Environmental Risk Management Initiative for China's Overseas Investment

Green Finance Committee (GFC) of China Society for Finance and Banking

Investment Association of China (IAC)

China Banking Association (CBA)

Asset Management Association of China (AMAC)

Insurance Asset Management Association of China (IAMAC)

China Trustee Association (CTA)

Foreign Economic Cooperation Office (FECO) of Ministry of Environment Protection

September 5, 2017

Environmental Risk Management Initiative for China’s Overseas Investment

By improving the environmental risk management of their overseas investments and by adopting responsible investment principles, Chinese financial institutions and enterprises can significantly accelerate progress towards key sustainability goals, such as the ‘greening’ of the Belt and Road (B&R) Initiative, the fulfilment the 2030 Agenda for Sustainable Development and the Paris Agreement on climate change, and the implementation of the ‘Guidelines for Establishing the Green Financial System’ enacted by the seven state ministries. To encourage and guide this effort by Chinese financial institutions and enterprises, the following Environmental Risk Management Initiative for China’s Overseas Investment has now been jointly launched, by the Green Finance Committee (GFC) of China Society for Finance and Banking, Investment Association of China (IAC), China Banking Association (CBA), Asset Management Association of China (AMAC) , Insurance Asset Management Association of China (IAMAC), China Trustee Association (CTA), and the Foreign Economic Cooperation Office (FECO) of the Ministry of Environment Protection.

I. **Financial institutions and enterprises engaged in overseas investment should fully understand the environmental laws, regulations and standards of the host countries, as well as the key environmental risks for their projects.** Financial institutions and enterprises are encouraged to understand and analyze the host countries’ environmental laws, regulations, policies and standards, and to identify, assess, mitigate and manage environmental risks for their business activities within host countries. They should also urge their partners to improve environmental performance.

II. **Entities engaged in overseas investment should understand the environmental laws, regulations and standards for the specific sectors of their projects, as well as the sector-specific environmental risks and mitigation approaches.** Financial institutions and enterprises are encouraged to fully understand relevant environmental standards both in China and in host countries, as well as the prevailing international standards, and adopt the highest standard where feasible. They should conduct in-depth environmental due diligence, and maintain a high level of vigilance for potential environmental impacts from industries such as mining, coal-fired power, infrastructure, steel, cement, building materials, chemicals, and textile and dyeing. In addition, they should use environmental risk analysis tools to fully identify and assess potential impacts on air, water, soil and forestry, and take steps to effectively manage such risks.

III. **In making overseas investments, banks should refer to relevant international sustainability standards, and institutional investors should refer to the UN Principles for Responsible Investment.** These institutions should take full account of ESG (environmental, social and governance) factors during the investment decision-making process, as well as during project implementation. They will also need to establish a sound internal process for environmental risk management. This calls for categorizing and managing environmental risks according to appropriate risk levels, and conducting environmental and social due diligence needed to support credit and investment decision-making. They should also jointly develop action plans with investees based on risks identified during due diligence, and continouously monitor the implementation of action plans and client environmental performance after disbursement of funding.

IV. **Entities engaged in overseas investment are encouraged to take steps to improve the disclosure of ESG information.** Such steps could include actively engaging with environmental protection organizations, and using information disclosure as a tool for improving project review and internal management procedures. In keeping with relevant laws and regulations, financial institutions are encouraged to disclose information on proposed project profiles, the size of financing and the environmental impact summary before the investment is made. Companies are encouraged to disclose environmental impact assessment reports in English or the local language prior to project construction. Financial institutions and enterprises are also encouraged to disclose ESG information annually with reference to the standards of the Global Reporting Initiative (GRI). Investment entities should clarify where the responsibility for environmental information disclosure sits within their organization. Material information of projects that may involve major environmental and social risks should be disclosed to investors, shareholders and regulatory agencies. Financial institutions and enterprises are also encouraged to strengthen communications with key stakeholders.

V. **Financial institutions should make full use of resources and support available from their headquarters, as well as from international capital market and third-party institutions, with a view to improving their internal procedures and capacity for environmental risk management in overseas branches.** Financial institutions should have consistent approaches towards environmental risk management, and clearly defined roles and responsibilities for their headquarters and overseas branches. Headquarters need to guide overseas branches in: improving their lending practices and other business operations guidelines with respect to environmental risk assessment; designing specific risk categorization and convenants; improving environmental risk categorization; and defining investee responsibilities. Headquarters of financial institutions should also provide regular training programs to build the capacity of their overseas branches for green lending and investment.

