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Corporate Social Responsibility Reporting of Two Note-issuing Banks in Hong Kong

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Corporate social responsibility reporting of two note-issuing banks in Hong Kong

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Abstract

The environmental performance and management disclosure of organisations has over the past decade come under increased scrutiny due to a number of factors including, in particular, the impact organisations have had on the world's environment and the corresponding rapid change in the world's climate. These concerns have made organisations, including financial institutions, review the level of their environmental performance and management disclosures to demonstrate, amongst other objectives, their level of social responsibility. Financial institutions due to the nature of their business are not generally seen to contribute directly to the degradation of the environment however they do provide the funds for many organisations' projects which do directly impact on the environment.

This paper will review the environmental performance and management disclosures of two note issuing banks in Hong Kong; the Hongkong and Shangihai Banking Corporation (HSBC) and Bank of China (Hong Kong) Limited (BOCHK) from 2003 to 2006. This review will be conducted with reference to the Equator Principles, a voluntary environmental performance framework, which were developed specifically for financial institutions. The second purpose of this paper is to contribute to the literature on legitimation theory with specific reference to the social constructionalist perspective of legitimation.

Keywords: Environmental reporting; Equator Principles; Legitimation; Hongkong and Shanghai Banking Corporation (HSBC); Bank of China

Introduction

The state of the world's environment and the impact of mankind on the ecology of the world has lead to increased public concern and scrutiny of the operations and performance of organisations. Organisations are now expected to be able to demonstrate that they are aware and addressing the impact of their operations on the environment and society in general. Although private sector financial institutions, such as banks, do not significantly contribute directly to the degradation of the environment, they provide project funding for many organisations whose operations do directly impact on the environment. Coulson explains that "from an ethical perspective … a lender financing corporate activity should take some responsibility for the social and environmental impact of their transactions" (2007, p. 267). Despite this there are no mandatory environmental reporting disclosure requirements for private sector financial institutions in Hong Kong. Rather the banks in Hong Kong have been voluntarily producing individual environmental performance and management reports. The main purpose of this paper is to review the environmental reporting practices of two note issuing banks in Hong Kong; the Hongkong and Shangihai Banking Corporation (HSBC) and Bank of China (Hong Kong) Limited (BOCHK) for the period of 2003 to 2006. This paper will also focus on the processes these two banks use to establish a relationship between their actions and their values through the use of environmental performance reports.

The next section of this paper discusses the current state of environmental performance and management reporting with specific reference to the two Hong Kong banks. This is followed with a discussion of the Equator Principles and how legitimation theory may apply to environmental reporting. Finally, conclusions will be drawn.

Environmental Reporting

An increasing number of organisations in both the public and private sectors have over the past two decades have been developing and producing reports on their environmental performance and management. This increase in environmental reporting has been linked to a number of drivers such as greater societal concern with the impact of organisations operations on the environment (Ho *et al.*, 1994), increased expectations of society of organisational behaviour (Adams, 2004; Deegan, 2002; O'Donovan, 2002) and, perhaps more dubiously, due to organisations recognising environmental and social risks to, or opportunities for greater, profitability (Burritt and Welch, 1997, p, 542; Coulson, 2007, p. 266). Deegan suggests that environmental disclosure [adoption] decisions may be driven by the desire to survive [be seen as legitimate] or by management's "view that the community has a right to know about the organisations actions (2007, p. 144).

The majority of environmental reporting by organisations is only a voluntary practice, not required by regulation (Wilmshurst and Frost, 1999, p.10) and this voluntary nature of environmental reporting impacts on the consistency and comparability of the various environmental reports. This has led to the suggestion that generally only good news is reported (Deegan and Rankin, 1996; Burritt and Welch 1997) as organisations, generally, have no legal requirement to disclose. Where there is legislation on environmental reporting it is generally based on breaches rather than positive performance which reflects the reporting practices of organisations. In the finance industry Coulson outlines that

> "as environmental legislation has increased bank lenders have developed risk-assessment procedures to offset potential liability from environmental damage caused by their borrowers" (2007, p. 267)

This suggests that the environmental disclosures by banks are focused on limiting exposures due to environmental impacts of projects that they have financed rather than on the actual environmental impact of the project.

A number of private sector organisations have been voluntarily providing reports to varying degrees on their environmental performance and management. This voluntary reporting has lead to the development and implementation of a number different types of reporting such as triple bottom-line reporting[1] which incorporates environmental, financial and social performance. However, even though there is a growing number of private sector organisations outlining quite explicitly, in their annual report, their environmental successes there is a notable absence of reporting of organisations' environmental failures.

In Hong Kong, there is no mandatory requirement of listed companies to disclose their environmental management and performance and the enforcement of social and environmental legislation is only negligible (Ng, 2000; Gao *et al.*, 2005; Ho *et al.*, 1994). However government departments, bureaux and government-owned organizations have been required, since 1998, to publish yearly environmental reports, disclosing their environmental performance (The Hong Kong Institute of Chartered Secretaries, 2006; Chiu *et al.*, 2002). The introduction of mandatory environmental reporting in the public sector in Hong

[1] Triple Bottom Line report is defined as "a publicly released document that provides information about the social, environmental and economic performance of the reporting organisation".(Deegan, Cooper and Shelly 2005, p. 2)

Kong appears to be an attempt to encourage the private sector to adopt similar reporting practices yet environmental reporting in the private section in Hong Kong is still at a nascent stage. This outcome reflects the suggestion that Hong Kong companies have traditionally faced little external pressures for disclosing social and environmental information (Lynn, 1992; Ng, 2000; Gao *et al.*, 2005).

