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*Paper*

**Principles of Environmental Management in Banking**

by

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The impact of climate change and the derivative of the environmental damage is a decrease in the quantity of natural resources and the quality of human life, which must be solved immediately. This situation is a force of the company with a business transformation process based environment in order to address the issue of sustainability of these natural resources. Environment that was initially seen as an external factor to the process of production management and marketing, is now seen as a central factor in a variety of production and marketing strategies (Srivastava, 1994; Hart, 1995).

Not only in Indonesia, environmental issues have become a global issue. This condition is certainly forcing each country to provide more attention for this environmental problem. There are three main reasons why Indonesia need to address environmental issues seriously :

1. The realization that Indonesia responded to this difficult environment itself;
2. Legacy to future generations, that natural resources should be conserved for long-term development;
3. To create the human development (Salim, 1980:23).

Various ways have been sought by the government, including by improving legal instruments particularly related to the Environment. One of the latest legal product endorsed by the Law No. 32 of 2009 concerning the Protection and Environmental Management. In Indonesia, the impact of environmental damage, either directly or indirectly perceived by the public, especially the businesses which is directly related to the quality and productivity of natural resources. Data from the Ministry of Cooperatives and Small and Medium Enterprises Republic of Indonesia showing the number of SMEs in Indonesia in 2011 are 53.2 million units. This is able to absorb the labor 90,896,270 or 97.04% of the total employment. By sector, agricultural is more dominant in MSMEs number which amounted to 49.81%, with the largest labor absorption that is 40.73% of the total employment. Therefore, the environmental damage would be very serious not only in this sector but will be extended to other sectors.

Efforts to increase the awareness and role of businesses (SMEs) in the micro and global environmental conservation, can be reached by encouraging conventional manufacturers (SMEs) being an environmentally sound SMEs. This effort has been very urgent because manufacturer is the major contributor of environmental damage, although their contribution was different from one another.

To overcome this, one of the efforts made by the government through the Ministry of Environment (MoE) is the Performance Rating of Corporate Compliance in Environmental Management (PROPER) as an alternative arrangement of instruments developed since 1995. The program was originally known as PROPER PROKASIH based on one media into multimedia. Implementation of PROPER aims to: (1) Increase companies awareness of environmental management (2) Increase the commitment of *stakeholders* in environmental conservation (3) Improve the performance of sustainable environmental management (4) Raise awareness of businesses to comply with legislation in the field environment and (5) Encourage the application of the principles of *Reduce, Reuse, Recycle* and *Recovery* (4R) in waste management.

Related to the implementation of environmental programs, Bank Indonesia in mid-1993 has consistently lent Loan Fund of *The Overseas Economic Cooperation Fund, the Loan Agreement (OECF)* for the *Small Scale Industry Program* (SSI Program) and the *Pollution Abatement Equipment Program* (PAE Program). Especially for PAE Program, Bank Indonesia in collaboration with Ministry of Environment and the participating banks (BCA, Bank Danamon, BII, Lippo Bank, National Commercial Bank, PT. BBD (Limited), PT. BEII (Limited), PT. BNI (Limited), PT. Bapindo (Limited), BPD and BPD Maluku Nusa Tenggara). Meanwhile, outside the Program PAE, Ministry of Environment has distributed various soft loan schemes include: *Industrial Efficiency and Pollution Control-Kreditanstalt fur Wiederaufbau (IEPC-KfW)* Phase I and II, as well as the investment environment for SMEs Financing (*Debt of Nature Swap Scheme, DNS*).

Various environmental crises such as climate change or global warming is urging people to be friendly with nature again. "Greening" Movement also occurs in the banking industry with terminology "*Green Banking*". Actually, the term "*Green Banking*" has a wider scope than just green and associated with the development environment. However, the term also includes empowering communities towards a better social life. *Green Banking* defined as banks run their business based on the principles of sustainable development. Especially in the credit and financing, namely the balance of ecology (environment), human welfare and the social and cultural development.

Bank Indonesia issued a policy to promote inclusive financial intermediation and in line with the global trends which have incorporated aspects of environmental protection. Banking requires a clear direction and policy and that adequate measures so that banks are able to support sustainable development. Meanwhile, the government has the power to influence the system of financial institutions-both banks and non-banks are concerned with environmental issues. Banking should be firm and selective in providing financial assistance, especially to those who are convicted of environmental destruction.

