Can African Banks Balance National Development and ESG Implementation?

The ‘Future of Banking in South Africa’, an Executive Roundtable hosted by SunTec Business Solutions was held in Johannesburg, South Africa on March 9, 2023. The event brought together leaders from prominent banks in South Africa and from SunTec for a candid discussion complying to the Chatham House Rule around the various impacts on the banking industry and its outlook in the region. The delegates deliberated and shared opinions on the following key focus areas for the South African banking industry:

1. Banking-as-a-Service (BaaS)
2. Environmental, Social & Governance (ESG)
3. Dynamic Segmentation

This report summarizes the key points discussed during the session on 'Environmental, Social and Governance’ (ESG) featuring representatives from leading banks in South Africa. This session was moderated by Clinton Abbott, Senior Vice President, SunTec. During the session, Clinton shared a story about a tobacco farmer who brought USD 2 million to a bank to open an account. The farmer's original bank was reducing their portfolio risk, which led the farmer to seek out a different bank. Despite being turned away by other banks, the manager of this particular bank accepted the deposit. However, it breached the loan contract stipulations with their DFI (Development Finance Institution) partner. Consequently, the DFI funder imposed a penalty of 2% of the total credit facility amount. This was due to the contravention of the maximum tobacco funding allocation within the credit portfolio agreed upon between the Bank and the DFI partner.

DFIs have their unique set of guidelines and regulations for investments in various sectors, industries, and geographies, including ESG criteria. These penalty clauses are included in credit portfolio agreements to ensure that the portfolio aligns with the DFI's sustainable investment objectives. Such incidents highlight the importance of compliance with DFI requirements and ESG regulations for banks. Due diligence is crucial when originating or managing account portfolios to avoid penalties and ensure compliance.

This report presents some of the other key points that were discussed and shared by the delegates. Most importantly it highlights that ESG mandates cannot be dictated by a governing body of developed nations with an expectation that the same framework will work for a developing economy in Africa or Asia.

Is ESG a Risk or an Opportunity?

ESG mandates are applicable to all corporate entities and banks are no exception. In this article published on the Ernst & Young website, the authors Praveen Tekchandani, Shuhui Toh, and Aloysius Fua examine how companies must view ESG risks as opportunities to attract investors and reduce their total cost of capital. Banks must deliberate upon responsible tax management, cybersecurity, or data privacy as key areas of consideration for their ESG goals.

As seen in the above example of the tobacco farmer and the bank manager who got penalized, it becomes crucial for banks to educate their client-facing and decision-making employees at all levels to understand the nuances of the ESG mandate and whether then transactions are in line with the stipulated ESG guidelines.

Climate Change and Net Zero Emission Goals

There is no denying that climate change is real, and all countries are being impacted by it. Banks need to understand that climate change is indeed a long-term material risk for them, and they must establish a proper roadmap, a deadline, and linked objectives that help meet their 'Net Zero Emission Goals'.

For banks, this is yet another expense item to be added, and it will take a fair bit of time to put this into practice. Despite the costs and immense efforts associated with framing ESG policies and following them, several African banks are taking steps to implement ESG policies.

Taxation and Sustainability

Regulators are now levying carbon and environmental taxes on corporate entities. This works as a tax mechanism that prompts firms to follow 'positive' ESG behavior and incentivizes organizations that can achieve their ESG goals or are able to bring down their 'carbon footprint' by following sustainable business practices.

Zambia National Commercial Bank (Zanaco) is taking the lead on ESG and related sustainable banking efforts in Africa. They are the first bank in the region to issue an integrated ESG report in partnership with Deloitte. The report showcases what Zanaco is working on in the area of ESG. The bank is working closely with farmers in Zambia focusing on planting trees, helping farmers take care of them, and providing livelihood to the farmers. Carbon credits and Green ATMs are another key component on which the bank is focusing.

Understanding ESG Taxes and Regulatory Requirements

Countries are framing rules and formulating policies and taxes that focus on holding organizations accountable for their carbon footprints and the amount of damage that they cause to the environment. Countries like the USA, Sweden, and Singapore have a huge list of rules mapped to ESG requirements. Developing nations are working closely to understand the changes being proclaimed in climate conferences such as the G20 Summit, World Economic Forum Meet at Davos, and similar events. It is important that banks have a clear idea of the rules and regulations in the countries they operate in to avoid being penalized by regulatory bodies.

