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The Potential of Environmental Law and Policy to Influence the Banking Industry towards a Green Economy and 'Green Lending'

A South African perspective

BY

ZAINUB RASOOL

RESEARCH REPORT
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Supervisor: **Professor T. Murombo**

2018

Declaration

I, **Zainub Rasool**, declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

I have submitted my final Research Report through TurnItIn and have attached the report to my submission.

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Date: 1st August 2018

Abstract

Through the implementation and strengthening of environmental laws and international standards, banks globally face direct and indirect liability, including reputational risks through the association of funding high risk activities having adverse environmental impacts. Environmental laws and international standards have created a specific focus on protecting the environment against environmental crimes and managing risks associated with activities that pose threats to the ecosystem. Although the alleged perpetrators of these environmental crimes are high risk industries which undertake operations that have a high negative environmental impact, banks need to contend with the possibility of attracting lender liability. Under South African legislation, lender liability is expressed through the duty of care principle which applies to all operations, businesses and individuals. Breach of environmental laws could lead to directors being prosecuted in the ordinary cause of law. There is also high focus being placed by the South African government to move towards a sustainable economy by addressing environmental concerns and reducing carbon emissions. Banks, who play a role in facilitating economic development through its lending operations can have a positive impact in promoting sustainable development through their processes.

Based on the above, banks have proceeded to incorporate environmental considerations by adopting environmental management systems and sustainable solutions into their lending processes. This measure is adopted to minimise lender liability, facilitate sustainable development and contribute to the government's goal to progress towards becoming a green economy.

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Acronyms

BASA	Banking Association of South Africa
CDP	Carbon Disclosure Project
ESF	Environmental and Social Framework
ESMS	Environmental and Social Risk Management System
EP	Equator Principles
IFC	International Funding Corporation
IRP	Integrated Resource Plan
IDFIs	International Development Funding Institutions
JSE	Johannesburg Stock Exchange
NEMA	National Environmental Management Act, 1998
NEMWA	National Environmental Management Waste Act, 2008
NGOs	Non-governmental organisations
POCA	Prevention of Organised Crime act, 1998
RMB	Rand Merchant Bank
REIPPPP	Renewable Energy Independent Power Producer Procurement Programme
IISD	The International Institute for Sustainable Development
UNEP FI	United Nations Environment Programme Finance Initiative
VOCs	Volatile Organic Compounds
WEF	World Economic Forum

1.1 Introduction

Environmental risk manifest itself across a broad spectrum of industries across the globe. Economic development, using human driven activities, has over the years negatively impacted the earth's natural resources to the extent that the well-being and dependence of the current and future organisms on these natural resources are threatened.[1] Although economic development is a key focus for South Africa's growth, the negative impacts imposed on the environment and its natural resources are deeply concerning. Human induced activities undertaken in various sectors can be identified as the causal link between economic development and the negative impacts of climate change, loss of biodiversity, soil erosion, water scarcity and deforestation among others.[2] The need to create sustainable economies across the globe has emerged over the past few decades, and as such the creation of environmental and sustainability treaties, policies and legislation has since emerged. These policies and regulations have been created with the core aim of ensuring environmental concerns are considered during economic development and further enhance the regulation of high risk activities that have a negative impact on the environment and ecosystem.[3]

Although entities operating within the mining, petroleum, energy and construction sectors are deemed to be high risk sectors whose activities directly contribute towards environmental degradation; unbeknown to most, financial institutions and more specifically the banking industry is far from exempt from environmental risks and attracting environmental liability in respect of these risks. As a key facilitator in the economy,[4] banks can be held liable directly or indirectly for clean-up and other costs involved in the remediation of the damaged environment. The role and business operations of a bank is to provide financial and intermediary services between the borrowing and lending of money.[5] Through the nature of its business operations and influence over economic development, banks have the potential to contribute positively or

[1] UNEP 'Impacts of a changing Environment on the Corporate Sector', *GEO-5 for Business*, (2013), 6.
[2] Ibid 8-13.
[3] MHA Jeucken & JJ Bouma 'The Changing Environment of Banks' in *Greener Management International* (1999), 22-23.
[4] S Abel 'Role of Banks in the economy' *The Herald* (October 2013) <http://www.herald.co.zw/role-of-banks - in-the-economy/>
[5] Ibid.

negatively towards sustainable development. To achieve a sustainable economy, the banking sector, through adoption of international principles and promulgation of environmental legislation, has been pressured into changing the way in which its business operations are conducted. As environmental risks dominate the global risk landscape[6] and environmental conditions exacerbate, banks and other industries need to incorporate environmentally friendly processes and systems to cater for risks. The increased focus also stems from legislation on environmental crimes becoming punishable for directors who can be held criminally liable under the Prevention of Organised Crime act, 1998 (POCA).[7]

Consequently, banks globally have adopted sustainable banking practices to promote and achieve a green economy by developing policies to cater for environmental risks, adopting principles to be adapted into their lending processes and developing systems specifically used for the identification and management of environmental risks.[8]

1.2 Statement of the problem

Over the past few years, the banking industry globally, has been targeted by environmentalists and environmental non-governmental organisations (NGOs) for contributing to environmental degradation and climate change through its lending to high risk activities and projects within high risk sectors.[9] This research report provides an analyses of how the banking industry has gradually recognised their role in contributing towards a sustainable economy and to give effect to this recognition has adopted environmental principles, processes and policies as part of their funding approval processes.

1.3 Objectives of the study

The overall objective of the study is to unpack how environmental risks affect banking institutions and to what extent has the banking industry provided for environmental risks in their funding approval processes. The study further analyses the lender liability provision

[6] The global risks report 2017 (12th edition) <http://www.weforum.org/docs/GRR17_Report_web.pdf>
[7] Prevention of Organised Crime Act 121 of 1998
[8] JH Coetzee 'Sustainability-Environmental risks and legal liabilities of South African Banks' (December 2013) pg. 1
[9] H Tabuchi 'Environmentalists target bankers behind pipeline' *New York Times* (November 2016), <http://mobile.nytimes.com>

stipulated under the National Environmental Management Act, 1998 (NEMA)[10] and the recent developments in contamination of land under the National Environmental Management Waste Act, 2008 (NEMWA) and its effect on the banking industry.[11] The study, lastly provides a high level overview of the global movement towards the banking industry addressing environmental concerns in funding approval processes, specifically focusing on the adoption of international environmental standards applicable in conducting due diligence processes.

In summary, therefore, the study addresses key aspects by providing:

1. An analysis of the lender liability provision made under NEMA and the contamination of land provision stipulated under NEMWA and its implications for the banking industry.

2. A case study to be conducted on FirstRand Bank Limited, one of the major banks in South Africa, highlighting its environmental risk management process adopted to cater for environmental risks.

3. Challenges faced by the banking sector in their attempts to comply with legislation and international standards.

1.4 Research Methodology

The research is conducted by analysing an array of primary and secondary resources, specifically looking at national and international legislation, international conventions, case law, published books and various websites. This approach has enabled the researcher to gain an understanding to evaluate the transition of how banks have included environmental consideration in their funding processes. Having set out the problem above and the method adopted, chapter 2 of the report sets out the various types of environmental risks from a global and national perspective and further engages with the international environmental regulatory context and national environmental legislation and its role in promoting the way banks conduct their business operations.

[10] National Environmental Management Act, 107 of 1998
[11] National Environmental Management Waste Act, 59 of 2008

Chapter 3 of the report will present a case study on FirstRand Bank Limited, analysing their commitment to environmental protection and sustainable banking and the method adopted to include environmental concerns into lending. Chapter 4 of the report will provide the conclusion of the research, highlighting challenges faced by banks in complying with international and national regulations and will further set out the benefits for banks in considering environmental concerns into their lending operations.

2.1 Introduction

Environmental concerns and risks manifest itself across a broad spectrum of industries across the globe. Although entities operating within the mining, petroleum, energy and construction sectors are deemed to be high risk sectors that play a major role in contributing towards climate change and environmental degradation, unbeknown to most, banks are far from exempt from environmental risks. Although, financial institutions may not be environmental polluters themselves - through their lending processes and funding provided to high risk projects and activities they can indirectly attract environmental liability for clean-up and other costs involved in the remediation of damage caused to the environment.[12]

These direct or indirect costs not only affect a bank from a financial lending perspective, but also that regulatory and reputational risks may occur. This section explores the nature of environmental risk and its direct and indirect impact on the banking industry. There is also an increasing importance placed by national legislation and international regulation on how banks in South Africa structure their approval processes to include environmental risk as part of their assessment in providing funding to borrowers. In the past, the banking industry mainly focussed on the nature and profitability of the borrower. However, this approach has shifted drastically to assess not only the desirability of the borrower, but also the borrower activity or project for which funds have been requested. The sections below provide an overview of the nature of environmental risks that are currently present globally and in South Africa and how these risks affect the banking industry.

This section further looks at the extent to which national legislation places a duty on lenders towards ensuring environmental compliance as a result of the imposition of the lender liability provision stipulated under the NEMA[13]. It further assesses the extent to which international regulation has played a role in encouraging consideration of environmental issues in lending processes.

[12] OM Elsakit & AC Worthington 'Using Environmental and Social Information in Lending Decisions' International Journal of Economics and Finance vol.5 (1) (2012) 113-114.
[13] Ibid (note 10 above), 28.

