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# *Managing Sustainability risks and opportunities in the financial services sector*

*Non-Executive Directors Briefing*

*May 2012*

*Phil Case*

*PwC UK*



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# ***Agenda***

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- 1.** Objectives and key interests
  - 2.** What is Sustainability/Responsible Investment and why is it important?
  - 3.** Drivers for action and the market response
  - 4.** Key considerations for Non-Executive Directors
  - 5.** Q&A
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# *Objectives and key interests*

# *1*

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## ***Introduction and objectives***

***The objectives of this session are to explore:***

What is understood by Sustainable Development and 'Responsible Investment', and why it is important

What is the financial services sector's response to the sustainability agenda and how are leading companies positioning themselves?

What are some of the key questions to consider when addressing sustainability issues for Non-Executive Directors (NEDs)?

Your own thoughts and perceptions on the sustainability agenda

# ***Setting the scene: How do we want to work together today?***

## **Openness**

Share issues, concerns and experiences



## **Collaboration**

Work together to enrich our knowledge



## **Learning**

Focus on “doing things differently”



## **Confidentiality**

Chatham House rules



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## ***Key interests***

What sustainability issue is a key concern or of special interest to you **personally**?

What sustainability issue is a key concern or of special interest to the **organisations** you work with?

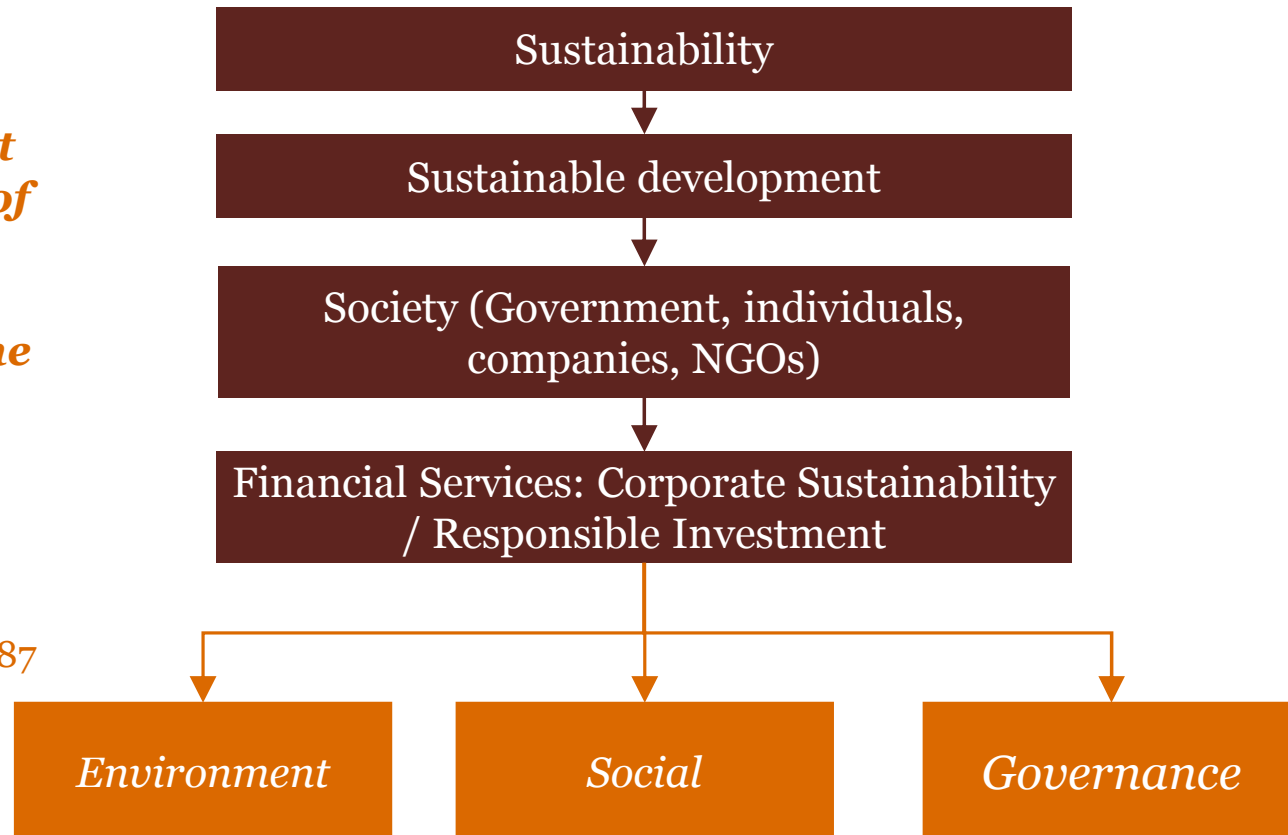
# *What is Sustainability / Responsible Investment and why is it important?*

