



ESG POLICY

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ENVIRONMENTAL, SOCIAL & GOVERNANCE POLICY

Table of Contents

	Page No.
List of Abbreviations	2
Definitions	3
A. Introduction	4
B. Objective	5
C. Guiding Principles	6
D. Implementation	7
E. Oversight	8
F. Key Focus Areas	10
G. Review	11

List of Abbreviations

AE	- Accredited Entity
BOD	- Board of Directors
CA	- Institute of Chartered Accountant of Sri Lanka
CBSL	- Central Bank of Sri Lanka
CSE	- Colombo Stock Exchange
DFCC	- DFCC Bank
ESG	- Environment, Social and Governance
E&S	- Environmental and Social
ESMC	- Executive Sustainability Management Committee
ESMS	- Environmental & Social Management System
GCF	- Green Climate Fund
GHG	- Greenhouse Gas
GOSL	- Government of Sri Lanka
MSME	- Micro, Small, and Medium Enterprises
PS	- IFC Performance Standards
SBI	- Sustainable Banking Initiative
SBP	- Sustainable Banking Principles
SDGs	- Sustainable Development Goals
SLBA	- Sri Lanka Banks' Association
SU	- Sustainability Unit

Definitions

- **“Accredited Entity (AE)”** means an entity that is accredited by the Green Climate Fund in accordance with its Governing Instrument and relevant Board Decisions. The role of an AE relates to the management and oversight of project implementation, which includes the origination and preparation of a funding proposal, the subsequent management of the necessary stages of the implementation process until its conclusion (project management) on behalf of the provider of funds, and reporting obligations. An AE may also be the executing entity, responsible for the operational implementation and execution of the project.
- **“Disadvantaged or vulnerable”** refers to those who may be more likely to be adversely affected by the project impacts and/or more limited than others in their ability to take advantage of a project’s benefits. Such an individual/group is also more likely to be excluded from/unable to participate fully in the mainstream consultation process and as such may require specific measures and/or assistance to do so.
- **“Environmental and Social Management System (ESMS)”** refers to a set of management processes and procedures that allow a financial institution to identify, analyze, control and reduce the environmental and social impacts of its lending activities in a consistent way and to improve performance in this regard over time.
- **“Sustainable Finance”** refers to investment decisions that take into account the Environment, Social and Governance (ESG) factors of an economic activity or project. Environmental factors include, for example, mitigation of the climate crisis or use of sustainable resources. Social factors include, for example, human and animal rights, as well as consumer protection and diverse hiring practices. Governance factors refer to for example, the management, employee relations and compensation practices of both public and private organizations.
- **“Sustainable Enterprise”** is defined as a business which makes an effort to positively impact the environment and improve the living standards of individuals in society whilst contributing to economic development.
- **“Social Enterprise”** is defined as a business that operates with a mission to achieve a social objective”. The social objective is more important than the profit motivation – the profit is more a means to sustain the business to achieve the social objective.
- **“Green Finance”** refers to a structured financial activity that has been created to ensure a better environmental outcome.

A. Introduction

1. DFCC Bank (DFCC), being a leading bank in Sri Lanka with a heritage of supporting the nation's development, is committed to the promotion of sustainable development per its vision "to be the leading financial solutions provider sustainably developing individuals and businesses".
2. In 2020, the DFCC developed and obtained Board approval for its first formal Sustainability Policy, Strategy and Plan for the period 2020 to 2030 (the 'Sustainability Strategy'). The main features of DFCC Sustainability Strategy are depicted in figure 1 below:



Figure 1: DFCC Sustainability Strategy

3. Sustainable Financing

DFCC is a pioneering signatory to the eleven “Sustainable Banking Principles”^[1] (SBP) established in 2015, of the **Sri Lanka Banks’ Association (SLBA)** under the **Sustainable Banking Initiative (SBI)**, and is committed to adapting these principles in its operations. In addition, DFCC is adhering to the eight (8) **IFC Performance Standards**^[2] (IFC-PS). Accordingly, DFCC has implemented a comprehensive **Environmental & Social Management System (ESMS)** since 2016, so as to ensure E&S aspects are an integral part of facility appraisal and follow up activities. Further in 2023, DFCC became the first entity in Sri Lanka to obtain accreditation of the “**Green Climate Fund**”^[3] (GCF), hence as an **Accredited Entity (AE)**, the Bank has enhanced roles and responsibilities on ESG aspects and is expected to actively assist Sri Lanka to achieve its climate related goals. In addition, in order to harness the opportunities arising from sustainable financing, DFCC has introduced Green Deposits and Green Bonds

¹ <https://sustainablebanking.lk/>

² <https://www.ifc.org/en/insights-reports/2012/ifc-performance-standards>

³ <https://www.greenclimate.fund/>

4. Regulatory Background

With growing public awareness and concern over **Environment, Social, Governance (ESG)** aspects driving changes in consumer behavior, investments, regulations etc., various stakeholders including funding agencies and regulators are enforcing action on such aspects. The **Central Bank of Sri Lanka (CBSL)** and the **Colombo Stock Exchange (CSE)** have mandated the adoption of ESG Policies for Licensed Banks / Listed Companies.

