



BOMBAY CHAMBER

Bombay Chamber
of Commerce & Industry

SQ

raising the Sustainability Quotient



Editorial

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Vol.III No.1 Jan.-Mar. 2013

Responsible Financing

Responsibility of Environmental and Social Governance (ESG) is today no longer limited to the National Governments alone. This responsibility is shared by other important stakeholders that include community, markets and financing institutions (FI). Amongst these, FI have an important role to play.

By establishing ESG in their operations, FIs have influenced their partners and borrowers to practice sustainability. In some cases, ESG at FIs has even influenced the national governments. ESG at FIs consists of environmental and social policies on exclusions, risk assessment and management related procedures such as screening and due diligence. ESG tracks implementation of the environmental management plans, asks for public consultations as relevant and ensures adequate and timely compensation to those affected. In many cases, these requirements and the subsequent reporting go well beyond the laws of the land or national ESG. ESGs at some FIs have led to effective Corporate Environmental & Social Responsibility related programmes as well as novel initiatives such as "Green ATMs".

Development FIs (DFIs) such as the World Bank and Asian Development Bank (ADB)

apply their environmental and social safeguards while providing development assistance. Application of these safeguards has often resulted into higher development effectiveness.

More than 80 private sector FIs have signed up today for the Equator Principles (EPs). These banks, called as EPFIs, include HSBC, Standard Chartered, Deutsche Bank etc. EPs form the foundation of the ESG. For projects financed more than 10 million USD, the EPFIs have to follow commonly agreed principles and procedures that address sustainability. Such a practice has not only reduced the credit risks but has improved the financial, environmental and social returns of the investments made.

Many FIs have signed up initiatives such as UN Global Compact and UNEP Finance Initiative (UNEP FI). Under UN Global Compact alone, more than 12 trillion dollars of investments are under environmental and social scan. In some countries FIs have set up ESGs on a collective basis. Example is the ESG set up by British Bankers Association in the UK for its members. Even in a country like Bangladesh, Bangladesh Bankers Association has drafted a common ESG for implementation across its members.

In India, in the non-banking financing institution category, Infrastructure Leasing and Financial Services (IL&FS) has been the



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Published & Printed by :

Bombay Chamber
of Commerce and Industry
'The Ruby', 4th Floor, NW
29, Senapati Bapat Marg, Dadar (W)
Mumbai 400 028
Tel.: 61200200 Fax : 61200213
Email: bcci@bombaychamber.com

Subscription Cost :

Rs. 500/- per annum [hard copy]

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Bulletin do not necessarily reflect the views of
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leader and has been operating Environmental and Social Policy Framework (ESPF) since 1996. Today, ESGs are established and operated at other infrastructure financing institutions as well such as IDFC and IIFCL. DFIs such as World Bank and ADB have played an important role for such a "push". In the commercial banking sector, Yes Bank has taken a lead by signing up UNEP FI and has been first commercial Indian bank in India with interest in mainstreaming sustainability.

While there are around 28 international EPFIs operating in India, no Indian Bank has

yet signed for EP. Indian Bankers Association is silent on a common ESG. Indeed, ESG today is not a part of the DNA of Indian FIs.

In this issue of SQ, we are featuring knowledge articles and case studies on ESG at FIs underscoring the importance of sustainable investments. Sustainable investments are those that benefit the economy, community and the environment. We hope that Indian FIs move in this direction and align with the sustainability related practices at the leading FIs of the world.

- Prasad Modak

FEEDBACK

The current issue 'Raising the Sustainability Quotient' is excellent, since it covers the general information, specific industry experience and critique views in the same publication. It is a great idea to have critique section since it will help in opening dialogue for improvements.

The only requirement for constructive dialogue is that people need to understand the evolution and challenges of the subject (for example green buildings), before expressing their views. It is suggested that a blog is opened on Bombay chambers website under sustainability section, where people can interact once the issue is published and register their view/comments/ improvements etc. This will make the overall process more interactive and live.

On the issue on green buildings, in my opinion the important point is that green ratings should be looked in right perspective. Some building may be rated gold, but it doesn't mean it is inferior to platinum rated building. The reason for this could be that, there may be some

parameter which cannot be fulfilled due to constraints (Legal/space etc), which sometime results in lower ratings.

- Dnyanesh, CMC Ltd.

It is interesting to see the articles with focus on green rating. As of now we are able to achieve considerable success in spreading the message about the importance of Green buildings and the result is before eyes with explosive growth. Now the need of the hour is to ensure that these buildings are maintained consistently to achieve the green benefits without deviating from the initial designs. Hence, we need to promote the knowledge on maintenance of the green buildings.

It is suggested that one of the theme in the upcoming publication may focus on the topic "How to maintain the Green buildings in the long run to meet the intended requirements".

- P. Sreenivas Raju, ACC Ltd.

Great Compilation!

- Yogendra Saxena, TATA Power

Sustainability at Financial Institutions

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Introduction

We all know financial institutions hold a position of power and hence need to be responsible. At the same time, these institutions are exposed to several risks, many of which tie back to inherent environmental and social (E&S) risks. Management of such risks is crucial to any financial institution's assets and reputation. That is where Environmental and Social Governance, referred to as ESG, comes into the picture. ESG is a way to measure and regulate those impacts of investments that are not usually considered as direct financial impacts and generally encompass environmental, social and ethical considerations.

ESG policies, where optimally applied and followed, help mitigate the following risks:

Credit risks that include default in loan payment if unable to meet project schedule due to pending environmental approvals or outstanding social issues, fines and penalties, pollution cleanup costs or diminished value of collateral taken in the form of real estate.

Legal risks that can arise due to possession of contaminated sites/properties or pollution-causing assets as a result of loan default by borrowers.

Reputational risks that could arise because of involvement in projects that

are viewed as environmentally or socially damaging or because of inadequate checks to ensure that borrowers follow E&S regulations.

Although direct financial activities (eg. day-to-day functioning of a bank) themselves do cause some level of negative E&S impacts, the same are minimal as compared to the indirect impacts of a financial institution's activities. Therefore, the primary concern for sustainability at financial institutions includes all derived impacts that occur forward-facing in a financial institution's value chain - which are critical and difficult to measure.

Hence, sustainability at financial institutions can encompass two areas: (i) Management of E&S risks that are tied to the projects or investments in which a financial institution is involved (ii) Availability of environmentally and socially beneficial financial products such as Clean Energy Funds, Green Home loans or Microcredit, to name a few.

Evolution of the concept

E&S risk management has become a part of financial institutions in the recent past. Its emergence can be traced back to risk concerns raised in the United States in the 1980s when the Superfund Act (CERCLA - Comprehensive Environmental Response, Compensation, and Liability Act) was implemented. As per this Act, banks could be held responsible for the

environmental pollution caused by their customers and be liable to pay remediation costs if they were identified as a party responsible, in some way, of hazardous contamination of sites.

