PROYECTO ECOBANKING

INCAE BUSINESS SCHOOL | CLACDS Centro Latinoamericano para la Competitividad y el Desarrollo Sostenible

THE STATE OF ENVIRONMENTAL AND SOCIAL POLICY AND PRACTICE IN LATIN AMERICAN FINANCIAL INSTITUTIONS

RESULTS OF THE 2016 ECOBANKING SURVEY

FMO Entrepreneurial Development Bank

CAF BANCO DE DESARROLLO DE AMÉRICA LATINA

BAC CREDOMATIC

PHILIPS

The Ecobanking Survey

This study about the State of Environmental and Social Policies and Practices at Financial Institutions in Latin America was promoted by the Ecobanking project of the Latin American Center for Competitiveness and Sustainable Development (CLACDS), of INCAE Business School, to document the progress and challenges facing the region's financial sector with respect to the development and implementation of environmental and social practices in its operations. As a result of the assessment, Ecobanking has been able to discern the level of commitment of the institutions to the goal of steering the region towards a more sustainable development path. Furthermore, we have identified areas of improvement as well as tools that could reinforce the role of banks as agents of change.

The data collection began in February 2016 and ended in May of the same year; however, with the aim of enriching the analysis while taking into account important cause-effect relationships that added value to the preliminary results from March 2017, an adjustment was made to the data, which ended in June, 2017.

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The team

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Aknowledgements

The Ecobanking Project is grateful for the strategic and financial collaboration of its partners BAC Credomatic, Philips, FMO and CAF-Latin American Development Bank.
The views and conclusions expressed in this report do not necessarily reflect the positions of INCAE Business School or the members of the Ecobanking Project, nor does the mention of programs or software used imply their approval or promotion.

Note: *free translation of the original version written in Spanish*

EXECUTIVE SUMMARY

This study evaluates the current state of the integration of environmental and social issues into financial institutions in Latin America. It aims to provide a framework for shared introspection about where we are, where we want to be, and what paths we can take to get there, with the objective of identifying opportunities for improvement within organizations, and thus steer their capacities towards the implementation of actions in areas where there are pending issues.

The study was conducted during the second half of 2016, applying a survey through the Qualtrics® platform to a database of the premier Latin American financial institutions. The survey information was crossed and collated using dynamic tables as the basis of the descriptive analyses. A Sustainability Performance Index (SPI) was also developed, which classifies institutions according to their level of progress in the implementation and development of environmental and social policies. In addition, econometric models were run to reveal correlations between variables that explain the behavior of institutions.

From the analysis of the main research areas of this study it was found that, of all institutions surveyed, 75% indicated they have a functioning environmental and social policy, while 70% maintain a working sustainability strategy. Concerning the operationalization of policies and strategy; only 54% claimed to have an actual environmental and social risk analysis system (ESRAS) and 55% offer financial services for environmental and social investments, but only 44% of ESRAS institutions monitor their management system. In contrast, Corporate Social Responsibility is present in almost all organizations (94%), but only 44% publish sustainability reports.

Regarding the SPI, which categorizes where financial institutions are relative to the total number of institutions evaluated, 57.5% were favorably classified in the "advanced institutions" category, 20% as "follower institutions" and 22.5% in the category of "laggard institutions". Within the group of advanced institutions, a subgroup of fourteen institutions (leaders) - equivalent of 30% of the total of advanced institutions - had a perfect score.

The information presented in this report enables the region's financial institutions to pinpoint their level of progress in relation to the inclusion of sustainability parameters in their operations, with respect to the overall performance of the banks in the region, and to identify the areas in which they need to improve. It also enables the Ecobanking Project to fine-tune its position and implement activities that more accurately support FIs to address the challenges identified.

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1. INTRODUCTION

decades as a result of the pressure of human activity on natural resources, which threatens not only the ecosystems but also the human species itself - the overall annual net loss of forest surface tops 8.1 million acres and more than 23,000 species are on the brink of extinction around the world; in addition, water stress is affecting more than 2 billion people globally (UN, 2016)- all of which makes it necessary to rethink the concept of development and to take measures to deal with the problem.

The situation described has raised awareness in countries and society in general; and concern has gradually moved public and private bodies in the world to show greater interest in the creation of policies focused on the management of the impacts induced in the environment and, consequently, on human activities. However, greater efforts by the different stakeholder entities are needed in order to include environmental and social criteria in decision-making and develop a long-term vision of the management of natural resources in favor of sustainable development.

Consumers are now more aware of acquiring environmentally friendly and socially responsible products and services.

This trend has direct impacts on companies and global capital flows, whose decision makers must recognize and respond to the challenges it entails: it creates risks, but also opportunities that must be properly managed to evolve and remain viable in the market in the long run. Therefore, the inclusion of environmental and social measures in companies' operations becomes necessary, due to the influence of market trends as well as that of opinion groups which have an impact on consumers, and of governmental regulations.

Thus, all economic sectors, without exception, have an important role to play in contributing to sustainable development. However, Financial Institutions - which do not have direct actions that are considered aggressive against the environment or society, but which can indirectly affect the environmental and social conditions through the funding of a project - are called upon to be protagonists, because they have a wide range of action on the economy, as well as the potential to influence other industries to promote more sustainable development in their activities and thus generate shared value.

Globally, it is increasingly common that leading Financial Institutions accept the challenge of adapting their business models towards more sustainable practices and consider environmental and

social issues relevant in their activities, as it represents an opportunity to sustain their competitive advantage. With the voluntary incorporation of sustainability practices, environmental and social criteria, and the adoption of internationally accepted standards for environmental and social risk management in their operations, new and better business opportunities are created, minimizing risks, reducing costs, and improving reputation, among other benefits.

In Latin America, sustainability is evidenced in governmental and institutional policies and initiatives. However, there is still a long way to go so that more institutions, especially in the financial sector, develop a long-term vision that includes environmental and social issues as a strategic axis in their sustainability agendas, to efficiently and comprehensively manage the new opportunities and risks related to the integration of the principles of sustainability in their business models.

Leadership is required within institutions to implement policies, processes and strategies towards the development of tools to analyze and evaluate environmental and social risks, in addition to designing new financial products with an environmental and social focus, generating long term value for shareholders and society. Furthermore, it is necessary to measure the performance of the operation of these policies to fine-tune efforts towards continuous improvement.

Therefore, this study is part of the Ecobanking Project's efforts to shed light on the State of the Environmental and Social Policies and Practices in Financial Institutions in Latin America; as an evaluation of progress in the development of sustainability policies and strategies, and of the capacity to create tools, knowledge and skills within organizations to include environmental and social issues within their operations, as well as their willingness to increase the transparency of its operations through sustainability reports. Thus, the results of the research can serve as a guide for institutions to reinforce their capabilities in the areas where they still have deficiencies.

About Ecobanking

The Ecobanking Project (**www.ecobankingproject.org**) is a division of the Latin American Center for Competitiveness and Sustainable Development (CLACDS) of the INCAE Business School (**www.incae.edu**). It focuses on improving the competitiveness of the Latin American financial sector by promoting and supporting innovative -green and social- sustainability-oriented investments.

The Ecobanking Project, hand in hand with its partners FMO, Philips, CAF-Latin American Development Bank and BAC Credomatic, aims to promote a long-term sustainability vision among Latin American financial institutions to energize the regional sector's capacity for self-transformation to adopt environmental best practices that international institutions are implementing in their various business areas, so that they can create value for their different stakeholders (collaborators, partners, clients, among others).

Through its activities, the Ecobanking Project aims to contribute to the creation of the tools and elements necessary to forge a more sustainable financial system; with the following objectives: to increase green loans, to develop new financial products, to expand the range of sustainable financing activities, and to help position financial institutions in the region as the first choice of development financing institutions to promote sustainability plans and objectives.

2. GENERAL OBJECTIVE

This study aims to evaluate the State of Environmental and Social Policies and Practices in Financial Institutions in Latin America, with the goal of documenting the advances and challenges facing the financial sector in the development and implementation of environmental and social practices in their operations.

2.1 Specific Objectives

• Identify the main players and types of financial institutions in the region which include environmental and social practices in their operations.

• Evaluate the progress in the governance of sustainability in FIs, which guides the actions and dictates the guidelines for the creation of practices focused on sustainability.

• Determine the progress of the operationalization of policies and strategies, with the implementation of instruments of analysis, measurement and assessment of risk, and the creation of financial services for environmental and social investments that allow the capitalization of new financing opportunities in accordance with sustainability principles.

• To characterize Corporate Social Responsibility efforts in these institutions and to compare them with the progress of policies and strategies of sustainability within the institutions.

• Identify the commitment of the financial institutions to make their activities transparent through sustainability reports.

• Guide the creation and development of specific skills so that the financial sector strengthens its role as an agent of change in the region and promotes the large-scale financing of projects that are viable financially, environmentally and socially.

3. METHODOLOGY

The present study was conducted during the second half of 2016, in the form of an online survey based on the Qualtrics® data collection and validation software, followed by telephone calls. The questionnaire comprises 46 questions that were posed to different financial institutions in Latin America, with the purpose of determining the State of Environmental and Social Policies and Practices in Financial Institutions in Latin America; and the advances and challenges facing the financial sector in order to operate under sustainability principles.

3.1 Development of the Questionnaire

INCAE faculty and in-house experts on financial-sector sustainability issues from the Ecobanking Project developed a 46-question survey based on past experiences in studies on similar topics, to be submitted to multiple financial institutions in various countries in Latin America. This questionnaire was reviewed and validated by the Ecobanking partners and additional experts from the Ecobanking Project.

The questionnaire consists of five sections that cover the main topics of analysis of this research, which are:

1. General information on the financial institutions; their type and classification, their ownership structure, the market segment they serve, their total assets.

2. Governance of Environmental and Social Issues: This section explores the level of progress of financial institutions towards the development of environmental and social policies, and the conception of a sustainability strategy based on the impacts that the organization produces in society.

3. Operationalization of Policies and Strategy: This section analyzes the status of implementation of tools for the measurement, analysis, control and monitoring of environmental and social risks, as well as the creation of financial services tailored for environmental and social investments.

4. Corporate Social Responsibility (CSR): The CSR programs of the participating organizations are examined in this section; the management of the direct impact of their operations, the main areas they cover and the specific projects of each area of action.

5. Sustainability Reports: This section presents the commitment of the institutions to further the transparency of their activities through this communications tool.

3.2 Selection of Participating Institutions

During the preparatory phase, a database was developed of the main financial institutions in the Latin American region, and of key executives in charge of areas related to risk, environmental management, green credits, among other topics. The institutions included in the database are government-owned and private banks, regional banks, branches of transnational banks and development banks, as well as some unregulated financial institutions.

The project sought to include a representative number of institutions in each country in the database, and then contacted the managers and executives of the previously identified organizations, according to the profile required for this research, to present the project and its objectives, and to invite them to participate in the study.

Then, the identified contacts were sent an invitation to answer the questionnaire arranged online on the Qualtrics® platform.

3.3 Data Analysis

Once the information was collected, we reviewed and debugged the database in detail, making sure not to duplicate institutions that had answered the survey. After a more detailed review of the answers, several institutions were identified that had reported some apparently contradictory responses. As a result, those replies were reviewed through telephone contacts, to ensure that only verified information was being processed.

Next, exhaustive processing was done using Excel dynamic tables, to cross and collate information from the different sections described above with the categories in which the participating institutions were classified (type of financial institution, ownership structure, market segment), among other crosses. With the information obtained, we developed visualizations that were the bases of the descriptive analyzes, as well as the new hypotheses and conclusions of this study.

In addition, using selected relevant criteria (whether the institutions have environmental and social policy, sustainability strategy, Environmental and Social Risk Analysis System ESRAS, green credits, CSR, if they are signatories of international agreements, and if they publish reports of sustainability), a Sustainability Performance Index (SDI) was developed, which classifies, identifies and determines the status of institutions in terms of progress and commitment to the development, implementation and reporting (transparency) of environmental and social policies.
For the construction of this index we considered a methodology of sum of

weighted averages. For each of the seven index indicators, the Ecobanking experts assigned a fixed coefficient that seeks to represent the relative importance of each element in the composition of the index. That is, if a variable has a greater percentage weight within the index, it is a variable that has greater importance in the the global sustainability performance of the institutions analyzed.

The following table presents in detail the relative weights selected for the SPI conformation:

Table 1. *Relative criteria and weights assigned for the development of the Sustainability Performance Index.*

Indicator	Relative weight
Sustainability Policy has been Established	0,5
Sustainability Strategy has been Established	0,5
Environmental and Social Risk Analysis System is in Operation	1
Green Lending Products Developed and in Production	1
CSR Management Operational	0,5
Sustainability Reports Published	0,5
Party to International Agreements or Principles	1
Total	5

After the corresponding calculation of the SPI for each FI, a process of normalization of the averages of each component of the index was performed, with the goal of classifying its relative level of performance: "Advanced Institutions," "Follower Institutions" and "Laggard Institutions." To find these strata, the database was divided into three "thirds based on the maximum possible score (5); lower third (lower than 1.67), middle third (1.67 - 3.33) and upper third (3.34-5).

In addition, using the SAS statistical software, several econometric models were run with the identified variables, to determine which of them were correlated and thus help explain the behavior of the institutions in adopting measures focused on sustainable development.

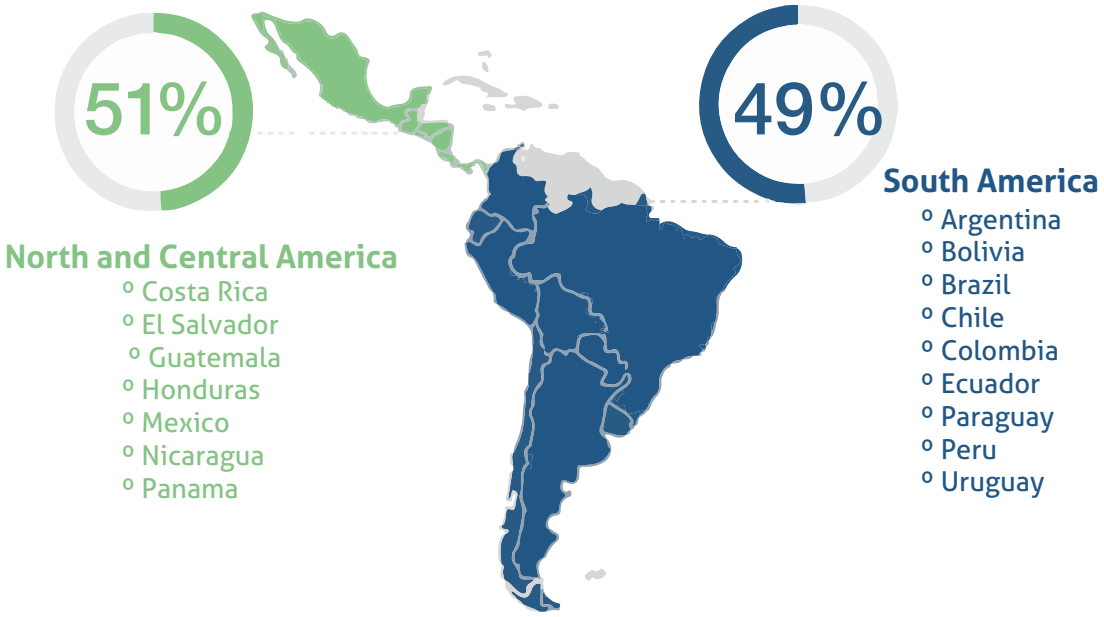
4. FINDINGS

The main conclusions of the survey are presented below. First, the type of institutions participating in the research is described. That is followed by a report and discussion on the governance of environmental and social issues, in which the state of environmental and social policy and the implementation of sustainability strategies is described. Next comes an analysis of the operationalization of sustainability policies and strategies, evaluating the progress in implementing an environmental and social risk analysis systems (ESRAS), in monitoring of the environmental and social management systems of the institutions, and in implementing financial services for environmental and social investments (ESFS). Subsequently, CSR is analyzed. Finally, the level of implementation of the sustainability reports as communication tools for the sustainability programs of the evaluated institutions is explored.

4.1 Characterization of Participating Institutions

The present study was carried out in the Latin American region including a total of 80 financial institutions from 16 countries, as well as a development institution with headquarters in the United States and a high presence in Latin America. 51% of these financial institutions come from North and Central America (Mexico, Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica and Panama) and 49% from South America (Colombia, Ecuador, Peru, Brazil, Bolivia, Paraguay, Uruguay, Chile and Argentina (Figure 1).

Figure 1. *Home country of participating organizations*



Classified by ownership structure, most participating financial institutions are private corporations (54 , or 80% of the sample), 9% are state-owned, 9% include mixed capital and 2% are international organizations (Inter-American Development Bank IDB, for example). Of all participating organizations, 55% are commercial banks (44 banks), 20% development banks and 25% other institutions (microfinance, insurers, cooperatives, NGOs). As for the market they serve, 66% are first-tier (53 banks), 20% second-tier and 8% serve entities on the first and second-tiers (Figures 2 and 3).

