SOCIAL AND ENVIRONMENTAL POLICY AND RISK MANAGEMENT

PROCEDURES OF PAN ASIA BANKING CORPORATION PLC

(SEMS POLICY)

(For regulatory disclosure purpose to be published in the bank website)

1. Pan Asia Bank Environment and Social Policy

1.1 Introduction

Pan Asia Bank believes that working to promote sustainability is good business practice. We recognize that our operation has direct and indirect environmental and social impacts and by managing these impacts we can better manage the costs of doing business and the risks to our portfolio. This Policy outlines how the Bank will address the environmental and social impacts of its investments.

1.2 Regulatory Directions

In terms of Section 46(1) of the Banking Act, in order to ensure the soundness of the banking system, the Monetary Board of CBSL has issued the Directions on Sustainable Finance activities in licensed banks on 22nd June 2022 to be in line with Sustainable Finance Road Map of CBSL which provides a broader direction to financial institutions in order to manage environmental, social and governance (ESG) risks effectively and to promote assistance to businesses that are greener, climate-friendly, and socially inclusive. Further CBSL through its publication on 06th May 2022 established a classification and measurement system for sustainable activities, which is a taxonomy for Green Finance activities in Sri Lanka, Considering the national importance of promoting sustainable financing initiatives and the need for providing a governance and risk management framework for licensed banks in respect of sustainable finance activities.

Corporate Governance

This policy will discuss in brief how the controls are imposed to mitigate same and duties and responsibilities of each unit with monitoring authority of same. This policy is in compliance with the requirement set in the Banking Act Direction No 07 of 2011 and Section 9 of the CSE Circular No:04/2023 dated 11th September 2023 on listing rules on Corporate Governance.

Environmental Objectives and Guiding Principles for Developing the Sri Lanka Green Finance Taxonomy

Environmental Objectives	1. Climate change mitigation 2. Climate change adaptation 3. Pollution prevention and control 4. Ecological conservation and resource efficiency
Guiding Principles	1. Substantial contribution 2. Do no significant harm (DNSH) 3. Respect Sri Lanka's green development priorities 4. Science-based screening 5. Compatible with international standards and practices 6. Dynamic adjustment

The following sectors/ activities have been identified as priority sectors to provide sustainable lending facilities by licensed banks.

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.…

1.3 Commitments

PABC commits and mobilizes billions of rupees of capital into a variety of companies and projects, including SMEs and corporate loans. We recognize that some of our clients undertake activities that may be associated with environmental and social impacts and risks. Pan Asia Bank is committed to incorporating environmental and social considerations into credit and risk analysis, and we expect all our borrowers to comply with all legal and regulatory requirements, including all relevant environmental and social laws of Sri Lanka. In addition, we will not finance activities on our Exclusion List, a list of activities that we consider having unacceptable environment and social risks.

Pan Asia Bank has institutionalized the following commitments for all new facilities:

- All our clients are reviewed against our Exclusion List and loan applications from clients whose activities are on our Exclusion List will be rejected.
- We will assess the extent of any potentially significant environmental and social impacts, and only provide financing for projects if they are expected to be designed, built, operated, and maintained in a manner consistent with our Environment and Social Policy and the laws and regulations of Sri Lanka.
- We will monitor all transactions and work with our clients to help them continue to comply with our Environment and Social Policy.
- We will communicate our policy commitments to our clients and stakeholders on our website.

1.4 Environment and Social Risk Management Policy

The Environment and Social (E&S) Risk Management Policy is based on the commitment to incorporate environmental considerations into credit and risk analysis. The environmental and social risk management procedures have the objective of ensuring that the Bank effectively assesses and manages environmental and social risk associated with our client transactions. There are two benchmarks against which transactions are measured:

- The laws and regulations of Sri Lanka; and
- The Exclusion List

Pan Asia Bank's Environment and Social Risk Management (ESRM) policy covers all activities of the Bank. The ESRM policy applies throughout the loan cycle, from loan application through the decision process and monitoring of the transaction.

Retail banking usually has minimal E&S risks. As such, Pan Asia Bank will ensure that all retail banking facilities are designed to avoid lending to activities on the Exclusion List. However, a more rigorous procedure is applied to SME and Corporate Banking, where activities may have a greater environmental and/or social impact.
The ESRM policy is governed by the Credit Risk Department. Branch Managers and Area Managers are responsible for implementing the procedures. The E&S Officer is the manager in charge of Credit Risk and the E&S Coordinator is an appointed officer in the grade of Executive and above.