VI. **Entities engaged in overseas investment should improve the use of quantitative analysis of the environmental costs and benefits as part of the investment decision-making process.** Financial institutions and enterprises are encouraged to quantify the environmental costs and benefits of overseas investment projects, including different types of pollutant discharge, energy consumption and water use, as a basis for decision-making. For different types of projects, appropriate evaluation indicators and assessment methods should be used. To ensure the applicability of the quantitative analysis, the calculation of environmental costs and benefits should take into consideration such factors as the host country's level of technology development and environmental situation, while international standards should be used as benchmarks where appropriate.

VII. **Entities engaged in overseas investment are encouraged to use third-party service providers for assessing and managing environmental and social risks for major projects.** During overseas investment activities, Chinese financial institutions and enterprises are encouraged to make full use of lawyers, environmental consultants, non-governmental organizations (NGOs), think tanks, and other professional service providers to understand the host countries' environmental laws and regulations. They should also carry out environmental impact assessments in accordance with local provisions and sector best practices, as well as identify and prevent environmental risks at the project, local and international level, and establish communication platforms with stakeholders. Enterprises are encouraged to adopt multiple means of conflict management, including mediation, for settling environment-related disputes.

VIII. **Investment entities are encouraged to use green finance instruments for overseas projects, especially medium- and long-term infrastructure projects.** Institutions investing overseas should actively apply green finance instruments such as green bonds, green ABS, YieldCo, and emission rights-based financing tools, as well as financing from green investment funds, to moblize capital for green projects, support the development of green finance market and green finance products, and strengthen environmental information disclosure and internal processes as required by the use of green finance instruments. They should also engage third party institutions (such as green rating, green index, and green certification agencies) to help strengthen project environmental risk management.

IX. **Enterprises engaged in overseas investment are encouraged to use environmental liability insurance as a risk management tool for projects with high environmental risk.** Enterprises should seek to leverage insurance companies’ capacity for mitigating environmental risks and reducing the probability of environmental accidents. They should also abide by the insurance requirements of host countries on environmental pollution liability in high environmental risk sectors (such as mining, petroleum, chemicals, and transportation of hazardous materials), and actively use environmental liability insurance provided by international insurers to manage potential legal and financial risks caused by environmental accidents. China's insurance institutions should actively participate in the "Belt and Road" initiative by developing environmental liability insurance products for overseas investment projects, and play an active role in monitoring and encouraging enterprises to reduce environmental risks in overseas investment.

X. **Green supply chain management should be adopted in project design and initiation, project bidding, and in the procurement of raw materials and equipment procurement for large overseas infrastructure projects.** This will help promote green operations for suppliers of raw materials, equipment and services. Under the green procurement principles, a green bidding process should be explored for contractors for project management, engineering contracts, project operations and maintenance, as well as raw materials and equipment, and green procurement of office suppliers should be implemented. Voluntary initiatives on green supply chain are also encouraged in areas such as the development of ‘white lists’ for green supply chain materials and equipment, the release of green supply chain performance indices, and the improvement of transparency and information connectivity in relation to the green supply chain.

XI. **Financial institutions should take steps to ‘green’ trade finance and supply chain finance.** This can help reduce financing costs and improving access to finance for green suppliers. Financial institutions should carry out their risk management efforts based on ‘green features’ of suppliers, with a view to supporting and encouraging green suppliers. They can guide customers to strengthen their environment and social risk management with respect to supply chain management, which will in turn help promote a green transformation of their businesses. Financial institutions can also actively develop innovative financial products and services that will facilitate the greening of all steps in the process: the supply chain, production, procurement and consumption.

XII. **The Green Finance Committee (GFC) of China Society for Finance**

and Banking and Investment Association of China (IAC), together with China Banking Association (CBA), Asset Management Association of China (AMAC), Insurance Asset Management Association of China (IAMAC)，China Trustee Association (CTA), the Foreign Economic Cooperation Office (FECO) of the Ministry of Environment Protection and other industrial associations and institutions will provide more capacity building services in the area of environmental risk management for financial institutions and enterprises investing overseas. The green finance service platform, supported by relevant industry associations, will carry out many activities to facilitate these efforts, such as: organizing training programs on green investment and financing; developing case studies on greening overseas investment and environmental risk management manuals; developing a website for the "Belt & Road" environmental risk management; and improving information sharing among investors. Industry associations should also provide guidance on engagement with the international community, NGOs and stakeholders, and to establish quality communication channels for China's financial institutions and enterprises.

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