BUSINESS ISSUES BULLETIN
54370
Translated from original Vietnamese document
VIETNAM
THE BUSINESS INFORMATION CENTER AT THE VIETNAM CHAMBER OF COMMERCE AND INDUSTRY
No.27 (30) October 2009

CHINA'S GREEN CREDIT POLICY
Experience and Lessons for Vietnam

Sustainability[1] is now increasingly recognized as central to the growth of emerging market economies. For the private sector, this represents both a demand for greater social and environmental responsibility as well as a new landscape of business opportunity. The financial sector has been late to respond to this trend but is emerging as an important driver across all sectors of the economy. New standards and codes of conduct have been developed within the banking sector to promote corporate accountability, transparency, and consideration of impacts on environment and society. A clear example is the Equator Principles[2], a voluntary set of principles for environmental and social risk management in project finance, adopted by an increasing number of leading banks that operate in developing countries. At the same time, some developing country governments have been taking action to turn to commercial banks to address pressing environmental and social issues.

This Bulletin introduces a policy initiative enacted by the Chinese government to address negative environmental impacts. The policy encourages the banking sector to apply environmental risk management practices and commit to providing financing to projects and businesses that promote environmental protection. The lessons learned in China can benefit Vietnam and serve as a model for Vietnam's financial sector.

China's decades of double-digit annual economic growth have been achieved at an enormous sacrifice to the environment. Certain by-products and behaviors that have been directly linked to economic growth, namely pollution and unsustainable energy consumption, are now threatening economic and social development, as well as the country's global standing. Side effects from China's rapid economic growth and development are high costs to resources and significant environmental degradation. Moreover, with China's emergence as a global producer and investor, the country's enterprises are increasingly being scrutinized - at home as well as abroad - for their environmental and social performance. Banks have helped to fuel economic growth by providing credit to enterprises, often pursuant to national economic policies or at the behest of local authorities. However, banks have also seen how severe environmental problems in these enterprises can lead to non-performing loans. As a result, Chinese financial institutions, especially commercial banks, are now more aware of the need for enterprises to follow Chinese laws on environmental assessment and protection.

The Chinese government has recently introduced its Green Credit Policy, which uses financial policy tools and incentives to improve enterprise performance and reduce pollution. The government is expecting the country's financial sector to play a central role in establishing and enforcing this policy. In response, various large state-owned banks as well as joint stock banks are currently studying, developing, and implementing measures to ensure the success of the Green Credit Policy.

The Green Credit Policy - an initiative that requires inter-agency coordination

China's Green Credit Policy aims to guide loan financing away from highly polluting and/or energy consuming enterprises and projects towards enterprises and organizations favoring energy conservation and emissions reduction. The policy was jointly developed by the State Environmental Protection Agency (SEPA), the People's Bank of China (PBOC), and the China Banking Regulatory Commission (CBRC) in July 2007. According to the policy, firms that fail to pass an environmental assessment or implement state environmental protection regulations will be disqualified from receiving loans from any financial institution. Firms that have already obtained loans but are later discovered to have violated the environmental regulations may have to pay back their loans.

To ensure that implementation of this policy is strictly enforced, a 'credit blacklist' of companies not meeting environmental standards has been developed and maintained by the Ministry of Environmental Protection (MEP)[3]. Banks are prohibited from lending to companies on the list until the companies remedy their environmental violations and are cleared from the blacklist. This list is included in PBOC's credit information database in the Credit Information System Bureau.[4]

At the same time, MEP and CBRC signed an agreement to establish an information-sharing mechanism that enables CBRC to incorporate environmental protection and compliance into its banking policies and compliance monitoring activities.

In November 2007, CBRC, as the primary authority responsible for the regulation and supervision of banking institutions, issued the important Guidelines on the Credit Granting for Energy Saving and Emissions Reduction. This document encourages financial institutions to implement the Green Credit Policy alongside the government's broader environmental policies, including supporting enterprises working in environmental protection; controlling lending to the 'liang gao' industries[5], and categorizing all projects according to the extent of their environmental impacts.

Response of commercial banks to this policy

The policy sends a strong message to banks concerning new responsibilities towards environmental protection. It encourages banks to manage risks caused by environmental and social issues, and will also help protect corporate reputations. Additionally, it creates an opportunity to explore new business ventures associated with energy conservation and emissions reduction.

