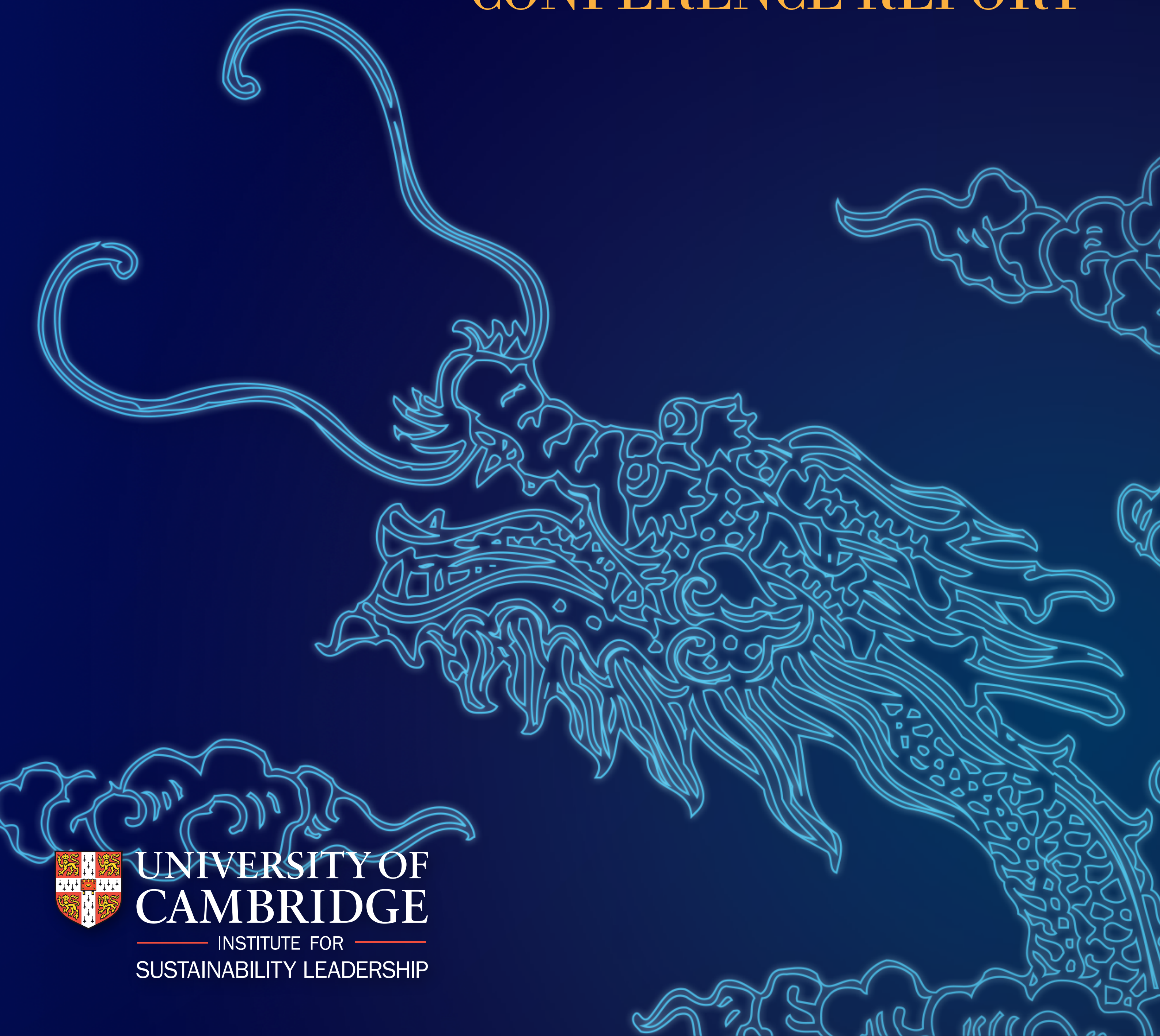
BANKING ENVIRONMENT INITIATIVE FORUM 2014

CONFERENCE REPORT



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BARCLAYS

Antony Jenkins, CEO of Barclays, introduces the BEI Forum report

Why today is the right time to build on the BEI's momentum

I am delighted that this year we have held the Banking Environment Initiative's Forum in Hong Kong. The environmental agenda has huge momentum and innovation, and fast growing economies have the power to make a significant contribution towards addressing environmental, social and resource scarcity issues.

It has been estimated that climate change is costing the world over $1.2 trillion a year. Issues surrounding the environment – be they lack of resources, clean energy, clean air or climate change – are very real and they are reaching a tipping point. The problems are complex, and long term in nature, and the collaboration of many stakeholders will be necessary to address them. Banks have an integral role to play in the acceleration to a sustainable low carbon economy.

The BEI's focus is on delivering solutions which respond to client and market needs, and encouraging industry-wide collaboration. Many firms will be undertaking individual work in this area, but the power of the collective can supplement, support and promote this agenda.

The door is open for more banks to not just join us, but to take a leading role in driving this initiative forward. Leaders of large organisations are familiar with the challenge of improving efficiency whilst delivering sustainable growth – the question is how we do this in a world where success is increasingly measured in the short term.

We need to play a role in developing new solutions and pioneering products and services that will help our clients respond to the environmental issues facing their business, and that focus on long term as well as short term goals.

This is about being leaders, committed to protecting the strength of our businesses and making a positive difference to future generations through sustainable finance. For the first time ever, a recent report by the Intergovernmental Panel for Climate Change (IPCC) contained a chapter dedicated entirely to investment and finance.

The emerging Green Bonds market is an example of the growing interest in sustainable finance, and of the environmental innovation that is happening now across our industry. Renewable energy and clean technology financing are other areas where the financial services industry can make a big contribution to help encourage sustainable development. We need to support and intensify investment in new, emerging technologies, to create opportunities for new markets and drive sustainable growth for generations to come.

The BEI has developed a track record of driving real evolution of banking products and services, for example with the 'Sustainable Shipment' Letter of Credit. This work is gaining momentum and has been welcomed by the White House, the World Economic Forum and the United Nations, among others.

This is testament to the efforts of this group, but also to our customers and clients' increasing interest in sustainability. Without this engagement, we will not achieve progress. This is the underlying tenet of the Banking Environment Initiative. We have to work collaboratively on this agenda, be it with corporates, government organisations, or NGOs. Engaging with stakeholders and forging new partnerships will be critical to delivering innovative outcomes. Communities around the world are already suffering as a result of climate change, resource scarcity, and deforestation. We all have an important role to play in coming up with solutions. Access to sustainable finance is a crucial element, and Barclays is committed to playing a leading role.

There is now real momentum that we need to build on. The Banking Environment Initiative has the governance, the structure and the participation to move the dial and make a lasting impact. Now we need the commitment from members to really take this forward.

