

# FMO

Finance for Development

*UNEP FI 2009 Global Roundtable  
Environmental & Social Risk  
Analysis (ESRA)  
Introductory Training Workshop*

*Sustainable finance – from Equator Principles to  
microfinance*

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# Credit risk and sustainable development

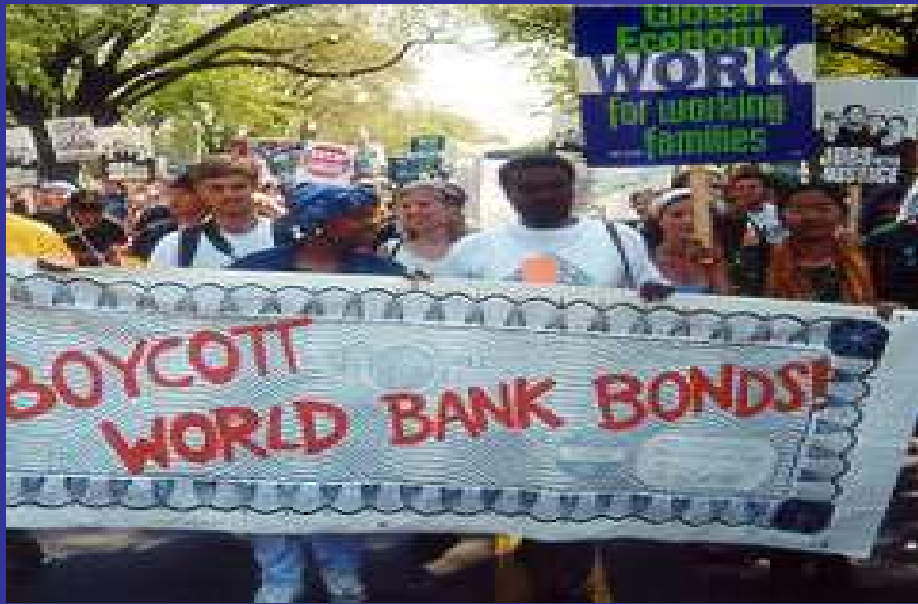
Question:

Why is sustainability important for Financial Institutions?



# Environmental and social issues in companies can impact the risk level of a Financial Institution that finances them:

- *Credit Risk*
  - defaults
  - payment rescheduling
- *Systemic Risk*
  - sector-wide practices
  - market devaluation
- *Security Risk*
  - defunct / devalued collateral
- *Legal Risk*
  - potential transfer of liability from borrower to lender
- *Funding Risk*
  - access to capital (e.g. FMO)
  - cost of funds
- *Reputational Risk*
  - national
  - international



# For value and values reasons, FIs do not want to be involved any more in companies that ...

- Do not comply with national legislation:  problems with licences
- Are eco-inefficient:  relatively high costs
- Do not comply with emerging customer demands  decrease of market share
- Can be a target of NGO campaigns  impact on reputation

So:

Financial Institutions start evaluating their (large industrial high risk) clients against environmental and social benchmarks

For instance IFC Performance Standards –  
Equator Principles

## The FMO approach:

### Direct Investments in Companies / Projects

- Policy & Management System
- Capacity
- Compliance with international standards – IFC Performance Standards

- Financial Institution Clients
- Policies
- FI portfolio management (ESMS)
- Different approaches for FIs, Funds and MFIs
- Training + follow-up

## Sustainability-related opportunities beyond risk management exist for FIs:

- New financial products
- New business development

## 2. Environmental and social risk management for MFIs – the FMO approach

Question:

What has this all to do with microfinance?

We are not talking this... but this...



Maybe not large impacts, but there are millions of micro-businesses: Cumulative impacts

and not this ...



but this...



