environmental incidents to the bank, or that the borrower is required to comply with any future environmental legislation affecting their operations.

6 ESG credit risk assessment

The banks interviewed use a typical three-stage process:

1. General investigation: Schematic diagrams or verbal descriptions of the process that should be followed by the investment officer, in the consideration of ESG issues. A series of prompts in these diagrams/descriptions indicate to the investment officer the most appropriate response required. Four banks used this tool.

2. In-depth research and interviews: This stage involves a more detailed follow-up of the items flagged in the first stage and may require a review of the issues, such as: historical land usage, type of technology being used, extent of land contamination, environmental management, emergency and mitigation procedures, insurance cover.

3. In-depth investigation: At this stage, in-depth investigation is undertaken by bank-appointed specialists or in-house specialists. This may include a full environmental due diligence and/or an environmental and social impact assessment (ESIA). These costs are borne by the borrower. In some cases, banks may request that the borrower redo the ESIA. This is required where the ESIA standards used are not deemed to be sufficient, or the clients appointed ESIA consultants are not considered to be credible (i.e. independent). All banks indicated that they would require compliance with local EIA legislation as a minimum. Where this was not deemed appropriate, compliance with World Bank and IFC standards were used. One bank noted that this had been an issue, particularly where clients indicate that an ESIA has been undertaken by local consultant in terms of the local legislation. As a result the bank now encourages African clients to engage with their environmental help desk, as early in the lending process as possible, so that appropriate standards can be set and environmental consultants identified. An additional challenge noted was that an analysis takes time and investment officers often take the route of least resistance, that is, implementing the credit policies without undertaking in-depth analysis.

The banks used differing techniques for putting a price tag on the potential environmental risks and liabilities. Given the diverse range of environmental issues, no one technique is suited to assessing all types of risk and liabilities. The most commonly used techniques, however, were professional judgement and engineering cost estimates.

Following completion of the assessment process, the banks had a range of methods for incorporating their assessment into their lending decisions. These included:

- Making a note for discussion at a credit committee meeting,
- Providing a numerical score for incorporation into a model and provision of a generic low/high risk score.

In all cases the banks were in agreement that it is impossible to provide an exact indication of the extent to which ESG issues influence credit risk decisions.

Similarly, the banks were unanimous in saying that given current lack of formalisation concerning ESG practises it would be difficult to provide a summary of the financial exposure a bank had to ESG issues. All banks indicated that while it is possible to provide a rough summary of the financial exposures to certain “dirty” sectors, this did not necessarily provide a good estimation of ESG risk exposure. This is especially the case because clean up liability could, in some cases, be in excess of the loan value.

None of the banks interviewed were able to provide examples where ESG issues had directly influenced the pricing of a loan, although several banks did indicate that loans had been turned down as a result of ESG issues.

All banks noted that factoring ESG issues into a deal, provided increased expense for the banks and the clients and had the potential to make the deal a lot more time consuming. Foreign banks noted that some business in Africa is lost to local banks that do not include ESG issues into their credit risk assessments. This lack of level playing fields was cited by three banks, which indicated that responsible
competitiveness is an issue that the South African banking industry body should tackle.

7 ESG policy procedure and management

This section provides an overview of the manner in which the participating banks ensure that their policies and procedures are indeed being implemented and managed.

- The primary tool used by banks is the self-audit mechanism. Four of the banks, with more formalised ESG policies and procedures, indicated that annual audits of lending documentation were undertaken, in order to assess the application of the ESG credit policies. Incidents where the policy has not been applied were reported and remedial action undertaken. In all cases, the banks indicated that these exceptions were treated seriously, with the offending lending officers likely to be given additional ESG credit supervision.

- In addition to auditing, those banks that provide a centralised help desk or specialised ESG services, indicated that they track the usage of these services as a means of monitoring the application of ESG policy implementation. As one bank requires sign-off from the ESG office prior to all lending decisions being made by the credit committee, they had a very good understanding of the implementation of their ESG credit policies. One bank indicated that their in-house environmental team was made up of environmental experts seconded from major environmental firms. It would appear that the larger banks with more resources were able to afford such in-house expertise.

- Those banks that do not have a centralised ESG credit risk team, indicated that while outside consultants were some times appointed by the credit risk committees, they had no formalised manner of tracking the implementation of their ESG credit risk policies.

- All of the banks indicated that they made use of external specialised services for technical or legal information in relation to ESG issues.

- One bank indicated that they provided technical assistance grants to their clients in order to undertake capacity building in relation to ESG issues. This bank has developed an in-house training academy for social and environmental issues, which it uses for undertaking capacity building of this nature.

- A critical component ensuring effective implementation of ESG credit policies, is specialised in-house training in relation to the content of the ESG policies and the ESG credit risk procedures. Fifty percent of the banks indicated that they had specialised training courses for credit officers focusing on ESG assessment procedures. This training took the form of in-house lectures and production of manuals. Two banks also undertook online training in the form of tutorials and case studies. Three banks indicated that they had up-to-date registers listing which credit risk managers and investment officers had been through the ESG training seminars. One bank had included ESG training as a key performance indicator for senior credit risk managers, who are required to complete a certain number of ESG training seminars on an annual basis. Use of internal emails, newsletters, case studies and the company intranet for communication of ESG issues was commonly practiced by four of the banks.

- Only one bank provided evidence of the use of an indicator for monitoring ESG credit policies. In this case, the indicator described the % of credit extended in a particular year that complied with the banks ESG credit policy.

8 ESG reporting

This section provides an overview of the extent to which the banks reported or communicated with their stakeholders, regarding the application of ESG policies and procedures.

- All of the participating banks provided a reference to the direct and indirect impacts associated with their lending activities in there annual reports. In some cases a brief overview of the manner in which indirect impacts are addressed was included in the annual report.

- Seven of the banks provided direct reference, in their annual reports, to the manner in which ESG issues are factored into credit assessments (one bank provided an example of this).

- Four banks gave details in their annual reports of the training they provide to lending officers.

- Three banks reported in their annual reports the extent to which they engage with external stakeholders
concerning ESG issues and the provision of credit.