Banking Environment Initiative opens a new chapter in Asia

Barclays CEO calls on banks to help create a global economy driven by sustainable finance

Barclays Chief Executive Antony Jenkins led a group of representatives of global banks meeting in Hong Kong on June 24, 2014 to explore ways that banks can work with companies to promote sustainable means of production, starting with agricultural commodities.

The Forum laid the groundwork for the Banking Environment Initiative (BEI) to broaden its remit by including more financial institutions and companies in its working groups, and intensifying its engagement in Asia.

Members committed to build on the BEI's alliance with commodities and consumer goods companies to combat deforestation, and to push ahead with a programme to foster sustainable trade in agricultural commodities via such financial solutions as BEI's recently introduced Sustainable Shipment Letter of Credit.

"The BEI Forum chose Asia because of the scale of innovation, and the momentum on the continent in relation to the environmental agenda," said Mr Jenkins in his keynote address to the BEI Forum.

Mr Jenkins delivered a challenge to the group. "The industrial revolution would not have happened," he said, "without a new modern banking system, a new money economy and credit facilities, and without our investment now, the evolution of the economy towards one driven by sustainable finance will not be possible."

That investment, he emphasised, will address both environmental need and sustainable economic growth. "This isn't about becoming green warriors, but about leaders committed to protecting the strength of our businesses and making a positive difference for future generations."

As an example, Mr Jenkins cited the BEI's alliance with consumer goods companies, now two years running, to reduce deforestation. This partnership between the Consumer Goods Forum and the BEI aims to help companies achieve zero net deforestation in their supply chains by 2020.

Together, they have forged the BEI-CGF 'Soft Commodities Compact', a unique, client-led initiative that seeks to mobilise the banking industry to help meet achieve this heady, but achievable goal. Earlier this year, Barclays, BNP Paribas, Deutsche Bank, Lloyds Banking Group, RBS, Santander, UBS and Westpac became the first group of banks to adopt this Compact.

Mr Jenkins noted that the collaboration has defined two time-bound commitments for banks: to work with consumer goods companies to develop appropriate financing solutions that support the growth of markets producing palm oil, timber products, soy and beef without contributing to deforestation and, where needed, to raise the standards they expect of certain clients in high-risk geographies so that they are encouraged to improve their sustainability performance.

Representatives of BNP Paribas, Deutsche Bank and corporate participants such as Unilever and Nestle discussed the goals and challenges facing the Compact at the Forum.

The BEI introduced a Sustainable Shipment Letter of Credit at the World Economic Forum in January 2014. Its next move was to partner with the International Finance Corporation (IFC) to enable preferential treatment in trade in agricultural goods that meet internationally recognised sustainability standards. Palm oil certified by the Roundtable on Sustainable Palm Oil (RSPO) is the first commodity to be made eligible for the programme, with more expected to follow.

The initiative continues to develop and explore new ideas for credit-based instruments as drivers of trade that support sustainable development. Participants in this collaboration, including Barclays and Westpac and commodities giants Cargill and Olam, discussed their findings at the Forum and debated methods of taking the initiative further.

Recognition for the role of finance in a sustainable future is emerging. Mr Jenkins noted that the Intergovernmental Panel on Climate Change (IPCC) for the first time included a chapter on investment and finance in its annual report. Interest in green finance has been growing incrementally, with total investment in the green bond market reaching \$11bn in 2013. As of June this year, investment is now more than \$6bn. The IFC projects that the green bond market will reach \$50bn in 2015.

The role of banks has become more visible; so too has the BEI's profile. "What started as industry collaboration is now receiving support and endorsement from the White House, the World Economic Forum and the United Nations," Mr Jenkins said.

Jeremy Wilson, Vice Chairman, Corporate Banking, Barclays and chair of the BEI working group noted that the BEI was at a "tipping point" and that the "door is open for more banks to not just join us but to take a leading role in driving this initiative forward."

Mr Wilson noted that among the attendees at the Forum, by far the largest constituency was from Asia. "That is exactly what we want. This audience includes not just banks, but stakeholders from around the world that are interested in supporting the Banking Environment Initiative." He noted the BEI Forum's decision to hold the meeting had an "investigative purpose". "We really do want to understand what works in Asia, what is needed in Asia, what is wanted in Asia and what will work best as we work forward. The economic axis of the planet is moving in this direction. The voice of this community is going to be particularly important for any global initiative."

Among the participants at the Forum were representatives from non-BEI-member Asian banks that have successfully introduced elements of sustainable financing to consumer and corporate customers. Namita Vikas, country head, responsible banking for YES Bank, India's fourth largest consumer bank, described the bank's introduction of financial products that support microfinancing of sustainable building and agricultural projects.

Dr Wang Yao, director of the Research Centre for Climate and Energy Finance, Central University of Finance and Economics, Beijing, spoke of regulatory involvement in encouraging greener production across industries, including green credit guidelines issues by China Banking Regulatory Commission, which have led banks to compile their own green credit policies, standards and indicators. Dr Rui Li, head of structured financing, investment banking at the Shanghai Pudong Development Bank (SPDB), spoke of her bank's participation in China's green credit initiative.

China's regulatory involvement in the financing side of sustainable development could influence government policymakers elsewhere. Dr Jake Reynolds, director of business and policy leaders groups, University of Cambridge Institute for Sustainability Leadership (CISL) noted that China's influence was growing here, changing the "North-South" character of sustainable initiatives. Lending guidelines developed by banks in China are now being introduced via China's economic cooperation with African governments and businesses into developing nations on that continent – a distinctly 'South-South' influence.

Beijing-based Emily Chew, Senior Analyst & Asia-Pac Regional Lead, MSCI ESG Research, described the intensifying public pressure on China's government to stem the nation's pollution woes as a catalyst for banking engagement in environmental initiatives there. She noted that social media furnishes an example of the avenues that citizens can adopt to foist accountability on local governments. Alibaba, effectively China's Amazon, recently released an application for mobile phones with sufficient detail to identify local contributors to air pollution.

Ms Chew spoke of the rise of investment opportunities for sustainable stocks and bonds, but cautioned that transparency is still limited and that the market could be gamed. But she noted that investors are beginning to use environmental, social and governance reporting information for company engagement. She also said that in the past several months in China large commercial banks have approached MSCI to incorporate its ESG information "at scale for very large lending portfolios".

"It's interesting to see the potential convergence of the banking community and the investment community coming at ESG from slightly different but also similar angles," said Ms Chew.

As Barclays' Mr Wilson said in his summation, "This subject is moving forward. This is the first conference on the environment that I have attended where there has been so much specific talk on the action – what have people done, what are we going to do to advance."

He urged the BEI to build on the power of its collective effort. "That means for the BEI that it needs more banks, moving down and through the scale, because the regional banks have a very big say in where they can provide support, not just the global banks."