1.5 Public Awareness and Communications

It is Pan Asia Bank's policy to be transparent with its Environment and Social Policy. As such we will make this policy available on the company website and will report annually in our Annual Report on compliance with our Policy.

2.0 Environment and Social Risk Management Procedures

2.1 Scope of Application

The E&S risks associated with transactions depend on the type of activity to be financed and the size and location of the transaction. Typically, Retail loans are considered to have minimal E&S risk, while SME loans may be low or medium risk, and some corporate loans may have more complex risks, depending on their sector and location. For SME and Corporate loans, in addition to ensuring that activities to be financed are not on the Exclusion List, it is essential to confirm the beneficiary's compliance with relevant E&S laws and regulations. Pan Asia Bank's approach to risk management is commensurate with the level of risk of a particular loan.

SEMS risk management process is applied for the facilities where the cumulative/group exposure is decided by the Bank (net of cash with exception to schematized facilities, temporary facilities). In the case of restructuring / rescheduling application is on a case-by-case basis depending on bank's ability to access information that the bank required.

The degree to which it being applied depends on the level of the E&S risk rating associated with the credit facility. The application is integrated into the loan sanction process undertaken by the respective approving authorities in the credit chain.

The salient points of the process are as below:

1. As soon as the borrower approaches the bank for a credit facility, the exclusion list is applied to all Retail, SME, and corporate loans. The exclusion list should be applied to the purpose of the facility proposed.

2. SEMS risk management process is applied if the bank's cumulative/group exposure exceeds the limit decided by the Bank. The emphasis is given to web-search, E & S questionnaire, visit reports, regulatory requirements (licenses) and reports from external consultants depending on the risk rating.

3. Retail loans are screened only against the exclusion list and could proceed if they do not breach the same.

4. Cash backed, leasing, pawning, credit cards, all personal loans including Sammana, Margin Trading facilities and all temporary facilities to be excluded from the SEMS process considering the inherent competitiveness of the product, purpose, and degree of impact to the society and the environment.

5. Branch Manager/Credit Officer/Relationship Manager should build the relationship with the client and better understand the intended purpose of the loan. The SMES risk rating process should be applied when the classification is done as per the SEMS policy.

6. After risk rating is completed the branch manager / credit officer selects the E&S questionnaire that appropriated for the risk level of the loan and,

b) Before meeting the client undertakes a desk study to establish which licenses are required by the company as per the SEMS policy of the bank and check publicly available information about the borrower.

c) For medium risk transactions – Branch Manager/ Relationship Manager should meet the client, using the E&S questionnaire in appendix 5 of the SEMS and verify E&S compliance requirements by collecting documents relating to the questions. The questionnaire should be submitted along with the E & S section of the credit report when the papers are presented for the approval.

d) For high-risk transactions – to verify all regulatory compliances and questions in the E&S questionnaire in appendix 6 of the SEMS policy, Branch Manager/Relationship Manager should undertake a visit around the company's relevant premises to confirm. The questionnaire should be submitted along with the visit report and E & S section of the credit report when the papers are presented for approval.

e) If the company is not fully compliant with the regulatory requirements (i.e. does not have all its Licenses) discuss with the client what would be required to bring the company into compliance and how long that would take. Respective Branch Managers/Relationship Managers should incorporate the required covenants accordingly.

7. Define any non-compliance, constraints to compliance and corrective actions in covenants in the Credit Paper.

a) Risk overview of the E & S risks should be incorporated by the credit risk department for onward submission to the Board Credit Committee.

b) All supportive documents/ evidence collected along with the E&S questionnaire should be referred to Credit Risk Management unit for their assessment and scrutinization prior to disbursement of the credit facility by the Credit Administration Unit. In case of a situation where client is reluctant to provide such required information in physical form, Branch Manager / Relationship Manager should peruse original documents during client visits and confirm the compliance of E&S requirements in writing by clearly stating the observations in the questionnaire.

c) Any follow-up action should be addressed by the LRM process conducted by the Credit Risk Department. Branch Managers/ Relationship Managers should ensure follow up action in the case of the renewal.

2.2. SEMS Risk Evaluation and Approval Process

Specific guidelines were issued by the bank to the credit officers at branches, SEMS officers in Credit Risk Department and approving authorities in the business \over the SEMS risk evaluation and approval process of a credit facility.

2.3 ESRM Procedures for Retail Loan Applications

2.3.1 Exclusion List

A retail loan is a facility provided to an individual or joint customer for personal use.

The first step is to screen the borrower's activities against the Exclusion. If the potential beneficiary is involved in any activity on the Exclusion List, reject the application.

Retail loans are not required to have any further E&S assessment.