So why do an increasing number of organisations develop and produce voluntary environmental performance and management reports? It has been suggested (Adams, 2004; Deegan, 2002; O'Donovan, 2002) that organisations are motivated by an implied social contract between the organisation and members of society [stakeholders] to legitimise various activities of their respective organisations. Deegan (2002) explains this motivation for voluntary environmental reporting seems to be in contrast to the perceived [accepted] reason for external reporting, that is managers accept they are required, to give an account of [disclose] the organisation's total performance, financial as well as environmental (Adams 2004, p.732). To be accountable, the environmental reports should be "transparent and represent a genuine attempt to provide an account which covers negative as well as positive aspects of all material impacts" (Adams 2004, p.732). Deegan (2002) also suggests that there are a number of other possible motivations why an organisation may decide to disclose their environmental performance and management such as: to comply with legal requirements; economic rationality considerations; comply with borrowing requirements; community expectations; manage particular stakeholder groups; comply with industry requirements or particular codes of conduct; to forestall efforts to introduce more onerous disclosure regulations; and to win particular reporting awards (Deegan 2002, pp.290 – 291). For example the ACCA[2] recognises and awards organisations, irrespective of which sector they operate in, "for excellence in environmental, social and sustainability reporting" (ACCA 2008a). The aim of the awards are "to *give recognition* [emphasis added] to those organisations which report and disclose environmental, social or full sustainability information; encourage the uptake of environmental and sustainability reporting; and raise awareness of corporate transparency issues" (ACCA 2008b).

[2] ACCA (the Association of Chartered Certified Accountants) is a global body for professional accountants with over 320,000 members and students in 170 countries.

Due to the nature of voluntary reporting organisations will not always disclose all relevant information from a stakeholder perspective. Besides the option for including or excluding negative information in environmental reports there is also

> "A lack of consensus on key issues such as the objectives of reporting, the qualitative characteristics the information should possess; the audience of the reports; the "best" presentation formats, and so forth" (Deegan 2002, p. 286)

One of the possible motivations identified by Deegan (2002) why organisations may decide to disclose environmental performance and management - to comply with industry requirements or particular codes of conduct (p. 291) may address the issue of environmental report consistency. The following section of this paper will discuss the one group of voluntary reporting industry requirements, Equator Principles, which were developed and implemented by the international financial industry.

Equator Principles

In 2003 leading global lending institutions developed a set of principles, the Equator Principles, as a way to encourage private lenders to consider social and environmental issues when providing funding for infrastructure projects (Dillard *et al.*, 2004, p.508, Deegan, 2006, p.275). The Equator Principles [refer to appendix 1] are based on the International Finance Corporation's[3] (IFC) *minimum* environmental and social policy framework for providing financial support to projects (Coulson 2007, p. 270; Wright 2007, p. 2) and are voluntary guidelines with the primary focus on project financing issues in developing countries (Andrew 2007, p. 41). The adoption of the Equator Principles by a financial institution implicitly implies "a bank needs to justify why they are progressing a transaction [financing a project]" (Coulson 2007, p. 274). In addition Deegan suggests that "having a code of environmental management could arguably be seen as a symbolic commitment to improved environmental performance by the industry body that developed the code, and by those companies who commit to it" (2007, p. 141).

The Equator Principles were revised in 2006 by (*member organisations??*) to address a number of concerns [limitations] of the earlier principles such as reducing the threshold of projects when the principles are applicable. Andrew (2007) explains the most significant change was the inclusion of Principle 10 which outlines that each funding organisation which adopts the Equator Principles is to "report publicly at least annually about its Equator Principles implementation

[3] International Finance Corporation is the private sector lending arm of the World Bank Group (Wright 2007, p. 2)

processes and experience, taking into account appropriate confidentiality considerations" (www.equator-principle.com). However this is not seen to be enough as Coulson explains there "are increased calls for … some formal association with an ombudsman and some means of auditing performance (2007, p. 274).

Initially only ten banks adopted the Equator Principles (Missbach, 2004, p.78) however by the end of June 2008 approximately 60 private lending institutions had 'signed' on to adopt the principles (www.equator-principles.com). That is, these institutions have "promised that they will take *some* [emphasis added] responsibility for the environment and social impact of the projects they finance" (Missbach 2004, p. 79). This promise [agreement] …………….

