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GREEN INVESTMENT

Tighter Emission Controls Could Land Polluters in Hot Water

Blue-green algae were once again found to be blooming along the southern shore of Tai Lake in late March. Coming so soon after last year's outbreak – which disrupted the water supply of two million people for more than a week – this caused a lot of concern. People began asking what the government had done to restore the water's quality.

China has about 7% of the world's water resources and roughly 20% of its population. It also has a severe regional water imbalance, with about four-fifths of its water supply in the south. Industrial water pollution has a negative impact on both the quality and quantity of drinkable and usable water. Chemical-intensive agriculture and its massive use of chemical fertilisers is another source of pollution. In fact, the effects of the water crisis on China's growth could be as serious as those of climate change. China is scouring the world for natural resources like oil and timber, but trade deals cannot solve water problems.

> A pollution incident like the blue algae bloom in Tai Lake can provoke a knee-jerk "environmental protection storm" that involves every factory in the area.

Around 500 riverside factories and plants in Wuxi were ordered to halt their operations as soon as last year's major environmental pollution incident was reported. These factories were alleged to have discharged wastewater containing the phosphates that feed toxic algae directly into the river without treating it properly. The State Environmental Protection Administration (now the Ministry of Environmental Protection or MEP), afterwards imposed a ban on industrial operations in provinces and watersheds that were being affected by the worsening pollution. These included some factories owned by renowned multinational corporations like Unilever and Hitachi Construction Machinery. The ban was not lifted until they had complied with environmental laws and passed the Ministry's environmental assessments.

As for longer-term measures, the MEP is collaborating with other departments to promote ecological agriculture in order to reduce the use of pesticides and fertilisers. It is also closely working with the Chinese Banks Regulatory Commission (CBRC) to establish a credit database that details the environmental track records of individual companies. Banks have been ordered to reject new loan applications from those that fail to make the grade (see "China's banks should open up to the world about green issues" in this issue).

After all these efforts, it was frustrating to see the algae blooming again this year. (For more details and analysis about the

A sewage exit discharging untreated wastewater in Jiangsu Province.

algae bloom problems, as well as the government's measures against pollution from crop fields, please see the recent Greenpeace report entitled "Chemical Intensive Agriculture Pollution: Invisible Culprit Behind Algae Bloom" at http://www.greenpeace.org/china/zh/press/reports/blue-algae-report) One important lesson that needs to be learned from the Tai Lake episode is that corrective measures, such as direct fines or the withdrawal of loan facilities, always come too late, after the damage has been done. And companies have grown accustomed to pouring untreated wastewater into rivers, because the regulatory risk involved is too small, compared with the huge profits they make.

It should be emphasised that even "good" companies – those which comply with the laws and regulations – cannot avoid being affected by water-related risks. A pollution incident like the blue algae bloom in Tai Lake can provoke a knee-jerk "environmental protection storm" that involves every factory in the area. For that reason, investors should look for solid information and adequate disclosures about emission performances from companies as a guarantee of their ability to survive any sanctions that are imposed and subsequent disruptions to their operations.

In developed countries, reporting and monitoring by citizens and other stakeholder groups are recognised as effective ways to increase the risks companies face if they break the law. They also strengthen regulatory oversight. However, in China, the lack of publicly available emission data hinders the public's participation in the process. As a result, stakeholders, such as communities who live close to the polluting factories, are powerless to safeguard their livelihoods from the consequences.

As Pan Yue, the MEP's Vice President, puts it: "The current situation is critical. Illegal emissions by companies are causing serious problems, and the number of large-scale pollution incidents has risen to an all-time high. Public discontent is growing, and the number of collective actions is increasing. When people call on polluting companies to release more emission data information, they usually hide behind 'business confidentiality' as a shield. Environmental information disclosure aims to strengthen the public's monitoring of corporate behaviour and facilitate public opinion, in order to put pressure on companies to comply with environmental regulations." (http://gov.people.com.cn/GB/46738/5767906.html May 23, 2007, author's translation)

Against this backdrop, investors who feel concerned about water-related risks and corporate governance issues should keep an eye on the trial implementation of "Measures on Open Environmental Information", which took effect on May 1, 2008. The new measures empower citizens and other organisations to seek environmental information about government departments and enterprises. For a list of the types of data it covers, see http://www.epa.gov/ogc/china/open_environmental.pdf. The trial implementation also stipulates that the Ministry of Environmental Protection should respond to the public's enquiries within 15 working days.

If companies insist on treating their emission data as "business secrets", they are in effect circumventing some good government initiatives to promote public monitoring and foster sectoral changes. Even worse for these companies, this type of defensive stance is unpalatable to a growing number of investors, who regard the disclosure of information and transparency as being crucial elements of good corporate governance, and it will in turn affect a company's growth and value in

China's water crisis

- Per-capita access to water resources is 2,200 cubic meters, just 30% of the world average.
- The total volume of wastewater discharged in the country in 2006 was 53.68 billion tonnes, of which 24.02 billion tonnes was industrial waste water. Paper and pulp production, chemical production, power generation and textile manufacturing are the top four contributing industries.
- In 2006, 28% of surface water (including rivers, lakes and reservoirs) was so highly polluted that it could not be used for any purpose; only 40% was suitable for domestic use.
- In 2005, 693 out of 1,406 reported environmental pollution incidents were related to water pollution. A further 842 were uncovered in 2006, resulting in total economic losses of RMB134.7million.