Can the 'West' Dictate ESG Terms to Africa?

One of the most interesting points made during the session was about how Western superpowers, which for years had taken advantage of Africa's natural resources, were now trying to enforce ESG requirements on developing nations. Several new discoveries of oil and natural gas have been made in Africa. This is the perfect opportunity for these countries to work on mining these resources, providing livelihood to the locals, building infrastructure, and creating a prosperous economy. Banks cannot deny loans to companies and public-private partnerships involved in these businesses citing ESG regulations. Adherence to ESG regulations cannot come at the cost of nation-building and developing a regional economy.

Greenwashing – An Inconvenient Truth

When Elon Musk said that ESG was a "Scam", it drew a lot of attention. There is growing discontent in the banking industry as more cases of greenwashing are being reported. Greenwashing is when a bank or a corporate entity provides misleading and false information about its climate change benefits through annual reports or advertisements. Some prominent cases of greenwashing include:

- Morningstar, an influential investor services firm that recently removed 1,200 funds with a combined value of 1.4 trillion US dollars from its 'sustainable list'.
- Fast-fashion brand H&M, for example, is currently being sued in a New York federal court for making false claims that its Conscious Collection is sustainable. The company uses more water to manufacture items in the collection than its normal clothes.
- As per a study commissioned by "The Economist" in 2021, twenty of the world's biggest ESG funds were invested in fossil-fuel producers, while others held stakes in oil producers, coal-mining, gambling, alcohol and tobacco.

Greenwashing is accounting fraud. The Securities and Exchange Commission has set up an ESG Task Force to prioritize the investigation of climate and ESG-related misconduct (greenwashing). The European Union is considering lowering capital requirements for sustainable finance.

It is a delicate situation as executives in leadership roles work towards fulfilling the aspirations of the company and helping developing economies grow. So, how can executives be held responsible for 'greenwashing'? The example of oil and natural gas exploration in Uganda, and money being provided for such businesses, came into focus. The key here is to balance responsible business development and caring about the environment. In the last three or four years, the whole ambit of ESG and what it entails has evolved. With boundaries getting blurred, financial institutions and corporates have been looking for loopholes that can be exploited to enable greenwashing, and banking regulators are penalizing such institutions.

Renewable Energy and Africa Resilient– A Better Tomorrow

Equity Bank in Kenya and Uganda got funding from Europe for solar energy implementation. Solar panels were offered to customers. This enabled both the customers who used solar panels and the bank to meet their ESG mandates. The bank's portfolio was also de-risked and they were able to do something good for the environment. This was then applied to the education sector and the Wings Program for doctors was launched to help bring back trained doctors to serve the public in Kenya.

The African Development Bank Group (AfDB) is also taking steps to meet ESG goals. A key focus area for the bank is to identify and assess the environmental impacts and risks created by the agencies or organizations that the bank funds.

The State of ESG in Africa

There is greater awareness about the need for ESG and sustainable business practices in Africa. The inaugural ESG Africa Conference took place last year and the next edition of the event will be held later this year in Johannesburg, which aims to answer several questions around ESG.

The ESG goals popularized in the USA are an off shoot of the UNDP goals on environment and sustainability. The role of NGOs in fostering ESG at the grassroots level is also something to consider. It will be interesting to see how banks in the South African region and other parts of the developing world look at their ESG mission statement and implement the mandates listed.
The key outcomes from the session on ESG are as follows:

- Climate change is real and organizations, especially banks, need to embed an ESG framework.
- The awareness about the need for ESG in Africa is increasing.
- The African continent is seeing a massive growth in its economy driven by the discovery of natural resources like coal, oil, and natural gas. With entire cities developing around mining operations, banks struggle to implement ESG rules to their corporate client's business. Western superpowers cannot preach about the environment and ESG guidelines to developing countries at the cost of nation building and economic growth.
- Greenwashing is accounting fraud.
- Responsible business development and caring for the environment must go hand-in-hand.
- Many can make money, few can make a difference, even less can do both – Help businesses be both.

The session ended with thoughts on how the next decade will be crucial for banks in Africa to get their ESG principles and vision right. In line with the 'Africa Resilient' theme, it is important to start the dialog on ESG and understand how banks, governments, and corporate entities can work together to arrive at a consensus and do what is best for all stakeholders.

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