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DEVELOPMENT OF SUSTAINABILITY AND GREEN BANKING REGULATIONS
EXISTING CODES AND PRACTICES

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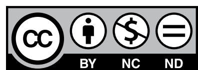

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ACRONYMS

BCB	Central Bank of Brazil
CBN	Central Bank of Nigeria
CBRC	China Banking Regulatory Commission
E&S	environmental and social
ERM	Environmental Risk Management
ESG	environmental, social and governance
FEBRABAN	Federação Brasileira de Bancos
FMO	Dutch Development Bank
FSB	Financial Stability Board
ICAAP	internal capital adequacy assessment process
IFC	International Finance Corporation
IPCC	Intergovernmental Panel on Climate Change
MBA	Mongolian Banking Association
MEP	Ministry of Environmental Protection
NSBP	Nigerian Sustainable Banking Principles
OJK	Otoritas Jasa Keuangan
PBoC	People's Bank of China
SELP	Socio-Environmental Liability Policy
UNEP	United Nations Environment Programme

EXECUTIVE SUMMARY

Recently, there has been a growing interest in the development of sustainable and green financial regulations globally. The interest is based on the increasing climate change risks for the financial sector on the one hand and on the other, a need to integrate the financial sector into a transition to a green economy. A regulative approach would be a significant departure from banks' approach to rely on purely voluntary codes of conduct as it concerns the integration of sustainability issues into their business. Interestingly, most of these regulatory approaches exist in developing and emerging countries such as China, Brazil, Bangladesh and Nigeria. The main drivers for regulatory approaches are internal pressure, such as social pressure and environmental pollution, external pressure from financial (aid) institutions such as the Dutch Development Bank (FMO) and the International Finance Corporation (IFC); and pressure from regional neighbours. If a transition to a green and sustainable industry should become a serious endeavour, one of the most influential sectors, the financial industry, cannot be neglected. Instead, the integration of sustainability aspects into financial regulations, domestically and internationally, could be a strong driver for achieving a transition to a sustainable economy in both developed and developing countries. Financial capital is one of the main drivers of all economies and consequently it should be connected with sustainability achievements. Industrialized countries can learn from emerging countries that have conducted this step successfully. However, more research is needed to explore why emerging countries follow a regulative approach, what the effects of the financial sustainability regulations are on the industry and sustainable development in the respective countries and what the barriers and opportunities are for implementing sustainable financial regulations in industrialized countries.

BACKGROUND

Recently, the Governor of the Bank of England, Mark Carney, asked the financial sector to examine their financial risks rising from stranded assets in the oil and coal sector. That call followed a request by the Bank of England to analyze climate change-related risks for the insurance sector in particular, with regard to their risk profile, and was a response to the findings of the Intergovernmental Panel on Climate Change (IPCC) that stated only a small part of the remaining fossil fuel reserves can be burned in order to mitigate climate change (Field et al. 2014). This is a rare example of central banks' and other financial regulators' intervention in assessing financial risks caused by environmental or sustainability issues.

Before this call, sustainability was on the fringes of corporate decision making in the financial sector. Although the financial sector managed environmental risks in the credit business (Weber, Fenchel and Scholz 2008) and offered some niche products, such as socially responsible investment funds, banks and other financial institutions did not follow a broader sustainability strategy (Weber 2014). Generally, banks were not forthcoming on the integration of environmental and social (E&S) risk considerations into their business and their relationship with clients. To a certain degree, because of the events of the last decade, especially the global financial economic crisis in 2007-2008, the need to integrate sustainability practices into the financial sector's internal processes has become increasingly salient, as has the recognition that the financial sector's business relationships are exposed to E&S risks. However, financial, environmental and social sustainability of the financial sector is still mostly seen as separated. Consequently, the connection between the financial sector and sustainable development — especially the indirect impact of the industry on society and the environment — is often neglected (ibid.). Nevertheless, E&S issues are becoming so important for financial institutions that clients and other stakeholders are subjected to non-financial risk evaluations more than ever before. This development has seen more financial institutions, especially banks, joining in the sustainable development drive while adopting processes, such as sustainability reporting, and complying with best practice standards and codes, such as the Equator Principles (Weber and Acheta 2014).

The growing adoption of sustainability practices in banks should be connected with the strategic roles financial institutions play in the economy of a nation and their capacity to foster sustainable development through their own activities, instead of being focused on niche products and internal environmental activities reducing direct impacts. M. H. A. Jeucken and J. J. Bouma (1999) were explicit in expatiating on this when they posited that banks, as important intermediaries, hold a unique and central position with respect to sustainable development. According to them, this intermediary role is both "quantitative and qualitative," which duly equip banks "to weigh risks and attach a price to these risks," thereby allowing banks to utilize such "price differentiation" to "foster sustainability." This highlights the banks' capacity to enhance the implementation and integration of E&S values in the contemporary business environment and consequently support a transition to a greener economy.

