SUSTAINABLE FINANCING POLICY FRAMEWORK

1.0 Introduction

1.1 Sustainable Finance

Sustainable finance is a process of taking environmental, social and governance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects. Environmental considerations might include climate change mitigation and adaptation, as well as the environment more broadly, for instance the preservation of biodiversity, pollution prevention and the circular economy. Social considerations could refer to issues of inequality, inclusiveness, labour relations, investment in human capital and communities, as well as human rights issues. The governance of public and private institutions including management structures, employee relations and executive remuneration plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.

1.2 National Context

Sri Lanka is facing increasing environmental and climate challenges. Frequent natural disasters, deforestation and forest degradation, degradation of coastal and marine ecosystems, climate change and extreme weather, air and water pollution and loss of biodiversity hinder its sustainable economic growth. Sri Lanka may face a 1.2 percent loss of annual GDP by 2050 if measures are not taken to address climate change. Sri Lanka is also one of the biodiversity hot-spots in the world and it is estimated that additional investment of Sri Lankan Rupees 30 billion within next five years is needed to achieve national biodiversity targets and to avoid future expenses related to biodiversity restoration and management. Sri Lanka is the first country to appoint a Parliamentary Select Committee on Sustainable Development. It established the Sustainable Development Council to ensure that the country's growth is sustainable. The Sustainable Development Act No. 19 of 2017 enacted by the Parliament provides the legal framework and the national policy for implementing the SDGs. Additionally, the Sustainable Sri

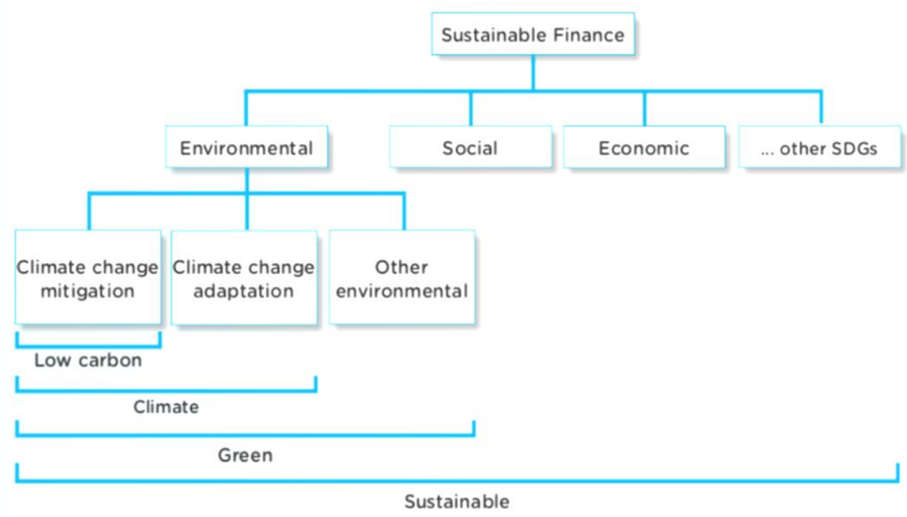
Lanka Vision and Strategic Path 2030 identifies the need of a balanced, inclusive and green growth path to facilitate a transition from "Conventional Sri Lanka 2018" to "Sustainable Sri Lanka 2030".

2.0 Environmental, Social & Governance (ESG) Framework

An ESG framework is a systematic approach for identifying, assessing and integrating the economic, environmental and social impacts of a business on society as well as the environment. In addition to stating a financial institution's commitment to environmental and social management, the ESG explains its procedures for identifying, assessing and managing environmental and social risk of financial transactions, defines the decision-making process, describes the roles, responsibilities and capacity needs of staff for doing so and states the documentation and record keeping requirements. It also guides the institution on screening and categorizing of transactions based on their environmental and social risk, conducting environmental and social due diligence and monitoring the client's/investor's environmental and social performance. It ensures that the Financial Institution's activities are in compliance with its environmental and social standards.

Sustainable Development is essentially an integration between economic development and environmental and social protection and the issue of whether companies should consider about the impacts of their activities on the society or environment is no longer open for discussion. MBSL recognizes that its operations can have direct and indirect undesirable impacts on the environment and the community in which it operates. In line with many leading companies MBSL has realized the critical importance of managing and controlling corporate social, environmental and economic performance. The company is determined to responsibly manage the environmental and social risks associated with its operations in order to minimize the negative impacts on the environment and its stakeholders and it is committed to conduct its business in an environmentally friendly and socially responsible manner.

Elements of Sustainable Finance



2.1 Key Objectives

- To enhance the understanding of Environmental, Social & Governance risks (ESG) associated with its transactions.
- To promote improved environmental and social risk management of client companies
- Adherence to Local & International Risk Management Practices when financing private sector activities and thereby to significantly reduce the institution's environmental, social & governance risks.
- To implement the Roadmap, following the timelines given in the action plan.