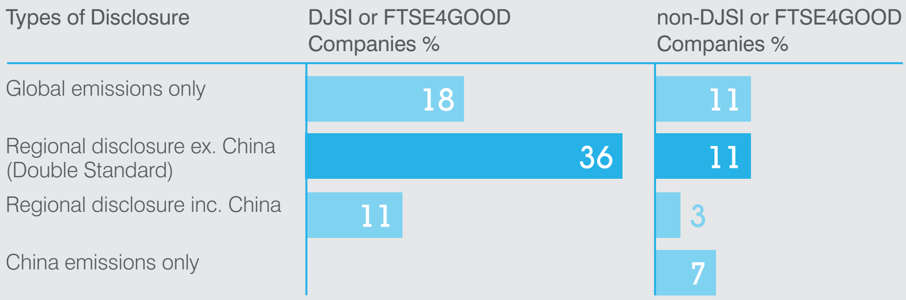
(Source: Greenpeace research)

Recent incidents and their financial impact on the companies involved

- In 2005, an explosion in a PetroChina chemical plant released 100 tonnes of benzene and other toxic substances into the Songhua River, the main source of water supplies for the 3.8 million residents of Harbin. The spill struck a blow to PetroChina, which is listed in New York, as Western shareholders reconsidered their positions in the company's stock. California's State Treasurer called on the California State Teachers Retirement System to sell its US$24-million equity stake in the company. In addition to local lawsuits filed by Harbin citizen groups, the company also faces the possibility of class action legal challenges in the US, a further risk to shareholders.
- Also in 2005, the Shaoguan Smelting Plant in Yingde City released large quantities of cadmium into a major river, thus raising cadmium levels to 10 times the mandatory safety standard. Shaoguan and 14 other smelting plants were forced to shut down by the authorities while the risk of further spills was assessed. Investors in its parent company, Zhongjin Lingnan Nonferrous Metals, which is listed on China's Shenzhen Stock Exchange, lost out when trading in its shares was suspended, and they were down in value when it resumed.

(Source: Half full or half empty? A set of indicative guidelines for water-related risks and an overview of emerging opportunities for financial institutions, UNEP Finance Initiatives 2007)

Chart I: Contamination emission information disclosure of 28 Fortune 100 Companies



* Boeing has not published contamination emission information on its official website.
Source: Greenpeace

the longer term.

Can companies that claim to differentiate themselves from their competitors by adopting best practices and having a high reputation for their sustainability performance ride out these new changes and challenges? In fact, investors will hesitate to finance companies that fail to adjust to rising environmental standards and move their production bases to China as a key global business strategy.

Following the procedures set forth for the trial implementation of the "Measures on Open Environmental Information", Greenpeace has filed requests for emission data about the operations in China of some of the world's biggest multinational corporation as well as local companies that are subject to such disclosure requirements. Their level of disclosure and the accuracy of emission data received will serve as a good example of the readiness of those companies to come to grips with the new paradigms of China's environmental protection efforts.

A recent Greenpeace survey may serve as a good way to predict the responses of these companies. The survey covered 28 companies on the Fortune 100 list for 2007. It revealed that only six of them disclosed information about their emissions in China on their official websites. On the other hand, 13 of them reported their global emission performance and their performances in certain individual countries and regions; yet they remained silent about China. These companies are evidently adopting double standards in their policies about disclosing emission information. .

The survey's other findings are summarized in Chart 1. It is worth noting that more than 50% of the 18 companies covered by the FTSE4GOOD or the Dow Jones Sustainability Indexes family (DJSI) appear to be adopting similar duplicity, in contrast to nearly 100% whose record is satisfactory if regional disclosures are not taken into account. One example of this practice is BASF, which is included as a component in both FSTE4GOOD and DJSI. The survey has uncovered the fact that some pieces in the jigsaw puzzle about the overall ratings and rankings of individual companies are missing. And data about the emissions of their operations in China are essential if one is to arrive at an accurate and concise judgment about their overall performance.

The Greenpeace findings show that FTSE4GOOD and DJSE companies like BASF, whose reputations are buoyed by their high sustainability ratings, will be prone to additional risk if their emission performances in emerging markets come under critical scrutiny. Proactive investors therefore need to consider taking more aggressive action to urge the firms in their emerging market portfolios to release their emissions data voluntarily, and to make their pollution control policies available for public

As neighboring chemicals factories carelessly discharge wastewater, the drinking water of a village in Jiangsu province is heavily contaminated. Greenpeace workers examine underground water drawn up by the villagers

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scrutiny. One immediate benefit of such greater transparency is obvious: it would reduce the operational and management costs they incur in handling enquiries from governments and other stakeholders.

Sceptics will no doubt revive the old argument about China's environmental policies: namely that good initiatives get spoiled by poor implementation. Similar concerns have been raised by many official Chinese media at the provincial level. On the other hand, more practical activists, such as Ma Jun, Director of the Institute of Public and Environmental Affairs, are reviewing their databases about China's water and air pollution standards in order to reveal a greater amount of data about corporate emissions (http://www.chinadialogue.net/article/show/single/en/1962-Your-right-to-know-a-historic-moment).

Activist stakeholders are setting examples that will encourage more members of the general public to use the new law to satisfy their right to know. Corporate managements have two choices before this quantum leap takes place: either they continue making efforts to circumvent the law by classifying their emission data as "confidential business information", or else they act in a concerted manner to level the playing field by revealing their emissions. By encouraging companies to do the latter, the new law is about more than just risk assessment and due diligence by investors. It also marks the start of an upward spiral that will eventually transform those sectors that are sensitive to water-related risks.

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Palm Plantations Driving Destruction:

Why Unilever now supports a halt to deforestation

PALM OIL IS used in food production, biofuels, and the oleochemicals contained in personal care products like hand lotions, soaps and detergents. Against the backdrop of an agricultural bull run, the price of palm oil futures rocketed by 70% to M$3,673 during the 12 months up to the end of May this year. Yet the rising value of this commodity has not dampened the world's demand for it. In fact, it is expected to double and triple by 2030 and 2050, respectively.