# 2

# ***Sustainable Development and Responsible Investment***

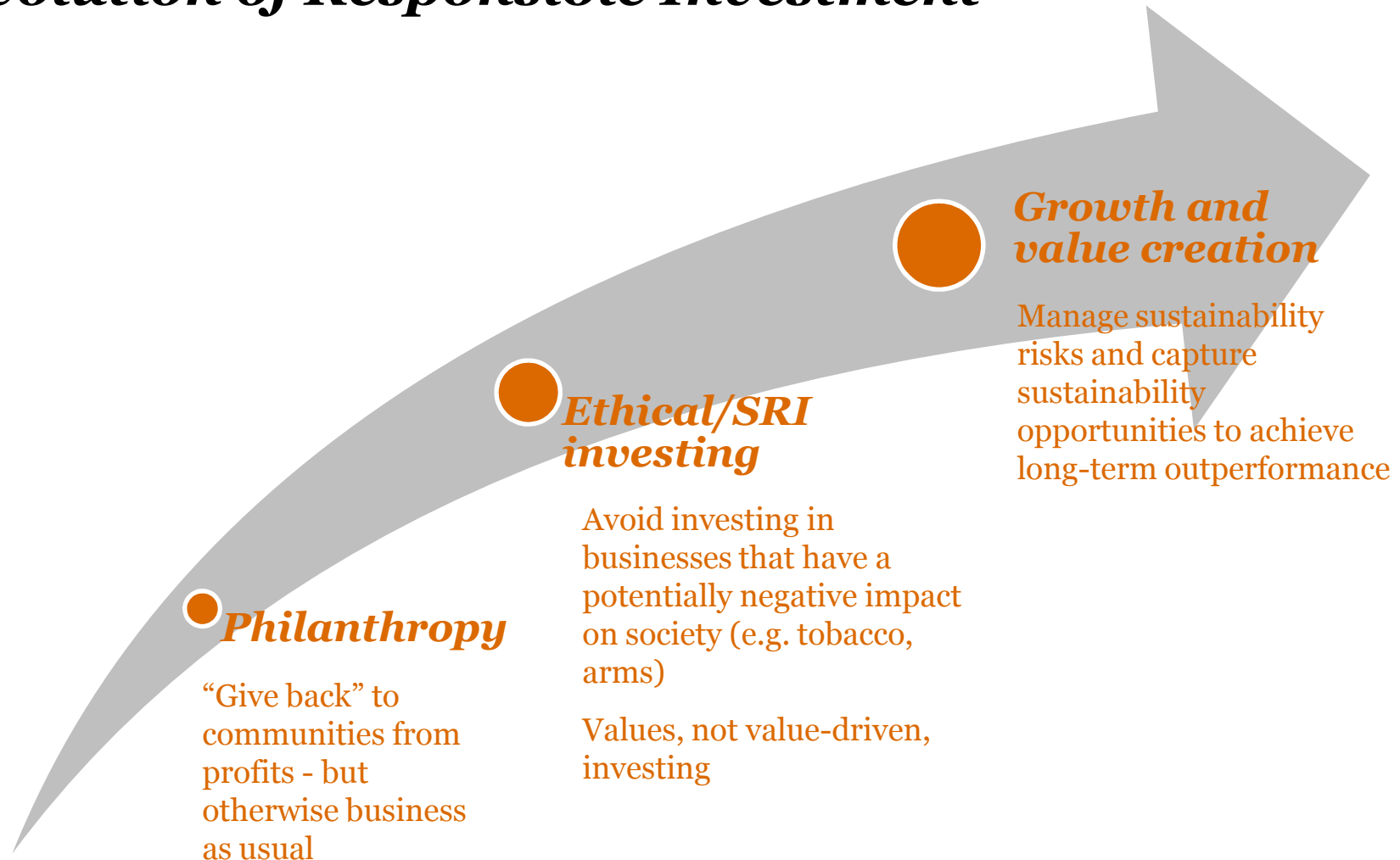
***“Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs”***