9 Opportunities and costs of applying ESG policies as highlighted by South African Banks

Having good ESG practices in place allows local banks to more easily access financing from multilateral banks and in addition, more easily participate in syndicated loans:

- Two banks indicated that as a result of having good ESG practices in place, they were able to more easily access financing from multilateral banks and in addition, were more easily able to participate in syndicated loans.

Applying ESG credit policies minimizes the downside of transactions, and significantly boosts the upside:

- This involves an extensive desktop review and the use of screening tools, in order to establish whether further investigation is required. The IFC Environmental Assessment guidelines are used by several banks at this stage, in order to establish the category of project and the necessary response. Depending on the scale of potential impact, an initial site investigation may be undertaken at this point in time.

The application of ESG policies assisted in identifying good creditors:

- The same two banks indicated that their experience in applying ESG policies has indicated that there is a strong relationship between creditors with good management and creditors who had in place good governance, environmental and social systems. As a result of this insight, these banks indicated that the application of ESG policies assisted in identifying good clients to lend money to. One bank indicated that as a result of their decision to work closely with clients to resolve ESG issues in the credit application process, they are able to grow and develop better relations with these clients and so develop a more loyal client base.

ESG issues can pose a burden in the short term, but provide long-term opportunity:

- Some banks are of the opinion that it is just a question of time before major liability cases become a reality in South Africa and across the African continent. Others are convinced that the positive impacts of incorporating ESG factors in credit risk assessment provide sufficient justification of long-term opportunity. While these points are contradictory all of the banks agreed that consideration of ESG issues is here to stay.
**South Africa Summary**

This section summarizes the findings of the South African interviews, and provides a snapshot view of where the participating financial institutions comparatively stand in terms of their broad level commitments to sustainability and the extent to which Environmental Social and Governance issues factor in credit risk assessment policies.

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<td><strong>Just starting out:</strong></td>
<td>Banks in this group have recognised the link between their lending activities and sustainability issues. In all cases, broad policies exist, however, not all of these policies are formally adopted by the bank’s board. Some banks go as far as mentioning the fact that they intend starting to factor ESG issues in their credit risk assessment processes. These banks displayed evidence of initial training concerning broad ESG policies. While these banks tend to include ESG factors into credit risk assessments as a part of good business practice, there is little formalisation of procedures or guidelines. These banks typically focus only on their project financing activities in terms of the application of ESG issues, with reputation damage being the primary driver.</td>
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<tr>
<td>Three banks</td>
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| **Starting to formalise:**  | Banks in this group actively manage ESG issues in their credit risk assessment processes, through defined policies and procedures. They typically apply their policies across the bank’s entire operations with a focus on project financing. In all cases, investment officers are required to implement the ESG credit policy at the start of the loan application procedure. This procedure, in all cases, followed the generic process of desktop review, in-depth interviews, followed by in-depth investigation. All of these banks typically displayed evidence of using ESG analysis tools, such as sector classification and in addition, external consultants. These banks all indicated that training regarding ESG policies was undertaken, although detailed records of this training is not necessarily kept. In all cases these banks provide reference to the application of ESG credit procedures in their sustainability reports and some of these banks indicated that they had engaged with stakeholders in connection with ESG credit-related issues. |
| Four banks                  |                                                                 |

| **Displaying best practice:** | All of these banks displayed several elements of what is considered best practice and in addition displayed a level of maturity regarding their application. Details concerning what is considered best practice are provided in the Sustainability Credit Risk Assessment Guidance section of the report (pp13-19). The following factors are included: |
| Three banks                  | • Board-endorsed cross-function policies, |
|                             | • Defined ESG credit risk tools, |
|                             | • In-house technical support, |
|                             | • Performance indicators for credit risk managers, |
|                             | • Comprehensive reporting, |
|                             | • Detailed training and training tools, |
|                             | • Engagement with stakeholders. |
Nigeria

1 Sustainability policies

When questioned on the nature of broad sustainability policies, of the 12 participating institutions:

- Three banks indicated that they had a policy establishing the links between environmental and social issues and the bank’s credit practices. Two of these banks indicated that these policies had been put in place for the sole purpose of aligning themselves with multilateral banks, so that credit facilities could be accessed.

- One bank had both an over-arching policy that touched on environmental, social and governance issues, as well as having a credit policy that made specific reference to ESG issues. This bank had a clearly defined system for reviewing the policy and ensuring that implementation was clearly allocated to a responsible individual. In addition, this bank’s ESG policy made clear reference to the scope of its application, applicable standards and its geographic boundaries.

- All 12 banks interviewed indicated that they had some form of credit policy, which established a hierarchy of decision-making and lending authority. Of these 12 banks, only one bank indicated that they had a detailed credit policy that specifically identified ESG issues as critical to all credit assessment procedures. In addition to this, two banks indicated that they had credit policies making explicit reference to ESG issues. However, the two banks indicated that their policies where aligned with the IFC policy standards and that they were only applied when accessing the specific IFC credit lines (although one bank did indicate its intention to extend the policy to all areas of the bank’s financing activities). Both of these banks indicated that their ESG credit policies had been signed off by their respective boards.

- The two banks with policies aligned with multilateral finance organisations had policies that were structured to include the following:
  - Rationale/ objective of the policy
  - Standards
  - Procedures
  - Roles and responsibilities
  - Use of experts
  - Training
  - Communication and reporting
  - Monitoring and review

The content and structuring of the above policies provide a solid basis, from which the bank could approach ESG issues. Unfortunately the application of these policies was limited to the credit lines of the main funding organisations (IFC, Dutch FMO, European Investment Bank).

2 ESG issues

The following results were given, when participating financial institutions were questioned on the extent to which ESG issues factor in credit risk assessment policies:

- Ten of the 12 participating banks indicated that no environmental or social sub-clauses existed within their existing credit policies. Notwithstanding, these banks did, however, agree that such a policy would be beneficial for protecting the bank’s value, accessing foreign credit lines and enhancing reputation.

- All of the banks indicated that governance policies were in the process of in being revised to reflect the Central Bank’s code of Good Governance. The banks all agreed that this provided a useful benchmark for good corporate governance. In respect of assessing clients’ governance practices, all banks indicated that they applied the Know-Your-Client standards as specified by the Central Bank and that they required their clients to comply with the Government’s anti-money-laundering requirements.

