

THE ROLE OF ENHANCED DUE DILIGENCE IN THE REGULATION OF SOCIOENVIRONMENTAL RISK MANAGEMENT FOR FINANCIAL FIRMS

Financial institutions are exposed to socioenvironmental risk, which is defined as potential losses due to social conflicts and environmental hazard. Consequently, the Superintendency of Banks, Insurance and Private Retirement Management Funds (SBS) has recently issued regulation aimed at promoting sound practices to manage such a risk.

This document describes the key design features of this regulation and contains six sections: the first section explains the mandate of the regulator; the second section details the particular features of socioenvironmental risk; the third section describes traditional approaches to deal with socioenvironmental risk; the fourth section presents the case for enhanced due diligence; the fifth section presents the key elements of these rules; and the sixth section describes the expected results and concludes this document.

It is worth noting that this regulation does not attempt to transfer the responsibility or roles that belong to the specialized public institutions to the financial system's firms; neither to make such firms responsible for potential breaches of social and environmental rules by projects and/or their primary suppliers.

I. RESPONSIBILITY OF THE REGULATOR

The SBS is charged with the overall responsibility for the prudent management and good functioning of the financial system of Peru, including banks, municipal credit institutions, rural credit institutions, the finance companies and the specialized lending institutions for microcredit. The SBS stands in for deposit holders in seeking the stability of the financial system; and through regulation and supervision, the SBS promotes supervised financial firms taking reasonable risks and exercising prudent management. The financial regulator has the key responsibility of ensuring that such actions have been adequately adopted.

In Peru, financial institutions know that socioenvironmental risk is particularly important because mining and logging industries represent a significant portion of the GDP, and their areas of operation frequently house communities with longstanding expectations. So that a survey conducted by the SBS in May 2012 reveals that our ten largest banks (that lend more than 99% of total corporate loans) consider that monitoring socioenvironmental risk is very relevant.

Events, such as those occurred in Conga and Tia María, clearly show the various effects and relevance of this risk for our domestic economy and financial system. Socioenvironmental risk is a particular form of risk and it has special features as will be discussed in the immediately following section.

II. THE SPECIAL NATURE OF SOCIOENVIRONMENTAL RISK

Socioenvironmental risk is the possibility of losses due to occurrence of social conflicts related to project developments. Typical cases are conflicts over water rights between mining enterprises and neighboring towns or villages, conflicts over logging rights between native tribes and lumber companies, conflicts over uses of water between hydroelectric dams and agriculture, and other similar cases. In these instances, the conflict is typically between large companies and collectivities of citizens that feel their traditional way of life is threatened or the economic basis of their existence will be endangered if a particular project goes forward. The financial system's exposure to this risk is broad.

Financial institutions are exposed to this risk through different products and services, including project finance, corporate loans, lines of credit, bridge loans and advisory services.

To better understand why socioenvironmental risk is particularly relevant for the financial sector it is key to be aware of its special features:

(a) The prevalence of externalities

Socioenvironmental risks do not have narrowly focused costs and benefits. When such a conflict breaks out, it will most likely affect:

- (i) International variables pertinent to the country such as macroeconomic risk, interest costs, debt capacity and credit terms.
- (ii) Regional and National Authorities (via tax revenues and required new expenditures).
- (iii) Local authorities (via tax revenues and required new expenditures).
- (iv) Suppliers and clients of the enterprise concerned.
- (v) Other economic activities in the zone of influence upstream and downstream.
- (vi) Other divisions and workers of the company involved.

Externalities can indeed be thought to dominate such risks. When the main direct finance for large projects originates outside the country, the direct credit risk is held abroad. By the same token, the main credit risk *inside the country* will originate with borrowers whose risk is produced by the external effects of the project (i.e. the impact on workers, suppliers, clients, small businesses, tax collection, etc.)

(b) The spread by contagion

For illustrative purposes it may be considered that the spread of socioenvironmental risk behaves like an epidemic, whose rate of propagation is only obvious after the fact. By the same token, social conflicts quickly expand through channels that have not necessarily been foreseen.

Much like epidemics, conflicts do not require contiguity nor do they respect mountain ranges or borders. Conflicts can and do spill over, and often in unexpected ways. But conflicts also burn out, again like epidemics: when all opponents of a mining project have moved out, there will no longer be opposition; by the same token, when the mine's investors have decided to go elsewhere, the level of conflict will decrease rapidly.