The hard utility of soft power

The partnership between the Banking Environment Initiative (BEI) and the Consumer Goods Forum (CGF) stands as a benchmark of what banks can accomplish in collaboration with industry to ensure sustainability in the sourcing and production of commodities – and of the challenges that still remain.

Under an alliance dubbed the Soft Commodities Compact, participating companies from the CGF and banks from the BEI committed this year to achieve zero net deforestation in the companies' supply chains by 2020.

Companies within the CGF have ample clout to do so. Founded in 2009, the CGF was formed following the merger of three industry associations, the International Committee of Food Chains (CEIS), the Global Commerce Initiative (GCI), and the Global CEO Forum.

It is difficult to pin down a precise number for the combined procurement power of this group, but with members among the largest consumer goods companies in the world – from Swiss-based Nestle, with 2013 turnover of $103.1bn, to US-based Walmart, with 2013 net sales of $473bn – an idea of the enormous spending power and commensurate influence within this group is easy to grasp.

The select companies and banks from the CGF that forged the Soft Commodities Compact now bring this influence to bear on the sourcing, trading and production of four key commodities: soya, timber, beef and palm oil.

Andrew Voysey, Director, Finance Sector Platforms, University of Cambridge Institute for Sustainability Leadership (CISL) – the secretariat of the BEI – adds that the compact "is testing whether such a partnership could help to further align the banking industry's services with the Consumer Goods Forum." The Soft Commodities Compact also works with strategic partners like non-government organizations (NGOs) and governments.

The Soft Commodities Compact laid down two commitments. The first is to develop financial services solutions to help accelerate the transition of supply chains. The second is to raising industry wide banking standards to support the new market norms that have seen consumer goods companies increasingly working with their suppliers towards through their procurement relationships.

How this is playing out was the subject of the panel Achieving Zero Net Deforestation: the BEI-CGF Soft Commodities Compact, at the BEI Forum, held in Hong Kong on June 24. Members from participating companies and banks, as well as a representative from the World Wildlife Fund, also an advisor to the Soft Commodities Compact , were mostly sanguine about the compact's ability to meet its 2020 deadline, but agreed that greater participation was needed across the supply chain and that essential definitions of such basics as how to classify land as natural forest should be tightened.

Ultimately the success of an environmental initiative by business relies on the sustainability – as in costs – of sustainability drives. Even better if they become woven into business process and contribute to profitability. Is this happening, or are efforts like the Soft Commodities Compact simply a 'nice to have', merely a response to pressures by irritating non-governmental organisations?

"There are some core business drivers at play," said Benjamin Ware, Head of Responsible Sourcing, of Swiss-based Nestle. "There are three reasons. The first is operational. For the food business to be profitable, there is really no magic formula. You need a sustainable long-term supply of raw materials. This long-term supply cannot be made by depleting natural resources, such as the forest or the water supply."

"Just as important, sustainability is a requirement of our clients – the Walmarts, Tescos and Carrefours of this world. We're being asked by our clients to report on supply chain activities from the farm to the fork at the table."

"The third is Nestle's own corporate principles of sustainable finance," Mr Ware said, holding up a pamphlet detailing the principles. "This is one of the core documents you look at when you want to do financing. The upstream supply chain must respect good ethical and sustainability requirements."

Nestle's interaction with the supply chain in its responsible sourcing programmes involves more than effort to ensure that its products do not have a deforestation footprint. In the case of palm oil production, the company not only audits suppliers, but offers communities of growers technical assistance in sustainable practices.

Stephan Moeller, Vice President Group Sustainability, Deutsche Bank AG, also dismissed the notion that the bank's involvement in sustainability was merely a reputational issue. "It's more strategic," he said. "We wanted to explore how we could help the consumer goods industry drive deforestation out of the supply chain. In fact, clients asked more and more how we could support them in their efforts to attain more sustainable production. But we also realize that in developing solutions we might have additional business opportunities."

From the client's perspective, Mr Moeller said, the omission of sustainable practices added a growing

element of risk that banks are wise to monitor. "It could lead to competitive disadvantage and economic risk for them. Financial risk is a typical banking risk that needs to be managed appropriately."

Unilever, the Anglo-Dutch multinational consumer goods company, has undertaken a natural hedge against this type of risk for some time. In fact, one main concern for the company now is seeking to drive solutions that go beyond the individual company approach to support a wider set of industry initiatives. Cherie Tan, Global Procurement Director for Tropical Materials and Smallholder Development, Unilever, described this as "Working across the boundaries of your own industry."

Unilever has come to this approach after an initial commitment made in 2009 to double the size the company's business whilst reducing its environmental footprint and increasing the positive social impact. "Back then, we didn't have all the answers and today, we still don't. We need to partner with others in the industry to make it happen."

"Partnerships are key for Unilever. Hence, we collaborated with many of our suppliers to get them to work with us towards making very similar commitments," Ms Tan says. "This involves bringing them together to discuss the complexities, how do you drive transformation in the industry."

Unilever's engagement with its business partners goes across the value chain, including financial institutions. Pierre-Joseph Costa, Head of Commodity Finance for Asia Pacific, BNP Paribas, recalls that "we were invited by Unilever to join the Soft Commodities Compact because of our palm oil policy. Underlying the invitation was a realization that there's no way we can succeed unless we have a concerted approach."

"The whole supply chain is moving," Mr Costa noted, "fortified by rising consumers, producers, investor awareness." But he argues that a cost exists for participants. "If you decided that you are going to deal with companies with certain principles and you decide not to deal with those companies that don't align with those principles, there is a risk of losing business – and we have lost business in the short run."

"It is important to take a long term view. Ultimately, we want to bank with the best customers and we believe that the best customers are the ones who also takes a long term view on key sustainability issues"

From the perspective of an NGO, Jeanne Stampe, Asia Finance & Commodities Specialist of the World Wildlife Fund was sanguine that disconnecting Asia's high growth from deforestation can be achieved, although perhaps equally practical about the difficulty of the task and the coordinated effort needed by the various stakeholders, including national governments.

"There is enough non-forested land," she said. "for crops to be planted with minimal negative impact on bio diversity and local communities. Indonesia has 13.5m hectares under cultivation for palm oil compared to non- forested lands estimated at 12-74m hectares. Even if the lower figures are assumed, there is enough non-forested land to meet a doubling in palm oil demand by 2050."

The effectiveness of any programme to reduce deforestation must rely on communication and collaboration with local communities, Ms Stampe emphasizes.

Regarding the drive for certification of growing practices under the Roundtable for Sustainable Palm Oil (RSPO), she said the WWF "has found that by observing free prior and informed consent and ensuring that traditional livelihoods can be maintained, there is a reduction in social conflicts that lead to operational stoppages.

Those conclusions were supported by a WWF study *Profitability and Sustainability in Palm Oil Production: An analysis of incremental financial costs and benefits of RSPO compliance.*

The study supported the conclusion that there could be growth in food supply chains while still protecting the forest and protecting livelihoods.