Financial institutions in the United States became the first ones to introduce environmental policies to address credit risks in late 1980s, followed by European institutions in mid 1990s. By late 1990s a significant number of financial institutions incorporated E&S risk management as a part of their credit risk assessment practices. The 1990s saw the introduction of the United Nations Environment Programme Finance Initiative - UNEP FI (1992), the Clean Development Mechanism (1997) and the Dow Jones Sustainability Index (1999). All these are means for financial institutions to integrate the concept of sustainability within their business functions. The concept of Triple Bottom Line was also introduced during this decade.

The first decade of the 21st century saw the launch of several principles, mechanisms and introduction of policies in the realm of ESG for financial institutions; some of which are: the Climate Disclosure Project, the Equator Principles (EP), United Nation's Principles for Responsible Investment (PRI), the Collevocchio Declaration and Global Reporting Initiative guidelines.

An overview of the global evolution is shown in Figure 1.

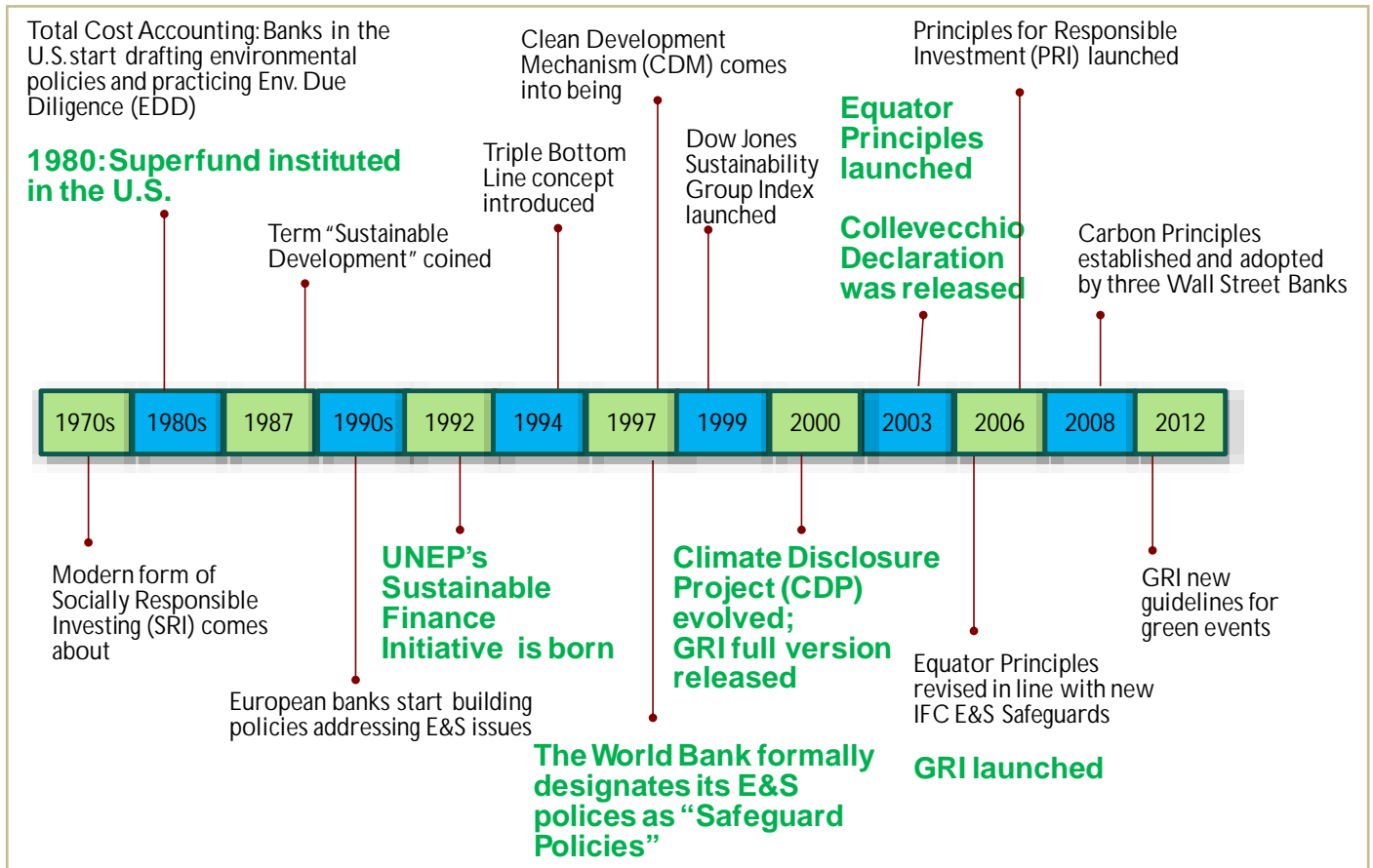


Figure 1: Evolution of ESG Concept

The Equator Principles (EP) are perhaps the most specific set of 10 principles, formulated by 10 commercial banks in 2003, that are focused on E&S risk analysis for Project Finance loans which are above \$10 million. The Principles are in a constant 'evolving state' and have recently got revised (in 2012) to formulate the EP III framework to now include applicability to project-related corporate loans, among other changes. The EP, refers to the IFC¹ Performance Standards, include a generic set of principles that serve as step-by-step guidelines for a project finance loan. In brief, EP financial institutions should ensure the following steps: (i) review and categorization of project, (ii) detailed environmental and social assessment, (iii) compliance with regulations, (iv)

follow-through of an E&S Action plan, (v) stakeholder engagement, (vi) grievance mechanism and (vii) independent review of assessment.

Although the EP can be touted as the best existing effort towards a standard set of guidelines for project finance loans, there are a couple of marked drawbacks to them. There is not yet a stringent monitoring system in place to keep a tab on how well the Principles are being followed by member institutions, as a large number of information is self-reported and transparency can become questionable. There is also a valid question of "Does one size fit all?", since E&S requirements, political and regulatory scenarios vary widely across regions all over the world. Such variations

tend to play a crucial role in determining the need and intensity of E&S risk management.

Indian Scenario

While comparing the evolution of sustainability at financial institutions in the Indian context, one can notice that banks have made progress in provision of services to disadvantaged sections of the society, rural areas and financially weaker sections of the society. However, there does not seem to be enough awareness about E&S problems that arise as a result of a financial institution's existence in the value chain. Standardized policies or principles, which can manage E&S risks, are not followed by all financial institutions.