A variety of conditions can make for an area to be conflict prone. In certain cases, a concrete condition for a conflict to break out appears when all seems quiet, and then, abruptly, the conflict will break into the open. In other cases, a cauldron will smolder along without breaking out for a long time, perhaps only then to break out more fiercely.

Enhancing due diligence practices, a sustained and methodic effort to understand expectations and concerns of affected stakeholders, and establishing likely forms of contagion are activities that can mitigate this risk.

(c) The size and duration

Socioenvironmental risk and the conflicts that give rise to such risk depend for size and duration on a variety of factors. Gains and losses related to projects are often measured very differently by the various participants. For example, companies developing a project will likely have a straightforward calculus of profits and costs associated to remediation of adverse impacts and they will give due regard to reputational risk, whilst communities are likely to focus on costs and impacts of the project on their traditional life style and beliefs.

Focusing on widely differing indicators of financial, environmental, social and cultural values may also explain why there is a conflict to begin with, and will certainly affect how long and how intense both parties will keep to sustain their support or refusal to the project.

(d) The involvement of third parties

Another characteristic of conflicts generating socioenvironmental risk is the involvement of third parties that perceive a need to "right the balance" in information, resources and bargaining power between large corporate units and members of communities in order to improve decision making processes and contribute with sustainable development. However, there may be other goals, related to political or ideological agendas that may find fertile ground in such conflicts. Whatever the motivations, the involvement of third parties in such conflicts is not only typical but often affects the outcome and the level of conflict.

(e) The potential for escalation

Finally, conflicts and the socioenvironmental risk it entails have a tendency to escalate. One conflict breeds another; one socioenvironmental risk leads to fear of another. This, in turn, will cause loss of competitiveness and (at least locally) bring about a slowdown, causing its own losses.

Based on the special features of socioenvironmental risk, the financial system is exposed to three sources of risk:

- (i) Direct credit risk increases because interruptions and cancellations of projects and businesses caused by social conflict affect their ability to repay their loans, reducing the creditworthiness of borrowers and increasing their probability of default.
- (ii) Indirect credit risk also rises because socioenvironmental risk not only affects financiers of projects and businesses directly associated to an episode of social conflict, it also produces effects on non-financial institutions not directly involved in the conflict due to both the propagation and escalation that characterize social conflicts. Such features expand the universe of borrowers affected by such a risk.
- (iii) Episodes of social unrest damage the reputation of project developers and primary suppliers but also increase reputational risk of lenders as they could be seen as financiers and sponsors of such projects and businesses.

Negative impacts of social conflicts also reach output, employment and fiscal revenues as well as the effects on investment prospects in sectors likely to be affected by social tensions. All these adverse effects are actively tracked by market analysts and rating agencies with the subsequent impact on country risk evaluations¹. The next section reveals challenges faced by traditional approaches to tackle socioenvironmental risk's special features described above, explaining why our regulations' design should consider a broader and more effective approach.

III. TRADITIONAL APPROACHES TO DEALING WITH SOCIOENVIRONMENTAL RISK

The traditional approach to dealing with any risk in a financial setting requires measuring its probability and its impact (related to size and duration), but because of all above mentioned special features of socioenvironmental risk, the measurement of such a risk becomes exceedingly complex and may be insufficient. For instance, requiring loan provisions and capital charges may work for the accountability of potential losses of certain type of risks or for aligning incentives but will be unable to cope with the broader consequences for suppliers, clients, or other third parties.

Therefore, a broader framework is needed to deal with socioenvironmental risk. Since provisioning is an economically inefficient tool in this case, we need to look beyond, at a mechanism that is able to:

- (i) reduce the likelihood of conflicts so that, the risk is minimized;
- (ii) reduce the intensity of the conflicts so that, if the risk occurs, it is contained;

¹ Statements by representatives from investment banks and rating agencies alert on risks of social conflicts affecting investments (see for instance statements by Moody's to Gestion on 9/3/12 or Bank of America's opinions on 13/6/12).

- (iii) reduce the risk of contagion, so that the risk does not spread;
- (iv) take into account the effects on third parties (externalities); and
- (v) where necessary, take into account the macro effects.

All this implies an approach based on a broad sweep which, while being able to accommodate the role of the individual transaction, is also able to take into account interactions which clearly go beyond individual loans.

IV. BRINGING IN THE EXTERNALITIES THROUGH ENHANCED DUE DILIGENCE

Enhanced due diligence in essence implies a careful review and forecast of what is likely to happen as a project develops, so its design enhance and includes preemptive measures and mitigation. Otherwise, it is difficult if not impossible to prevent undesired effects. Enhanced due diligence makes it possible to bring in the impact on third parties and other externalities that characterize this risk and therefore it becomes indispensable to *internalize the externalities*.

