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SUSTAINABLE BANKING IN ASEAN
The past year has seen growing collaboration and commitment on sustainability in ASEAN, with an increasing focus from governments on meeting the Sustainable Development Goals (SDGs).

Despite this progress, however, ASEAN countries remain some of the most vulnerable in the world to climate change; while other issues – such as deforestation, biodiversity loss, water scarcity and human rights abuse – continue to threaten the region. Furthermore, according to the United Nations Economic and Social Commission for Asia Pacific (UNESCAP), ASEAN nations are not on track to meet key environmental and social SDGs by 2030. In order to address these issues, ASEAN must do more to adapt to a resource- and carbon-constrained world and transition to a sustainable, low-carbon economy.

At a global level, we are witnessing rapid change in the sustainable finance landscape, which will have wide-reaching implications for ASEAN banks. The European Commission action plan on sustainable finance will be game-changing for the entire financial system due to its introduction of a new sustainability taxonomy through which investors, insurers and banks will assess their clients and investments. We are already seeing the finance sector respond by moving ahead of regulation. The United Nations Environment Programme Finance Initiative (UNEPFI) Banking Principles, expected to be released in 2019, will offer a set of harmonized sustainable banking guidelines that will mirror the Principles for Responsible Investment (PRI) for investors and likely have a similar impact on the banking industry. Meanwhile, minimum industry standards for financial products to be labelled ‘green’ are being expanded beyond green bonds with the release of the Green Loan Principles earlier in 2018.

In addition to regulations and standards, the finance sector is developing and pilot-testing methodologies for banks to assess and manage climate risk in their portfolios. A working group of 16 member banks, in collaboration with UNEPFI, issued guidance on how to implement the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD); while the 2° Investing Initiative is piloting a draft methodology for banks to align their lending portfolios with the transition pathway required to limit climate warming to 2°C. Such action is increasingly supported by the growing number of investors who recognize the risks and opportunities presented by a carbon- and resource-constrained world, and expect banks and banks’ clients to adapt their business models accordingly. In the past year we have seen significant investor action pushing companies to disclose against the TCFD framework, as well as greater pressure for banks to manage climate-related risks in line with TCFD recommendations.

The finance sector has a unique enabling role to play in the transition to a sustainable, low-carbon economy. ASEAN banks must use the conditions of access to, and cost of, capital to encourage their clients to take ambitious steps to transform the region’s
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food, energy, transport and infrastructure systems. While improved environmental and social risk management is critical, banks can also tap into significant opportunities presented by sustainable development, which will require extensive private sector financing, especially in emerging markets.

In last year’s report, we highlighted the general misalignment of finance sector guidelines and regulations with national policies on sustainable development and climate change across ASEAN, and the resulting fact that banks were not fully harnessing their potential to drive sustainable development in the region.

This year’s report shows that banks in ASEAN are moving in the right direction; however, they must accelerate their efforts in order to stay competitive, resilient and relevant in a resource-constrained, low-carbon future while ensuring that their products and services do not result in negative environmental and social impacts.

OVERVIEW OF REPORT

This report is an update of the Sustainable Banking in ASEAN report issued by WWF in partnership with the National University of Singapore (NUS) Centre for Governance, Institutions and Organisations (CGIO) in October 2017. This report benchmarks 34 banks in six ASEAN countries – namely Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam – on their corporate governance practices and their integration of environmental, social and governance (ESG) factors into their business. The ESG factors include (but are not limited to) those which are having a particular impact in ASEAN, such as climate risk, deforestation, water scarcity, human rights and labour issues. The assessment is based on a framework of indicators that represent (i) sound corporate governance practice (board, shareholders and stakeholders, disclosure and transparency, audit and risk); and (ii) robust ESG integration practice (purpose, policies, processes, people, products, portfolio). We used English-language disclosures available publicly as of 3 July 2018 as the sole basis for the assessment, as these represent the information typically accessible to all stakeholders. We then compared this year’s results with last year’s to establish the progress that ASEAN banks have made on corporate governance and ESG integration.