2.2 International Context and Best Practices

2.2.1 Environmental Risks – A Global Perspective

The vast rate of depleting and degrading natural resources has led to an increased focus on environmental risks globally. Pollution and climate change appear to be the most pressing environmental risks across all countries with major effects caused to natural resources, change in atmospheric spheres and temperature.[14] The increase in the global population, fossil fuel consumption, and the use of harmful substances in activities have led to another crucial effect on natural resources not only by dependency, but also the negative effects of greenhouse gases which are responsible for global warming and ozone layer depletion.[15]

With the population increasing and human activities growing, loss of biodiversity and deforestation are becoming more prominent.[16] The impact of environmental risks does not only directly affect humans, but also the operations and optimal functioning of businesses and enterprises who directly rely on natural resources. Although environmental risks are deemed to have a greater impact in the future, measures and adaptations to address these risks are necessary to curb and prevent long term irreversible damage.[17] The diagram below depicts some of the global environmental risks present.[18]

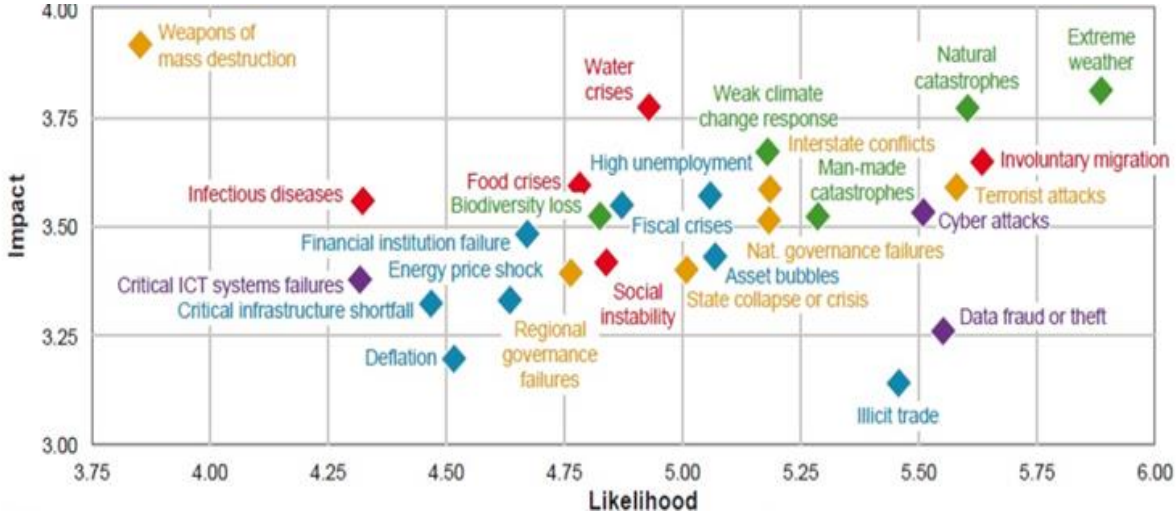


Figure 1: The Global Risk Landscape 2017

[14] Environmental concerns at <http://www.conserve-energy-future.com/top-25-environmental-concerns.php>
[15] Ibid.
[16] Environmental concerns (note 14 above).
[17] Intergovernmental Panel on Climate Change (IPCC) at <http:// http://www.ipcc.ch/>
[18] 'The global risks report 2017', 12th edition <http://www3.weforum.org/docs/GRR17_Report_web.pdf>

The most prominent environmental risks highlighted by the World Economic Forum (WEF) for 2017 include extreme weather events, large natural disasters, failure of mitigation and adaptation to climate change and man-made environmental causes. As per the risk report prepared by the WEF, environmental risks dominate the global risk landscape in terms of both impact and likelihood.[19]

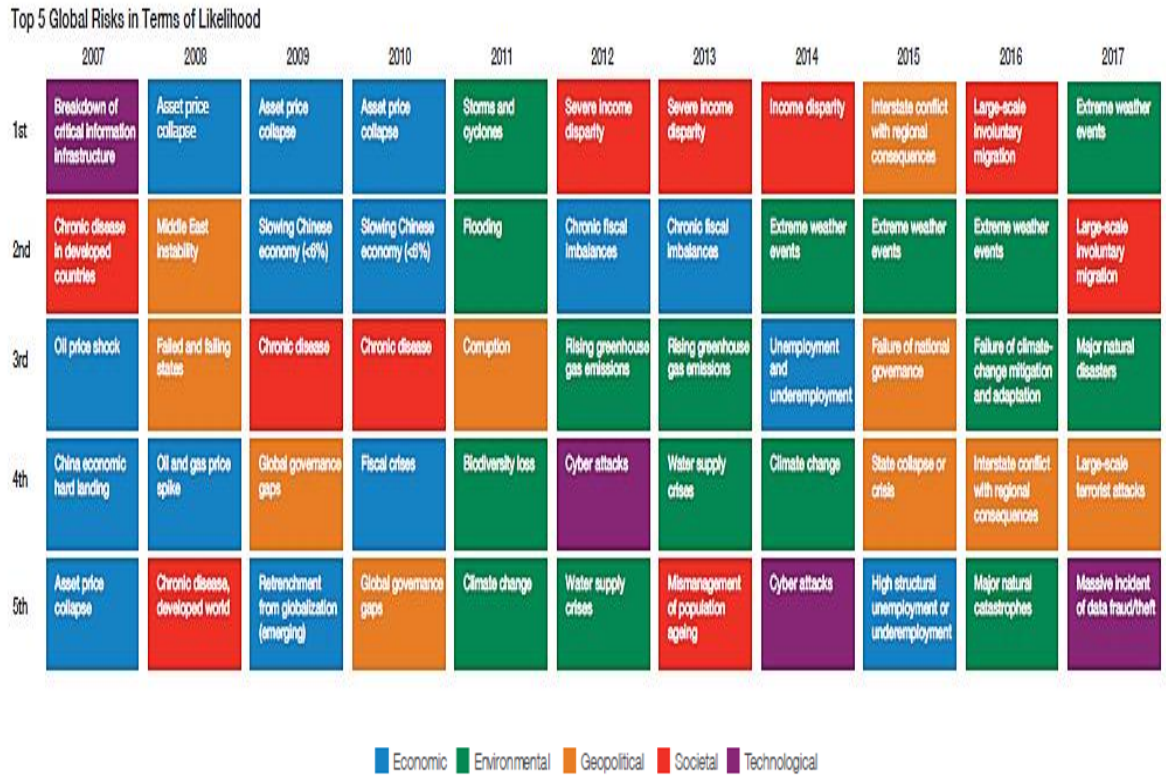


Figure 2: Top 5 Global Risks in Terms of Likelihood [The Evolving Risks Landscape, 2007-2017]

The diagram above depicts the top five global risks highlighted by the WEF from 2007 to 2017. In terms of the diagram, environmental risks were first featured in 2011 with storms, flooding, loss of biodiversity and climate change having four out of five spots on the risks most likely to occur.[20] Since 2011 to 2017, environmental risks have been listed in the top five.

With the constant change of the environment and severe impact on the ecosystem, the world is quickly reaching a state of severe environmental crisis.[21]

[19] Ibid.
[20] Global Risk Report (note 18 above), 4.
[21] UNEP, '*Human Vulnerability to Environmental Change*', Chapter 3 at <https://web.unep.org/geo/sites/unep.org.geo/files/documents/chapter3_vulnerability.pdf>



Figure 3: Top 5 Global Risks in Terms of Impact [The Evolving Risks Landscape, 2007-2017]

As the diagram demonstrates, again environmental risks have been highlighted as having an impact globally since 2011 and features the top five risks in terms of impact from 2011 to 2017. In 2016, failure to adapt and mitigate climate change was highlighted as having the highest impact globally and in 2017 natural disasters, failure to adapt and mitigate climate change and extreme weather patterns feature on the top five risks. The diagrams above evidently show that environmental risks are becoming a great concern and as the years pass on more environmental risks are considered in the landscape.

2.2.2 Environmental Risks for the Banking Industry

Environmental risks for the banking industry can be defined as the risk associated with funding a project or activity that has the potential to negatively impact the wellbeing of society, the environment and its surroundings.[22] These risks are a hazard having immediate adverse effects on the environment, alternatively having a negative impact through an undesirable activity caused by human intervention that could lead to adverse effects if not managed appropriately. Another form of environmental risk for the banking industry is the negative impact caused by

[22] IFC 'Environmental and Social Risks for Financial Institutions' < https://firstforsustainability.org/risk-management/understanding-environmental-and-social-risk/environmental-and-social-risk-for-financial-institutions/>

the lack of natural resources on a borrower's operations, leading to a decrease in business productivity. Because of this, the borrower's profitability may be affected leading to a decrease in profits which may affect their ability to meet instalment payments *in lieu* of the funding provided by banks.[23]

The banking sector funds activities and projects across all industries. By nature of the funding provided to high risk projects that could potentially have an adverse effect on the environment, banks and other lenders are not excluded from attracting environmental risks. Environmental risks for banks act as a direct credit risk especially in cases where a borrower's cash flow becomes adversely affected by environmental violations, attracting fines for non-compliance with regulations or clean-up costs orders.[24] Because of these cost orders, the borrower's profitability could potentially deteriorate depending on the nature and scale of the fine, having a direct impact on their ability to pay outstanding bank loans; instalments etc.[25] In fulfilling their securitisation position, banks procure immovable property as collateral *in lieu* of the funding provided. Another direct environmental risk for banks is de-valued collateral held as a result of contamination which negatively affects its security position.[26] As highlighted above, banks are being targeted by NGOs for contributing to environmental degradation through their lending. Protests by NGOs and communities have the potential to disrupt operations which affect productivity and cash flow of the borrower,[27] and in turn the bank. As more awareness is drawn on environmental crimes, borrowers who significantly contribute to climate change or environmental degradation may face reputational risk and lose investors which, not only brings the company to disrepute, but may also affect their profitability.[28]

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[23] Global Technical Services: environmental risk defined <http://www.crawfordandcompany.com/media/1295554/gts_enviroriskservcs_brochure.pdf>

[24] Environmental and Social Risks for Financial Institutions (note 22 above). V*erulam Fuel Distributors CC Truck & General Insurance Co Ltd and Another 2005 (1) SA 70 (W).):* The plaintiff successfully sued the defendant for payment of R96 359,64 and R997 667.64 respectfully for clean-up costs as a result of fuel spillage causing ecological damage. In its of claim the plaintiff alleged that in terms of s 20 of the National Water Act, 1998 (the Water Act) and s 30 of the National Environmental Management Act, 1998 (the Environmental Act) it became legally liable 'to pay the costs relating to all reasonable measures to contain and minimise the effects of the spill, to undertake clean-up procedures and to remedy the effects of the spill'.