Figure 2. *Classification of participating institutions by ownership structure, type of financial institution and by market segment served, in percentages.*

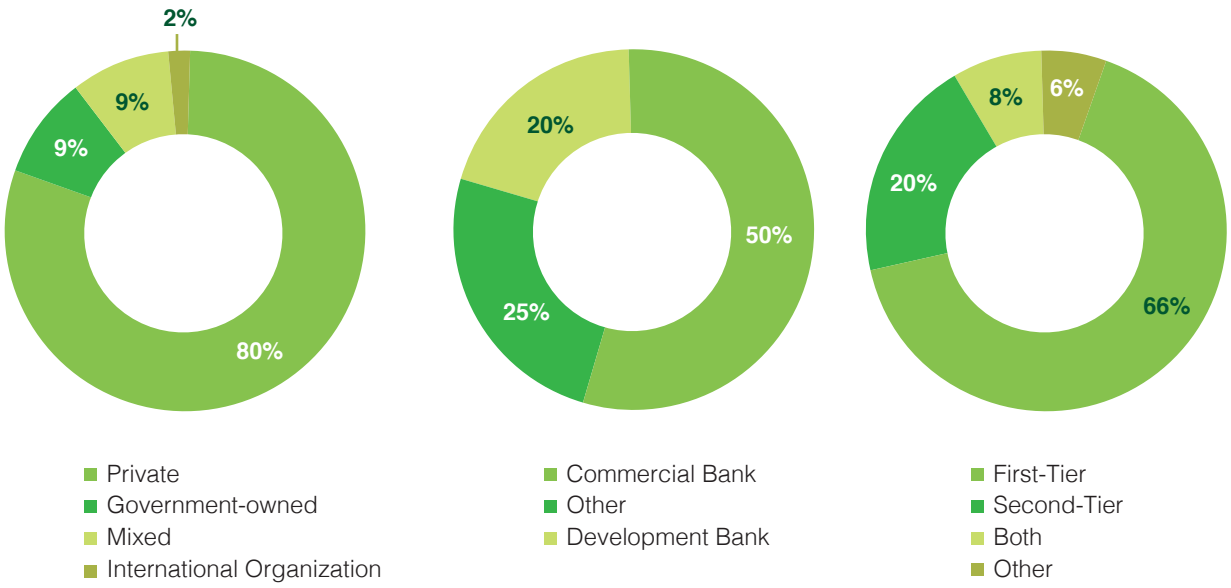
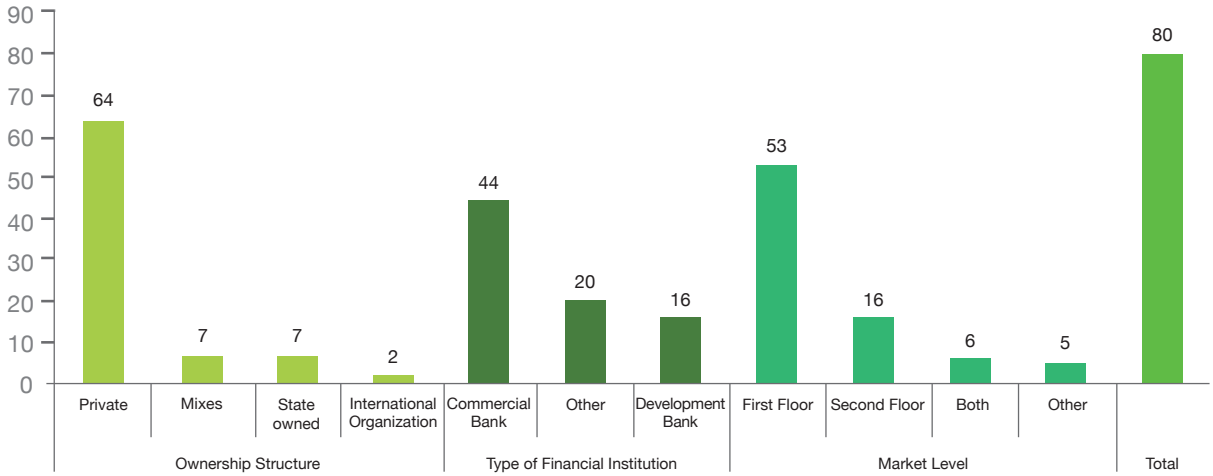


Figure 3. *Characterization of the participating institutions by ownership structure, type of financial institution and market, in absolute values*



Regarding the size of the institutions, the poll included a question about the value of their assets as of 2016. Of a total of 64 institutions that answered this question; 14% are worth less than USD $ 100 million, while the majority (54%) is concentrated between USD $ 100 million - USD $ 5 billion, 14% between USD $ 5 - USD $ 10 billion, 6% between USD $ 10 and USD $ 15 billion, 2% between USD $ 15 and USD $ 20 billion and 11% greater than USD $ 20 billion (Table 2). The average value is USD $ 6.777 billion, and the minimum values of USD $ 310,600 and maximum of USD $ 69.759 billion.

Table 2. *Distribution of participating financial institutions by total assets*

Assets (millions of USD)	Number of cases	Percentage
<USD $100	9	14%
USD $100 - USD $5.000	**34**	**53%**
USD $5.000 - USD $10.000	9	14%
USD $10.000 - USD $15.000	4	6%
USD $15.000 - USD $20.000	1	2%
> USD $20.000	7	11%
Total	**64**	**100%**

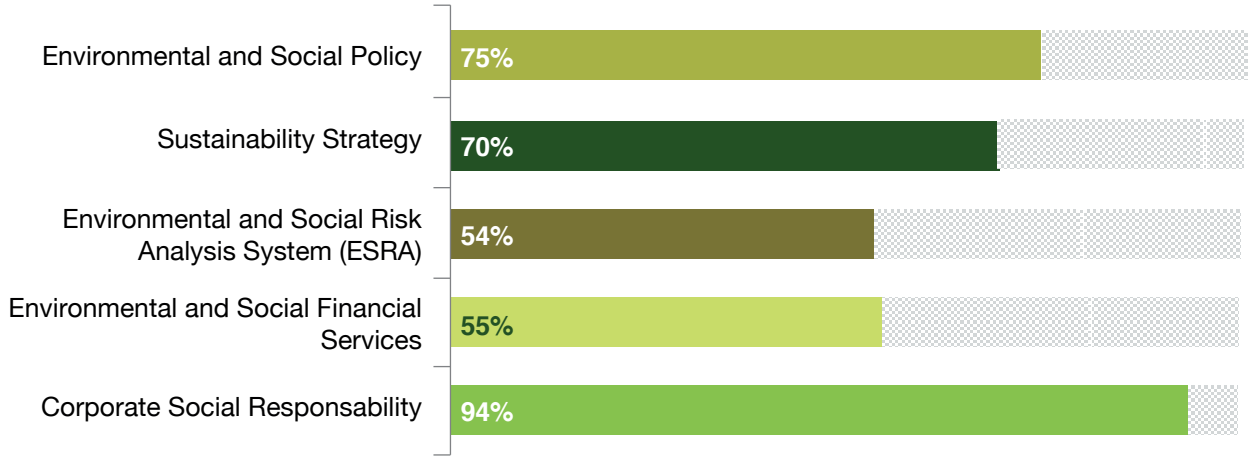
4.2 General Results

This section presents the major areas of research analysis as to to the State of Environmental and Social Policies and Practices in Latin America (Figure 4). It was found that, of the universe of surveyed institutions, 75% have a functioning environmental and social policy, but 25% of institutions in the sample have not yet assumed governance of these issues, and do not have an environmental and social policy. Similarly, 30% do not have a sustainability strategy to guide the actions of the institutions in relation to the management of environmental and social issues within the organization as well as with its clients.

Furthermore, the stated policies of the organizations on these issues do not seem to translate to an adequate operationalization at the core business level: lending money and managing risk. Only 54% of the respondents indicated that they have an environmental and social risk analysis system (ESRAS) and only 55% offer financial services for environmental and social investments.

On the other hand, CSR - which in the Region takes on many different meanings, some of them quite superficial - is in place in almost all organizations (94%). This may lead to new lines of action, depending on the hypotheses used to explain this scenario: 1) the sustainability strategy includes "only the easy parts": such as CSR; 2) Functional managers do not have the capacity or tools required to implement risk management systems or new credit products; 3) the incentives and performance evaluations of these organizations may not measure middle managers' compliance with the sustainability strategy (they only measure Key Performance Indicators, regular KPIs, but do not incorporate sustainability variables in their management control systems).

Figure 4. *General Results on main issues evaluated.* **n = 80**



4.3 Governance of Environmental and Social Issues

This section examines how upper management, within the Latin American organizations evaluated in this research, have formulated environmental and social policies to govern the actions and dictate the guidelines within the institutions, as well as the formulation of a sustainability strategy based on the impacts they produce in society, thus deducing the level of commitment they have vis a vis sustainable development.

The development of an environmental and social policy within an institution points to where the actions of the organization are headed in these areas, showing its collaborators, its clients and society in general its vision regarding sustainable development. A well-structured policy, which dictates the guidelines to be followed in environmental and social issues, becomes the basis for the formulation of a sustainability strategy and a guide for the creation and implementation of tools for the measurement, analysis and control of environmental and social risks facing the business.

4.3.1 Environmental and Social Policy

Most of the institutions evaluated have reported that they have an environmental and social policy (75%), while 12.5% are in the process of developing their policy, and the remaining 12.5% do not have a policy for management of environmental and social issues in their organizations (Figure 5). In Figure 6, this number is broken down in more detail by type of institution. Both government-owned and private institutions, in more than 70% of instances, have a policy of this type. Similarly, more than 75% of both commercial and development banks have an environmental and social policy. If classified by the market segment they serve, close to 80% of first-tier banks have an environmental and social policy, while that percentage drops to 62.5% for second-tier banks.

Of the respondents who say they have an environmental and social policy, more than three-quarters indicate that their policy is their own and was developed internally (83%), 12% have their own policy based on the parent company, and only 5 % uses the environmental and social policy of their parent company (Figure 7). This is a phenomenon that could partly explain why the policies are not always implemented with the same force as other regular mandates, or why the development of a policy does not always consider international principles, even if the bank is a signatory to such agreements.

Figure 5. *Institutions that have an environmental and social policy* **n = 80**

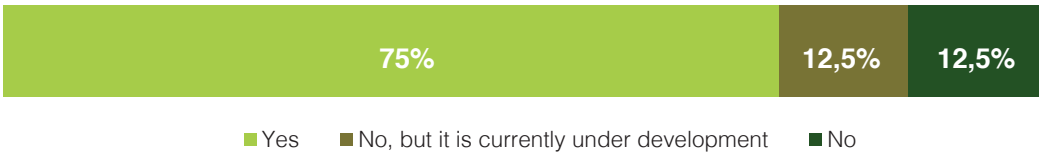


Figure 6. *Environmental and Social Policy by type of institution* **n = 80**

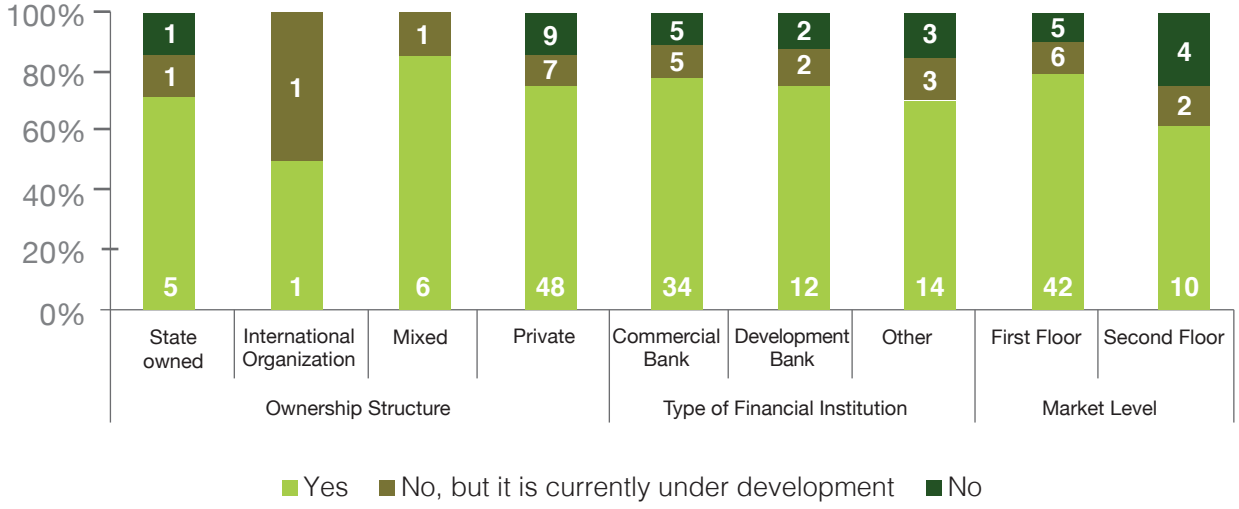
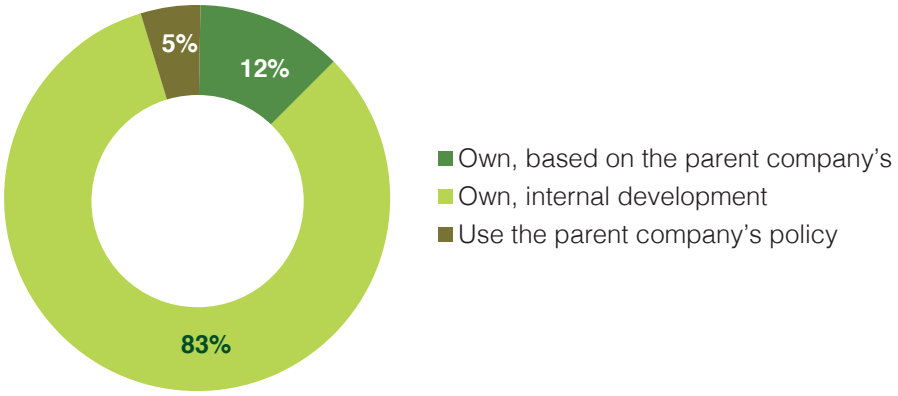


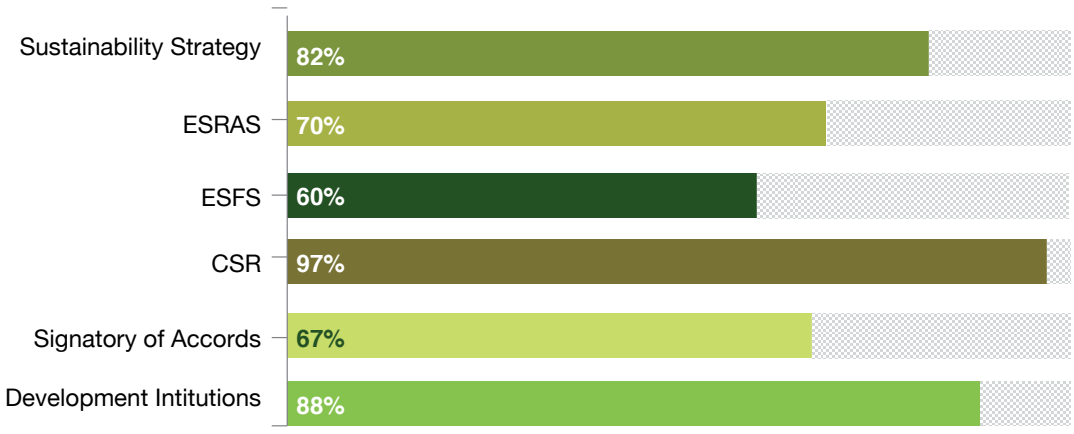
Figure 7. *Source of the Environmental and Social Policy* **n = 60**



On the other hand, considering only the institutions that have an environmental and social policy (Figure 8); 82% have a sustainability strategy based on the direct impacts they producs, but 18% do not have such a strategy. In addition, 70% have an environmental and social risk analysis system implemented in their operations. With respect to financial services for environmental and social investments, only 60% offer this type of services.

These results highlight that developing and approving a sustainability policy does not ensure the creation of a strategy that will render it operational in the competitive context of each institution. More specifically, the strategy is reflected more often in the development of ESRAS than in the implementation of financial services for environmental and social projects (ESFS). Many organizations that have well established relationships with development banks have made progress in governance work. In terms of sustainability and risk principles, it can be observed that the sustainability strategy is not always guided by the best international practices (UN Global Compact, IFC and Equator Principles).