A recent Greenpeace report entitled "Hidden Liability of Palm Oil" presented a sectoral analysis of palm oil production. It highlighted the critical issues that face Indonesia's rainforests as palm oil suppliers clear more and more tracts of land to make way for new plantations.

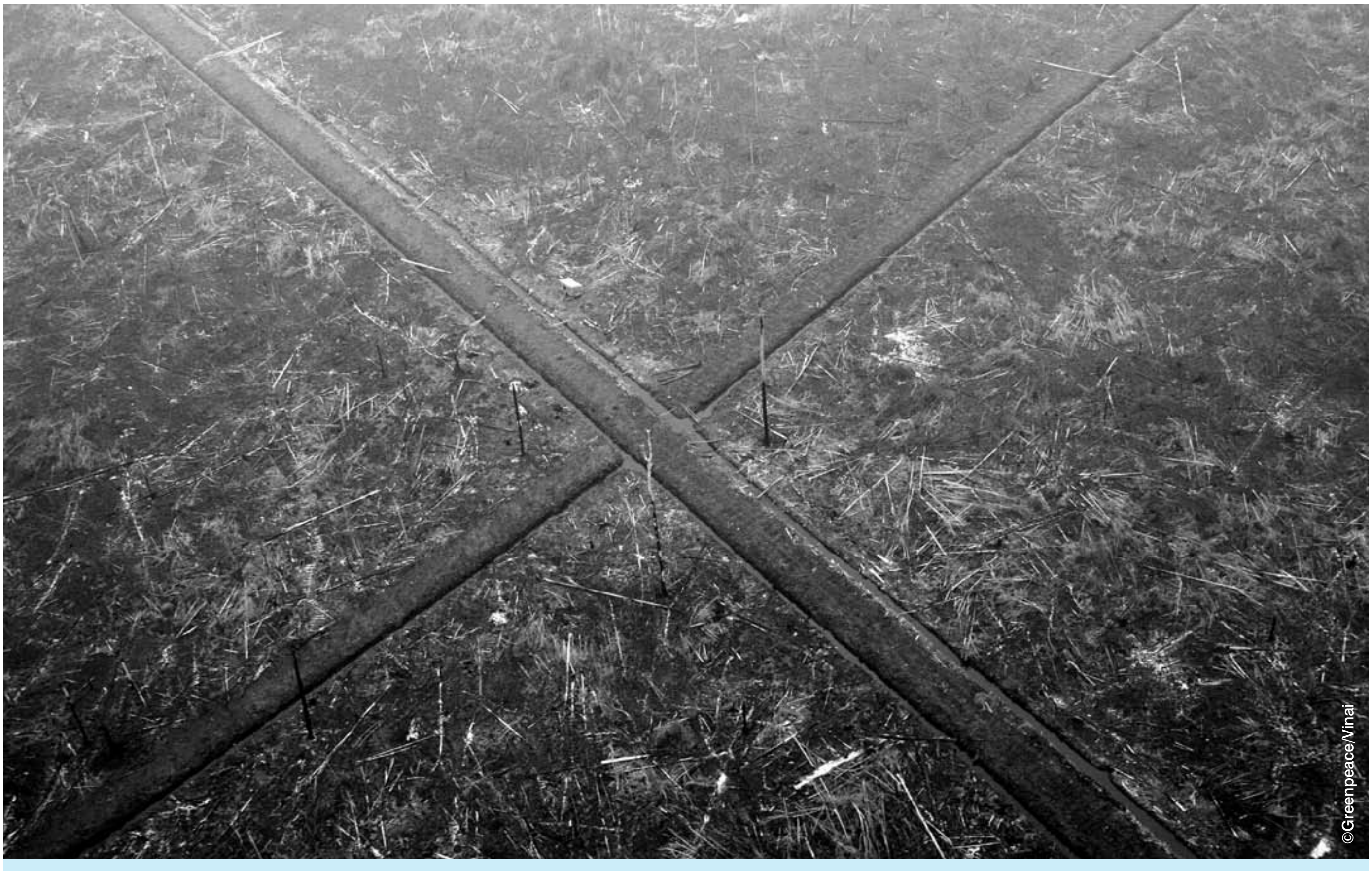
Although thousands of multinationals use palm oil in their products, we are highlighting Unilever because it underpins some of the company's most profitable brands. In fact, Unilever uses about 3% of the world's entire annual production of palm oil, making it the world's biggest single user of palm oil. It sources about half of this from Indonesia; in 2005, Unilever bought one out of every 20 tonnes produced in the country. And palm oil plantations are widely recognised as having significant impacts on the rainforests themselves, as well as the corresponding impact on the climate.

A 2007 United Nations Environment Program (UNEP) report stated that palm oil plantations are now the leading cause of rainforest destruction in Indonesia, and this deforestation has propelled Indonesia into the number three slot on the list of the world's biggest emitters of greenhouse gases. Between 1991 and 2006, almost 5 million hectares of new palm oil concessions were established in the country, the equivalent to more than 50 football pitches an hour. Much of this area was previously forest or peatland. The Indonesian Palm Oil Research Institute (IOPRI) estimates that two-thirds of all the palm oil plantations

Box I: The link between palm oil plantations and the destruction of forest and peatland

- Sinar Mas and Unilever have a long-established business relationship. Sinar Mas claims to have "the largest land bank in the world for new plantations" and it has publicly announced plans to expand its holdings in the heavily forested Indonesian province of Papua and in Kalimantan by 1.3 million hectares. However, an internal company presentation obtained by Greenpeace indicates that Sinar Mas plans to develop a rainforest area of up to 2.8 million hectares in Papua alone.
- The IOI Group has a plantation land holding of nearly 152,000 hectares (of which 43,000 hectares have already been planted) in Kalimantan via a joint venture, and 72% of its Indonesian holdings (including 63,000 hectares in Central Kalimantan) have yet to be planted. The company has been involved in oleochemicals since 1980, and in 2006 it became the world's largest producer of these. IOI is implicated in recent or ongoing forest destruction in Central Kalimantan, as well as the deforestation of orangutan habitats and peatlands
- A proposed million-hectare palm oil plantation planned in Papua by two Chinese companies and Sinar Mas appears to be temporarily on hold. According to a newspaper article quoting Hong Kong Construction's CEO, Chen Libo, the plan, which also involved CNOOC, will require further research and assessment before it is implemented. Chen added that Greenpeace has expressed concern over rainforest destruction and the negative environmental impact associated with the proposed project, and that the Indonesian government has now intervened.