Brundtland Report, 1987

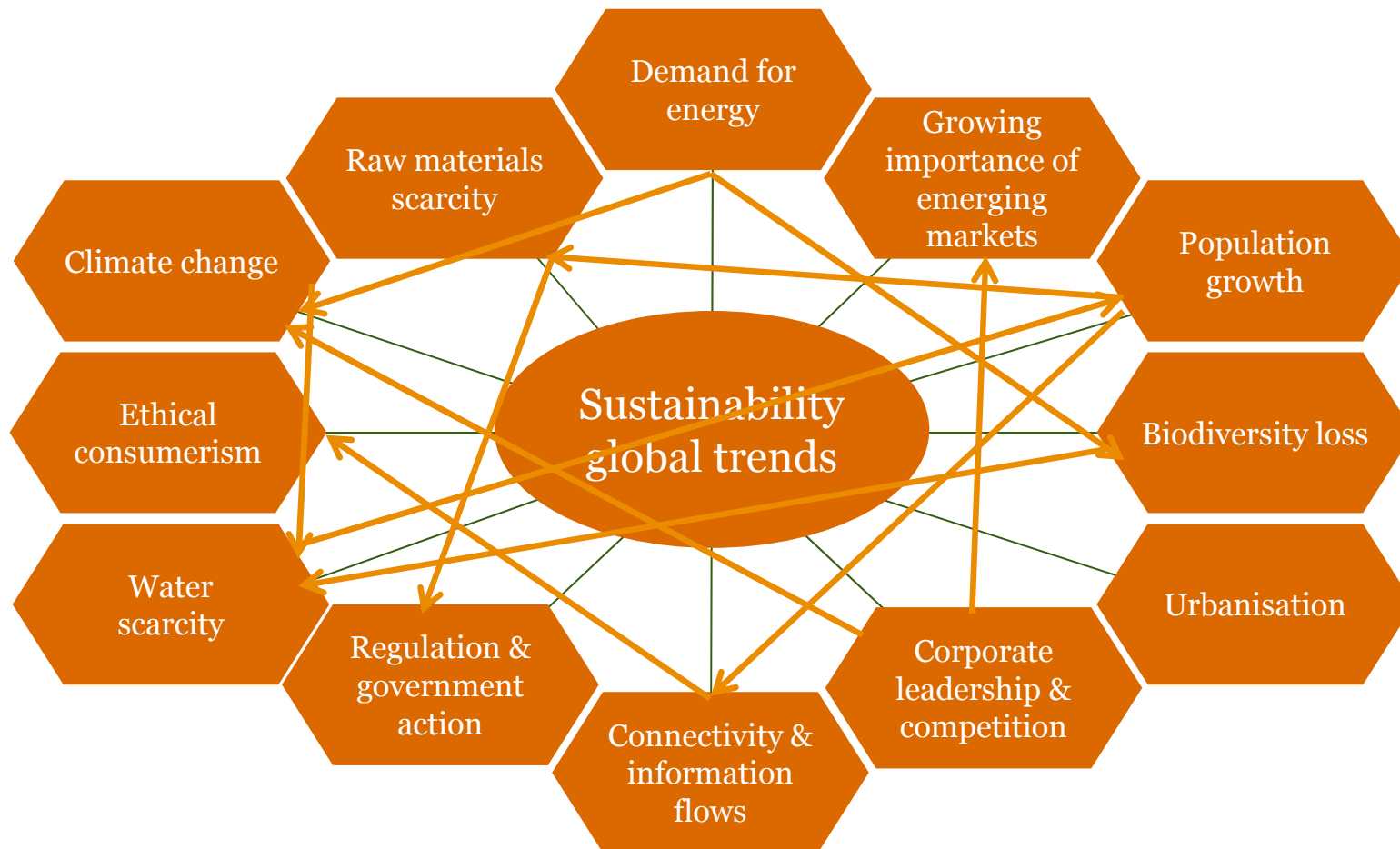




# *Evolution of Responsible Investment*

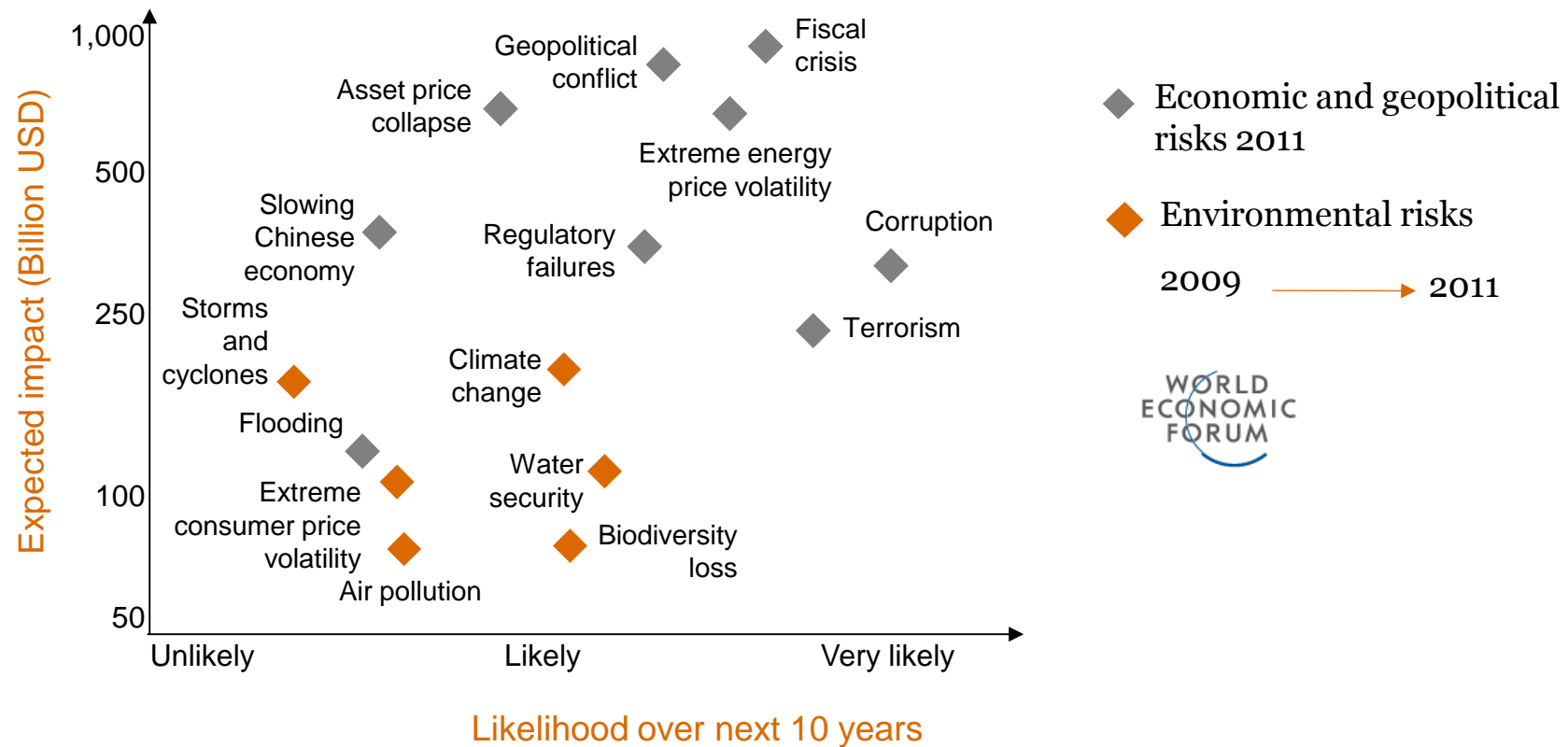


## ***Major trends are creating new risks for investors***



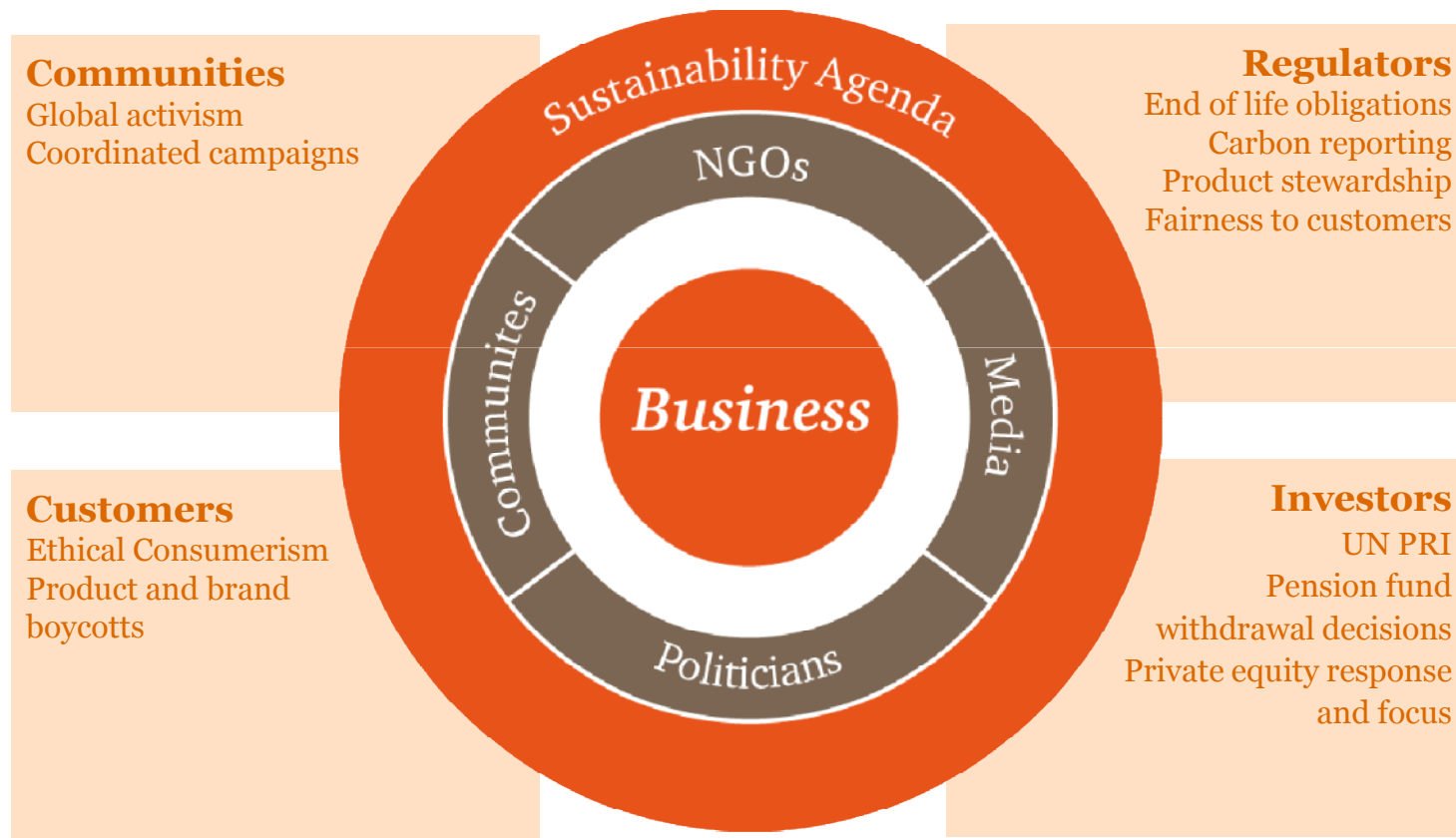
Source: PwC, Project Blue ([http://www.pwc.com/gx/en/financial-services/projectblue/index.jhtml?WT.mc\\_id=0212-ProjectBlue\\_gx+Animated+Logo](http://www.pwc.com/gx/en/financial-services/projectblue/index.jhtml?WT.mc_id=0212-ProjectBlue_gx+Animated+Logo))