[25] Environmental and Social Risks for Financial Institutions (note 22 above).

[26] International Association of Assessing Officers, 'Standard on the Valuation of Properties Affected by Environmental Contamination' July 2001: Environmental factors are increasingly important in property valuation as the market has become more aware of the potentially detrimental effects of chemical, radiation noise, and other contaminants on air, water (surface water and groundwater), soil, and overall environment. In certain cases, especially when incomplete information is available on the effects of a contaminant, the market may overreact, and prices may be depressed more than is rational.

[27] Brown, J 'Platinum Mines under fire' (May 2017) *Fin24* found at https://www.fin24.com: Protests that impact local mines were reducing production and earnings. Protesters blocked access to the mines, stopping employees from going to work. These disruptions caused losses in production, millions of rands in earnings being forfeited and more jobs were shed.

[28] Environmental and Social Risks for Financial Institutions (note 22 above).

Through the association with funding activities that have adverse effects on the environment, banks are prone to attract reputational risks because of negative publicity which ultimately could result in retraction of investors and loss in market share.

2.2.3 International Regulation and Best Practices

Managing and regulating environmental concerns has become a global drive with several initiatives implemented to manage environmental risks. The International Institute for Sustainable Development ('IISD') has identified two focus areas which drive the promotion and adoption of sustainability within the banking sector as follows:

> The pursuit of environmental and social responsibility in a bank's operations through environmental initiatives (such as recycling programmes or improvements in energy efficiency) and socially responsible initiatives (such as support for cultural events, improved human resources practises and charitable donations); and the integration of sustainability into a bank's core business through the integration of environmental and social considerations into product design, mission policy and strategies.[29]

One of the most notable initiatives is the United Nations Environment Programme Finance Initiative (UNEP FI) developed in the early 1990s.[30] The initiative is associated with over two hundred financial institutions worldwide with a core aim and mandate of promoting sustainable finance by encouraging economic growth in line with the protection of the environment.[31] Through the initiative, the UNEP has promoted the development of environmental management strategies within financial institutions allowing them to reduce the possibility of incurring environmental liability and maintaining the profitability of their businesses. Another objective of the UNEP FI is to provide financial institutions with the environmental technologies and services as well as driving environmental policies.[32]

Another notable global initiative is the Equator Principles (EP) drafted and implemented by the International Funding Corporation (IFC) in conjunction with major leading banks globally.[33]

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[29] Sustainable Banking, The International Institute for Sustainable Development <https://www.iisd.org/business/banking/sus_banking.aspx>
[30] United Nations Environment Programme – Finance Initiative (UNEP-FI) <http://www.unepfi.org>
[31] Ibid.
[32] UNEP - FI (note 30 above).
[33] Equator Principles, <http://www.equator-principles.com/resources/equator_principles_III.pdf>

To date around 90 institutions have signed up and adopted the EP with a commitment to apply an environmental and social due diligence assessment to all projects where the total capital costs exceed US ten million dollars. These principles are intended to provide guidance as the minimum standards prescribed to be applied during due diligence assessments and assist in providing environmentally responsible and sound decision making.[34]

The current EP principles can be summarised as follows:[35]

Principle	Description and actions	Typical examples
1. **Review and categorisation**	Project categories: A: significant impacts B: limited impacts that can be mitigated C: minimal/no impacts	Most projects (e.g. renewable energy) are classified as B. Large-scale mining operations are typically A.
2. **Environmental and social assessment**	Category A and B projects require a full environmental impact assessment (EIA).	EIAs are done before finance is sought and include specialist input, e.g. bat and bird studies for wind farms.
3. **Applicable environmental and social standards**	Country-specific and mostly: – IFC Performance Standards* – World Bank Group Environmental, Health and Safety Guidelines	General guidelines and industry-specific guidelines prescribe minimum performance levels and standards.
4. **Management system and action plan**	Projects must have environmental and social management systems and action plans in place for identified issues.	The management system gives effect to the Principles; the action plan is an agreed roadmap to address non-compliance gaps.
5. **Stakeholder engagement**	Projects need to show effective and ongoing stakeholder engagement. This is usually done during the initial EIA process, but can continue throughout a project's life.	Reports need to be communicated in the local language and encourage feedback.
6. **Grievance mechanism**	Projects may require a grievance mechanism to manage and resolve potential grievances.	These must be tailored to the unique environmental and social risks involved.
7. **Independent review**	An independent consultant acting for the bank (i.e. not for the project) needs to assess all steps for compliance with the Principles.	Project lenders appoint their own adviser to assist in the due diligence of a proposed project.
8. **Covenants**	Lenders need to include certain minimum provisions and covenants in loan documentation, relating to compliance with the Principles.	These include compliance with local environmental laws, applicable standards, action and reporting.
9. **Independent monitoring and reporting**	Projects must be monitored by an independent consultant working for the lenders.	Advisers report annually on compliance, including reviewing data and site visits.
10. **Reporting and transparency**	Information and annual reports must be publicly available.	Equator banks must report annually.

Source: Adapted from the Equator Principles (Source: www.equator-principles.com)
*IFC = International Finance Corporation; in respect of environmental and social sustainability

Figure 4: Equator Principles

Through the adoption of these principles, banks undertake to ensure that funding that meets the required threshold will undergo an environmental review and risk categorisation which will

[34] Ibid.
[35] Incorporating the Equator Principles into Debt Financing, Old Mutual (2015) <http://ww2.oldmutual.co.za/old-mutual-investment-group/insights/magazines/tomorrow-2015/incorporating-the-equator-principles-into-debt-financing>

determine the risk associated with a project.[36] An additional benefit provided by subscribing to the principles is the collaboration and understanding of a broader policy application, best practice rules, and knowledge transfer across all countries.[37]

To improve development outcomes, the World Bank has approved a new Environmental and Social Framework (ESF)[38] to enhance protection provided to the environment and people during project funding. The new ESF has been updated to include current environmental and social concerns identified and several initiatives have been added such as procurement reform and climate and gender strategies.[39] Some of the expanded protection provided under the new ESF include comprehensive labour condition protections, community health and safety measures, and stakeholder engagement throughout the life cycle of the project. The new ESF will come into effect in 2018 and will be applied to all new project funding. The new ESF further consists of new safeguards (standards) and are summarised as follows:[40]

THE WORLD BANK	Environmental and Social Safeguards
Environmental and Social Standard 1:	Assessment and Management of Environmental and Social Risks and Impacts
Environmental and Social Standard 2:	Labour and Working Conditions
Environmental and Social Standard 3:	Resource Efficiency and Pollution Prevention and Management
Environmental and Social Standard 4:	Community Health and Safety
Environmental and Social Standard 5:	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement
Environmental and Social Standard 6:	Biodiversity Conservation and Sustainable Management of Living Natural Resources
Environmental and Social Standard 7:	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities
Environmental and Social Standard 8:	Cultural Heritage
Environmental and Social Standard 9:	Financial Intermediaries
Environmental and Social Standard 10:	Stakeholder Engagement and Information Disclosure

Figure 5: The world Bank – Environmental and Social Standards

[36] Incorporating the Equator Principles into Debt Financing, (note 35 above).
[37] The benefits of Equator Principles, <http://www.equator-principles.com/index.php/adoption/benefits>
[38] 'The Environmental and Social Framework' (March 2017) <http://www.worldbank.org/en/programs/environmental-and-social-policies-for-projects/brief/the-environmental-and-social-framework-esf>
[39] Ibid.
[40] The World Bank 'Environmental and Social Framework' <http://documents.worldbank.org/curated/en/383011492423734099/pdf/114278-WP-REVISED-PUBLIC-Environmental-and-Social-Framework.pdf>

The main benefits of the new ESF is that it promotes sustainable development by considering a greater range of environmental and social risks and places greater emphasis on the borrowers environmental and sustainable framework aiming to improve and enhance the environmental and social protection adopted by the borrower fulfilling their national and international environmental and social obligations.[41] One of the main criticisms of the ESF is that the standards are often imposed over and above what is required under national laws and that these standards do not recognise the different legal frameworks across the globe, making it difficult to enforce.[42]