It should be noted that enhanced due diligence cannot by itself avoid or extinguish socioenvironmental conflict and risk. Such risk may continue to be present. However, proper due diligence and the foresight that it requires makes it possible to fashion strategies that have a superior probability of containing the conflict and the attendant risk. Nonetheless, foresight can never be perfect, and thus there will always be events not anticipated which will cause even the best plans to miscarry; on the other hand, there can also be serendipity which will allow events to develop unexpectedly well. Either way, it is desirable to anticipate where possible and to fashion strategies that provide for more than one option or strategy for a given situation.

V. IMPLEMENTING ENHANCED DUE DILIGENCE

The goal of this regulation is to establish the minimum requirements covering the risk factors to be assessed by financial firms; the process of risk categorization; the conditions that trigger the need for an independent review and the elaboration of a management plan; and the inclusion of *loan agreement clauses* that commit the borrower to take specific actions to build and maintain a good relationship with the community and to protect the environment.

It is, however, necessary to ensure that financial rules should not imply that either financial firms or their clients be held responsible for external factors outside of their control such as (local or regional) political dynamics or a preexisting unequal distribution of income. These factors clearly go beyond the responsibility and scope of the business of any private company, and therefore financial rules should not be considered as a tool to require the private sector to replace the government in its duties nor even supplement sectorial legislation that is and should be issued by the relevant authorities.

Regulatory scope

The SBS has established the business activities that have to apply minimum requirements defined in these rules, including project developers that might trigger social tensions because of the likely impacts on communities and the environment as well as their primary suppliers. The latter being defined as businesses that provide goods or materials that are essential for a project and that can produce effects on environmental conditions similar to those caused by project developers.

In this regard, the SBS has used a broad concept of project, which is defined as: “the development of a business at an identified location and for which feasibility and socioenvironmental impact assessments on the area of influence are required”. Such a definition is sufficiently broad because the term “development” includes exploration, installation, operation, and expansion or material changes, as well as decommission of facilities, all necessary to carry out such a business. The SBS has also clearly established that advisory services, project finance and wholesale lending should be included in socioenvironmental risk management systems.

Therefore, these rules consider two separate frameworks. The first framework focuses on project developers whilst the second framework targets primary suppliers.

When a whole project is funded, these rules apply on the basis of the estimated total investment for such project, considering a threshold of USD 10 million, which covers all major projects that have been involved in episodes of social conflict in Peru and is consistent with international guidelines such as the Equator Principles and the International Finance Corporation (IFC) Performance Standards.

For wholesale loans related to a project’s development phase, these rules apply when the financial firm’s loan amount related to the project (before syndication or sale) is at least US\$25 million and the aggregate loan amount related to the project is at least US\$ 50 million in the financial system.

These rules do not distinguish between drawn and undrawn exposures, so both indirect and direct loans -even temporary (bridge) loans- are treated similarly for the purposes of this regulation.

The SBS does not limit voluntary expansion of the scope of this regulation to other financial products and services, so firms are explicitly allowed to apply –at its discretion- requirements similar or identical to those contained in this regulation when offering other services and products.

Evaluation and categorization of risk factors

The SBS has considered that financial firms should apply a questionnaire to their clients as the starting point of this socio-environmental risk management process and that such a questionnaire can be used to categorize the level of socio-environmental risk.

Another distinctive feature of these rules is the relevance given to a good relationship between the client and the community. This feature is supported by abundant evidence on the strong relationship between the quality of the company-community relationship and the long-term sustainability of businesses.

The evaluation of the likelihood and severity of social conflict for a particular project considers six components or risk factors: socio-environmental baseline; compliance with legal requirements; likely impacts; mitigation measures; quality of engagement and dialogue; and presence of grievance mechanisms.

Based on these factors, financial firms need to assess whether their clients have developed and maintain a good relationship with their communities and then map such an internal assessment into three categories of socio-environmental risk: high, medium and low.

Although the rules do not require a standardized model to categorize socio-environmental risk, they clearly indicate that such a categorization should be based on the answers to the questionnaire, especially those referred to the social baseline, the level of engagement with communities in the area of influence and the quality of dialogue and grievance mechanisms.