Meanwhile, the global environment since the financial crisis has demonstrated that the financial sector has a significant impact on the economy and society, and that an increasing number of financial products do not serve the real economy. It should have been expected that stakeholders would put pressure on the financial sector to support sustainable societies and businesses (Dore 2008; Korslund 2013). The reason for this is simple; individuals and organizations require finance to grow and succeed.

This places significant responsibility on banks to influence corporate environmental discipline through financial policies and guidelines that are beneficial to environmental issues, sustainable development and resources (Chang, Peng and Wang 2008). However, it seems that stakeholder pressure is not strong enough to have a significant impact on the financial sector, and that financial regulators hesitate to integrate sustainability into their financial regulations.

E&S GOVERNANCE IN BANKS

Banks have not shown a big interest in proactive strategies with regard to the environment and sustainability because they consider themselves to be in a more environmentally friendly industry, especially concerning emissions and pollution, when compared to the other sectors such as oil and gas and energy. Put in perspective, banks would rather work in concert with the regulatory provisions of a particular industry or country. Where there is weak resolve with regards to E&S issues, most banks do not feel obligated to go beyond the legal requirements, but assume that regulation should happen "at the source" of negative environmental and societal impacts. In some cases, however, banks have adopted voluntary principles and codes of conduct, such as the Equator Principles for project finance to manage E&S risks in their businesses (Weber and Acheta 2014). Key performance indicators of banks, however, are not traditionally designed to monitor environmental, social and governance (ESG) issues connected with financial products and services, but rather the economic performance and the financial risks without concern for the cost to the environment. As noted by A. Kern (2014, 7), "the regulatory framework that governs today's banking system is not being used to its full capacity; with some notable exceptions, systemic environmental risks appear to be in the collective blind spot of bank supervisors." Thus, Kern recommends an integration of environmental and sustainability criteria into banking regulations.

Perhaps due to the lack of respective regulations and despite potential exposure to risk, financial institutions were slow to examine the environmental performance of their clients based on the reasoning that such examination would imply "interference" with a client's activities (Richardson 2002). Events in recent years, however, demonstrate a reversal in this trend (Weber 2012). The last financial crisis from 2008 to 2011 revealed the importance of sustainability to the financial sector, as the crisis was linked in part to banks that lacked lending and investment discipline and did not integrate societal problems such as the over-indebtedness of homeowners that was bundled into asset-backed securities products. This, coupled with banks investing in industries linked to climate change and environmental degradation, has also come under criticism, especially from environmental groups and other stakeholders. "These combined forces have led to an emphasis on increased regulation of the banking and financial sector by state and international actors, and an emphasis on recuperation of trust by banks" (Stephens and Skinner 2013, 175-76). Therefore, a recent United Nations Environment Programme (UNEP) inquiry[1] has asked for a solution for the "tragedy of the horizon" (Zadek and Robins 2015, IV) by addressing and overcoming the short-termism of the financial sector and taking into account a longer-term sustainability view.

The consideration of E&S risks in banking is a relatively new approach. An example of this is the UNEP inquiry, which focuses on how the financial industry can play a major role in mainstreaming the relationship between the ESG issues within its framework. According to E. Grigoryeva et al. (2007), a number of voluntary initiatives focusing on the financial sector and the environment, such as the United Nations Principles for Responsible Investing or the Equator Principles, have evolved. These codes of conduct have become increasingly relevant for analyzing the risks inherent in the lending process through E&S responsibility of organizations or projects. Consequently, they have the potential to act as a guide for business decision making for banks.

Despite the growing influence of ESG in banks, there is a long way to go as standardization and ensuring legislation are still required, and these practices remain largely industry driven. Therefore, as J. Stampe (2014, 12) notes, it is a challenge to "ensure global long-term financial stability and economic development, the banking sector needs to significantly change its attitudes and actions to promote more responsible and sustainable business practices." This sentiment for a sustainable financial sector was recently echoed at the 2015 World Economic Forum and by the UNEP inquiry for a sustainable financial sector (Zadek and Robins 2015). While stressing that the banking sector has a responsibility to deliver strong investment returns to its shareholders, the sector must also ensure that the way it does business and who it conducts business with positively affects the communities and the natural environment in which it operates.

The connection between the financial sector and sustainable development is what embedding sustainability into financial system aims to achieve. As Stampe (2014, 12) notes, "ESG challenges have profound implications for businesses, the economy and society at large, representing both risks and opportunities that must be addressed if long-term economic and social growth and stability are to

1 The Inquiry into the Design of a Sustainable Financial System has been initiated by the UNEP to advance policy options to improve the financial system's effectiveness in mobilizing capital toward a green and inclusive economy — in other words, sustainable development. Established in January 2014, it will publish its final report toward the end of 2015.

be maintained. These have particular relevance to banks in relation to their role as financial intermediaries and as capital raising agents."

