



Banking Sector Rating

Environmental and Social Standards in the Areas of Forest Conversion and Forestry

– A Research Paper Prepared for WWF Germany –

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Summary

The worldwide loss of forest areas is triggering a variety of environmental and social problems and changes, some of which are having a global impact. In particular, the accelerated clearance of tropical rainforests which has been going on for decades poses a dramatic threat to forest stands in many regions of the world. While blame for this development was in the past frequently laid at the door of the countries concerned or of unscrupulous entrepreneurs, interest groups such as environmental or human rights organisations have in recent years increasingly turned their attention to international flows of finance. They have organised and continue to organise effective media campaigns denouncing banks operating internationally for having financed activities or projects that have a significant negative impact on forests worthy of protection.

This study, commissioned by WWF Germany, therefore analyses the existence and application of environmental and social standards by banks in relation to the financing of projects in the field of forest conversion and forestry. The survey is the world's first rating devoted explicitly and exclusively to this field. To this end, eleven, primarily German, banks which had in the past been subject to public criticism because of a variety of controversial financing decisions were selected. Both private commercial banks and public institutions were included. The financial institutions are all involved in relevant types of financing, principally project and export financing, and include some of the world's major project financiers.

In order to take stock of and evaluate the approaches currently being taken by the banks, relevant information was first collected. To this end, detailed interviews were conducted with the companies involved and publicly available company publications were analysed. In order to validate externally the information provided by the banks and to research areas of investigation which the banks did not generally report on, a large number of non-governmental organisations (NGOs) were also surveyed on this issue. As part of a structured rating, the information was then evaluated and assigned a weighting on the basis of approximately 30 separate criteria. The range of scores used in the rating extends from A+ to D-. The main areas examined here include the existence and application of appropriate standards, as well as internal and external communications and transparency. A further area of the study analysed whether the banks surveyed as part of the study had in the recent past financed projects or activities which had been criticised by NGOs because of their negative impact on forests worthy of protection. Due to the fact that the study was chiefly conceived as an inventory of existing standards and structures and that it was not yet possible to obtain a conclusive picture of the effectiveness of structures in the banks, which in many cases were not developed until a few years ago, this section was not included in the overall rating score, but was treated separately.

All eleven companies were contacted and asked to make relevant information available for the study and in so doing to submit to external appraisal in this area. Eight of the eleven banks (ABN AMRO, Commerzbank, DEG, Dresdner Bank, HypoVereinsbank, KfW, UBS and WestLB) complied with the request and provided a comprehensive range of materials. The other three companies (Deutsche Bank, IKB Industriebank and NORD/LB) were unwilling to participate in the study. The lack of public openness and transparency in this area meant that no ratings of these banks were produced. However, external interest groups were surveyed and publicly available information was analysed in relation to these banks as well.

The section of the survey on the "Existence of standards" revealed that scarcely any banks had developed their own environmental and social standards for financing projects over and above generally held policies. As a rule, the institutions recognise internationally valid standards or guidelines of other institutions such as those of the World Bank or of export credit agencies such as Hermes. The standards which are observed in practice frequently depend on the type of financing and the partners involved. The lack of commitment to universally valid standards proved to be problematic in relation to the binding force of the banks' voluntary undertakings.

In most cases, the banks examined adhere to the standards of the World Bank Group, which have been developed since the early 1980s as a result of external pressure. The most important set of rules are the ten rather qualitative Safeguard Policies, which are designed to prevent activities financed by the World Bank from having particularly negative effects on the natural environment and on population groups in need of special protection. The Forests Policy of the World Bank is particularly relevant to the issues underlying the study. In contrast, the Pollution Prevention and Abatement Handbook, which was developed by the World Bank and is also referred to by banks, is of no major significance in terms of forest-related issues.

ABN AMRO, DEG and HVB turned in the best performances in this area. ABN AMRO carried the day with its forestry policy, which sets the standard for the industry and is also recognised by NGOs. This policy was developed in collaboration with NGOs and in certain important areas extends beyond that of the World Bank. DEG uses inter alia the standards of the German Federal Ministry for Economic Cooperation and Development (Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ)), which also call for stricter measures in some areas. While HVB has not developed its own standards, it does undertake to observe in all cases World Bank standards for relevant transactions. All the other banks have developed some general internal guidelines or generally take as a guide the standards of partner organisations. Their binding force is, however, limited and depends in part on the type of financing or on the partner organisation, so it cannot be guaranteed that certain minimum standards will be observed in every transaction. Banks joining an initiative launched in the middle of 2003, the Equator Principles, pledge to observe certain standards based on those of the World Bank. These are restricted, however, to the field of project financing. The Principles have been recognized by, among others, ABN AMRO, Dresdner Bank, HVB and WestLB.