Need for independent reviewers and management plans

In the case of high-risk borrowers, financial institutions have to require their clients to hire independent expertise to verify in-situ the quality of the company-community relationship. The independent review should be conducted by qualified professionals (individual or organization) with expertise in the management of company-community relationships and who are not associated with the client.

Independent experts should also evaluate responses to the questionnaire's sections on socioenvironmental baselines, likely impacts, engagement and dialogue, grievance mechanism and further evaluate other components of the questionnaire at the request of the financier.

Independent experts could also help to draft the risk management plan. The drafting of such a plan must be understood as the next logical step after completing the risk assessment, especially if this assessment indicates that the project developer or the primary supplier is exposed to high socioenvironmental risk. In those cases, and only if the level of risk is within the range acceptable to the lender, the regulation asks financial firms to agree with the client on a risk management plan including measures that, in the opinion of the financier, are required for the project or the primary supplier to improve its social and environmental risk category. Such a risk management plan should be included as a binding loan covenant and then monitored, at least annually.

This frequent monitoring should serve to evaluate if the financial firm's client is actually following the recommendations after the initial assessment and if it is taking actions agreed upon in the risk management plan. As before, the rules are not restrictive and allow the financial firm to require, at its discretion, social and environmental risk plans for additional businesses of their clients.

Additional covenants in the terms of contract

The risk management system must translate all the evaluation and further risk categorization efforts into clauses that commit project developers and primary suppliers to take actions to reduce their levels of socioenvironmental risk, linking those clauses to particular consequences if there are contractual breaches. The specific consequences are not prescribed in the regulations but need to be decided by the financier in accord with what is appropriate in each particular case. The above notwithstanding, the SBS does require certain minimum commitments or/and liabilities to be enshrined in the corresponding contracts:

- A commitment and/or obligation to comply, during the life of the project, with the requirements listed in social and environmental regulations, as well as with international treaties, conventions and agreements, strictly mandated by Peruvian law;
- A commitment and/or obligation to report regularly to the firm following a given structure and with a frequency proportional to the severity of the potential impacts (but at least annually). The reports will be prepared by specialists working for the client or independent reviewers. As a minimum, they shall present evidence the client complies with the minimum requirements established by the social and environmental regulations, and the international treaties, conventions and agreements strictly mandated by Peruvian law. They shall also include a description of the social and environmental risk management plan for high social and environmental risk; and
- A commitment and/or obligation to follow the social and environmental risk management plan.

In addition, if clients are project developers, they should also commit to the following:

- A commitment and/or obligation to follow the social and environmental risk management plan.
- A commitment and/or obligation to allow the firm unrestricted access to the facilities of the project.
- A commitment and/or obligation to comply with all terms and conditions of permits issued for the project;
- A commitment and/or obligation to dismantle the project's facilities (if applicable), following a decommissioning plan previously agreed upon with the local community;
- Clauses outlining the actions the firms and its clients shall undertake should the project fail to meet the minimum requirements set forth in the social and environmental regulations, and the international treaties, covenants and agreements strictly mandated by Peruvian law.

VI. EXPECTED CONSEQUENCES OF THE IMPROVED REGULATORY FRAMEWORK

Several positive consequences are expected to follow:

- (a) more careful forecasts of financial results will be made;
- (b) these consequences will incorporate possible effects of socioenvironmental conflicts;
- (c) to ensure the existence of adequate and reliable information on such possible conflicts, a new body of information and expertise in this area will arise;
- (d) to provide options for avoidance and containment of conflicts, various mitigation strategies will be developed and expertise in their application will arise;
- (e) incentives for the observation of socioenvironmental regulations will increase, since they will become enforceable by covenant, not only by law;
- (f) to reduce or eliminate a source of conflict, insisting on full compliance with such rules and adopting a narrow interpretation of such;
- (g) broad community acceptance of proposed projects will increase as benefits become more clearly revealed and negative consequences reduced;
- (h) broader consequences (externalities) will naturally become embedded in the forecasts and consequences, thereby bringing out more clearly how the public good is impacted by the actions of the various players;
- (i) macroeconomic consequences of socioenvironmental conflicts will be easily observable, and thereby become much more subject to offset, avoidance, or compensation;
- (j) the systemic impacts on the financial system will become more clearly revealed, thereby allowing the Regulator to act preemptively to prevent or reduce undesirable consequences of this risk.

Avoiding unnecessary paperwork or duplication of effort in the implementation of these rules is a priority for the SBS. Accordingly, these rules have been drafted with an eye towards harmonizing their implementation with other standards and rules that companies, particularly in the extractive industry, must follow.

