Westpac

AN ENHANCED APPROACH TO EMBEDDING ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS IN BUSINESS AND INSTITUTIONAL LENDING

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BACKGROUND

As with most service companies, Westpac's major Environmental, Social and Governance (ESG) impacts occur indirectly, through everyday lending and investment activities.

These indirect impacts present a number of potential business risks both from a credit, operational and reputational risk perspective. On the flipside, the effective management of ESG issues provides Westpac with an unparalleled opportunity to contribute to the sustainability practices of a number of different sectors across the economy.

Westpac has an innovative and comprehensive framework currently in place to manage the ESG impacts of its business activities, including:

- A comprehensive risk framework which includes scrutiny of any activity or transaction where there is community concern;
- The adoption of the Equator Principles, a framework for assessing social and environmental risks in project finance;
- Signatory to the United Nations Principles for Responsible Investment. These Principles commit institutional investors to incorporate Environmental, Social and Governance considerations into investment analysis, decision making and ownership priorities;
- The policies to ensure lending proposals are assessed to identify and mitigate environmental risks;
- Offering a range of environmentally-linked products and services.

Westpac is currently reviewing its risk policies and processes to enhance the assessment and disclosure of ESG risks, particularly within its lending activities. This has focussed on identifying material issues and risks, examining cross-functional issue-based policies and expanding sector-specific policies to address key ESG risks.

As part of this review, Westpac has engaged KPMG's Sustainability Advisory Services to perform procedures agreed with Westpac on existing ESG risk management processes in current lending practices, and on building additional policies and frameworks for managing ESG risks.

KPMG APPROACH

The approach taken by KPMG in conducting this project involved the following three stages:

1. Interviews with relevant Westpac staff to consider current processes and lending practices;
2. Inquiry into and observation of current ESG policies and risk assessments of others within the global banking sector;
3. Preparation of a management report outlining project observations.

KEY IMPROVEMENT OPPORTUNITIES

KPMG has outlined a number of recommendations and improvement opportunities. A snapshot of initial opportunities which Westpac is reviewing to strengthen current policies and practices is outlined below.

1. Improved Transparency of Current Activities

As highlighted above, Westpac has a range of processes and policies to address the management of non-traditional risks in lending.

It is recommended that Westpac consider methods to better disclose these existing policies to provide external stakeholders – including rating agencies and NGOs – with a more transparent view of Westpac's process.

2. Integration Of ESG Considerations into Credit and Risk Policies

It is recommended that Westpac consider developing an overarching 'ESG Lending Policy Statement' which is aligned with Westpac's overall business principles – *Our Principles for Doing Business* – and integrated into credit and risk policies.

This will facilitate the linkage between Westpac's approach to lending and the Westpac business principles and values, and will mandate the management of broader operational and reputational risks associated with these 'non-traditional' or Environment, Social and Governance (ESG) issues.

3. Emerging Risk Assessment

It is recommended that the Research Group within Westpac's Corporate and Institutional Banking more fully consider ESG risks and issues as part of its annual sector strategy review.

This is an innovative approach in which emerging sectoral risks are considered and identified in a 'forward looking' manner.

This approach significantly boosts the sector guidance policies outlined below and, most importantly, allows Westpac to consider emerging upside financing opportunities, specifically around environmental and low-emission technologies.

4. Sector Guidance

To enhance the mitigation of potential ESG sectoral risks and clearly articulate Westpac's position on key sustainability issues, it is recommended that Westpac consider developing prescriptive policies and guidelines.

It is recommended that Westpac consider integrating and referencing these policies in existing Westpac Sector Policies. A range of high-risk sectors and issues are being considered, including: energy, agriculture, forestry, climate change and human rights.

5. Training

It is recommended that Westpac consider additional training for credit managers and relationship managers to help ensure ESG risks are explicitly considered alongside more traditional business risks when lending decisions are made.

NEXT STEPS

Westpac is now considering KPMG's key recommendations. Westpac is looking to finalise its response and ESG lending policies in close alignment with a range of internal and external stakeholders, including key NGOs, government and community groups.

Westpac will provide an update on its approach in the 2007 Stakeholder Impact Report.

KEY CONTACTS

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