SUSTAINABLE BANKING NETWORK (SBN)

GLOBAL PROGRESS REPORT

FEBRUARY 2018

EXECUTIVE SUMMARY

Sustainable Banking Network

International Finance Corporation
WORLD BANK GROUP

Creating Markets, Creating Opportunities

The global SBN activities have been supported by the Government of China through the Ministry of Finance, the Government of Denmark, and the Government of Japan through the Ministry of Finance since 2012. Partners and donors supporting IFC's regional environmental and social risk management (ESRM) projects include: the government of Switzerland through the State Secretariat for Economic Affairs (SECO), the government of the United Kingdom through the Department for International Development (DFID), the government of Japan through the Ministry of Finance, and the government of Canada through the Department of Foreign Affairs.

Government of People's Republic of China, through the Ministry of Finance

Government of Denmark

From the People of Japan
Government of Japan, through the Ministry of Finance

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs FDEA
State Secretariat for Economic Affairs SECO

Government of Switzerland through the State Secretariat for Economic Affairs (SECO).

UKaid from the British people
Government of United Kingdom through the Department for International Development

Canada
Government of Canada, through the Department of Foreign Affairs

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Abbreviations and Acronyms

BRICS	Brazil, Russia,India, China, and South Africa
DfID	Department for International Development
E&S	environmental and social
ESG	environmental, social, and governance
ESMS	environmental and social management system
ESRM	environmental and social risk management
EY	Ernst & Young
FI	financial institutions
FCS	fragile and conflict-affected state
FSB	Financial Sustainability Board
GHG	green house gas
GRI	Global Reporting Initiative
IDA	International Development Association
IFC	International Finance Corporation
JSE	Johannesburg Stock Exchange
NDC	Nationally Determined Contributions
PRI	Principles for Responsible Investment
PSI	Principles for Sustainable Insurance
SASB	Sustainability Accounting Standards Board
SBN	Sustainable Banking Network
SDG	Sustainable Development Goals
SECO	State Secretariat for Economic Affairs
SSE	Sustainable Stock Exchanges
TCFD	Task Force on Climate-related Financial Disclosures
UN	United Nations
UNEP	United Nations Environment Programme

Executive Summary

Emerging markets have become a major driver for sustainable development and addressing climate change. Reaching the United Nations Sustainable Development Goals (SDG) and climate targets will require a sustained effort and an estimated $70 trillion[1,2] of financing by 2030. In emerging markets, banks hold assets estimated at more than $50 trillion, which gives them the potential to make a substantial difference in sustainable development.

Market-based sustainable finance initiatives led by the members of the Sustainable Banking Network (SBN) have made significant progress in directing the financial sector toward sustainability. Established with support from the International Finance Corporation (IFC) in 2012, SBN represents a community of financial sector regulators and banking associations from 34 emerging market economies with a shared ambition to transform the financial markets towards sustainability. SBN members now represent $42.6 trillion in banking assets, accounting for more than 85 percent of the total banking assets in emerging markets.

SBN member-led national sustainable finance policies and principles are a new effort to change behaviors of financial institutions (FIs). In most countries, these policies and principles are not hard regulations but strategic and technical "how to" guidance to help FIs to systematically integrate sustainability considerations into business strategy and operations. The guidance developed in the member countries varies in form: (i) mandatory policies, guidelines and roadmaps, advanced by regulators (for example: China, Indonesia, Peru), (ii) voluntary industry principles, led by banking associations (for example: Mongolia, Colombia, Kenya), or (iii) co-existence of policy-led regulations and industry-led principles (for example: Brazil, South Africa).

This report is SBN's first Global Progress Report. The report presents a systematic view of progress toward sustainable finance among the emerging economies represented by SBN. It is based on a unique measurement framework to assess sustainable finance initiatives across emerging markets. The Global Progress Report was informed by country progress reports that were prepared for 15 SBN members implementing sustainable finance policy initiatives. Country specific reports detail each country's good practice and highlight areas of focus to support and encourage members to further accelerate efforts in sustainable finance. With $38.3 trillion in banking assets, these 15 member countries account for more than 76 percent of emerging market banking assets.