¹ International Finance Corporation

Sustainability at financial institutions in India started being considered seriously only about five to six years back. In 2007, the Reserve Bank of India (RBI) drew attention to the role of banks in Corporate Social Responsibility, Sustainable Development and Non-Financial Reporting. It was followed by the inception of the S&P ESG India Index in 2008 by National Stock Exchange (NSE). 2011 saw a few initiatives - RBI issued a Master Circular on Priority Sector Lending; Securities and Exchange Board of India (SEBI) passed a board resolution that mandates 100 listed companies to report on their ESG initiatives through a Business Responsibility Report based on the National Voluntary Guidelines on Social, Economic and Environmental Responsibilities of Business released by Ministry of Corporate Affairs. In 2012 the first live carbon index was launched by Bombay Stock Exchange (BSE), named as GREENEX.

An overview of the comparatively recent evolution in India is shown in Figure 2.

As of February 2013, 79 financial institutions in 33 countries are members to the EP; whereas, the UNEP FI has 215 members in 49 countries. The membership base to the UNEP FI is diverse and includes members from banks, insurance and investment institutions; while EP members are limited to Project Finance institutions.

An overall regional plotting of the membership base for the EP shows that very few institutions from Asian countries are members to these international principles; whereas there are a significant number of members to the UNEP FI in the Asian region; as shown in Figure 3.

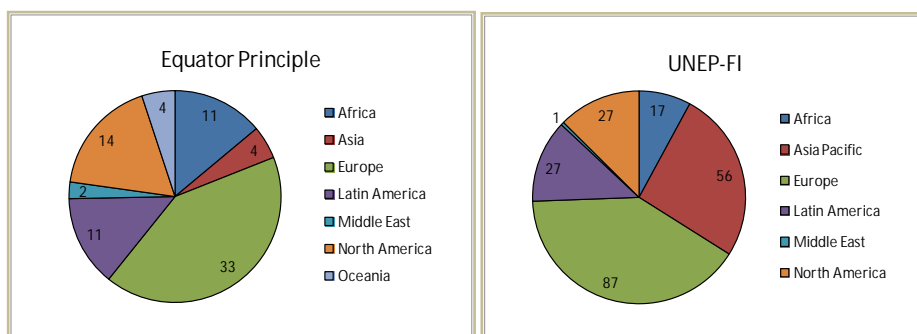


Figure 3: Regional distribution of members to the Equator Principles and UNEP-FI

However, no Indian financial institution is a member of the EP, while two Indian financial institutions namely Infrastructure Leasing & Financial Services (IL&FS) and YES Bank Ltd. are members to the UNEP FI.

Comparisons - Indian vs. International scenario

International and Indian trends on sustainability at financial institutions are consistent on few parameters only.

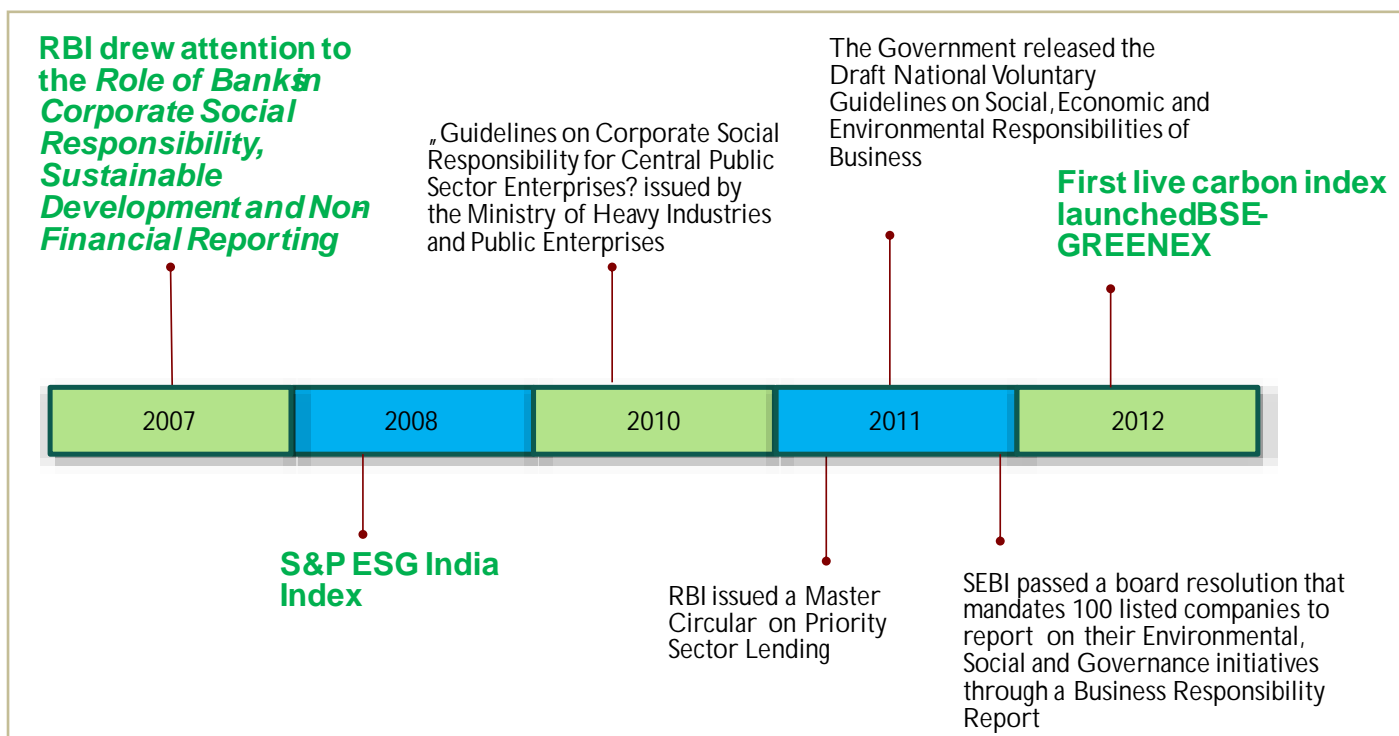


Figure 2: Evolution of ESG concept (India Scenario)

There is a significant increase in the membership to the plethora of international standards and principles by a number of financial institutions in the Americas and Europe. This trend does not extend to India, as only a handful of institutions are members to such international commitments. Financial institutions in India have not showcased adequate proactiveness and hence very few have voluntarily adopted international standards or principles. Further, it is unclear whether international policies are a 'right fit' in the Indian context.

When it comes to regulatory drivers, India has seen a rise in the efforts and initiatives taken by, mainly, the Ministry of Finance, Ministry of Corporate Affairs and the Ministry of Environment and Forest. These efforts are in tandem to the increase in environmental and social regulations in the European Union and the US. There is also a growing interest in sustainability indices in India with the inception of the S&P ESG India Index, Carbon Disclosure Index and BSE-GREENEX; this progression is in line with international trends such as the existence of the Dow Jones Sustainability Index or the Financial Times Stock Exchange FTSE4Good.