In an effort firmly in contributing to the preservation of the environment, banks are required to include the clause regarding the possibility of environmental issues that could result in the termination of credit, including the possibility of a *banker's clause*. At the time of evaluation, banks are required to continuously monitor environmental risks of the business-funded credit. For the application of the concept of *green banking* in Indonesia, by legal, Indonesia already has a Law.7 of 1992 concerning banking, which requires banks to pay attention to the Environmental Impact Assessment (EIA) for large enterprises or high risk projects funded so will not damage the environment. Law no.32 of 2009 concerning the Protection and Management of the Environment can also be used to reinforce the bank's mission concerned on environmental sustainability. Basically, the implementation of *green banking* involves many parties, especially the *multi-stakeholder* banking itself, such as from banks, customers, government, capital markets, and so on.

### **The Concept of *Green Banking***

Bank, the environment and development are three important elements that quality is always expected to rise. The quality and performance of the bank will surely help determine the condition of the State's economy, more specifically, can contribute greatly to the development in the broadest sense, because the bank is an agent of development that expected to run accordance with the targets expected all *stakeholders*.

The problem is, the development effort through industrialization often causes serious environmental damage and pollution. One result of development activities across various sectors are more and more waste production, both the amount and type of waste has caused pollution that damages the environment.

Aware of the impact as mentioned above, of course, it is necessary to build a good environmental management. Therefore, it is incumbent upon the government to outline the policy environment and foster public awareness of the importance of the environment.

Green financing have started echoed by central bank of Indonesia and the Ministry of Environment on the Memorandum of Understanding dated December 17, 2010 under the theme of "*green banking*", a concept or credit financing and banking products that prioritize other aspects of sustainability, both economic, socio-cultural environment and technology. To realize the practice of "green financing" and "green banking" in a comprehensive manner in addition to regulators, the role of clients and shareholders is needed. Awareness both stakeholders especially those who care about sustainability issues can accelerate business bank senior management to adjust to the environment.

### Benefit Green Banking Policy

*Green banking* should be preceded first by the practice *green industry* because the banks are there. Therefore, the *green industry* certification should be emphasized, given the bank's sustainability also depends on the industry. There are some benefits for the companies that is investing environment. For example, certified eco-friendly, improving corporate image, reduce costs, expand market share, as well as jobs and contribute to the reduction of urban litter. Meanwhile, the benefits of the practice *green banking*, among others, banks could provide a cheap source of financing for borrowers with environmental, reducing production constraints debtors, business continuity is guaranteed, providing credit facilities to SMEs and interests can be kept low so that the loan portfolio healthier banks.

In addition, the role of banks in this environment problems urgently needed because of the limited government funding for environmental management. During the period 2005-2010, the budget for environment an average of Rp4, 78 trillion, lower than the share of other expenditures. Therefore, the role of banks could answer financial problem that afflicts environmental conservation programs.

There are four critical program for the implementation of green banking in Indonesia, namely :

1. Preparing legal devices that generate Bank Indonesia regulations on green banking, including implementation guideline.
2. Producing information related to customer guidelines and information on environmental compliance.
3. Presenting education and socialization, such as risk management and so on.
4. Research that produce an academic paper on green banking. This step has to start from within the bank itself, such as minimizing operational paper (*paperless*), reduce the consumption of energy (electricity), the use of alternative energy, care for people and the environment around the bank, and so on.

Financing projects on environmentally sound bank has been shown to increase competitiveness and provide distinctive advantages in business strategy. Thus, banks are expected to increase the role and the attention to financing the projects that have attention to improving environmental quality.

To the environmental consequences of the loans, the banks need to be more sensitive, Indonesia's financial institutions with environmental (Green Banking) started to appear, such as in applying environmental impact assessment is an important part of credit analysis and documentation regarding credit (loan documentation).

Banks are expected to focus more on the provision of credit to businesses that do not result in environmental damage, leading to sustainable business and socially acceptable,

does not produce harmful products, the companies involved in the conservation and recycling, running ethics in business.

Bank Indonesia has issued Bank Indonesia Regulation.7/2/PBI/2005 dated January 20, 2005 concerning Asset Quality Rating for Commercial Banks (State Gazette of the Republic of Indonesia Year 2005 No.12 Supplement to Statute Book No. 4471). Bank Indonesia Regulation has set execution Circular Letter of Bank Indonesia 7/3/DPNP dated January 31, 2005 to all commercial banks conducting conventional business regarding Asset Quality Rating for Commercial Banks. Bank Indonesia Regulation and Circular has been determined that in assessing the prospects of the business, the bank needs to pay attention to the efforts made by the debtor to maintain the environment. Furthermore, the Circular mentioned above have been given instructions or rules regarding things that must be considered in terms of assessing the bank's business prospects by the debtor to manage the environment, in particular large-scale borrowers who have an important impact environment.

