

CASE STUDY

INDUSTRIAL AND COMMERCIAL BANK OF CHINA



Engagement objective: **Environment**

Integrate climate change considerations into core business strategy

August 2019

The Industrial and Commercial Bank of China (ICBC) has made substantial improvements to manage environmental risks and lending in environmentally sensitive sectors following investor engagement. This case study details how Hermes EOS has engaged with the company since 2013 on the significant environmental challenges it faces.

Background

ICBC is the largest bank in the world in terms of total assets at approximately US\$4tn¹. We were concerned about the company's exposure to climate-related risks, given the scale of its financing in China and under the Belt and Road Initiative. Its involvement in the controversial Dakota Access Pipeline oil project² was delayed due to breaches of environmental and social requirements. This exposed weaknesses in the application of the Equator Principles, which the company had committed to abide by.

\$4TN approximate total assets of ICBC, making it the largest bank in the world



Our engagement

We initiated engagement on environmental policy in 2013 and established an objective on climate change in April 2016, voicing our concerns over the management of environmental and social risks and shortcomings in the current Equator Principles with the chair of the group board's risk management committee.

Engagement timeline

- 2013** initiated engagement on environmental policy
- 2016** established an objective on climate change
- 2017** company attended the first CDP technical training seminar which we contributed to as a speaker
- 2018** shared examples on how to integrate carbon emissions information into investment portfolio level analysis

We shared our views that under the current loan syndication model, the responsibilities of due diligence, including social and environmental impact assessments, were unclear. They could fall mainly on the lead banks or be shared amongst the supporting banks. We made recommendations as to how the model could be strengthened through revision of the Equator Principles, applicable to all signatories.

¹ <https://www.spglobal.com/marketintelligence/en/news-insights/trending/kesHt7afSvSE73yIRQw5A2> and <https://fxssi.com/top-20-largest-world-banks-in-current-year>

² <http://news.bostoncommonasset.com/-content/uploads/2017/02/Investor-Statement-to-Banks-Financing-the-Dakota-Access-Pipeline-FINAL-with-signatories-2-17-17.pdf>



We recommended stronger covenants for responsibility and accountability of impact assessments and improved internal procedures.

We recommended stronger covenants for responsibility and accountability of impact assessments and improved internal procedures. We encouraged the company to reduce its lending to high risk sectors and expand its exposure to green financing. With our invitation, the company attended the first CDP technical training seminar which we contributed to as a speaker in February 2017. We also asked the company to adopt the Task Force on Climate-related Financial Disclosures (TCFD) recommendations in its reporting.

We encouraged company-wide efforts to proactively involve itself in the China-UK TCFD pilot group, of which Hermes Investment Management is also a member, supported by the Chinese government and the City of London. For example, to assist with the implementation into the company's key business units, we shared examples with the director of the credit department on how to integrate carbon emissions information into investment portfolio level analysis in February 2018, based on our experience.



Changes at the company

In 2016, the company published a detailed report on the *Impact of Environmental Factors on Credit Risk of Commercial Banks*³, explaining its strengthened approach to managing environmental risks. It collaborated with Trucost, now part of S&P Global, an external information provider, to understand climate-related risks in its portfolio in greater detail, with the findings published in the report *Internationalisation of Environmental Costs for Investment Stress Testing*⁴.

It has systematically reduced lending to sectors that are environmentally sensitive or damaging and increased lending to environmentally friendly sectors. In March 2016, ICBC became the first financial institution to issue renminbi-denominated green bonds with a total issue size of RMB10bn and a coupon rate of 2.95%. The bond was issued in London. The funds raised support green industries.

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ICBC became a member of the China-UK TCFD pilot group. In 2018, the company led the publication of the three-year action plan for the group's Chinese members. The action plan has committed ICBC to: establishing a comprehensive database for input into broader stress testing by 2019; environmental risk information on high-risk sectors including scenario analysis and stress testing to be disclosed by 2020; and expansion of such analysis to all companies by 2021.

In 2018, ICBC became a founding member of the United Nations Environment Finance Initiative Principles for Responsible Banking (UNEP FI)⁵. The objective is to redefine a bank's purpose and business model to align with the UN Sustainable Development Goals and the Paris Agreement on climate change.

Sustainable Development Goals



Next steps

We continue to engage with the company on environmental risk management. We will monitor its implementation of the three-year action plan as a member of the China-UK TCFD pilot group, encouraging its leadership in adopting the UNEP FI Principles for Responsible Banking and its strengthening of environmental and social impact assessments in all aspects of its business activities, both within China and overseas.



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Case studies are shown to demonstrate engagement, EOS does not make any investment recommendations and the information is not an offer to buy or sell securities.

³ http://www.greenfinance.org.cn/upfile/upfile/file/ICBC%E7%8E%AF%E5%A2%83%E5%8E%8B%E5%8A%9B%E6%B5%8B%E8%AF%95%E8%AE%B%E6%96%87_2016-03-19_08-49-24.pdf

⁴ https://www.longfinance.net/media/documents/ICBC-report_EN_v5.pdf

⁵ <https://www.unepfi.org/banking/bankingprinciples/>

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Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

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Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities

Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

Credit

Absolute return, global high yield, multi strategy, unconstrained, real estate debt and direct lending

Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

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