Why sustainable letters of credit may be just the start

"If we look through that entire chain of products the obvious place to start was the letter of credit," reflected Dan Roberts of Barclays, relating the origin of one of the Banking Environment Initiative's landmark programmes.

"Through data supplied by the Roundtable for Sustainable Palm Oil (RSPO), we can see that already about 15% of palm oil is RSPO certified," said Mr Roberts, who is managing director, Head of Trade & Working Capital, Corporate Banking Origination at the UK-based bank. "Somewhere along the chain the banks are already processing these. It requires the disclosure of individual transactions between buyer and seller. The bank has that information."

Banks may not literally be within the supply chain, but they touch every transaction along the way – with the suppliers, the traders, the producers, the customer end buyers.

This original insight led to the groundbreaking BEI collaboration with industry to develop trade finance instruments that inject an incentive for responsible purchasing practices into supply chain. The BEI introduced its Sustainable Shipment Letter of Credit (SSLC) at the World Economic Forum in January 2014. Next, it partnered with the International Finance Corporation (IFC) to enable preferential treatment in trade in agricultural goods that meet internationally recognized sustainability standards. Palm oil certified by Roundtable on Sustainable Palm Oil (RSPO) is the first commodity to be made eligible for the programme, with more expected to follow.

The instrument's utility is straightforward. The SSLC requires that goods have been produced in a sustainable way, and allows clients to track the sustainable origin within the existing letter of credit.

The BEI Forum in Hong Kong on June 24 provided a favorable juncture to reflect on the milestone, discuss next steps and develop ideas on how the innovation could gain more general use.

The first two transactions of the SSLC were enacted with Singapore-based major multinational agribusiness group Wilmar, with the buyers in the US. Mr Roberts, one of the architects of the SSLC programme, said these first transactions opened a window on the challenges of developing the instrument to peak effectiveness.

"In developing a letter of credit, one service a bank can offer is documentary collection, in other words, handling the documents if not necessarily guaranteeing the payment. Some companies use this service, which allows visibility of information, while other companies use them not at all – or in all shades between," Mr Roberts said.

The challenge, then, became gaining visibility on the necessary information in the transaction to verify whether the goods have been produced with sustainable practices. "We found we needed to expand our thinking to encompass the diversity of transactions that companies undertake, which ranges from Letters of Credit to Documentary Collections and Open Accounts," he said. "We have to be specific about what it is we're asking our operational staff to look for. Even in palm oil, it was beginning to get complicated. We're still certainly on the learning curve."

From the corporate side, Jayant Parande, who heads treasury at Olam, the Singapore-listed soft commodities agri-business, said that the attraction to use the SSLC stems from the company's focus on sustainable growth as well as the relationship with its customers. "The pull from customers obviously helps," he said. "Customers want to know that we are able to access products that are sustainably produced. So the pull comes not just from the non-governmental organizations (NGOs), but from customers themselves. From our point of view it makes sense for more banks to get onto this. There's plenty of room to grow."

Bruce Blakeman, vice president, Corporate Affairs, Asia-Pacific, for Cargill, the US-based commodities giant, suggested that companies need to recognize a broader agenda than compliance with regulators or customer agendas. Programmes like the SSLC "promote sustainability, and move the industry. We have to feed the world in 2050, to grow more on the same land we have today. Cargill has done this for the past 20-30 years. It's all in the standard operating procedures, just the way you do business, more than about compliance. If it's seen as another compliance thing, it won't catch."

Axel Boye-Moller, Westpac's transaction banking head in Asia, agreed that the SSLC initiative should be seen as an opportunity, not another compliance obligation. "Sustainable sourcing is a critical strategic issue for our customers involved in buying or selling agricultural commodities. The SSLC provides us and other banks with an opportunity to engage with clients on this topic, and discuss a solution which will support their sustainability agenda as well their commercial objectives."

Cargill's Blakeman added that companies must face the cost. "This does cost more money," he said. "Cargill spends over a million just doing traceability. It is more expensive to do things differently. And particularly across the supply chain, when you clear land to plant more – that's the way we've got to go."

"We have to spend money to do it right at the beginning. That's where deforestation happens, when you clear the land and plant more palm, what can you do to convince growers and developers to say I'm going to do this in a sustainable way? I'm going to do high conservation value analysis. I'm going to do a high carbon stock study and I'm going to live with the results of that and set aside what's high carbon stock, what's high conservation, and look at the land that is more acceptable for planting. We have to support that piece of the supply chain right through the trading piece."

Barclays' Roberts noted that recognition of the cost element is addressed by the International Finance Corporation's involvement in the SSLC via an incentive mechanism relating to the IFC's Global Trade Finance Platform (GTFP).

This platform offers trade finance banks partial or full guarantees covering payment risk on emerging markets trade. It helps mitigate banks' risk in these transactions and also lowers their cost of capital. Earlier on, the IFC had committed to offering banks preferential terms for shipments that could be verified as contributing to greenhouse emission reduction. The IFC this year opted to make the BEI's SSLC eligible for the similar treatment offered by the GTFP programme.

Whether a bank takes the IFC's cue and does pass and does give preferential terms based on the lower capital cost of the transaction is a matter of bank culture.

The next steps for sustainable finance

How should we gain acceptance for sustainable financial products where demand is greatest?

With the Sustainable Shipment Letter of Credit (SSLC) now a reality, the question is one of uptake: will it be adopted into the mainstream of financial practice in soft commodities supply chains – and eventually in other sectors as well?

"My point of view is you have to get some scale into the concept first," says Bruce Blakeman, vice president, Corporate Affairs, Asia-Pacific, of US-based Cargill Inc. "If you look at the values of the commodities flows in the four agricultural sectors that the Soft Commodities Compact is looking at [palm oil, soya, beef and timber], those values are enormous, and they would certainly lend themselves to a capital markets solution, such as securitization."

He adds, "That would be an interesting development, one that would provide a means for banks to offtake the risk. But you need scale for securitization." The next step in the view of the head of treasury of Singapore-based soft commodity supply chain solution provider Olam, Jayant Parande, also concerns developing scale. "We need critical mass of participation among traders and producers, which would require getting down to the second and third tier in the market."

The need for scale becomes apparent when actual existing demand for sustainable product is considered. Dan Roberts, managing director, Head of Trade & Working Capital, Corporate Banking Origination, Barclays, noted that demand for sustainable palm oil is only 20% of the total global output.

"The elephant in the room is that the demand for sustainable palm oil is not that big," Mr Roberts says. "It hasn't made impact on the big markets of India, Pakistan and most of all China. We'll have to move in the direction of advocating more sustainable purchases of palm oil in these markets." On the upside, he notes, the International Finance Corporation's scheme to support the Sustainable Shipment Letter of Credit – a similar initiative to its Global Trade Financing Platform – "works best with trade flows being imported into these countries."