Consequently, integrating sustainability strategies into the financial sector is not only important for managing risks and opportunities inside the sector, but also from an inside-out view, taking the impact of the sector on other industries as provider of financial capital into account.

ESG INTEGRATION — WHY BANKS?

Having addressed the issue of ESG in banks and its importance, it is worthy to note the reason why this is critical to the twenty-first century system of banking. According to S. Zadek and N. Robins (2015), about 45 percent of all banks in the 39 countries monitored by the Financial Stability Board (FSB) hold the largest share of the financial sector's assets, a staggering US$139 trillion. This singular revelation shows the key position banks hold in our financial system, although it can be different in some countries because of financial regulations that restrict the business of banks. Stemming from this reality, the banking sector has always been highly regulated for monetary and market-related purposes. However, the demands of modern banking, the inherent risk of banking business with regards to E&S issues, the reality of our present age concerning environmental pollution and climate change, and the rising expectations of diverse stakeholder and pressure groups have expanded these expectations with regards to environmental responsibility and regulation.

This scenario was partly what encouraged early adopters of ESG, in particular in the developed economies of the world. Because of different motivations, including external stakeholder pressure, banks adopted voluntary codes of conduct with regard to the environment and sustainability, although the industry was late compared to other, mainly polluting, industries (Weber, Diaz and Schwegler 2014). Standards and codes of conduct promote corporate accountability, transparency and consideration of impacts on the environment and society.

Despite these efforts, there are two missing links — first, the constitution of sector-wide policies to ensure standardized practices with regard to the environment and society. Most of the current voluntary codes of conduct do not have any enforcement or accountability mechanisms. Consequently, signatories of financial sector codes of conduct do not have to fear any other consequences than reputational issues from not following their own guidelines. The second missing link is the inertia of developing economies to this process. Particularly in emerging and developing countries, regulators show an increasing interest in sustainability issues in the financial sector, which is leading to the development of various regulatory-driven green banking principles across the world.

This growing interest is creating a new standard and sustainability structure, which is novel to the banking industry and to sustainable finance practices globally. The reason for this development can be asserted from B. J. Richardson's (2002, 55) postulation that "the rise of sustainability concepts in environmental policy has added to the sense of urgency in regulatory reform such that institutional and policy reforms to support sustainable development are considered." As Zadek and Robins (2015, 7) note, "A growing number of developing country regulators and central banks are supplementing this dynamic system with their own guidelines and requirements to ensure that core banking functions such as credit approval are aligned with their country's social and environmental priorities so that financial risks and negative environmental externalities are reduced."

THE RISE OF SUSTAINABLE FINANCE REGULATIONS

Two important questions are why financial regulators may be interested in environmental performance of the business and whether there is a need for regulators to include sustainability into their guidelines. S. Zadek and Z. Chenghui (2014, 2) believe the last financial crisis played a key role in this. They state, "the global financial crisis has highlighted the weaknesses in the financial system that favours capital allocation, increasing both specific and systemic risks. Policy interventions into the workings of financial markets to reduce systemic risks, have focused on addressing short-term biases, misaligned incentives and better stewardship of assets, as well as improved transparency, governance and accountability."

The integration of sustainability issues into financial regulations is already happening in developing and emerging countries but not in industrialized countries, even though industrialized countries were more strongly connected with both the origins and the effects of the financial crisis. Emerging markets are taking the lead in regulating sustainable banking practices, focusing on the impact of the financial sector on sustainable development. In Western industrialized countries, such as those in the European Union, the term "sustainable financial sector" is used to describe the financial sustainability, or the financial health, of the financial sector (see, for instance, European Commission 2011).

The implementation of financial sustainability regulations leads to another question: why are the emerging economies taking the lead in the development of this process? In addressing this, it should be noted that the establishment of environmental and sustainable development practices started as voluntary efforts among individual banks, and sometimes a combination of two or more banks, to form standards, codes or development strategies for internal processes to help introduce, strengthen and

integrate sustainability issues and processes within their business functions and activities (for example, the Equator Principles). However, as discussed earlier, this was not popular in the emerging economies, mainly because of two reasons: awareness and capacity.

J. G. Speth and P. M. Haas (2007) argue that countries vary in their ability to formulate and enforce environmental policies. They assert that developed countries are generally induced to comply with international environmental treaty obligations through features in treaties and by the potential of adverse publicity. This may not be the same for developing countries, as the conditionalities are often different since many of these countries do not have respective regulations in place or are not able to enforce them adequately.

Zadek and Chenghui (2014), however, suggest that the influencing factors are more than just a propensity to comply with policies. They argue that in the absence of clear environmental standards for different industries, the financial sector could play a central role in supporting high-sustainability performance and in penalizing low performance of their clients. A financial regulatory approach is useful for establishing sustainable banking practices in emerging markets, not only because it creates a level playing field for all players, but it also helps collaboration and capacity development; the lack of both has been a hindering factor in enabling banks in these countries to adopt systems that effectively manage E&S risks and opportunities (Poser 2014). This is partly due to a lack of information, human capacity, knowledge dearth and sometimes existing business climates and regulations.