2.2 ESG strategies & standards

The Social Sustainability Strategy of MBSL clearly states that it is our ultimate goal to be able to derive and sustain economic, social and environmental value, long into the future. It is also stated that MBSL has begun gauging the consequences of its actions and taking responsibility for how its business decisions are affecting shareholders, customers, employees, society and the environment.

In essence sustainable banking ensures that the commercial activities of a bank does not benefit only its owners and employees but also its customers and wider economy, while at the same time mitigating any adverse effects on the natural environment and society.

As in Sustainable Development in Sustainable Financing, there are 3 dimensions; environmental, social and economic. This is sometimes referred to as “the triple bottom line” approach which ensures that banks focus on an integrated approach, an integration between economic development along with environmental protection and social stability.

MBSL recognizes that:

- The company’s credit policies guarantee that approval for loans depends on whether the project/activity is in compliance with the environmental and social standards set by the Central Environmental Authority (CEA) of Sri Lanka.
- The company makes a significant investment towards environmental protection, reforestation and bio-diversity conservation.
- The company gives priority to finance renewable and clean technology projects.

2.4.1 Environmental and Social Strategies

The company strives to ensure that all activities and projects will be in compliance with the environmental and social standards stated in the Applicable local, provincial and national laws on environment, health, safety and social issues.

The Bank’s commitment to its goal and efforts to manage environmental and social risk across its operations is demonstrated in the Environmental and Social (E&S) Strategies adopted by the Bank.

Key Points in the Environmental and Social Strategies of the Bank:

- All activities undertaken by the company are consistent with its environmental and social standards and the requirements applicable in Sri Lanka
- All projects for which lending is considered are reviewed against the applicable requirements and projects are financed only when they are expected to be designed, built, operated and maintained in a manner consistent with the applicable requirements

- Efforts are made to ensure that all projects financed by the Bank are operated in compliance with the applicable requirements on an ongoing basis.
- Clients of the Bank understand strategies made by the Bank in this area.

2.5 ESG Training & Development

- The Human Resource Management division of MBSL shall incorporate ESG training requirements into the annual training plan in order to achieve sustainable financing goals & objectives.
- The company shall identify suitable personnel internally & develop internal expertise to implement sustainable finance goals.
- The company shall hire sustainable finance professionals as appropriate in order to implement the sustainable financing plans/road map.

3.0 Sustainable Financing Product Development

- MBSL shall develop sustainable financing products in order to implement the roadmap, following the timelines given in its action plan, or as amended.
- MBSL marketing & product development department shall develop sustainable loan/saving products in line with the board & CMC directions which shall be incorporated in the strategic plan such as,
  - Loan/saving products for energy efficiency, green building, green urban infrastructure, water saving and efficiency, and climate-smart agriculture through project loans, corporate loans, green mortgage loans, etc.
  - Sustainable saving products to mobilize small savings for sustainable activities and at the same time raise the public’s awareness on sustainable finance.
- MBSL marketing & product development department shall include the sustainable Financing product development in their annual plan in order to implement the sustainable financing plans/road map

4.0 Financial Inclusion with Digital Tools

Sri Lanka has identified financial inclusion as one of the priorities to achieve sustainable economic development. The country has made considerable progress in financial inclusion as there is a high level of physical access to financial institutions with more branches opening up in rural areas. However, there remain challenges in increasing the financial literacy and financial awareness to enable clients to use financial services effectively and in improving payments and settlement systems. Limited or no access to the formal financial sector is still faced by micro, small and medium enterprises (MSMEs), low-income households, youth and women. This pillar can be combined with Sri Lanka's National Financial Inclusion Strategy, which is under development and aims to further enhance financial inclusion.

MBSL shall develop more accessible, affordable and efficient financial products and services tailored for individuals and communities that traditionally have had limited or no access to financial services. Explore the application of fintech and digital tools. Accordingly MBSL shall introduce internet banking & mobile banking tools for this purpose. Also MBSL shall improve access to essential financial products and services through various strategies. The Board of Directors shall define the overall financial inclusion strategy of MBSL in order to achieve sustainable financing objectives.

5.0 ESG Procedures

MBSL will categorize financial facilities based on the nature of the product and the level of ESG risk. This classification will help determine the appropriate procedures to be followed. Financial facilities granted under green products considered as low ESG risk facilities and will undergo the standard evaluation and approval process of the company.

5.1 Evaluation & Approval Process

The loan assessment process within the ESG framework will encompass the following key aspects

- Transaction Screening
- ESG Due Diligence
- ESG Risk Management
- Environmental and Social Risk Mitigation
- Dealing with loans under different risk categories

5.1.1 Transaction Screening

When the customer expresses an interest in obtaining a loan for a particular activity, the credit officer will go through the ESG guidelines in order to identify the ESG risk.