This report is aimed at banks, banking regulators and banking associations in ASEAN, to help them understand changes in – and improve the level of – ESG integration, both in individual banks and across the wider industry. The report is also aimed at investors, within ASEAN and globally, who can use it to assess banks’ progress on ESG integration, understand whether this is aligned with their own ESG commitments, and engage with the banks on the issue as required. Report users can access the interactive Sustainable Banking Assessment (SUSBA) website (www.susba.org) to further explore and compare the results.
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**KEY FINDINGS**

1. **Sustainability is still not formally included in the mandate of board committees, with only limited disclosure regarding board and senior-level oversight of material ESG issues such as climate change.** As was the case last year, sustainability was not disclosed as a consideration by any bank in the drafting of terms of reference for nominating, remuneration or audit committees. Additionally, 25 banks did not mention responsible lending in their leadership statement, and 30 did not disclose whether senior management has oversight of climate change risks, as recommended by the TCFD.

2. **Sustainability has not been fully embedded into corporate governance mechanisms and processes in ASEAN banks.** Integrating sustainability across corporate governance mechanisms is key to improving a bank’s sustainability performance. ASEAN banks are disclosing their sustainability practices to their stakeholders, with 33 out of 34 banks reporting on sustainability and 26 disclosing that they have policies on stakeholder engagement. However, further integration of sustainability remains limited, with only 11 banks disclosing that they review their environmental and social (E&S) policies and procedures periodically, and just seven disclosing that their bank has an external audit on sustainability.

3. **ASEAN banks have embraced sustainability as a core business strategy, with most banks now understanding that their ESG risks and opportunities lie mainly within their portfolios rather than their own operations.** Of the 34 ASEAN banks, only four still think of sustainability as related to managing their buildings’ and employees’ environmental footprints. Banks increasingly acknowledge the impact of climate risks on businesses, with 19 banks recognizing climate risk this year compared to 12 last year. Around half of the banks now recognize the relevance of the SDGs to their businesses – eight more than last year.

4. **The banks' inclusion of sustainability in their corporate strategies is not reflected in their policies and processes, with only slight improvements in the number of banks developing and disclosing sector-specific policies or requirements.** Nineteen banks have a standardized framework for E&S risk assessment, compared to 15 last year. Four additional banks disclosed that they have sector policies, bringing the total to seven, but disclosure of the policies themselves was limited, with just three banks disclosing one or two of their key policies (rather than all their policies, which is the market practice for international banks).

5. **Banks show increased disclosure of responsibilities associated with ESG implementation, and some are creating new sustainable finance products to capture opportunities.** However, capacity gaps and lack of training are still making it difficult for banks to implement robust ESG risk management and capture the upside via product development and the transitioning of their portfolios. Eleven banks – compared to four last year – disclosed responsibilities of departments or committees involved in ESG implementation.
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However, only three banks disclosed the existence of a dedicated ESG team; while 12 disclosed having some form of ESG training for staff, compared to 11 last year. These numbers suggest a capacity gap, which manifests itself in a lack of disclosure on E&S risk management policies and processes and insufficient capture of opportunities via capital allocation and sustainable finance products. Although 22 banks mentioned sustainable banking products, only two banks have specifically allocated capital for sustainable finance activities.

6. Disclosure on portfolio-level management of ESG risks and opportunities is still lacking. This suggests that banks are not yet prepared to fulfil TCFD-related disclosure requirements that investors are starting to expect. Only two banks disclosed that they assess E&S risk at the portfolio level. No banks disclosed the accumulated E&S risks or carbon intensity across their portfolios, nor did any indicate whether they are aligning their portfolios to a resource- and carbon-constrained world by setting targets for reducing risk exposure or for green financing, which are all TCFD recommendations. This suggests there could be hidden E&S risks embedded in these banks’ portfolios, and that they would benefit from a more strategic approach to both risk management and the capture of E&S opportunities.

RECOMMENDATIONS

WE RECOMMEND ASEAN BANKS:

- Embed sustainable finance into their core business strategy, drawing upon the six fundamental pillars of ESG integration and employing science-based criteria and standards to drive resilient and sustainable growth in the real economy. This strategy should be at least in line with, or more ambitious than, national agendas on climate change and sustainable development.

- Elevate sustainability to a core part of corporate governance by including it in board-level terms of reference and in remuneration criteria, and by providing sustainability and ESG training to boards and senior management to help them understand the related risks and opportunities.

- Assess portfolio-level exposure to climate risks (including transition and physical risks) by conducting forward-looking scenario analysis for high-risk sectors, and require clients in these sectors to set science-based targets with appropriate transition plans. Banks can set science-based targets for portfolio alignment with the SDGs and the Paris Agreement.

