Environmental Risk Management in Lending –

Opportunities and Implementation Aspects for Banks

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Challenges

- Managing internal resources
- Managing environmental risks in core banking activities
- Identifying profitable endeavors during crisis

Opportunities

- Achieving cost and resource efficiency
- Improved credit risk awareness and control
- Profiting from market niche by developing portfolio of green products

Level of environmental responsibility

Environmental Responsibility:
An Overview from Banking Perspective

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PER ASPERA AD ASTRA 2002

Environmental Impact from the Activities of a Commercial Bank

Direct Impact: from Internal Consumption Resources

- **Electricity, gas, heating**
- **Water**
- **Paper**
- **Toners**

Increasing awareness of personnel regarding environmental impact of consumption

Change in consumption patterns toward saving and preservation

Decrease in costs and improved P&L effect

Indirect Impact: from Core Banking Activities

- **Corporate Lending**
- **Mortgage Lending**
- **Trade Finance**
- **Asset Management**

Lending on condition that beneficiaries comply with environmental legislation and manage pollution. Environmental risk monitoring and reporting

Exclusion of heavily polluting or hazardous industries from financing

Mitigation of environmental causes for credit and reputation risk

Improved risk management and image of the bank

Direct Environmental Impact from Banking Activities

Direct Environmental Impacts: Definition

The direct environmental impact from banking activities can be identified in the following areas, more specifically in the consumption of:

- Energy
- Water
- Paper and other stationary materials
- Travel

The consumption levels in some of the cases (water, electricity) are considered related to fixed OPEX, in others they can be modified through change of internal processes (paper, toners, travel).

Managing Internal Processes: Why Do It?

1. Cost saving
2. Achieving efficiency in internal processes as a result of redesign
3. Improved image

Important side effect of managing internal processes towards becoming "green": increasing awareness of personnel for environmental issues. Opportunity significant percent of employees to work as agents of change in the broader society.

Direct Environmental Impact Strategy of Bank

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Direct environmental impact strategy: energy, water, paper, toners and travel management scheme

Decrease on consumption

Cost reduction

Improved awareness in personnel regarding environmental issues

Transfer of consumption patterns and environmental awareness at home: Personnel become more environmentally cautious in their private life

Multiplier effect

Indirect Environmental Impact from Banking Activities

Indirect Impact: Why Care?

Climate change alters the face of risk for financial institutions as:

1. More stringent regulatory requirements towards business eco functioning are devised. These are meant to tackle pollution and climate change
2. Risk of extreme weather events rises

Environmental risk has two main aspects:

1. The risk of a loan becoming non-performing due to fines or bans on the beneficiary which place him in a position to be unable to serve his obligations to the bank
2. The risk of obtaining collateral with heavy environmental issues that make it practically not usable, i.e. the cost of cleaning collateral*

** EBRD Environmental and Social Risk Management Manual*

The Green Economy and the Financial Sector

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The Green Economy …and The Financial Sector