Financial institutions in North America and Europe are increasingly incorporating ESG criteria in mainstream investment decision making. Whereas, in India one can see that a financial institution may adopt ESG criteria mainly because the IFC and World Bank require their clients to follow their Performance Standards; which shows that criteria for receiving funding is the main driver.

Disclosure of non-financial impacts in the form of a Corporate Responsibility report or a Sustainability report has now become common for a significant

number of financial institutions internationally. Comparatively, such disclosure is limited in India. At the same time, with the introduction of the 2011 Board resolution by SEBI which mandates 100 listed companies to report on their ESG initiatives through a Business Responsibility report, it is likely that the trend will extend to Indian financial institutions in the future.

Overall, although one can see positive trends in the Indian context, sustainability at financial institutions in India is still at an 'introduction stage' and initiatives need to move at a faster pace to catch up to the current international scenario.

Challenges for Indian Financial Institutions

A need assessment² conducted at 10 financial institutions in 2012 (Personal interviews, July 2012, Mumbai) in addition to secondary research threw light on the variety of challenges and perceived notions of ESG at financial institutions. Some of the major ones are highlighted below.

Firstly, economic benefit is of primary importance to financial institutions and will remain so. This is because a financial institution's goal is to look at short term achievements, since what appear in the books every quarter matters a lot. Further, because sustainability is perceived as external to core business functions and credit risks, financial institutions largely fail to consider E&S risks as significant.

A large proportion of financial institutions believe that compliance to existing regulations is the right approach. Although that would be optimal in a 'perfect world' where all regulations already existed to tackle all sorts of risks and that those regulations were followed

transparently; the same is not a reality in India. Enforcement of regulations and understanding the effects of E&S risks is a major challenge.

Implementation of E&S policies and procedures is viewed as a barrier to business operations and perceived as a possible factor to loss of clients. Financial institutions tend to shy away from voluntary policies due to these notions. Although one can see a shift in this trend as banks and other financial institutions are now realizing the importance on keeping a check on E&S risks, it may still take a number of years for ESG to become norm at all financial institutions in India.

Lastly, the fourth major challenge is the generic nature of international policies such as the Equator Principles. Some Indian financial institutions have cited that such principles cannot be followed in India due to the vast difference in the capacities, operating environments and national requirements as compared to the same in American or European nations.

Conclusion

To summarize, sustainability at financial institutions is an evolving concept. International guidelines and policies for ESG at financial institutions do guide them to implement a means of mitigating E&S risks within their business operations. Although adopting such guidelines help to assert their seriousness towards sustainable development, it is likely that financial institutions may do so only to enhance their brand value. In India, financial institutions have a long way to go to successfully consider E&S impacts as critical impacts for their business operations. So far, the main drivers for inclusion of ESG at financial institutions have been: regulations and criteria for

² Study carried by the author during her internship at Environmental Management Centre LLP during Summer of 2012

funding from multilateral organizations. Lack of awareness of critical negative impact of investments on the environment and society, and existence of corruption in the political system seem to be the top two reasons for non-inclusion of formal ESG policies within most financial institutions in India.

On the flip side, the future of sustainability at financial institutions looks positive. With the introduction of new regulations and with increasing awareness due to unfavorable experiences with E&S risks for some

financial institutions, there seems to be a rise of 'buy-in' of top level management. In the near future, most, if not all, financial institutions will have to incorporate a value based approach to take responsibility of E&S concerns. However, above all, the question of whether financial institutions need to be proactive and voluntarily adopt either international principles or self-formulated E&S guideline or whether governments should be held responsible for addressing E&S problems remains a debatable and unanswered question.

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Accounting for the Environmental Costs

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The Institute of Cost Accountants of India (ICAI) has very thoughtfully considered the need for a cost accounting standard on tracking pollution control costs. The Cost Accounting Standards Board (CASB) of ICAI has brought out recently CAS 14 which after the exposure period has become mandatory for corporate India from the year 2012. The CAS 14 sets out the principles of measurement, assignment, presentation and disclosure of costs related to pollution control in a highly structured manner. CASB has played a proactive role in bringing out such a unique standard which is one of its kind in the world. In a way, with the development of CAS 14, India sets the path for the global reporting on environment issues.

Concern for environment, climate change and inclusive growth is at the heart of all economic planning and activities worldwide today. Bundled along with social responsibilities and

governance and labelled as sustainability today, the philosophy of sustainable development is the basic platform of all economic activities at the macro and at the enterprise level. Of the three themes of sustainability (Economic, Environment and Social), environment in particular has been occupying the centre stage for almost three decades, though the intensity is at a much higher level today as the world has started severely experiencing the impact of climate change. The Accounting for costs of environment management as a consequence has to become seriously an internal process for business activity and with linkages perhaps with external reporting.

UN prescription for Environment Cost and Management Accounting

United Nations Commission on Sustainable Development constituted a

working group way back in 1998 on "Improving the Role of the Governments in the promotion of Environment Management Accounting (EMA)". In the early part of the decade the expert group submitted a report on "Policy Pathways for Promoting Environmental Management Accounting (EMA)". The recommendations of this working group has become very relevant for India today as the Ministry of Environment and Forests (MoEF) of Government of India has launched a major initiative of integrating the environment concerns with the corporate strategies, which converges with CAS 14 ideology. CAS 14 alongwith Management Accounting guidelines of environment issued by ICAI will be a trend setting development for the rest of the world. The present article explores broadly the content of the Management Accounting Guidelines (MAG) on EMA and the CAS 14 issued by CASB of ICAI.

³ Mr. Raman has also been the past President of South Asian Federation of Accountants

The UN Task Force Report defines EMA broadly and delineates the identification, collection, estimation, analysis, internal reporting aspects and use of physical flow information (i.e. materials, water and energy flows). It also describes the environmental cost information and other monetary information for taking decisions within organisations for both conventional as well and environmental matters. The Task Force Report further proceeds to state that, *"EMA data is certainly the most valuable for management activities with a specific environmental component, or management decisions with the potential for significant environmental impact or consequences. Thus, even conventional management decisions, previously considered to be non environmental, will be increasingly impacted by the environmental costs in the future. From this perspective, EMA is and will become increasingly valuable for all types of routine management decisions, such as product pricing and capital budgeting. EMA is also recognised as being of great value for external reporting purposes."*

CAS 14 framework on Pollution Control Costs

CAS 14 of the ICAI treats the costs of pollution control as a separate item and calls for disclosure of the same as product cost. Towards this, an elaborate measurement, assignment and reporting principles have been dealt with utmost clarity in the cost accounting standard.

The definition part of the standard deals with various types of pollution such as air, water and land and brings clarity as to what is a pollutant; when pollution occurs and what are the acceptable limits of any pollutant. This sort of classification automatically signifies that the pollution control costs cannot be clubbed and will

have to be measured and presented as per the type of pollution. Therefore, the cost accounting systems of the company need to record the costs in the internal systems accordingly.