On the surface this appears to be a positive development, financial institutions voluntarily agreeing to place a greater amount of emphasis on the environment and acknowledging the possible impact on the environment of the infrastructure projects for which they provide funding. However scratch away at the surface and there are a number of concerns which are glossed over by the adoption of the Equator Principles. For example Missbach (2004) explains that

> The principles apply only to a very small fraction of a banks activities … they are weakened by not being applied to project finance deals where a bank may be a financial advisor, underwriter, arranger or lead manager (Missbach 2004, p. 79)

So when a bank promotes the fact they have adopted the Equator Principles it is entirely possible they may be performing a number of activities associated with funding an infrastructure project and not be required to abide by the Equator Principles. For example, they may be performing a financial advisory role for an infrastructure project, rather than providing funding, and therefore they are not required to approach this role under the guidance of the Equator Principles (Missbach 2004). There is the issue that "many transactions [project finance] are carried out as a syndication exercise" (Coulson, 2007, p. 270). Another concern is there is no independent monitoring process where projects, which are funded by an Equator Principle Financial Institution, can be assessed as being completed as per the Equator Principles (Wright 2007, p. 9). This concern is compounded by the fact that there is no overseeing body (Missbach 2004; Wright 2007) and all communication with stakeholders is through the Equator Principles website which is "hosted by one of the adopting banks on a rotating basis" (Wright 2007, p. 9), which creates an issue relating to potential conflicts of interest.

Whilst one of the key aspects of the Equator Principles is that they are voluntary there is also, surprisingly, a very explicit disclaimer at the end of the principles

> ***DISCLAIMER:*** The adopting EPFIs view these Principles as a financial industry benchmark for developing individual, internal social and environmental policies, procedures and practices. As with all internal policies, these Principles do not create any rights in, or liability to, any person, public or private. Institutions are adopting and implementing these Principles voluntarily and independently, without reliance on or recourse to IFC or the World Bank. (www.equator-principles.com)

This raises the question why would a private lending institution adopt the Equator Principles if they are voluntary, not-monitored and covered by a explicit disclaimer. Wright and Rwabizambuga (Wilmshurst and Frost, 1999, O'Donovan, 2002) suggest all Equator Principle Financial Institutions will benefit from membership irrespective of their actual practices as there are no processes to "monitor the corporate practices of members" (p. 91). This is consistent with Deegan's question

> "are such [environmental disclosures] really reflective of an acceptance that an organisation has an accountability for its social and environmental performance, *or* are they merely a mechanism to support the existence of the organisation?" (2007, p. 143).

There are also benefits for organisations to adopt voluntary codes, such as the Equator Principles, as these organisations will be seen as operating within best practices (Wright and Rwabizambuga 2006, 95). The Equator Principles offer the financial sector an opportunity to jump on the band-wagon of environmental reporting in an explicit way which inturn will increase the legitimacy of their institutions (Andrew 2007, p. 44).

The following section will discuss the theoretical framework of this paper, legitimation.

Legitimation

The theoretical framework which has been in favour for a number of years in attempting to explain why organisations conduct certain activities such as implementing voluntary environmental reporting is legitimacy theory (Deegan, 2006, p.275; Deegan 2007, p. 129; Dillard *et al.*, 2004, p.508). Legitimacy theory asserts that organisations continually work to ensure their activities are perceived externally as being 'legitimate' due to the notion there is a social contract between society and the organisation (Deegan, 2006, p. 276; Deegan 2007, p. 127). This is consistent with Deegan's explanation "organisations exist to the extent that the particular society considers that they are legitimate" (2007, p. 131). Guthrie & Parker (1977, p.340) suggest that organisations disclose their environmental performance [at least the favourable component] so they may be conceived as reacting positively to the environment (p. 344) which is essential for influencing legitimacy (Deegan 2007, p. 139) .

This paper however is going to review the two banks environmental reporting for the period 2003 to 2006 through legitimation theory which focuses more on the processes rather than on the result [legitimacy]. Deegan cities Lindblom's (1994) explaining the difference between legitimation and legitimacy with legitimation "the process that leads an organisation being adjudged legitimate", and legitimacy as "a status or condition" (Deegan 2006, p. 275; Deegan 2007, p. 127). Richardson defines legitimation as the processes "which create and validate the normative order of society" (1987, p. 343) whereas Wisman (1980, p.90) and Dirsmith (1986, p. 358) suggested that legitimation is the process where social knowledge and expectations explain and justify social behaviour and the changes of social institutions [organisations]. Berger and Luckmann (1966) suggest that the process of legitimation is a societal necessity of "keeping chaos at bay" (p. 121) while Hopwood (1987) [cited in Richardson 1987, p. 347] suggests legitimation is a "process of creating rationales which give order to a chaotic array of actions arising out of the pragmatic problems facing society. Organisations will use different legitimating processes depending on whether the organisation wants to build, regain or extend it legitimacy" (O'Donovan 2002, p. 349). Deegan explains

> "that an organisation seeking to be legitimate it is not the *actual* conduct of the organisation that is important, it is what society collectively knows or *perceives* about the organisation's conduct that shapes legitimacy" (2007, p. 128)

Richardson (1980) suggests there are three different perspectives of legitimation: structural functionalist; social constructionalist; and hegemonic (p. 342). The structural functionalist perspective "presumes that both values and actions are defined by the functions which must be performed for a social system to survive (Richardson 1987, p. 343), whereas the social constructionalist perspective "regards values as emerging from interaction among member of society" (Richardson 1987, p. 343). The hegemonic, dominance through non-coercive means, perspective "regards values as an aspect of elite ideologies" (Richardson 1987, p. 343) and therefore should remain unquestioned (Rahaman *et al.*, 2004, p.40).