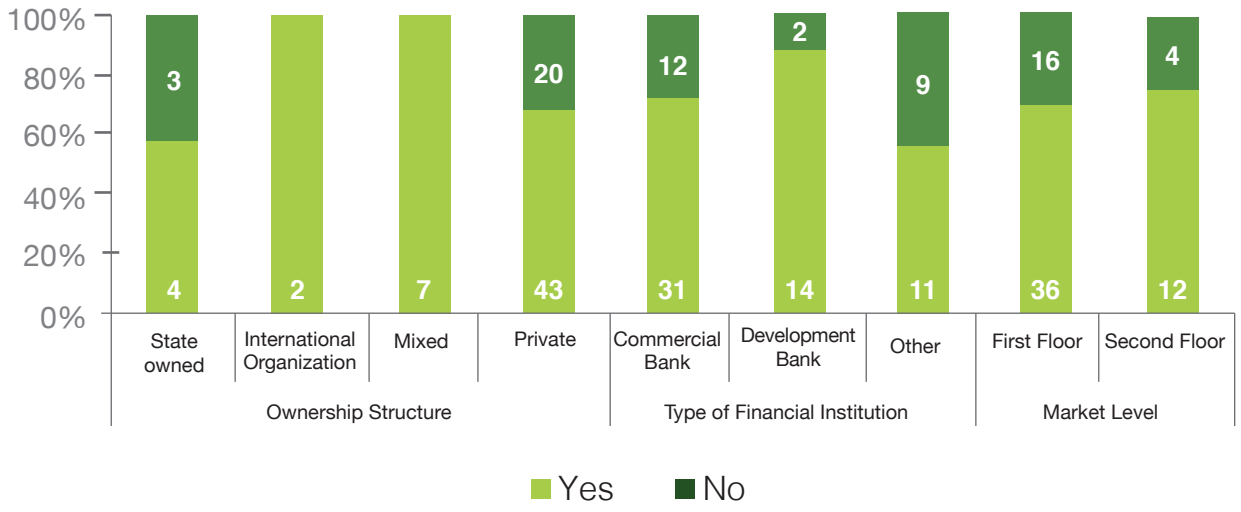
Figure 8. *Classifications of the institutions that have an Environmental and Social Policy* **n = 60**



4.3.2 Sustainability Strategy

Considering only those institutions that have developed and implemented a sustainability strategy within their organizations; 70% of the respondents have a sustainability strategy based on the impacts that the company produces in society, and as much as 30% do not yet have a strategy of this kind. 68% of private institutions and 57% of the government entities surveyed have a sustainability strategy. A similar comparison by existence of a sustainability strategy show commercial banks at 72%, somewhat behind development banks at 87%. The proportion of first- and second-tier banks with a sustainability strategy reach 69% and 75% respectively (Figure 9).

Figure 9. *Sustainability Strategy based on the impacts caused by the organization on society, by type of institution* **n = 80**



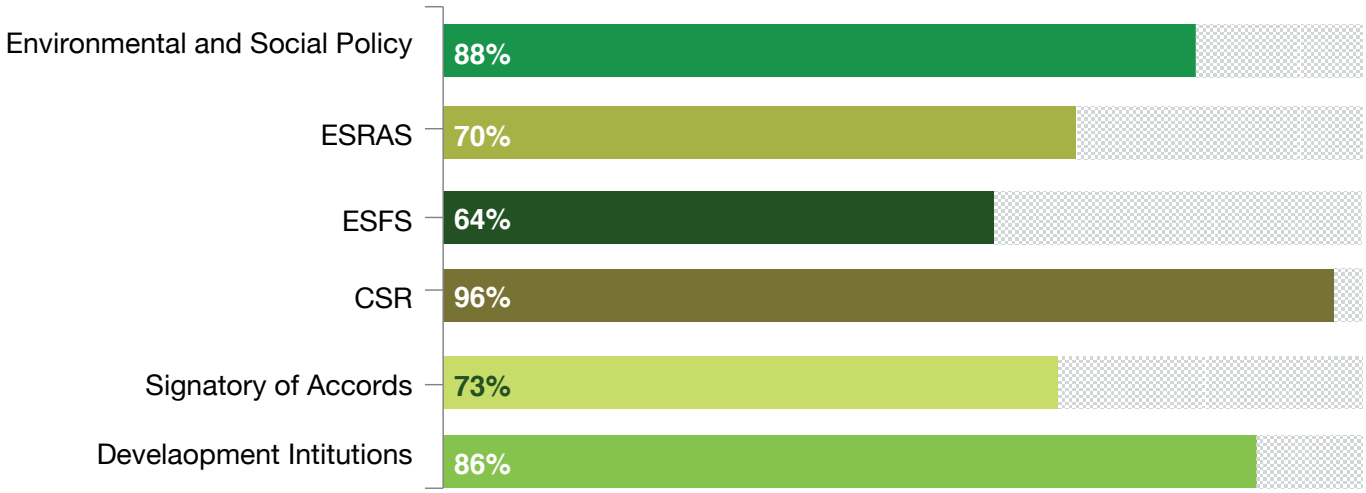
Of those institutions that have a sustainability strategy, only 88% have so far implemented an institutional environmental and social policy that governs such a strategy, and it is not clear how the remaining 12% operate without an established policy that dictates guidelines for the creation of the strategy (Figure 10). On the other hand, 70% of the institutions that have a sustainability strategy have implemented an environmental and social risk analysis (ESRAS) system, and 64% offer some type of product for financing environmental and social projects (ESFS). This indicates that there is still a large percentage of institutions that have not yet operationalized their sustainability strategy through these tools.

Green product development (ESFS) show even more of gap than the development of ESRAS, even though three quarters of the respondents are signatories of international agreements and a large majority of those that have a strategy has managed to establish relationships with development institutions.

This may indicate: (1) that relations with international organizations -including funding or special capital for product development- have not been strengthened adequately, perhaps because they do not align the processes of their institutions; or (2) lack of capacity to interpret and better follow up on international agreements.

On the other hand, a large majority (96%) of institutions that have a sustainability strategy also have a Corporate Social Responsibility (CSR) program. As noted above, this can be an indicator that sustainability strategy and CSR programs are generally focused on common and widespread environmental and social programs and projects (see the CSR section below) or that the management does not have a sustainability agenda and strategy that considers the implementation of a risk system, or that offers financial services for environmental and social investments. Therefore, this points to the need to refocus CSR in the financial sector towards more contributory strategies for sustainability.

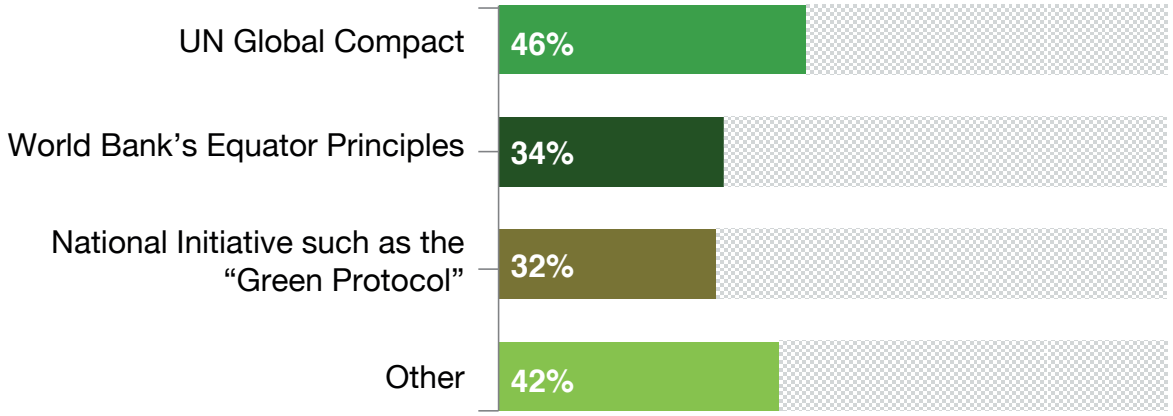
Figure 10. *Characterization of institutions that have a sustainability strategy.* **n = 56**



4.3.3 Adherence to Sustainability Principles and Standards

Of the institutions surveyed, 59% indicated that they are signatories to one or more international agreements. Of the organizations that have some adherence to the principles and standards of sustainability, 46% are a signatory of the UN Global Compact, 34% to the Equator Principles of the World Bank's IFC, 32% subscribe to some national initiative such as the Green Protocol (Brazil and Colombia), and 42% follow other types of standards, usually country-specific (such as "Carbon Neutral Principles") (Figure 11).

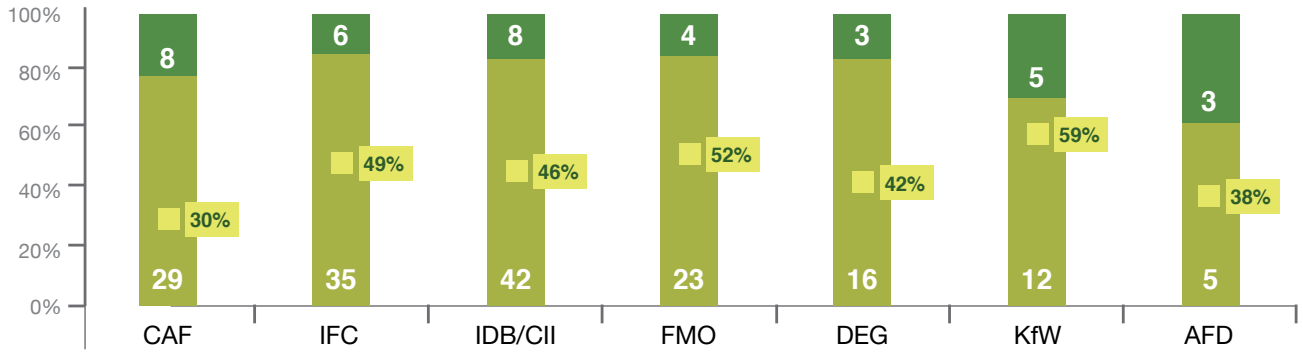
Figure 11. *Sustainability principles and standards adopted by participating institutions.* **n = 50**



4.3.4 Development Organizations with which Financial Institutions have formal relations

Eighty-one percent of all assessed financial institutions either has or used to have formal relations with one or more development institutions. Generally speaking, in most cases agreements with these institutions includes environmental and social conditions. For example, of the institutions that have some type of relationship with CAF - Latin American Development Bank -, 78% have an agreement currently in force and 30% of cases include or included environmental and social conditions. In the case of institutions that have agreements with the World Bank's IFC, 85% of these relationships are in force and in 49% of cases the agreements include environmental and social conditions (Figure 12).

Figure 12. *Development Organizations with which Financial Institutions have formal relations* **n = 73**



4.4 Operationalization of Policy and Strategy

This section explores the extent to which the evaluated institutions have put their environmental and social policies and their sustainability strategies into operation within their organizations, through the implementation of a sustainability plan. Specifically, the implementation of the environmental and social risk analysis systems within the financial institutions is analyzed as tools for the analysis and prevention of environmental and social risks. In addition, how closely financial institutions monitor the environmental and social management systems (ESRAS) is verified. The design, operation and financing of financial services for environmental and social investments is also analyzed, as green lending instruments for channeling funds.

4.4.1 Environmental and Social Risk Analysis System (ESRAS).

Financial institutions, like their clients, are constantly exposed to latent environmental and social risks in their activities. These risks could have a negative impact if not detected and taken care of in time, whether in the collateral that guarantees the financing of the projects, in the reputation of the institution, in its customers' cash flow, or in legal implications.

Due to the above, the timely implementation of an environmental and social risk analysis system represents opportunities to: avoid environmental and social risks, improve the image of the institution for its commitment to sustainability, produce shared value for its clients and stakeholders, generate new business opportunities; and create new products and services in the green market, among others.

An environmental and social risk analysis system include a set of policies, mechanisms, tools and procedures that provide a bank with a clear vision of the environmental and social risks in its portfolio at different levels of aggregation (individual loans, sectors and regions), which leads to the identification, prioritization and focus on the most important environmental and social risks in its portfolio (IDB, 2014), so as to minimize the chances of assuming the costs generated by these risks.

In this research, only 54% of the evaluated financial institutions have developed and implemented an environmental and social risk analysis system (ESRAS). By type of ownership, 55% of private institutions and only 29% of public institutions have implemented this system compared to 60% of commercial banks and 63% of development banks. For their part, it was found that the first and second-tier banks have ESRAS at 55% and 56% respectively (Figure 13).

While it is true that 8% of the institutions are in the process of developing an ESRAS, 46% of financial institutions still do not have an appropriate mechanism to analyze and manage the environmental and social risks of the projects they are funding. This may indicate a lack of capacity to standardize these risks so they can be evaluated with the risks most conventionally measured by the bank.

Figure 13. *ESRAS by type of institution*

n = 80

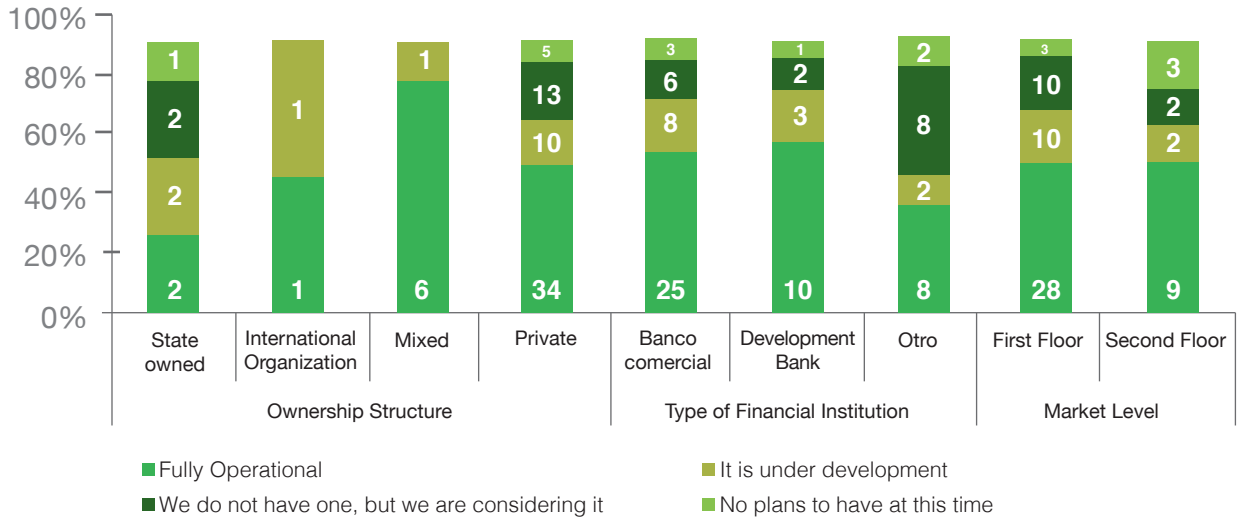


Figure 14 shows that most institutions that have a working environmental and social risk analysis system review the risks of loans and investments of all its clients and review loan and client investment risks in sectors that are considered high risk. Figure 15 indicates that most financial institutions with an ESRAS review loan risks, regardless of the amount to be funded or if it exceeds an established amount.

More than half of the respondents evaluate risks without regard to customer and amount, the other half is diffuse, using sector criteria, bank exposure, and other traditional criteria.

Figure 14. *Scope of ESRAS by type of customer.*

n = 76

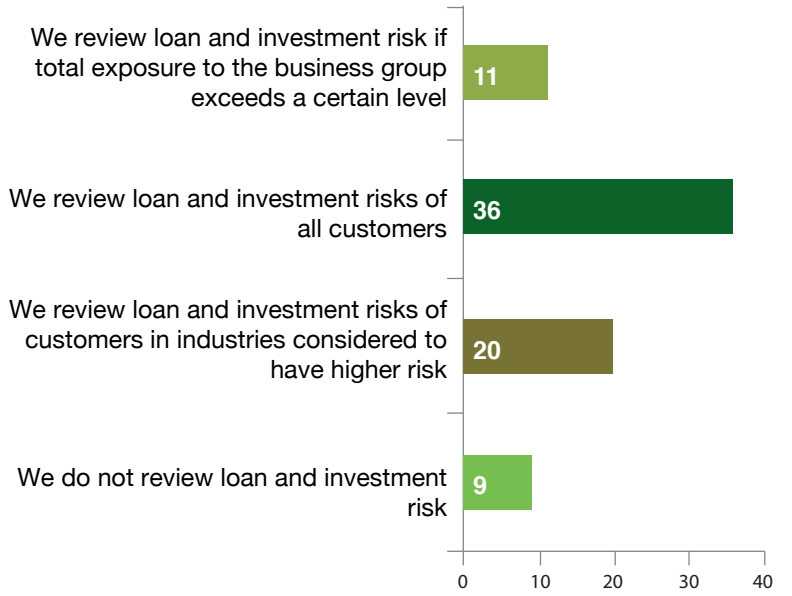
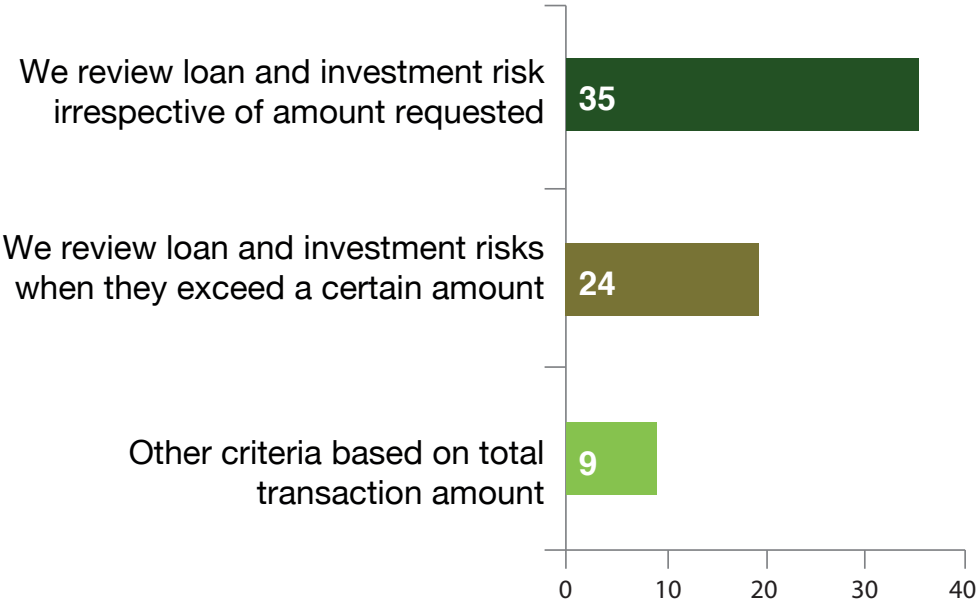
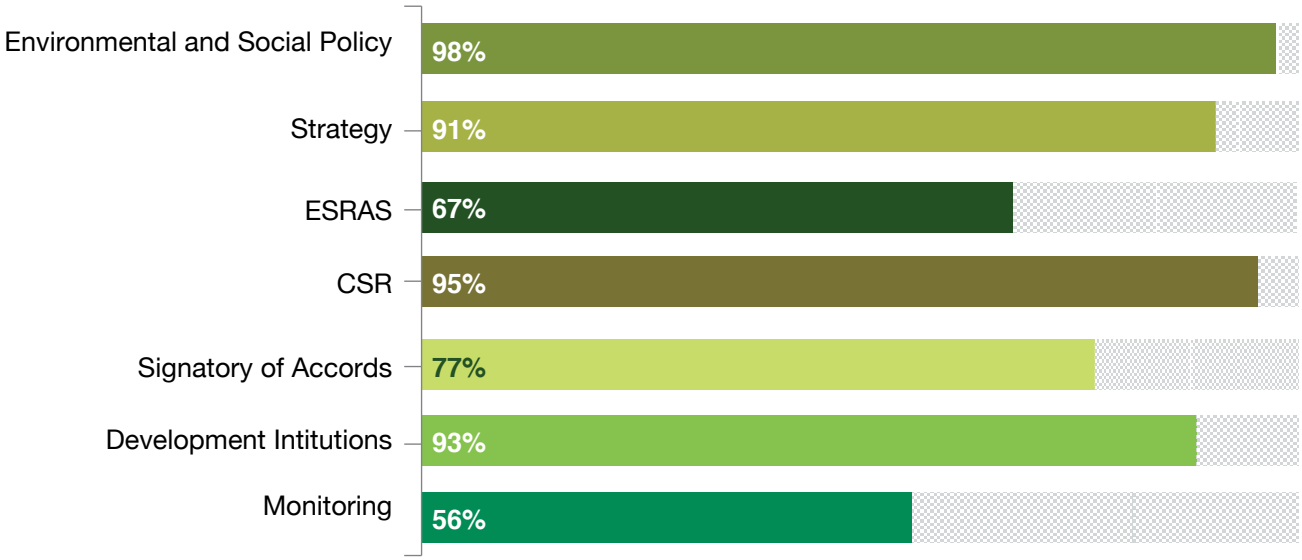