5.1.2 Identified Priority Sectors for Sustainable Finance Activities in line with the CBSL guidelines,

Identified Sectors	Prioritized Sub Sectors
Agriculture, forestry and logging	Sustainable agriculture, forestry development
Manufacturing	Energy saving machinery/ equipment
Electric power generation, transmission and distribution	Renewable energy projects
Transportation and storage	All forms of sustainable transport and storage
Water supply, sewerage and waste management	Water supply/management projects, Waste management projects
Construction	Green construction projects
Sustainable Tourism and recreation	All sustainable tourism and recreational activities
Other Sectors	Gas, steam and air conditioning supply, Financial Services, Information and communications technology, Sustainable Women Empowerment initiatives etc.

5.1.2 ESG Due Diligence

An ESG process reviews any potential environmental and social risks associated with the projects/ activities for which a loan application is received and ensures that the transaction does not carry an environmental and social risk that would pose a potential liability/ risk to the company.

Financial facilities are required to carry out due diligence in compliance with the regulations set forth by the National Environmental Act (NEA). The NEA outlines the necessary criteria for conducting an Environmental Impact Assessment (EIA) and obtaining an Environmental Protection License (EPL).

5.1.3 ESG Risk Management

The company's lending process primarily evaluates credit risks and implements a credit risk rating system. However, with the implementation of the new ESMS procedure, Credit Officers will classify loan projects based on their potential Environmental & Social risks. This classification will be done by reviewing the industry sector and technical aspects of the project, as well as conducting inspections. The risk categorization for ESG is conducted based on the prescribed activities (Extraordinary Gazette No.2264/18 -27 Jan 2022) for which a license is required which was issued under the national environment act no.47 of 1980.The projects will be categorized as **A for High risk**, **B & C for Medium risk**, and **D for Low risk**.

5.1.4 Environmental and Social Risk Mitigation

Risk categorization is an integral part of the ESG process. Loans requested by clients are subject to a process of Risk Categorization of their (potential) Environmental and Social impacts.

Low Risk: Projects with minimal or no adverse social or environmental impacts. Environmental and social impacts are expected to be negligible. Since impacts are minimal to null, there are no specific requirements regarding ESG Risk Mitigation for Low risk Category

Medium Risk : Projects with potential limited adverse social or environmental impacts that are few in number, site-specific, largely reversible environmental and social impacts which can be readily identified and standard preventative and/ or remedial measures can be prescribed and readily addressed through mitigation measures.

High Risk: Projects with potential significant adverse environmental and / or social impacts which are sensitive, diverse, irreversible and/ or unprecedented. There may be highly significant, negative and/ or long-term environmental and social impacts, the magnitude of which is difficult to determine at the application stage. An impact is considered a sensitive impact if it is irreversible, affect vulnerable groups, indigenous communities, involve involuntary displacement and resettlement s, or affect significant heritage sites.

5.1.5 Dealing with loans under different risk categories

The following procedure would be used for different categories of projects/ activities.

For High Risk proposals, the procedure requires a review and assessment of environmental and social risks and impacts through a detailed ESG due diligence process.

5.1.6 Final Approval

The usual process of consultations and negotiations would take place with the Applicant for loan approval. This process is more complex for High Risk Category projects. After the due diligence a detailed ESG comment-made by the "Sustainability Officer/Credit Officer" would be tabled to the approval authority based on the due diligence reports. Then, required clauses/ action plan (Complying with the Local/International guidelines & standard) would be incorporated into the contract. All approval of High Risk facilities will be accompanied by an independent assessment by the Risk Management Department.

5.2 Monitoring ESG Risk

Requirements for monitoring also differ by the category of the project/ Activity. For High Risk Category projects on the other hand close monitoring would be conducted for monitoring of ESG issues. Hence, for High Risk Category projects/ activities, Environmental and Social Performance including status of implementation of the migratory Measures will be evaluated on an annual basis. The Benchmark for Performance will be the on-going compliance against the Applicable Requirements. The

Sustainability Officer/Credit Officer has to monitor the Environmental and Social Performance of High Risk projects annually and visits the site occasionally, if necessary. The results of this monitoring should be fed back to the overall reporting system.

6.0 Disclosures & Reporting

Tools and mechanism to tag sustainable assets could help track the total public and private sustainable finance flows in the country, monitor and evaluate effectiveness of measures that have been introduced, and identify areas for market and regulatory improvement.

Accordingly the required modification in the system will be introduced to tag the sustainable financing sectors & ESG risk category of projects/loans. MBSL shall disclose environmental and social impacts generated from business activities using international recognized reporting frame work and regulatory requirements.

07. Review of Sustainable Financing Policy Framework

The Board of Directors shall review the sustainable financing policy frame work periodically and when required due to the changes in the existing regulations, standards, and best practices as appropriate.