The need to bridge the gap between the current state of the financial sector and a more sustainable one has led to the support and influence of international multilateral organizations and development finance institutions in the establishment and integration of sustainability in the emerging markets, which is a key factor for the development of this process in developing countries. Banks in these countries rely on capital from development finance institutions. In turn, these institutions strive to ensure that the capital is used in a sustainable way, with a positive impact on society and the environment. Therefore, financial sustainability regulations support capital flows to developing-country banks.

External financial capital, however, is not the only reason for developing countries to implement financial sector regulations. Negative environmental impacts of core industries or social development issues are other motivators. Therefore, the following section will present the current regulations for a sustainable financial sector.

COUNTRIES WITH SUSTAINABLE FINANCE REGULATIONS

It should be noted that the implementation of sustainable financial sector regulations is a fast-evolving area of study, hence the list continues to change by the day. For example, Mongolia launched its sustainable finance policy in December 2014. As more countries adopt similar regulations, the list will keep expanding. Also notable is the fact that some countries are in the process of establishing individual standards and protocols that could be completed before the end of 2015. The seven countries this paper focuses on are Bangladesh, Brazil, China, Colombia, Indonesia, Mongolia and Nigeria.

Some countries do not have sustainability or green policies in particular for the banking sector, yet they have an overarching policy that covers several industries in which the financial sector is also covered. It should be noted that there are other countries in the process of developing their own banking regulatory policies, while others have policies that cut across sectors and are in part related to the banking sector with expectations for compliance and implementation. Examples of these are Kenya, India, Turkey, the United Kingdom and South Africa. Others with established "work-in-progress" in financial sector regulation are Thailand, Laos, Vietnam, Peru and Nepal.

One other interesting finding of this research is that although there are similarities in structure (for example, Nigeria and Mongolia; Brazil and Colombia), each policy is unique for the contextual reality of respective countries plays a significant role in the development and adoption of the regulations. As stated above, this paper focuses on countries with fully established banking sustainability frameworks. The spread of these countries and some basic data about the regulations are presented in Table 1.

Table 1: Countries with Established Sustainable Banking Frameworks

Country	Name of Policy	Year(s) of Launch	Sector Specific (If Applicable)	Codes (Voluntary or Involuntary)
Bangladesh	Environmental Risk Management (ERM) Guideline	2011	No	Voluntary
Brazil	Protocol Verde Socio-Environmental Liability Policy	2009, 2012	Yes - Amazon Resolution - Sugar Cane Resolution - Slave Labour Resolution - Internal Capital Adequacy Assessment Process (ICAAP)	Voluntary (Green Protocol) Mandatory
Colombia	Green Protocol (Protocolo Verde)	2012	No	Voluntary
China	Green Credit Guidelines	2007, 2012, 2014	Yes	Mandatory
Indonesia	Roadmap for Sustainable Finance in Indonesia	2014	No	Mandatory
Mongolia	Mongolian Sustainable Finance Principles and Sector Guidelines	2014	Yes - Agriculture Sector Guideline - Construction and Infrastructure Sector Guideline - Manufacturing Sector Guideline - Mining Sector Guideline	Mandatory
Nigeria	The Nigerian Sustainable Banking Principles	2012	Yes - Power - Agriculture - Oil and Gas	Mandatory

Source: Authors' analysis.

Below is a brief analysis of the structure and approach of the respective green banking policies and guidelines in each of the seven countries listed in Table 1.

Bangladesh

The Bangladesh E&S guideline for banks is called ERM Guidelines (Weber, Hoque and Islam 2015). The policy was formulated and launched in 2011 by the Bangladesh Bank, the country's central bank, with the support of its local banks and other international and local stakeholders.

The ERM guideline is mandatory for Bangladeshi banks. The guideline also mandates banks to train their staff and raise their awareness on E&S issues, formulate their own E&S risk management framework, introduce sector-specific policies and start reporting on E&S issues.

The policy includes the classification of investments into high-, medium- and low-risk categories and division into sector-specific aspects to complement the general due-diligence guidelines. It also focuses on strengthening the banks' ability to evaluate environmental risks as part of lending and investment activities (Islam and Das 2013).

The guidelines were established as a minimum standard on what banks and other financial institutions should be having in terms of ERM. The main goals are to protect the banks' financing from the risks of a deteriorating environment and ensure sustainable banking practices (Bangladesh Bank 2011). In addition, it aims to ensure a level playing field is maintained in the financial sector in Bangladesh. The policy was also clear that banks and other financial institutions can go beyond the guidelines.