In addition to the initiatives above, funding provided to banks by certain International Development Funding Institutions (IDFIs) often place loan conditions on borrowing banks to develop and implement an Environmental and Social Risk Management System (ESMS) to cater for environmental and social risks.[43] Through these funding lines, borrowing banks commit to ensure that an ESMS is implemented and if not that they commit to ensure compliance with same over a determined period. These conditions imposed by IDFIs are monitored and audited on an annual basis to ensure that environmental risks are managed and mitigated accordingly.[44]

Although the South African legal system provides legislation and regulations for the identified categories listed in the World Bank standards, the application and assessment of these standards against a borrower's activity may at times prove to be problematic as the domestic legislation may not always prescribe regulations for specific activities. A further challenge in respect of applying these standards is the lack of banking regulation enforcing and supporting environmental regulations and environmental consideration in funding. Although Basel III[45] requires banks to assess the impact of a specific environmental risk on the banks operational exposures, a report supported by the UNEP and the University of Cambridge suggests that Basel III only marginally addresses environmental risks.[46] The report suggests that the Basel

[41] Ibid.
[42] Humphrey, C 'Time for a new approach to environmental and social protection at multilateral development banks' 2016 found at <https://www.odi.org/sites/odi.org.uk/files/resource-documents/10419.pdf>
[43] IFC 'Environmental and Social Review Procedures Manual' October 2016 found at <http://www.ifc.org/wps/wcm/connect/d0db8c41-cfb0-45e9-b66a-522c88f270a5>
[44] Ibid.
[45] Basel III - is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the global banking sector.
[46] 'Stability and Sustainability in Banking Reform - Are environmental risks missing in Basel III?' (2014) <https://www.cisl.cam.ac.uk/publications/publication-pdfs/stability-and-sustainability-basel-iii-final-repor.pdf>

Committee should unequivocally acknowledge that environmental risks have a significant impact on the stability of the economy and as such should encourage bank regulators to adopt current best practices to address environmental concerns and consequences for non-compliance should be enforced.[47]

It is evident that through subscribing to the principles above, banks in South Africa are forced to change the way they conduct their business operations. As such, banks openly recognise their role as an intermediary in the economy in contributing towards sustainable development and its move towards creating a green economy and providing green funding.

2.3 Environmental risk in South Africa

2.3.1 Context

Environmental risks in South Africa stem from various contributors such as economic and population growth, rising energy use and the focus on redressing poverty which remains a problem and among the root causes of most environmental problems.[48] The two major causes of South Africa's environmental concerns arise because of its rapid population growth and its attempt to move towards keeping up with developed countries. As the demand and reliance on natural resources for survival increase, natural resources continue to deplete. Another pressing issue contributing towards natural resources depletion is urbanisation as the need for economic growth for South Africa continues. During the early 2000s, South Africa was ranked as the 7th largest air polluter in the world.[49] In 2009, South Africa emitted approximately 450 million tonnes of air pollutants dropping to the 12th largest air polluter in the world. In terms of the governments Integrated Resource Plan (IRP),[50] it is envisaged that by 2050 South Africa's carbon emissions would have increased by 29 per cent compared to the 1990 level.[51] Whilst coal supplies 75 per cent of South Africa's primary energy, 93 per cent of electricity generation

[47] Stability and Sustainability in Banking Reform, (note 46 above) 8.
[48] Human Population: Environment < http://www.prb.org/Publications /Lesson -Plans/HumanPopulation/ Environment.aspx>
[49] AB Sebitosi 'Energy efficiency, security of supply and the environment in South Africa: Moving beyond the Strategy documents' 3 (2008) 1591–1596
[50] Integrated Resource Plan (2016) - It is a subset of the Integrated Energy Plan. The IRP is also not a short or medium-term operational plan but a plan that directs the expansion of the electricity supply over the given period.
[51] 'OECD environmental outlook to 2050' Chapter 3: Climate Change (November 2011) pg.13

and 30 per cent of petroleum liquids,[52] it is imperative for the country to quickly reduce its greenhouse gas emissions.

Environmental risks are channelled through the ecosystem through multiple sources such as air, water and soil. Whilst various natural sources such as the release of carbon dioxide and carbon monoxide from wildfires, the release of volatile organic compounds (VOCs) by pine trees and the release of methane from domestic animals, earth-quakes and floods contribute to environmental degradation, a large portion and the most notable thereof is environmental harm which emanates from anthropogenic sources.[53] These anthropogenic sources (human driven sources) such as fossil fuel burning in industrial processes, vehicle and aircraft emissions, electricity generation, domestic fuel burning, agricultural expansion, land development and the use of household materials that contain pollutants and waste incineration has contributed to the deteriorating state of the environment over the years.[54] With these growing environmental problems and increasing undesirable negative impacts caused by various industrial and other sectors, banks attract environmental risk and liability through the financing of projects and activities contributing to environmental concerns.

2.3.2 Effect of environmental risks on businesses and operations

Although some businesses and operations contribute to environmental risks, these risks can have an adverse impact on other entities which are reliant on environmental resources for the sustainability and continuity of their operations. Eskom for example, South Africa's largest electricity utility, generates and supplies 95 per cent of electricity through coal powered stations.[55] In 2007, Eskom introduced *'load shedding'* or rather blackout periods interrupting the electricity supply for scheduled periods.[56] The energy shortage during these periods had a critical effect on the economy showing an estimated R13.7 billion in losses during the first quarter of 2015.[57] During these periods, many businesses, corporates and industries relying on

[52] 'Eskom: Long-term coal supply a worry' (February 2011) <www.iol.co.za/business-report/economy/eskomn long-term-coal-supply-a-worry-1020542>
[53] What's Your Impact, 'Main Sources of Carbon Dioxide Emissions' <https://whatsyourimpact.org/greenhouse-gases/carbon-dioxide-emissions>
[54] Ibid.
[55] The Importance of Coal, Statistics South Africa 2015 <http://www.statssa.gov.za/?p=4820>
[56] A Goldberg 'the economic impact of load-shedding: the case of South African retailers, University of Pretoria, 2015, 6.
[57] Ibid.

the supply of electricity experienced a loss in production, damage to machinery and stock being spoilt thus resulting in a downturn of profits.[58]

The scarcity and lack of water can also be seen as an environmental risk. As the imbalance between the supply and the demand of water differs, stricter measures of water usage and water cuts are being imposed by the government to ensure conservation. Although, the conservation is a measure to protect the environment, water restrictions are an environmental risk for the economy.[59] Legal precedents regarding the control and management of climate change contributors have also recently been addressed under the *Earthlife Africa Johannesburg v Minister of Environmental Affairs and Others*[60] where the High Court set aside the environmental approval for the proposed new Thabametsi coal-fired power station, due to inadequate consideration of the project's significant climate change impacts.[61]

Environmental risks are thus becoming a growing concern for businesses. As environmental legislation and regulations become stricter, the need to adapt and mitigate environmental concerns into operations is essential.[62] With the slow increase in environmental insurance, businesses are affecting by addressing these risks through business profits which can negatively impact their cashflow.[63]

2.4 National legislation

2.4.1. Sustainable development and the Constitution

International environmental law and more specifically international environmental principles influence the way in which national government create and adopt environmental legislation and policies. These principles are adopted by national government through their inclusion in legislation to give effect to a specific treaty or convention that the state is a signatory to with a

[58] S Anderson 'How Does Load Shedding Impact your Business' Leads to Business (2016) <https://blog.l2b.co.za/how-does-loadshedding-impact-your-business/>
[59] South Africa's Water Shortage is huge risk to businesses and the economy (January 2017) <http://www.702.co.za/articles/240440/south-africa-s-water-shortage-is-huge-risk-to-business-and-the-economy>
[60] Earthlife Africa Johannesburg v Minister of Environmental Affairs and Others 2017 2 All SA 519 (GP) (8 March 2017)
[61] Ibid.
[62] Environmental Risks, a Growing concern for Businesses <http://www.agcs.allianz.com/global-offices/south-africa/news-press-africa/4993/>
[63] Ibid.

purpose to control, manage or regulate a specific area of environmental concern. Although the concept of sustainable development has been around for many years, the notion was given prominence to at the 1972 UN Conference on the Human Environment held in Stockholm[64] and can be defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".[65] The concept of sustainable development is closely linked and imbedded within section 24 of the Constitution which states that everyone has a right to an environment not harmful to their health and wellbeing. To give effect to the right and the importance of sustainable development, section 24(b)(iii) explicitly makes provision for sustainable development thus imposing a positive duty on the government to adopt *legislative measures* to prevent environmental harm and achieve sustainable development.[66]

Giving effect to its commitment to environmental protection, the National Development Plan 2030 for South Africa makes provision for sustainability and the transition to a low-carbon economy which is envisaged through the reduction in carbon emissions, development of sustainable green products and improving policy and regulation for environmental protection.[67] Under the plan, the move towards growing a green economy and a sustainable community is envisaged through conserving and sustaining the environment by using natural resources efficiently.