Figure 15. *Scope of ESRAS by type of transaction* **n = 76**



Slightly more than half of the institutions using a ESRAS effectively monitor this system (56%), which means that 44% of the institutions do not have an effective system for assessing the environmental and social risks of their clients and their projects. Also, it should be noted that there are a number of institutions that make their credits under an ESRAS but have no strategy (9%), i.e. the risk analysis system can go one way and the strategy (which in general is better measured), go the other way. The relationship with development institutions does seem to be a factor in pushing organizations to establish an ESRAS (Figure 16).

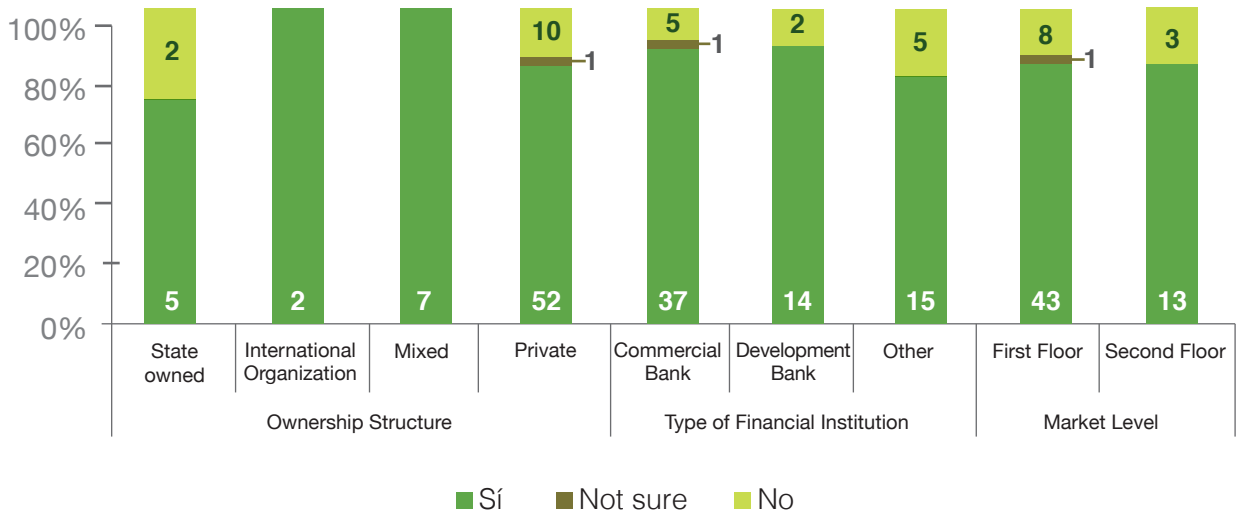
Figure 16. *Characterization of institutions with an Esras.* **n = 43**



4.4.1.1 Environmental Issues in the Approval of Loans and/or Investments

On the other hand, most institutions (84%) indicated that they take into account environmental issues in the approval of loans or investments, although, as indicated above, not all institutions have a system for the analysis of environmental and social risks. In particular, as shown in Figure 17, 83% of private institutions take into account environmental risks for loan approvals. Similarly, commercial and development banks all point out that environmental risks are relevant for the approval of projects. There is still work to be done in development and second-tier institutions. In the region, it cannot be assumed that development organizations, , already incorporate or effectively follow-up these issues simply because of their orientation or mandate.

Figure 17. *Consideration of environmental issues for the approval of loans and investments.* **n = 80**



4.4.1.2 Review, Analysis and Approval of Projects with Environmental and Social Risks

Upon investigating who, within the structure of the financial institutions and according to their established approval workflow, reviews and analyzes the environmental and social risks of projects classified as having high environmental or social risk, it was determined in this investigation that this task is most often handled by the members of the credit analysis team (45%). Other institutions rely on an internal expert who evaluates these projects (25%), however, 30% of institutions delegate this function to an external expert (Figure 18). Due to the above, there is a need, for a good percentage

of institutions, to strengthen and develop the capabilities of their human talent in these areas.

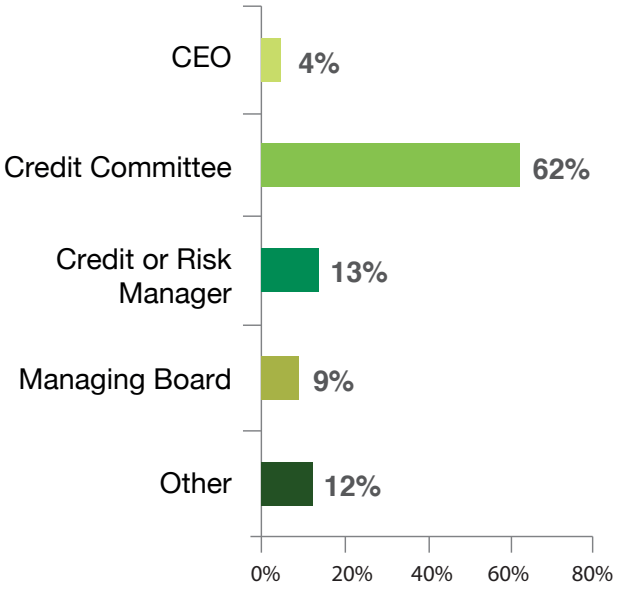
Regarding the organizational level at which the decision is made to accept or not the environmental and social risks detected, in 62% of cases the credit committee is responsible for deciding, while in 13% of cases credit or risk managers determine whether the risks are acceptable or not, as a condition for funding a project (Figure 19).

Figure 18. *Party Responsible for the revision and analysis of high environmental and social risk projects.*

n = 67

Figure 19. *Organizational decision-making level at which the determination is made on whether the identified environmental and social risks are acceptable, allowing the transaction to move forward*

n = 67



As shown in Figure 20, 60% of surveyed banks indicated that upon completing the process of review and analysis of environmental and social risks, they have rejected applications for loans due to environmental and social causes. In addition, 69% of all institutions report that clients have been asked to incorporate elements of environmental or social risk mitigation as a precondition for approval for investment loans (Figure 21).

Even though there is an important number of institutions that has not managed to implement policy and strategy guidelines, those organizations that have been able to establish an ESRAS and IFC Performance Standards seem to generate more consistent results when observing "outcome" variables of the implementation of those systems. An example of this is the rejection of applications and the request for incorporation of elements of risk mitigation.

Figure 20. *Loan applications rejected due to environmental and social causes* **n = 73**

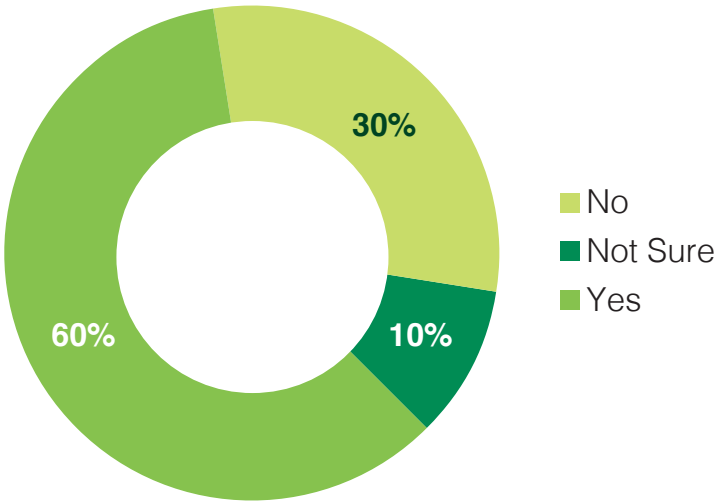
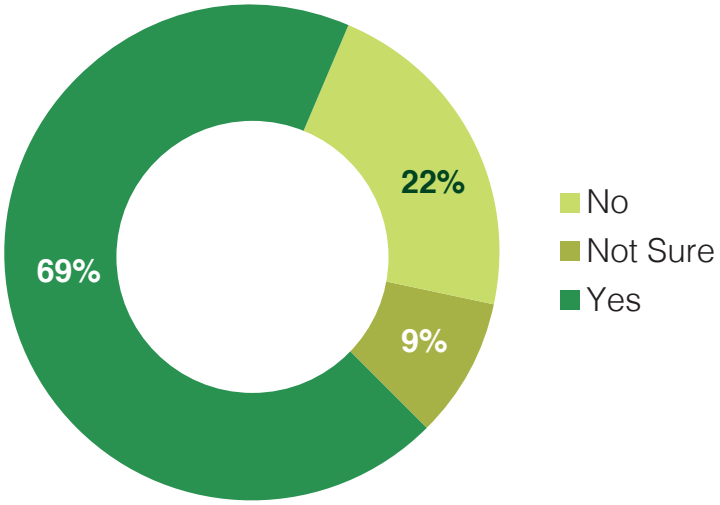


Figure 21. *Request that customers include mitigation elements as a condition to approve loans* **n = 73**



4.4.1.3 Monitoring and Control Indicators

Monitoring is essential in environmental and social risk analysis systems, as an integral part of strategic planning. The point being to follow up at key moments on the projects and funds granted through financial services for environmental and social investments. Monitoring serves the verification process, so that the requirements agreed between the parties are met as well as to incorporate modifications into concrete actions, as long as the contracts permit.

Querying the institutions that have a system of environmental and social risk analysis (ESRAS) in operation, on whether their management system currently measures the environmental and social performance and impact of clients and their projects, it was found that only 56% possess a monitoring program for these ends and, despite having a ESRAS, 44% of institutions do not follow up on clients or projects after they are funded. If these data are analyzed within the total number of institutions responding to the survey, the percentage of banks monitoring the projects is reduced to 41% and there are up to 52% of organizations that do not verify if the funds are employed without causing negative impacts on the environment or society (Figure 22).

By disaggregating these results and breaking down the analysis by type of institution, it can be seen in Figure 23 that both state and private institutions, commercial banks and development banks, as well as first and second tier institutions show similar situations.

The above seems to indicate that most institutions have a pending task to keep track of the funds they provide to their clients, since they are only reviewing the potential risks prior to the approval of the projects and are not verifying whether their disbursements are helping create environmental and social issues en the places where projects are implemented.

Figure 22. *Monitoring the environmental and social impact of customers and their projects* **n = 73**

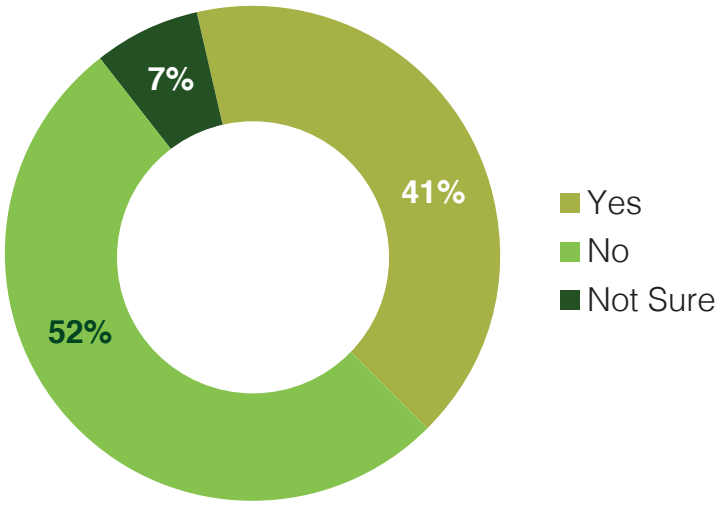
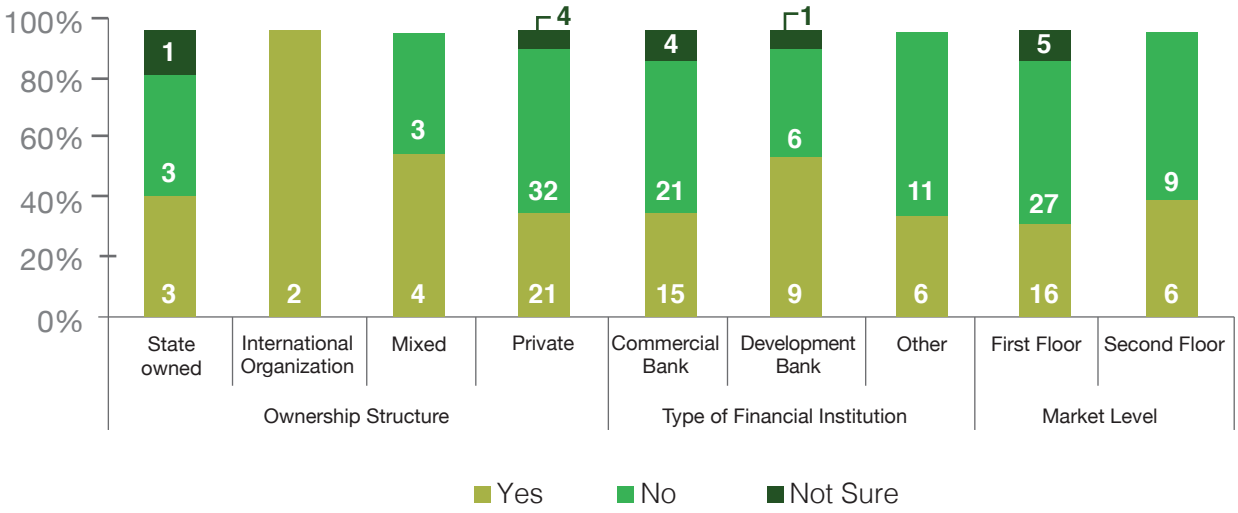


Figure 23. *Monitoring the performance or environmental and social impact of customers and their projects, by type of institution* **n = 73**



4.4.2 Financial Services for Environmental and Social Investments (ESFS)

The financial services for environmental investments that financial institutions make available to their customers are their way of executing their vision and policies on the management of environmental and social issues and the impact they hope to achieve. Once they have a sustainability policy and strategy that points the way forward with respect to the inclusion of environmental and social issues in the financial sector, the development of ESFS becomes more feasible, thus improving its credit operations. In addition, financial institutions can take advantage of the potential environmental and social risks of clients and their projects, which are detected with ESRAS, and not see them as risks, but as business opportunities to generate new products and financial services. This effort leads to the need to design financing lines for new green markets and businesses.