(Source: Greenpeace research)



Shows degraded land after fires have destroyed the forest in preparation for oil palm plantation.

that are currently productive involved deforestation (See Box I).

In May 2008, Unilever announced an important about-turn in its policies after a Greenpeace campaign highlighted the links between deforestation, the palm oil industry and companies like Unilever that buy from suppliers who are involved in deforestation. The company agreed to support the call for an immediate moratorium on any palm oil expansion that would lead to further deforestation. This is a positive step, yet the challenge will be to see whether its suppliers likewise agree to support such a moratorium. If they do not, the fact that there is currently no system in place to trace the origin of palm oil means that the oil contained in many Unilever products could still have come from deforested land.

Under such a scenario, the hidden problems in Unilever's supply chain could pose three types of risk to the company:

Reputational risk: Unilever's revenue and reputation are concentrated in 12 "billion € brands". Greenpeace research confirms that the company's largest brands use palm oil as ingredients. They include Knorr and HeartBrand (Walls, worth €4billion), "Dirt is Good" (Persil, Omo and Surf Excel, worth a total of €3billion) and Dove (worth €1.3 billion). Our field investigations also yielded evidence that Unilever suppliers have been draining peatlands that are over eight metres deep, violating the legally allowed limit of two metres. Obviously the exposure of such illicit practices by its palm oil suppliers will cause greater damage to Unilever's famous brands than it will to the suppliers themselves.

Personal and home care products have very sensitive reputations, and any risk to them could harm Unilever's present revenue streams and future business development. According to a December 2007 Bank of America Equity Research report, Home Care is "the fastest-growing category within Unilever". Worth €7.2billion, this category includes the well-established Dove brand,

Moratorium would be a key step, but its success could only be guaranteed if other major players like Nestlé, Procter & Gamble, and Kraft act simultaneously.

and the emerging "Dirt is Good" brand platform.

Governance risk: Despite the abundance of information that is available about the clearance of rainforest and the burning of peatland for oil palm plantations in Indonesia, the country still claims it has significant land – 600,000 hectares a year over the next seven years – available for the expansion of oil palm estates (http://www.ft.com/cms/s/0/ab563322-2b5d-11dd-a7fc-000077b07658.html). One reason for this uncontrolled situation is the Indonesian government's weak regulatory oversight. Another is the dysfunctional nature of the Roundtable on Sustainable Palm Oil (RSPO), which consists of corporate giants like Cadbury, Nestlé and Tesco; global agricultural commodity traders including Cargill and ADM; and many palm oil producers themselves. While the RSPO's stated aims are the development of a global definition of sustainable palm oil production and better management practices, the organisation has been impotent in halting the industry's expansion into rainforests and peatlands. Furthermore, it has no system to segregate palm oil that meets its criteria from palm oil that results from deforestation. If it is untraceable, end users like Unilever have no control over their supplies. Ironically, the RSPO is chaired by Unilever.

Financial risk: Wetlands International estimates that 2.8 million hectares of degraded peatlands had been incorporated into palm oil concession areas by 2006. The average annual degradation emissions from these peatlands represent at least 476 million tonnes of CO2 – equal to 1% of the world's entire emissions. If Unilever means to curb its greenhouse gas emissions and offset its carbon emissions in a responsible way, and if it takes its entire supply chain (not just manufacturing process) into account, then the cost of offsetting CO2 emissions caused by the deforestation and destruction of peatlands becomes ridiculously expensive.

Preliminary calculations by Greenpeace suggest that 23.8 million tonnes of CO2 – nearly half of all the emissions in Unilever's supply chain – are attributable to the palm oil that it sources from Indonesia. Point Carbon predicts that carbon trading prices under Phase II of the Kyoto Protocol (2008–2012) will average €30 per tonne of CO2. If Unilever were to offset the emissions associated with its palm oil supply, it would cost the company €714m a year, equal to nearly 14% of its 2007 profits.

If Unilever takes these three areas of liability seriously, its only viable long-term option will be to clean up its supply chain. In April 2008, the company agreed to support an immediate moratorium on deforestation and peatland destruction. Such a moratorium would be a key step, but its success could only be guaranteed if other major players like Nestlé, Procter & Gamble, and Kraft act simultaneously. Greenpeace analysis shows that these three giants account for 0.5%, >1% and 0.5% of global palm oil consumption, respectively. However, none of them has yet proclaimed its support for a moratorium. Perhaps more importantly, none of the major palm oil producers has shown any interest in halting the expansion of its concessions into intact rainforests either.

High-profile NGO campaigning and intensifying conflicts with affected local communities are increasing the trend for consumers and investors to take impact on the environment into account when they make decisions.

High-profile NGO campaigning and intensifying conflicts with affected local communities are increasing the trend for consumers and investors to take the impact on the environment into account when they make decisions. Investors who care about climate change and deforestation should check whether Unilever is at least mitigating the risks, and at best gaining the advantage of being a "first mover" in its business strategies. The other giants who are also large users of palm oil should likewise be asked to audit their supply chains, and they should make some joint efforts to revive the RSPO, so that further deforestation caused by palm oil plantations is immediately stopped.