One of the elements that could lead to developing scale would be product standards to be adopted by an industry body such as the International Chamber of Commerce, which through its banking commission sets the rules for trade finance globally, Mr Roberts says.

Namita Vikas, Senior President & Country Head of Responsible Banking for India's YES Bank suggests that scale of responsible operations could be built with a more engaged attitude by banks. "The new normal scenario, defined by recouping from the 2008 financial crisis, needs to give way to a new new-normal state. Though the banking sector may not have all the solutions to today's economic instability, this proactive approach may provide the much needed impetus to the economy". Ms Vikas adds "A holistic approach towards banking, with a balanced risk appetite and triple bottom line practices would contribute to inclusive growth which is the need of the hour in an emerging economy such as India."

The need to be nudged to ESG

The tools for better responsible investing have been embraced, but a little faith is still required

Corporate involvement in sustainable initiatives is a proven incentive to a significant component of the global investor base. But do those investors gain better value over time in betting their money on companies with claims to green operations? Generally accepted to be true, the value proposition is still not beyond question.

This was acknowledged by Bo Kratz, Managing Director, Head of Asia Pacific, Northern Trust Asset Management. "To quote John Maynard Keynes, 'The market can stay irrational longer than you can stay solvent', so although we believe that well behaving companies will eventually be rewarded, it might take a long time. Let's be blunt, there is currently little proof that a sustainable ESG (environmental, social and governance) approach is always going to be better from an investment point of view. In some studies, the results are good, in some studies 'sin' stocks actually do better than 'well-behaving' stocks," Mr Kratz said.

"But if we, the investment community, believe that the success of the ESG approach will be conclusive, we must take a leap of faith to the future and accept that the next 10-15 years will be different from the last decade or so."

"What promotes responsible behavior? If common sense could do that, we'd be there already. People need to be nudged," Mr Kratz added.

In fact, the nudging is happening, enabled by increasingly sophisticated means to assess company performance in the ESG realm. One of these is supplied by MSCI, the leading provider of decision support tools to institutional investors, from pension funds to boutique hedge funds. MSCI ESG Research offers services that are used by institutional investors and asset managers to "uncover risks and opportunities that conventional investment research might not detect" regarding the maintenance of environmental, social and governance standards by companies in their portfolios.

Emily Chew, Senior Analyst & Asia-Pac Regional Lead, MSCI ESG Research, noted that "divestment is a very big theme globally now. Investors are coming to the conclusion that for certain extractive companies in particular the risk hasn't been priced in. "

Ms Chew saw two countervailing trends in the market. "Some investors engage more and more with companies, and you see this possibly taking off particularly in Japan with their stewardship code. But there's also a strong trend toward benchmark-driven passive investing, investing at scale, which is somewhat antithetical to where the idea of ESG traditionally came from, which was knowing your stocks intimately. Meeting this challenge – ESG integration in the context of passive investing – is the next big puzzle for the ESG industry to solve."

Meanwhile, awareness of environmental risk in China has intensified into a major political issue, which has led to developments spilling over into the financial sector. New milestones include the strengthening of China's 25-year-old environmental protection law, passed by legislators this April, providing authorities greater powers and handing out harsher punishments to violators.

The National Development and Reform Commission (NDRC) also unveiled a carbon trading scheme last year that has grown – even as a pilot, which it is currently – into the largest such scheme outside of Europe. It was initially launched in 2013 and covering 7 cities and regions, with 638 companies covered in the Southern city of Shenzhen alone.

China has also embarked on a major "south-to-north" water transfer scheme. The nation, which is home to one-fifth of the world's population, but only 7% of its water supply, faces a dire shortage of water particularly in its northern provinces. The State Council, China's cabinet, has authorised 170 projects to unfold over the next six years that will speed up the $62bn south-north water transfer project and cut back demand for water from farming.

A keen issue in China, awareness over sustainability issues has emerged throughout Asia in recent years. Thailand and South Korea have pilot carbon trading schemes. The government of Park Geun-hye has launched reforms aimed at imposing transparency among family-owned conglomerates and overhauling the tax code.

Amid this changing environment throughout Asia, Ms Chew noted that MSCI ESG Research is, "seeing increasing interest from large commercial banks, at scale, for very large lending portfolios. The banking community and the ESG community come at the problem from slightly different but complementary angles."

MSCI is an information provider, not an investor. Ronnie Lim, Senior Investment Specialist from Robeco Hong Kong, a prominent independent asset manager based in the Netherlands, noted that his firm makes both investment and divestment decisions, based on long-term strategies. "ESG investments," he said, "are necessarily long-term investments."

Robeco has 33 ESG analysts based in Europe and a team of 10 professionals involved in active engagement. "We maintain our role as responsible investors, because our clients expect this. We are very thorough in explaining how we as an investment manager come to our decision-making process."

Robeco has an exclusion list of twelve countries and eight public companies. Given the thousands of companies on the MSCI Index, with this exclusion list allows "us to tailor screens to suit investors while having a large enough investment universe," said Mr Lim.

As for the question of whether sustainable investing performs better for investors over time, Mr Lim said, "We have 15 years of data now, looking at over 3,000 companies every year with over 100 ESG factors. It's a large data set. We have found some evidence through complex testing, and after adjusting for biases, ESG - or sustainable investing- can make better investment returns."

He cautioned that "correlation does not imply causation" - that "a company that has a better energy consumption programme does not necessarily have more sustainable margins."

In some respects, Mr Lim asserted, those findings are secondary to the real issues. Looking at companies through the lens of this extensive ESG criterion "makes us a better informed investor."

Rising environmental concern in China brings public participation

Alibaba collaborates on pollution tracking apps

Activism for a better environment is on the rise in China, a reminder to the government that its vow to tackle severe air and water pollution is being watched closely by the populace.

On the other hand, "the government now understands that public opinion can be harnessed to assist in the implementation of certain policy objectives," says Emily Chew, Senior Analyst & Asia-Pac Regional Lead, MSCI ESG Research.

Very possibly Alibaba Group Holding, the e-commerce giant founded by Jack Ma and which is planning its New York IPO in July, had this in mind with the release of two apps that allow citizens to participate in pollution monitoring.

The first, developed in collaboration with the Institute for Environmental and Public Affairs, a Beijing-based environmental non-government organization (NGO), allows the public to get real-time pollution data in 190 cities and monitor 3,685 companies, naming polluting companies at any given time.

The technology is sophisticated enough to monitor specific chemicals present in the air, with data that allows users to link that form of pollution to a specific factory. "Users can literally find out which factory is polluting their back yard," Ms Chew adds.

Another app, still in trial stages, invites the public to participate in mapping water quality across China with low-cost testing kits purchased through the company.