The measurement segment of CAS 14 brings out with clarity as to what elements of resources need to be measured as pollution control costs. For example, the remediation or restoration costs which are likely to be incurred in the future needs to be quantified and included in the current cost structure. But this will be limited to the extent of the environment damage caused in the current reporting period and the liability proportioned accordingly. Further, all types of resources such as consumables, manpower, utilities, repairs etc included in the relevant financial heads need to be stripped out and bundled as pollution control costs under CAS 14.

The assignment segment of CAS 14 speaks of charging the costs to the product cost structure based on logical principles. Applying principles of cause and effect, a product should be charged with pollution control costs based on the pollutants it generates. Alternatively based on spending principle and the benefit which a product receives for cleaning pollution, the costs can be attributed to the product. Ultimately, a product cost structure should be reflective of pollution control costs as a separate line item.

The presentation and the disclosure segment of CAS 14 calls for a classified way of presenting the costs of pollution such as internal and external costs classified into various types of pollution. CAS 14 has become mandatory for various companies coming under the threshold limit of maintaining cost accounting information from the accounting year ending 31st March 2012.

Management Accounting Guidelines (MAG) for Environment

Considering the importance of the internal and external financial reporting/management accounting on environmental issues by the corporate sector, the premier body of cost and management accounting in India ICAI has issued two guidelines in 2009 as below:

- Management Accounting Guidelines III (MAG III) for Managing Corporate Environment Strategies
- Management Accounting Guidelines IV (MAG IV) on Tools and Techniques for Environment Accounting

These guidelines (MAG) were built with the technical support from the CMA Canada which is also the national body of cost and management accounting of Canada.

MAG III

The MAG III on Managing Corporate Environment Strategies advocates that the environment management focus in any corporate entity passes through three maturity levels as below:

- The primary level of maturity is looking at the compliance part of environmental law and taking only the steps required by the regulation. Examples have been dealt with to clarify this.
- The second level looks at the subject from environmental cost management to gain competitive advantage in doing business.
- In the third level the strategy is to make environment a part of the business model itself.

The characteristics of each maturity level have been elaborately dealt with and the guidelines can help in self assessment and benchmarking for any entity whose project is subject to the environment clearances from MoEF. As a tool coupled with an assessment kit, MAG III can help prioritize the enforcement focus of the MoEF and check adherence to its terms of reference.

MAG IV

The MAG IV on environment accounting tools issued by ICAI is a continuum of MAG III. It provides the principles of classification and the techniques for measuring environment costs. These principles can also form the basis of internal reporting to the governing body as well as for external reporting to stakeholders bringing out the maturity of the entity in environment management. The operative part of the MAG IV on Tools and Techniques of Environment Accounting is structured in three sections:

1. Maturity levels of implementing corporate environment strategies which have been dealt with in the MAG III explained earlier
2. Definition of environment costs
3. Tools and techniques of accounting for environment in management reporting

Definition section deals extensively with various perspectives of understanding environment costs and accounting. The organizational definition of environment costs would depend on how they intend to use the information and as well as on the scale and scope of the exercise. Different frameworks have been considered in this section. For example, the framework of US Environmental Protection Agency (EPA) and the Global Environment Management Initiative consider the environment costs in the categories of conventional, potentially hidden costs, contingent and image related costs. The section also comes up with an internal and external classification. Here the internal costs are more traceable into ledgers whereas the externalities are not traceable into ledgers or transactions but brought into the ambit through exotic cost estimation models.

The third section of MAG IV sets out different approaches of management accounting of environment costs considering the different maturity level of the entity, as below:

- A simple approach of transaction accounting and allocation of environment costs
- The second approach makes a life cycle approach to environment costs

- The third approach creates a hierarchy of costs based on the comprehensiveness of the approach linked with the level of maturity in corporate environment strategy
- Fourth approach is based on the framework activity based costing
- Fifth approach is based on accounting costs inside the organization as well as costs incurred in the society because of a business model called as Full Cost approach

The MAG has also been forwarded by the Confederation of the Indian Industry (CII) owing to its importance.

To summarize, it can be said that ICAI recognises the need for accounting for costs of environment management and hence made efforts in giving guidelines and accounting standards for environmental costs such as CAS 14 and MAS. In the coming years, as integrated reporting (financial as well as non financial reporting) becomes mandatory; these standards may help in developing the internal reporting process for any business activity and with linkages perhaps with external reporting.

YES BANK along with GIZ (Gesellschaft fuer Internationale Zusammenarbeit GmbH), UNEP FI (United Nations Environment Program Finance Initiative) and RIRA (Responsible Investment Research Association) is launching the Sustainability Series, a first-ever initiative in India which would focus on increasing Environment & Social (E&S) Risk Awareness in Industry. The first of the series is an "Introductory training workshop on E&S Risk Management" will be held on Tuesday, April 23, 2013 at Jade Hall, 3rd Floor, Nehru Centre, Worli, Mumbai. The aim of the workshop is to sensitize risk managers across the financial sector towards E&S risks of their clients and/or investment partners. Participants will be oriented towards practical mechanisms and tools for implementation of the risk evaluation methods, including case-study based exercises and activities.

To register visit : https://www.surveymonkey.com/s/Training_Mumbai

Environment & Social Policy Framework @ IIML

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Traditionally, the financial sector was perceived as environmentally friendly causing minimal environmental impacts on the use of energy, water and paper. However, today it is recognized that the financial sector is indirectly responsible for environmental impacts through their lending or investment activities.

Infrastructure Leasing & Financial Services Limited (IL&FS) has been the first non-banking financial institution in India to recognize its responsibilities as a lender and investor and has established a system for incorporating environmental and social governance in its business operations. It is one of India's leading infrastructure development and finance companies with comprehensive capabilities to undertake infrastructure projects from concept to commissioning.

Journey: ESPF at IL&FS

The journey started way back in 1995 when IL&FS was borrowing funds from the World Bank, which required it to set up an environmental and social governance system in line with their safeguards. Thus, Environmental and Social Report (ESR) was established for IL&FS to incorporate environmental and social considerations in the project cycle of infrastructure development. This system was applicable to only those infrastructure projects where the line of credit from World Bank was being utilized. During this time, the Vadodara-Halol Toll Road Project developed by

IL&FS was adjudged by the World Bank as a best practice example for Environment Risk Mitigation and Social Rehabilitation Plan.

In 2007, with the passage of over ten years since the ESR's first implementation, a need was felt to update the ESR considering the internal and external transformations in and around IL&FS. Since the ESR was introduced, some national policies and legislation were amended, while new ones were introduced. For example, the year 2006 saw the introduction of India's first National Environmental Policy. Since 2003, India also had its own National Resettlement and Rehabilitation Policy (NRRP), the latest version being approved by the Union Cabinet in 2007. India also became either a signatory of or responsive towards global Multilateral Environmental Agreements (MEAs) not previously addressed in the ESR. Therefore, it was imperative that the ESR be brought up-to-date with the latest legislative and globally recommended and agreed codes of conduct.