It should be noted that Unilever is expanding its brand penetration into new global markets, especially China. China's emerging middle class is predominantly young and predisposed to green living ideas, so Unilever's prompt action on this issue might position it to reap a rich harvest.

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Survey team walk through a fire stricken forest in the Riau region. Palm oil companies have recently cleared forest and peatlands in preparation for oil palm plantations.

China's Banks Should Open Up to the World About Green Issues

In July 2007, the Ministry of Environmental Protection (MEP), the China of Bank Regulatory Commission (CBRC) and the People's Bank of China (PBOC) – the country's central bank – signed an agreement to establish a corporate credit database. Its stated purpose is to serve as a tool for tracking illegal behaviour and non-compliance by companies, and for enhancing the environmental risk assessments conducted by the credit analysts and lenders in China's banks.

The PBOC and CBRC are supposed to disseminate the information contained in this database to all the country's banks, as a key reference for them to develop corporate credit profiles. So far, the agreement has been implemented in around 20 provinces, and after six months some showcase examples had already been reported. For instance, a group of financiers in Shanxi Province cancelled and reclaimed loans worth a total of RMB60 million that they had advanced to four companies. In Jiangxu, loan applications totalling RMB1 billion by companies who were causing pollution were rejected. The MEP also issued a more comprehensive update during a briefing to the Chinese media about the first phase of its implementation of green credit policies in February 2008. (see http://english.mep.gov.cn/News_service/news_release/200803/t20080310_119113.htm)

On the face of things, it looks as if the green credit policy has been as effective in immediately halting many polluting projects as previous "environmental protection storms". But the amounts involved in the reported cases are just peanuts compared to the total credit portfolios of China's top banks. For instance, the Industrial and Commercial Bank of China (ICBC), the world's second-largest listed bank in terms of market capitalisation, has a credit portfolio of half a trillion USD. Of this, 40% is rated as "environmentally sensitive" by Innovest, a global provider of research analysis about the performance of companies in the environmental, social, and strategic governance areas.

So, these successes should not encourage false hopes that all the problems have been solved. A lot more effort is still needed to overcome the huge environmental destruction caused by China's unprecedented economic development during the past 30 years. The green credit policy is merely an overdue revelation about the loopholes that exist in the risk assessment and due diligence methods of Chinese banks. Yet, it is still a big step forward, in the spirit of the Chinese proverb that "a journey of 1,000 miles begins with the first step". Also, it differs from the top-down interventionist approach adopted in previous "environmental protection storms", inasmuch as it represents a new policy and a new way of thinking about how market mechanisms and financial tools can be leveraged to protect the environment.

Sectoral emphasis is another innovation in this new policy. The MEP and Chinese Bank Regulatory Commission have jointly called on Chinese bankers and lenders to hone their environmental risk assessment and due diligence skills in order to withhold cheap credit from businesses that fall within the "Liang Gao" (两高) framework, i.e. companies responsible for high degrees of pollution and high energy consumption.

The idea is that cutting their credit lines will prevent them from generating further profits by exploiting the environment. In the long run, it will also mean that value can only be created through greater energy efficiency and cleaner manufacturing technologies. Banks are supposed to play a key role in this process by providing economic incentives for reforms in individual sectors. The policy also encompasses some other initiatives that have either already been embarked upon, or which are currently in the pipeline (See Box I).

The ICBC has already built up an environmental management system and risk database to track its 60,000 customers. Loan requests which fall within the "Liang Gao" category are ranked under four subsections. Projects that receive the lowest scores are the least likely to receive loans because they carry the highest environmental risk. Are other banks following this example? The China Development Bank – a policy bank that manages a big portfolio of infrastructure projects – has established a fund to support energy savings and emission reductions in projects that involve

Box I: Key green initiative terminologies

- The "Three Simultaneities" policy (三同时) means that facilities to prevent or control pollution and other hazards to the public should be designed, constructed and put into operation at the same time as the construction of the principal parts of the project. Companies that violate this policy should have their loan applications rejected, or else loans that have already been disbursed to them should be foreclosed.
- Green Initial Public Offering (IPO): Companies from 13 sectors that fall within the "Liang Gao" framework must undergo an environmental review conducted by MEP when they apply for an IPO or refinancing. Besides its internal assessments, the MEP will initiate a 10-day consultation period, during which it will gather the public's opinions about the IPO applicant. Ten of the 37 IPO applications that have been reviewed since the implementation of this policy were either rejected or subjected to further reviews.
- The ICBC's "One-Ballot-Veto" scheme (一票否决制) stipulates that a borrower's environmental performance should be the decisive factor when considering a loan application. Banks should refuse to lend money to projects that do not comply with environmental policies. Companies and projects on the Ministry of Environmental Protection's list of enterprises whose operations have been halted in certain regions or watersheds should have their loan applications and all forms of credit support suspended until the sanctions against them have been lifted.

coal-fired power stations, water-polluting industries, etc. Up to 2007, it had disbursed more than RMB30 billion, of which RMB4.5 billion had been allocated to clean up the pollution at Tai Lake (see "Tighter emission controls could land polluters in hot water" in this issue).

It is no coincidence that the ICBC was the first Chinese bank to start participating in the Carbon Disclosure Project, a global initiative to audit corporate carbon emissions. Its latest corporate social responsibility review also states that it will pay close attention to the evolution of the Equator Principles, a benchmark for the financial industry to manage social and environmental issues related to project financing, as well as ensuring compliance with environmental protection requirements. Furthermore, it vowed to "take 'Green Credit' as a long-term growth strategy and endeavour to build the ICBC into a model bank for 'Green Credit'". (http://www.icbc.com.cn/download/nb/2008/shehuizerenbaogao_2007e.pdf, p24)

However, such encouraging efforts about sustainability issues by the ICBC and the Chinese banking sector in general are not widely recognised by the international financial community. A recent article in The Banker magazine failed to assign any ratings for the environmental, social and governance (ESG) performances of China's three biggest listed banks in terms of market capitalisation – the ICBC, Bank of China and China Construction Bank. It explained they could not be rated because it was more difficult to secure critical information about them – such as their ESG risk exposure and the strategic profit opportunities they leveraged – than it was for the other banks it had surveyed. In the face of such problems, only Chinese banks themselves can substantiate their green business strategies.