Reinforcing the focus of sustainable development under the Constitution, the court, in the *Fuel Retailers Association of South Africa v Director-General Environmental Management Department of Agriculture, Conservation and Environment, Mpumalanga Province and Others*[68] scrutinised the definition and context of sustainable development and averred that:

> Promotion of development requires the protection of the environment. Yet the environment cannot be protected if development does not pay attention to the costs of environmental destruction. The environment and development are thus inexorably linked...[69] It envisages that environmental considerations will be balanced with socio-economic considerations through the ideal of sustainable development. This is apparent from s 24(b)(iii) which provides that the

[64] History of Sustainable Development <http://www.sd-commission.org.uk/pages/history_sd.html>
[65] Oxford University Press, *"Our Common Future (Brundtland Report)"*, The World Commission on Environment and Development (WCED), (1987) 41.
[66] The Constitution of the Republic of South Africa, 1996.
[67] National Development Plan, 2030 – South African Government < https://www.gov.za/issues/national-development-plan-2030>
[68] Fuel Retailers Association of South Africa v Director-General Environmental Management Department of Agriculture, Conservation and Environment, Mpumalanga Province and Others 2007 6 SA 4 (CC).
[69] Fuel Retailers case (note 68 above) Para 44.

> environment will be protected by securing "ecologically sustainable development and use of natural resources while promoting justifiable economic and social development". Sustainable development and sustainable use and exploitation of natural resources are at the core of the protection of the environment.[70]

It is evident from the plan that the concept of sustainable development has been identified as the framework to reconcile economic and social growth together with the protection of the environment. Banks will need to adopt this approach by incorporating the sustainable development concept in their lending processes [71]to achieve a balance between their contribution to development, economic growth and environmental protection.

2.4.2 NEMA and other related environmental regulations

In giving effect to the constitutional right to a protected environment, the NEMA was adopted to provide the underlying framework for environmental laws in South Africa with a purpose of establishing principles for decision making on matters affecting the environment.[72] Section 2 of NEMA expressly affirms that *economic*, *social* and *environmental* concerns must be integrated in all planning and decision making and to promote this, sets out environmental management principles such as, the precautionary principle, the polluter pays principle, the preventative principle, all of which reinforces the concept of sustainable development.[73] In terms of managing environmental risks, the NEMA provides that a risk-adverse approach must be adopted taking into account current and future consequences, the negative impacts on people and the environment and that measures to remediate negative impacts must be taken into account during the decision making phase.[74] Section 28 of the NEMA, providing for the duty of care, avers that any person who caused or may cause any degradation to the environment *must* exercise a duty of care by ensuring that reasonable measures to prevent harm is taken.[75] The duty of care principle is further applicable to owners of land or premises, persons in control of land or premises including persons who have the right to use or undertake an activity or process on the land or premises, which caused or is likely to cause significant environmental

[70] Fuel Retailers case (note 68 above) Para 45.
[71] IFC, 'Banking on Sustainability - Financing Environmental and Social Opportunities in Emerging Markets' found at <http://www.ifc.org> banks can adopt a sustainable approach by developing new standards and codes of conduct to promote corporate accountability, transparency, and consideration of impacts on environment and society including integrating sustainable due diligence considerations into credit approval process.
[72] National Environmental Management Act (note 10 above), Sec 1.
[73] National Environmental Management Act (note 10 above), Sec 2.
[74] Ibid.
[75] National Environmental Management Act (note 10 above), Sec 28.

harm or degradation.[76] Section 28 further avers that the State may recover all costs incurred for the remediation of the harm from:

> (a) any person who is or was responsible for, or who directly or indirectly contributed to, the pollution or degradation or the potential pollution or degradation…
> (9) The Director-General or provincial head of department may in respect of the recovery of costs under subsection (8), claim proportionally from any other person who benefited from the measures undertaken under subsection (7).[77]

Making the duty of care more onerous is the proposed amendments to section 28 under the National Environmental Management Amendment Bill.[78] Under the amendment, the duty of care obligation is imposed on every person who caused, or may cause significant pollution or degradation to take reasonable measures to prevent such pollution or degradation.[79] This proposed amendment will in effect introduce the potential for an extended liability to which persons other than owners and persons in control of activities may in future find themselves being targeted by the authorities for clean-up or other measures even though they have not caused the degradation.[80] The proposed amendment bill will further introduce joint and several liability with regard to recovery of costs and clean-up costs issued by the authorities.[81] Although, section 28 does not expressly provide for lender liability, as banks directly benefit from interest received from funding high risk activities that could potentially cause environmental harm and indirectly benefit through gaining market share, and taking property as collateral, it is evident from the above that banks are far from exempt from environmental liability and as such the duty of care becomes a vital act for banks to exercise. The proposed amendments also stress the importance of undertaking proper environmental due diligence assessments at the time of acquiring any potentially polluting business, or purchasing any property that may be contaminated.[82]

Strengthening the extent of environmental liability is found under section 34 of NEMA which avers that directors may be personally liable for damages and costs incurred because of harm

[76] Ibid
[77] National Environmental Management Act (note 10 above), Sec 28.
[78] National Environmental Management Amendment Bill, 2017.
[79] Ibid.
[80] Vermaak, M 'Changes proposed in the 2017 NEMA Amendment Bill could significantly change the liability position under NEMA' Bowman's Attorneys found at <http://www.bowmanslaw.com>
[81] Ibid.
[82] Changes proposed to NEMA (Note 80 above).

caused to the environment, this provision does not exclude directors of banks.[83] Where activities fall under the Environmental Impact Assessment regulations, a concise assessment and analysis considering all environmental and social aspects of a proposed activity is required to be undertaken by the activity owner at their own cost.[84] The costs involved in undertaking the assessment, lodging it with the department for approval and applying for annual audits can become a costly exercise for complex projects[85] which could impact the borrowers cash flow, affecting their business continuity and negatively affecting their credibility. The risk for the bank in this case is whether the borrower has the financial capacity to carry additional costs in applying for various environmental permits and authorisations and monitoring these permits in the long run. Non-compliance with environmental permits could also lead to additional costs if fines are imposed or operations are shut down due to the non-compliance. Not only does this have a credit impact on the bank, but also legal risks, reputational risks and liability could follow because of the borrower's non-compliance and funding a non-compliant activity.[86]

Another important piece of legislation that prompts financial institutions to consider environmental matters into their lending processes is the National Environmental Management: Waste Act ('NEMWA') which was promulgated with the core purpose of managing waste and contamination in South Africa.[87] Under the Act, and where land or property has been identified as being contaminated by the department, a cost order for the remediation of the contamination may be imposed on the owner.[88] What is important to note under this provision is that it applies retrospectively and includes all contaminated land prior to commencement of the Act with the effect of formally noting the contamination of the land on the deeds of register.[89]

2.4.3 Banking Regulations

Corporate governance regulations and related codes of conduct also play a role in ensuring that banks consider environmental concerns in their operations. Highlighted under the King IV Report is the duty to contribute towards good corporate citizenship and as such, banks play a vital role in ensuring that they operate in a manner which results in long term positive

[83] National Environmental Management Act (note 10 above), Sec 34.
[84] EIA Process, Western Cape Province 'how to guide' <https://www.westerncape.gov.za/eadp/files/eia-process-how-to-guide.pdf>
[85] Ibid.
[86] National Environmental Management Act (note 10 above), sec 34.
[87] National Environmental Management Waste Act (note 11 above) sec 35 – 41.
[88] Ibid.
[89] National Environmental Management Waste Act (note 11 above) sec 35-36.

sustainable outcomes.[90] The report further promotes the concept of sustainable development by reiterating the need for an integrated response between environmental, social and economic aspects and that organisations are compelled to embed the element of sustainable development into their operations,[91] further implying that identifying environmental and social risks should be part of business decisions and risk management processes. Integrated reporting requirements is another important principle embedded in the report which places a duty on companies, including banks to report not only on their financial performance but also their contribution towards sustainable development.[92] This implies that banks are also liable to ensure that environmental practices are adopted, that updated environmental laws and regulations are considered regularly and that environmental compliance be monitored in all lending processes.[93] Although the King IV principles are voluntarily undertaken, these principles are binding for a bank having a primary listing on the Johannesburg Stock Exchange (JSE).[94] As such, a court will consider the King IV principles for matters arising out of non-compliance with corporate governance. Failing to comply with corporate governance practices may result in liability for the board of directors.[95]

Under the Banking Association of South Africa's (BASA) Code of Conduct for Managing Environmental and Social Risks, members are committed to ensuring sustainable development and further recognise their role in promoting and contributing towards sustainable development. [96] As part of this undertaking banks in South Africa are committed to ensuring that their operations are conducted in a sustainable manner, that they collaborate with key governmental stakeholders in addressing environmental concerns and that they continue to make progress in building response strategies to address these concerns.[97] Through the code of conduct, banks acknowledge that they have a duty to adhere to national legislation and

[90] 'King IV Report on Corporate Governance for South Africa 2016' Institute of Directors Southern Africa 2016 <http://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/king_iv/King_IV_Report/IoDSA_King_IV_Report_-_WebVe.pdf>

[91] 'King IV Report' Getting to Grips with King IV, 2016 <http://www.batseta.org.za/uploads/ftp /Seminars /Seminars_2016/October_2016/150411_Nkonki_Inc_King_IV_Report_Alert_2016_April.pdf>

[92] Ibid - King IV defines Integrated Reporting ("IR") as the activities of the organisation which creates value creation. It also encourages organisations to report on the positive and negative activities and the effect the activities have on the economy, society and the environment.

[93] G Nel 'Environmental Law and Liability' <http://www.enviropaedia.com/topic/default.php?topic_id=293>

[94] Werksmans Attorneys 'A Review of King IV Report on Corporate Governance' <http://www.werksmans.com/assets/pdf/061741%20WERKSMANS%20king%20iv%20booklet.pdf>

[95] A review of King IV report on Corporate Governance (note 90 above) 21.