- Disclose sustainable finance practices, portfolio-level risk exposures and science-based targets and metrics using the recommended six pillars framework (and in alignment with TCFD for climate-related issues); in order to be accountable to stakeholders and enable shareholders to benchmark relative sustainability performance and portfolio resilience.

- Collaborate with stakeholders – such as regulators, banking associations and NGOs – to benefit from peer-to-peer learning and enhance capacity on sustainable finance, jointly develop science-based disclosure and impact measurement frameworks/methodologies, become signatories to the UNEPFI Banking Principles once issued, and generally act to create industry-wide change and ensure a level playing field.
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WE RECOMMEND ASEAN BANKING REGULATORS AND BANKING ASSOCIATIONS:

- Facilitate ESG integration in the banking sector by establishing or enhancing time-bound national sustainable finance regulations or industry association guidelines, including sector-specific guidelines with minimum standards, and monitor progress to ensure timely implementation.

- Design these sustainable finance regulations based on global best practice, including science-based criteria and standards, in dialogue with policy-makers in charge of climate change and sustainable development agendas. The regulations should combine mandatory requirements where necessary with incentives for the finance sector to contribute to national goals on the SDGs and the Paris Agreement.

- Work with science-based organizations to undertake analysis of climate risks across the banking sector, including climate stress testing, to understand the resilience of the industry. Make it mandatory for banks to perform environmental stress tests, assess portfolio alignment and disclose climate risk in line with TCFD recommendations.

- Collaborate with regulators and banking associations from other ASEAN countries to facilitate peer-to-peer learning and harmonize ESG regulations, and join the Central Banks and Supervisors Network for Greening the Financial System. This will create a level playing field, ensure regulatory consistency for banks, and prevent a race to the bottom in terms of sustainable finance standards.

- Support capacity-building for the banking industry by working with NGOs who can provide deep insights into material E&S issues and create useful tools and guides on due diligence and risk assessment as well as including sustainable finance into mandatory training modules for all banking sector employees in credit, risk, relationship management, compliance, legal and audit functions.

WE RECOMMEND SHAREHOLDERS OF ASEAN BANKS:

- Engage with ASEAN banks in investment portfolios at both board and C-suite level to support the five recommendations above and assert their influence as shareholders through voting and engagement.

- Request specifically that banks:
  - Disclose in line with TCFD recommendations, including an assessment of their portfolio-level exposure to climate and other ESG risks;
  - Conduct forward-looking climate scenario analysis of loan portfolios, in order to assess the level of alignment with investors’ own climate/ESG commitments and policies, as well as with the SDGs and the Paris Agreement; and
  - Make public decarbonization commitments using science-based targets, to minimize their exposure to climate risk and align their portfolios with the SDGs and the Paris Agreement.

- Engage with regulators, stock exchanges and banking associations to demonstrate support for sustainable finance regulations and affirm the business case for sustainable finance.
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WWF CAN SUPPORT THE ASIAN BANKING SECTOR IN THE FOLLOWING WAYS:

- Build capacity in banks on ESG integration and share expert insights into key ESG issues such as climate, water and deforestation. This will enable banks to meet sustainable finance regulations, minimize exposure to ESG risk, capitalize on opportunities and fulfill their potential to drive sustainable development.

- Provide insights gained from our work on cutting-edge initiatives in sustainable finance and ongoing developments in global regulations, for example the European Commission Action Plan on Sustainable Finance.

- Facilitate landscape-level multi-stakeholder initiatives to structure innovative green finance solutions, with effective conservation indicators and outcomes, targeted at both international and regional companies, SMEs and smallholders.

- Develop practical tools and guides for the banking sector that facilitate ESG integration and reflect the latest science-based perspectives on sustainability.

- Provide expert insights on E&S issues to banking sector regulators and banking associations to support their formulation of sustainable finance regulations and sensitive sector guidelines.

- Monitor ESG integration progress in the ASEAN banking sector by issuing annual reports on banks’ disclosure and the extent to which sustainable finance and relevant regulatory frameworks are harmonized across borders.

CGIO CAN SUPPORT THE ASIAN BANKING SECTOR IN THE FOLLOWING WAYS:

- Analyse the strengths and weaknesses of listed companies’ corporate governance disclosures using comprehensive frameworks, and use these findings to highlight overall trends in corporate governance across ASEAN.

- Shed light on outstanding progress and stagnation among banks’ practices and disclosures, for the use of regulators and policy-makers.

- Demonstrate the links between corporate governance and sustainability through research and by organizing events, conferences and seminars.