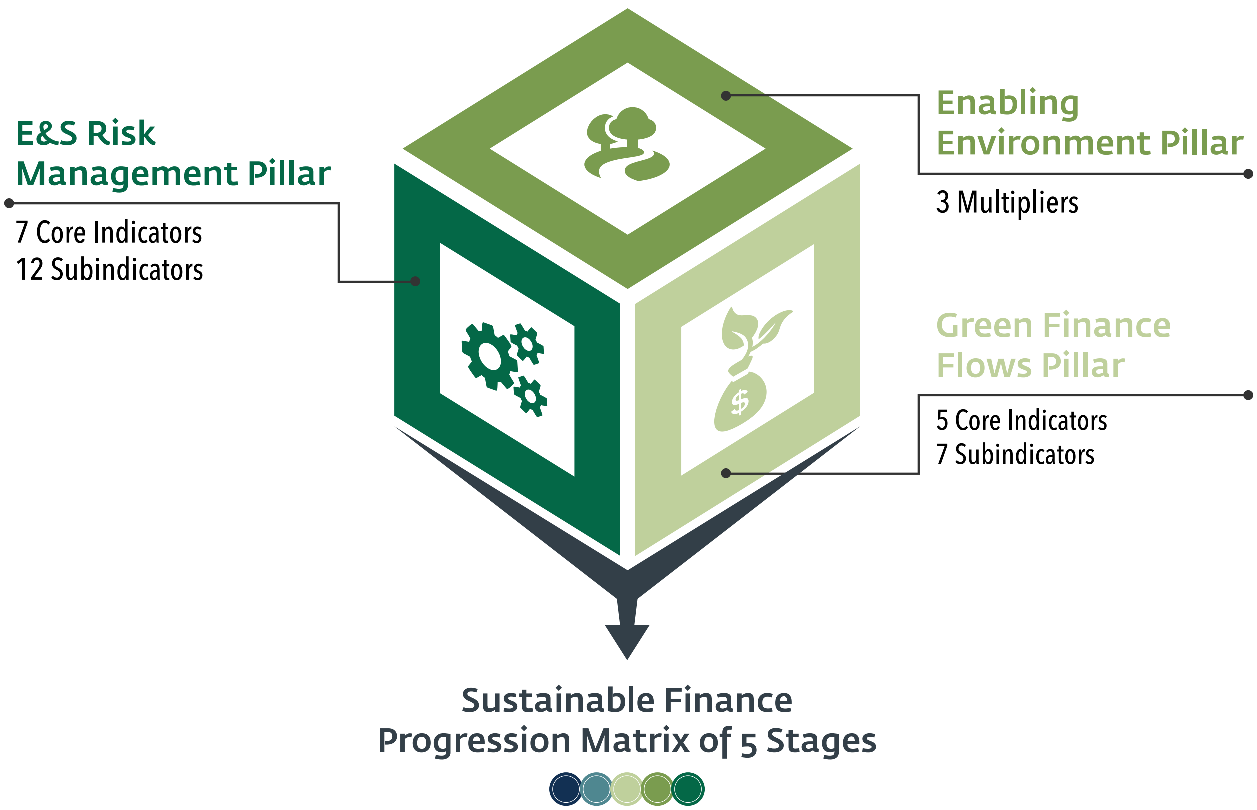
The SBN measurement framework, developed, and agreed to by SBN members, draws on international good practice, as well as SBN members' experiences and innovations. National sustainable finance policies and principles were assessed for environmental and social risk management practices by banks, green finance flows and enabling environment for comprehensiveness in coverage, depth and clarity. Assessment results feed into a SBN progression matrix to illustrate

1 UNCTAD - World Investment Report (2014): http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf

2 All dollar amounts are in U.S. dollars, unless noted

the collective progress of SBN members. The framework will be applied continuously to measure progress annually. It allows each member to review their own progress and identify the strengths and weaknesses of their own approach, be it mandatory, voluntary or hybrid.