[96] Banking Association of South Africa's (BASA) Code of Conduct for Managing Environmental and Social Risks2011<http://www.banking.org.za/docs/default-source/market-conduct-division/the-banking-association-south- africa-code-of-conduct-for-management-environmental-and-social-risk.pdf? sfvrsn=2>

[97] Ibid.

international best practices and also assess their own operations contribution to environmental risks and mitigate same.[98] The code of conduct is also structured to ensure that banks credit policies are updated to make provision for environmental risks and that green economic technologies are considered in support of the transition to a low carbon economy.[99] Members who have adopted the code of conduct are further reviewed on a regular basis to ensure compliance with the principles under the code.

It can be argued that the sustainable development principle stipulated under the King IV Report may serve as a *reasonable measure* giving effect to section 24(b) of the Constitution. Apart from the Constitution and environmental regulations, domestic banking regulations have been structured to influence and encourage the way banks operate to include environmental concerns in decision making.

[98] BASAs Code of Conduct, (note 96 above).
[99] BASAs Code of Conduct, (note 96 above).

FirstRand Bank Limited [FirstRand]

The case study highlights the implementation and approach adopted by FirstRand in its move towards establishing sustainable banking and environmental protection practices and related social concerns into their processes.

FirstRand is one of the largest listed financial institutions in South Africa providing an array of services and products ranging from banking, investment, insurance and telecommunications to its customers. Within its group, FirstRand is structured into multiple brands or rather divisions having its own management structures and individual Chief Executive Officers (CEOs). In addition to South Africa, the group has expanded its footprint into nine countries in Africa, adopted branches within London and India and has representative offices in Kenya, Dubai, Angola, Shanghai and Mauritius.[100]

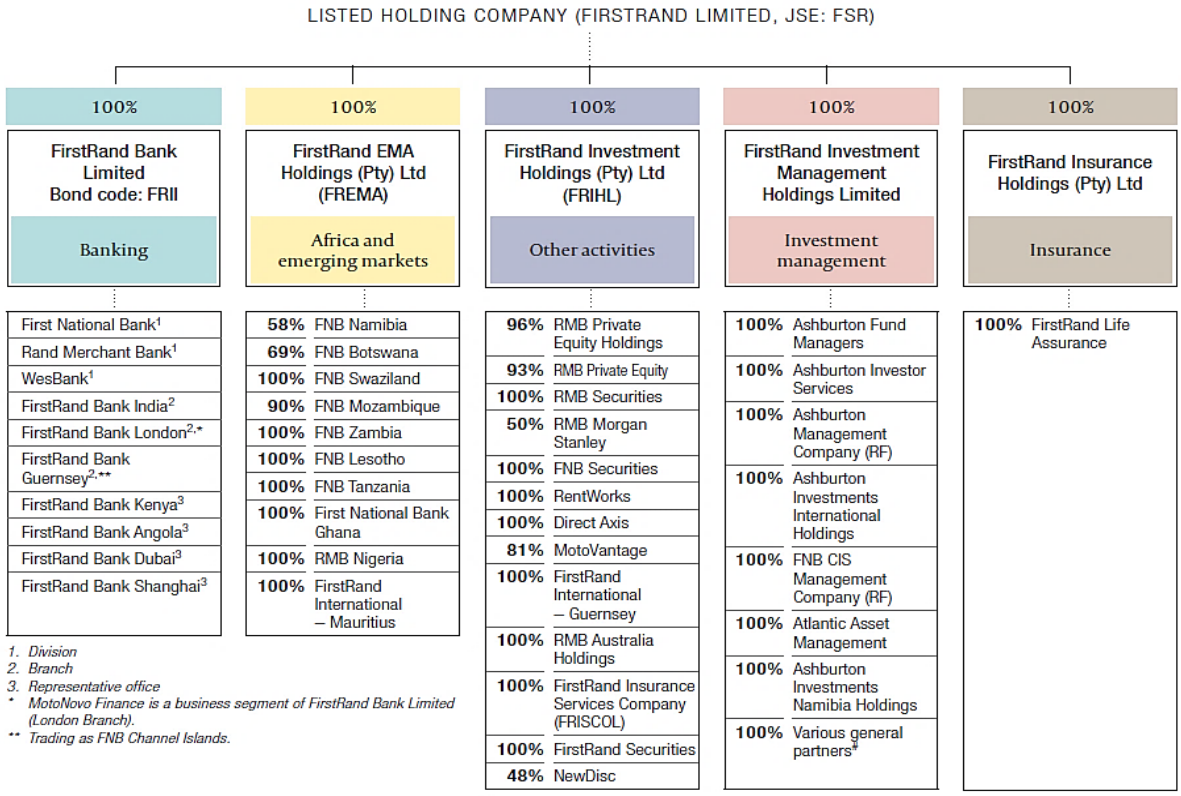


Figure 6: FirstRand Group Structure

[100] Analysis of financial results – for the six months ended 31 December 2016 <http://www.firstrand.co.za>

FirstRand initiated its quest to include environmental concerns into its operations during 2006 and set up an environmental risk forum consisting of stakeholders from all divisions as part of its strategy to achieve sustainable banking procedures. The aim and mandate of the forum was to assess FirstRand's environmental and social risks and address environmental matters such as climate change, energy efficiency and reporting thereof.[101]

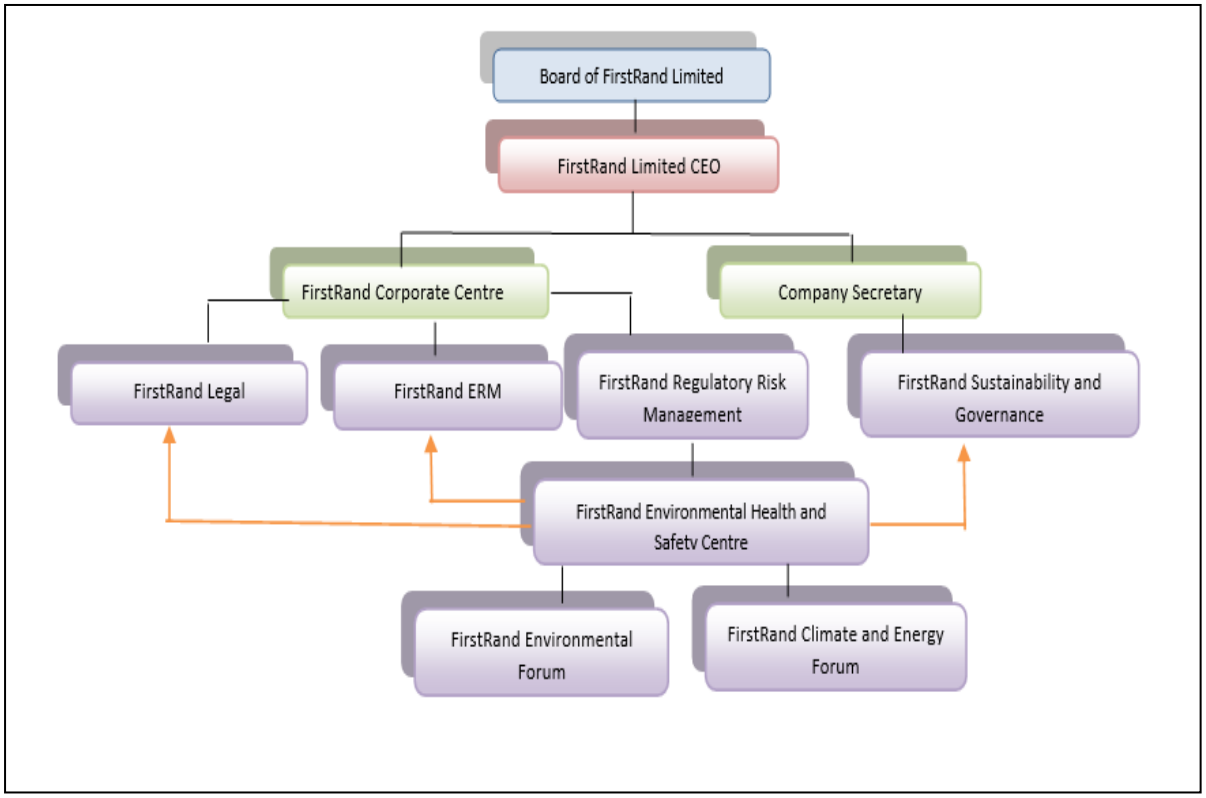


Figure 7: Structure of Environmental Management at FirstRand

3.1 Policy development, international commitment and national obligation

In their commitment to addressing environmental concerns into operations, FirstRand developed an environmental policy in which they acknowledged that 'management of the environment is the cornerstone in promoting a justifiable social, environmental and economic developed country'[102] and as such committed to complying with all relevant national and international environmental requirements.[103] Under the King IV Report, banks have a duty to

[101] FirstRand Group – South Africa, Environmental and Social Risk Management System, The Ecobanking project – UNEP FI, March 2011.
[102] FirstRand banking group's environmental policy <http://www.firstrand.com>
[103] Ibid.

ensure sustainable development is adopted in their operations.[104] The commitment undertaken by FirstRand supports the sustainable development principle stipulated under the King IV Report giving effect to corporate governance compliance. The commitment undertaken by FirstRand further supports the BASAs initiative to address environmental and social risks in banking practices, to which all four major banks in South Africa are party to.[105] Considering the duty of care principle stipulated under section 28 of the NEMA, by adopting policies in support of environmental management, FirstRand's contribution towards environmental protection and sustainable development is recognised.