For instance, information dealing with environmental impacts and mitigation measures is already being required by national environmental authorities as well as international and should involve no duplication.

The net result of the Regulation is expected to be a safer financial system, more effectively underpinning the real economy and better serving the dynamic needs of a growing economy.

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Republic of Peru

Annex 1: International standards relevant for Peru

This annex summarizes international standards that address socio-environmental risk management and that may be relevant for Peru.

The UN Guiding Principles on Business and Human Rights

The UN Human Rights Council unanimously adopted the Guiding Principles on Business and Human Rights² in June 2011, for implementation of the UN 'Protect, Respect and Remedy' Framework on Business and Human Rights. The Framework proposed relies on three pillars. These are:

- The state duty to protect human rights to prevent abuses by third parties, including business, through appropriate policies, regulation, and adjudication;
- The corporate responsibility to respect human rights, that is, to act with due diligence to avoid infringing on the rights of others and address adverse impacts with which they are involved. In addition, transparency, disclosure and more formal reporting are key components of implementing the corporate responsibility to respect human rights ; and
- The need for greater access to effective remedies for human rights abuses, both judicial and non-judicial.

The Framework and Guiding Principles reflect a wide-ranging agreement on how to manage the risks that business can pose to human rights. They describe the distinct roles of States and business in preventing and addressing human rights harm by:

- Highlighting what steps States can and should take to foster business respect for human rights;
- Providing a blueprint for businesses on the policies and procedures they need in order to know and show that they respect human rights in practice;
- Offering the basis for a reasonable set of benchmarks for stakeholders to assess business respect for human rights; and
- Underscoring the importance of connectivity - between and within States, companies, and other stakeholders - in addressing human rights challenges.

ISO26000

The International Standard ISO26000 was prepared by ISO/TMB Working group on Social Responsibility which released on 1 November 2010. It provides guidance on understanding, implementing and continuously improving the social responsibility of organizations, which is understood as the impacts of an organization's actions on society and the environment. The ISO 26000 has been incorporated by Peru into domestic regulations as the standard for corporate responsibility.

The standard on corporate and social responsibility applies to financial institutions as well as real sector companies, and indeed organizations of other types. It encompasses

² The UN Guiding Principles were developed by the Special Representative of the UN Secretary-General for Business and Human Rights, Professor John Ruggie, over the six years of his UN mandate from 2005 to 2011.

organizational governance; human rights (in line with the UN Guiding Principles); labor practices; the environment; fair operating practices; consumer issues; and community involvement and development.

ISO26000 reflects the main concepts associated to the corporate responsibility to respect human rights that are included in the UN Guiding Principles on Business and Human Rights (see above). It also contains an important section on stakeholder engagement, which includes the appropriate means of consulting with those stakeholder groups impacted by an organization's activities. Nevertheless, this section does not supply indicators to evaluate the quality of these processes and outcomes in practice.

OECD Guideline for Multinational Enterprises

The Guidelines for Multinational Enterprises of the Organization for Economic Cooperation and Development, have been adopted by Peru. Actually, Peru is one of 44 governments following these Guidelines, which are recommendations for responsible business conduct that the adhering governments encourage multinational enterprises operating in or from adhering countries to observe wherever they operate.

Adhering governments are obliged to set up National Contact Points (NCPs) whose main role is to further the effectiveness of the Guidelines by undertaking promotional activities, handling enquiries, and contributing to the resolution of issues that arise from the alleged non-observance of the guidelines in specific instances. Peru's NCP is located within Proinversion.

The Guidelines address business conduct in the following areas: disclosure; human rights; employment and industrial relations; environment; bribery; consumer interests; science and technology; competition; and taxation.

Companies are encouraged to carry out due diligence with regard to the risks associated with many of these issues. The due diligence concept is based on the definition established in the UN Guiding Principles on Business and Human Rights. The Human Rights chapter of the Guidelines itself mirrors closely the UN Guiding Principles.

IFC Performance Standards

The Performance Standards define clients' responsibilities for managing their environmental and social risks and those standards are complemented by the Guidance Notes, in order to provide guidance to clients in meeting the Performance Standards. This guidance is oriented on how clients have to identify risks and impacts, and are designed to help avoid, mitigate, and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations of the client in relation to project-level activities. Together, the eight Performance Standards establish standards that the client is to meet throughout the life of an investment by the International Finance Corporation (IFC)³.