3 ESG Credit Risk Policy Implementation

This section focuses on how Nigerian banks are translating their ESG credit policies into actual practice. Only the results from the three banks that have ESG policies are presented:
All three banks indicated that the day-to-day implementation of the policy was the responsibility of the individual investment officers.

In all three banks a basic series of tools existed to support investment officers. These tools consisted of the following:
- Documentation outlining the project review procedure,
- Basic exclusion and categorisation lists.

One of the three banks indicated that they had more detailed risk matrices for each industrial sector, legal registers and a specialist environmental help desk that provides advice on projects.

None of the three banks were able to provide examples where ESG issues had directly influenced the pricing of a loan, although there was an indication that loans had been turned down as a result of ESG issues.

The three banks had a varied approach to dealing with their clients in relation to ESG issues. One bank indicated a more participatory approach to resolving ESG issues with its clients. The remaining two banks indicated a hands-off, non-prescriptive relationship with clients concerning ESG issues.

The interviews indicated that all three banks include ESG covenants and waivers, where applicable, in their financial agreements. This may include, for example, the requirement that the borrower report any major environmental incidents to the bank, or that the borrower is required to comply with any future environmental legislation affecting their operations.

4 ESG Credit Risk Policy Assessment

This section presents exclusively results from the three banks that have ESG policies.

All three banks indicated that where ESG issues were identified, a generic process was followed that included a desk-top study followed by in-depth client interviews and where necessary, in-depth specialist studies. If detailed investigations were required, a detailed environmental and social impact assessment was typically undertaken.

In all cases, the investment officers relied on their professional judgment to review a lending application on its merits, prior to bringing it to the credit committee for consideration.

All three banks indicated that the Environmental Impact Assessment should be undertaken in line with the applicable country regulations, as well as the World Bank/IFC environmental health and safety guidelines. Where such EIAs were required, credit officers are obliged to ensure that the mitigation measure specified in the Environmental Management Plan forms the basis of an ESG covenant within the facility agreement.

Following completion of the assessment process, the banks all indicated that the preferred method of incorporating their assessment into their lending decisions was to include a note on the client file for discussion at a credit committee meeting.

All banks noted that factoring ESG issues in a deal provided increased expense for both the banks and the clients, and had the potential to make the deal a lot more time consuming. Nonetheless, all banks strongly believed that the process added value. The three banks did pinpoint that applying ESG criteria did, in some cases, drive clients away.

5 ESG Policy and Procedure Management

This section provides an overview of the manner in which the banks ensure that their ESG policies and procedures are indeed being implemented and managed. Again, this section focuses solely on the three banks with ESG policies and procedures.

One of the three banks indicated that formalised annual audits of lending documentation were undertaken, in order to assess the application of the ESG credit policies. Incidents where the policy has not been applied were reported and remedial action undertaken. The bank indicated that exceptions were treated seriously, with the offending lending officers likely to be given additional ESG credit supervision.

The remaining two banks were unable to provide clear assurance that the internal audit mechanism was in place, to ensure effective implementation policies and procedures.
None of the three banks indicated having any ESG expert representation at a board level, to ensure effective ESG implementation.

All three banks indicated that, where applicable, they made use of external specialised services for technical or legal information in relation to ESG issues.

A critical component ensuring effective implementation of ESG credit policies is specialized in-house training in relation to the content of the ESG policies and the ESG credit risk procedures. Two of the banks indicated that they had been recipients of external training by international multilateral finance institutions; however, the extent of internal training was limited. The remaining bank indicated that it had a detailed in-house training system for ESG issues and that this was undertaken through online training modules. All credit officers in this particular bank were required to log a specified number of training modules, in order to be certified to act as a credit officer. In addition, this bank indicated that it also made use of occasional newsletters and case studies on ESG issues.

6 ESG Reporting

This section provides an overview of the extent to which the participating banks reported or communicated with their stakeholders, regarding the application of ESG policies and procedures.

All of the banks interviewed undertook some form of annual reporting, although the concept of pure sustainability reporting is not well entrenched within the Nigerian banking sector.

Only one bank could claim to have a sustainability report, even if this report was presented at a global level, which is of little relevance to a local Nigerian stakeholder.

While no direct sustainability reports were provided by local banks, two banks did make reference to impacts associated with the banks’ lending activities. Beyond this, no further details were provided in the annual reports, concerning the manner in which the banks account for the indirect impacts of their credit lines.

7 Opportunities and costs of applying ESG policies

The Nigerian banking sector is coming out of an intense period of change and as a result, addressing the management of ESG issues is not seen as a high priority.

While only three of the Nigerian Banks interviewed provided specific evidence of ESG credit policies, all the banks agreed that the application of ESG credit policies was seen as an important factor in protecting the bank’s value.

In addition, all the banks agreed that the key driver of ESG issues in Nigeria was the potential to access foreign credit lines, participate in syndicated loan facilities and enhance the bank’s reputation. Similarly, all the banks agreed that the concerns over lender liability were not a key driver of ESG issues in Nigeria.

Discussion with the banks that had no ESG policies did indicate that some of them had experiences of poor performing loans as a result of ESG issues. They further indicated that if ESG screens had been applied, these loans could have been avoided.
**Nigeria Summary**

This section provides a snapshot view of where the sample study participating financial institutions in Nigeria stand in terms of their broad level commitments to sustainability and the extent to which Environmental Social and Governance issues factor in credit risk assessment policies.