Brazil

The Green Protocols, popularly known as Protocol Verde, were developed for public and private banks in Brazil. It is a set of voluntary guidelines developed by the Brazilian banking association, Federação Brasileira de Bancos (FEBRABAN), in alliance with the country's Ministry of Environment and public banks. The Protocol Verde was first released in 2008 when guidelines were issued for public banks while private banks signed the protocol in 2009 (FEBRABAN 2012).

Among other objectives, the protocol aims to improve cooperation between financial institutions on sustainable development in Brazil. Commitments made under the protocol include the provision of financial credit lines and programs: to promote the population's quality of life and sustainable use of the environment; to consider the impacts and environmental costs in managing assets and projects; to promote conscious consumption of natural resources and materials derived from internal processes; to inform, sensitize and continuously engage interested associates into policy and sustainable practice; and to

promote cooperation and integration of efforts among the signatories to the protocol (ibid.).

However, in 2014, the Central Bank of Brazil (Banco Central do Brasil [BCB]) issued a resolution on E&S risk management for banks. This complements various circulars and regulations on sustainable banking that were published before then, especially between 2008 and 2011. The resolution addresses key E&S issues such as Amazon resolution, sugar cane resolution, slave labour resolution and ICAAP with the goal of making the financial sector more sustainable (Pimentel 2012).

This resolution, known as Resolution No. 4,327, decrees financial institutions authorized to operate by the BCB to draft and execute a Socio-Environmental Liability Policy (SELP). The goal is to establish an integrated view of economic, social and environmental issues in financial institutions and to establish an environmental and social policy to support a sustainable development in Brazil. SELP includes systems, routines and procedures for classifying, evaluating, monitoring, mitigating and controlling the socio-environmental risk of banks' activities and operations. Under this policy, financial institutions will also have to conduct a preliminary evaluation of the potential socio-environmental impacts of new types of products and services (Stampe 2014).

China

Because of significant negative environmental impacts of Chinese industries, China started a green finance program that introduced guidelines and regulations for integrating environmental issues into financial decision making (Bai, Faure and Liu 2013) that has achieved international recognition (Zadek and Robins 2015). In contrast to earlier programs such as the Comprehensive Environmental Response, Compensation and Liability Act in the United States and in environmental regulations in Europe, the Chinese initiative focuses on banks and other lenders directly.

One of the programs is the green credit policy, started in 2006 and overseen by three agencies, the Ministry of Environmental Protection (MEP), the People's Bank of China (PBoC) and the China Banking Regulatory Commission (CBRC) (Aizawa and Chaofei 2010). Part of the program is that banks should restrict loans to heavily polluting industries and offer different interest rates depending on the environmental performance of the lenders' sector (Zhao and Xu 2012). The program allows for loans already provided to be withdrawn if an environmental accident or instances of non-compliance occur (Jin and Mengqi 2011). China's green credit policy was introduced in 2007 and was jointly formulated by the MEP, CBRC and PBoC in July 2007. A consequence of the program is that, since 2007, Chinese banks have been introducing environmental policies (Chan-Fishel 2007). Whether the program has been implemented successfully and can contribute to environmental improvements as well as to a low-carbon economy, however, is the subject of debate (Jiguang and Zhiqun 2011; Zhang, Yang and Bi 2011). Consequently, the CBRC issued green credit guidelines in 2012 (Zhao and Xu 2012).

The goal of the policy is to ensure that Chinese banks direct loans away from highly polluting and high energy-consuming enterprises and projects and toward enterprises favouring energy efficiency and emission-reduction projects.

The policy was the basis for the formulation of sustainable banking in China and acted as the foundation for the 2012 CBRC green credit guidelines. The 2012 guidelines applied to policy banks, commercial banks, rural cooperative banks and rural credit unions established within China. These guidelines were improved in 2014 with the establishment of a monitoring and evaluating system for green credit within the Chinese financial system.

As stated in the CBRC policy document, the guidelines were developed based on the Banking Industry Regulation and Administration Law of the People's Republic of China and Commercial Banking Law of the People's Republic of China. Their goal is to promote green credit growth among financial institutions.

Since 2007, Chinese banks are expected to assess environmental risks in loan applications and integrate environmental considerations into bank investment choices. To enable banks to implement systems to assess these risks, the green credit guidelines were launched in 2012. The guidelines specify how banks should integrate sustainability into their lending practices, both in domestic and overseas financing. As a final step, the Green Credit Guidelines Statistical System was implemented in 2014, requiring Chinese banking institutions to report loan balances in 12 green sectors based on international sustainability standards, including sustainable forestry, sustainable agriculture and overseas lending.

Colombia

Colombia also introduced a Green Protocol (Protocolo Verde), which is similar to the Brazilian Green Protocol. The Colombian Protocol Verde is a set of voluntary guidelines developed by the Colombian banking association Asobancaria (Poser 2014). The association is the representative body of the Colombian financial sector and its membership consists of domestic and foreign commercial public and private banks and other financial corporations. The Central Bank of Colombia holds an honorary membership of the association.