# Concern over sustainability risks is growing



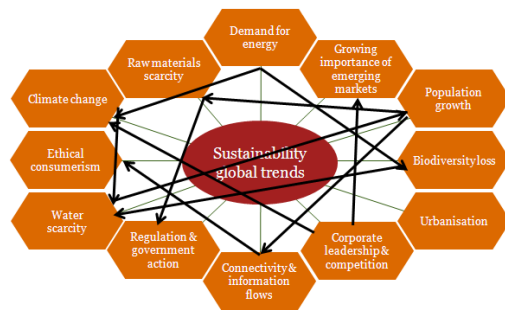
Source: World Economic Forum Global Risks Report (2009 – 2011)

## ***Changing stakeholder dynamics: Creating new challenges***



# ***Sustainability issues have business implications for companies***

## **Megatrends**



## **Risks to companies**

- Penalties/fines as a result of breaches (e.g. HSE)
- Litigation
- Waste management
- Loss of social / regulatory licence to operate
- Reputational cost
- Rising cost of energy
- Increased competition for and cost of (scarce) raw materials
- Increased regulation

## **Opportunities for companies**

- Improved operational efficiency
- Customer attraction and retention/increased market share
- Increased revenues/profit from “responsible” products/services
- Improved risk management
- Improved access to capital
- Increased and sustained shareholder value
- Employee attraction and retention

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## *Drivers for action and the market response*

# 3

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## ***Risks for banks***

### **Financial**

- Inability to make repayments due to environmental/ social costs
- Loss of value of collateral/assets as a result of contamination or non-compliance

### **Legal**

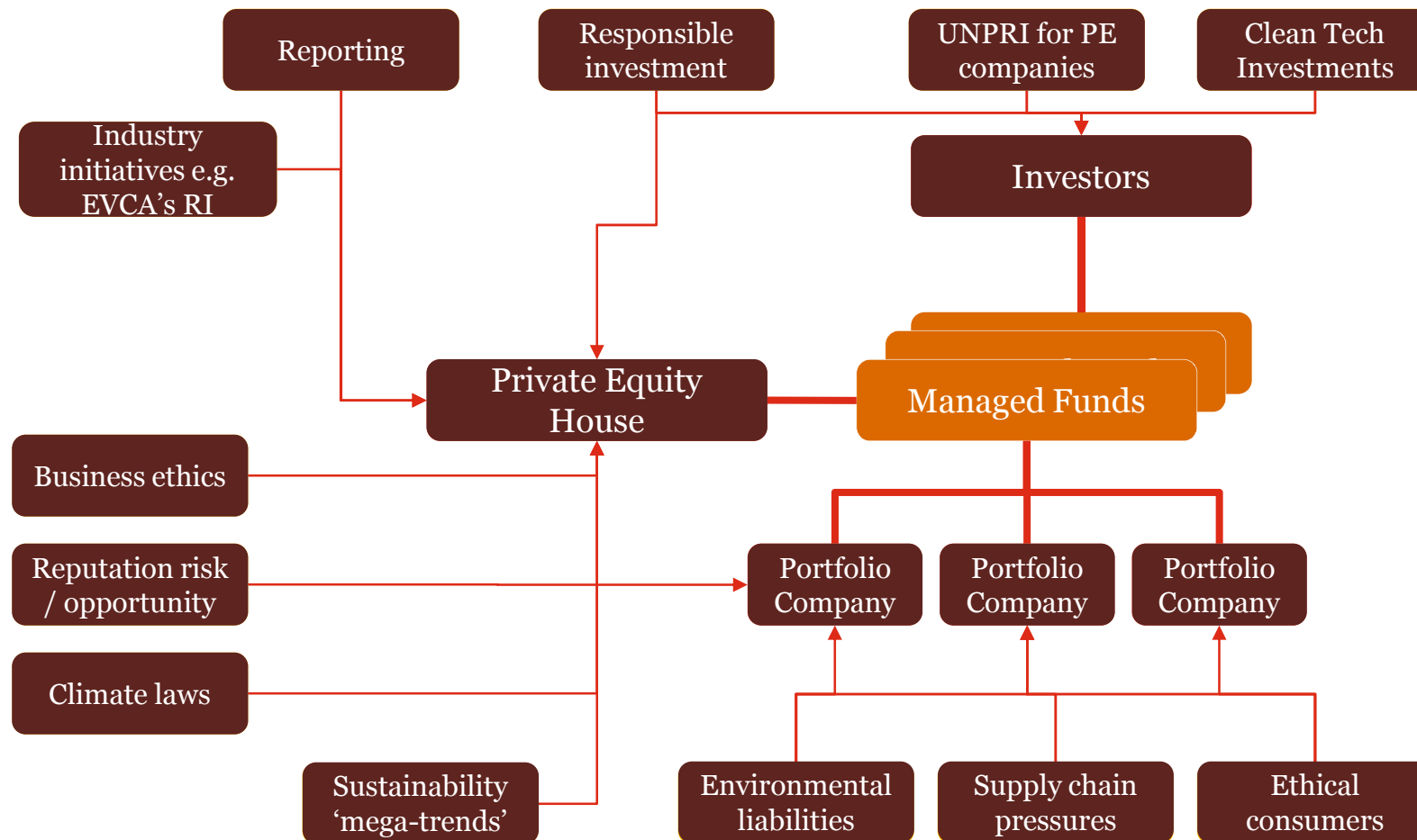
- Potential direct liability for bank (to pay for clean-up of contamination caused by a customer) through control of client company or possession of assets