<table>
<thead>
<tr>
<th><strong>ESG issues not on the radar:</strong></th>
<th>These banks have not yet drawn the link between their lending activities and social and environmental degradation. Similarly these banks have not yet seen that the inclusion of ESG issues into credit screening processes can protect the bank’s value. More fundamentally, these banks do not appear to fully grasp the concept of sustainability and do not see that they have a role to play in forwarding this agenda. This general lack of awareness can be linked to a lack of capacity. Despite this, these banks appeared keen and willing to address these issues in the future.</th>
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<td>Three banks</td>
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<tr>
<th><strong>Moving towards the start line:</strong></th>
<th>This group represented 50% of the sample. Banks in this group are beginning to grasp the idea of sustainability and are beginning to accept the link between their lending activities and sustainability issues. In all cases no ESG policies existed although there was in general a desire to begin developing such policies. Banks in this group see the potential to enhance relationships with foreign banks and to potentially access on-lending opportunities is the key motivating factor in driving behaviour change.</th>
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<td>Six banks</td>
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<tr>
<th><strong>Moving towards formalization:</strong></th>
<th>Banks in this group actively manage ESG issues for a select portion of their loan portfolio. This is done through defined policies and procedures that are aligned to international financial institution policies and procedures. These banks require investment officers to implement the ESG credit policy at the start of the loan application procedure. This procedure, in all cases, followed the generic process of desktop review, in-depth interviews followed by in-depth investigation. These banks all indicated that some form of external training had been received however ongoing internal training was limited. These banks did make passing reference to the application of ESG credit screens in their annual report. However, as yet they have not provided dedicated sustainability reports addressing these issues to stakeholders.</th>
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<td>Two banks</td>
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<tr>
<th><strong>Displaying elements of best practice:</strong></th>
<th>This bank displayed several elements of what is considered best practice and in addition, displayed a level of maturity regarding their application. Details concerning what is considered as best practice are provided in the Sustainability Credit Risk Assessment Guidance section of the report (pp13-19). They include:</th>
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<tr>
<td>One bank</td>
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<tr>
<td>- Board-endorsed cross-function policies,</td>
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<td>- Defined ESG credit risk tools,</td>
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<td>- In-house technical support,</td>
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<td>- Performance indicators for credit risk managers,</td>
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<td>- Comprehensive reporting,</td>
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<td>- Detailed training and training tools,</td>
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<td>- Engagement with stakeholders.</td>
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Summary Observations

3 banks are displaying elements of best practice
1 bank is displaying elements of best practice
4 banks are starting to formalize
3 banks are moving towards formalization
6 banks are moving towards the start line
4 banks are starting out
1 bank is displaying elements of best practice

For 3 banks ESG issues are not yet on the radar
Appendix

1.0 Research Questionnaire

Section One: General

The objective of this section is to capture some basic background information on the organisation (this will be supplemented with a review of the organisations year end and sustainability report prior to the interview).

Date and Time of Interview
Interviewer Name
Organisation Name
Respondent Name
Respondent Position
Respondent Department

Section 2: Policy Framework for Sustainability Credit Risk Assessments (SCRA)

The objective of this section is to identify the degree to which environmental, social and governance issues are addressed within the organisations policy and management structures.

1. Please provide a description of the policy and structures in your organisation that specifically support ESG credit risk assessment. In describing the policies please note:
   - Year of policy adoption
   - Policy review procedures, please provide dates
   - Policy amendments, please provide dates
   - Who has ultimate responsibility for the policy (please state their position)
   - Who has ultimate accountability for the policy
   - Scope of policy: Geographic and Product/market segmentation (see guide below as applicable)
   - Any objectives or targets and timetables pertaining to the implementation of the policy
   - Any thresholds that determine the application of the policy
   - Whether the policy is publicly available or how the policy can be accessed.

2. Please describe which of the banks product markets that currently apply ESG credit assessments. In answering this question please describe:
   - Product category
     - Personal loans
     - SME loans
     - Corporate
     - Project
   - Type of loan financing
     - Unsecured
     - Secured on Land
     - Secured Other
     - Project Finance as Recourse
     - Non-recourse

50 Non recourse – A loan where the lending bank is only entitled to repayment from the profits of the project the loan is funding, not from other assets of the borrower.
3 Are there any instances where the bank policy does not apply?
• When the bank is not the lead bank in a syndicated transaction
• Where a borrower enjoys third party guarantees

4 Does the bank have any specific environmental or social products or services?
• Green Loans
• Bonds
• MortgESG
• Clean technology
• Energy Efficiency
• Etc
If so please provide details of (Target Market characteristics, screening criteria, loan conditions, special conditions or pricing offers)

Section 3: Method of implementing SCRA
The objective of this section is to gain an understanding how SCRA is applied within the specific organisation.

1 What are triggers the application of SCRA? (Product Type, Industry Sector, Loan Size, Geographic location)

2 Summarise the key elements of the SCRA process
• Types of risk identified (reputation, direct, indirect)
• Tools used in assessment (questionnaires, matrix’s etc)
• Types of social or environmental standards used
• Key issues that are given priority
  I. Industrial sectors/ processes?
  II. Geographic location?
  III. Contaminated land, and/or air, water?
  IV. Legislation/ compliance issues?
  V. Environmental certifications?
  VI. Market dynamics?
  VII. Size of borrower?
• Are potential customers into environmental risk classifications? If so, what specific factors act as “triggers” which establish the need to proceed to a higher level of risk analysis?
• What form does the result of the SCRA take? E.g. Note on file? Influence on credit rating/ ranking? Other?
• What impacts may the SCRA have on the terms of the financing or the nature of the overall client relationship? E.g. Pricing? Loan repayment schedule? Additional covenants or waivers? Availability of other products? Other?

3 Is the originator or client relationship manager aware of the elements of SCRA?

4 Do external advisers play a role in the conduct of your SCRA? If so, what is the profession of such advisers and what function do they provide? How extensively are they used?

5 In what proportion of cases does SCRA involves the use of the following, please state an average percentage (%) for each:
  I. Manual desktop review?
  II. Face to face discussion?
  III. Site visits?
  IV. Site investigation?
  V. Standard on-line assessment
VI. Expert (IT) systems analysis?
VII. Other?

6 Do you formally measure the level of environmental risk within your portfolio? If so, how is this risk measured?

7 What are some of the challenges you are faced with in terms of implementing SCRA within your organisation?

8 Are you able to reference any institution that you would consider as leading edge in terms of the application of SECRA?