The protocol provides a voluntary framework for sustainable finance in Colombia and it was developed and adopted by Colombia's major commercial banks in

2012. The signing of this voluntary agreement between the Colombian government and the financial sector was aimed at generating environmental benefits for Colombian society. Similar to the Brazilian Protocol, it includes different strategies and guidelines for banks to offer credit lines and investments that will contribute to quality of life and sustainable use of renewable natural resources (Nolet et al. 2014).

The protocol also considers the impact and environmental costs in asset management, risk analysis and project financing. It aims to connect efforts of the Colombian government with regard to sustainable development with business practices of the financial sector in particular with regard to the development of products and services for financing activities and projects with social and environmental benefits. In addition, the Colombian financial sector plans to develop ways to offer attractive financing for projects in fields such as renewable energy, eco-tourism and carbon finance (Piza, Arévalo and Jacob 2012).

Indonesia

The Financial Services Authority of Indonesia, otherwise called Otoritas Jasa Keuangan (OJK), is the Indonesian government agency that regulates and supervises the country's financial services sector. In 2014, OJK unveiled a new regulation, which stipulated the medium- and long-term road map for the country's financial sector with regards to sustainable finance until the end of 2014. The policy, the *Roadmap for Sustainable Finance in Indonesia 2015–2019*, sets forth a detailed work plan for banking, capital market and non-banking sectors with the end goal of sustainable finance in Indonesia (OJK 2014).

According to the Indonesian road map policy document:

> "The development orientation to increase durability and competitiveness is based on the premise that sustainable finance is a challenge and a new opportunity that Financial Services Institutions can benefit from to grow and develop more stably. Furthermore, to achieve this through systematic stages, OJK in cooperation with relevant institutions have developed a Sustainable Finance Roadmap. This roadmap sets forth the end goal of sustainable finance in Indonesia to be achieved in the medium term (2015–2019) and long term (2015–2024) by the financial services industry under the supervision of OJK and determines and prepares the benchmark for improvements in sustainable finance." (OJK 2014, 4)

The end goal of sustainable finance is split into medium- and long-term targets. Medium-term targets centre on the basic regulatory framework and reporting system. Long-term goals focus on integrated risk management, corporate governance, bank rating and an integrated sustainable finance information system (OJK 2014).

Mongolia

In December 2014, Mongolia established the Mongolian Sustainable Finance Principles and Sector Guidelines, which provide a framework to help local banks integrate E&S considerations into lending decisions and product design. The policy is the outcome of months of collaboration and engagement between the main players in the Mongolian banking industry, led by the Mongolian Banking Association (MBA), the Ministry of Environment, Green Development and Tourism, the Bank of Mongolia and other stakeholders and development finance institutions. The policy consists of sector guidelines and sustainable finance principles called the Mongolian Sustainable Finance Principles (MBA 2014). The sector guidelines are made up of the agriculture sector guideline, the construction and infrastructure sector guideline, manufacturing sector guideline and the mining sector guideline.

The banking principles and sector guidelines effectively took effect on January 1, 2015 based on eight principles (MBA 2014, 4):

- protect the natural environment;
- protect people and communities;
- protect cultural heritage;
- promote "green economy" growth;
- promote financial inclusion;
- promote ethical finance and corporate governance;
- promote transparency and accountability; and
- practice what we preach.

The principles are complemented by a list of items prohibited to be financed.

Nigeria

The Nigerian Sustainable Banking Principles (NSBP) was approved and launched by the country's bankers committee in July 2012. The bankers committee consists of the Central Bank of Nigeria (CBN), commercial banks, discount houses and development finance institutions in the country. The NSBP was released as a banking circular and in effect was made mandatory and became a regulation on September 2012 with a three-year full compliance and implementation process.

According to the CBN news release "the adoption of the principles is in furtherance of the Committee's commitment to deliver positive development impacts to the society while protecting the communities and environment in which financial institutions and their clients operate" (CBN 2012, 7). The policy is made of the NSBP, the NSBP guidance notes and three overarching principles for the three main sectors of the Nigerian economy — power, agriculture and oil and gas.

The following policy documents were released as mandatory for the implementation of the NSBP in the country:

- the Nigerian sustainable banking principles;
- the Nigerian sustainable banking principles power sector guidelines;
- the Nigerian sustainable banking principles agriculture sector guidelines; and
- the Nigerian sustainable banking principles oil and gas sector guidelines.

Overall, the NSBP consists of nine principles that cover E&S risk management, E&S footprint, human rights, women's economic empowerment, financial inclusion, E&S governance, capacity building, collaborative partnerships and reporting.