In 2009, FirstRand adopted the Equator Principles with a commitment to integrate the IFC performance standards, the World Bank Groups Environmental and Social Framework (ESF) and Health and Safety principles (EHS) into its lending.[106] In 2010, FirstRand signed the United Nations Environment Programme Finance Initiative (UNEP FI) with a core purpose of strengthening its relationship and advancing its strategy and goals towards meeting its environmental and sustainability commitment.[107]

FirstRand had also become a member to the UNEP FIs African Task Force and the National Business Initiative Climate Change Working Group providing advice and recommendations to the Business Unity South Africa on identifying methods of adapting climate change risks into business practices, mitigating risks and developing financing mechanisms in respect of climate change matters. Being a member to the South African Sustainable Finance Forum, FirstRand provided input on legislation and issues affecting the financial sectors and how the banking sector needs to customise their operations to cater for legislation and risks affecting its operations.[108] FirstRand is also a signatory to the United Nations Global Compact which requires its members to adhere to a set of standards by adopting a precautionary approach to environmental risks aimed at promoting environmental protection, environmental responsibility in lending and developing environmentally friendly technologies and products.[109]

[104] Getting to Grips with King IV, (note 91 above).
[105] BASAs Code of Conduct, (note 96 above).
[106] FirstRand adopts Equator Principles, FA News. (July 2009) <https://www.fanews.co.za>
[107] 2013 environmental and social risks in banking and equator principles report – FirstRand Bank <http://www.firstrand.com>
[108] FirstRand Group – South Africa, Environmental and Social Risk Management System, (note 101 above).
[109] FirstRand sustainability report 2008 <http://www.firstrand.com>

3.2 Environmental and social management procedure

To give effect to its national and international obligations, commitments and its support to moving towards sustainable banking, FirstRand developed an environmental and social management procedure to identify environmental and social risks in its lending activities across all corporate and commercial transactions. This approach incorporated the development of policies, procedures and processes across all divisions and subsidiaries, with oversight provided from various ethics, risk and credit committees. FirstRand identified environmental risks specifically as a direct credit risk leading to losses; however, did not rule out the possibility that legal, regulatory and reputational risks may arise. The environmental management process developed by FirstRand has been formalised for proactive measurement and monitoring of risks associated with lending enhancing its scope to bank long term sustainable borrower's including meeting the requirements as stipulated under section 28 of NEMA.[110]

The management system developed by the Group incorporates an automated screening tool used to risk rate borrower's activities in accordance with a risk rating system. The risk rating is based on the level of potential environmental or social risks associated with the activity that they may fund.[111] Once a transaction is loaded onto the system and the relevant borrower information, sector and activity is recorded and submitted, the system categorises the transaction based on the information recorded and provides a value of high risk, medium risk and low risk as per the categorisation below:[112]

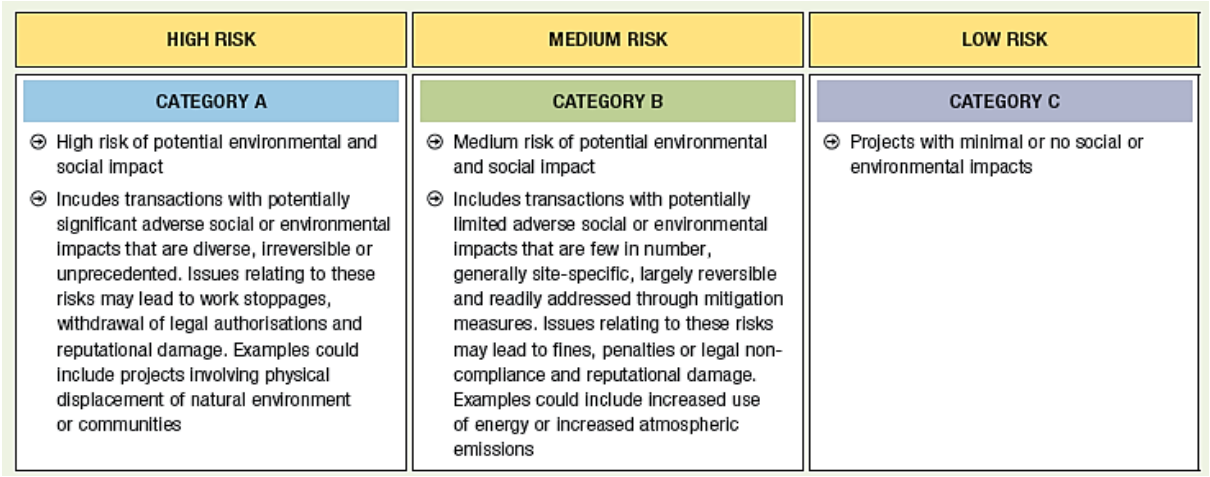


Figure 8: FirstRand transaction categorisation

[110] FirstRand Environmental and Social Risk Assessment Report 2016 <http://www.firstrand.co.za/Sustainability/EquatorPrinciplesReports/2016%20Environmental%20and%20social%20risk%20assessment%20report.pdf>
[111] Ibid. 5.
[112] Note 110 above. 5- FirstRand transaction categorisation.

The management system is further developed to submit transactions electronically to appointed environmental specialists where a transaction has been categorised as high or medium risk. The role of the environmental specialist is to identify potential risks attached to the borrower's activity by conducting a due diligence assessment. Through the due diligence process, specialists may request information and documents relating to the proposed activity in order to assess potential environmental and social risks attached to the activity by determining if the client is legally compliant (by assessing all requirements necessary under NEMA and its related legislations), whether all requirements have been met if the activity is a listed activity under the NEMA and if there are any outstanding environment and social issues that are required to be addressed by the borrower.[113] The due diligence assessment further assists FirstRand in assessing the client's ability to manage these risks with a core aim of reducing increased costs to the borrower for future actions that may arise as a result of environmental and social noncompliance, protecting the banks security position in event of contaminated property and reducing the risk of attracting lender liability.[114] The management of these risks identified and recommendations made are considered part of the credit application considerations for approval. Where transactions have risks that could potentially cause harm to the environment or reputational concerns to the bank, these are escalated to committees or senior environmental experts to mitigate and adopt measures by incorporating loan conditions in agreements and monitoring same for compliance by borrowers where risks can be managed, alternatively declining the facility where risks cannot be mitigated.[115] To ensure uniformity and standards across all divisions and subsidiaries, FirstRand has undertaken to ensure that the process is rolled out and applied in all divisions across all their international subsidiaries.[116]

3.3 FirstRand's environmental performance and environmental initiatives

According to FirstRand's Environmental and Social Risk Assessment Report, a total number of 6 530 lending transactions had been screened for environmental and social risks during the 2016 period.[117] Out of these transaction, 35 per cent were from the real estate sector, 24 per cent from agriculture and 17 per cent from the industrial sector. What is interesting to note is

[113] FirstRand Environmental and Social Risk Assessment Report 2016, (note 110 above), 4.
[114] Ibid.
[115] note 110 above.
[116] note 110 above.
[117] note 110 above, 1.

that five transactions were reported to be renewable energy transactions with one additional project finance advisory deal for renewable energy taking place in Africa.[118]

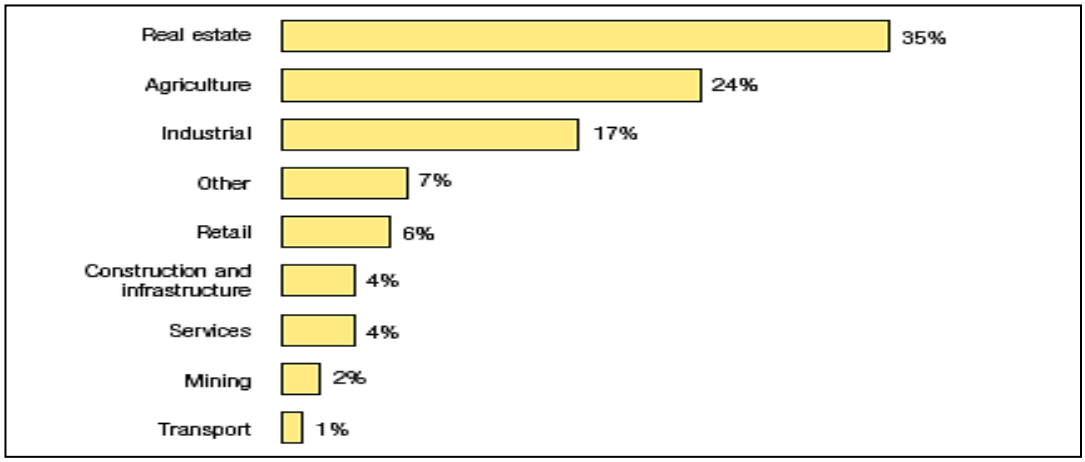


Figure 9: FirstRand transactions reviewed per sector 2016

The Group has rolled out environmental training within all franchises and subsidiaries to create awareness around the process adopted and has further amended their property valuation process to include contamination of land risk factors in their collateral processes.[119]