9 Please describe the how you perceive the overlap between governance and SCRA

Section 4: Influences on Governance and SCRA

The aim of this section is to establish what drives the implementation of SCRA within the bank and how this is linked to governance

1 What is driving the implementation of SCRA at the bank? (rank in order of importance)

I. International Regulations/Guidelines (BASEL II, OECD Guidelines)
II. National Regulations (NEMA, Air Pollution Control Act, Water Act)
III. Codes (King II, Charter, Equator Principles )
IV. Reputation Management
V. Income Generation opportunities
VI. Credit ratings
VII. Protection of security value
VIII. Default risk minimisation
IX. Other

2 How is Social and Environmental Credit Risk linked to other risks, credit or otherwise within the corporate governance procedures of the bank? (e.g. reputation & political risk exposure) Please specify type of risk and association

3 Please provide additional details on your motives for conducting SCRA. E.g.
- Local and international legislation and regulation (e.g. land registration/ liability regimes/ define requirements/certification requirements)?
- Government incentives (e.g. tax incentives)?
- Reputation risk management?
- Political risk management?
- Exposure to certain customer groups/sectors?
- Competition/ other banks?
- Stakeholder demand?
- Wider demands of society?
- Corporate governance?
- Transparency (e.g. accuracy in reporting of liabilities)?
- Desire to bring down default rates?
- Protection of security value?

Expand, giving priority to your motives.

4 Have you any third party affiliations that influence your conduct on Governance and SCRA? E.g. UNEP, WBCSD, Green parties/ NGOs, Government working groups, Banking associations, Environmental working groups, Others?
Section 5: Embedding SCRA

This final section is focused on establishing how the bank embeds SCRA within the organisation.

1. Please provide details of resources made available to support policy implementation, including where available financial cost information. Eg Policy and procedural guidance documentation? Handbook/manuals? On-line procedural assessment in the bank (i.e. bank’s intranet)? Other?
   - Board member training
   - Fraud and tip off hot lines
   - Lender training:
     - Classes for new lending officers? Number of days? In-house?
     - Classes for experienced lenders? Number of days? In-house?
     - On-line/CD-rom training package?
     - Video training package?
     - Other?
   - Technical support team (dept./unit, please indicate external advisers roles)
     - Environmental business advisers?
     - Environmental auditors?
     - Property valuers incorporating environmental assessment?
     - Environmental scientists
     - Panel of investment officers
     - Researchers
     - Other?
   - Environmental Help-line
     - Bank specialists?
     - Investment officers?

2. Do you set targets as part of policy performance review/evaluation? Please comment on examples of performance indicators and performance levels achieved.

3. How frequently is policy and implementation reviewed?

4. Does your organisation publish information/report internally and externally on its governance, and social and environmental credit risk performance? If so,
   - What is reported?
   - What is your target audience (E.g. shareholders, brokerage community, employees, customers, regulators, environmental groups)?
   - How often do you report?
   - In what medium do you report
     - E.g. Annual report
       i. Environmental/sustainable development report/other
       ii. Internal newsletter
       iii. Website
       iv. Other

5. What are the key factors you use to benchmark yourself against other banks?

6. What organisational structures/procedures do you have in place for consultation/feedback/continuous improvement?

Final discussion points:
Do you perceive SCRA to have an impact on your bank’s profitability and/or shareholder value? Please provide a statement of opinion and justification for discussion.
2.0 Sustainable Banking

Sustainable banking can be interpreted to mean the process whereby banks consider the impacts of their operations, products and services on the ability of current or future generations to meet their needs. Viewed in this way, banks can be deemed to have direct and indirect impacts.

Direct impacts are those related to the operation of a bank and would include issues such as energy efficiency, waste recycling, ecological footprint, employment conditions.

Indirect impacts are those that follow from the products and services that banks provide, typically these impacts are associated with the finance and investment activities of banks.

The journey to sustainable banking typically takes banks through the following four progressive stages:

1. Defensive Banking – in this stage, sustainability issues are opposed as they are seen as a threat to bank profitability.
2. Preventative Banking – at this point banks begin to realise that there are cost savings to be made and risks to be averted through the application of some sustainability related activities, i.e. cutting back on energy costs and undertaking environmental risk assessments.
3. Offensive Banking – by now the bank is beginning to see the benefit of sustainability activities and actively pursues opportunities for green products and openly engages ESG discussions with its major stakeholders. Developing sustainability funds and undertaking sustainability reporting typically characterises banks in this phase.
4. Sustainable Banking – in the final phase of “evolution” the concept of sustainability has penetrated the core corporate philosophy of the bank and its shareholders. This allows the bank to pursue projects that offer the highest rate of sustainable return while remaining profitable. This is in stark contrast with the first phase where the highest rate of return, irrespective of the cost to environment or society, is sought.

There are clear liabilities associated with contaminated land and pollution. Other risks linked to not considering environmental, social and governance issues in credit assessments include:

- Default risk as a result of the client being involved in protracted social negotiations
- Devaluing of collateral through pollution
- Reputation risk – particularly important for deposit taking institutions
- Loss of funding opportunities from international financial institutes
- Reduced access to private / international capital
- Denial of government permits
- Excessive project delays.

Aside from the potential liabilities there are very obvious opportunities to be leveraged from sustainable banking practices:

- Enhanced ability to access international funding
- Enhanced ability to identify lending opportunities for environmental projects
- Providing cleaner production and eco-efficiency advisory services for SME’s
- Accessing ethical investment funds
- Providing risk management services to high risk industries.

It should be remembered that responsible lending is only one part of sustainable banking. Leading global banks count the following as a part of their sustainable banking activities:

- Responsible investing & environmental funds,
- Transparency and disclosure of governance practices,
- Proactive support for green technologies,
- Microfinance,
- Social investment,
- Minimising operating impacts (energy & resource consumption)
- Collaboration on regional sustainability issues
- Stakeholder engagement.
While the above is applicable globally, the notion of sustainable banking requires further refinement when considering the developmental challenges that Africa faces. These challenges include:

- Addressing poverty through job creation and economic growth;
- Providing basic infrastructure such as housing, water and electricity;
- Balancing environmental sacrifice with socio-economic development;
- Confronting the impact of HIV/AIDS;
- Provision of education and skill development.