2.3.2 Credit Paper: Decision and Risk Control

You are required to confirm in the E&S section of the credit paper that the loan is not on the exclusion list.

2.4 ESRM Procedures for SME and Corporate Loan Applications

2.4.1 Exclusion List

The first step is to screen the borrower's activities against the Exclusion List. If the potential beneficiary is involved in any activity on the Exclusion List, reject the application.

2.4.2 Risk Rating

As the Bank's approach to E&S risk management is commensurate with E&S risk, it is important to determine the E&S risk rating of all loans. The process for assigning a risk rating is different for SME and Corporate loans.

2.4.2.1 SME Loans

A SME is a company, partnership or sole proprietorship with an annual turnover is less than Rs.1.0 billion as per the latest audited financial statements and/ or the facility exposure is stipulated by the bank. Also, facilities granted to all individuals and joint customers for business purposes with the above criteria are also treated as SME facilities. Credit Facility will be categorized as medium risk considering the number of employees and/or requirement of an Environmental Protection License (EPL) and/or Scheduled Waste License (SWL). Otherwise, it is a low-risk loan.

2.4.2.2 Corporate Loans

A corporate loan is a facility to a company, partnership, or sole proprietorship where the Annual turnover is more than LKR 1.0 billion as per the latest audited financial statements and/ or the facility exposure is as stated by the bank. If the business sector code of the loan is either Agriculture; Industry' Tourism and Leisure; Construction and Property Development; Other Services; or Infrastructure, it may be considered a high-risk loan. E&S Officer to confirm the risk level of the facility. All other sectors are considered medium risk loans.

Guidelines were issued by the bank to identify high risk activities and to conduct risk rating procedures for corporate loans.

2.4.3 Risk Assessment Procedure

While the main requirement is to ensure that the client's activities are compliant with regulatory requirements, the procedure for verifying compliance will depend on the level of risk.

2.4.3.1 Low Risk Transactions

For low-risk activities, a simple confirmation from the client that they have all their required permits and licenses and are compliance with all regulatory requirements, will suffice. If you have any concerns, undertake a web search for any adverse reports including reports of any non-compliances or complaints.

2.4.3.2 Medium Risk Transactions

For medium risk transactions, it will be necessary to verify that the company has all the regulatory requirements, licenses and permits relating to the relevant risk areas. There are two steps to the assessment:

- Search online media for the beneficiary's history of fines or legal action taken against it. Check publicly available databases for any criminal or civil action in recent years and for any liabilities (current or potential) that may affect the beneficiary's business in the future.
- Meet the management and use the E&S Questionnaire to verify compliance and define any covenants for the Offer Letter.

2.4.3.3 High Risk Transactions

For high-risk transactions, you also need to verify that the company has all the regulatory requirements, licenses and permits relating to the relevant risk areas. There are three steps to the assessment:

- Search online media for the beneficiary's history of fines or legal action taken against it. Check publicly available databases for any criminal or civil action in recent years and for any liabilities (current or potential that may affect the beneficiary's business in the future.
- Meet the management and use the E&S Questionnaire to verify compliance and define any covenants for the Offer Letter.
- For high-risk transactions, it is mandatory to conduct an operational site visit to further evaluate the E&S risks identified during the management discussions and investigate how the beneficiary's E&S management systems are applied in practice. You may consider asking the E&S Coordinator to undertake the site visit with you. Look for evidence of poor environmental management or poor working conditions.

Assess any E&S risks identified and decide whether to recommend approving or rejecting the loan application from an E&S perspective:

- Reject the loan if significant E&S risks have been found and the beneficiary is unable or unwilling to mitigate the risks.

- Consider approving the application from an E&S risk perspective if E&S risks are acceptable and/or the beneficiary agrees to E&S Risk Control Covenants. Consider the cost of any E&S Risk Control Covenants when determining the loan amount. Would it be beneficial to support the beneficiary with additional finance to improve E&S performance?

2.4.4 Credit Paper: Decision and Risk Control

2.4.4.1 Low Risk Transactions

Decision: For low-risk transactions, prepare the submission for the Credit Report to confirm the following:

•The company's activities are not on the Exclusion List.

•E&S risk level of the transaction; and

•If standard warranties can be applied, referring to compliance with the laws or Sri Lanka.

Risk control: Include regulatory compliance in the warranties.

2.4.4.2 Medium and High-Risk Transactions

Decision: For medium and high-risk transactions, prepare a submission for the Credit Report to outline the following:

•Confirm the company's activities are not on the Exclusion List.

•E&S risk level of the transaction.

•Summary of any regulatory non-compliances.

•Specific E&S risks of this transaction; and

•Corrective actions required.