Transparency and disclosure issues also undermined the overall ESG assessments of Chinese banks in benchmarking research conducted by BankTrack, an NGO concerned with bank lending to environmentally and socially sensitive projects. Of the three Chinese banks evaluated, two, including the Bank of China, did not receive any score, due to the opacity of their social and environmental policies.

Given their deep pockets, Chinese banks do not seem unduly worried about their failure to gain ratings or rankings for their sustainability policies. But if some of them, like the ICBC, nurture global aspirations, they will need to consider a more strategic approach to this issue, as it is likely to affect their success in achieving their goals.

Considering the examples given in the MEP's briefing, why do Chinese banks tend to maintain such a low profile? They are making their performance on sustainability issues hazy by failing to disclose critical information and policies, and by not adopting international best practices or participating in global reporting initiatives. There might be two reasons for this: perhaps they do not recognise the strategic value of doing business in a more transparent way; or else maybe they feel that such disclosures would reveal that they are not doing enough.

The Banker article also showed that the stock prices of banks that achieved the highest ESG ratings performed better than those of their lower-rated peers during the market downturn over the past six months. Investors nowadays agree that a positive correlation exists between ESG and financial performance. On the other hand, the financial performance of banks that are coy about discussing ESG issues tends to be below par.

It might be unrealistic to expect Chinese banks to disclose environmental data in order to prove themselves as financially competitive as an AAA-rated institution like ABNAmro. Yet, increasing their environmental disclosure would immediately benefit their reputations. Demonstrating a forward-looking attitude would help them to burnish their image, thus enabling them to benefit from the intangible value that this will create. Having a good brand image contributes to any corporation's "soft competitiveness". The attractiveness of their profile to investors and the financial community as a whole is becoming an increasingly important factor as Chinese banks implement the country's "reaching out" policy by growing more aggressive in the US and European markets.

Traditionally, Chinese business people place a high value on their credibility, and they are anxious to "look good". That may partly explain why Chinese banks are reluctant to reveal their environmental performance in open forums. As we have seen with some of their African investments, controversies concerning their lending projects may be fuelling anxieties about making greater disclosures. In this context, they are basing the limits of their disclosure on considerations of practicality and self-confidence. Banks that are implementing a global strategy take themselves seriously, and they wish to appear as competitive as their international counterparts. It is therefore remarkable that the ICBC has become the first Chinese bank to participate in the Carbon Disclosure Project, and it is a strong indication that it is confident about adopting international best practices and professional standards.

What more can be done if the second reason holds true, namely that Chinese banks do not feel they are doing enough? If their near-term goal is to create greater shareholder value, it is just as essential for them to adopt the international standards and best practices of global banks as it is for them to reduce their non-performing loans. The International Financial Corporation, the private arm of the World Bank, has been helping Chinese banks to strengthen their environmental management capabilities. In February 2008, it signed an agreement with the MEP for its environmental, health and safety (EHS)

The reform of China's banking sector may be underpinned by many good initiatives and bold moves, especially in terms of green lending and financing. Yet even a sympathetic outsider will find it hard to evaluate them if the banks themselves do not act in a more engaging manner to balance their aggressive stance about global expansion.

standards and the Equator Principles to be translated into Chinese, in order to promote the implementation of the "Liang Gao" policy among the country's banks. In line with this type of collaboration, it would not be surprising to see the first Chinese banks signing the Equator Principles, thereby showing that they are not "walking alone".

While such convergence should take place, it is equally important for Chinese banks to establish a separate platform within the "Liang Gao" framework in order to steer the development of their environmental disclosure and green financing policies. This could take the form of an open consortium consisting of the biggest Chinese banks which between them control trillions of dollars in assets – something comparable to the Equator Principles or the UNEP Principles for Responsible Investment. Such a platform might seem counter-intuitive, but it would offer a number of benefits.

First, a voluntary joint initiative like the Equator Principles would allow its members to share implementation risks and costs. Second, it would create a level playing field in which the laggards would become highly conspicuous, thus heightening the risks they face for failing to follow the trend. If the prime movers like the ICBC do a good job, it would trigger a race-to-the-top dynamic. Third, it would lower the entry barrier for provincial banks and smaller financiers, lessening the costs of kick-starting their own green credit programmes. Last, but not least, it would showcase the success of the "Liang Gao" framework and other green finance initiatives. In that respect, it would be a disclosure initiative in itself, and it would therefore be an effective way for Chinese banks to clean up perceptions about themselves.

The reform of China's banking sector may be underpinned by many good initiatives and bold moves, especially in terms of green lending and financing. Yet even a sympathetic outsider will find it hard to evaluate them if the banks themselves do not act in a more engaging manner to balance their aggressive stance about global expansion. The gap between these two aspects will widen unless they move faster on the issues discussed above. Their very first steps look promising, yet they still have a long journey ahead of them.

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IPO Review:
The Samling listing – why everyone must share the blame

It isn't uncommon for a company to write some lengthy paragraphs to disclose environmental issues that might create uncertainties about the future of its business and its profitability when it seeks a stock market listing (see below). What is unusual is when such issues materialise so quickly. With hindsight, subscribers and investors in Samling Global should have taken these signals seriously.