Auditing projects that adopted the ESR in those ten years and evaluation of ground level experiences enabled assessment of the effectiveness of the implemented environmental and social procedures. The feedback received was that the integration of environmental and social issues is important throughout the various stages of the project cycle – concept, design and implementation,

and that this is achievable at a relatively marginal cost. While the net benefits of this integration were not quantified, there was sufficient evidence to suggest that the associated environmental and social risks were significantly offset or lowered. In sum, the application of the ESR provided IL&FS an edge over its peers.

Cognizant of the emerging trend of mainstreaming environmental and social considerations into financial operations, be it loans, equity or merchant banking, IL&FS ratified its support to sustainability in finance by signing the United Nations Environmental Programme Finance Initiative (UNEP FI) on December 5, 2006. Given our broadening business canvas, with a wide range of services covering project development and implementation, financial transactions and advisory services across Group Companies and Special Purpose Vehicles (SPVs), it was important that we adopt a more elaborate version of the ESR. Thus the Environmental and Social Policy Framework (ESPF) was developed through a consultative mechanism at the corporate and group companies. The ESPF was approved by IL&FS Board in May 2008 and was made applicable to IL&FS, its subsidiaries and associate companies.

The ESPF has been designed to proactively identify and safeguard against environmental, health and safety and social (E&S) risks to IL&FS and its companies in their projects, investments

and advisory services. It has been structured using Deming's Plan-Do-Check-Act cycle that advocates continual which is the basis of various standard management systems.

During the period between 2008 and 2009 a number of pilot applications of ESPF were conducted across projects, transactions and advisory services of various group companies to understand the nature and scale of environmental and social risks in their businesses.

It was decided to implement ESPF in a phased manner at the corporate level and in select few subsidiaries.

A Corporate Environmental and Social (E&S) Cell was created for overall guidance⁴, advise and coordination related to the ESPF. The E&S Cell performed the responsibilities of knowledge management, communication and outreach, training (and workshops) and compliance monitoring for ESPF.

Journey: ESPF at IIML

IL&FS Investment Managers Limited (IIML) was among the first set of group companies where ESPF was launched. IIML is one of the oldest and largest private equity fund managers in India. IIML manages/advises funds focused on investing in infrastructure, real estate and general private equity. IIML fund's investments range from passive minority investments to controlling (majority) stakes.

At IIML, we first identified Coordinators who could work with the Corporate Cell to establish ESPF in the company. The task on ESPF was assigned to them in addition to their mainstream work in the

company. A series of meetings were organized by the Corporate Cell with the Coordinators and IIML's investment teams to understand the business operations and workflows. The business processes for the various operations at IIML were mapped.

During consultations with investment teams, the challenge was to explain the relevance of ESPF to IIML. We faced substantial amount of resistance at first, as the general thinking among the teams was that financial services do not cause environmental impacts. Breaking that mental barrier and bringing the investment teams on board to establish and implement ESPF was a humungous task.

During this process we realized that the ESPF framework would have to be customized for IIML and also approved by IIML's Board for a better buy-in at the company. Thus, application of ESPF to IIML was tailored to meet the needs of its business verticals and was approved by IIML board on 26th April, 2010.

While in most financial institutions, a separate team is created for implementation of environmental and social safeguards, IL&FS made the investment teams responsible for implementation of ESPF.

The system was so designed that environmental and social procedures were mainstreamed in IIML's business workflows. Thus the same team responsible for bringing business was made responsible for ensuring that environmental risks are minimised. The investment teams continually put forth their difficulty of not being equipped with domain knowledge to implement the system. Hence, a number of training

sessions were conducted by the Corporate Cell on a variety of topics such as applicable environmental & social regulations; environmental and social issues related to different sectors; method of implementing procedures under ESPF etc. The thought behind such mainstreaming was that actual management of environmental and social considerations in investments will happen when the primary team is made responsible. The Company Coordinators ensure this process with the assistance of the Corporate Cell.

Another challenge which the investment teams face is regarding the action to be taken in the event of a new environmental and social risk identified in an investment. Here the stance taken is not to pull out the investment, but instead work with the investee company to achieve compliance and implement good practices. This calls for a lot of effort from the investment teams.

The ESPF has been designed as a dynamic system, wherein the learnings from periodic monitoring and reviews are used to update the system and procedures. At IIML, we are three years into implementation of ESPF and the journey of learning and adapting is still on.

Environmental and Social Policy Framework of IIML

The ESPF comprises of the following:

1. Environmental and Social Policy;
2. Guiding and operational Principles; and
3. Environmental and Social Risk Identification and Management Process

The Environmental and Social (E&S)

⁴ Environmental Management Centre, Mumbai was outsourced for this purpose

Policy of IIML retains the spirit of IL&FS Policy while customizing it to the company's business canvas. Through its policy, IIML recognizes environmental, health, safety and social considerations in its business operations to add value and minimize adverse impacts and risks, in order to enhance value of its fund's investments. For this purpose, IIML has established and implemented mechanisms to encourage, influence or mandate its stakeholders and business partners to conserve natural resources, protect the environment, provide safe and healthy workplace for their employees and contractual staff and restore standards of living for those affected by its project operations.

The E&S Policy of IIML is implemented through its application of Guiding, Operational and Engagement Principles. The Guiding Principles embody the spirit of the IIML ESPF and are non-negotiable. The Operational Principles provide guidance to IIML in enacting the ESPF. The Engagement Principles mirror the ideology of the IIML ESPF. These have been devised for investments where IIML does not have majority control. They serve to further IIML's aspiration to inspire and encourage all stakeholders, including partners and co-investors towards continual improvement in their areas of operation.

The Policy and Principles are implemented in IIML's investments through a Risk Identification and Management process. The process consists of four steps – conducting environmental and social screening, assigning a risk rating, identifying risk reduction controls and conducting periodic monitoring.

The screening process involves checking

whether the project for prospective investment involves any activities or aspects deemed illegal by Indian regulations or is banned by international conventions to which India is a signatory. The process also identifies whether the said investment faces any risks due to location in environmentally and socially sensitive areas.

Considering the various environmental and social risks posed to IIML, E&S risk rating criteria has been developed for the three verticals within IIML viz real estate, growth capital and infrastructure. The risk rating criteria are used to assign the transaction a high, moderate or low risk. Investment agreements with promoters and investee companies incorporate covenants for EHSS safeguards as per IIML ESPF.

Based on the risks identified in a particular transaction, various risk reduction controls are applied. An action plan is prepared for implementation of the risk reduction controls and the action

plan is further periodically monitored based on the risk rating.

