It was a bright Monday morning when Hanan Fathy, the Head of the Arab African International Bank Corporate Social Responsibility (CSR) and Sustainability Unit, started preparations for the upcoming bank board meeting. Hanan had been contemplating how she could better convince the board members that including social and environmental risks in the loans assessment was a definite plus for the bank. She knew it was in line with the sustainability strategy of the bank. Yet, applying this particular aspect of loan assessment would definitely bring tension among the board members. Including social and environmental risk assessment to loans evaluation would add costs to the bank and it would be difficult for board members to accept the extra costs. Without any mandatory regulations in the local and regional market, they would also likely lose business to their peers. “How can I convince the board to add social and environmental aspects to loans assessment?” Hanan thought to herself as she realized that her coffee had already gone cold.

The CSR and Sustainability Unit at the AAIB

At a very early stage in the Egyptian sustainability discussions, the Arab African International Bank (AAIB) had taken leaps on its sustainability journey. According to its official website,
“since 2003 the AAIB realized an instinctive notion that the bank’s role goes beyond profit making to involve a moral mission towards its stakeholders, country and community. The AAIB Sustainability 360° journey is the harvest of more than a decade, a long journey that witnessed giant strides in institutionalizing Environmental, Social and Governance (issues) within the bank’s DNA in a manner that involves not only material contribution but also operational involvement to ensure concrete results.” The bank highlighted that the strategy of its sustainability unit went beyond philanthropy to empowerment of different stakeholders in the bank’s ecosystem, beyond CSR to sustainability (i.e. environmental, social, and governance aspects), and beyond internal impact to “public advocacy”, creating a structural change and paradigm shift in sustainable reporting for the Egyptian banking industry.

The Equator Principles (EP)

The EP was an international framework that addressed environmental and social risks in the loan portfolio. In 2003, ten private banks worldwide united under one common framework, the EP, to address environmental and social issues in financing large-scale infrastructure and energy projects. Under that system, the clientele coming to a bank for a loan were not only subject to the traditional financial risk assessment, but also subject to Environmental and Social Risk Assessment (ESRA).

The EP was not a common concept in Egypt at that time and was only applied by one bank in the Middle East and North African Region (MENA). Hanan Fathy had realized that it was an important step to benchmark against international standards even though the bank did not face any mandatory regulatory pressures. Yet, joining the EP system involved a compliance cost. To take that step, the bank had to go through rigorous procedures to qualify. The bank had to commit to annual reporting and disclosure of clientele project lending risk status in addition to internal conformity to the EP guidelines. The bank had to refer to rigorous third party consultation to reach the required standards. In general, the bank would also incur further costs accounting for “due diligence, categorization of projects, monitoring compliance, and client engagement” (Amalric, 2005). Moreover, the bank faced high opportunity costs for choosing only projects that complied with the EP standards. Even though there were many expected internal and external challenges, the CSR and Sustainability Unit, headed by Hanan Fathy, felt it was worth it. It aligned with her Unit’s role in the bank and she knew the benefits would outweigh the costs.

There were many advantages related to the incorporation of ESRA and in joining the EP in general. Hanan Fathy believed it would give the bank a competitive edge in the market. Even though there was a lack of mandatory requirements, Egypt was on the move to well-embrace sustainability discussions and requirements. In that regard, the AAIB would be a pioneer and leader in sustainable banking. AAIB would be seen in the market as really practicing sustainability as a core business activity and not just the usual philanthropy that was common in among competitors. Technically, the bank would also be minimizing its business risks with
clients who had high social and environmental risks themselves. On the international level, the bank would be more capable of global dialogue and outreach especially in cases of loan syndications, where several banks would cooperate in giving out large sum loans to particular clients.

The Challenge

The challenges that faced the bank in introducing the EP were both internal and external. First, the CSR and Sustainability Unit had to face shareholder comments such as:

“Why should we engage and commit to such criteria when it is not obligatory?”
“Why do you want to impose this on us?”
“How can we prove the relationship between the EESG pillars (Economic, Environment, Governance and Society) embedded in the EP and the bank’s financial viability?”
“How can we argue that this leads to long term viability and sustainability for the shareholders of the bank?”

The second internal challenge was that there was considerable lack of knowledge regarding EP in general, especially given the fact that other banks were not implementing it. Some of the shareholders had also commented on this noting that “endorsing the EP would escalate our costs as we work on establishing rigorous policies and procedures to revamp our entire operating system and challenge the status quo for banks in Egypt. You told us that we will need to hire a consultant to assist with project lending assessment, and then the client would have to hire another consultant to confirm the internal and external assessment we provide!”

“You also told us that the EP endorsement restricts lending to particular industries such as the Tobacco industry! Our clients will naturally go to all the other banks that don’t have all these restrictions and complex procedures,” another shareholder had continued.

Hanan and her team had realized that the bank’s sustainability commitment created a major external challenge for their potential clients. Their clients had to carry the extra costs to get a third party verification of their environmental and social risk status. When bank customers applied for a loan, AAIB would ask them to provide information to fulfill the EP criteria. How could the bank convince them of the extra effort and costs of their application, noting that this was not the norm in the market?

Despite all the challenges, Hanan and the Unit had decided to explain that the endorsement of the EP was the seed to sustainable finance that the world was embracing. Moreover, the bank had already been playing a leading role in Sustainable Finance within the regional market. Embracing the EP just meant a further step.
Hanan explained during a closed meeting with the Unit team members, “It simply goes beyond just the ‘bottom line’! Whereas previously financial institutions had a narrow focus on operations and results (profitability), today a sustainable financial institution recognizes that extra-financial environmental, social and governance (ESG) issues impact both its operations and its financial results, both today and tomorrow. Furthermore, a sustainable financial institution understands that its operations influence society as well as a diverse universe of specific stakeholders: consumers, customers, investors, media, non-governmental organizations (NGOs) and regulatory authorities.”

With this closing comment, Hanan and the Sustainability Unit decided to take ESRA to the next level. The challenge was to convince the board members to engage the bank to ESRA in project lending. But, what were the best strategies and tactics to convince the board members?”

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