Samling Global (HKSE: 3898) raised US$269 million for its IPO on the Hong Kong Stock Exchange (HKSE) in March 2007. Based in the Malaysian state of Sarawak on Borneo island, the group is one of Malaysia's biggest logging companies. It oversees about 4 million hectares of forest concessions in Malaysia, Guyana, Papua New Guinea and New Zealand.

In 2003, Greenpeace exposed Samling's illegal logging on land that was in the possession of customary landowners around Lake Murray in western Papua New Guinea. Other NGOs – including Global Witness, the Bruno Manser Foundation and local communities of the Penan people – criticised the company for its systematic destruction of tropical rainforests in Sarawak, one of the world's most important centres of biological diversity and the ancestral home of the Penan.

In Guyana, a Samling subsidiary, Barama, had its Forest Stewardship Council (FSC) certificate suspended in January 2007, following an independent review that revealed "major systematic nonconformities" with FSC standards. According to Banktrack, Barama does not intend to contest this decision (http://www.banktrack.org/?visitor=1&show=167&id=76). Barama also did not contest a US$480,000 fine imposed by the government of Guyana in October 2007, when it was accused of under-reporting the number of logs it had harvested from local firms.

Thirty-seven NGOs in 18 countries launched protests against Samling's IPO at the end of February 2007. Their action was completely understandable. Given its appalling track record and the likelihood that it would cause a disastrous impact to virgin rainforest, Samling's move to tap money from Hong Kong investors was highly questionable.

The apparent inconsistencies of the financiers who underwrote the deal added further fuel to the flames. They were led by Credit Suisse, with HSBC and Macquarie as the joint bookrunners. Credit Suisse and HSBC are both signatories to the Equator Principles and UNEP's Global Compact and Finance Initiatives. Their roles in the dubious

- "Global environmental organizations have affected certain markets, primarily in developed countries, by exerting pressure on large retailers to purchase wood products that meet acceptable environmental standards, such as certified wood products. In these markets, there is a risk that any inability by us to meet these standards could adversely affect sales of and demand for our wood products…" (p. 55)
- "We can provide no assurance that such activities and activism by indigenous communities and environmental groups will not adversely affect our business, revenues or operating results in the event that any of such activities are successful. We similarly can provide no assurance that adverse publicity will not be generated in connection with such activities locally and internationally…" (p. 45)
- "As at the Latest Practicable Date, we are still working with the independent assessor and the FSC to resolve the CARs (Corrective Action Requests) and our FSC certification in Guyana remains suspended… In the event that we do not resolve the CARs, our suspended FSC certification in Guyana may be withdrawn." (p .38)

–cited from Samling Global Initial Public Offering Prospectus, February 2007 deal and the due diligence it involved were challenged. For example, Janette Bulkan of Yale University questioned why neither had conducted its own technical review, and why a review by the Finnish consultancy Jaako Pöyry, which was commissioned by Samling's Singapore office, was used as an "independent technical report" in the IPO prospectus (http://www.illegal-logging.info/uploads/Samling_Barama.pdf).

The controversy badly harmed the reputation of both banks. HSBC has its own forest policy (Credit Suisse might also have one, but it is not publicly available). The former defended itself by reviewing Samling's global operations and the extent it complied with HSBC policy. In May 2007, HSBC also gave assurances that it would track the company's performance. However, these assurances sounded weak, because they were not accompanied by an action plan stating measurable benchmarks, nor did HSBC say what it would do if Samling systematically failed to improve its logging practices.

Quite the contrary, in fact. Following its successful flotation, Samling failed to live up to any expectations the two banks might have had about its performance. A dossier prepared by Janette Bulkan for two Swiss NGOs – the Bruno Manser Foundation (BMF) and the Society for Threatened Peoples (GfbV - Gesellschaft für bedrohte Völker) – reported that investigations during the last two years had uncovered serious illegal and fraudulent operations by the company. BMF and GfbV presented the dossier to officials of Credit Suisse on May 3, 2007, and at the bank's annual general meeting the following day.

In September 2007, the Malaysian Timber Certification Council threatened to revoke its certification of 56,000 hectares of tropical forest in the Upper Baram region of Sarawak unless Samling resolved a land conflict with Penan communities who were blockading it.

To date, the Samling subsidiary Barama has failed to publish any plan to deal with the major and minor corrective actions requested by SGS Qualifor, the FSC-accredited certification body, in January 2007.

The number of listed firms engaged in other environmentally sensitive sectors – such as mining, power generation and agriculture – is growing. The companies in these sectors, some of which are based in mainland China or have operations in Hong Kong, are just as prone to polluting and destroying the environment as Samling.

Samling's shares closed at HK$1.1 at the end of March 2008, having plummeted by nearly 50% from the offering price of HK$2.08 12 months earlier.

The lesson of this story is that the regulators of an IPO should be subjected to the same scrutiny as the underwriting banks and the company itself. Their key function is to protect the rights of investors by ensuring there is sufficient disclosure and thorough due diligence. In the case of Samling, the HKSE could be said to have done the former, but not the latter. The HKSE might have its own environmental due diligence guidelines and policies, but these have not been made public. Neither has it stated its position about environmental concerns, and how these influence its approval of listing applications.

Only a few companies involved in the forestry sector are listed in Hong Kong. They include Hong Kong Construction (HKSE: 190), which owns biofuel and oil palm businesses in Malaysia (see the article about Unilever). However, the number of listed firms engaged in other environmentally sensitive sectors – such as mining, power generation and agriculture – is growing. The companies in these sectors, some of which are based in mainland China or have operations in Hong Kong, are just as prone to polluting and destroying the environment as Samling. To protect the investor community's interests, the HKSE needs to make the same aggressive efforts to strengthen the importance of environmental considerations in its listings decisions that it has put into attracting more companies, particularly mainland ones, to list in Hong Kong.

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Children playing on the shore of Lake Murray. Eco-forestry initiatives in the region will help pay for the education of these youngsters.

