Environmental and social management system

Introduction

Our approach to environmental and social (ES) sustainability

As a truly African brand, we have a vested interest in supporting Africa's long-term environmental sustainability. In 2019 we became a signatory to the United Nations Environment Programme Finance Initiative Principles for Responsible Banking which set out the global banking industry's role in helping to meet the objectives of the United Nations Sustainable Development Goals and the Paris Climate Agreement. We also adhere to the Equator Principles, a global risk management framework whereby we determine, assess and manage ES risk in all projects.

We recognise our continent's vulnerability to climate change, and together with like-minded partners, we are developing sustainable and value-creating solutions to some of Africa's greatest environmental challenges.

With various progressive climate-linked initiatives, we are contributing towards ensuring that future generations have the natural resources available to live an equal, if not better, way of life as current generations.

We place ES sustainability at the heart of our culture and operations. We encourage the sustainable management of our physical assets, progressive lending practices and economic activities that promote economic prosperity, environmental protection, and social justice for current and future generations. This includes:

- Managing climate and associated social risks.
- Managing our direct ecological impact.
- Providing innovative, sustainable financial products and advisory services to support a just transition to a low-carbon economy.
- Employing enhanced assessment criteria for capital allocation decisions, which would incorporate climate change, positive impact and our environmental, social and governance commitments.

Our environmental and social management system (ESMS)

We are committed to sustainable and responsible investment, lending and economic practices through effectively managing our ES risks by implementing an ESMS. The ESMS provides systematic guidance for the identification, evaluation, management and monitoring of ES risks and opportunities for all potential investments and financial activities.

This ESMS summary supports our sustainability risk policy and the Enterprise Risk Management Framework.

Overview of our ESMS

The ESMS is set out to identify, assess, manage, and monitor the ES risks and impacts of loans on an ongoing basis. The key purpose of an ESMS is to avoid, eliminate, off-set, or reduce to acceptable levels, any adverse ES impacts, and to achieve ES benefits with good governance practice. Potential ES risks associated with our investment/lending practices relate to, but are not limited to, the following:

- Water consumption and management
- Waste and pollution management
- Energy performance
- Biodiversity management
- Greenhouse gas (GHG) emissions
- Climate Change
- Human rights including child labour, forced labour or slavery
- Employee health and safety
- Labour and working conditions, employee engagement
- Community health, safety and security
- Land acquisition and involuntary resettlement
- Indigenous people
- Cultural heritage

Failure to implement a robust ESMS could lead to numerous risks for us including:

a. **Collateral/guarantee risk:** Reduction in the value of the collateral and guarantees associated with clients due to ES issues.
b. **Legal risk:** ES impacts which result in any legal disputes/actions.
c. **Credit/financial risk:** Clients unwilling or unable to fulfil contractual obligations as a result of ES issues e.g., civil liability, impaired solvency or, settlements.
d. **Funding risk:** Poor lending and economic practices resulting in not being eligible for funding, especially where ES requirements are mandatory.
e. **Liability risk:** By taking possession of collateral assets, we are exposed to liability risk stemming from a client's legal obligations which may include fines, penalties, and costs for addressing third-party claims for damages due to negligence in managing ES.
f. **Reputational risks:** Risk of negative publicity associated with our lending and client activity. Reduced brand value and image.

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The ESMS allows us to capitalize on opportunities associated with sustainable finance, i.e., developing products and services that have positive impacts on the environment, people and economy. As such key objectives are:

- To integrate ES considerations into the lifecycle of loans to our eligible clients to ensure that ES risks and impacts are consistently identified, screened, and managed.
- To set out the responsibilities for ES risk and impact identification, assessment, decision-making, as well as monitoring and escalation.
- To support ongoing capacity building of the ESMS across Absa and our clients in order to manage ES risks and impacts.

Hence, our benefits from adopting an ESMS include, but are not limited to:

a. Risk reduction and impact avoidance/mitigation, including avoiding costs associated with ES incidents and potential remedial actions.
b. Better operational and cost efficiency.
c. Improved external relations, investor and client confidence and public image.
d. Increased access to markets and investors who demand robust ES management.