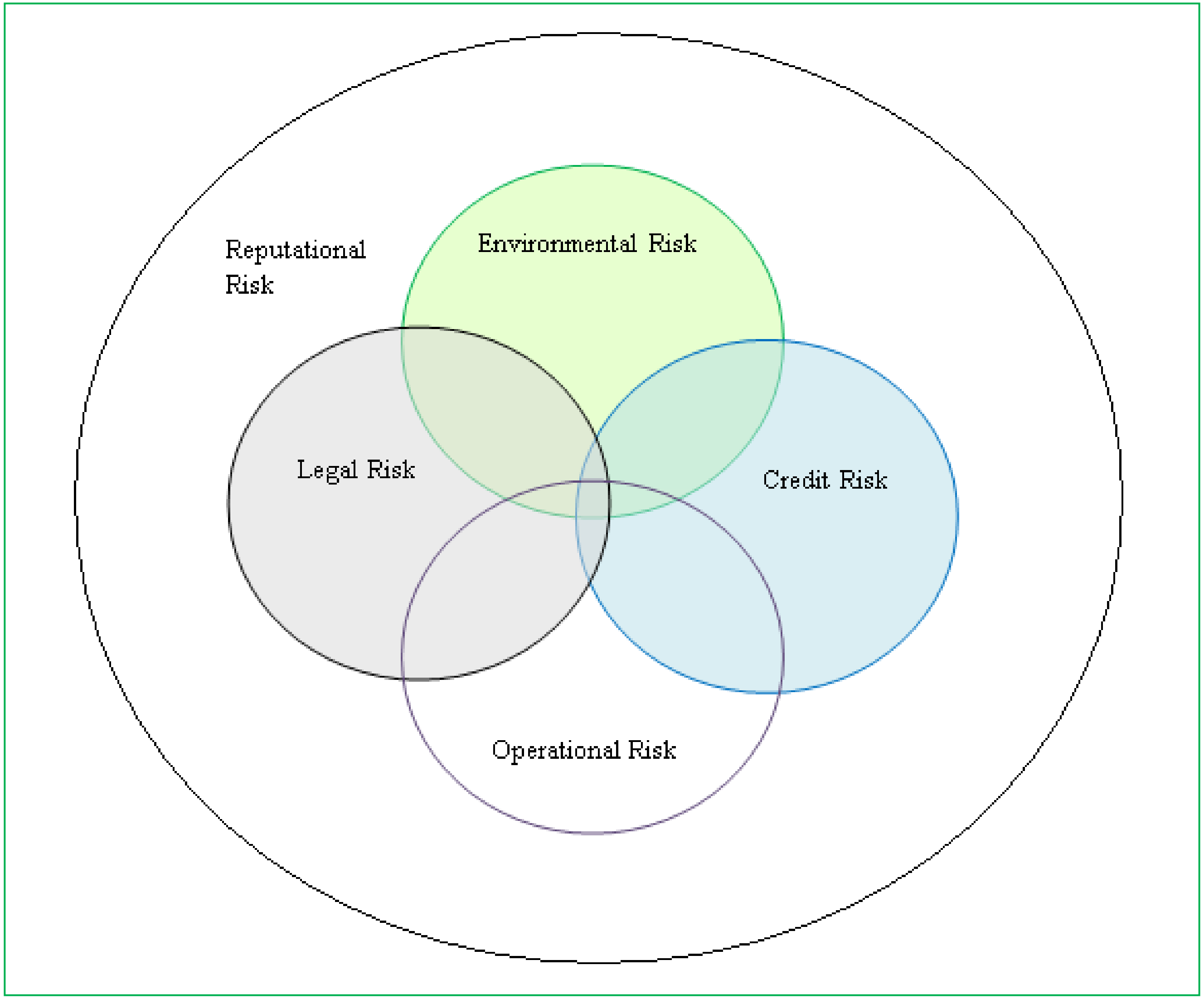
"Support for the green economy and the environment goes hand-in hand with the Cohesion Policy's objective to deliver sustainable growth, jobs and competitiveness. In a difficult financial climate, this investment will be instrumental in creating long-term employment and reviving local economies, as well as underpinning the EU's commitment to the fight against climate change.“

Danuta Hübner, European Commissioner for Regional Policy (9/3/2009)

„The financial sector can play a critical role in the transformation to a more sustainable environment.
As financial intermediaries in an economy, financial institutions can contribute to mitigating environmental problems, while at the same time taking advantage of the opportunities that sustainability offers to the finance sector.

[UNEP FI (2004): Finance & Sustainability in CEE]

The Challenge for Banks:
Managing Environmental Risk in Lending



Determinants of Environmental Risk in Lending

The key determinants of environmental risk exposure for a bank can be identified among the following, and assigned a score to produce a final environmental risk rating:

1. Nature of economic activity of the customer
2. Amount of loan
3. Term of loan
4. Nature of collateral

The above are being used in a card for scoring the environmental risk*

Other, qualitative criteria, applied on the client, are:

1. Financial strength
2. Management capacity
3. Degree of innovation
4. History

EBRD Environmental and Social Risk Management Manual

Legal Macroframework

Directive 2004/35/EC

Law on the Responsibility for Prevention and Elimination of Environmental Damages

The framework introduces:

- “Polluter Pays” principle
- The cases in which this principle applies
- List of industries for which it is applicable both in case of action and inaction

Effects from Application of Environmental Risk Management in Core Banking Activities

Environmental risk management in core banking activities

Applying environmental criteria in financing

Refusing funds to heavily polluting business

Encourage business to have environmentally friendly operations

Spreading application of environmentally friendly operations throughout economic agents, boosting awareness in corporations

Multiplier effect

Opportunities for banks to increase financing in the area of green facilities, machines and equipment so that businesses become compliant with environmental criteria

Opportunities for Banks

Changing business and legislative environment, apart from risks, creates opportunities for banks, especially for financing the below:

- Investments by enterprises whose businesses are covered by the EU Emissions Trading Scheme
- Energy efficiency
- Innovative technology solutions aiming at enhancing the efficiency and reduction of pollution caused by enterprises and hence ensue compliance with legislation
- Bio agriculture and bio production development

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THANK YOU!