### **Reputation**

- Damage to reputation through association with polluting, exploitative or 'unethical' customers

- Environmental and social risk should also be considered at a portfolio level
- A bank should avoid overexposure to particular industries sensitive to environmental/ social pressures

## *Drivers for Action in Private Equity*





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## ***Managing environmental and social risks in finance***

*Investors and banking professionals have incorporated environmental and social issues into their activities for two decades now*

This is usually achieved through one, or a combination, of the following approaches:







- Screening (e.g. ‘ethical investment’, ‘responsible lending’)
- Risk-based assessment (e.g. ‘environmental credit risk assessment’)
- Engagement (e.g. ‘responsible engagement overlay’)

# ***Sustainability/Responsible Investment***

## **The business case**

<b><i>Business benefits</i></b>	
• Improving risk management	• Preserve licence to operate
• Enhanced brand and reputation	• Promoting and increasing innovation
• Customer attraction and retention	• Improved access to capital
• Enhance human and intellectual capital	• Building and sustaining shareholder value
• Attracting and retaining talented staff	• Identification of new opportunities
• Improved operational efficiency	• Generating increased revenues

# Examples of value creation

Company	What they've done	Tangible benefits
	<ul style="list-style-type: none"> <li>Forever Food: Ensuring that consumers have food to eat – forever</li> <li>100% wild and farmed fish from certified sustainable resources by 2012</li> </ul>	<ul style="list-style-type: none"> <li>Launch of Omega-3 fish finger in 2007 resulted in 78% of consumers switching from Cod to Pollack (3,000 tonne reduction in annual Cod catch)</li> <li>Brand/ reputation benefits</li> </ul>
	<ul style="list-style-type: none"> <li>Mission Zero sustainability strategy: to become a zero-impact organisation</li> </ul>	<ul style="list-style-type: none"> <li>Eco-efficiency savings of \$433m (1995 – 2010)</li> <li>Winner of inaugural BusinessGreen Leaders Award</li> </ul>
	<ul style="list-style-type: none"> <li>Annual R&amp;D spend: \$700 mn in 2006 to \$1.5 bn by 2010</li> </ul>	<ul style="list-style-type: none"> <li>Revenue of \$21 bn in 2011 (twice the growth rate of the company average)</li> </ul>
	<ul style="list-style-type: none"> <li>Reduce packaging by 5% globally by 2013 (2008 Baseline)</li> <li>Vision: zero waste target</li> </ul>	<ul style="list-style-type: none"> <li>Estimated saving of \$3.4 billion annually from packaging reduction activities</li> </ul>
	<ul style="list-style-type: none"> <li>Innovation focus on products which promote resource efficiency and climate protection</li> </ul>	<ul style="list-style-type: none"> <li>Sales of €7.7bn from climate protection products (2010), which accounts for 20% of total sales</li> </ul>
	<ul style="list-style-type: none"> <li>Launched the Green Portfolio Program at 16 of its portfolio companies to help these companies manage their environmental impacts and improve business performance</li> </ul>	<ul style="list-style-type: none"> <li>Collectively, companies have achieved more than \$365 million in financial impact and avoided 810,000 metric tons of GHG emissions, 2.2 million tons of waste, and 300 million litres of water</li> </ul>

# *What are leading banks doing to manage sustainability issues? Examples..*

Standard Chartered Sustainability Review 2010

Search

From the Chairman and Group Chief Executive

Our approach

Contributing to the real economy

Promoting sustainable finance

Leading the way in communities

Supporting information

Our approach and progress

Commitment to standards

Environmental and social risk assessment

Client engagement

Developing staff capacity

Renewable energy and environmental finance (REEF)

Environmental and social risk assessment

We have developed sector-specific risk assessment tools, comprising a series of questions related to a client's operations and ability to manage environmental and social risks. These tools, known collectively as ESRA, are sector-specific in line with our position statements. They are designed to provide relationship managers and credit officers in our Wholesale Banking business with an adaptable yet simple means of assessing our clients' E&S and reputational risk performance.

ESRA helps us measure a client's performance against industry peers, while building a long-term view of their ability and capacity to manage E&S and governance risks and associated challenges. It considers our clients' track record in complying with relevant laws and regulations along with their E&S management systems, their membership of renowned industry bodies, their media and NGO profile, and their plan and strategy for reducing greenhouse gas emissions.

Streamlining internal processes

In 2010, we updated the ESRA to enhance its user-friendliness and alignment to international regulations, standards and industry-specific requirements. ESRA is integrated into Credit Mate, our system for assessing credit. This keeps an electronic record of appraisal and approvals, ensuring that a client's E&S profile is reviewed alongside the client's creditworthiness on an ongoing basis. To highlight our recently published position statement on water, we have added new questions to the checklist, relating to water conservation and pollution. We have also provided Credit Mate with additional checks and balances to ensure that relationship managers complement E&S performance assessments with client conversations or third-party verification.