So our mission was:

Develop a PRACTICAL field guide for MFI loan officers

# Sector table with main risks per sector

'X' Indicates when there is a significant risk  
 • Indicates when there is a limited risk

Indicative E&S category

**Red:** High E&S risk  
**Blue:** Medium E&S risk  
**Yellow:** Low E&S risk

...air pollution	...deforestation	...fish depletion	...littering and disease and pest occurrence	...soil depletion	...water pollution	...fire and explosion	...infection of HIV/AIDS	...intoxication	...occurrence of diseases	...occurrence of harmful bacteria and diseases	...personal injury	...bad working environment	...harmful child labour	...unfair labour conditions

For the sectors...

...the main risks are

HR1	Agricultural crop production with use of chemical pesticides and	Red	X			•			X		X		•	•
HR2	Charcoal making	Red	X	X		•		•				X	•	•
HR3	Chemical industries	Red	X		X	X	•		X		•	X	•	•
HR4	Forestry / wood production	Red		X		X					X		•	•
HR5	Laundry services / dry-cleaner	Red				X			X			X	X	•
HR6	Leather production/tanning	Red	•		•	X		X	•		•	X	•	•
HR7	Metal working /forging/electroplating	Red	•		•	X	X	•			X	X	•	•

# Fact sheets per sector

## HR1 - Agricultural crop production with use of chemical pesticides and fertilizers

### **SIGNAL**

*The main risks are ...*

... deforestation



... intoxication



... personal injury



### **ANALYSE**

*There is a problem if ...*

- Forest is managed unsustainable (illegal and/or without reforestation plan)
- No safeguards are available and/or used when necessary (mask, goggles, gloves, overall)
- No relevant Chemical Fact Sheets are available
- Storage is unsafe, unlocked or located near sleeping/ eating place
- Machines look unsafe, are ill maintained or have dangerous parts
- No safeguards are available and/or used when necessary (mask, goggles, gloves, helmet, proper working clothes)
- No safety precautions seem available

### **DISCUSS**

*Acknowledge that ...*

- Deforestation, if not performed carefully and in a sustainable way causes land erosion and degradation, and in rainy periods increased water runoff and mud floods
- Applying/handling toxic substances with proper safeguards prevents illness
- Safe storage prevents chemical reactions, explosion, fire, leakage and intoxication
- Well maintained machines are safe and cheaper in use
- Operating a machine with proper safeguards prevents accidents
- Machines can leak oil/lubricants, which might spoil drinking water
- Proper safeguard measures should be available

### **SUGGEST**

*Suggest the client to ...*

- ⓪ Agree only on permitted and sustainable forms of pristine land use
- ⓪ Apply reforestation: plant new trees
- ⓪ Not over-use chemicals
- ⓪ Consider integrated pest control
- ⓪ Provide and use safeguards when working with chemicals (mask, goggles, gloves, overall)
- ⓪ Create a separate storage locked away from children and located separately from living/eating place
- ⓪ Establish contingency plans for accidents
- ⓪ Have fire fighting equipment and first aid kit available
- ⓪ Safe disposal of waste
- ⓪ Position machines on a safe spot and cover dangerous moving parts
- ⓪ Take up and strictly follow maintenance routine and lubrication practices for moving parts of equipment
- ⓪ Keep machines clean and in good shape
- ⓪ Employ experienced operators only
- ⓪ Provide and use safeguards (mask, goggles, gloves, helmet and proper working clothes)
- ⓪ Re-use scrap / disposals
- ⓪ Establish contingency plans for accidents
- ⓪ Have first aid kit available