The ESMS is a dynamic and continuous process that requires engagement between Absa, our employees, clients, funders and other stakeholders that are directly or indirectly impacted by our financed activities and decisions. It will assess and provide a second line ES lens on our business units investment and transaction activities by providing guidance on ES requirements during the investment/ transaction decision-making process. It will assist our business owners with on-going monitoring and management of clients against ES risk and performance.

Our ESMS entails a structured approach to managing ES risks on a continuous basis, which can lead to improved financial, social and environmental outcomes. As such, we carefully consider the level of ES risks and impacts associated with current and potential clients' decisions, based on the specific characteristics and circumstances including the nature, scale, location, technology, management capacity and commitment, as well as their track record.

Key elements of the ESMS include the following:

a. **Standard*:*** The framework for the entire management system. The standard articulates the objectives and principles that provide guidance on applicable requirements, accountability and responsibility for its implementation.
b. **Roles, responsibilities and oversight:** A clear definition of who is responsible for developing and driving the ESMS and stating who participates in each element of its implementation.
c. **Procedures:** Actions at the various stages of the process. These are underpinned by specific tools to ensure consistent application.
d. **Performance management and monitoring:** A periodic review to refine and improve the system. These consider how, when, and by whom reviews are undertaken.
e. **Reporting and communication:** Channels for reporting to relevant governance forums and communication with key stakeholders (e.g., funders) about how the management system is functioning alongside the ES performance of the investments/portfolio.

The ESMS commits us to further meet regulatory requirements and other best practices identified for the management of ES impacts. It considers applicable national and local regulations, the requirements of funders, and aims to align with local and international standards for social and environmental management including the International Finance Corporation. As an adaptive management strategy, the ESMS is a living document that will be reviewed and updated annually, as well as whenever an urgent need arises. The ESMS describes our whole environmental management system including the procedures and tools designed to implement the ESMS (refer to figure 1).

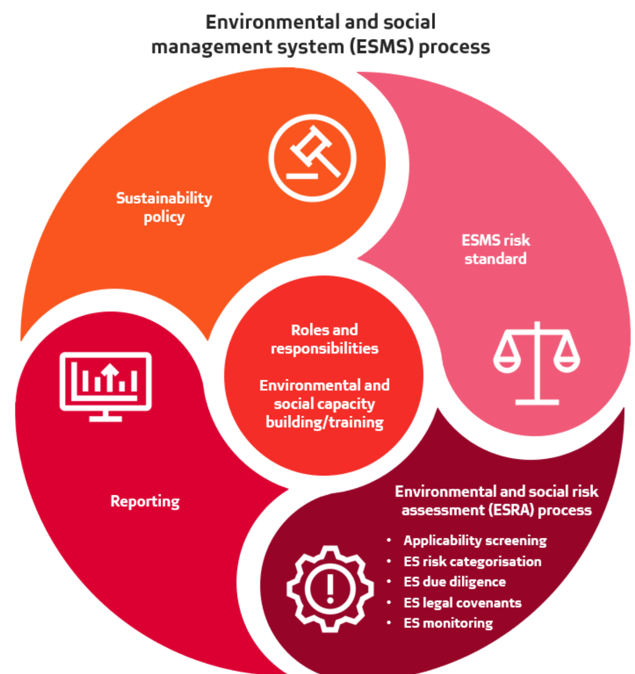

Figure 1: Absa's ESMS process

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ES risk assessment (ESRA) process

Our ESRA process is embedded into the credit process, from applicable deal origination through to final loan repayment or exit. It provides a structured approach for the assessment, monitoring and recording of a client's ES performance. The requirements in the ESRA are applicable to transactions where a client's business activities may adversely impact:

- The natural environment (including climate and biodiversity).
- Human rights, labour and working conditions.
- Employee occupational health and safety.
- Community health and safety.
- Involuntary resettlement; risk of adverse impacts on indigenous people or cultural heritage.