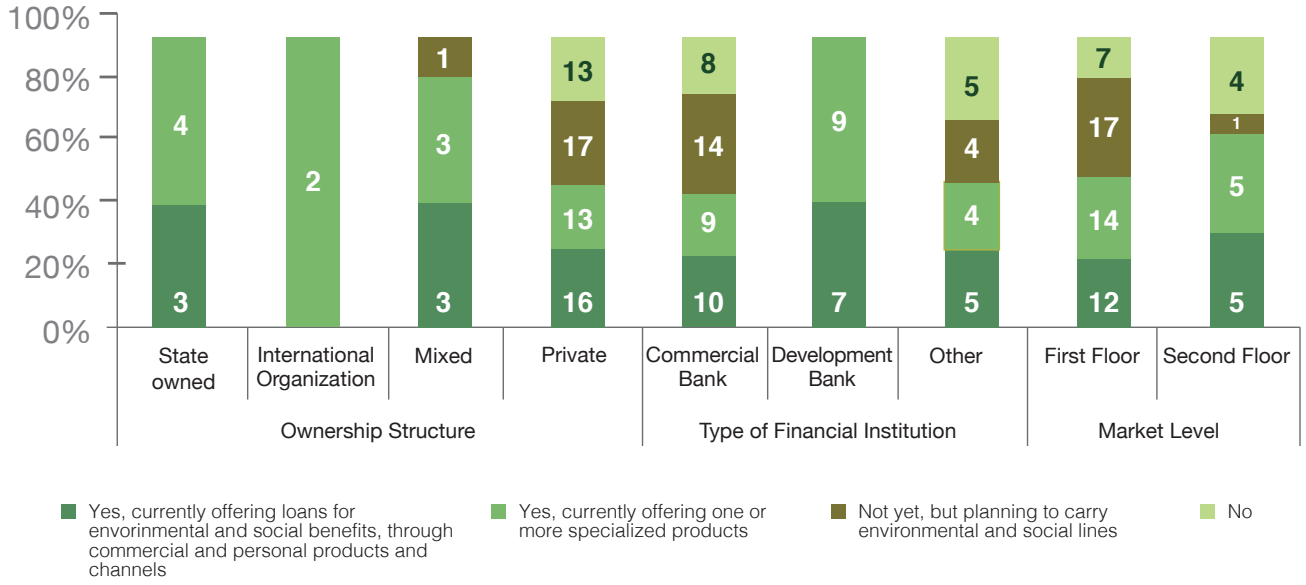
It is important to note that ESFS represent business opportunities that generate monetary benefits, for example, in the reduction of costs from the implementation of an energy efficiency program by a client. ESFS also provide benefits to financial institutions: diversification of risk, portfolios and sources of income, attraction of new sources of funding, strengthening of sustainability programs or the incursion in new markets.

This research determined that 59% of the evaluated institutions offer this type of financial services - 50% of them offer one or more specialized products and 50% offers loans for environmental and social benefits through commercial and personal products and channels. Of those who answered this question, 41% do not offer this type of investment, and of those, 58%

plan to have environmental and social lines in the future. As can be seen in Figure 24, private institutions, commercial banks and first-tier institutions all exhibit a behavior consistent with that described above.

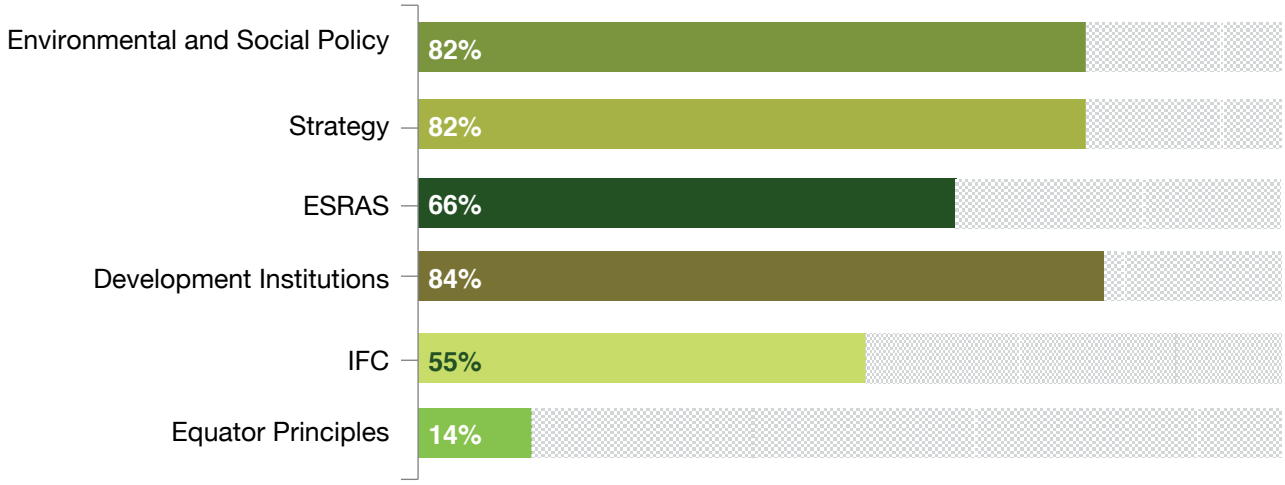
It is important to note that in some categories "green" loans or ESFS are taken more as a specialized offering than as an adaptation of the current portfolio or added value to the products traditionally offered by the bank, that is, they are not considered as instruments to enter new markets. In other words, it could be inferred that progress is being made, but that the vast majority of institutions surveyed consider ESFS as "pilot" or special products, not as part of their core business.

Figure 24. *ESFS by type of institution* **n = 80**



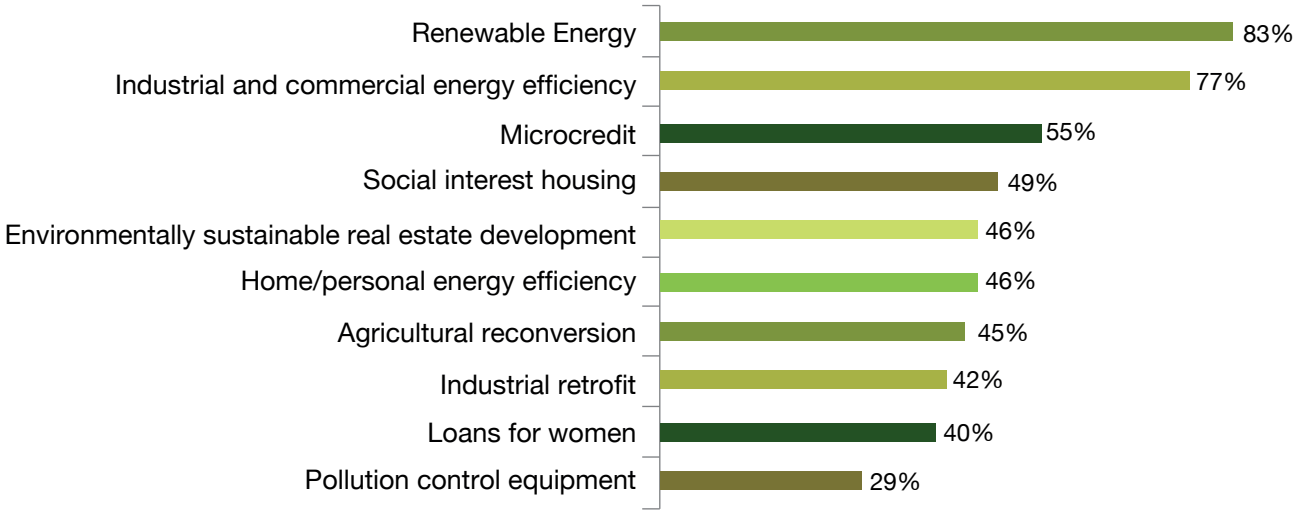
Considering only the institutions that offer environmental and social financial services, 82% of them have an environmental and social policy and a sustainability strategy, which indicates 18% of those institutions are offering this type of financial services without being covered or aligned with a policy or strategy. Also, only 66% have an environmental and social risk analysis system, although 84% have formal agreements with development institutions (IFC, IDB, others). In addition, it can be seen that there is a disconnect between international principles for risk management and "green" loans, taking into account the percentage of institutions that apply the Equator Principles (14%) and the IFC Performance Standards (55%) (Figure 25).

Figure 25. *Characterization of institutions offering ESFS* **n = 44**



The five main areas in which institutions show a greater penchant for providing financial services for environmental and social investments are projects related to: renewable energy (83%), energy efficiency in industry and commerce (77%), microcredit (55%), social interest housing (49%), and green or environmentally sustainable real estate development (46%), (Figure 26).

Figure 26. *Main target areas for ESFS investments* **n = 65**



Banks that offer financial services for environmental and social investments finance these projects through own funds (29%), intermediation of international capital (11%), but the most common form is the combination of the two (47%) (Figure 27), considering that 84% of these banks have some formal relationship with an international development institution. For private, commercial and first-tier institutions, the combination of funds is the main source of capital for the environmental and social loans they offer (Figure 28).

Figure 27. *Source of funding for ESFS* **n = 38**

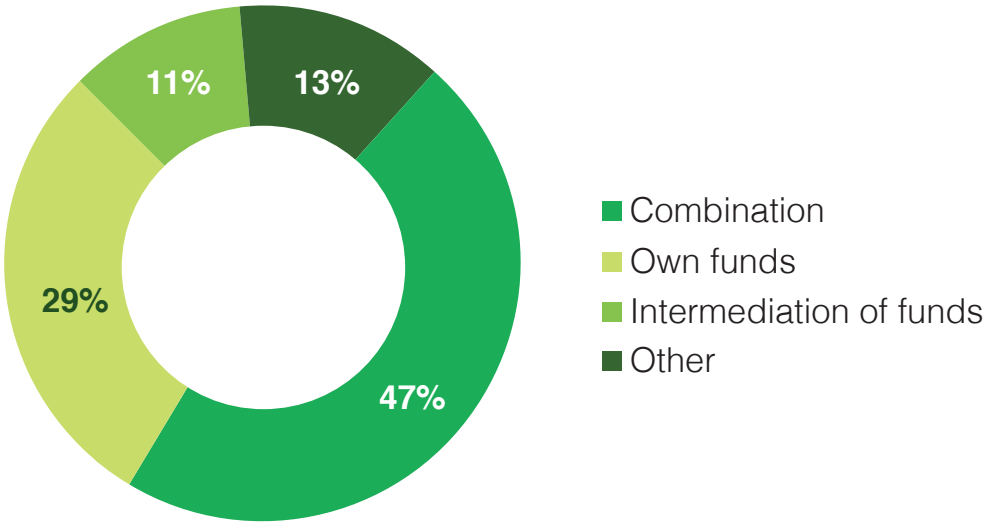
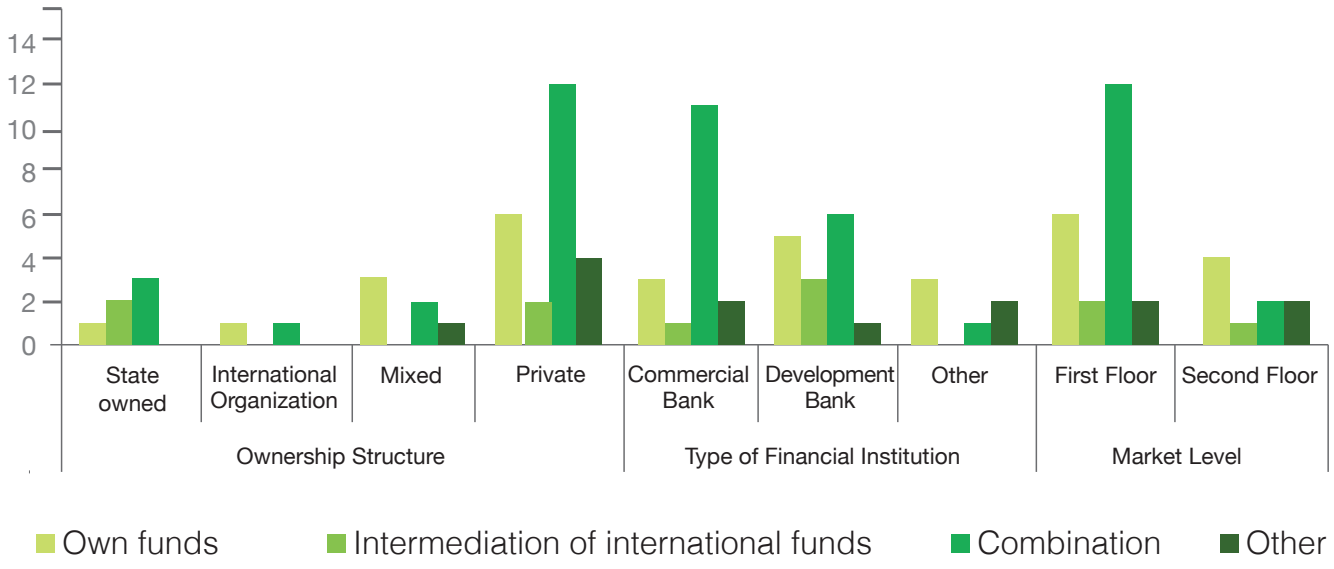


Figure 28. *Source of funding for ESFS, by type of institution* **n = 38**



Financial institutions that provide services for environmental and social investments, and which finance projects through capital intermediation, frequently receive special conditions that accompany the financing, the main ones being: longer repayment period (23%), interest rate (23%), technical support for the financial institution (19%), technical support for clients of the financial institution (4%), and others (Figure 29). A preferential interest rate is the most common condition for private, commercial, and first-tier banks (Figure 30).

Figure 29. *Capital intermediation; special conditions accompanying the financing* **n = 26**

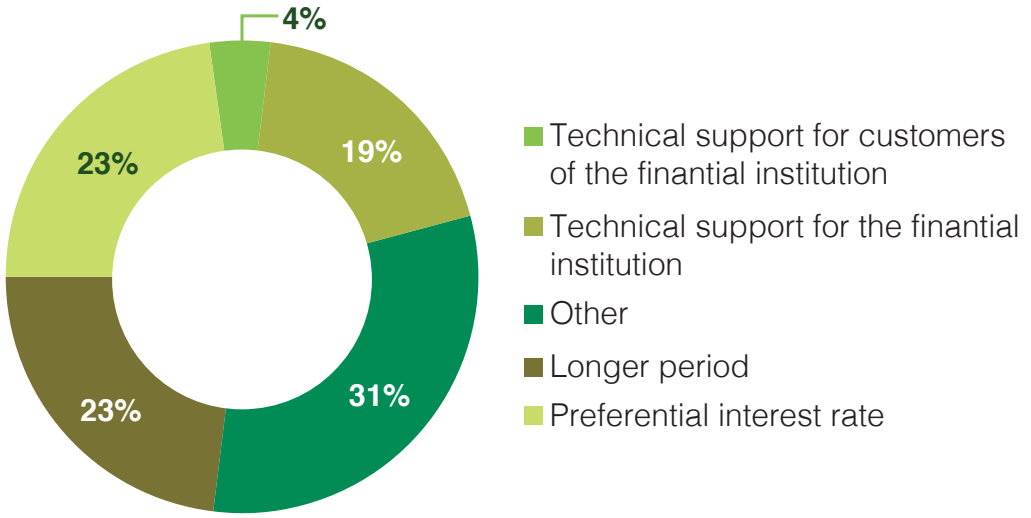
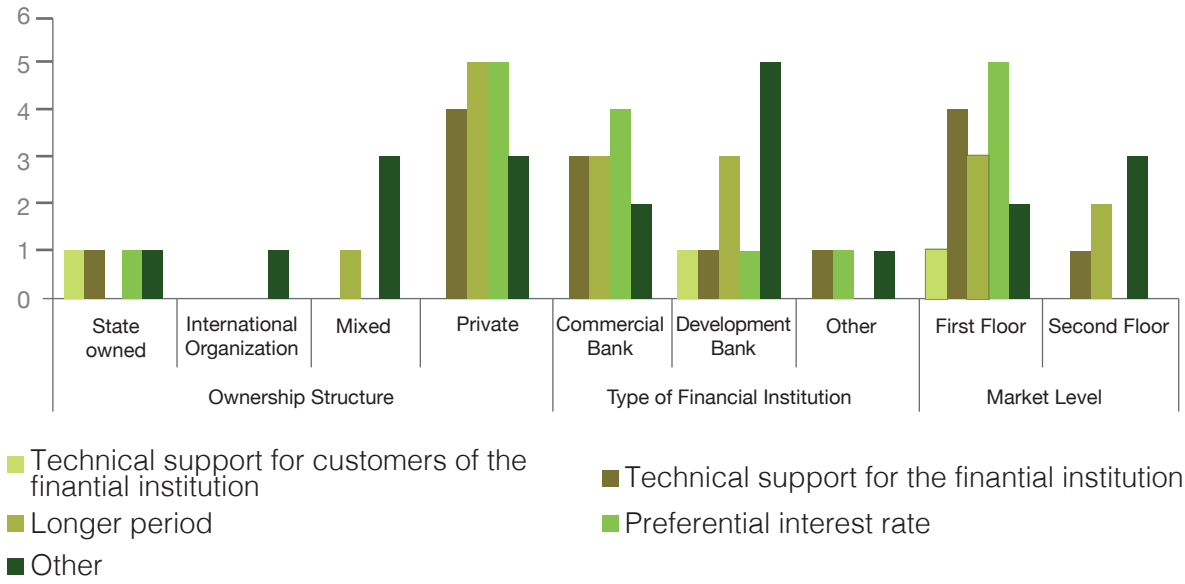


Figure 30. *Capital intermediation; special conditions accompanying the financing* **n = 26**



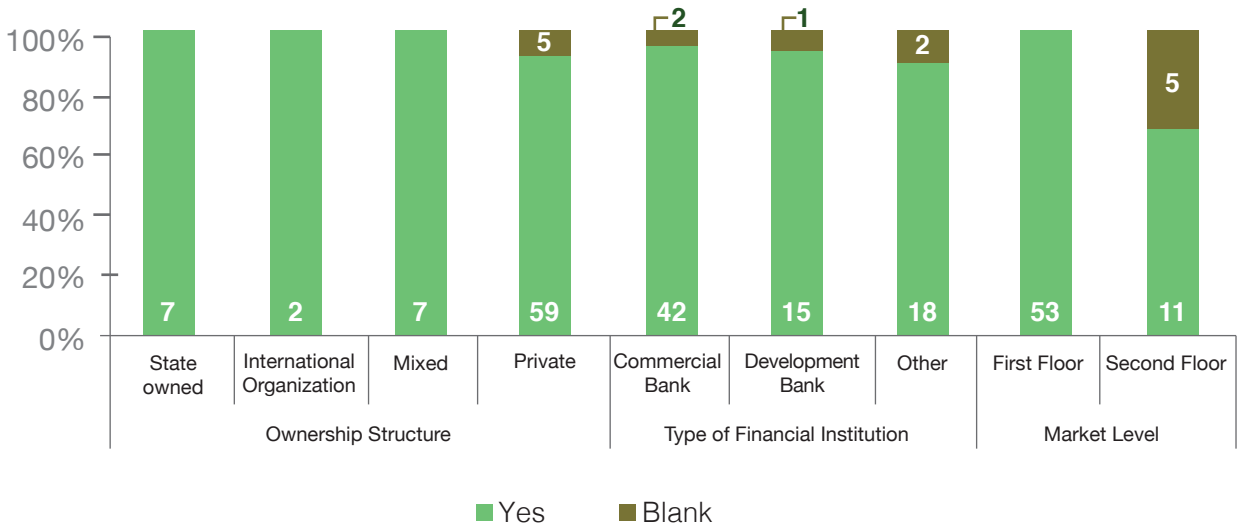
4.5 Corporate Social Responsibility

According to the World Bank (2006), Corporate Social Responsibility is what companies do in support of sustainable development; the balance between economic growth, social welfare and the rational use of natural resources and the environment. In addition, it considers that this balance is fundamental for the operation of businesses and that companies must become an active participant in solving the challenges facing society for a more stable and prosperous environment.