The implementation of ESPF at IIML is subject to internal reviews and external audit to determine continued conformance with the requirements of the IIML ESPF. Internal reviews are conducted with the objective of strengthening the system and its implementation in IIML. External audit is conducted at the end of every FY by IL&FS Corporate with the objective of receiving assurance from a third party on implementation of ESPF. The assurance statement given by the auditing agency forms a part of the IL&FS Annual Report. The findings and observations of these reviews and audit feed into the system to enable better implementation of ESPF.

Benefits of ESPF

The implementation of ESPF has brought a number of intangible benefits to IIML. Today our investment teams are aware and sensitive towards environmental,



Figure 1: Investments projects of IIML

health & safety and social issues. With an early warning of the environmental and social risks in a transaction, IIML has the opportunity to plan actions accordingly and make an informed decision. IIML also works with its investee companies to achieve the objectives of its policy and thus creating a brand in the market.

We have been implementing ESPF in a competitive market where not many financial institutions consider environmental and social safeguards in their investments. Through ESPF we have taken the responsibility of influencing the market towards environmentally and socially sound practices.

In conclusion, implementing ESPF for the last three years has been a learning experience for us in enabling sustainable development.....and the journey goes on! We are constantly working towards making the system more robust by pooling in our experiences and engaging in a dialogue with our stakeholders.

Implementing Sustainability in Private Equity at Actis

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Introduction

Investors have famously lagged behind the corporate sector in aligning their strategies with sustainability. Endemic short-termism has been one problem; lack of interest from the ultimate asset owners, such as pension funds and insurance companies, is another. This last barrier is starting to change, however. The Principles for Responsible Investment now have over a thousand financial institutions backing it with USD33 trillion assets under management, committed to integrating environmental, social and governance into their operations. Investment mandates increasingly incorporate sustainability factors – just as supply chain requirements do in the corporate sector.

The private equity sector has moved particularly rapidly over the past five years, making up for its late start. With far longer holding periods than their stock market investing cousins often matched by seats on company boards, private equity is turning into the asset class of

choice for long-term sustainable investment. Actis, a private equity investor in emerging markets, has been at the forefront of this movement from the time it was set up in 2004. With \$4.5bn under management and 107 investment professionals, Actis invests in 70 companies across South Asia, South East Asia, China and Latin America. In addition to returning best financial outcomes to its investors, Actis ensures that best practices for business integrity, health, safety, climate change mitigation and energy efficiency are implemented across the portfolio.

Actis's approach to responsible investment

Actis believes that the integration of sustainability factors into investment analysis and decision making generates sustainable returns. Actis uses its in-house responsible investment team, and a commitment to international best practice to make sustainability issues an integral part of the investment process. Three elements are critical for sustainable investment to take root are:

risk minimisation, value enhancement and integrity assurance.

Risk minimisation: The first task for a responsible investor must be to evaluate and minimise the market, regulatory and reputational risks of an investment arising from potential environmental, climate change, social, ethical and governance factors. Well-defined procedures for screening all investments according to a consistent set of social, health, safety, environmental, and climate change risks are integrated into the investment decision making procedures, and discussed at the firm's Investment Committee. This due diligence is important for identifying potential problems and developing action plans to reduce risks and enhance performance. This procedure also constitutes an important tool in screening out investments that have high business integrity risks in markets where governance standards are low and political interference in business practices is rampant.

Value enhancement: Once an investment is made, Actis professionals construct action plans for improving the value of investments through the implementation of best in class sustainability practices. A special effort is made to identify and measure non financial drivers of value in order to link them to revenue growth or cost savings as the case may be. The payoff of this approach is evident in returns generated at exit.

Integrity assurance: The third element of a sustainability strategy is to assure the integrity of investments by transparent and accountable reporting; enabling a timely response to rising client and societal expectations of corporate behaviour. Actis has instituted a quarterly reporting system for its portfolio companies to include reporting on sustainability issues. Actis also reports to the UNPRI on an annual basis, to the Carbon Disclosure Project, and provides additional updates to its investors as required.

This approach to responsible investing, as illustrated in Figure 1 below, is fully integrated with Actis's investment strategy, and results in enhanced market value of the investment portfolio.

Case studies from the Actis portfolio

We endeavour to implement the above approach across our portfolio although final outcomes and interactions with individual companies will vary depending on the sector and location. A brief description of how the Actis approach worked in two of our Indian portfolio companies is discussed below.

Case 1: Nilgiris

Nilgiris is a dairy and bakery manufacturer and retailer, operating in Southern India for over a hundred years. It is a well-established brand and a family-run business—well known to children and grandparents alike. Nilgiris has expanded its dairy and bakery manufacturing facility with 96 retail franchises.

Actis invested in Nilgiris in 2006. Initial due diligence at the time of investment highlighted a number of challenges relating to environmental and sanitary conditions. However, the decision to go ahead with the investment despite these conditions was based on the conviction that Actis could work with Nilgiris and bring in the right management to transform the facilities.



International Standards of Food Safety

Actis worked with Nilgiris to implement best in class international food safety standards and management systems which resulted in better quality products and a more effective monitoring system. The dairy unit was certified to the ISO Food Safety Standard in 2009 and the bakery unit in May 2011. The workers were not only provided with protective gear, but also trained in health & safety so that everyone understood the centrality of clean operating conditions in this iconic food business. Six years on from the initial investment, the end result has been tangible improvements in product quality, operational efficiency and worker productivity.

Innovation

In the last couple of years, Actis added a range of organic products that cater to rising demand for healthy living. As the incidence of diabetes is on the rise in India, by diversifying Nilgiris' product offering to include organic, low fat, low sugar breads that are high in fibre and rich in proteins, Nilgiris is offering an additional choice to customers. This has been a smart business decision to seize a market opportunity. It has also meant that Nilgiris is able to demonstrate its responsiveness to changing social and lifestyle needs.