During the 2015/2016 financial year, FirstRand had participated in the draft National Greenhouse Gas Emission Reporting Regulations pertaining to carbon emission reporting. The Group also participates in the UK- based Carbon Disclosure Project (CDP) with the aim of reducing their own carbon emissions. For its participation in the CDP for more than 6 years FirstRand had received a gold award and received 99 out of 100 points for its carbon disclosure.[120] During 2016, FirstRand managed to reduce its carbon emissions by seven per cent with a reduction in emissions from road travel by 50 per cent.[121] The drive to reduce its carbon emissions does not only emanate from the Groups commitment to assisting in the transition towards a low-carbon economy but also the realisation that the lack of energy and water pose a threat to their business operations. Through its investment banking division, Rand Merchant Bank (RMB), FirstRand had participated in the Renewable Energy Independent

[118] Ibid.
[119] FirstRand Environmental and Social Risk Assessment Report 2016, (note 106 above), 1.
[120] Ibid.
[121] FirstRand Climate and Energy Report 2016 <http://www.firstrand.co.za/Sustainability/EquatorPrinciplesReports/2016%20FirstRand%20climate%20change%20and%20energy%20report.pdf>

Power Producer Procurement Programme (REIPPPP) and expanded its operations by developing solar panel product offerings.[122]

It is evident from the case study above that FirstRand has adopted environmental concerns into their lending and business operations. Although the adoption of the above international policies and international best practices are voluntarily undertaken, it nonetheless enhances FirstRand's ability, environmental management system and due diligence adopted. Through the adoption of these policies, FirstRand complies with their corporate governance obligation under the King IV Report. The adoption of these international best practices further demonstrates FirstRand's long term commitment to ensuring sustainable banking practices across all its divisions. The adoption of the principles subsequently provided FirstRand with a benchmark on assessing environmental and social risks in their project financing allowing them an opportunity to identify risks, to raise concerns with borrower's and address and mitigate these risks accordingly.

What is clear from the case study above, is that the inclusion of environmental management processes, policies and international commitments influenced by national banking and environmental regulation together with international environmental regulation, not only has a positive impact on banking operations but also contributes to ensuring a positive step is taken towards reaching a low-carbon economy – giving effect to sustainable development.

[122] Ibid.

4.1 Challenges for the banking industry

As highlighted above, the NEMA including the sectoral environmental regulations does not expressly make provision for lender liability but rather through the adoption of the duty of care principle. The extent and measure of liability a lender could face is further not determined under the act making it rather difficult for lenders to assess the credit risk attached to funding a borrower's activity.[123] The absence of a set precedent regarding banks financing activities of borrowers who are in breach of their environmental conditions and legal obligations further extends these risks making it difficult for banks to assess the risk.[124] The constant change and evolution in the listed activities (i.e. Listing Notice 3),[125] new requirements for activity expansions and legal requirements associated with these changes, gives rise to additional costs being imposed on borrowers for conducting EIAs and environmental audits at their own costs which could have an impact on the borrower's cash flow and in turn on the bank.[126] Any contravention of section 28 of the NEMA is considered a schedule 3 offence. Should a bank fail to provide proof that reasonable steps were taken to address any environmental concerns or crimes this could lead to fines and possible convictions.[127]

As banks acquire property as collateral creating an indirect link to control of the activity undertaken on the secured property, any issues of non-compliance resulting in clean-up costs or fines could potentially be passed on to the bank in event that the borrower is unable to address same.[128] Making the security position more onerous is the provisions made under the NEMWA placing a duty on owners of property to clean up any contamination. The effect of placing a statutory restriction on the contaminated land makes it difficult to sell and transfer the secured property. Contamination will also have an adverse impact on the value of the security taken, placing the bank at a loss. As the provision applies retrospectively,[129] the effect of this is that a bank could potentially have taken security of several properties or land that could be

[123] National Environmental Management Act (note 10 above), Sec 28.
[124] Ibid.
[125] Listing Notice 3: List of Activities and Competent Authorities Identified under sections 24(2) and 24D of NEMA, 1998 – previous notices were Listing notice 1 and Listing notice 2.
[126] EIA Process, (note 84 above).
[127] National Environmental Management Act (note 10 above), Sec 28.
[128] Leadership 'Environmental Sustainability in The Banking Sector' (March 2014) found at http://www.leadershiponline.co.za/articles/environmental-sustainability-in-the-banking-sector-10290.html
[129] National Environmental Management Waste Act (note 11 above).

contaminated and in its attempt to sell the property or land after a borrower defaults could become problematic as a result of the transfer provision. This provision under NEMWA is a direct collateral risk for a bank as it impacts the securitisation taken by banks as part of the lending process and the risk of retrospective remediation costs associated with contaminated land being forced onto the bank by the State in the event of foreclosure on property which could result is substantial losses.

In keeping up with international best practices, banks face further criticism in complying with commitments made. The Equator Principles for example, although a notable set of standards, is a voluntary undertaking made by banks across the globe to ensure sustainable practices are applied – the EP adoption comes without any strict enforcement regulations leaving uncertainty re the compliance with the standards set.[130] Although the principles make provision for banks to disclose transactions funded that apply to the EP threshold, the criteria for the level of disclosure in the assessment is not provided for. Without proper guidelines being provided on disclosure requirements, this gives banks the discretion to disclose the information in ways that could potentially conceal the true environmental and social impact of the activity.[131] The need for developed national and international banking regulations, support and strict enforcement measures for non-compliance by borrowers is eminent for banks to effectively imbed environmental considerations into their operations.

There is a further challenge imposed on developing countries to adhere to developed country standards creating difficulties for economic development. For example, most African countries are still under-developed and to increase economic development, the use of existing resources are necessary to curb costs, create employment and provide sustenance. As such the banking industry has a duty to promote development plans set out within their jurisdiction.[132] Applying developed country standards could potentially hamper the development of a country which do not have the funds, technology and resources to provide alternative solutions. This is a clear case of the development gap across the globe where on one hand international commitments are made to receive benefits and on the other the application of the standards becomes problematic for economic development.

[130] UNEP 'The Equator Principles – do they make banks more sustainable' <http://unepinquiry.org/wp-content/uploads/2016/02/The_Equator_Principles_Do_They_Make_Banks_More_Sustainable.pdf>
[131] Ibid.
[132] Challenges facing the developed countries, Chapter 36 < <http://wps.prenhall.com/wps/media/objects/1310/1341624/Chapter36W.pdf>

Based on the submissions above, it is evident that legislative requirements[133] make it prudent for banks to structure their process to include environmental concerns as it is uncertain as to what point a bank would become liable, the extent of liability that would be imposed, the accuracy of the collateral they hold and whether the nature of these activities could lead to reputational risks and criminal charges against directors. What is clear from NEMA and NEMWA is that banks are not provided with protection against these risks.

4.2 Conclusion and Recommendations

The inclusion of environmental concerns and the adoption of environmental management processes benefits the banking industry to address an array of risks such as:

- credit risks – in assessing the borrower's compliance with laws and avoidance of fines which could affect their profitability and in return the borrower's ability to repay loans;
- legal risks – the management of environmental concerns can aid the banking industry against lender liability and 3rd party claims as a defence that a level of duty of care was adopted at the time the funding was provided;
- regulatory risks – to ensure that the banking industry meets its commitments made under the Banking Association of South Africa and International Financiers;
- collateral risks – to identify any issues of contamination of land prior to securing property to avoid a negative security position and clean-up costs in event of the borrower defaulting; and
- reputational risks – by assessing the risks associated with a borrower's activity this allows for the bank to identify the desirability in funding the activity and the association with the negative environmental impacts thereof. The management of environmental risks can further be used as a response to environmental organisations targeting financial institutions for contributing to climate change through their lending operations.

Using environmental management tools and screening transactions for these risks not only benefit banks from addressing and avoiding liability but opportunities may also arise. For example, borrowers who rely on electricity, an opportunity and innovation for banks in this

[133] The Constitution (note 66 above), National Environmental Management Act, (note 10 above, National Environmental Management Waste Act (Note 11 above), Prevention of Organised Crimes Act (note 7 above)

case would be to provide green product solutions by developing renewable energy products as alternatives. These opportunities benefit the bank in that it creates reputational benefits increasing their credibility and improves market share. On the other hand, environmental management processes adopted by banks also provides benefits and awareness to borrowers. In event a borrower is not aware of the changing laws and the environmental regulations required for undertaking an activity, by the awareness provided by the bank, the borrower benefits in that:

- an opportunity to rectify the non-compliance is provided; and
- it reduces increased costs incurred by the borrower should any fines be received in respect of non-compliance.

Environmental laws are constantly changing and regulations governing activities requiring environmental authorisation are updated as and when the need to regulate an activity becomes eminent. The changing environmental regulations exacerbates the risks open to the banking sector as the extent of lender liability is unclear from current legislation. To cater for these risks banks will need to adopt stronger environmental and sustainability principles and policies, formulate these principles into all aspects of their lending cycle, adopt stricter environmental management systems enabling them to identify potential risks and mitigate same by incorporating monitoring and auditing measures to adequately assess the long-term effects of the risks.

This study aimed to ascertain the participation and contribution of the banking industry in contributing towards a green and sustainable economy. As a consequence of the changing environment, banks need to change the way they operate to cater for these scenarios to adequately adapt and mitigate associated risks. From the submission above it is evident that the global and local banking industry have moved towards stirring the world and various economies in the right direction by addressing environmental concerns through commitments made by adopting various codes of conduct and conventions, by developing systems to manage environmental risks and by reducing their own contribution towards climate change. Banks have undertaken their duty of care and realised their contribution in promoting environmental protection. Although challenges in terms of changing legislation exist, banks continue to meet their commitments in contributing to a green and sustainable economy.

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