A report undertaken by the African Institute for Corporate Citizenship (AICC) and UNEP FI ATF in September 2004 entitled “Sustainability Banking in Africa” identified the following as the main challenges to implementing sustainable banking in Africa:

- Short term time frames associated with political risks: Due to the perceived political risk in many African countries, there is a reluctance of banks to finance long term projects. This short-term focus to lending by definition precludes the notion of sustainability.
- Capacity at a government level: Relates specifically to the lack of capacity at a government level, across Africa, to effectively implement and police regulations affecting the financial services sector.
- Regulatory environment: Inadequate or restrictive regulatory frameworks for the banking sector in Africa hamper the development of new, innovative products that could forward the goals of sustainability.
- Capacity in the financial sector: Low level of recognition of the sustainability issues in the banking sector in Africa and the associated lack of capacity.
- Poor management of environmental and social issues: Few banks in Africa actively manage social and environmental issues through formalised management systems such as ISO 1400.
- Poor corporate governance: Low level of transparency and disclosure around financing practices and subsequent low level of sustainability reporting by banks in Africa.

### 3.0 Equator Principles

The Equator Principles were jointly developed in 2003 by the International Finance Corporation (IFC) and ten of the world’s largest banks, including ABN AMRO, Barclays and Citigroup. The principles were developed in order to define a consistent approach to managing environmental and social risks in project financing. The Principles aim to ensure that financiers play a more substantial role in promoting sound environmental management and responsible social development.

The Equator Principles were revised in July 2006, to reflect the learning of stakeholders and bankers in the application of the principles over the past three years.

Under the revised Equator Principles, participating banks will require projects of US$10 Million or more to comply with IFC’s environmental and social “Performance Standards”. Details of the IFC performance standards can be found at http://www.ifc.org

The new standards build upon the environmental and social requirements that IFC currently applies to private sector projects it finances in the developing world. The new standards cover more areas than the old safeguards and expand on areas already covered. Specifically, eight new standards have been developed, covering the following:

- Performance Standard 1: Social and Environmental Assessment and Management System
- Performance Standard 2: Labour and Working Conditions
- Performance Standard 3: Pollution Prevention and Abatement
- Performance Standard 4: Community Health, Safety and Security
- Performance Standard 5: Land Acquisition and Involuntary Resettlement
- Performance Standard 6: Biodiversity Conservation and Sustainable Natural Resource Management
- Performance Standard 7: Indigenous Peoples
- Performance Standard 8: Cultural Heritage

The new Standards, for the first time, expand requirements to such areas as labour rights, community...
health and safety and security. The new standards contain stronger requirements for community engagement and consultation; biodiversity protection; community and worker grievance mechanisms; use of security forces; greenhouse gas monitoring; and greater disclosure of information to the public by IFC and client companies.

The standards adopt a new outcomes-based approach, which requires client companies to have in place effective management systems that allow them to handle social and environmental risks as an integral part of their basic operations and business model.

3.1 Application of the Equator Principles

Proposed projects are classified into one of three categories, depending on the type, location, sensitivity and scale of the project and the nature and magnitude of its potential environmental and social impacts. The 2006 Principles retain the three-tier (‘A’, ‘B’, ‘C’) categorisation system. However, the category descriptions have been amended to refer directly to social impacts. The categories are now described as follows:

- **Category A** – Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented.
- **Category B** – Projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.
- **Category C** – Projects with minimal or no social or environmental impacts.

For all proposed Category A and B projects, the borrower must complete an Environmental and Social Impact Assessment (ESIA) that satisfactorily addresses key environmental and social issues identified during the categorisation process. Beyond preliminary screening, no further environmental assessment will be required for proposed Category C projects. In addition to an overall assessment of the environmental and social conditions, the Equator Principles set out a wide range of concerns that the ESIA must address in the context of the business of the project, including:

- compliance with applicable host country laws and international treaties;
- impacts on the environment and indigenous communities;
- consideration of feasible environmental and socially preferable alternatives.

The ESIA must also address the project’s overall compliance with (or justified deviation from) the minimum standards applicable under the World Bank and IFC pollution prevention and abatement guidelines and, for projects located in low- and middle-income countries, applicable IFC Performance Standards.

For all Category A projects and appropriate Category B projects, the borrower must commission an Environmental Action Plan and Management System (EAPMP) which draws on the conclusions of the ESIA and addresses mitigation, action plans, monitoring, management of risk and schedules.

For lenders, the EAPMP is likely to form the basis for monitoring compliance throughout the life of the project.

For all category ‘A’ projects and, as appropriate, category ‘B’ projects, the revised principles require Equator financial institutions, or borrowers, to retain independent environmental and/or social experts to verify, for the benefit of the Equator financial institution, the monitoring information supplied by the borrower. This requirement is stronger than the equivalent provision in the original principles, which only called for the appointment of independent experts where necessary for additional monitoring and reporting. In combination with the feedback loop established by the grievance mechanism, this requirement should help to ensure ongoing compliance during the life of the project.

For all Category A projects, and appropriate Category B projects, the financier must be satisfied that the borrower, or a third-party expert, has consulted with affected groups, including indigenous peoples and local non-governmental organisations. The ESIA, or a summary, must be made available to the public for a reasonable minimum period in local language. The ESIA and EMP must take account of those consultations and for Category A projects, will be subject to independent expert review.

Significantly, the 2006 version of the Equator Principles introduces the following three important changes:

1. All projects require mitigation and management measures to be addressed in the social and
2 For all category ‘A’ projects and, as appropriate, category ‘B’ projects, they require an independent social or environmental expert to review the social and environmental assessment.

3 For all category ‘A’ projects and, as appropriate, category ‘B’ projects located in ‘other countries’, they require a grievance mechanism to be set up to allow project affected communities to raise concerns and grievances throughout the construction and operation of the project.