Financial institutions are called on to contribute, to add value and generate a positive impact in society, from actions directly linked to the conduct of their business. Therefore, they should be more responsible in exercising their assigned function of financial intermediation, to meet the demands of the clients and the stakeholders, promoting credits and investments that are environmentally and socially responsible.

CSR programs are very ingrained and widespread within the different financial institutions in the region. This investigation determined that 94% of all institutions have a CSR program; which is reflected in almost all the categories in which the participating institutions were grouped (Figure 31), with the exception of second-tier institutions, where only 69% have a CSR program.

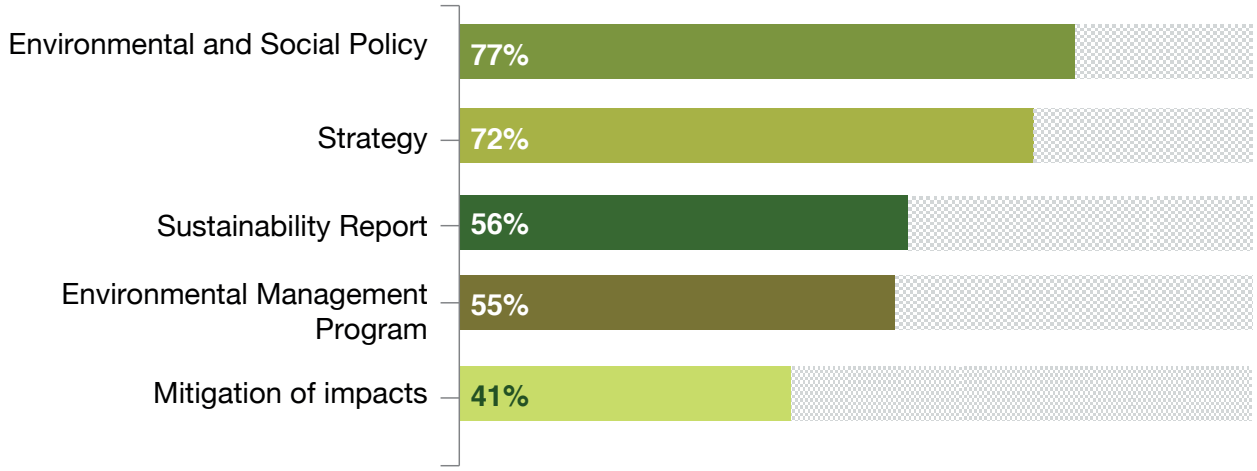
Figure 31. *CSR by type of financial institution* **n = 80**



Having a CSR program does not always imply transparently reporting the results of the activities they serve, and in less than half the cases it means that the CSR program is linked to a sustainability strategy, nor does it imply a focus on mitigating the direct impacts of the organization. It often just means the fulfillment of some of the

issues traditionally considered in reactive CSR programs in Latin America (recycling, renewable energy, and others); in but a few cases CSR involves issues related to the organization's business (in this case, financial intermediation services, to mention the primary one). (Figure 32).

Figure 32. *Characterization of institutions with a CSR* n = 75

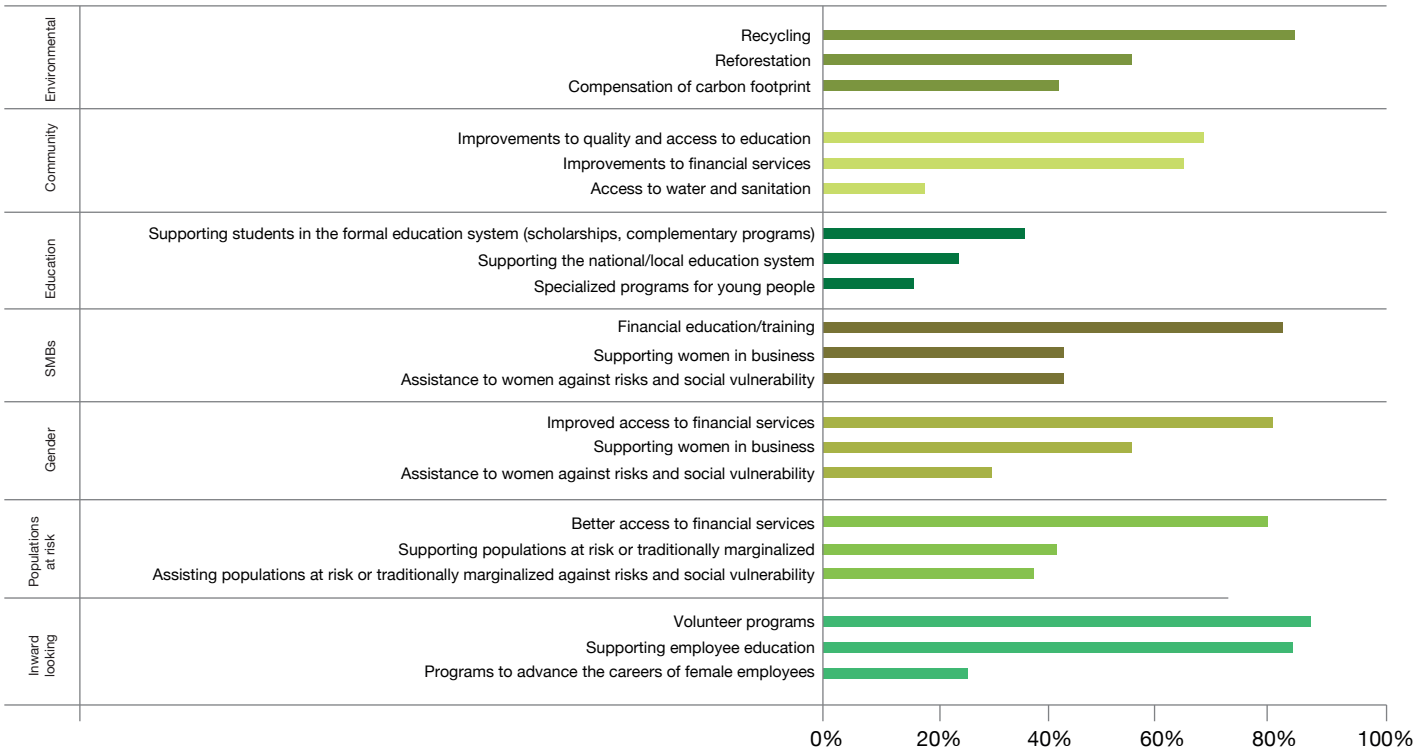


As indicated in Figure 33, the environment, respect for the rule of law and transparency are the three main areas that cover the CSR policies and strategies of the institutions investigated, with 93%, 80% and 80% of recurrence, respectively. Other topics considered include respect for the interests of stakeholders (75%), ethical behavior and work practices (73%), human rights (68%) and community development and involvement (66%). With lesser importance but still present on CSR programs are respect for international standards of behavior (58%) and fair operating practices (56%). From the above, it is observed that many of the areas with greater emphasis by the institutions in the sample are still at a basic level of compliance.

The main activities included under each of the CSR areas indicated above are shown in Figure 34, noting a greater presence of activities in areas more closely related to the main business of these institutions. Several relevant areas exhibit, as their main action, either better access to services or financial education. Certain areas of technical assistance or programs in specific population niches (e.g. youth) are less recurrent in organizations, perhaps because they are **1)** more difficult to implement, **2)** more difficult to subsequently link to credit products or deposits; **3)** their risks less well understood by financial institutions.

Figure 33. *Areas covered by CSR policy and strategy* **n = 71**

Figure 34. *Specific Areas; main CSR programs and activities* **n = 71**



Box 1. Five concrete cases of CSR projects and activities in Latin American Financial Institutions

It is common to find, in the CSR programs of the evaluated financial institutions, a list of "traditional" projects and activities that are not directly linked to their core business and that means doing compliance.

By way of example here are some cases:

1. One of the evaluated institutions reported that it has an internal and external institutional scholarship program for children of low-income workers and students under the age of 18.
2. A program aimed at children between the ages of 6 and 9, which consists on helping them deal with the emotional difficulties inherent to their age, so that they feel good about themselves and others, and thus are better able to participate in the learning process, since it affects their academic results.
3. Project to donate houses to families that include among its members a person with severe disability.
4. Another institution conducted an internal campaign, where bank clients decided how to distribute the bank's CSR grant budget to support the work of NGOs.
5. Program that consisted of supporting social-sports schools, which champion the formation and promotion of values through sport.

4.5.1 Internal Operations

As to whether they have developed a formal program to manage the direct environmental impact of their operations, 54% of institutions indicated that they have a program of this type, and a considerable percentage (43%) said that it does not manage the environmental impact it produces in any way (Figure 35), which contrasts with the high percentage of institutions with CSR programs (94%).

The apparent disconnect between CSR and impact management is evident in Figure 36, where the same trend appears in diverse types of organizations. In proportional terms, first-tier commercial banks are the prime example of this phenomenon, together with government banks.

The main areas of action included in the direct impact management programs are presented in Figure 37, and are generally energy efficiency (91%), recycling (75%), reduction in the use of paper (75%), water usage efficiency (70%) and sustainable architecture (41%).

Figure 35. *Formal program for managing the direct environmental impact of operations* **n = 75**

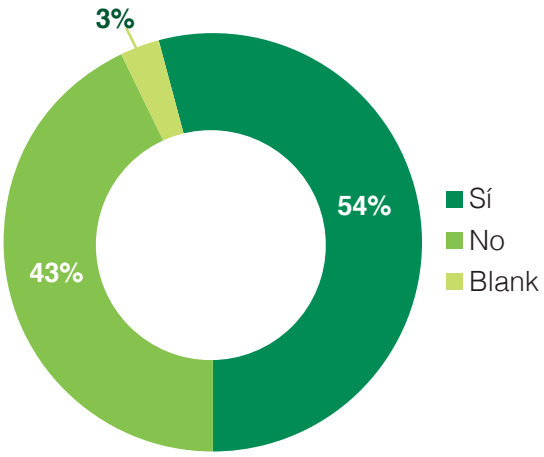


Figure 36. *Formal program for managing the direct environmental impact of operations, by type of institution* **n = 80**

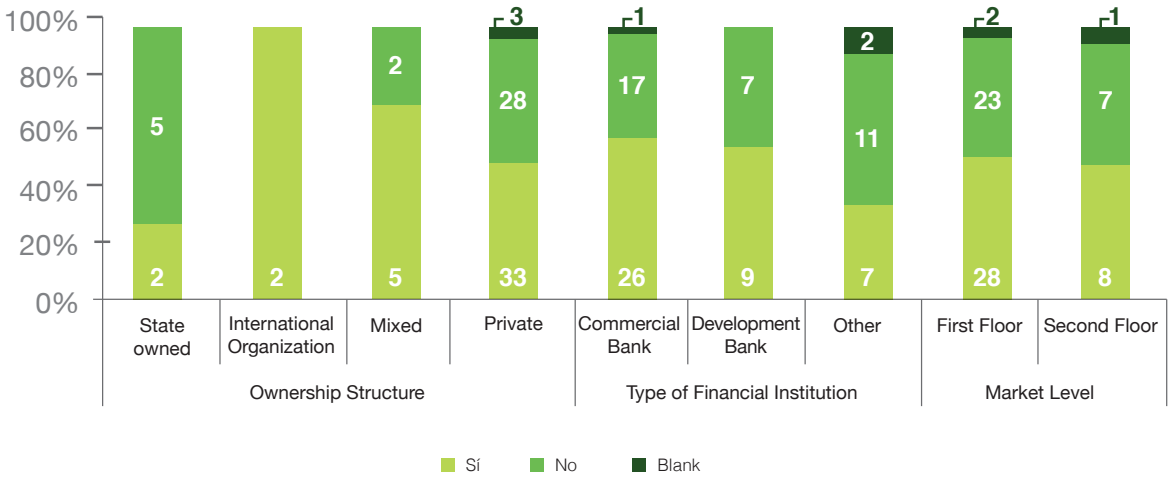
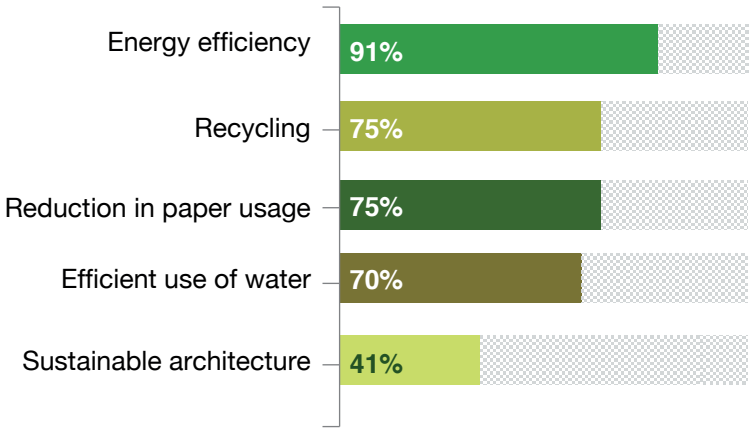


Figure 37. *Areas covered by the direct impact management program* **n = 75**



A little over half (51%) of the institutions that indicated that they have a program to manage the direct impacts they produce noting that they carry out specific actions to mitigate these impacts: 16% mentioned that they are in the process of developing a mitigation plan; up to 30% indicated that they do not keep track, but that are thinking about having a mitigation plan and the remaining 3% do not have nor do they intend to develop a plan to mitigate the generated impacts (Figure 38). Private, commercial and first-tier banks are the most oriented to mitigate the impacts they generate (Figure 39).