Both developments were received positively by the commercial banks and lending institutions. Consequently, they are altering their lending practices to favor enterprises that comply with the stated environmental safeguards. For example, in 2008, 35 enterprises in Huzhou City of Zhejiang Province were denied bank loans totaling 214 million Yuan because they failed to meet environmental protection standards. Similarly, the Guangdong provincial banking system (excluding

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(1) According to Nobel Prize-winning physician Murray Gell-Mann, sustainability can be defined as 'living on nature's income rather than its capital'.
(2)Based on IFC's social and environmental performance standards, this voluntary set of principles is applicable to projects in all industry sectors, with a total capital cost of $10 million or more, and to project finance advisory activities. Participating institutions agree not to "provide loans directly to projects where the borrower will not or is unable to comply with our environmental and social policies and procedures." Each bank implements its own policies and procedures to reflect the principles.
(3) MEP has been upgraded from State Environmental Protection Authority (SEPA).
(4) Over 40,000 information entries on environmental protection are included in this database.
(5) In Mandarin this means 'double high' referring to heavily polluting and energy intensive industries.

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IFC International Finance Corporation
World Bank Group

The *Business Issue Bulletin* provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Vietnam, and exposure to different opinions held by various stakeholders on the topic.

The *Bulletin* is supported by Finland, Ireland, New Zealand, the Netherlands, and Switzerland.

The Green Credit Policy - an initiative that requires inter-agency coordination

● The 'greening' of the banking industry has two complementary aspects: 1) directing credit toward environmentally favorable projects and enterprises which are committed to sustainability, and 2) denying financial support to environmentally damaging projects and enterprises. While both aspects can be directed and controlled by regulation, the key to successful adoption of a Green Credit Policy is to demonstrate how green lending increases profits and reduces risk, thus generating economic gain to lenders while simultaneously supporting better environmental and social conditions for the greater public.

The Green Credit Policy not only responds to China's demand for curbing pollution and energy consumption, but also appeals to the natural instinct of banks to generate reliable revenues from lending and minimize lending risks to enterprises that do not adhere to environmental regulations or that cause catastrophic incidents.

Mr. Ye Yanfei, Deputy Director-General
Statistics Department, China Banking Regulatory Commission (CBRC)[9]

The establishment of 14 'liang gao' industries in China is an exemplary practice. However, for such a policy to be implemented in Vietnam, a roadmap should be established. With the current limited awareness level of officials, especially local governments, businesses and the general public, any attempts for immediate and obligatory enforcement are unlikely to be viable. Government efforts to create conducive conditions and introduce incentives for loans and investment in energy saving and renewable energy projects is a feasible option.

Mr. Nguyen Phu Cuong, Deputy Head of Science and Technology Department
Ministry of Industry and Trade

● I highly regard the Green Credit Policy effort of the Chinese government and its achievements in environment protection and energy saving. China's experience in developing this Green Credit Policy is definitely practical for Vietnam, particularly for consideration of developing a similar scheme for the banking sector.

Mr. Cat Quang Duong, Deputy Head of Credit Department
State Bank of Vietnam

● China's experience in using credit policy for energy saving and pollution alleviation with the close coordination of various governmental agencies (banking supervision, planning & investment, finance, environmental protection, etc.) sets a good example that Vietnam should learn from. However, to effectively employ such a policy, all relevant parties need to be well-prepared, from awareness among investors and the banking sector, to procedures with a specific and clear coordinating mechanism.

We do not have a list of firms that have committed severe environmental violations in Vietnam, nor do we have a two-way information system between relevant agencies such as in China. Environmental impact assessment is a good pollution control tool, especially as the Environment Law of 2005 is now in effect. Enforcement and compliance with environmental protection rules by investors and businesses, however, remains superficial. Authorities also lack information about the use of environmental impact assessments by financial institutions. In addition, the project classification system based on environmental impacts does not exist.

Ms. Le Minh Toan, Deputy Head of Planning and Finance Department
Environment Administration

China's experience in utilizing economic measures to protect the environment is useful. There is a primary need to set forth environmental protection targets with specific criteria and mandates in the socioeconomic development plan. Based on this, ministries and sectors can develop relevant legal normative regulations to guide implementation among enterprises.

Ms. Phan Thanh Ha, Deputy Head of Financial and Monetary Department
Ministry of Planning and Investment

Response of commercial banks to this policy

● Green credit policies have been adopted extensively using voluntary principles, with the guidance and monitoring of relevant government agencies in China. I see that Chinese banks have all implemented this Green Credit Policy, though probably to different degrees. The largest Chinese bank, ICBC has utilized a green credit procedure for all projects, regardless of size, with environment-related standards even higher than the national norms.