These three perspectives reflect different ontological, "the nature of being or reality" (Dillard, 1991, p.11), assumptions. Morgan and Smircich (1979) suggest there is a continuum of ontological assumptions ranging from reality as a concrete structure [structural functionalist perspective] to reality a social construction [social constructionalist] to reality as a projection of human imagination (completely internal to the researcher). Burrell and Morgan's (1979) more simplistic model suggests ontological assumptions can either be founded on reality which exists independently of the individual [realism - structural functionalist perspective] or reality which is created based on artificial creations for describing and making sense of the external world [nominalism – social construction] (Burrell and Morgan 1979, p. 4). This simplistic model is also reflected in Gaffikin who uses the terms Realist and Constructionist (2006, p. 8)

Reality as a social construction assumes reality is a continuous process created through the medium of language, labels, actions and routines (Burrell and Morgan 1979, p. 4; Morgan and Smircich 1980, p. 494). The following section of this paper will focus on the social constructionalist perspective of legitimation.

Social constructionist perspective

Richardson (1987) explains that the "social constructionalist perspective regards values as emerging from interaction among members of society. These values are usually directed [determined] by certain groups in society who are seen to be experts, such as professionals [for example accountants]" (p. 343). These professionals contribute to the knowledge which society is able to construct its social reality (Richardson 1987, p. 348). Reality as a social construction assumes reality [social world external to the individual] is a continuous process created through the medium of language, labels, actions and routines (Burrell and Morgan 1979, p. 4; Morgan and Smircich 1980, p. 494). Under this assumption of reality Morgan and Smircich (1980) suggest that

> "human beings create their realities in the most fundamental ways, in an attempt to make their world intelligible to themselves and to others" (p. 494).

This is consistent with Boland and Pondy's (1983) discussion of groups of people [management] who, as being responsible for others, construct their social reality through symbolical interaction and inturn "give meaning to their ongoing stream of experience" (p. 223).

The social constructionalist perspective sees the social world as an emergent social process which is created by the individuals concerned. Social reality, insofar as it is recognised to have any existence outside the consciousness of any single individual, is regarded as being little more than a network of assumptions and intersubjectively[4] shared meanings. (Burrell and Morgan 1979, p. 29).

[4] Intersubjectivity: The world is experienced from the outset not as the private world of a single individual but as an intersubjective world common to us all. We interpret events in a manner which is identical for all practical purposes and assume that we all would have broadly the same experience if

The following section of this paper will examine and review the environmental reporting practices of two note issuing banks in Hong Kong; the Hongkong and Shangihai Banking Corporation (HSBC) and Bank of China (Hong Kong) Limited (BOCHK) for the period of 2003 to 2006.

Environmental performance and management reporting in China

The State Environmental Protection Administration (SEPA), now Ministry of Environmental Protection (MEP), of China has signed a deal with the International Finance Corporation (IFC) in Beijing on 24 January 2008 to introduce the Equator Principles in China (China Daily, 2008; International Finance Corporation, 2008; Bosshard, 2008a). The SEPA and IFC have conducted joint research on adapting the Equator Principles as well as developing environmental benchmarks for lending in China's financial sector. SEPA ,which is not a political heavyweight in Beijing's power apparatus, believe the use of adequate market tools (integrating the Equator Principles into China) will have an impact on the industrial sector in encouraging business to recognise the environmental costs of their operations and thus focus on reducing the likelihood of environmental problems from the beginning (Bosshard, 2008b, Guo, 2008). SEPA is the only national government department sanctioning companies that don't comply with the Equator Principles. However, none of the measures adopted by SEPA explicitly refer to the environmental track record of Chinese overseas investors.

There have been a number of positive developments in China's banking sector in relation to social responsibility. More banks[5] released CSR reports in 2007which covered various aspects including corporate governance, employee relations and philanthropic activities. Although they did not focus on how the environmental and social issues impact the banking/lending business, these reports are a starting point for Chinese banks to practice non-financial disclosures (Guo, 2008). At the end of 2006, the People Bank of China (PBOC), the central bank of China, collaborated with SEPA to integrate information on corporate pollution records into the database for corporate credit. PBOC then urged all commercial banks in China to conduct a strict screening of environmental issue in their lending process. This increased focused contributed to the Industrial Bank in China being awarded runner up of the Financial Times 2007 Sustainability Banking Awards (Guo, 2008; Financial Times, 2007) which "*recognise* [emphasis

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we were to change places. In this way, we routinely make sense of the other's talk and action and bring off our own "acceptable" activities. (Silverman 1975, p. 277)

[5] For example, China Construction Bank, Shanghai Pudong Development Bank, and China Merchant Bank.

added] banks and other financial institutions that have shown leadership and innovation in integrating social, environmental and corporate governance considerations into their operations" (Financial Times 2008). .

Hongkong and Shangihai Banking Corporation (HSBC)

The HSBC is one of the world's largest banking groups. It was founded in Hong Kong in 1865 when the position of the western powers in China was strengthened by the Treaty of Nanking[6] which opened an immense expansion of trade with the west. HSBC became a local Hong Kong organisation financing trade for the Treaty Ports of China and which was owned by the local mercantile community (Benton, 1983; Chiu, 1973; Tsai, 1993). The same year that the HSBC was founded it began issuing bank notes.