5. In this spirit, the Bank has drawn up this ESG Policy which encapsulates its commitment to the national agenda of ensuring inclusive and sustainable development in the country. DFCC recognises the importance of good lending practices, which incorporate not only sound financial viability, but also environmental protection, social responsibility and governance aspects. It also recognises the risks associated with unsustainable business practices and the opportunities associated with the change that is required. Accordingly, the Bank endeavors to be a responsible corporate citizen, committed to preservation and enhancement of the environment and upliftment of society, whilst meeting related governance aspects.

B. Objective

6. This ESG Policy articulates how DFCC aligns its strategic business objectives with the ESG principles, with its envisaged key areas of focus as enumerated in this policy. The Bank's ESG Policy has been designed in harmony with the applicable national laws and regulations and international standards and is aimed at positioning the Bank as an ESG standard setter through its activities.
7. Objectives of the DFCC ESG Policy are as follows;

7.1 Financing activities which:

- (a) are financially sustainable, contribute to economic development and ensure protection of the environment and the society through efficient use of resources
- (b) take account of the adverse E&S impacts of their operations and take appropriate steps to avoid, minimize and mitigate any risks
- (c) are designed, implemented and operated in compliance with all E&S laws and regulations prevailing in Sri Lanka or any other country where applicable
- (d) are in line with Sri Lanka's international agreements and commitments related to climate change, biodiversity, human rights etc.

7.2 Complying with the following directives / initiatives of the CBSL:

- (a) Road-map for Sustainable Finance in Sri Lanka (2019)^[4]
- (b) Banking Act Direction No. 5 of 2022 on Sustainable Finance Activities of Licensed Banks^[5]
- (c) Sri Lanka Green Finance Taxonomy (2022)^[6].

7.3 Complying with the directives of the CSE:

- (a) Circular No. 4/2023 of the CSE on "Amendment to Section 9 of the Listing Rules of the CSE"^[7], which requires the existence of an ESG Policy.

⁴ https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/sri_lanka_sustainable_finance_roadmap_2019.pdf

⁵ https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/cdg/Banking_Act_Directions_No_5_of_2022.pdf

⁶ https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/sl_green_finance_taxonomy.pdf

7.4 Complying with the sustainability disclosure standards issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka)^[8], i.e.

- (a) SLFRS S1 - General Requirements for Disclosure of Sustainability-related Financial Information
- (b) SLFRS S2 - Climate-related Disclosures

7.5 Complying with requirements of the GCF and other external funding sources.

7.6 Adopting national and international ESG best practices where applicable and appropriate.

C. Guiding Principles

8. Following principles will guide how DFCC will implement and achieve the objectives of this policy:

8.1 Integration of ESG aspects

To incorporate ESG considerations in ways that not only include safeguard measures of “do no harm,” but also improve ESG outcomes and generate co-benefits to the environment and the communities that depend on it.

8.2 Scaled risk-based approach

The ESG aspects will be implemented in a risk-based manner and not in a blunt, one-size-fits-all approach. This approach will require that ESG requirements and processes are commensurate with the level of risk.

8.3 Coherence and links with relevant policies and practices of DFCC

The ESG Policy is an overarching policy that shall be consistent and linked with relevant policies and practices of DFCC, such as the “Child & Forced Labor Policy”, “Diversity, Equity & Inclusion Policy” and others, as appropriate, including those relevant policies that are still to be developed.

8.4 Continuous improvement and best practices

The ESG Policy, along with ESMS will be continuously reviewed and updated to sustain its relevance and responsiveness to the prevailing organizational, social, economic and political conditions. They will also be consistently aligned with international best practices and applicable standards, reflecting the experiences and lessons learned by DFCC.

8.5 Compliance with applicable laws

DFCC will not support activities that do not comply with applicable laws, including national laws and/or obligations of the country under relevant international treaties and agreements.