Ms. Phan Thanh Ha, Deputy Head of Financial and Monetary Department
Ministry of Planning and Investment

● The implementation of environmental and social risk management at ICBC and IB is positive, exemplified by well-developed organizational structures, management apparatus, monitoring and supervision mechanisms, and credit review and granting functions. The two banks themselves agree that the introduction of environment and social risk management policy in the current context is a necessity. The question rests with the long-term and sustainable development outlook for the bank, that "profit is one-off, sustainable development is permanent". Though further analysis is needed to assess the impacts and effects of this policy on bank performance, I think that the implementation of the environmental risk management system by the two banks is impressive.

Mr. Ho Xuan Nghiem, Deputy CEO
Sacombank

After adopting the Equator Principles in October 2008, Industrial Bank (IB) has been focusing on building its environmental and social management systems, as well as constructing a dedicated Sustainable Finance Division to implement the Equator Principles. This team has developed internal environmental and social policy and procedures and is in the process of integrating environmental and social considerations into their credit review processes. IB is also training staff, from senior management to credit officers, in both headquarters and local branches. At the same time, it is reaching out to educate clients about IB's environmental and social requirements, and providing training to key clients.

Mr. Hua Bing, General Manager of Legal & Compliance Department
Industrial Bank of China[10]

(9) At the meetings with Vietnamese government and banker group, Aug 2009 in Beijing and Fuzhou.
(10) At meetings with Vietnamese government and banker group, August 2009 in Fuzhou, China.

Strong commitment from both central and local government is vital to the success

● To date, the State Bank has never circulated guidelines or reminders to commercial banks on their involvement in environmental protection, which I think is the first step to make to raise awareness of commercial banks. If little improvement is observed after such education and communication, compulsory rules can be considered to force commercial banks to comply with environment risk management provisions in releasing loans.

The establishment of a database that provides a list of enterprises violating environmental protection laws or causing heavy environmental pollution, versus a list of businesses playing a proactive role in environmental protection and projects using clean and innovative energy at environment management authorities is a very good idea which is also likely to positively affect credit management of commercial banks. I would like to see it implemented as soon as possible.

Ms. Le Thi Kim Nga, Member of Management Board
Vietcombank

● In addition to CBRC's periodic on-site examination and compliance audits to strengthen the implementation of this Green Credit Policy, CBRC asks all banks to report on a quarterly basis on the progress of implementing environmental risk management as well as loan classification based on environmental impacts. CBRC will then conduct analysis of an individual bank's portfolio to assess whether it is too weighted towards high environmental risk industries and sectors.

● To support banks in this area, CBRC partners with other governmental agencies and a number of international organizations, including IFC and Equator Banks to organize training and workshops allowing banks to exchange experience and gain exposure to international best practices in managing environmental and social risks. CBRC has set up a web-based information system on enterprise environmental performance. Most of banks can access to this portal and check information about their potential borrowers and even existing clients.

Mr. Ye Yanfei, Deputy Director, Statistics Department
China Banking Regulatory Commission (CBRC)

● Currently, financial institutions operating in Vietnam are obliged to report monthly on loan portfolios to the State Bank. However, they only need to provide information on outstanding loans, type of customers, sectors, and are not required to report the environmental and social impacts of the projects they finance. Most local banks have not yet employed environmental and social risk management systems. The State Bank should consider requesting all banks to apply environmental and social risk management in credit decision making processes in the near future if the goal is to develop the banking system sustainably and to contribute to environmental protection.

Mr. Cat Quang Duong, Deputy Head of Credit Department
State Bank of Vietnam

The case for Vietnam

● Energy consumption by local businesses at present can be divided in two categories: 1) businesses using advanced equipment and technologies, mostly recently established manufacturing facilities, 100% foreign-owned or joint venture businesses, accounting for a modest proportion; and 2) businesses using old, outdated equipment and technologies, taking a major share. If the latter group invests more in upgrading technologies and management practices, this could help save up to 25 percent of energy consumption. This, in turn, can also become a potential market for financial institutions.

Mr. Nguyen Phu Cuong, Deputy Head of Science and Technology Department
Ministry of Industry and Trade

● We should consider this policy model on a pilot basis, for example with projects in the basins of the three rivers Cau, Nhue Day, and Dong Nai, where our priority should be to address environmental pollution issues and for which a master plan for environmental protection has been approved by the Prime Minister.