ESRA applicability screening

We screen transactions against applicable requirements such as the exclusion list, legal compliance to national ES legislation as well as the performance standards provided for in the ESRA tool. The exclusion list (as per agreements with various development funding institutions) contains activities that are deemed sensitive, where exposure to such activities is deemed to have an adverse impact on the environment or society (considered as reputational risks to our organisation). The applicability matrix in Figure 2 below, is aligned to applicable requirements as per agreements with development funding institutions, the equator principles as well as the Sustainable Finance Framework. Our process for determining the applicability of requirements in line with the nature and type of transaction is incorporated into the ESRA tool.

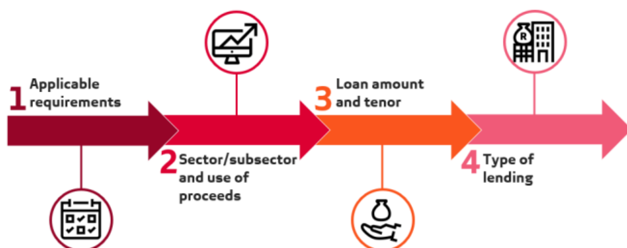

Figure 2: ESRA applicability matrix

ES risk categorization

Our first step in identifying ES risks and opportunities is to assess the inherent impacts associated with a particular activity or industry, which is done in the form of ES risk categorization. This would allow for prioritization of expected levels of risk and impact on people and the natural environment related to particular sectors and their associated activities. Factors such as scale, location, sensitivity and magnitude of impact of the respective sector and activity must be considered on a case-by-case basis in the business unit.

We classify transactions into the following three categories:

- **High risk / Category A:** The client's activities are likely to have significant adverse impacts that are irreversible, sensitive, diverse or unprecedented.
- **Medium risk / Category B:** The client's activities may result in specific impacts, but these impacts are site specific and few if any of them are irreversible.
- **Low risk/ Category C:** The client is likely to have minimal or no adverse impacts.

ES due diligence (ESDD)

Our ESDD process provides insight on the types of potential risks and impacts associated with the transaction. The level of ESDD is informed by the ES risk categorization associated with the transaction activity i.e., for a risk category A, a detailed ESDD is required, for a risk category B, a moderate ESDD is required, and for a risk category C, a minimal ESDD is required.

ES legal covenants

The outcome of our due diligence highlights specific issues requiring mitigation or management, and these are appropriately considered by our credit sanctioners and credit committees, and incorporated into our conditions for financing for the client.

ES monitoring and reporting

Transaction monitoring is informed by the level of risks and recommended actions. Reporting is done in accordance with our governance structures and externally through our public reports.

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Climate risk and opportunities

Banks and insurers are facing increasing pressure to manage financial risk related to climate change, with significant risks manifesting from physical and transition risks associated with climate change. Climate-related risks have the potential to destabilize the normal functioning of the stability of the financial system, as well as threaten our financial stability and clients. We expect climate change risks to lead to serious negative consequences for the economy, through physical risks associated with more frequent severe weather events, lasting environmental changes and the transition risks posed by the policy and technological changes necessary to achieve a greener economy.

Physical risks are linked to the geographical location of our clients' activities, the use of proceeds and their assets. They impact on the resilience of our clients' operations or assets to cope with changes in the climate related to, among others, extreme temperature, droughts and severe weather patterns. Transition risks are a function of our and our clients' ability to adjust to the transition occurring due to policy, markets, or technology shifts for a low-carbon economy.

Climate risks and opportunities affect our analyses of credit, operational, insurance, reputational and market risks and could leave carbon-intensive assets stranded and affect the value of financial instruments. We continue to enhance the ES risk assessment to expand on climate change analysis.

Awareness and capacity building

Training on the ESMS is conducted for our employees, including key roles. Our training covers the purpose, process and application of the ESMS to particular transactions/investments.

ESMS review

Our ESMS is reviewed annually and continuously improved by lessons learned across the portfolio as well as emerging practices. A review of the ESMS may also be triggered by any change in our operations or operating environment, or to make enhancements to better manage the risk.

Our risk team continuously track and update the ESMS for emerging ES risks that may affect our activities now and in the future.

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