Figure 38. *Mitigation of direct environmental impacts of the financial institutions* **n = 75**

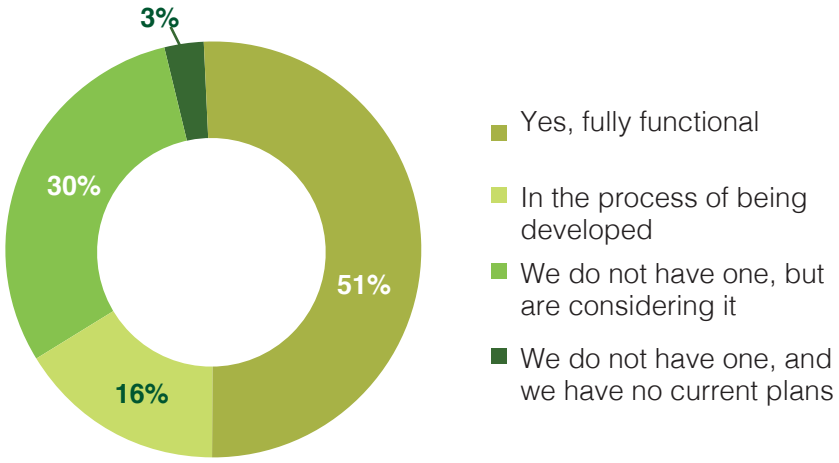
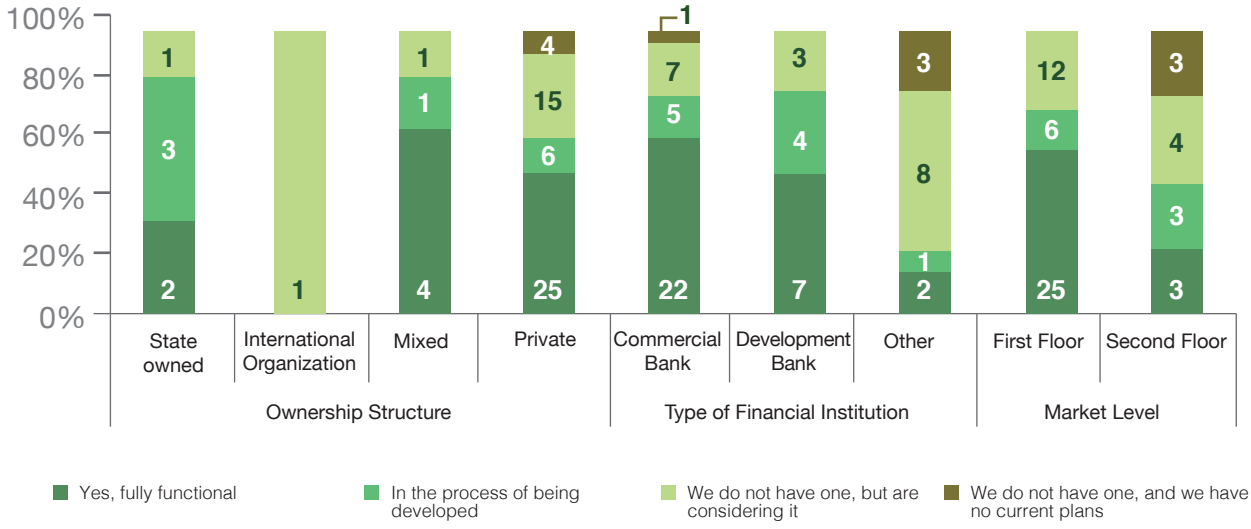


Figure 39. *Mitigation of direct environmental impacts of the financial institutions by type of institution* **n = 80**



4.6 Sustainability Reports

Sustainability reports are strategic communication tools used by institutions to inform their different stakeholder groups about the results generated from their activities; these include economic, environmental and social results obtained during given period. The purpose of reporting and making transparent the actions of the institutions is to establish and/or strengthen links between the institutions and the different stakeholders. Out of 75 institutions that answered this question, it was found that 56% publish a sustainability report with actions and programs related to sustainability (Figure 40). Although most financial institutions have a CSR program as noted above, 44% are not reporting. The foregoing may be because these institutions do not at the moment, intend to establish a more direct communication with the different interested parties, or because they are not prepared to discuss sustainability issues with their stakeholders, or perhaps they have not undertaken the task of collecting information with the quality parameters necessary for a sustainability report.

In addition, 61% of the institutions that indicated that they publish a sustainability report use the Global Reporting Initiative (GRI) guide, which is an internationally approved document, 29% use their own guide, 5% use a national GRI –type guide, and 5% use another type of international guide (Figure 41).

The above denotes that there is little interest in distributing a report, with the required quality parameters, as a central element of the process of transparency and accountability, probably because there is little pressure from local competition to generate it, since it is not part of regulatory requirements, or because of the typical structure of capital and funding of most of these institutions.

Figure 40. *Institutions that publish a sustainability report*
n = 75

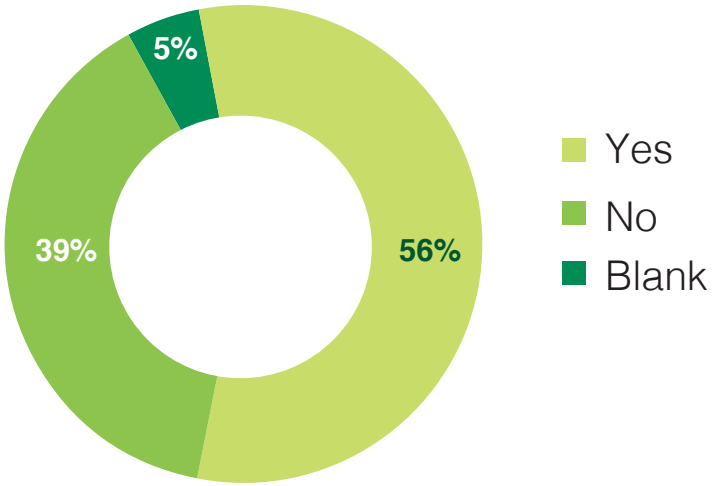
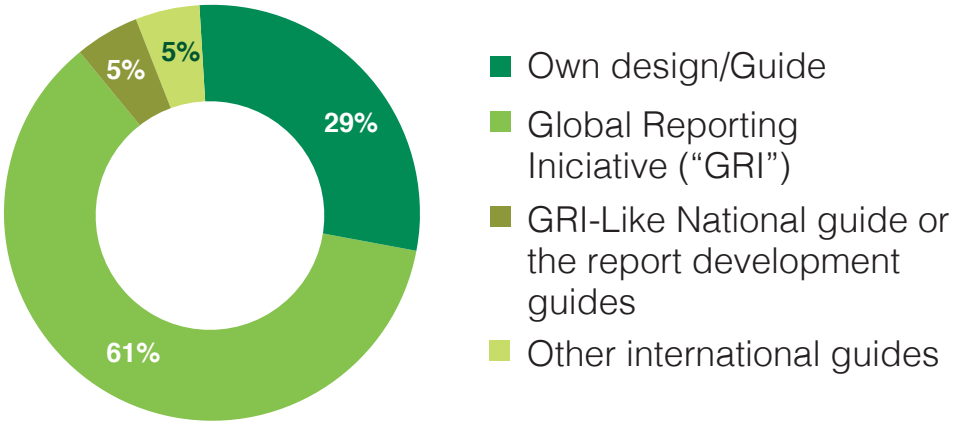


Figure 41. *Guide used for sustainability report* n = 42



4.7 Sustainability Performance Index

4.7.1 General description

The main purpose of this index is to characterize the state of the art with respect to the incorporation of sustainability as a value creation and competitive advantage element in the region's Financial Institutions. Similarly, it seeks to interpret in a general way the corporate behavior of these organizations, by understanding the variations in their relative performance compared to other players in the industry.

The SPI has is based on the first Environmental Performance Index presented in the regional study carried out in 2001 by the Ecobanking Project. For this edition, a decision was made to modify the composition of the Index, with the aim of incorporating new elements of governance, management and transparency, of both environmental and social variables .[1]

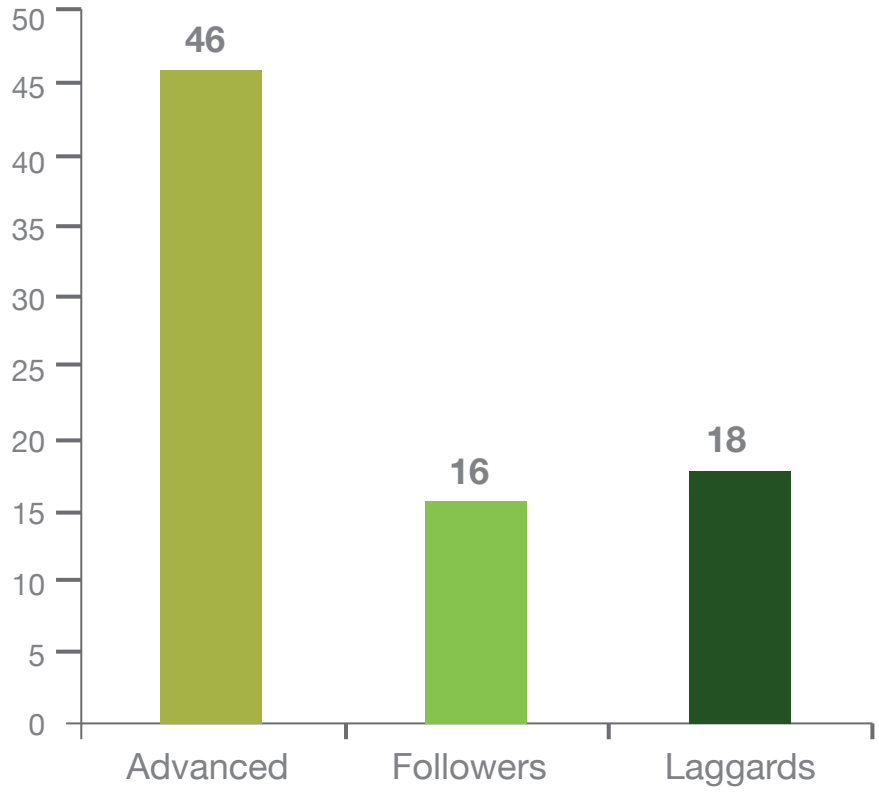
The application of the SPI, for the sample of Financial Institutions participating in the regional survey, reflects a certain dispersion of results. On a scale of 0 to 5, the average score of the observations turned out to be 3.11, a score slightly higher than the midpoint of the projected scale (x = 2.5). Likewise, it is observed that the sample presents FIs with a score of 0 (lowest possible) as well as 5 (maximum), covering the entire range of performance.

The analysis of the participating FIs based on this index comprised a classification in which, according to its score, three groups of institutions were created: "Advanced," "Follower" and "Laggard." The objective was to identify the relative level of Latin American FIs versus their peers, as well as to determine which are the components of the index that generate more significant changes in institutional performance in sustainability. A quick review reveals – favorably- that most institutions out

The description of the calculation and aggregation methodology of the Sustainability Performance Index can be found in section 3.3 of this document.

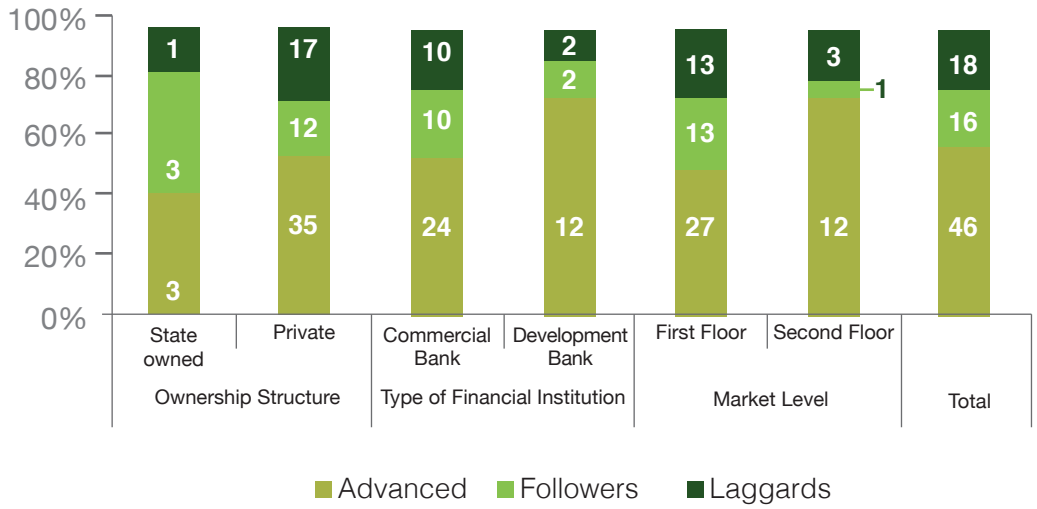
of a total of 80- are in the first tier of performance or "Advanced Institutions", with 46 institutions with a sufficient score to be considered in that category (Figure 42). The "Follower" category - or second tier - is made up of 16 FIs, leaving a total of 18 organizations in the "Laggards" category.

Figure 42. *Distribution of FIs by performance level* **n = 80**



If the results of the SPI are classified by ownership structure, the finding is that private banks presents a higher proportion of Advanced institutions, in relation to the proportion listed under government-owned banks. Regarding the type of Financial Institution, it can be seen that, among development banks, there is a more than proportional portion of organizations classified as Advanced, ***in relation to commercial banks - whose performance pattern as a group is very similar to the pattern of the total sample. Likewise, the segmentation of institutions by market level reflects a behavior similar to the breakdown by type of institution -associated with the fact that most of the development banks in the sample are represented by second-tier institutions.***

Figure 43. *Distribution of SPI 2017 by various criteria* **n = 80**

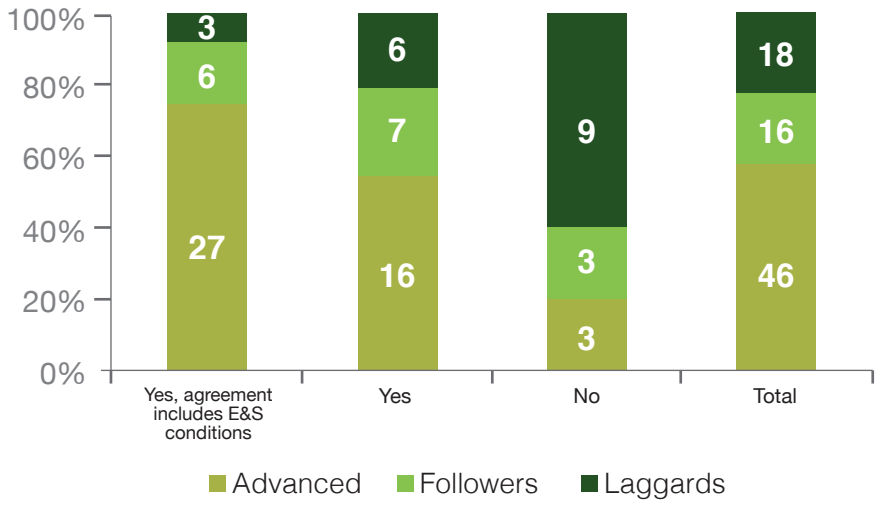


Additionally, an analysis was carried out taking into account the depth of relationship that the FIs in the sample maintain or have maintained with development institutions, mainly with second-tier development banks - both multilateral and bilateral - that due to their nature and policy guidelines seek to promote a more sustainable financial management, mainly through differentiated financing and technical assistance. This exercise was carried out under the premise that a greater involvement -and expectations- on the part of development financial institutions, should promote a better governance and operationalization of environmental and social issues in the institutions they fund.

The results are consistent with the above hypothesis, since - as shown in Figure 44 - there seems to be a clear difference in performance - measured by the SPI - between institutions that neither have nor used to have a formal relationship with development and financial institutions and those that do: the graph in question shows that 60% of the surveyed institutions that have not had a relationship with development banks have an SPI that classifies them in the group of laggard FIs.

Based on the same approach, it is worth noting that an important distinction was also found internally in organizations that do have a formal relationship with financial development institutions. Of those institutions that have relations with development FIs, but whose agreement does not formally include conditions for the management of environmental and social aspects, 55% have an Advanced condition, according to their SPI. However, the percentage of institutions within the Advanced category increases to 75% when considering only FIs that have formal agreements that include -and monitor- environmental and social aspects.

Figure 44. *SPI Distribution of financial institutions that have formal relationships with development financial institutions* **n = 80**



4.7.2 Performance categories

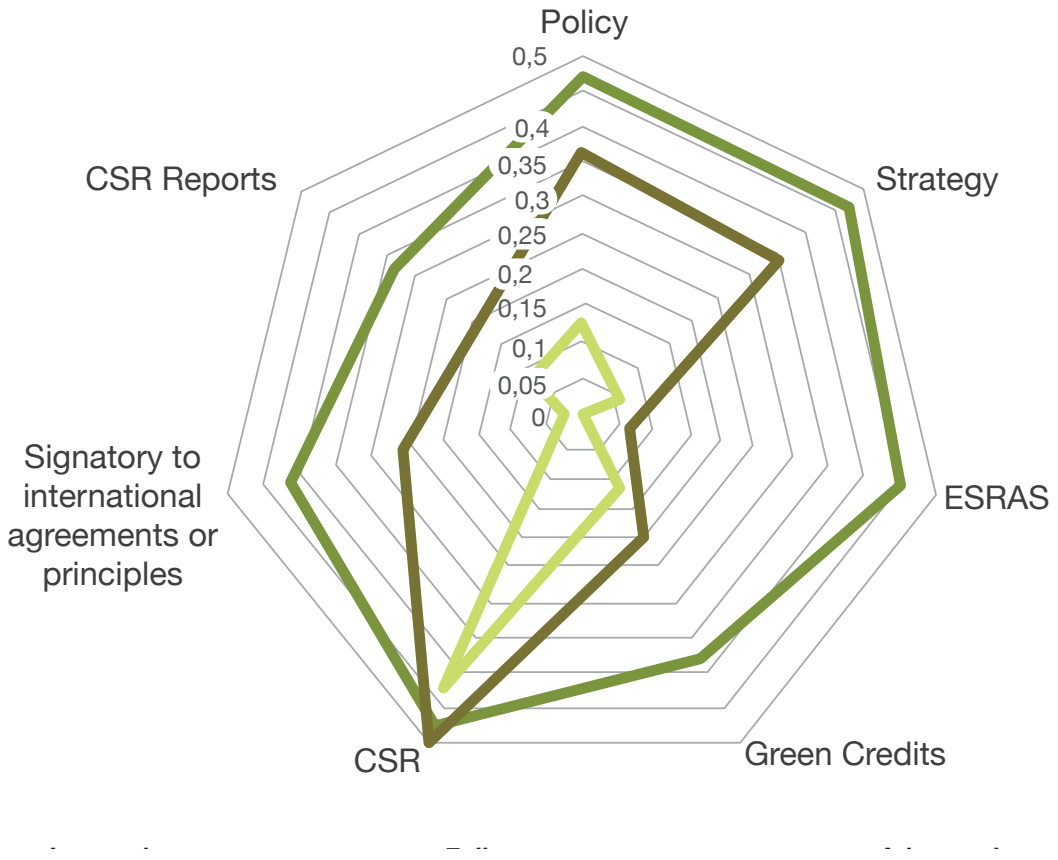
Laggard Institutions: The main positive characteristic that this group exhibits is a high persistence of CSR management -although not quite as much as the two more advanced groups. In this third tier, there is also an incipient development of policy instruments towards sustainability, but without a shift towards strategy. Likewise, this incipient governance is not –for the most part - based or supported by international principles or good practices. Probably, the characteristic just described justifies the little to none existence of either ESRAS or Green Credits in this group.