### **Also think of...**

... littering and disease and pest occurrence



... harmful child labour



... unfair labour conditions



Background, relevant legislation, minimal requirements

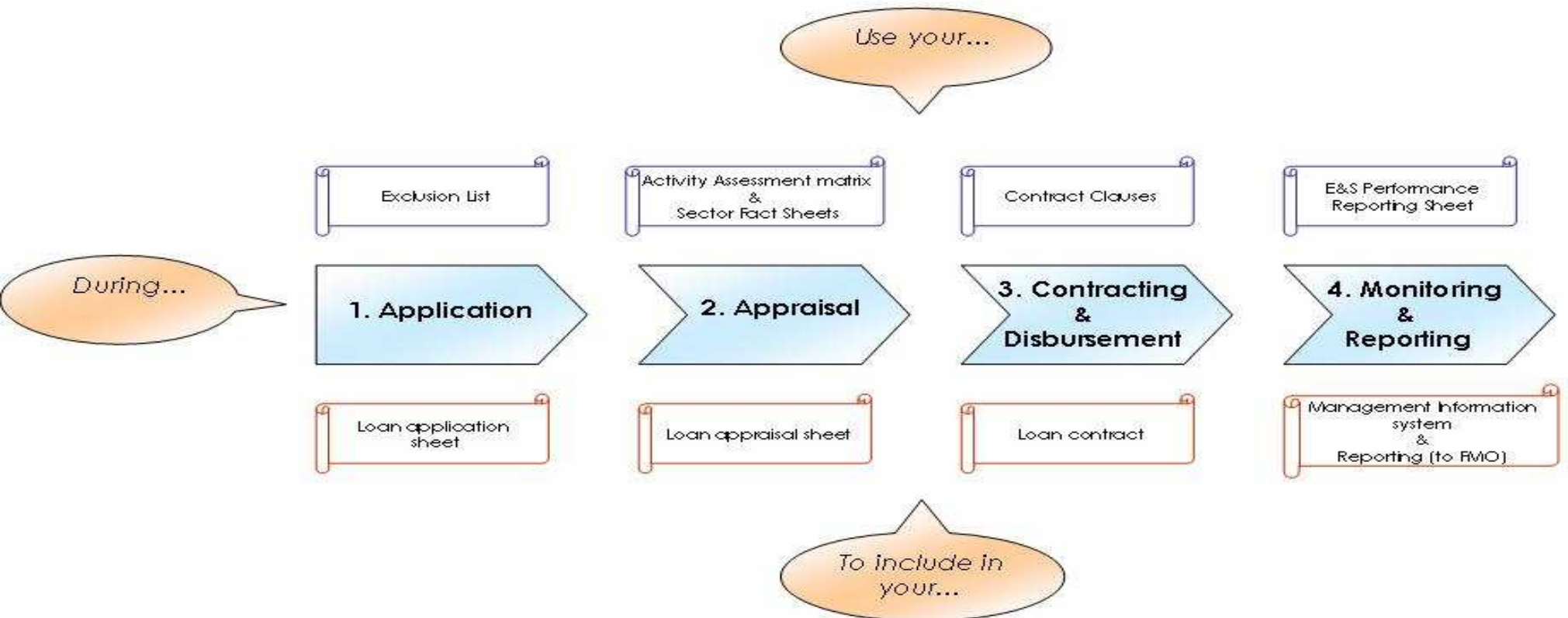
- ILO Conventions 138 and 182
- Don't install diesel generator sets without approval certificate
- Have MSDS available when working with chemicals

Solutions, tips, further information

- Farmers should use pesticides that are permitted.
- Farmers should consider to carry out integrated pest management (biological – physical – chemical)
- Fix leaks promptly. Dripping joints can waste over 76 liters of water a day
- In case there is no waste disposal facility: Contact (alone or in collaboration with other entrepreneurs) local council and ask for improved public service

# Guidance to implement environmental and social risk management in the MFI loan process

Figure 1. **Coupling Environmental & Social issues into the loan cycle**



# What's in it for the microbusiness Client?

- Reduced costs and risks
- Improved (operational) management / increased productivity
- Consumer trust and business opportunities
- Improved reputation
- Access to financial markets

... and if it is good for the client it is good for the MFI too!

# So how can an MFI implement this?

The FMO Sustainability Guidance e-toolkit can help

Downloadable from [www.fmo.nl](http://www.fmo.nl)