This type of public participation, via mobile phone apps and social media, is a reminder to the government that "It is necessary to deal with environmental problems, or otherwise they will be dealing with social instability," Ms Chew says.

Namita Vikas, Senior President and Country Head-Responsible Banking and Chief Sustainability Officer at YES Bank

Saying YES to less affluent banking customers in India

India's YES Bank is harnessing technology for 'frugal innovation' and bringing vital services to those at the lower end of the economic pyramid

Take a glance at India's YES Bank's sustainability report and you will be struck by the difference of this document to similar reports in more affluent countries.

Known as the youngest greenfield bank in India, YES Bank has grown rapidly since its founding by its current MD & CEO, Rana Kapoor in 2004. Net profit increased 24.4% in its fiscal 2013 ended March 2014, compared to the previous year (In India, the financial year cycle is from April to March). The bank had also increased its asset size during the period, without compromising asset quality. For instance, the bank opened 43 branches in its final fiscal quarter ending in March 2014, bringing the total to 560 branches. But the ratio of non-performing advances to total advances was distinctly low at 0.05%.

These figures may seem insignificant, but given the context of YES Bank's expansion - tied up as it is with reaching the 'base of the pyramid' (the masses of potential customers with small incomes), they are an instance of the business case for sustainability. The bank's most recent sustainability report has an image of an economic pyramid on its cover, implying upward mobility from the pyramid's wide bottom.

What differentiates this report from, say, one by Denmark's oil and shipping giant AP Moller Maersk is the audience it is most trying to reach. Maersk – like most banks and industrial companies in Europe, Japan and the US – is sending a message to mostly affluent investors as well as stakeholders such as customers and non-government organizations. YES Bank, a privately owned bank, is trying to reach stakeholders, too, but it is also trying to reach potential customers at the base of the pyramid. It is effectively a sustainability audit that has a side function as a marketing document to the bank's rising aspirational customer base.

YES Bank dubs this approach "financial inclusion" and makes a point of innovating new approaches and products to reach less affluent customers. The bank has a robust program of lending to self-help groups of less-affluent customers that pool their capital resources. The program, called YES Livelihood Enhancement Action supported by a business correspondent model, described succinctly on its website as leveraging "existing retail shops, telecom connectivity and banking infrastructure to extend branchless banking services to a common man …." It puts an accent on using technology for what it calls "frugal innovation". One of these is its YES Sahaj Micro ATM, a service deployed via low-end mobile handsets and Bluetooth thermal printers. The service allows the bank realtime tracking of transactions, allowing visibility that fortifies risk management. There are many other similar services in its inclusive banking program.

Namita Vikas, Senior President and Country Head-Responsible Banking and Chief Sustainability Officer, said "over the past ten years of our existence, YES Bank has always been focusing on inclusive growth." The bank's drive came in recognition that "in India, despite formidable bank outreach and rural footprint of banks, 64% of the population lack access to savings accounts, 87% lack access to ATMs and 73% of farming lacks access to formal credit." Speaking at the Banking Environment Initiative Forum in Hong Kong on June 24, she recalled, how the banks correspondent system and technology were harnessed to help migrant workers from villages with jobs in big cities.

"About two years ago we saw a challenge. Urban migrant labourers could not easily remit money back home to the villages due to lack of access to bank accounts in cities because of the central bank's regulations," said Ms Vikas.

This forced the laborers, in many cases, to leave their hard-earned cash with slumlords in the cities. Public sector banks would only open their counters for two hours a day for migrant transactions, making it impossible for many of the workers to have access to a bank at all, given the lines and the time required getting to the window.

The bank decided to tap its current correspondent network – typically a 7-Eleven store – which allowed remittances to be sent by the workers from easily accessible locations and initiated on a mobile device. The money lands in destination accounts within 15 seconds today.

"With this model, we've brought the transaction touch point closer to the customer, in this case the bottom-of-the-pyramid laborer that is available even at non-banking hours," Ms Vikas said. The program took off like gangbusters. At the beginning, it recorded 300,000 unique transactions. Now this banking service records about 8 million unique transactions in the past financial year alone. Nearly 58% of these transactions take place after banking hours. The stunning uptake on this banking service had led to me-too programs at other banks in India. Arguably, YES Bank's innovation contributes to common social good. As Ms Vikas pointed out, the program "Saves millions of working hours of labor," an eventual boon to national productivity.

Ms Vikas noted that the bank's focus on sustainable initiatives involves clients throughout the pyramid, not just its base. The bank regularly invites major corporate clients to discussion groups and presentations to encourage them to embrace environmental and social initiatives.

Global Forest Watch: Big data's all-seeing eye on deforestation

App now offers information for soft commodities

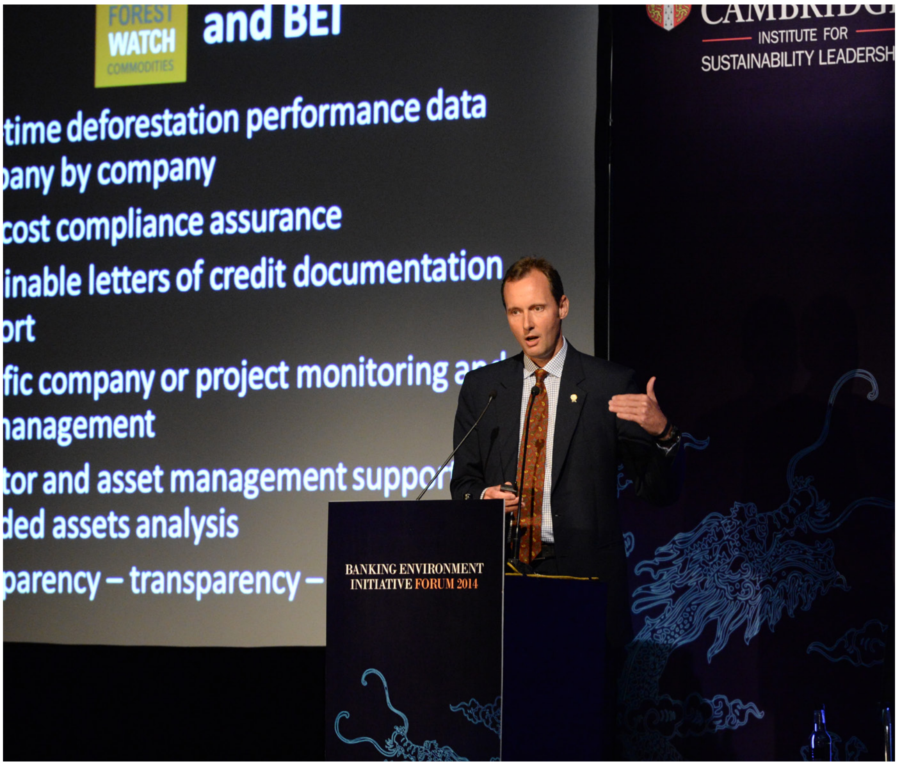
Big data as a phrase is a rare case of a buzzword transforming into an everyday reality. Big data allows huge amounts of complex information to be processed to support business decisions.