Report tools

Feedback

Useful links

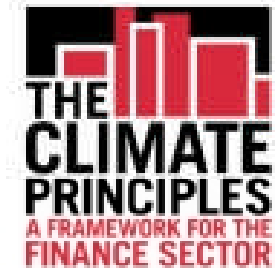
Supporting information

Resource centre

Annual Report 2010

StandardChartered.com

## *Examples of leading industry initiatives among financial services institutions*



CARBON DISCLOSURE PROJECT



## What are leading private equity houses doing to manage sustainability issues? Examples..

“

*Through a range of operational improvements at 14 companies around the world, [KKR's] Green Portfolio Program has achieved over \$365 million in operating cost savings and avoided 810,000 metric tons of greenhouse gas (GHG) emissions, 2.6 million tons of waste and 300 million liters of water since 2008.*

Greenbiz 12/11

”

### In the USA:

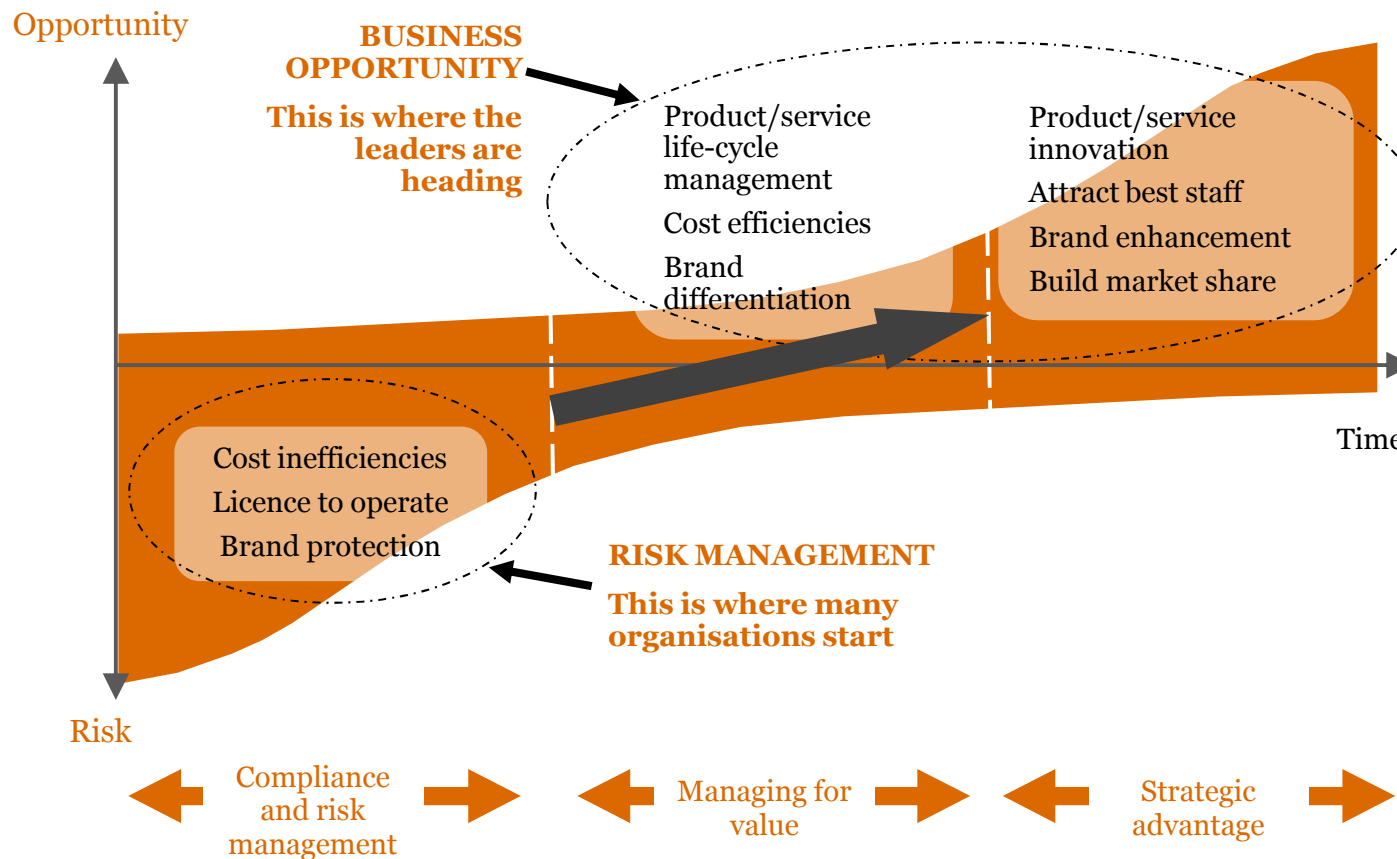
- **KKR** worked with EDF to develop the ‘**Green Portfolio Program**’ producing high-profile successes within their portfolio.
- **Carlyle** have also worked with EDF to develop the EcoValueScreen, an **environmental due diligence screen** focussed on identifying new opportunities for operational improvement and value creation.

### In the UK:

- We are preferred suppliers to a major global PE House for sustainability opportunity and risks assessments for all their global acquisitions.
- We have worked with a UK-based global PE House to develop a PE-focused electronic sustainability risk assessment Toolkit, refreshed policies and procedures, training and a portfolio survey.
- Several PE Houses now have dedicated resources, or project teams working on sustainability issues: for example, **Doughty Hanson, Actis and 3i** each have a **dedicated Head of Sustainability** and Doughty monitor sustainability issues within their portfolio at least monthly, reporting issues to investors bi-annually.

# ***Sustainability / Responsible Investment***

## *Positioning a response*



## *Discussion*

1. Where do you think your organisation is positioned in this chart?
2. What do you view as the key challenges and opportunities for your company based on what you have heard?