In the letter stated that the provisions on matters relating to environmental management set out in the Regulation of Bank Indonesia and Bank Indonesia Circular Letter of the above is in line or an explanation of the implementation of Article 8 of Law No.7 of 1992 concerning Banking as amended by Act No.10 of 1998, which among other things stated that need to be considered in the distribution of the supply of funds is the result of Environmental Impact Assessment (EIA) for large-scale enterprises or high risk.

In the Circular Letter of Bank Indonesia was stated that "The obligation is also listed in the EIA Law.23 of 1997 on Environmental Management, as amended by Act No. 32 of 2009 on the Protection and Management of Environmental and Government Regulation No. 27 Year 1999 on EIA". Statements contained in the Circular Letter of Bank Indonesia is an expression of awareness and affirmation that the obligations contained in the bank's Environmental Management Law also an obligation that must be obeyed.

Lending by banks can be a problem when the loan was used for the business or activity that ultimately lead to or result in pollution or environmental destruction. In this case ought agencies or financial institutions that provide loans can be mobilized to participate in the management of the environment, because companies that wish to grow depending on the credit facility. As one of the financiers, the Bank does not just simply look at economic considerations, but also integration with the environment. Thus, banks are not co-finance projects that are expected to be adverse impacts ecosystems.

In the banking system, with the consideration of environmental factors will eliminate balance risks in the provision of credit to the debtor. It is necessary to develop an environmental risk analysis capabilities ecologically accountable. Therefore in entering the

era of development focused on technology to predict the risk of loss required expertise in precision accuracy.

Thus the bank credit risk analysis is not limited to the analysis based on the performance of the project, but also need a method of analysis that takes into account the external costs (benefit and risk analysis) that involves multiple disciplines (inter and multidiscipline science), in particular to understand the environment life. With the enactment of the Banking Act and as a result of the implementation of the precautionary principle (Prudent banking) and the issue of bank soundness, the banking sector would be very concerned about the environmental problems.

Banks in providing credit do not want financed projects cause environmental pollution, such as to cause public unrest. Because bank credit lenders will be held accountable, in this case the environmental analysis and assessment of the environmental impact.

From the above, the law explicitly Banking duties have included banks in Indonesia to implement green banking and this is in accordance with the steps required national banks to participate in conservation and environmental responsibility to implement environmentally development as mandated in PROPENAS Year 2000-2004 and are becoming increasingly apparent. Putting aside the environmental aspects it can result in reduced risk level of prosperity.

Financing environmental projects has been shown to increase competitiveness and provide distinctive advantages for banks that implement the business strategy. Thus, banks are expected to increase the role and the attention to financing projects that have attention to improving environmental quality.

If the industry were financed by bank runs well and does not cause negative impacts on the environment, the result of interest income on loans can be run in accordance with the bank's cash flow. Similarly, return capacity of credit given to the industry can be secured on collectibility. If all sectors of the industry-funded bank has no significant negative impacts that can be expected in the industrial sector bank financing will increase as well. This suggests that banking operations are highly affected by the development sector funded.

### **Pilot Project "Creation of New Entrepreneurs"**

In addition to the above, the Bank Indonesia also supports the government's efforts to reduce the unemployment by implementing the Creation of New Entrepreneur program especially new entrepreneurs with environmental concern (greenpreneur). The program is in synergy with relevant *stakeholders* having entrepreneurship development program based on

the consideration that unemployment in Indonesia occurred at secondary school graduates or high-school, Diploma and Higher Education.

The New Entrepreneur Creation Program of Bank Indonesia is initiated as a contribution of Bank Indonesia in the real sector and SMEs development and support of National Entrepreneurship Movement (GKN), launched by the government on February 2, 2011 involved 13 (thirteen) ministries. Bank Indonesia through the creation of new entrepreneur program will provide a series of activities to foster entrepreneurship for young people, equipping them with the knowledge and skills to be able to conduct its business which environmental sustainability.

In addition to the training provided by professional and experienced facilitators, Bank Indonesia through Corporate Social Responsibility (CSR) programs also provide start up capital for participants considered having a business idea and feasible business development, focusing on green business, can provide added value for themselves and the environment. Furthermore, after providing start up capital, Bank Indonesia in collaboration with experts will also provide technical assistance and capacity building in term of the production and marketing including the management of patents.

Participants who successfully implement the business ideas will also be included in the exhibition and linked to the banks to obtain loans. One of the problems faced by new entrepreneurs and micro-scale business is difficult to obtain a loan from banks because they are not bankable. That's why one of the goals of this program is to create a potential customer for the banking industry in the future.