Follower Institutions: In the second tier of performers there is a significantly greater presence of governance instruments (both policy and strategy). The existence of these tools in these institutions may derive from the implementation -generally more decidedly-of international agreements or principles (Equator Principles, IFC, Global Compact). However, the operationalization of the policy and strategy still presents important challenges: The Green Credit indicator and the ESRAS indicator increased its average in relation to the lower tier, but by a small amount. It should also be noted that this group of FIs gives a relatively greater value to the processes of transparency and the creation of sustainability reports.

Advanced Institutions: The main differentiator of advanced FIs for their performance in sustainability is their ability to operationalize their policy and strategy in the core business areas. As shown in Figure 45, the main gap between the

follower group and the lead group is seen in the indicator related to the existence and operation of an environmental and social risk analysis system, followed by the existence of " green" credit products. On the other hand, it is noted that the performance area with the least progress in this group corresponds to the report and transparency indicator. However, this group of institutions has a very "balanced" performance profile on average, since for all the indicators that make up the index the average score of the first third is higher than the average score of the normalized scale for each indicator (2,5).

Figure 45. *SPI 2017 Normalized averages by indicator and performance level* **n = 80**



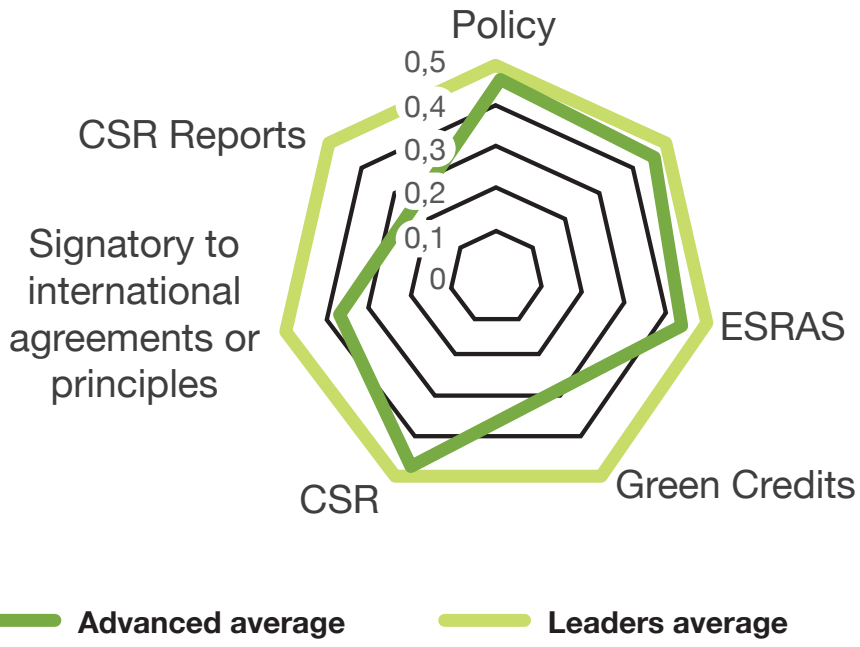
Box 2. Leading Financial Institutions

When performing the segmentation by performance levels, a particularly relevant subgroup of FIs was detected: a total of fourteen institutions that -according to the proposed methodology- reached the highest possible weighted score, complying with the full performance standard proposed for each indicator that makes up the SPI.

This subgroup -included of course in the SPI performance group of Advanced institutions- differs from the rest of the group mainly in two of the SPI indicators: the creation and publication of formal CSR/Sustainability reports and the green credit indicator. It should be noted - as can be seen in Figure 46 - that the largest average performance gap between the Leaders subgroup and the rest of the Advanced group (excluding the leading FIs) is observed in these two indicators: CSR Reports, followed by green credits.

According to experts from the Ecobanking Project, the pattern of gaps described in the previous paragraph coincides with the main differences between the leading global financial institutions in sustainability and their followers. In other words, an institution that has truly internalized sustainability as a source of competitive advantage must be able to create an innovative portfolio of "green" credit products as a fundamental part of its placement strategy and, therefore, capitalize on this effort by publishing its progress in a fast, transparent and standardized way, with the goal of improving the positioning of their brand through environmental and social performance.

Figure 46. *SSPI 2017 Normalized averages by indicator and difference between advanced and leading institutions*



5. CONCLUSIONS

With the information collected, the Ecobanking project has been able to generate a broad panorama on the current state of sustainable banking in Latin America. The research has managed to document the current practices regarding the identification, management and mitigation of environmental and social risks, the development of an environmental and social policy and the development of a sustainability strategy, based on the impacts produced by the sector. Similarly, the ability of FIs to develop financial instruments that allow them to capitalize on financing opportunities under sustainability principles and on the content of CSR programs has been reviewed.

With all this information, the Ecobanking Project is in a better position to propose and execute activities that more precisely support the financial institutions of the region to address the identified challenges. It also allows participating banks to identify their own SPI and evaluate their level of performance relative to other banks in the region in the areas addressed in the framework of this research.

5.1 Advances

This study has allowed Ecobanking to elucidate the different degrees of progress around the insertion of governance and operational parameters in sustainability as pillars of the competitive position of financial institutions in the Latin American region.

It is noted that - with respect to preceding reports, led by Ecobanking or other organizations in the region - there is a greater relative number of organizations with a growing level of performance in terms of their commitment to sustainability. This is evidenced by the non-negligible proportion of organizations that already present corporate policy instruments with some environmental and social orientation, indicating that these issues are already positioned as important in the top management of many FIs.

The regional landscape of the industry has changed not only in the scope of this trend, but in the deepening of programs and tools that communicate the mandate of senior management.

A significant number of institutions manage environmental and social risks with solid and valid tools within the organization. Likewise, more FIs have migrated from green credit pilot programs to regular credit products and guarantees that are already part of formal placement strategies. In summary, there is a group of organizations that appears to be capturing greater value - and protecting their competitive advantage - by creating a virtuous circle based on better understanding their risks and opportunities for sustainability: they understand and better calibrate the variables that generate the risks of new technologies/industries and sectors, make smarter loan placements and attract more and more attractive resources to generate formal credit products.

Likewise, it is positive that the pattern described above is also present in a greater variety of financial institutions, including some non-regulated institutions that were part of the sample of this study. This can have very important implications for the region, since many of these institutions influence productive landscapes traditionally outside the focus of attention of commercial banking. Therefore, if these organizations manage to refine the operation of better environmental and social practices, they could increase their incidence in the social progress of individuals and companies that have reduced access to conventional banking.

5.2 Barriers to better performance

We have also identified more precisely some barriers for the adoption of environmental and social considerations in the FIs. Each category of barriers is proposed as possible hypotheses to respond to gaps or inconsistencies in the behavior of the FIs reflected in the results of the survey. Below is a brief description of these barriers:

• **Governance:** in some organizations, a low level of commitment by senior management is detected - which is identified by the lack of a sustainability policy. It is possible that, in a large proportion of these cases, top management has not participated in events or spaces for the creation of capacities specific to their role and which instill the strategic importance of the insertion of environmental and social variables within the business model of their organizations.

•**Management Control and Performance Evaluation:** most FIs in the region have a management control system that measures the performance of the organization in its different business areas and, therefore, that of the decision makers within each of them and their teams. On the other hand, the analysis of the base survey of this report shows that even when the institutions have ESRAS and ESFS in operation; implementation, and the contribution that they make to organizational goals are often

not measured with the same sophistication and rigor as the performance of other instruments more commonly offered by the financial industry. This can reveal a lack of indicators, incentives and correct signals for board members and managers to evaluate the true impact of these tools and systems in favor of sustainability.

•New risk factors: this is defined as a knowledge barrier. Some of the emerging technologies, industries or customers that present opportunities to incorporate better criteria towards environmental and social performance are relatively new to a large majority of financial institutions. Therefore, the way to parameterize risks - or the technical elements to consider them - changes, and requires different analytical tools and capabilities. Likewise, the marginal analysis changes about how "green" financial services can modify the risk profile of certain groups of borrowers, by promoting investments that improve their competitive position and, therefore, their ability to pay.

This capacity vacuum has multidimensional impacts for FIs and can restrict access to capital; mainly from international funds or institutions, which tend to verify the existence of adequate systems of analysis and management of environmental and social risks. This restriction, in turn, has consequences for the diversification of the institution's funding (and likely its cost). On the other hand, an incomplete understanding of risks - or insufficient tools for their analysis - also reduces the range of action of the FIs to perform intermediation in "green" industries or technologies with proven high growth potential and with increasing investment volumes, such as renewable energy projects; conventional and non- conventional, energy efficiency and "green" housing, to name a few.

This also compromises the ability of an institution to make a social impact through its management, as well as strengthen its relations with multilateral institutions.

CAF -Development Bank of Latin America-, for example, considers strategically linking "green" housing financing with a broader concept of sustainable cities, while FMO, the development bank of the Netherlands, invests in key sectors (agribusiness, renewable energy, green finance), which they consider crucial for social progress and the sustainable growth of business, through agreements with financial institutions to make finance more sustainable and accessible to all.

5.3 A new paradigm for Corporate Social Responsibility in banking

The survey performed by the Ecobanking Project shows that, in the vast majority of FIs, the concept of CSR is known and is being implemented. However, when

drilling down on this area of analysis, the study shows that the existence of CSR programs does not imply that the activities or projects of these kinds are: 1) aligned with the business strategy and positioning of the respective FIs, or 2) integrating a set of activities closer to a paradigm of good practices in specific CSR for the financial sector. While Ecobanking recognizes the effort in management and investment in many of these programs, it also emphasizes that CSR is broader and must advocate voluntarily integrating environmental and social concerns into its work.

In the case of banking a greater effort must be made to design and select, based on the business model, those actions that will contribute the most to sustainability (for example, planting trees is likely not one of these actions, but to fund projects in SMEs or financially educating certain clients may be). For Ecobanking, some of the main "postulates" of CSR for financial institutions include:

- Contribute, add value and generate impact in society, based on actions directly linked to your business: providing loans and technical assistance.
- Promote environmentally and socially responsible investments.
- Abandon the traditional passive perspective of the financial sector of financing only what clients request.
- Be responsible in the exercise of the function assigned to the financial system, commonly understood as the role of fiduciary to meet the demands of customers and stakeholders.

5.4 A path to close performance gaps

Through the construction and analysis of the Sustainability Performance Index for FIs, the Ecobanking Project has identified some elements that have an impact on the level of commitment and incorporation that these institutions exhibit regarding environmental and social issues. SPI results suggest there is at least one "road map" that the financial institutions of the region can follow to increase their positioning in these areas, in a progressive manner. Thus, the SPI approach could reduce the performance gap that seems to exist between the Advanced, the Follower and the Laggard institutions. Specifically, institutions classified as Laggards could significantly advance if they decide to subscribe and consciously adopt the international principles of good practices for the sector, mainly for Sustainability and Risk. That way, the top managers of these institutions could base decisions on reasonable and proven parameters to improve their policies and create sustainability strategies with greater probabilities of success in their operation.

For their part, follower institutions should look for the right partners; mainly for funding and capacity building, to advance in the operationalization of their strategies, mainly in relation to their environmental and social risk analysis systems and to the creation of innovative "green" credit products, an area in which the advanced institutions of the sample proved to have

multifaceted programs linked to different credit products within their portfolio.

The results also confirm the significant role played by development financial institutions, mainly second-tier organizations. As shown in the SPI analyzes, the region's financial institutions improve their performance in sustainability when faced with raised environmental and social expectations from international development banks, in large part tied to special sources of income.

Therefore, these results confirm the need - and the opportunity - that the development banks that serve the region´s financial sector exert a greater influence, capitalizing on good past experiences. This way, more FIs will perceive clearer market signals to extend risk analysis systems and other sustainability practices to their entire operation, practices that are often maintained only as a result of specific financing requirements.

This process of relative evaluation has also generated valuable lessons for the Ecobanking Project.

The specific gaps identified for each performance tier elucidate more precise actions within their field of action, especially in relation to the support to the financial sector in capacity building activities.

The Ecobanking Project encourages decision-makers in the regional financial sector to incorporate the SPI into its self-evaluation and benchmarking practice. This with the object of using the index as a mechanism to identify which management area to prioritize depending on the current level of performance, their priority stakeholders and their ability to link these variables to their competitive position.

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7. ANNEXES

7.1 The Sustainability Strategy and International Agreements

When performing a statistical analysis on different variables (type of financial institution, ownership structure, market level, environmental and social policy, and sustainability strategy), to determine what is necessary for a financial institution to be a signatory to an international agreement (UN Global Compact, Equator Principles, National Initiatives, other), It was verified, by means of a multiple regression, that having a sustainability strategy is a determining factor for organizations to be signatories of international agreements (value p = 0.005) (Table 1). This independent statistical test is consistent with what is stated in section 4.3.2 (Sustainability Strategy), where it was determined that, of the financial institutions that have a sustainability strategy in operation, 73% are signatories to international agreements. Therefore, it is noted that the sustainability strategy is key in the institutions so that they adopt internationally accepted actions.

Table 1. Regression analysis: Signatory of International Agreements versus Type of financial institution, Ownership structure, Market level, E&S Policy, and Sustainability Strategy.

Table 1. *Regression analysis: Signatory of International Agreements versus Type of financial institution, Ownership structure, Market level, E&S Policy, and Sustainability Strategy.*

Analysis of variance	DF	Adj SS	Adj MS	F-Value	P-Value
Regression	5	4,2726	0,85453	4,22	**0,002**
Type of financial institution	1	0,1197	0,11970	0,59	0,444
Ownership structure	1	0,0095	0,00950	0,05	0,829
Market level	1	0,3222	0,32222	1,59	0,211
Policy	1	0,4239	0,42390	2,10	0,152
Strategy	1	1,7116	1,71160	8,46	**0,005**

7.2 ESRAS and its direct relationship with the E&S Policy and Sustainability Strategy

Table 2 shows that having an environmental and social policy is statistically key for financial institutions to adopt a system for analyzing environmental and social risks within their organizations (p value <0.005). Likewise, maintaining a sustainability strategy also explains that FIs have an operating ESRAS (p = 0.003). In addition, this is consistent with the results obtained in section 4.4.1 (ESRAS), where it was established that, of the institutions that have ESRAS, 98% have an E&S policy and 91% maintain a sustainability strategy.

As discussed in section 4.3 (Governance of environmental and social issues), an environmental and social policy leads the way to the development of a sustainability strategy, and together they dictate the guidelines for the creation of tools for measurement, analysis and control of environmental and social risks faced by organizations.

Table 2. *Regression analysis: Environmental and Social Risks Analysis System (ESRAS) versus Type of financial institution, Ownership structure, Market segment, Policy, Strategy, Signatory of international agreements.*

Análisis de la Varianza	DF	Adj SS	Adj MS	F-Value	P-Value
Regression	6	5,9246	0,98743	15,26	**0,000**
Type of financial institute	1	0,0007	0,00072	0,01	0,916
Ownership structure	1	0,0538	0,05378	0,83	0,365
Ownership structure	1	0,0002	0,00021	0,00	0,955
Policy	1	1,7334	1,73336	26,79	**0,000**
Strategy	1	0,6002	0,60023	9,28	**0,003**
Signatory to international agreements	1	0,1498	0,14984	2,32	0,133

7.3 Financial Services for Environmental and Social Investments (ESFS) as products of the Sustainability Strategy

Table 3 indicates that, from a series of variables, having a sustainability strategy is the variable that explains the development of financial lines for environmental and social investments (ESFS) or "green products" (value p = 0.006). In section 4.4.3 (ESFS) it was found that 82% of organizations that have developed green products also have a sustainability strategy in place. This is consistent since an organization with a well-structured sustainability strategy is more likely to develop tools to operationalize the company's environmental and social policy.

Table 3. Regression analysis: Financial Services for Environmental and Social Investments (ESFS) versus Type of financial institution, Ownership structure, Market level, Policy, Strategy, Equator Principles - IFC performance standards, Relationship with Development Institutions.

Table 3. *Regression Analysis: Financial Services for Environmental and Social Investments (SFAS) versus Type of financial institution, Ownership structure, Market level, Politics, Strategy, Principles of Ecuador - IFC Performance Standards, Relationship with Development Institutions.*

Análisis de la Varianza	DF	Adj SS	Adj MS	F-Value	P-Value
Regression	7	2,84315	0,40616	2,91	**0,014**
Type of financial institute	1	0,01465	0,01465	0,11	0,747
Ownership structure	1	0,63719	0,63719	4,57	0,038
Ownership structure	1	0,00465	0,00465	0,03	0,856
Policy	1	0,02436	0,02436	0,17	0,678
Strategy	1	1,18307	1,18307	8,48	**0,006**
Equator principles/IFC performance standards	1	0,16443	0,16443	1,18	0,284
Development institutions	1	0,03910	0,03910	0,28	0,599

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