INCLUSIVE GREEN FINANCE
SURVEY OF THE POLICY LANDSCAPE

PREVENTION

Prevention policies aim to avoid undesirable outcomes by lowering financial, social and environmental risks.

PARAGUAY

Flexible Guide for the Management of Environmental and Social Risks that encourages including non-financial risk in credit decisions

BRAZIL

Issued detailed guidelines to support the adoption of a Social-Environmental Responsibility Policy (Política de Responsabilidade Socioambiental) and made the application of these guidelines a condition for commercial banks to operate

PAKISTAN

Issued Green Banking Guidelines with a sizable section on ERM that offers guidance to banks on developing their own green financing products and services

NEPAL

Adopted Guidelines on Environmental and Social Risk Management for Banks and Financial Institutions, which apply to bank lending for SME finance, commercial leasing, term finance and project finance

BANGLADESH

Introduced Environmental Risk Management Guideline and Environmental Due Diligence Checklists to regulated financial institutions

AFI members are increasingly enacting Environmental and Social Risk Management (ESRM) Guidelines, which assess and address the social and environmental externalities and risks of a financial institution's activities. By requiring that attention be paid to the byproducts, secondary effects and unintended consequences of financing, an ESRM policy not only creates an environment for more holistic finance, but also lowers financial, societal and environmental risk.

E(S)RM GUIDELINES

- **Bangladesh Bank** was one of the first AFI member institutions to introduce Environmental Risk Management (ERM) Guideline[76] and Environmental Due Diligence Checklists. These were originally drafted in line with Bangladesh's commitments to the UN Millennium Development Goals (MDGs) and were intended to enable commercial banks to assess risk more accurately and finance environmentally sensitive projects. Bangladesh Bank has since held a series of multi-stakeholder consultations to update its ERM as Guidance on Environmental and Social Risk Management for Banks and Financial Institutions.
- Meanwhile, **Banco Central do Brasil** has issued detailed guidelines to support the adoption of a Social-Environmental Responsibility Policy (Política de Responsabilidade Socioambiental, or PRSA) and made the application of these guidelines a condition for commercial banks to operate. The central bank has also made other efforts to integrate ESRM into commercial bank management and operations, such as requiring banks to take environmental and social stress tests, collect data on financial losses due to environmental damages and submit an annual report on these issues to the central bank.

Pakistan, Nepal and Paraguay introduced E(S)RM more recently and their approaches have been more flexible.

- In 2017, the **State Bank of Pakistan** issued Green Banking Guidelines with a sizable section on ERM that offers guidance to banks on developing their own green financing products and services. The Guidelines also call for banks to reduce their environmental impact in branches and head offices. Social risks are not covered in the Guidelines.
- In 2018, **Nepal Rastra Bank** adopted Guidelines on Environmental and Social Risk Management for Banks and Financial Institutions, which apply to bank lending for SME finance, commercial leasing, term finance and project finance. Banks or financial institutions engaged in these activities are required to create an environmental and social management system, and the Guidelines include a series of tools and templates to assist with this effort.
- **Banco Central de Paraguay** has modeled its ESRM approach on Nepal's, which is reflected in a rather flexible Guide for the Management of Environmental and Social Risks (2018) that encourages including non-financial risk in credit decisions.

ESRM regulations can be voluntary or compulsory and may be implemented at the initiative of the financial sector or the regulator.

To create a level playing field for financial institutions, ESRM rules should strive to cover the broadest possible spectrum of financial institutions and become mandatory rather than voluntary once the financial sector has had time to adapt. This will prevent regulatory arbitrage and willful evasion of the rules. Enactment of regulations and supervision practice are still evolving as regulators and the industry learn how to move forward.

CHALLENGES OF PREVENTION POLICIES

ESRM guidelines require both training for FSP staff and supervision resources from the regulator. With voluntary guidelines, there is a risk that not many FSPs will apply them. Another challenge is ensuring that conducting more thorough credit checks does not lead to financial exclusion. In addition, the current scope of ESRM guidelines could be expanded to include greenhouse gas emissions and take climate change adaptation needs into account. Wider use of ESRM guidelines would necessitate capacity building for supervisory institutions as well as increased compliance monitoring.

76 Bangladesh Bank, 2017