SOUTH INDIAN Bank
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SIB STUDENTS' ECONOMIC FORUM

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After burning their fingers in projects such as Enron and Union Carbide in the past, Indian banks and financial institutions are now looking at integrating sustainability into project financing by evaluating environmental and social risks during the appraisal process itself. The International Finance Corporation (I F C), National Institute of Bank Management (N I B M) and Asian Development Bank (A D B) have recently begun an initiative to sensitise Indian banks to the perils of financing projects that do not adhere to pollution norms. Extending Bank guarantees to Infrastructure projects can get affected with social and environmental issues.

What is Sustainability?

Sustainability is increasingly understood as the creation of not just financial and economic value but also long term environmental and social value for a wide range of stake holders-including share holders, employees, customers, suppliers and society with particular consideration for the needs of future generations.

As per the definition given by International Finance Corporation "sustainability is about ensuring long-term business success while contributing toward economic and social development, a healthy environment, and a stable society." For the financial institutions, it encompasses the following four dimensions of good business performance.

- The financial sustainability of the financial institution and its client-companies, so that they can continue to make a long-term contribution to development

- The economic sustainability of the projects and companies the financial institution finances, through their contribution to host economies.

- Environmental sustainability through the preservation of natural resources

- Social sustainability through improved living standards, poverty reduction, concern for the welfare of the society and respect for key human rights.

These considerations, taken together, aim to capture a whole range of factors that influence the decisions, activities, products, and services of financial institutions, including the social and environmental impacts of their work.

What is the importance of Sustainability?

The global importance of sustainability is reflected in changing consumer expectation and emerging national and international legislation. Companies' chances of operating successfully and engaging in international trade depend more and more on their ability to mitigate social and environmental risks and to capitalize on opportunities for innovation. Sustainability has become an essential element of competitive advantage and something businesses can no longer ignore.

Recognizing this trend, many companies are looking to integrate sustainability into their businesses. For many, the first challenge is knowing where and how to start. The next is getting the necessary inflows of capital to begin transforming their operations.

Financial institution, as the providers of finance for businesses of all shapes and sizes, have a pivotal role to play in promoting sustainability across industries, sectors, and communities. Sustainability also offers vast potential for financial institutions to improve their own products and services.

What are the two components of sustainability for financial institutions?

i) One component is managing social and environmental risks in strategic decision-making and lending. Financial institutions can strengthen their portfolio by systematically evaluating these risks in the loan or investment appraisal process. In this way, they can focus investments, on those companies and projects with high environmental, social, and financial performance. Doing so can help protect their asset portfolio by decreasing nonperforming loans, thereby increasing financial stability and protecting the bank's reputation.

ii) The other component is identifying opportunities for innovative product development in new areas related to sustainability. This entails creating financial products and services that support commercial development of products or activities with social and environmental benefits. A growing cluster of these opportunities has evolved and includes renewable energy, energy efficiency, cleaner production processes and technologies, biodiversity conservation, microfinance and financial services targeted to women. Business models that address these dimensions are yielding new clients and markets. They are also helping financial institutions differentiate themselves from competitors, improve their reputation among key customers and stakeholders, attract new capital, and generate goodwill and support from stakeholders.

Why should the commercial banks be concerned with social and environmental issues?

Through the portfolios of their customers, banks are exposed to a more diverse set of social and environmental issues than the average business and, to a certain extent, than other financial institutions. Accordingly, banks and other financial institutions are shifting their focus and reorienting their activities. They are increasingly moving from avoiding risks to creating opportunities: from defensive banking, where environmental management is seen as an additional cost, to sustainable banking, where sustainable development is seen as an advantage and an opportunity for growth.

What are the observations and recommendations of UN Secretary General's High-Level panel 2006?

- There is an increasingly compelling case for urgent action on the environment.
- Environmental priorities have too often been compartmentalized away from economic development priorities. However, global environmental degradation – including climate change – will have far-reaching economic and social implications that affect the world's ability to meet the Millennium Development Goals.
- Because the impacts are global and felt disproportionately by the poor, coordinated multilateral action to promote environmental sustainability is urgently required.
- The Report recommends that international environmental governance

should be strengthened and made more coherent in order to improve effectiveness and targeted action of environmental activities in the UN system.

- It has also stated that the Global Environment Facility should be strengthened as the major financial mechanism for the global environment, to help developing countries build their capacity. It should have a significant increase in resources to address the challenge posed by climate change and other environmental issues.
- A number of recommendations were made to make sure the UN helps countries mainstream environment in their strategies and actions, to elevate the status of sustainable development in the UN institutional architecture and in country activities, and to achieve the needed balance among the three pillars (economic, social and environmental) of sustainable development.

What is sustainable Finance?

i) Financially sound
ii) Environmentally sustainable
iii) Socially sustainable

No credit appraisal system is perfect. But banks can improve their risk management by taking into account the environmental and social risks also in addition to the credit risk, market risk and operational risk. This will enable the bank to offer advance products at a reduced price than its competitors.

Conclusion: The banking sector in emerging markets is becoming more complex and thus more vulnerable to financial and non- financial risks, as well as increased global competition. The government as well as the central banks in many countries are encouraging risk based approach to lending and investment. They encourage and even provide incentives for banks to incorporate systematic procedures for assessing social and environmental risks. Many countries have also updated their environmental legislation in the past decade. Though the legal frame work to reduce social and environmental risks are on the increase, its enforcement is a challenge. Banned industries in many developed countries are now being relocated to developing countries. Later on due to social pressure, some of these Industries may be forced to close down.