The CBN mandates full adoption and implementation of these principles and guidelines by the financial institutions and promises to provide incentives for compliance (CBN 2012). It also requires a quarterly report of progress from all banks with the expectation that all banks in Nigeria would have fully implemented and integrated the principles by December 2015.

REGULATORS' IMPACT AND IMPLICATIONS FOR GLOBAL SUSTAINABLE FINANCE

The information above raises the interesting question of why sustainable financial sector regulations can be found mainly in developing and emerging countries. The composition and spread also raises an issue as obviously the largest economies in Africa, Asia and Latin America are represented on the list. This is coupled with the inclusion of countries such as Indonesia, which is part of the Group of Twenty, and Colombia, Bangladesh and Mongolia, all of which have thriving economies.

As shown in Table 1, there are a growing number of countries from developing economies that are adopting a process that enables the establishment of a sustainable banking system backed by regulatory frameworks and standards. The interesting angle is that while the emerging market economies are developing self-driven, self-regulated, collaborative and country-specific sustainable banking systems, the same cannot be said of the more advanced economies. Despite being the progenitors of this process, advanced economies are still largely applying a voluntary non-compliant mode of sustainable banking management, the effectiveness of which is often doubted and requires further research (Macve and Chen 2010; O'Sullivan and O'Dwyer 2009; Wright and Rwabizambuga 2006) .

Last year, the European Commission released its non-financial reporting regulation results covering the top 6,000 companies, including the financial sector. In addition to the EU activities, European countries such as Turkey, France, Denmark and the United Kingdom have developed, or are in the process of developing, sustainability, social responsibility or environmental policies for diverse sectors including the financial industry. However, how much effect these would have, and are having, on the E&S risk management and lending decisions of the banks is unknown. It cannot be denied that emerging-countries leadership in "green credit" regulations points to a new phase in international banking standards (Zadek and Robins 2015).

DRIVERS OF THE SUSTAINABLE BANK POLICY

What is driving the integration of sustainability in financial regulations of emerging markets? As highlighted above, the driving interest for adopting these measures varies. As observed by Stampe (2014); the business case for integrating ESG is driven by a number of factors. First is its capacity to help in managing risks and to capitalize on opportunities. Stampe's report notes that these factors were the main drivers for the integration of sustainable banking and E&S practices in the banking sector as they tended to strengthen banks' capacity to rely on long-term benefits rather than focus on short to medium-term gains. Weber (2005) is more explicit regarding this, arguing that the conventional financial sector takes sustainability considerations into account because it is a business case, because regulators prescribe it, because of personal attitudes of leaders or because of the demand of clients. Bearing this in mind, it can be safely said that it was the contribution of all these factors that motivated regulators to integrate sustainability issues into financial regulations.

However, while each of the highlighted factors was at play and led individual banks into adopting frameworks and internal policies, based on their personal convictions, the regulatory drive to embed, enforce and ensure widespread adoption of this has been laggard. Hence, the institutionalization of E&S practices especially in the banking sector has been self-driven. But why are regulators

involved in sustainable finance issues in the countries described above?

C. Poser (2014) notes that financial institutions in Brazil, Colombia and Peru considered the creation of new business opportunities as one of the most important drivers for integrating sustainability issues into financial regulations. In some countries, certain drivers were considered especially significant. For example, Poser's report notes that in Nigeria, access to funding from investors or international financing institutions was identified as most important. Financial capital injected by foreign financial institutions such as the FMO, the IFC or other organizations are the main sources of finance for Nigerian banks. External financial institutions, however, have implemented sustainability guidelines and want to make sure that their investments are deployed according to certain sustainability principles. Consequently, Nigerian banks tried to establish processes and guidelines that meet these criteria.

In Bangladesh, in addition to the impact of the IFC, the relative absence of environmental regulations for polluting industries and their enforcement was a reason to focus on the financial sector as an "environmental regulator," and to create incentives to support environmental-friendly practices. The situation was similar in China, where environmental pollution has a significant impact on the environment and health. Consequently, financial mechanisms were applied to support non-polluting industries and penalize polluting industries.

Thus, based on this analysis, the following drivers help to explain integrating sustainability aspects into financial regulations that overlap in some countries:

- **Internal pressure, such as social pressure and environmental pollution (China, Brazil and Bangladesh):** Often, environmental issues are more significant in emerging economies, increasing the scope and urgency for identifying policy solutions that would seem unorthodox in a developed country context. This suggests that policy makers in emerging economies have a different view toward the financial sector than developed countries. Specifically, developed countries may view the financial sector as an intermediary in determining efficient allocations of capital, whereas developing countries may view the sector as a source of governance that justifies a more activist-policy approach with regard to sustainable development.