Figure 1: SBN Measurement Framework



1. *The E&S Risk Management Pillar assesses the degree to which national policies or principles provide comprehensive and in-depth guidance and requirements to FIs in managing E&S risks, including climate risk and the extent to which this guidance is applied by financial market participants.*
2. *The Green Finance Flows Pillar assesses the degree to which market infrastructure has been introduced to encourage FIs to direct their lending to projects and businesses with positive environmental and climate impacts and the resulting impact on capital flows.*
3. *The Enabling Environment Pillar assesses crosscutting factors that have been shown to have a multiplying or undermining effect in achieving the first two pillars.*

OVERALL FINDINGS

All SBN member countries are advancing sustainable finance, although they are at different stages of development.

The mapping indicates the following:

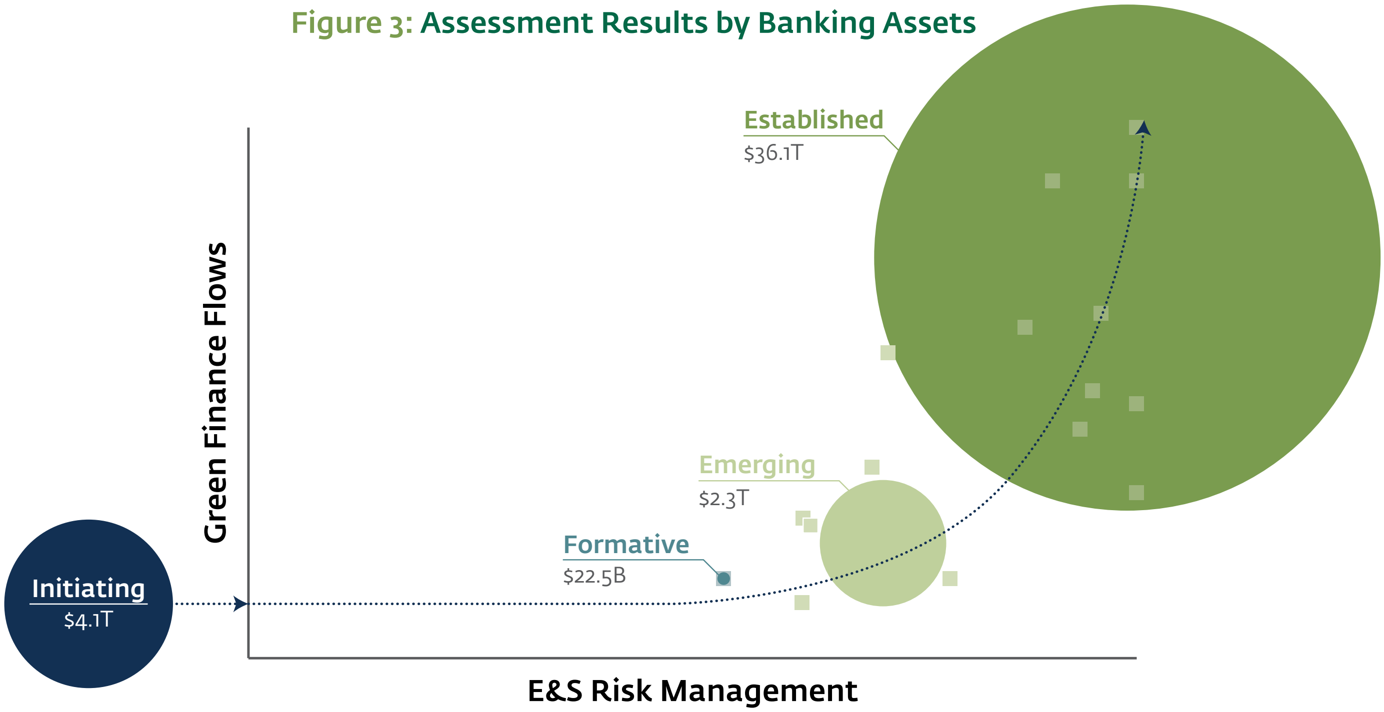
- 19 members are currently at the "initiating" stage, demonstrating a commitment to take sectorwide actions to promote sustainable finance.
- The 15 countries that have launched policies and principles currently fall into the following categories:
  - 1 country is at the "formative" level, with a policy formalized, but not yet implemented. This country is Ecuador.
  - 6 countries are at the "emerging" stage: they have policies and principles in place and have begun to implement these policies. These countries are: Kenya, Mexico, Morocco, Peru, South Africa and Turkey.
  - 8 countries are at the "established" stage: they have comprehensive implementation actions in place and have begun to report on results and impacts. These countries are: Bangladesh, Brazil, China, Colombia, Indonesia, Mongolia, Nigeria and Vietnam.
  - At this point, no member countries have reached the mature stage, with comprehensive behavior change demonstrated by the banks and other financial sector participants.