In 2003 when the Equator Principles were first released the HSBC was one of the initial ten financial institution to adopt Principles. Since then the HSBC chaired the Equator Principles working group in 2005 and played a major role in the redrafting of the Equator Principles in 2006 (HSBC, 2006a). The HSBC won the Sustainable Bank of the Year 2006 in the first Financial Times Sustainability Banking Awards and while it would be a improper to conclude that HSBC decided to disclose their environmental performance and management so as to "win a particular reporting award" (Deegan 2002, pp.291) it is important to consider other factors contributing to HSBC's application for [and possibly winning] the Financial Times award. These awards were launched by the Financial Times "in association with the International Finance Corporation, the private sector arm of the World Bank Group" (Financial Times 2006a). The International Finance Corporation is the organisation from which the Equator Principles were based (Equator Principles 2003). Indeed, the commentary by the Financial Times included that one of the reasons for winning the award as "leading adopter of Equator Principles" (Financial Times 2006b). This leads to the question about the legitimacy [real rather than apparent] of the awards. Have these organisations, including HSBC, created and then adopted the Equator Principles and then in conjunction with the Financial Times created a publicly recognised environmental reporting award? The conflict of interest is apparent, HSBC played a major role in re-drafting the Equator Principles and later won an award for being a "leading adopter of Equator Principles" (Financial Times 2006b).

[6] Treaty of Nanking, August 1842, was a Peace Treaty between the Queen of Great Britain and the Emperor of China which ended the first opium war that started due in May 1839. (http://web.jjay.cuny.edu/~jobrien/reference/ob24.html)

Over the period 2003 – 2006 HSBC has produced annually Corporate Responsibility reports which are separate from the Annual Report. These reports have discussed in general terms the organisation's adoption of the Equator Principles but, except for the 2006 report, provided little detailed environmental performance or management information [based on the Equator Principles] (Andrew 2007, 45). Even though HSBC appears to be actively seeking to promote their environmental credentials [legitimation process] they are still unsure whether or not a focus on environmental performance and management is appropriate. For example in HSBC's 2006 Corporate Responsibility Report the first page focuses on the Financial highlights of the group [refer Appendix 3], while further down the page [in much smaller font] HSBC outlines:

> In 2006, HSBC played a major role … in relaunching the Equator Principles (EPs) – global environment and social guidelines for project finance. These new guidelines improve the social standards that apply to financing projects and require greater transparency of reporting on implementation (HSBC, 2006a, p.1).

In 2005, the Head of HSBC Group Sustainable Development, Jon Williams claimed that the Equator Principles are a cornerstone of the bank's approach to how they finance projects and contribute to sustainable development. He also claimed that they have provided 30 per cent more project loans and declined fewer deals due to the bank's training of their staff with the internal and external requirements for compliance of the Principles (HSBC, 2006b). However, the bank did not provide any details on how they achieved an increase of project loans, the nature of these projects, and how they could help improve the social and environment.

In 2006 the HSBC engaged an organisation, Det Norske Veritas[7] (DNV), to review their adherence to the Equator Principles. Jon Williams, Head of HSBC Group Sustainable Development, stated that this third party [implies independence] review completed by DNV could enhance the creditability of their environmental reporting, while maintain confidentiality. However this statement implies the notion of transparency, a key factor in credible reporting, cannot be truly met if confidentiality is a guiding principle of the review. Mr Williams also claimed that this review has been received positively by all types of interested parties including NGOs, other banks, lawyers and accountants. He admitted that financial institutions, such as HSBC, have been under increasing pressure to disclose more information about how the Equator Principles are applied. He also

[7] A Norwegian company which provides, for several industry sectors such as IT, finance, climate change, food, automotive, energy, aerospace, healthcare, services for managing risk and certification.

believed that other financial institutions will follow suit in providing more detailed corporate social responsibility reporting and provide a third party verification (DNV Forum, No.2, 2007 p.16). These comments are consistent with the actions and implied objectives of China's State Environmental Protection Administration.

The company DNV, outlines on their website "[a] sound corporate responsibility approach helps you by improving your management of environmental, social and economic impacts from your business. Corporate responsibility will help you maintain long-term profitability" (http://www.dnv.com/services/assessment/corporate_responsibility/index.asp). DNV claim their verified report can help manage shareholder and stakeholder expectations [verification the organisation is considered legitimate] as well as signal the commitment to national, international, and/or industry standards for corporate responsibility[reduce the need of legislated environmental reporting requirements]. Yet with such grand objectives DNV expressly disclaims any liability or responsibility for any third party decision based upon the assurance statement.