Risk control: Where any corrective actions are required, agree with the client a program for bringing the operation into regulatory compliance and include it in the Offer Letter. Obtain written representation from the beneficiary of its full compliance with the laws and regulations in the Offer Letter and require the beneficiary to inform the Bank of any regulatory breaches. Include regulatory compliance in the warranties and covenants.

2.4.5 Loan Review: E&S Risk Monitoring

It is Pan Asia Bank policy to undertake loan reviews (known as the Loan Review Mechanism), either prior to staged disbursements or annually. The E&S risk monitoring will be undertaken during these loan reviews.

Review three areas:

•The beneficiary's continued compliance with regulatory requirements, including updating and renewal of licenses and permits.

•The beneficiary's progress in implementing agreed E&S Risk Control Covenants.

- Events of Change that could present new or increased E&S risks. Events of Change are defined as changes in the beneficiary's business activities; regulatory investigations and fines or penalties imposed on the beneficiary; public complaints or adverse media reports; accidents of incidents causing significant damage to the environment or human health and safety; amendments to relevant E&S laws and regulations; new developments or changes in land/property use on adjacent land.

If the beneficiary is not implementing the agreed E&S Risk Control Covenants or new E&S risks become apparent:

- Engage in discussions with the beneficiary to address areas of non-compliance and agree new control measures.
- Where the beneficiary needs additional resources to become compliant with the E&S conditions in the Offer Letter, consider providing further credit to improve E&S performance.
- Where engagement has failed, consider terminating the loan.

2.5 Roles and Responsibilities

The following roles and responsibilities apply:

- **Board Integrated Risk Management Committee:** compliance checking of LRM Progress Report.

- **The Director / Chief Executive Officer and relevant Key Management Personnel:** Ensure adequate resources, skills and expertise are allocated to the management of sustainable finance activities, clear articulation of the roles and responsibilities of business units and functions in managing risks associated with sustainable finance; and the Board of Directors are informed in a timely manner on material issues, relating to sustainable financing and business practices.

- **Chief Risk Officer:** Ensure policies, tools, metrics, operational procedures, and controls implemented by the bank in respect of sustainable finance are reviewed and updated regularly (at least annually) and integrated with other relevant policies and procedures of the Bank and compliance checking of Credit Papers regarding Social and Environmental Risk management and Inform the Board of Directors in a timely manner on material issues.

- **Sustainable Development Financing Unit:** This unit is coming under the purview of the Business Head who is in charge of Sustainable Financing Operations and shall develop innovative financial solutions to support sustainable initiatives and to develop and provide sustainable lending facilities to priority sectors ensuring the compliance with the requirements of the Sri Lanka Green Finance Taxonomy when identifying the priority sectors and activities. The Sustainable Development Financing Unit should measure the progress of sustainable finance initiatives at regular intervals and comply with the reporting requirements by the Bank Supervision Department and other stake holders. Further, should ensure capacity building on Sustainable Finance activities and provide adequate training for staff members.

- **Treasury Department:** shall consider raising funds via instruments such as green/sustainable bonds and allocate such funding to invest / fund in sustainable activities.

- **E&S Officer/Coordinator:** Support to the implementation of the E&S Risk Management Procedures. All the documentation related to SEMS Rating should be checked and confirmed to CAU with Risk recommendation/ Commentary. Further, should ensure capacity building for Social and Environmental Risk Management activities and provide adequate training to staff members.

- **Area Manager:** Verification of the information in the Credit Report and LRM Progress Review.

- **Branch Manager:** Review of the borrower's activities against Exclusion List complete mandatory E&S questionnaire; complete input to Credit Paper; complete input to LRM Progress Review

- **Credit Administration Unit**: Lodgment of security documents. Carry out compliance check as per the recommendation given by the risk department, prior to disbursement.

3. Reporting

3.1 General

Pan Asia Bank is committed to reporting on its environmental and social compliance to its stakeholders. To this end, it will confirm compliance with the Pan Asia Bank Environment and Social Policy in its Annual Report and to its international investors.

Also, the Bank has specific annual E&S reporting requirements for investors regarding its environment and social performance. Reports should be submitted no later than the end of each financial year.

3.2 Annual report Disclosures.

- Sustainable Development Financing Unit: An overview of bank's sustainable finance policies and activities and a statement on banks approach towards sustainable finance activities and way forward.

- Credit Risk: Identified sustainable finance related risks and associated mitigation measures.

3.3 Central Bank Returns

Sustainable Development Financing Unit: should ensure timely reporting of information required by the Bank Supervision Department on a quarterly basis.