Figure 2: SBN Progression Matrix with Assessment Results

Assessment based on progress up to and as of June 2017

* Pakistan launched its policy in October 2017, after the cut off date of June 2017 for the report

Figure 3: Assessment Results by Banking Assets



Note: Results for the E&S Risk pillar are represented on the x-axis. Results for the Green Finance Flows pillar are on the y-axis. Both results are adjusted using factors of the Enabling Environment pillar. The US dollar numbers are the aggregated banking assets of the countries represented in their respective stages and indicated by the size of the corresponding bubble.

Sustainable finance is expanding globally—wealth, market maturity, and level of development do not limit the transition to sustainable finance. Even the poorest countries can adopt sustainable finance policies. An analysis of country initiatives compared with income level, as defined by the World Bank, shows that member countries of all income levels are advancing the development of sustainable finance, with lower-income countries quickly joining the ranks. For example, Bangladesh was among the first movers in adopting sustainable finance regulation, with a per capita income of $1,358.

Emerging markets can make rapid progress, leapfrogging ahead, by learning from others. Peer-to-peer knowledge sharing is a hallmark of SBN, resulting in some countries rapidly applying successful ideas from other members to their own conditions. For example, Nepal was inspired to build environmental and economic resilience after a major earthquake in April 2015, and quickly adopted the related experiences from Bangladesh through regional study tours and peer learning supported by SBN.

ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT

Most member countries have developed polices and principles in alignment with good international industry practice, including the IFC Performance Standards and the Equator Principles which reference them. Two-thirds of the national sustainable finance policies and principles specifically refer to international standards, which offer a benchmark for the environmental and social (E&S) issues to be managed and offer guidance on how to do so. Most of the 15 national policies or principles have good coverage across the seven core indicators of the E&S Risk Management pillar.

Requirements for financial institutions to conduct E&S due diligence and report E&S performance particularly stand out. All 15 national policies or principles beyond the formative stage require FIs to perform E&S risks assessment and 11 countries have further required risk categorization to guide credit decision making. There remains room for further improvement in requiring FIs to continuously monitor E&S performance of their portfolio over time.

Some countries are also spurred to action by climate commitments. Commitments to meeting the United Nations Sustainable Development Goals (SDGs), and Nationally Determined Contributions (NDCs) under the Paris Agreement on Climate Change have led some SBN members to begin incorporating **climate risk** into their national policies or principles. FIs from these markets are starting to develop climate strategies, aligned with the country climate commitments.