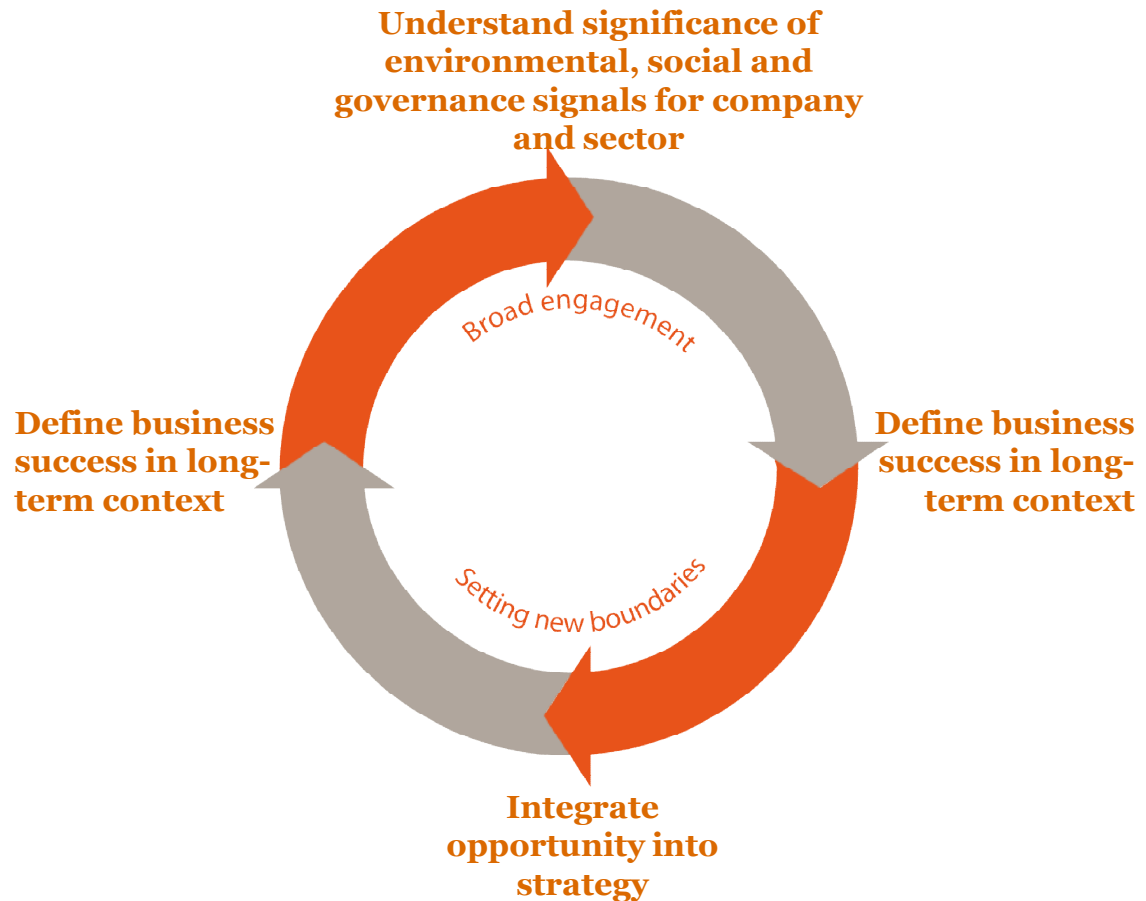
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# *Key considerations for Non-Executive Directors (NEDs)*

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## ***So what does this mean for the Executive and Board?***

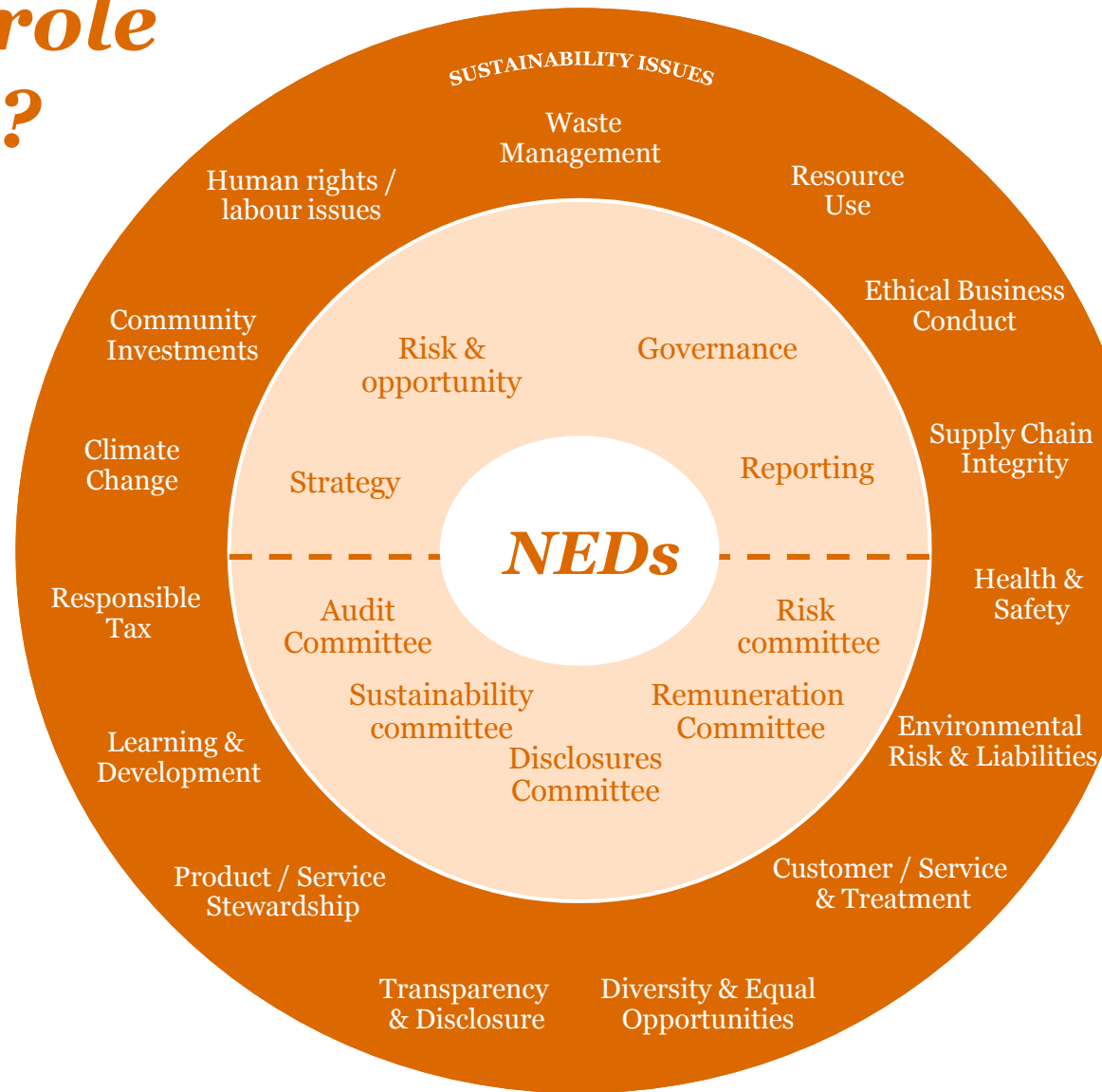
*Business leaders have defined a new business model for business of the future:*