Now apply this to a goal that certainly can be used as a strategic tool, but goes beyond business to support a social good. This indeed has been done in the area of creating transparency over – and therefore hopefully contributing to the reduction of – deforestation.

Global Forest Watch can be accessed by anyone for free at http://www.globalforestwatch.org/. It describes itself as "a dynamic online forest monitoring and alert system that empowers people everywhere to better manage forests." The GFW combines satellite technology, open data and 'crowdsourcing' – or the participation of citizens everywhere that possess mobile phones – to pool information. The GFW's purpose is to put "decision-relevant information in the hands of governments, companies, non-government organizations and the public."

The participants, supporting the administration and upgrade of the service span such organisations as Google, the University of Maryland, private satellite companies, and development agencies.

Nigel Sizer, Global Director, Forests Program, World Resources Institution (main picture), acknowledged that deforestation is a risk for many of the world's global businesses, specifically those in consumer goods reliant on the production of soya, beef, pulp, paper



and palm oil – the very focus of the Soft Commodities Compact, a collaboration between the Consumer Goods Forum and the BEI.

To this group, deforestation is not only a "risk to brands and supplies, it is an existential risk across the supply chain for those who are involved in the business," Mr Sizer said.

The GFW has harnessed Big Data on deforestation to remarkable effect. A user can see the effect on local forests in Paraguay of soy and beef production to the clarity of 30-meter resolution. It can track where forests in Indonesia are being cleared for pulp and paper and palm oil plantations – identifying the major company concessions so that their performance can be monitored. It can show fire data, updated daily, revealing how this is affecting forest cover.

Of special importance to the companies and banks that have forged the Soft Commodities Compact, Global Forest Watch has looked at its existing information resources and adapted them to produce direct and real-time visibility on deforestation as it relates to soft commodities. Working with the Roundtable for Sustainable Palm Oil (RSPO), the GFW-Commodities application offers the ability to monitor impact on forests at every plantation certified by the RSPO, including such granular data as different land classifications and whether clearances involve primary and secondary forests, and how many forest fires may be burning.

"This is tailored specifically for the business community," said Mr Sizer.

He noted that GFW-Commodities provides an important resource to banks within the BEI as well.

"Global Forest Watch and GFW-Commodities relate directly to the goals of BEI. What forests are being well managed or cleared and where and by whom is fundamental to the commitments that are being made here, and to understanding and knowing your clients and what they are doing" said Mr Sizer.

China's banks promote green credit from a 'strategic height'

In 2012, China led the world with its introduction of green credit guidelines. Are they working?

While the International Finance Corporation has endorsed green credit and encouraged governments to explore regulations that support green financing, few nations have taken up the challenge.

Then there's China. The China Banking Regulatory Commission (CBRC) issued its green credit guidelines for the nation's banks in February 2012, following on the issuance of a green credit policy in 2007.

The guidelines are less prescriptive than they are firm: "Banking institutions shall promote green credit from a strategic height, increase the support to green, low-carbon and recycling economy, fend off environmental and social risks, and improve their own environmental and social performance," writes the CBRC.

The regulator also calls on banks to monitor the environmental and social risks that in some way are connected to their lending portfolios, and to be mindful of "the hazards and risks on the environment and society that may be brought about by the construction, production and operating activities of banking institutions' clients and key affiliate parties thereof."

The drivers behind China's green credit guidelines are assuredly internal – the government has been aware for a decade of the possibility of social unrest tied to air and water pollution. But China's focus on environmentally responsible lending – still unique in the world – has already had influence beyond its borders. The IFC launched its Sustainable Banking Network, partly in response to China's actions, to guide developing nations in similar approaches.

The CBRC's guidelines are not mandatory. But many banks have responded by initiating their own green lending policies and monitoring processes. For Shanghai Pudong Development Bank this had been an ongoing process, since at least as far back as 2008, when the bank publicly released guidelines and suggestions for funding energy efficient projects. In 2010, it issued the Shanghai Pudong Development Bank Green Finance Five Year Plan. In 2011, it issued credit guidelines requiring the bank to focus on energy saving and clean industrialization. It has built on these guidelines in the following years.

SPDB has a dedicated multidisciplinary team to oversee environmental and social issues. The bank has formed partnerships with other international organisations to promote green technologies in energy efficiency and renewable energy. These include, along with the IFC, the Asian Development Bank and the Agence Française de Développement (AFD).

Along with China Merchant Bank and Huaxia Bank it introduced energy management contracting, offering loans for energy saving technologies. The bank has developed environmental and social risk management as an indicator to assess the performance of local branches in client loans.

SPDB has training programs on managing green finance from a loan officer's point of view. It also has a special web page describing green credit products.

"Green loans have been most influential," said Dr Wang Yao, Director, Research Centre for Climate and Energy Finance, Central University of Finance and Economics, Beijing (below). "Chinese environmental laws have been weak in constraining pollution but China's financial authority has been effective in influencing corporate behaviors via lenders."

She noted that, while the guidelines are not mandatory, the government has a long-term plan to introduce mandatory policy that will make them compulsory. "For now the official guideline for green loans is voluntary so it's not powerful enough, and that's an issue. So the authority would like to bring the guideline into mandatory policy though that would be a long-term plan. For the immediate future they are planning to launch incentives. The total portfolio size of green loans also needs to grow larger," said Dr Wang.

In the meantime, are the guidelines making a practical difference? Dr Li Rui, Head of structure financing, investment banking, Shanghai Pudong Development Bank, noted that SPDB's – has developed a more systematic way to assess green loan applications since the guidelines were published.

"We started to develop green loan business as corporate responsibility during 2007-2008. This has been a 'blue sea' for us as we expanded our cooperation with international financial institutions," said Dr Li.

"From 2012, when the guideline was published, our corporate finance and risk departments have been training our staff in the headquarters and branches, so that front-line loan officials can understand the guidelines. They will know whether applicants meet the basic requirement for green loans," she adds. SPBD's green credit portfolio has grown to Yuan150bn (US$24.2bn, £14.1bn), which was 12% of the bank's total portfolio at year end.

Part of banking green credit programs, to be sure, involve the refusal of credit to customers that do not pass assessments, a potentially difficult decision in competitive banking markets. But regulatory involvement has added a level of screening and accountability, which supports the approval process.

"When assessing those loans, those applicant needs to pass the review of China's environmental authority," noted Dr Li. "Otherwise their applications will be rejected at the initial stage."

China's growth is slowing, but annual gross domestic product growth – anticipated by the World Bank to be 7.6% in 2014 and 7.5% the following

year – is still at a level that would be considered high growth in the industrialised economies of Europe and North America. Especially in a high growth environment, introduction of regulation can lead to resistance.