Ms. Le Minh Toan, Deputy Head of Planning and Finance Department
Environment Administration

● In June 2005, Sacombank issued a provisional regulation on the establishment and operation of the Environment and Social Management Taskforce. In July 2009, Sacombank mainstreamed its environmental policies and formed an environment and social management committee. Sacombank is seeking to become a green bank. The adoption of Equator Principles is completely in sync with Sacombank's present development vision. Taking part in IFC's China study tour in August 2009, and reflecting on what has been accomplished, Sacombank is on track to speed up its implementation and observe Equator Principles as soon as possible. IFC's support to Vietnamese banks in training, field studies, development of benchmarks and establishment of models toward an equator bank is highly desirable and vital. IFC has been developing a series of supporting tools which can be used by local banks, including Sacombank, to stay increasingly updated on Equator Principles, environmental and social standards, as well as environmental, health, and safety guidelines.

Mr. Ho Xuan Nghiem, Deputy CEO
Sacombank

● Environment degradation in Vietnam has not been anywhere close to what is occurring in China. Nevertheless, relevant industries, including finance and banking, should start to demonstrate their social responsibilities now, through stricter control of loans, especially project financing areas.

Vietcombank has never encountered non-performing loans due to customer infringement of environmental protection regulations. That, however, does not necessarily mean such incidents will never happen. As a safeguard measure, we have planned on more stringent environment risk management for loan assessment and control. To do this, we will start utilizing environmental impact assessment reports for projects during the credit review process, and stricter reviews will be introduced for projects utilizing hazardous chemicals or posing potential environment and social risks. We will not finance projects using outdated production lines or old technologies which may adversely affect the environment. In fact, there was a case where we were performing regular audits of a cement factory in Vietnam, and learned that the company's staff were working in a hazardous and dusty environment. We subsequently reduced the company's loan balance to compel the company to improve conditions, and ultimately a total recall of the loan was employed.

Vietcombank is also considering a plan to develop toward a green bank, through raising awareness of the entire staff and integrating 'green' perspectives in our business strategy, service provision process, and especially customer assessment and management. Classification of loans based on environment-related factors used by ICBC is desirable and is one of our priorities for the future.

Ms. Le Thi Kim Nga, Member of Management Board
Vietcombank

● The banking sector should respond to the recent National Strategy for Cleaner Production in Industry until 2020[11] by only extending loans to projects/businesses complying with environmental protection and energy saving regulations. This is a new area for Vietnam in general, and for the State Bank in particular. The State Bank is seeking support from international organizations in the process of developing policies and regulations to manage the environmental and social risks in credit businesses and to develop the banking sector in a sustainable way. We are particularly interested in tools, guidelines and best practices in environmental and social risk evaluation of investment projects which can be utilized by our banks.

To get the banking sector to contribute to the national environmental protection and energy saving strategy, the State Bank needs cooperation from other related agencies, particularly the Ministry of Natural Resources and Environment (MONRE). I agree that it would be ideal if a communication channel were to be established between State Bank and MONRE so that the State Bank is able to inform credit institutions on businesses/projects violating environmental regulations. Such a blacklist is necessary but needs to be carefully set up as it might involve privacy issues.

Mr. Cat Quang Duong, Deputy Head of Credit Departmen
State Bank of Vietnam

● Perhaps the most important lesson learned from international and Chinese banks that have implemented the Equator Principles and Green Credit Policy is that environmental responsibility and commercial success can go hand in hand. Practicing good environmental and social risk management reduces credit losses, protects reputations, and generates profits for banks and their borrowers. Early adoption of good environmental and social practices reduces long-term costs, avoiding the necessity of spending resources on remedial work. These international and local policies and practices are tools to assist commercial banks to manage risks, particularly environmental and social risks, and in exploring sustainable business practices.

By effectively managing social and environmental risks and identifying opportunities alongside these risks, banks are beginning to create long-term value for their business. Some banks are driven toward a sustainability path because of the need to manage environmental and social risks, while others enter the path through their desire to offer innovative sustainability products and differentiate themselves from their competitors. While entry points will vary from bank to bank, it is our view that the optimal long-term value creation is a win-win approach to achieve our economic development and environmental protection agenda. We hope these international and regional experiences and lessons are useful for Vietnamese policy makers and commercial banks.