Source: World Business Council for Sustainable Development

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# *The wider role of the NED?*



## *Key considerations for NEDs in supporting a successful sustainability programme:*

1. Strategy
2. Governance
3. Management and Performance
4. Reporting

# ***Strategy: Linking sustainability to shareholder value***

***Unilever represents a leader in its approach for the following reasons:***

- The company has integrated sustainability into its core business functions
- The sustainability strategy is designed have a broad impact across the value-chain
- The Unilever Sustainable Living Plan commits to ambitious targets over the next decade
- The Plan is comprehensive and ambitious, rigorous, far-reaching and commercially focused



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## ***Strategy: Key questions for NEDs***

- What risks and opportunities are presented by the sustainability agenda and how should your companies respond?
- How will the evolving sustainability and market conditions lead to value creation or destruction for your company now and in future years?
- What requirements are you seeing coming from your customers and other key stakeholders (investors, employees, government, etc.)?

## ***Governance: Embedding sustainability***

### ***Actis represents a leader in its approach for the following reasons:***

- Actis promotes world class standards across a number of sustainability areas
- Established rigorous Environmental, Social and Governance (ESG) guidelines, supported by:
  1. A full time in-house dedicated team of qualified professionals
  2. The adoption of World Bank and IFC global standards
  3. Adherence to the United Nations' Principles for Principle Investment
  4. Improvement of ESG performance at all portfolio companies
  5. Integration of ESG issues into its investment decisions

ESG Documents	
	<b><i>Environmental, Social and Governance Code</i></b>
	<b><i>Environmental, Social and Governance Framework</i></b>
	<b><i>Environmental Policy 2011</i></b>
	<b><i>Actis's response to the United Nations Principles for Responsible Investment 2011</i></b>

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## ***Governance: Key questions for NEDs***

- How is sustainability embedded within existing governance arrangements across the organisation?
- Are there adequate procedures and frameworks in place for managing reputational risk?
- How are stakeholder needs understood and responded to? Does this include Treating Customers Fairly (TCF) principles?



# ***Management and Performance: Understanding how sustainability drives value***

***Standard Chartered represents a leader in its approach for the following reasons:***

- Sustainability is used to create a competitive advantage and to drive commercial success
- Developed new business opportunities while managing key sustainability risks
- Established has a coherent strategy and approach to managing and reporting on:
  1. Contributing to the real economy
  2. Promoting sustainable finance
  3. Leading the way in communities
- Recipient of a number of leading sustainability-related awards



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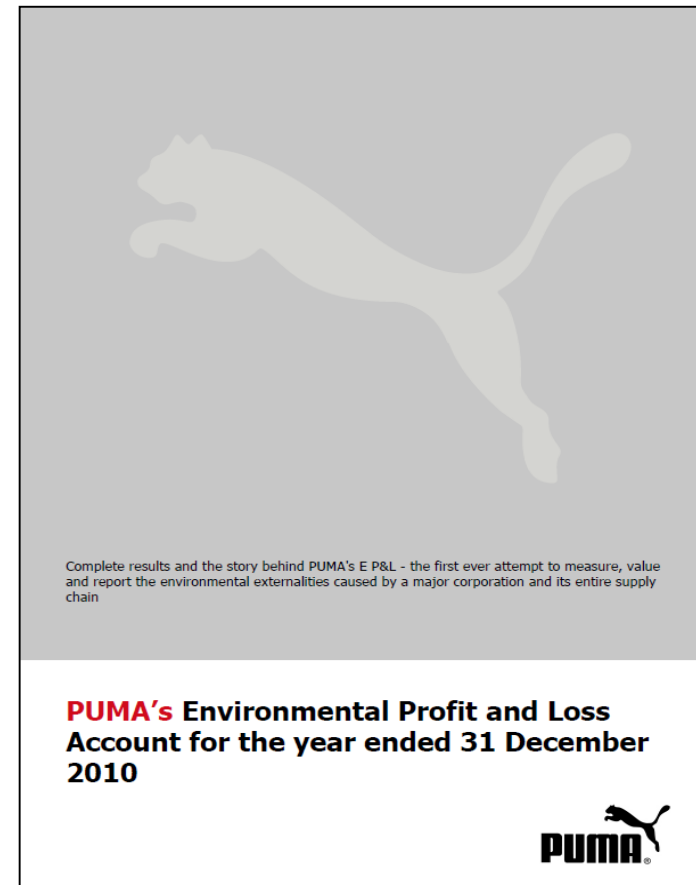
## ***Management and Performance: Key questions for NEDs***

- To what extent do risk processes incorporate robust analysis of sustainability issues?
- Are adequate plans put in place to manage risks effectively and realise opportunities?

## ***Reporting – An integrated approach***

***PUMA represents a leader in its approach for the following reasons:***

- Published an Environmental Profit and Loss Account (EP&L)
- Revolutionised the way the company thinks and reports about sustainability and a trend setter
- PUMA is using the results to:
  1. Inform corporate strategy
  2. Inform operational decisions
  3. Collaborate to drive change
  4. Improve risk management



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## ***Reporting: Key questions for NEDs***

- Who is your primary audience for reporting on sustainability performance?
- What management information is reported to senior management to support understanding of sustainability performance and how it affects wider business performance?
- How can reporting on sustainability performance be integrated with existing communication channels, such as the Annual Report?

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*Q&A*

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