"In the case of these guidelines, people may say 'why should banks be policing sustainability, when the banks' job is to feed capital into the economy?'" asked Dr Jake Reynolds, Director, Business and Policy Leaders Groups, University of Cambridge Institute for Sustainability Leadership, of the panelists. "Others might argue that banks aren't in a great position to know the difference between a polluting company and one with a sustainable approach. Have banks in China overcome these kinds of concerns?"

"There have always been controversies in green loan policy," said Dr Wang. "China is the first country to adopt financial regulations for green loans—that's a positive side. In 2012, the CBRC met with other financial regulators in emerging economies to launch the Green Credit Multinational Working Group. Its aim was to promote regular exchanges in terms of green credit policy development, evaluation and capacity building. Now the CBRC is seeking to develop a comprehensive regulatory regime, to gather relevant statistics, to clarify responsibilities and to carry out assessment ."

"From an academic perspective, I think there are still some shortcomings," Dr Wang added. "In 2013, green loans [from China's banks] amounted to 7% of total loans. Why is the proportion still so low? For one thing, the guideline lacks detail. It doesn't really tell you what to do. We don't have policy tools for rating environmental performances. As another example, the guideline didn't define what green farming is. The lack of details is a concern."

The short-term strategy, lack of ESG capacity and environmental information can lead to resistance to green lending," said Dr Wang. "Banks are not really keen to carry out green loans for their short-term financial benefits. Those high polluting industries, high emitters and overcapacity industries are always major clients of the banks, and that could weigh in their decision-making process."

Besides, the pressure to maintain high growth, particularly at the local government level, can lead to banks being resistant to green lending. Local governments overly pursue GDP growth, which can be achieved partly by promoting industries which already have overcapacity. They will push local banks, either [in their capacity as] shareholders or by imposing direct official pressure, to provide loans to those industries." Dr Wang added.

For green credit guidelines to succeed, the process will have to extend beyond compliance and must involve incentives for businesses to adopt greener practices. For this to happen, banks must innovate by tailoring and introducing new financial products with a green emphasis.

"We have been working with financial institutions like the IFC, World Bank, and the Asia Development Bank on green lending issues," said SPDB's Dr Li (above). "In green business, banks often need to work together to develop the financial products the market needs."

"Banks need to have different consideration from conventional loans. We were the first to consider only cash flows in the project when assessing the future profits of the energy management contractors, effectively looking at these potential credits as project financing. [The technique] was widely adopted in green loans by Chinese banks."

SPDB has also brought innovations to the local bond markets. It developed carbon bonds with the China Development Bank, connected with the future income of the issuers' five wind power plants. The issuer was a unit of China Guangdong Nuclear Power Group in Shenzhen, raising up to Yuan1bn (US$160m).

"This bond programme lets banks know the opportunities that a low-carbon economy can provide," Dr Li said. Innovation will certainly continue, China's green credit era is only at the start of what may be possible. "China's regulatory regime for environmental protection is still weak," said Dr Wang. "Many illegal, high-polluting companies exist. If we put the green credit guidelines into mandatory policy, there will be some huge impacts immediately."

But the change in public attitudes is leading to general acceptance of a banking environmental agenda.

"If we put this in the whole China context- as China is embracing a rapidly growing economy, for years we have put development first and environment second. Only after the air pollution issues worsened lately did people shift their attention to environmental issues. I'm sure that the green credit policies will guide banks and industries' green behavior with the more powerful regulations and the stronger public awareness." Dr Wang said.

Joining forces for sustainability

How IDH is linking state and private entities

During the Banking Environment Initiative's Hong Kong Forum on June 24, a number of financial approaches to promoting sustainability in the world were discussed: the advent of 'green bonds', banks promoting green credit, a multilateral organization like the International Finance Corporation offering to back the Sustainable Shipping Letter of Credit and the Soft Commodities Compact were only few.

Jeremy Wilson, Vice Chairman, Corporate Banking and chair of the BEI Working Group, in a comment at the end of the day, noted. "This is certainly the first conference that I have been to, where there has been so much specific talk on the action, in other words what have people done to make this move forward, rather than the talk."

The Forum wound up with a reminder that separate initiatives are not enough when facing problems as big as deforestation or reducing greenhouse gas emissions. Daniel Hazman, Regional Director, Asia, IDH, The Sustainable Trade Initiative, reminded Forum participants that banks are an essential partner in building a sustainable future in business.

"Without financial institutions, we are not able to scale and accelerate sustainable impact around commodity supply chains," Mr Hazman said.

IDH describes itself as an organisation that "accelerates and upscales sustainable trade by building impact-oriented coalitions of front-running companies, civil society organizations, governments and other stakeholders."

The group's effectiveness comes in building public-private partnerships to bring in "funds, entrepreneurship, procurement, power, legislation, laws, regulations, knowhow, networks and credibility."

The brief seems as broad as nature itself, but with simple reflection its efficacy is plain: the sustainability movement has brought in a multiplicity of participants and stakeholders in recent years. An organisation dedicated to facilitating a common bond, action and execution is now a necessary component to the realization of many goals.

How does this work? Mr Hazman gave an example of IDH's work with Root Capital, a non-profit social investment fund operating in Latin America and Africa, to lend to small-scale cooperatives of coffee growers in Central America and Peru.

Root Capital's goal in the lending schemes is to support cooperatives in having their coffee reach markets that pay premium prices for coffee grown via sustainable agricultural practices. Root Capital was able to achieve funding for these groups via a blended capital facility that involved a development bank foundation and a private "impact" investor.

The funds have been used for farm renovation and to help the farmers stave off leaf rust epidemic, which is affecting current crop yields in Central America.

Mr Hazman noted that the potential for public-private partnerships to enhance sustainable business practices is growing with new initiatives like Unilever's sustainability bond, issued in March 2014. The bond, a £250m 2% fixed rate note, due in December 2018, was the first green bond in the British sterling market and the first by a company in the fast moving consumer goods market.

Another recent example – the public side of the equation – came in May this year when China and the African Development Bank unveiled a $2bn multilateral investment fund, known as Africa's Growing Together Fund, which will provide co-financiing for agricultural projects, not necessarily with ownership of a China enterprise involved.

According to Mr Hazman, China's "interest is in the sustainability of its investment." If that intent is followed through, then the prospect of spreading sustainable agricultural practices to Africa is greatly improved. Funding possibilities could link "a social enterprise, a corporation, a sovereign wealth fund, producing different financing vehicles" in support of sustainable projects.

"We need to learn from the cases that develop, refine the ideas and scale them up," said Mr Hazman.

He adds, "Many corporations are investing in sustainability. Those that do know that their future business success will depend on sustainability. It is time for the financial sector to follow suit."

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