8.6 Biodiversity

All DFCC-financed projects will be designed and implemented in a manner that will protect and conserve biodiversity and critical habitats, ensure environmental flows of water, maintain the

⁷ https://cdn.cse.lk/cmt/upload_report_file/hPLxglBoBHBOZRNs_11Sep2023051530GMT_1694409330850.pdf

⁸ https://www.casrilanka.com/casl/index.php?option=com_content&view=article&id=4069&Itemid=341&lang=en

benefits of ecosystem services, and promote the sustainable use and management of living natural resources.

8.7 Labor and working conditions

All projects financed by DFCC will promote decent work, fair treatment, non-discrimination and equal opportunity for workers, guided by the relevant national laws and the core labor standards of the International Labor Organization.

8.8 Human rights

All projects supported by DFCC will be designed and implemented in a manner that will promote, protect and fulfill universal respect for, and observance of human rights for all, recognized by the United Nations. DFCC will require the application of robust ESG due diligence, so that the supported activities do not cause, promote, contribute to, perpetuate, or exacerbate adverse human rights impacts.

8.9 Indigenous People

All DFCC financed projects will avoid adverse impacts on indigenous people, and when avoidance is not possible, will minimize, mitigate and/or compensate appropriately and equitably for such impacts, in a consistent way and improve outcomes over time; promote benefits and opportunities; and respect and preserve indigenous culture, including the indigenous people's rights to lands, territories, resources, knowledge systems, and traditional livelihoods and practices. Accordingly, "Free, Prior and Informed Consent" will be obtained from Indigenous People for any activities undertaken on their land.

D. Implementation

9. The ESG Policy is intended to be used as an overarching framework for guiding the business activities of DFCC. Based on the focus areas identified in the Policy, the Bank shall endeavour to integrate ESG dimensions into its varied areas such as business strategy, product & service lines, policies, operations etc. This Policy shall act as the guiding document for an organised implementation of an ESG framework through resource allocation, capacity building, monitoring of performance and to implement structural improvement to enhance the Bank's performance under the ESG parameters.
10. The ESG Policy must be read together with the other policies/guidelines of the Bank which cater to the considerations under the focus areas defined herein. The DFCC ESG Policy shall be made available to its stakeholders on the intranet as well as its website to drive its commitment towards the meaningful implementation of the ESG principles in its day-to-day operations.
11. In terms of its non-retail, business lending activities, and as detailed in the ESMS, DFCC will carry out the following, using a risk based approach:
 - Evaluate E&S risks and effectiveness of mitigating measures as a part of the overall risk assessment process of lending and adopt an E&S risk classification system in accordance with international best practice
 - Review E&S compliance during the follow-up process through comprehensive checks on E&S concerns, including through site visits.
 - Ensure that measures are incorporated into the finance facilities to prevent the occurrence of adverse E&S impacts, which is the preferred basis over other options, such as minimization, mitigation or compensation.
 - Ensure that excluded sectors specified by the Bank are not financed (refer Annex 1)

- Require the business activities that DFCC Bank finances to:
 - Operate in an environmentally and socially responsible manner, complying with relevant government laws and regulations. Ensure that environmental safeguards as defined by the Environmental Protection Act and Rules and Regulations issued by the Central Environmental Authority of Sri Lanka, as well as relevant internationally and nationally accepted best E&S practices are integrated into project design prior to its financing and complied with during implementation and operation.
 - Comply with specific E&S guidelines of international funding agencies, in addition to pursuing the above mentioned objectives, when credit line funds are used to finance projects.
 - Not employ forced and/or child labor
 - Comply with occupational health and safety regulations
 - Adopt fair practices concerning employees in terms of recruitment, career development, terms & conditions of work, representation irrespective of gender, respect their diversity, treat them equally, and pay wages as per industry norms or at least the statutory minimum.
 - Safeguard environmentally sensitive areas and properties of cultural, religious and historical importance.
- Ensure that communities affected by a project to be financed are consulted and the relevant information is disclosed, if such a project creates adverse E&S impacts.
- Ensure that if a project involves resettlement of communities and/or affects indigenous people, costs and other measures required for the restoration and possible improvement in the economic status of the affected communities are integrated into the project.
- Incorporate E&S requirements into the terms and conditions of finance facilities, as appropriate and verify compliance during the follow-up process.
- Collaborate with other financial institutions, government agencies and other concerned organizations to improve E&S aspects, increase knowledge and disseminate such information.
- Provide employees with information and relevant training to understand and implement the Bank's ESMS
- Report on ESG aspects to both internal and external parties, and comply with statutory reporting requirements

