38- SUSTAINABLE DEVELOPMENT AND SUSTAINABLE FINANCE

A) Circular No. (2/BS, IBS/500/2022) to all Local Banks regarding the Sustainable Finance.

THE GOVERNOR

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Circular No. (2/BS, IBS/500/2022) to all Local Banks
Regarding the Sustainable Finance

In light of the greater attention to Sustainable Finance, and following the CBK approach to reassure the concept of sustainable development and take actions to implement and promote sustainable finance in the banking sector in light of the pillars embraced under Vision 2035 "New Kuwait" including sustainable development.

Find attached herewith the CBK directives to local banks concerning sustainable finance. These directives cover awareness of the significance of sustainable finance, defining the three pillars of Sustainability, i.e. Environment, Social, and Governance (ESG), and the key principles and directives that should be considered by banks with regard to sustainable finance and factors of sustainability.

Best Regards,

Basel A. Al-Haroon

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Directives regarding Sustainable Finance Environment, Social & Governance (ESG) Standards

I. Introduction

Attention to sustainable finance is increasing in line with the global trends to promote the concept of sustainable development. These trends reflect the role of financial institutions to achieve these goals.

The Report of United Nations Brundtland Commission issued in 1987 defined sustainable development as “Development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. This definition involves information, the most important of which is the limited ability of the environment to respond to current and future needs for humanity in light of the overarching **patterns of production and consumption** and available technologies. Therefore, sustainable development aims to achieve long-term stability of the economy, environment and the whole community.

Within the framework of the monetary and supervisory policies adopted by CBK aiming to provide an environment conducive to economic growth, and in line with the pillars of Vision 2035 “New Kuwait” for realizing sustainable development, and given the increasing attention to sustainable finance and the significant role of banking sector in serving the national economy, these principles include directives to local banks for promoting awareness of the sustainability standards, and then the key principles and trends that banks should consider with respect to sustainable finance and sustainability factors.

The sustainability standards are represented in three main pillars, namely Environment, Social, and Governance (ESG) standards. These three standards, known as "Three Pillars of Sustainability Governance", have become instruments to describe the three areas developed to constitute the key standards for measuring sustainability and professional practices when making investment and business decisions.

II. The Three Pillars of Sustainability:

A. Environment (E):

Environmental factors are the external drivers that have impacts on the operations and income of an entity not exclusively affected by market mechanisms on the one hand, and the impact of the business of such entities on the environment on other hand. With the diversity of these environmental factors (that may be determined in detail in light of the

international standards), of which the most important are those associated with the following:

1. Climate Change, and the required economic analysis (including financial risks) of the factors associated with climate changes and their impacts on investment decisions;
2. Hazardous Wastes and Environmental Contamination and the associated risks of industries or corporate activities and the costs of their disposal;
3. Natural Resources: Sustainability have become the core factor for investors in making environmental, social and corporate governance decisions. Resource depletion and the future of industries dependent on depleting raw materials has become vital when assessing the value of such entities. where the long-term view has become dominant among investors
4. Any other environmental factors, particularly those involving risk drivers associated with the banking business.

B. Social (S)

This pillar relates to various themes, such as providing job opportunities, improving work conditions that include equal wages, rights of all workers without discrimination, human capital, considering the impact on local communities, the health and well-being of employees, consumer protection, and maintaining the privacy and confidentiality of information.

C. Corporate Governance (C)

This pillar relates to the rights and responsibilities of the entity's board of directors, its senior management, shareholders, stakeholders, and issues that fall under governance relevant to the need for diverse experiences of the boards of directors, in addition to professional practices and related controls in the governance areas such as remuneration controls, wage packages, anti-corruption and mitigating the factors that may affect the stability of the organization.

III. Directives on Sustainable Finance (ESG)

In light of the above, and within the framework of the guidelines and pillars of sustainable finance, the following are key principles and guidelines that banks should take into consideration in respect of Sustainable Finance and Sustainability pillars:

1. Embedding Environment, Social, and Corporate Governance (ESG) factors within the Bank's corporate governance and risk management strategy so that it covers sustainable finance factors. The Bank should set clear goals under the umbrella of Sustainable Finance.

2. Embedding sustainability elements in what can be deemed as sustainable products and instruments in accordance with the issued or to be issued approved standards that may be used to define sustainability features.

3. Giving due care for launching financing products and instruments consistent with Green Finance activities as well as other environment and the climate friendly projects.

4. Supporting "Financial Inclusion" in general, and facilitate access to financial services.

5. Enhancing the Bank's ESG performance by launching new innovative financial solutions and banking products, and enhancing sustainability across the Bank activities.

6. Setting fundamentals to increase awareness of climate change risks, and encouraging the financing of projects that positively contribute to the aspects associated with the climate change.

7. Raising awareness, leveraging capabilities and training Bank staff to deepen their knowledge of the ways for implementing Sustainable Finance.

8. Implementing "Sustainability" principles on the bank's internal operations and activities by measuring the impact of carbon emissions from buildings and branches, improving waste management, adopting water and electricity efficiency standards, and utilizing environment-friendly buildings that cut down electricity consumption.

9. In cases where lending and investment decisions have a material impact on ESG, banks should consider the necessary considerations during the study and analysis of these cases and take the appropriate decisions in this regard.

10. Stressing the significance of **Financial Stability** within the framework of Sustainable Finance Guidelines, banks should consider the substantial impact of ESG standards on the banks' performance and financial stability. Governance failures and poor risk management have been key factors, inter alia, causing the Global Financial Crisis in 2008.

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11. Emphasizing the significance of **transparency** in relation to the Sustainable Finance Guidelines, banks should issue annual reports on sustainability ("Sustainability Report"), or incorporate within their annual reports published on their websites as a special section on Sustainability. Sustainability Report or the specific section about Sustainability in the annual report shall demonstrate the Bank's activities in respect of environmental, social and economic factors and enable stakeholders to assess the level of the Bank's sustainability during the reporting period.

12. Identifying and measuring the risks associated with climate change. This should consider when conducting the Internal Capital Adequacy Assessment Process (ICAAP) to address Pillar II risks.

13. Decisions made with respect to the Bank's policies and procedures on Sustainable Finance should be approved by the Board of Directors.

Since Climate-related Financial Risks constitute a part of the environmental factors of sustainability standards, banks, during implementation of these guidelines, should refer to Basel Committee on Banking Supervision document entitled the:

"Principles for Effective Management and Supervision of Climate-related Financial Risks".