- **External pressure from financial (aid) institutions such as the FMO and the IFC (Nigeria, Bangladesh, Mongolia and Indonesia):** No such pressure exists for developed economies, which already have established robust environmental regulatory systems. In the future, pressure may come from international organizations such as UNEP or international financial authorities such as the Basel Committee on Banking Supervision

- **Peer pressure from regional neighbours (Colombia and Peru):** Since Brazil, the most powerful economy in South America, has adopted sustainable finance regulations, other neighbouring countries may feel pressure or see the opportunity to go a similar route. This may support economic relations with the neighbouring country that has implemented guidelines, as well as foster a more sustainable financial industry.

CONCLUSIONS

The discussion about the development of sustainability and green banking regulations is an ongoing and evolving process that can help chart a new course for sustainable banking and finance in the coming years. As more countries adopt sustainable finance regulations, there is an opportunity to explore why such approaches may be successful and whether they should be implemented in industrialized countries as well. Hence, what would be a research agenda that addresses the question of whether industrialized countries should follow those that have implemented sustainable finance regulations?

Kern (2014) states the need for financial policy and regulation to be both aligned with environmental policy and regulation and coordinated so that the objectives and understanding of each area of expertise can be shared between the relevant agencies. This need cannot be denied, but questions remain regarding why financial and environmental policies are not aligned in industrialized countries and whether they should be aligned.

An argument against integrating sustainability into financial regulations is that as long as good E&S regulations are in place and banks follow the law and regulations, there is no need for integration of these issues in financial regulations. This, however, may be correct for basic E&S issues such as environmental pollution. Even for one of the most pressing issues of our time, greenhouse gas emissions, regulations are either weak or not established in many countries. Climate change, in turn, may create large risks for both society and the financial sector. Therefore, developing regulations for financiers with respect to assessing and managing their client's carbon dioxide emissions would make sense environmentally and financially.

These regulations would accept the role of the financial sector as a central sector with significant, if not the highest, impact on other industries. Without regulations, the financial industry will not be willing or able to "police" their clients with respect to environmental and societal impacts. If clear guidelines existed, the financial

sector would be supported in putting pressure on clients to achieve high sustainability standards in order to receive attractive finance. The Chinese experience with regard to their green credit program (Aizawa and Chaofei 2010; Bai, Faure and Liu 2013), however, suggests that good implementation is key for successful regulations with regard to a more sustainable financial sector.

If the transition to a green and sustainable industry should become a serious endeavour, the financial industry cannot be neglected. Instead, the integration of sustainability aspects into financial regulations, domestically and internationally, could be a strong driver for achieving the transition to a sustainable economy in both developed and developing countries. Financial capital is still one of the main drivers of economies and consequently it should be connected with sustainability achievements. In this case, industrialized countries could learn from emerging countries that have conducted this step successfully. As stated above, however, more research is needed with regard to the effectiveness of both voluntary codes of conduct and sustainable financial sector regulation.

As a first step, the motivations to implement sustainable finance regulations should be analyzed. One such catalyst may be that environmental problems are more significant in developing countries than in developed countries, and therefore lead to more internal and external pressures to become active. A second hypothesis to explain the implementation of financial sector regulations could be that the financial sector is not as privileged in the eyes of emerging markets as their developed counterparts and does not enjoy the same autonomy as in many industrialized countries. A third hypothesis would be countries that have implemented sustainable finance regulations see the financial sector as central for influencing other industries to move to more sustainable business practices.

A second research step would be to analyze the effect of those regulations and of voluntary codes of conduct on the sustainability of the financial sectors. This step would mainly focus on changes in business practices of banks and other financial institutions. Although a number of codes of conduct are in place in the financial sector, it is still unclear whether they have an impact on the business practices of the industry. The research hypothesis to be tested would be that both regulations and voluntary codes of conduct influence financial sector business practices into a more sustainable direction.

The third step would be to examine the effect of the new financial sector business practices on the sustainability performance of the respective countries, followed by an analysis of opportunities and barriers, as well as benefits and drawbacks of implementing sustainable finance regulations in industrialized countries.

Generally, it seems that even after the financial crisis, and despite certain organizations, such as the UNEP Inquiry into the Design of a Sustainable Financial System, having asked for a change in the financial sector, the pressure on the sector is still relatively low. Some change has occurred with regard to increasing capital requirements for financial institutions (Basel Committee on Banking Supervision 2014) and some financial institutions have begun to take sustainability into account more seriously, but in general there has not been a great deal of change in the sector. Hence, it will be interesting whether additional significant change will be seen in the future.

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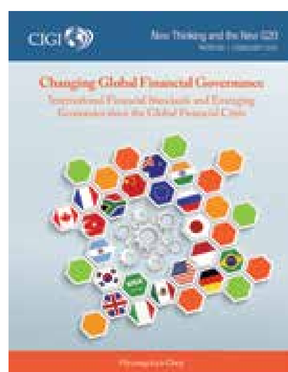

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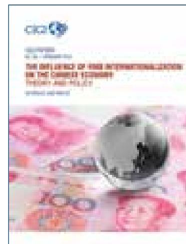

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