Greenpeace Inaugural Business Lecture in China

E. Neville Isdell, Chairman and Chief Executive Officer of The Coca-Cola Company, Zhang Zhaohui, Secretary General of the Chinese Refrigeration and Air-Conditioning Association (CRAA) held an open dialogue with Gerd Leipold, Executive Director of Greenpeace International at the Greenpeace Inaugural Business Lecture in Beijing on May 27, 2008. Their topic was an often-overlooked source of greenhouse emissions – the gases used in refrigeration and cooling systems – and the development of natural refrigerants as possible substitutes.

If their use remains unchecked, HFCs—one of the most commonly used gases in refrigeration—will constitute 8.6% of all greenhouse gases by 2050. Pound for pound, HFCs are more than 1,300 times more potent than carbon dioxide, another well-known contributor to global warming.

Compared with other aspects of the climate change problem, the use of refrigerants can be solved easily because natural alternatives to the old technology are readily available. However, the industry's inertia and strong lobbying by chemical manufacturers have prevented their adoption for commercial refrigeration and air-conditioning purposes. On the other hand, natural refrigerants are already widely used in domestic refrigerators around the world.

During the lecture, The Coca-Cola Company pledged to reduce its carbon footprint by buying 100,000 beverage coolers fitted with climate friendly new technologies. The company also said it will purchase and deploy refrigerators and vending machines cooled by compressed carbon dioxide rather than hydrofluorocarbons by 2010.

Greenpeace's Leipold acknowledged The Coca-Cola Company's efforts and leadership in tackling climate change problems related to refrigeration and cooling. However, he also pressed for the company to shift more rapidly to new technologies, given the fact that Coke buys close to a million new refrigerator units every year. He called on Coke to make all its new refrigerators HFC-free by 2012, in time for the London Olympics. In addition, he asked the Atlanta-based behemoth to show greater leadership by addressing other environmental issues linked to its operations, such as water issues in India.

The Greenpeace Business Lecture Series in China has been initiated to introduce the latest corporate trends and insights on environmental solutions. It offers a platform for open dialogue where leading corporate executives, policy makers, and members of the local environmental movement can engage in an honest, robust exchange of views about the challenges and opportunities facing corporations that operate in China today.

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Lo Sze Ping, Campaign Director of Greenpeace China, speaks at Greenpeace's Inaugural Business Lecture in May 27th, 2008.

International Conference on Public Participation in Environmental Protection

Held in Beijing on April 26 and 27, 2008, this conference aimed to highlight the importance of public participation in environmental protection, introduce the public participation experience in China and other countries, and discuss the best ways for the government, NGOs, and public to take part in protecting the environment in China. It was jointly organised by the Center for Environmental Education and Communications of the Ministry of Environmental Protection and Greenpeace, in partnership with the UNEP and the Delegation of the European Commission to China of the European Union.

During the conference, Greenpeace presented the findings of a survey that highlighted the record of 28 companies on the 2007 Fortune 100 list about disclosing the emissions of contaminants by their operations in mainland China. The survey revealed that only six of them (BP, Sinopec,

News Briefs

PetroChina, Honda, Panasonic and Sony) published such information on their official websites. Thirteen others (ExxonMobil, Shell, GM, Toyota, Total, GE, Ford, Nissan, Hitachi, Nestlé, BASF, BMW and Toshiba) disclosed information about their global emissions or emissions in certain other specific countries and regions, but they provided no corresponding figures for China (see "Tighter emission controls could land polluters in hot water" in this issue for more background and analysis).

Greenpeace has called on companies to disclose full environmental information, especially data relating to their emissions of contaminants in China. This will help to encourage better supervision by the public, and ensure that the corporations concerned implement clean production processes that eliminate pollution.

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Greenpeace China offers natural refrigeration solutions at the 2008 China Refrigeration Expo

GREENPEACE CHINA PARTICIPATED in the 19th International Exhibition for Refrigeration, Air-conditioning, Heating and Ventilation, Frozen Food Processing, Packaging and Storage (also known as the China Refrigeration Expo), which was held in Shanghai from April 9 to 11. According to its organiser, the Beijing International Exhibition Center, around 38,350 people from 101 countries attended the event.

During the Expo, Greenpeace China, GTZ Proklima (the German Technical Cooperation Agency) and Refrigerants, Naturally! (an industry coalition to phase out hydrofluorocarbons (HFCs) launched by Coca-Cola, Unilever and McDonald's in 2004) jointly conducted a public seminar entitled "Using Natural Refrigerants — Lessons China can Learn from Europe". Speakers from UNEP, the EU and Germany, as well as representatives from Shanghai Jiaotong University, Unilever China and Embraco, explained the advantages of natural refrigerants over hydrochlorofluorocarbons (HCFCs) and HFCs in mitigating climate change. The seminar was attended by representatives from major Chinese manufacturers of refrigeration appliances and Chinese government officials.

The Expo showcased many examples of natural refrigeration technology, including a hydrocarbon cooler and a CO2 cooler from PepsiCo, a hydrocarbon ice-cream cabinet from Unilever and hydrocarbon and CO2 compressors by Embraco. The commercial potential of natural refrigerants in China attracted a lot of attention from the participants. Since China has the world's largest producer of refrigerators and air-conditioners, it can make a big contribution to mitigating climate change through the use of natural refrigerants.

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Greenpeace in China

Greenpeace China was established in Hong Kong in 1997 and has since set up offices in Beijing and Guangzhou.

China's phenomenal economic growth in the last two decades has brought unprecedented environmental threats to the country and the world. Greenpeace believes that development should not come at the expense of the environment. We are committed to seeking and building a green growth pattern, together with the people of China.

GREENPEACE 绿色和平

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Greenpeace exists because this fragile Earth deserves a voice. It needs solutions. It needs change. It needs action.