DNV concluded from its work on the assurance engagement they undertook for HSBC [refer to Appendix 2] that HSBC

> … has good processes in place to ensure an adequate adoption of the Equator Principles. These are supported by a range of sector policies and associated guidelines and tools. There is a good level of awareness of the Equator Principles among personnel in the Credit and Risk functions, Project Export Finance and Sustainability Risk Managers. There is evidence of commitment and good collaboration between staff in these areas with regards to the adoption of Equator Principles and sustainability in general." (DNV 2008)

Bank of China Hong Kong (BOCHK)

Bank of China opened its first branch in Hong Kong in 1917, which marked the entry of state-owned Chinese banks into the colony's banking sector. In 2001 BOCHK was established by combining the businesses of ten of the twelve banks in Hong Kong originally belonging to the Bank of China Group (Bank of China (Hong Kong), 2008a). BOCHK which is part of the second largest banking group in Hong Kong, in terms of assets and deposits, began issuing banknotes in Hong Kong in 1994, three years before the transfer of the sovereignty of Hong Kong back to China from the British. While it is legally separate from its parent Bank of China (BOC) it maintains close relations in management and administration, and cooperation in various areas including reselling of BOC's insurance and securities services.

While the BOCHK has not adopted the Equator Principles it does provide some information on its website about its environmental performance. The information provided is significantly different to the information provided by HSBC. BOCHK in 2008 provided the following environmental performance: supported the Green School Award; sponsored the Hong Kong Tree Planting Day 2006; donated refurbished computers and related accessories to the Home-School-Community Computer Donation Campaign; participated in the One Company-One Year-One Environmental Project; and supported the Ocean Park Conservation Foundation and Ecotourism in Long Valley (Bank of China (Hong Kong), 2008b).

So why hasn't BOCHK adopted the Equator Principles? By looking at the market within which the organisation operates and environmental information provided (as outlined above) BOCHK is more focused on its role within its immediate environment and community. BOCHK serves the local Hong Kong community and project funding is provided mainly for projects in Hong Kong and Mainland China. That is, rather than outlining grand objectives it focuses on addressing specific local concerns. The Equator Principles would not be a valuable legitimation tool for BOCHK rather adoption would possibly detract from improving its legitimacy and may indeed place the reputation of the bank at risk. Rather the current environmental performance and management disclosures of the BOCHK, meets the needs of the organisation to remain legitimate in the society it operates.

Discussion and Conclusion

Voluntary environmental performance and management reporting has been used as means for promoting the social agenda of many private sector organisations and partially addressing the growing concern of the public on the impact of the operations of organisations on the environment. In the finance sector there is a set of globally developed principles, Equator Principles, which a growing number of international financial institutions have been adopting. In Hong Kong of the two note issuing banks in this study HSBC and BOCHK only the BOCHK has not adopted the Equator Principles. Deegan suggests that environmental disclosure [adoption] decisions may be driven by the desire to survive [be seen as legitimate] or by management's "view that the community has a right to know about the organisations actions (2007, p. 144). These suggestions are useful to reflect upon when considering HSBC's adoption and BOCHK's non-adoption of the Equator Principles. A review of the evidence outlined earlier in this paper suggests that the Equator Principles are a valuable legitimation tool for the HSBC "the worlds local bank" (HSBC 2008) to maintain its legitimacy within the global financial market. Where as the BOCHK does not operate in the same market, rather it concentrates on a local market, it could be suggested that the adoption of the Equator Principles may not be in the organisation's best interests [legitimacy]. This could be due to the fact that the majority of BOCHK's stakeholders are community members of Hong Kong. If the organisation placed too much focus on the global environment then the stakeholders could form the view their interests are being diluted in favour of minor stakeholder groups. This in turn would reduce the legitimacy the organisation holds to operate as a domestic financial institution.

In Hong Kong there are no mandatory requirements for environmental performance and management reporting disclosures of the operations of private sector organisations, however many private sector organisations, such as HSBC and BOCHK do disclose some information on their environmental performance and management. Most of the information disclosed presents the organisations in a favourable view, there is no mention of any environmental failures in their reports. This level of disclosure could be interpreted as an attempt to avoid the implementation of mandatory environmental disclosure requirements. The HSBC by voluntarily disclosing their environmental performance in relation to project lending by using the Equator Principles is a legitimation tool used to assist in maintaining legitimacy and therefore reducing the likelihood of the government intervening through the introduction of mandatory environmental reporting requirements. This legitimation process contributes to the construction of legitimating symbols within society, and reflect that HSBC could be seen as leaders in environmental reporting so much so that their actions [social construction] ensures that other financial institutions try to conform to their version of "reality". On the other hand, local banks such as BOCHK serve mainly the Chinese society in Hong Kong and their concept of social responsibility is satisfied by the family and community rather than the corporation. This local stakeholder perspective and the focus of BOCHK environmental reporting indicates a different a level of legitimacy which in turn requires different legitimation processes.

Legitimation is an important process which organisations use to gain, maintain or improve their position in society. Depending on the type of business and the objective of the legitimation processes, organisations will construct a social reality based on language, labels, actions and routine (Burrell and Morgan 1979, p. 4; Morgan and Smircich 1980, p.494) which is communicated to society via the appropriate environmental reporting and management processes.

Appendix 1

Principle 1: Review and Categorisation
A Equator Principles Financial Institution (EPFI) will categorise each project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC)

Principle 2: Social and Environmental Assessment
The borrower is to conduct a Social and Environmental Assessment process to address the relevant social and environmental impacts and risks of the proposed project.