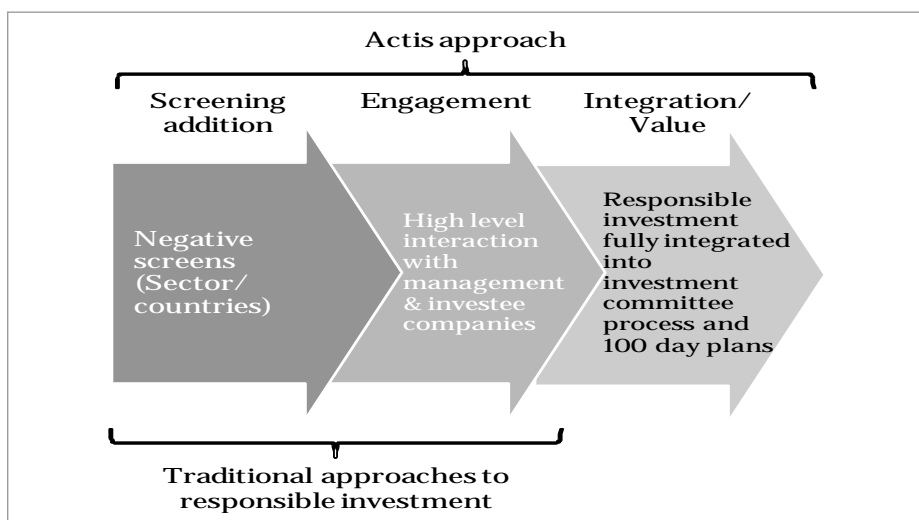


Figure 1: Actis's approach to Responsible Investment

Social Enterprise

Actis encouraged Nilgiris to see how they can use the power of sourcing to provide opportunities for producers from disadvantaged communities. Bhuiira Jam⁵ is produced by women in the hills of Himachal Pradesh in North India. These women live in remote areas, and find it very difficult to access fast-growing markets in the cities. Bhuiira enables them to overcome these barriers by producing a chemical free, high quality product. Nilgiris spotted a good product, which sells well, and decided to do business with these women in their mountain homes. The jam is now being sold in Nilgiris retail outlets in mega cities like Bangalore and Chennai, expanding the revenues for this previously isolated group of women.



Case 2: Paras Pharmaceuticals

Paras is a well known FMCG brand in India and was ideally placed to outpace market growth and deliver attractive investment returns when Actis bought a stake in the company in 2006.

During the four years that Actis held the company, it effectively showcased the international ESG standards developed by the company that potentially led to strong interest from blue-chip MNCs and final sale to Reckitt-Benckiser Plc.



Governance & leadership

Having started out as a small export business, it was of utmost importance to put in place a highly professional management team in order for the company to be internationally competitive. By tapping into its network of business leaders, Actis was able to successfully implement the management changes the company needed.

With the help of Actis, Paras was able to further strengthen its financial health. Improved sourcing, rationalised advertising spend and the launch of higher margin new products, all contributed to boost the EBITDA margin of the company.

Environment, Health and Safety

Actis worked closely with the company management to revamp its occupational health and safety policies and bring them in line with international standards.

Regular audits helped reduce safety lapses and ensured that working conditions were in line with international best practice.

Product safety protocols were aligned with requirements of the World Health Organisation, Good Medical Practice and the US Federal Drug Agency requirements.

Waste and waste water management practices were upgraded to conform to national legislation.

Conclusion

The approach and examples cited above underline the importance of integrating environmental and social sustainability in private equity investments in emerging markets. In many of these fast growing markets environmental degradation, carbon emissions, pollution, natural resource constraints and social issues are already placing constraints on economic growth. In this context and given increasing private equity activity in emerging markets, responsible investment strategies will become increasingly important for investors in these markets. Apart from obvious environmental and social benefits, such a strategy is clearly one that creates value both for the investor as well as the portfolio company.

⁵ Black grapes Jam

⁶ EBITDA is an acronym for earnings before interest, taxes, depreciation, and amortization

GRI's Global Conference on Sustainability and Reporting will be the sustainability leadership event of 2013. The Conference takes place on 22-24 May 2013 in Amsterdam, the Netherlands.

GRI Focal Point India is taking Indian delegation to attend GRI's upcoming Global Conference. At the conference, there will be a dedicated India-focused public session during the Conference, sharing India's journey in sustainability reporting and national trends of reporting.

The Conference will also mark the launch of the Linkage Document between the National Voluntary Guidelines (NVGs) released by the Ministry of Corporate Affairs, SEBI Business Responsibility Report (SEBI-BRR) and the GRI Guidelines (a joint initiative of GRI with IICA-GIZ). Other highlights of the conference would be -

- G4 Introduction Seminar - exclusive for Organizational Stakeholders and Delegation members
- Introductions and engagement with institutions and business around the world in different industry sector

Bombay Chamber Activities

Meeting with Maharashtra
Pollution Control Board (MPCB)
- March 13, 2013

The three member team from Bombay Chamber and Sustainability Committee met Mr. Rajiv Kumar Mittal, Member Secretary, MPCB on March 13, 2013. The objective of the meeting was to work in collaboration with MPCB to improve the quality of compliance report, training and discuss other areas of collaboration. We received encouraging response from the Mr. Mittal and it has been agreed to organise half day meeting with the team from Bombay Chamber and MPCB to brainstorm on the quality collaboration with MPCB and role of Industry in supporting MPCB.

Forthcoming Events

Civic Awards and Good Corporate Citizen Awards 2012-13

The Bombay Chamber is pleased to invite nominations for its annual Civic Awards and Good Corporate Citizen Awards. The awards are given to publicly acknowledge and honour conspicuous achievement by corporate organization to improve environmental, social and cultural metrics in by way of service to the community.

Categories: **Civic Awards**

1. Social Development
2. Environment
3. Art Culture & Heritage

Categories: **Good Corporate Citizen Awards**

1. Large Corporate (Above Rs.2,000 Cr. Turnover in the previous year)
2. Medium Corporate (Above Rs. 500 to 1,999 Cr. Turnover)
3. Small and Micro Companies (Below Rs. 500 Cr. Turnover)
4. Banks and Financial Institutions

To download application forms, please visit:

<http://www.bombaychamber.com/Awards.aspx>

Last Date for Submission: May 4, 2013

Sustainability in Business - Adopt, Report and Benefit - May 9, 2013

Bombay Chamber of Commerce and Industry under the auspices of its Sustainability Committee in collaboration with Ekonnnect Knowledge Foundation Announces an Orientation Session Sustainability in Business – Adopt, Report and Benefit on May 9, 2013 from 3.00 p.m. to 5.30 p.m. at the Meeting Room of Bombay Chamber Corporate Office at The Ruby, NW, 4th Floor, 29, Senapati Bapat Marg, Dadar (W), Mumbai 400 028.

Objectives:

- To create awareness about the need and importance of Sustainability reporting in SME sector
- To build the capacity of the professionals in Environmental/ Sustainability division in the SME sector
- To set the base for forthcoming course on Sustainability Reporting by Bombay Chamber and Ekonnnect to help the SME sector to prepare a road map for the same within their companies.

Key Speaker:

Dr. Prasad Modak, Director Ekonnnect; Executive President, Environmental Management Centre; Corporate Consultant, IL&FS Ltd; Professor (Adjunct), IIT Bombay; Consultant to major UN, Bilateral and Development Financing Institutions across the World such as the World Bank, ADB, UNEP, UNIDO, UNCRD etc and Governments such as Bangladesh, Egypt, Indonesia, Mauritius, Thailand, Vietnam etc.

Participation Fees : Rs. 500/- Per person (inclusive of 12.36% Service Tax)

For more details contact:

http://www.bombaychamber.com/Sustainability_in_Business__Adopt_Report_and_Benefit_631.aspx?EVENT

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