Performance Standard 1 "Assessment and Management of Environmental and Social Risks and Impacts" applies to all projects that have environmental and social risks and impacts. Clients are encouraged to manage them through its Environmental and Social Management System (ESMS), regardless of financing source. This standard establishes the importance of (i) integrated assessment to identify the environmental and social impacts, risks, and opportunities of projects; (ii) effective community engagement through disclosure of project-related information and consultation with local communities on matters that directly affect

³ The IFC is the private lending arm of the World Bank Group.

them; and (iii) the client's management of environmental and social performance throughout the life of the project".

Performance Standards 2 through 8 may also apply to IFC clients and establish objectives and requirements to avoid, minimize, and where residual impacts remain, to compensate/offset for risks and impacts to workers, affected Communities, and the environment. In addition, Performance Standards 2 through 8 describe potential environmental and social risks and impacts that require particular attention. These standards include labor and working conditions; resource efficiency and pollution prevention; community health, safety and security; land acquisition and involuntary resettlement; biodiversity conservation and sustainable management of living natural resources; indigenous peoples; and cultural heritage.

The Equator Principles

The Equator Principles are a set of standards designed to help banks identify and manage social and environmental risks associated with the direct financing of large infrastructure projects such as dams, mining and pipelines.

The Equator Principles were first established in association with the World Bank's International Finance Corporation (IFC) in 2003 and since then have been adopted by nearly 50 banks around the world, covering in excess of 85% of the global project finance market. The Principles were updated in mid-2006 to reflect the recent revision of the IFC's Performance Standards, on which the Principles are based.

The Equator Principles are designed to have effect primarily in countries with developing legal frameworks. By adopting the Equator Principles, adherents voluntarily commit to fund only new projects that can be developed and operated according to sound social and environmental standards. The Principles are now considered global best practice for ensuring applicable project finance proposals meet these standards.

UN Principles for Responsible Investment

The United Nations-backed Principles for Responsible Investment Initiative (PRI) is a network of international investors working together to put the six Principles for Responsible Investment into practice. These six principles are oriented to recognize the materiality of environmental, social and corporate governance issues. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating social and environmental governance issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organization's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

The six Principles, each of which has a number of sub-principles are:

- To incorporate ESG issues into investment analysis and decision-making processes.
- To be active owners and incorporate ESG issues into ownership policies and practices.
- To seek appropriate disclosure on ESG issues by the entities in which we invest.
- To promote acceptance and implementation of the Principles within the investment industry.
- To work together to enhance the effectiveness in implementing the Principles.
- To report on activities and progress towards implementing the Principles.

UNEPFI Statement of Commitment

The United Nations Environment Program (UNEP) Statement of Commitment by Financial Institutions (FI) on Sustainable Development represents the backbone of the Finance Initiative, which recognize that economic development needs to be compatible with human welfare and a healthy environment. To ignore this is to risk increasing social, environmental and financial costs. UNEP FI further recognizes that sustainable development is the collective responsibility of governments, businesses and individuals.

The Commitment to sustainable development - defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs – is seen as a fundamental aspect of sound business management. UNEP FI believes that sustainable development is best achieved by allowing markets to work within an appropriate framework of cost efficient regulations and economic instruments. Governments have a leadership role in establishing and enforcing long-term priorities and values.

UNEP FI works closely with over 200 financial institutions who are Signatories to the UNEP FI statements and a range of partner organizations to develop and promote linkages between sustainability and financial performance. Financial institutions are important contributors to sustainable development, through their interaction with other economic sectors and consumers and through their own financing, investment and trading activities.

The three categories under the Statement of Commitment relate to Sustainable Development, Sustainability Management and Public Awareness and Communication. Commitments include:

- Support for “a precautionary approach to environmental and social issues, which strives to anticipate and prevent potential negative impacts on the environment and society”;
- Beyond legal compliance, working “towards integrating environmental and social considerations into our operations and business decisions in all markets”;
- “Recognizing that identifying and quantifying environmental and social risks should be part of the normal process of risk assessment and management, both in domestic and international operations”;
- Recommending that “financial institutions develop and publish a statement of their sustainability policy and periodically report on the steps they have taken to promote the integration of environmental and social considerations into their operations”;
- Sharing “relevant information with customers, as appropriate, so that they may strengthen

their own capacity to reduce environmental and social risk and promote sustainable development”; and

- Fostering “openness and dialogue relating to sustainability matters with relevant stakeholders, including shareholders, employees, customers, regulators, policy-makers and the public”.