A full list of current (September 2006) signatories to the Equator Principles is provided below:

<table>
<thead>
<tr>
<th>ABN AMRO Bank, N.V.</th>
<th>Fortis</th>
<th>Banco Bradesco</th>
<th>HBOS</th>
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<tr>
<td>Banco do Brasil</td>
<td>HSBC Group</td>
<td>Banco Itaú</td>
<td>HVB Group</td>
</tr>
<tr>
<td>Banca Intesa</td>
<td>ING Group</td>
<td>Bank of America</td>
<td>KBC</td>
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<tr>
<td>BMO Financial Group</td>
<td>Manulife</td>
<td>BTMU</td>
<td>Mizuho Corporate Bank</td>
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<tr>
<td>Barclays plc</td>
<td>Millennium bcp</td>
<td>BBVA</td>
<td>Nedbank Group</td>
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<td>BES Group</td>
<td>Rabobank Group</td>
<td>Calyon</td>
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<td>Caja Navarra</td>
<td>Sanpaolo IMI</td>
<td>CIBC</td>
<td>Standard Chartered Bank</td>
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<tr>
<td>Citigroup Inc.</td>
<td>SMBC</td>
<td>Credit Suisse Group</td>
<td>The Royal Bank of Scotland</td>
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<td>Dexia Group</td>
<td>Unibanco</td>
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<tr>
<td>EKF</td>
<td>WestLB AG</td>
<td>FMO</td>
<td>Westpac Banking Corporation</td>
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4.0 King II

Listed companies in South Africa are required to disclose in their annual reports the degree to which they have complied with the provisions of the King Code II. Private companies are encouraged but not obliged to comply with the provisions of King II. King II promotes the concept of triple bottom-line accounting, which incorporates the economic, environmental and social aspects of the company’s activities.

King II sets out a code of corporate conduct and practices which require companies to deal with:

- the board of directors;
- risk management;
- internal audit;
- integrated sustainability reporting;
- auditing and accounting;
- relationship with stakeholders;
- communication.

King II sets the definitive benchmark for corporate governance practice in South African companies. Critically, the King Code compels organisations to integrate sustainability issues into their governance practices. For the banking sector, this would thus include the consideration of ESG issues in all lending.
decisions.

5.0 Nigerian Banking Sector Reforms
Apart from encouraging capital inflows and institutional consolidation, there are a number of other benefits that have come from the Nigerian Banking Sector reform process:

1. The liquidity engendered from the capital inflows has caused the interest rate to fall drastically, while an unprecedented 40% increase has been recorded in lending to the real sector.
2. With a higher single obligor limit, banks now have greater potential to finance “big ticket” transactions.
3. More banks now have access to credit lines from foreign banks. In an unprecedented move one bank received US$250 million from two banks.
4. Ownership of the banks has been diluted, which will help to reduce corporate governance abuse.
5. With all banks now virtually quoted on the Nigerian stock exchange there is greater regulatory oversight. Regulatory resources will now be focused on fewer and more stable banks.
6. Depositor confidence is bound to be greater and the interest rate on deposit lower, as a result of depositor perception of greater safety in larger institutions.
7. The banks will enjoy economies of scale and consequently pass on the benefit in the form of reduced bank charges.
8. The capital market has deepened and understanding about it has increased significantly among the population. The market has become more liquid and total capitalisation has markedly increased.

Prior to consolidation, the Nigerian banking sector was focused on lending money to the trade financing sector and most large local banks did not participate in long-term lending or project finance. However, post consolidation, there has been a definite move by some of the larger banks in Nigeria towards project finance and the bulking up of their credit portfolios. In addition, the consumer market is currently enjoying a lot of attention from a few of Nigeria’s larger banks. The expansion of the Nigerian Banking sector, into these areas, brings with it both new opportunities and risks.

A significant opportunity is the potential for Nigerian Banks to encourage sustainable economic growth through applying a sustainability screen in their credit risk management practices. The high state of flux in the sector presents an opportune moment to embed sustainability issues into banking processes, particularly as many ‘new’ banks are already going through a change process of merging policies, processes and systems.

6.0 Broad Based Black Economic Empowerment
BBBEE involves the economic empowerment of Previously Disadvantaged Individuals (which includes Black, Indian and Coloured persons) within four interrelated contexts:

• Direct empowerment – increasing the number of black people who manage, own and control enterprises and productive assets;
• Human resource and skills development – achieving equitable representation in all occupational categories and at all levels of the workforce;
• Indirect empowerment – promotion of preferential procurement from empowered enterprises and investment in enterprises owned or managed by black people
• Residual – involvement in social and industry developmental initiatives.

Two primary mechanisms have been introduced to ensure that these socio-economic strategies are implemented:

• Codes of Good Practice: these have been issued by the Minister of Trade and Industry and specify empowerment targets consistent with the objectives of the Act, as well as the periods within which these targets must be achieved. The public sector is required to apply and adhere to the BBBEE goals and targets set out in the Codes; (We should note these are still under development, and not finalised as yet).
• Transformation Charters: have been developed by major stakeholders in various sectors of the economy in order to promote transformation within that particular sector. The Charters are industry
specific, voluntary initiatives. (Some are voluntary, while others have been initiated by government).

Several Charters have been concluded in South Africa – Mining, Petroleum, Maritime, Financial Services, Information Communications Technology, Agriculture, Health and Tourism, amongst others. Numerous Charters are being negotiated amongst stakeholders on a continuing basis.

Through a formalised and regulated approached the government is driving a socio-economic transformation in South Africa. This transformation is considered to be a critical component of the broader sustainability agenda of the government.

7.0 Financial Sector Charter

A contentious issue has been the degree to which foreign banks operating in South Africa are bound to participate in the Charter, particularly in respect of ownership targets. As a compromise, foreign banks are permitted to invest a larger amount in the financing of empowerment deals (i.e. foreign banks are able to attain points usually awarded for black ownership by using their balance sheets to finance empowerment deals).

As a result of South Africa’s particular history, the government’s sustainable development agenda is skewed heavily towards addressing the socio-economic ravages of Apartheid. This is reflected in the FSC, which obliges the South African financial services sector to play an active role in the socio-economic transformation and development of the country. The FSC is thus a critical key driver of the social component of the broad sustainability agenda in the South African banking sector.

It is interesting to note that the FSC has not included purely social and environmental issues in the charter.

8.0 South African Legislation

Environmental legislation

NEMA is the core environmental statute in the country. It establishes universal guidelines and principles to facilitate environmental management and is also applied to manage pollution generally. NEMA provides for prevention and remediation of pollution and establishes a general duty of care. The 'Polluter Pays' principle applies under NEMA, and life cycle responsibility - in terms of which a person never loses responsibility for the environmental consequences of its actions - is also established in terms of NEMA.

The National Water Act has strong provisions governing the prevention and remediation of pollution, and it provides for a liability regime similar to that of the National Environmental Management Act.