12. With respect to risk management of ESG aspects, the Bank will carry out the following;

- Identify and evaluate the risks stemming from associated climate, environmental and other sustainable financing activities, considering the nature, scale, complexity, and interconnectedness of its operations and assess the magnitude and materiality of such risks.
- Incorporate ESG risk management to the entire decision-making processes, including environmental and social policies, risk assessment, environmental and social covenants.
- Consider all the material E&S risks, including climate related risks in the Basel Pillar II assessment under capital requirements
- Identify how the material risks will affect its business model and assess the potential impact on the bank.
- Implement effective risk management practices and internal controls to mitigate risks
- Conduct scenario analysis and stress testing as required, to assess the impact of potential/alternative climate related risks and green financing activities

E. Oversight

13. With this ESG policy, DFCC is establishing a governance framework and structure which includes conformance, performance and sustainability/ESG factors

14. As a part of the structured implementation of the ESG policy, the Board of Directors (BOD) is responsible for oversight of the implementation of the Sustainability Strategy and ESG initiatives, including the oversight on other sustainability and climate related matters. The BOD plays a leading role in integrating the management of the Bank's impacts on the people, planet and profit, into the organization's governance mechanisms, strategy, risk management and operations, in order to maintain the confidence and continued engagement of shareholders and all significant stakeholders.

The BOD is responsible for the establishment of a governance structure to support sustainability/ESG factors including its ability to create value and manage risks in the short, medium and long term, recognizing, managing and measuring on all pertinent aspects of sustainability using financial and non-financial measures. To facilitate these tasks, BOD shall be adequately informed on sustainability, climate and ESG related matters.

The BOD will consider sustainability/ESG risk and opportunities in DFCC's business model, operations, short and medium-term planning and in its long-term strategy to ensure that the Bank remains resilient and be able to deliver durable and sustainable value over the short, medium and long term in order to maintain the confidence and continued engagement of shareholders and all significant stakeholders

15. The **Executive Sustainability Management Committee (ESMC)**, comprising of selected corporate and senior management and headed by the Chief Executive Officer (CEO) is a dedicated committee established with the responsibility to drive the Sustainability Strategy; ESG initiatives, including sustainability and climate related matters; and manage and monitor the performance under the stated objectives, on a periodic basis. The ESMC meets approximately once in every six weeks and provides an added impetus to the Bank's ESG agenda.

Further there are various task forces i.e., Green Finance Task Force, Sustainable Entrepreneurship Task Force, Energy Efficiency Task Force, Paper Reduction task Force, Human Resources Efficiency and Wellness Task Force etc., established under the Sustainability Strategy that report to the ESMC on a periodic basis.

16. The **Sustainability Unit (SU)** is a unit of the Bank, which is responsible for implementing the Sustainability Strategy, the ESMS, Corporate Social Responsibility (CSR) activities and ESG & Sustainability reporting. The SU recommends appropriate processes, metrics and targets on sustainability and climate related matters for approval by the ESMC and senior management and for implementation by Business Units. The SU also reports on the progress of implementation on the tasks carried out by the Unit, issues encountered with suitable recommendations, to the ESMC, Credit Committee and to the Board of Directors on a periodic basis.



Figure 2 : Sustainability Governance Structure

17. In ensuring effective and efficient overseeing of ESG aspects, including Sustainable Finance activities, the BOD and Senior Management are responsible for the following:

- **To ensure that the policies, tools, metrics, operational procedures and controls** implemented by the bank in respect of E&S risks and sustainable finance activities are reviewed and updated regularly (at least annually) and integrated with other relevant policies and procedures of the bank
- **To ensure that adequate resources, skills and expertise** are allocated to the management of E&S risks and sustainable finance activities
- **Clear articulation of the roles and responsibilities** of business units and functions in managing risks associated with sustainable finance and E&S aspects
- **To ensure that the BOD is informed in a timely manner** on material issues, relating to E&S risks, sustainable financing and business practices.

F. Key Focus Areas

18. DFCC Bank has derived its six key focus areas of the ESG policy based on the materiality assessment and its strategic imperatives. These focus areas are subject to review in the view of the rapidly evolving business environment and emerging stakeholder preferences (refer Annex 2 for more details on the material themes).



Figure 3 : Key Focus Areas

G. Review

19. DFCC's ESG Policy shall be reviewed Annually or earlier when significant changes occur, in order to reflect the latest policy/ regulatory directions/ guidelines issued by the Government of Sri Lanka, CBSL, SEC, CA and any other statutory/ regulatory authority as applicable for the Bank.