The section of the study on the "Application of standards" examined internal structures and processes. Also included here were the integration of NGOs in these processes and the controlling of the stringent application of standards. Here, too, ABN AMRO and HVB stood out as a result of their comparatively clear description of internal audit processes, e.g. with regard to the obligatory performance of environmental impact assessments (EIAs). In addition, according to the information the banks themselves provided, there are no restrictions on the application of EIAs, e.g. depending on the volume of transactions. The situation at DEG is similar. Particularly with regard to EIAs, the other banks tended to remain non-committal. Moreover, certain audit processes are carried out only for projects above a certain size; in the case of project financing by WestLB, for example, only for projects with a value of USD 50 million and upwards. NGOs are not routinely integrated into the appraisal of financing projects by any of the banks.

Finally, the section of the study on "Communication and transparency" analysed internal training arrangements as well as the transparency of the banks toward the outside world. Compared with the other sections, the worst average results were achieved here. In particular, the information made available to the public about relevant standards and processes is to date far from comprehensive and aspects relevant to forestry are not described at all. Viewed in relative terms, the best performances here were by the two public development banks KfW and DEG. Other banks, e.g. ABN AMRO, Dresdner Bank, HVB and UBS, make at least basic information available. WestLB is planning to introduce relevant reporting in the near future, and Commerzbank has not to date published any relevant material.

The three sections of the study described above produced the following overall results: on the scale from A+ to D-, ABN AMRO came out on top with a B+ overall, closely followed by DEG and HVB, which likewise achieved a B+. These three banks performed relatively well in all the sections. Some distance behind came UBS with a B-, KfW and Dresdner Bank, each with a C+, and WestLB with a C. Of the eight banks taking part, Commerzbank came in eighth place with a C-. The overall grades and ranks for the companies that participated in the survey are displayed below.

Company	Existence of standards		Application of standards		Communication & transparency		Overall results	
	Rank	Grade	Rank	Grade	Rank	Grade	Rank	Grade
ABN AMRO	1.	A	3.	B+	3.	B-	1.	B+
Commerzbank	8.	C	8.	C-	8.	D-	8.	C-
DEG	2.	A-	2.	A-	2.	B-	2.	B+
Dresdner Bank	7.	C	5.	C+	6.	C	6.	C+
HVB	3.	B+	1.	A-	5.	C+	3.	B+
KfW	5.	C+	6.	C+	1.	B	5.	C+
UBS	4.	B-	4.	B-	4.	C+	4.	B-
WestLB	6.	C+	7.	C	7.	C-	7.	C

The three banks which declined to participate in the study have not been evaluated. In the cases of IKB and NORD/LB, information available publicly did not provide any references to relevant environmental and social standards and related processes. Deutsche Bank provides basic information about its sustainability reporting, but beyond general statements relating to this subject the documents do not contain any binding standards or details concerning internal structures and processes with regard to the financing of forestry-related projects.

Finally, an attempt was made in a separate review to gauge the environmental and social dimensions of the financing portfolios of the banks under examination. Due to the lack of communication of relevant information by the banks on the grounds of protecting confidential customer information, the review was restricted to specific financing projects which had been criticised publicly by NGOs because of their particularly negative impact on forests worthy of protection. This necessarily incomplete examination can therefore at best serve as an indication of a lack of stringency in applying standards.

All of the eleven banks examined in the study were financially involved in the paper, wood pulp and/or palm oil industries in Indonesia in the 1990s and were subject to massive criticism by NGOs. Some of the banks then sharpened up their risk management in this area and committed themselves to stricter environmental and social standards. Nonetheless, right up to the present there have from time to time been individual projects financed by the banks (in particular pipeline projects) which, according to NGOs, have caused unacceptable damage to forests worthy of protection. This has in part been due to inadequate de facto standards, but some of the projects were the outcome of processes seeking a balance e.g. between environmental and developmental goals and complied with World Bank standards.

It is not yet possible to make a definitive judgement on whether the risk to banks' reputations, which has increased as a result of public pressure, will bring about a fundamental rethinking in the management of risks relating to financing activities. Binding initiatives like the policies developed in collaboration with NGOs by ABN AMRO or the agreement on the Equator Principles are steps in this direction. Based on the environmental and social parameters of the projects and activities which they finance in the years to come, the banks will have to allow themselves to be measured against these voluntary commitments.