The Air Quality Act requires companies undertaking certain listed activities to obtain authorisation for their air emissions. The Air Quality Act will however not be fully implemented until regulations prescribing air quality norms and standards have been finalised. In the meantime the transitional provisions govern emitters with registration certificates issued under the Air Pollution Prevention Act of 1965.

While South Africa’s environmental legislation has developed considerably since 1994, the structures required to enforce and police adherence to the legislation are weak. Although the government is pursuing the development of Environmental Management Inspectors, a government funded special investigative unit focusing on environmental crimes, there has yet to be a major lender liability judgement passed by the South African courts. The result is that the issue of lender liability is treated casually in South Africa by both lenders and borrowers alike. This is an unfortunate situation as the scale and profile of lender liability cases in both Europe and the USA have been critical in changing the environmental lending practices of the banking sector. Notwithstanding, environmental legislation in South Africa is an important and growing ‘stick’ for driving the management of environmental issues in the lending practices of South African banks.

Governance Legislation

Additional drivers of good governance in South Africa include the following pieces of national legislation:

**Public Finance Management Act 1 of 1999** (commonly referred to as PFMA)

The PFMA seeks to promote a sustainable financial management culture in the public sector, by ensuring an effective use of government resources and monitoring their delivery on given mandate. Organisations such as IDC, Eskom, Transnet are controlled by the PFMA. As these State Owned
Enterprises play a significant role in the national economy, the standard of corporate governance is critical to sound functioning of the economy.

**Promotion of Access to Information Act 2 of 2000**
The object of the Act is to foster a culture of transparency and accountability in public and private bodies and to actively promote a society in which the people of South Africa have effective access to information to enable them to more fully exercise and protect all of their rights.

**Protected Disclosures Act of 2000**
This Act makes provision for procedures in terms of which employees in both the private and the public sector may disclose information regarding unlawful or irregular conduct by their employers or colleagues. The Act provides for the protection of employees who make a disclosure of unlawful behaviour.

**Financial Intelligence Centre Act of 2001**
The main objective of this Act is to provide for the establishment of structures and regulations that identify the proceeds of unlawful activities and to combat money laundering activities within South Africa. The regulatory regime of the Financial Intelligence Centre Act imposes 'know your client', record-keeping and reporting obligations on financial institutions.

These Acts provide important legal levers for pressure groups to ensure the sustainable operation of South African companies and state-owned enterprises.
Participating Institutions

United Nations Environment Programme Finance Initiative (UNEP FI)
The United Nations Environment Programme Finance Initiative (UNEP FI) is a global partnership between the United Nations Environment Programme and the private financial sector. UNEP FI works closely with the 170 financial institutions that are signatories to the UNEP FI Statements, and a range of partner organisations, to develop and promote linkages between the environment, sustainability and financial performance. Through regional activities, a comprehensive work programme, training activities and research, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

UNEP FI African Task Force (ATF)
The African Task Force is a platform of financial institutions that collaborate to drive sustainable development, and address the critical environmental and social issues, in Africa. The group has a mission of supporting and expanding sustainable financial practice in Africa.

The ATF consists of the following members:

- African Institute for Corporate Citizenship
- Banking Association of South Africa
- Citigroup South Africa
- Development Bank of South Africa
- Industrial Development Corporation
- Nedbank
- Standard Bank Group
- Standard Chartered Bank
- Swaziland Development & Savings Bank

Contact details:
United Nations Environment Programme Finance Initiative
African Task Force
Chemin des Anémones 15
CH-1219 Châtelaine, Genève
Switzerland
africa@unepfi.org
http://www.unepfi.org/atf

University of South Africa (UNISA) Centre for Corporate Citizenship (CCC)
The Centre for Corporate Citizenship is located within the College of Economic and Management Sciences at the University of South Africa. The strategic objectives of the Centre are to provide training and education, conduct research, and create a platform for information sharing and professional advice. The Centre also assists organisations in transforming and integrating corporate citizenship into their management practices.

Contact details:
University of South Africa (UNISA) Centre for Corporate Citizenship
College of Economic and Management Sciences
PO Box 392
UNISA
South Africa
ccc@unisa.ac.za
http://www.unisa.ac.za/ccc
Acknowledgements

Project Team United Nations Environment Programme Finance Initiative

Head of Unit     Paul Clements-Hunt
Project Lead     Philip Walker
Project Team     Natalie Ryan, Caroline Wei Yu Neng, Niamh O’Sullivan

Project Team University of South Africa Center for Corporate Citizenship

Director         Derick de Jongh
Project Lead     Jon Duncan
Project Team     Ralph Hamman, Paul Kapleus

Project Team African Task Force

Chairs           Cas Coovadia, Managing Director, Banking Association of South Africa
                 Justin Smith, Manager Governance & Sustainability, Nedbank
Project Team     Elsa Kruger-Cloete, Development Bank of South Africa
                 Sandra Ainley, Corporate Governance Manager, Standard Bank
                 James Cantamantu-Koomson, Standard Chartered
                 Happy Colisile Mavimbela, Environmental Officer, Swazibank
                 Donna Nemer Oosthuysie, Vice President - Strategic Planning and Public Affairs, Citigroup South Africa
                 Sean de Cleene, Director of Strategy, African Institute for Corporate Citizenship
                 Nalini Naidoo, Environmental, Health and Safety Specialist, Risk Management Department, Industrial Development Corporation (IDC) of South Africa Ltd

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Financial institutions play a critical role in society. Through the products and services they provide, financial institutions are uniquely placed to influence economic growth, and importantly, by including environmental, social and governance issues in decision-making, ensure long-term sustainable growth.

Yet, despite this, few African financial institutions currently include sustainability criteria in their lending business activities and credit risk approaches.

Over the course of 2006, we surveyed South African and Nigerian banks on their approaches to environmental, social and governance issues in credit risk policies. This was done in an effort to identify best practice and formulate guidance for African financial institutions.

This report details the outcomes of these surveys and provides practical sustainability credit risk guidance complemented by key findings and recommendations.

Guidance and findings should be of interest to financial institutions, legislators, civil society, central banks and financial sector policy makers throughout Africa.