GREEN FINANCE FLOWS

The SBN Global Progress Report highlights that the capital for green growth must come predominantly from the private sector. For example, in China, it is estimated that the private sector will need to finance more than 85 percent of the country's total green investment.[3] Many SBN members have introduced market incentives to drive banks to step up green investments. Incentives may focus on (i) positive recognition for good performers, such as through awards, preferential considerations and recognition during supervision; or (ii) increased lending to specific green sectors or market segments, such as through dedicated funds or credit lines. However, very few countries have developed and implemented systematic incentive mechanisms to promote and track green finance at this stage.

Private sector green financing is growing and beginning to demonstrate a business case for sustainable finance. Some SBN members are tracking the outcomes of green financing policies and principles to demonstrate the business case for sustainable finance. For example, statistics from China's top 21 banks (accounting for close to 80 percent of total banking assets) show that the loan balance toward green credit is $1.09 trillion, representing a 16 percent growth year-on-year, two percent higher than the overall lending growth rate. The non-performing loan (NPL) ratio of those banks' green credit lending stood at 0.41 percentage which is 1.35 percentage lower than the industry average, demonstrating better credit performances. Green credit now makes up approximately 10 percent of these banks' portfolios. Brazilian banks' lending to green sectors of the economy has grown from 11 percent of the banks' portfolios in 2013 to 14 percent in 2015.

An enormous gap still exists on green finance definitions, data, reporting, and incentives to facilitate private sector participation. Only a few markets are moving into the definition and reporting space. Bangladesh, Brazil, China, and South Africa have defined green assets and sectors for investment. The Brazilian Federation of Banks developed a methodology and tool to systematically track and report green loans and credit financing. Bangladesh and China are requiring financial institutions to report periodically on green finance flows. China is also providing them with a tool to report complex indicators, such as environmental benefits.

[3] China Green Finance Task Force. (2015). "Establishing China's Green Financial System", China Finance Publishing.

Although climate change is driving many sustainable finance initiatives, most policies and principles do not require financial institutions to align climate-related definitions and investment targets with countries' climate strategies. Only four national policies—in Bangladesh, China, Morocco, and Vietnam—specify climate as a standalone and specific environmental risk to be addressed.

ENABLING ENVIRONMENT

A sound enabling environment is critical to translate sustainable finance policies and principles into action. The three multiplier factors selected in this progress report are (i) implementation mechanism, (ii) policy infrastructure, and (iii) multistakeholder engagement. Countries in the established stage tend to perform well on both E&S risk management approaches and green finance dimensions when supported with strong enabling factors. Bangladesh, Brazil, and China are all founding members of SBN and had already embarked on their national initiatives when the Network was established in 2012. As a result, these countries have a longer history of building up market capacity, engaging stakeholders, and improving implementation mechanisms. All three countries have integrated sustainable finance considerations into banking supervision and have promulgated regulatory reporting requirements.

Success in the banking sector has led SBN members to expand reforms to other parts of the financial system. SBN members are expanding reforms beyond banking to include insurance, institutional investors, and capital markets. China and Indonesia have taken this approach, with South Africa in the process of developing an overarching set of policies or principles for the entire financial sector, including asset management and pension funds. Morocco's roadmap incorporates banks, insurance companies, and capital markets. Brazil is considering a range of actions, including improving disclosure, incentivizing green investments, and integrating environmental risks into underwriting policy.

CONCLUSION

The SBN members have shown that it is possible to unite a wide array of countries in support of sustainable finance and to achieve significant progress in a relatively short period of time. Despite choosing a range of implementation approaches, the 34 countries show a collective ambition and a consistent framework for measuring progress, positioning them to accelerate reforms further. The measurement initiative and growing knowledge base being developed through SBN—as well as the work the Network is undertaking to develop green bond markets—will create incentives for many more countries to grow their sustainable finance markets, better positioning the world to achieve the Sustainable Development Goals by 2030.

Access the SBN Global Progress Report and Country Reports at:

www.ifc.org/sbnreport

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