Ms. Rong Zhang, Program Officer
Environment and Social Development Department, IFC

(Continued from page 1)

Shenzhen) cut 400 million Yuan in loans for seven enterprises as a result of the information provided by the environmental protection information system.

In addition, several banks have already put in place internal systems, policies, procedures, databases, and tools to manage policy implementation. For example, the Industrial and Commercial Bank of China (ICBC) established a special database on 47,000 of its clients, focusing on environmental information and risk. It also adopted a 'one-ballot-veto' mechanism which allows for a single ballot rejection of loans based on a borrower's environmental performance. ICBC also ranks its borrowers based on their environmental performance on a nine-category basis, ranging from 'environmentally friendly' to 'potential environmental risk'.

Another notable development supporting the Green Credit Policy comes from the joint stock Industrial Bank (IB). IB's unique sustainability strategy began with a 2006 decision to become IFC's first partner bank in China to finance energy efficiency projects. By the end of 2008, IB had granted 86 loans for energy conservation and emissions reduction projects totaling 3.3 billion Yuan, covering 22 provinces in China. Also, in October 2008, IB announced its adoption of the Equator Principles, thereby becoming the first Chinese Equator bank.

Strong commitment from both central and local government is vital to the success

Although significant progress has been made after more than one year of implementing the Green Credit Policy, MEP admits that there are a number of challenges - especially at the provincial level. For instance, resistance by local governments to withdraw from highly-polluting, highly-profitable businesses (a key resource for local tax revenue); and limited awareness among local government officials and small-scale bankers about environmental issues limits the depth and breadth of implementation.

In the meantime, a comprehensive Green Policy Framework is being developed to further strengthen the enforcement of the Policy and to extend responsibility and accountability to the public sector. Led by MEP, it will include: "Green Insurance"[6], "Green Securities"[7], and an "Environmental Tax"[8]. This framework demonstrates increasing awareness and commitment from China's public sector to address environmental issues resulting from rapid economic development.

The case for Vietnam

Lessons learned from China's experience can serve as a valuable model for Vietnam. Recent news reported by the Ho Chi Minh City (HCMC) government that over 100 enterprises in HCMC's export processing zones and industrial parks do not have wastewater treatment systems is evidence of the fact that Vietnam's rapid growth is having negative environmental impacts. In addition, 70 enterprises were reported to be without waste gas treatment systems, and 22 of 106 central and private hospitals had not completed their wastewater treatment facilities. Other cases include pollution by manufacturing firms, including the case of Vedan Vietnam illegally dumping untreated waste into the Thi Vai River, a Korean MSG manufacturer dumping toxic waste, and a Vietnamese leather tanning company pumping carcinogenic chemicals into a HCMC river.

These cases should propel the government to take measures for more aggressive enforcement of environmental regulations by shutting down severely polluting production facilities and asking financial institutions to take into account environmental risks when lending. Vietnam's financial institutions should initiate steps to adopt some of the measures in the Green Credit Policy. In the short term, the public sector should encourage banks to adopt the Equator Principles and introduce preventative measures as a way to raise awareness. The government should then gradually move toward more restrictive standards (i.e. blacklisting) as seen in the Policy in China. While Vietnam is prioritizing economic development, it should not be at the expense of the environment. This is a message that should be integrated at all levels throughout various sectors.

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(6) Firms in industries highly prone to environmental accidents will be required to buy insurance on the basis of their environmental risk profile.
(7) Heavy industry companies, including those in power, cement, and steel, that seek an initial public offering must meet certain environmental criteria, and listed companies in certain heavy polluting industries must provide minimum levels of disclosure of environmental and energy performance.
(8) Environmental taxes based on different industries, products, and pollution levels.
(11) On September 7, 2009, the Prime Minister issued Decision No. 1419/QĐ-TTg, approving the National Strategy for Cleaner Production in Industry until 2020 with an aim to strengthen state management in environmental protection and optimizing the use of natural resources and energy, reducing emissions and improving people's lives.

BUSINESS ISSUES BULLETIN
• Publisher: Phan Hong Giang - Director of Business Information Center - BIZIC - VCCI • Office: 5th floor- International Trade Center - N0 9 Dao Duy Anh St., Hanoi
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• Tel: (84.4) 5743084 • Fax: (84.4) 5742773 • E-mail: vcci@hn.vnn.vn
• Layout and printed by: Newdays JSC.; 10,000 copies
• License N0: 27/GP-XBBT by the Ministry of Information and Communications, dated 19/5/2009