Principle 3: Applicable Social and Environmental Standards
The Social and Environmental Assessment process should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

Principle 4: Action Plan and Management System
For projects located in non-OECD countries, or in OECD countries not designated as High-Income, the borrower is to prepare an Action Plan which addresses the relevant findings, and draws on the conclusions of the Assessment.

Principle 5: Consultation and Disclosure
For projects located in non-OECD countries or in OECD countries not designated as High-Income, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner.

Principle 6: Grievance Mechanism
For projects located in non-OECD countries or in OECD countries not designated as High-Income, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system.

Principle 7: Independent Review
For all projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, Action Plan and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

Principle 8: Covenant*s*
An important strength of the Principles is the incorporation of covenants linked to compliance.

Principle 9: Independent Monitoring and Reporting
To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, require the appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.

Principle 10: EPFI Reporting
Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.

Appendix 2

DNV Assurance Statement
Equator Principles

Det Norske Veritas (hereafter 'DNV') has been commissioned by HSBC Holdings plc, (hereafter 'HSBC') to provide independent third party assurance services regarding HSBC's implementation of the Equator Principles (EP).

Our responsibility in performing this work is to the management of HSBC only and in accordance with the agreed terms of reference. DNV expressly disclaims any liability or responsibility for any third party decisions, whether investment or otherwise, based upon this Assurance Statement.

Scope
This is the second year DNV has verified HSBC's implementation and disclosure of EP against the principles of the AA1000 Assurance Standard (AA1000AS) and in accordance with the EP of July 2006.

In accordance with HSBC's request, this assurance engagement was carried out through document review and interviews with relevant personnel across HSBC Group, from HSBC Headquarters in London. It focused not only on HSBC's implementation of the EP, but also on HSBC's active role in promoting and developing the EP framework, in collaboration with other financial intuitions.

Compared with last year, the sample of projects has increased significantly. Out of all projects approved by Group Corporate Sustainability in 2007, DNV selected 4 Category A projects (out of a total of 7) and 1 Category B (out of total of 57). The total value of the sample represents 12.5% of the total loan value reported. In addition, DNV selected 1 Category A project approved in 2006 (for purposes of verifying continuity and monitoring).

Limitations

This assurance engagement was carried out taking into consideration the specific nature, scale and context of each individual project verified. As the life of each project can span over a number of years (from approval to completion of loan payment), this verification was carried out taking into consideration the current stage of each project and the level of control that would be expected from HSBC at that stage. Moreover, it is recognised that each project is often financed by a number of parties. Therefore, this verification also took into consideration HSBC's stake and role in each project, as well as its relationship with other bidding or financing partners in the project.

HSBC requested that this assurance engagement be carried out from the Group Head Office in London. This enabled us to gain a good understanding of policy-making and EP's implementation at Group level. This was supplemented by telephone interviews with HSBC Sustainability Risk Managers in Latin America (Mexico) and Asia Pacific (Hong Kong).

Two of the projects verified by DNV were approved by Group Corporate Sustainability in the last quarter of 2007 which meant that available documentation was limited. As of April 2008, the common terms agreement of one of these projects was still pending, thus most of the documentation was not available. As a result, this verification focused on the nature and implementation of Group Corporate Sustainability's approval / clearance process.

In order to verify the continued implementation of EP at different stages in the life of projects, we also reviewed one Category A project approved in 2006 (which was also subject to review during our 2007 assurance engagement).

Declaration of Independence
DNV did not provide any services to HSBC during 2007 that could conflict with the independence of our assurance work. DNV was not involved in the preparation of any information contained in the Sustainability Report.

DNV's Approach
This assurance engagement was carried out as part of the verification of HSBC's Sustainability Report 2007. It accounted for approximately 1/3 of all time spent on the verification of the Report and involved both face-to-face and telephone interviews as well as document review.

For this element of the work, the July 2006 EP, as described by the EP Secretariat was used as a basis. The overall assurance engagement was carried out in accordance with the guidelines contained in the DNV Protocol for Verification of Sustainability Reports, which is based both on the GRI G3 and the AA1000AS.

The assurance engagement was conducted between March and May 2008, by suitably qualified professionals, and comprised the following:

1. Interviewed a selection of HSBC representatives, including Group Corporate Sustainability representatives; directors of Credit and Risk, and Project and Export Finance (PEF); and Sustainability Risk Managers (SRMs) located in Mexico and Hong Kong;
2. Selected a sample of projects that would give a fair representation of HSBC's potential impacts and activities, hence the focus on Category A projects. All projects selected were proposed or are being carried out in either non-OECD countries or an OECD country not classified as 'High Income'. The majority of the projects selected are within the Oil

and Gas or Power sector, which represented 45% of HSBC EP loans in 2007. Where applicable, DNV also evaluated whether the relevant HSBC sustainability sector policy had been followed..

3. DNV had full access to all relevant project financing documentation available at HSBC Headquarters, including: technical due diligence reports by independent third parties; common terms agreement documentation; common facility agreements; internal correspondence between Group Corporate Sustainability and local PEF and SRM teams; environmental and social impact assessments; environmental action plans; and reports by independent third parties.

Conclusions

In DNV's opinion, HSBC has good processes in place to ensure an adequate adoption of the EP principles. These are supported by a range of sector policies and associated guidelines and tools. There is a good level of awareness of the EP principles among personnel in the Credit and Risk functions, Project Export Finance and Sustainability Risk Managers. There is evidence of commitment and good collaboration between staff in these areas with regards to the adoption of EP and sustainability in general.

Regarding the way in which EP related information is documented in the Sustainability Report, and taking into consideration the AA1000AS principles, the following comments are made:

- Materiality – In view of confidentiality limitations on the disclosure of project financing deals, we consider that the information contained in HSBC's Sustainability Report 2007 addresses the information requirements of its Stakeholders. We commend HSBC's decision to provide further disclosure of loans by sector in the 2007 Report.
- Completeness – In our opinion, the Report's section on EP provides a fair and balanced representation of HSBC's performance during 2007.
- Responsiveness – We can confirm that HSBC has undertaken a comprehensive stakeholder engagement exercise in 2007. A key finding of that exercise was that Stakeholders needed further information on EP. As a result, HSBC not only increased the level of detail and transparency in the EP section of the 2007 Report, but asked DNV to expand the scope of assurance engagement to include additional projects.

Commendations

We would like to commend HSBC for the following:

- Documentation of EP requirements in Function Instruction Manual (FIM), accessible to all relevant employees;
- Commenced planned implementation of an automated internal reporting mechanism (as recommended by DNV in last year's assurance statement);
- HSBC's active role in promoting the EP among other financial institutions and contribution to the development of the EP management structure and governance rules;
- Local PEFs' general awareness of EP evidenced by email correspondence;
- Provision of support by Group Corporate Sustainability to local offices;
- Level of awareness, competence and commitment of Group Corporate Sustainability team;
- Use of independent experts where applicable, to challenge the Group's thinking on sustainability, guide continual improvement and provide assurance to Stakeholders;
- Enhancement of monitoring requirements, e.g. Group Corporate Sustainability must be informed if projects become non-compliant with EP; should clearance be provided on a conditional basis, local group office needs to send confirmation to Group Corporate Sustainability that conditions have been in fact met.

Recommendations for improvement

- Rapid growth and significant staff increases in certain regions (Asia Pacific in particular) pose a challenge to ensuring that new employees are aware, competent and committed to adopting HSBC's processes and practices regarding EP and sustainability in general. Local regions, supported by Group Corporate Sustainability, should ensure that sustainability-related induction processes, training, and support are provided to new employees, as appropriate.
- Continue raising awareness of approval processes within local offices, in particular regarding the need for timely approval of certain projects by Group Corporate Sustainability, as stated in the Functional Instruction Manual.
- Raise awareness and deliver training to local credit teams and relationship managers on post-approval monitoring and control activities, relevant to the role of HSBC in given projects.

Antonio Ribeiro

Esther Garcia	David Salmon	Antonio Ribeiro
Head of CR Services (UK)	Country Manager (UK)	Verifier

DNV Ltd.
May 2008

Appendix 3

2006 in Review

Financial highlights

Profit before tax
US$22,086m
for 2006

Profit before tax
5.3%
increase on 2005

Assets
US$1,861b
at 31 December 2006

Dividends per share
US$0.81
in respect of 2006

Market capitalisation
US$212b
at 31 December 2006

Capital strength
13.5%
total capital ratio at 31 December 2006

Achievements

'Sustainable bank of the year'

HSBC was named overall winner in the first *Financial Times* Sustainable Banking Awards, in recognition of our leadership in merging social, environmental and business objectives.

Energy Sector Policy and Carbon Finance Strategy

We issued our fourth sector guideline, the *Energy Sector Policy*, which provides guidance for our employees on the environmental and social standards recognised as good practice within the energy industry. We also launched our Carbon Finance Strategy, which advises clients on the implications of climate change, and helps them to understand the challenges and opportunities of creating a lower carbon economy.

Future First

The HSBC Global Education Trust launched 'Future First', a five-year, US$10 million programme to help street children, children in care and orphans around the world. The programme supports education, livelihood training and rehabilitation projects, enabling these children to enter the mainstream of society.

Improving standards in the finance sector

In 2006, HSBC played a major role with the leading financial services companies and the International Finance Corporation in relaunching the Equator Principles (EPs) – global environmental and social guidelines for project finance. These new guidelines improve the social standards that apply to financing projects and require greater transparency of reporting on implementation. The EPs have been re-adopted by 52 financial institutions representing over US$50 billion or 80 per cent of global project financing (see page 18 for more information about our implementation of the principles).

Challenges

Carbon dioxide emissions

As part of our commitment to carbon neutrality, it is important that we reduce our total carbon dioxide (CO_2) emissions over time. During 2006, our CO_2 emissions per person, our key CO_2 measure, increased due to a change in the type of energy we were able to purchase and an increase in air travel. We have programmes in place to reverse this trend. For a growing business, it is a challenge to reduce emissions consistently. See 'Preventing climate change' on page 24 for more information about HSBC's commitment to carbon neutrality and how we are addressing our increased CO_2 emissions.

Measuring CR progress

We have been reporting for some years on the environmental impacts of our operations and the diversity of our workforce. However, there are other aspects of our business that may also have significant social and environmental dimensions, for which we have no global metrics. We recognise we need to develop these measures and report on them in future.

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