Backgrounds of sustainable finance – from Equator Principles to microfinance:
The FMO approach

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Program

09.00 – 09.15  1. Introduction FMO and myself

09.15 – 10.00  2. Who is who? What do you expect?
               (C)

10.30 – 11.30  3. E&S Risks – credit risks for an (M)FI?

11.30 – 12.00  4. Focus on MFIs
               (L)

13.00 – 14.30  5. Integrate E&S in the financing process
               (T)

15.00 – 15.30  6. Next steps – elements of an action plan

15.30 – 16.00  7. Opportunities for cooperation?
1. Introduction: Vision FMO

- The Netherlands Development Finance Company (FMO) invests risk capital in companies and financial institutions in developing countries.

- Goal is to create flourishing enterprises which can serve as engines of sustainable growth in their countries.
FMO: the entrepreneurial development bank

- Unique Public-Private Partnership - 51% / 49%
- Complementary and additional to commercial banks
- High risks with appropriate and market-driven returns
- Worldwide partnerships
- Long-term approach
The ‘Real’ Challenge – income distribution

THE WORLD ECONOMIC PYRAMID

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<th>Population (mln)</th>
<th>Growth</th>
<th>Purchasing power parity (US $)</th>
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Product & Services

Products
- Equity
- Mezzanine
- Loans
- Guarantees
- Syndications

Services
- Long term financing
- Local currency financing
- Capacity development
- Corporate governance & management support
- Environmental & social management support
New commitments

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<th>Year</th>
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Anton G. van Elteren

• Biologist by origin

• Environmental consultant for over 16 years

• 6 years with FMO

• First E&S on project finance, now client financial institutions support on E&S plus E&S Analyst

• Married, 2 kids
2. Who are you? And what do you expect?

Are you:

- An MFI
- Another type of FI
- Government
- An NGO
- Consultant
- None of the above?
3. Credit risk and sustainable development

Question:

Why is sustainability important for Financial Institutions?
Are these your clients?
NGOs become more clever ...
E&S 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 client 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) clients against environmental and social benchmarks.

For instance: banks *voluntary* apply IFC Performance Standards – Equator Principles … or become an UNEP FI signatory!
But:
There’s also something in it for the Client!

- Reduced costs and risks
- Improved (operational) management / increased productivity
- Consumer trust and business opportunities
- Improved reputation
- Easier access to financial markets
Next to that, sustainability-related opportunities also exist for FIs:

- New products (CO₂ trading)
- New business development (Renewables)
The FMO approach:

Direct Investments in Companies / Projects
- Policy & Management System
- Capacity
- Compliance with international benchmarks
  IFC Performance Standards + Sectoral Guidelines

Financial Institution Clients
- Policies
- FI portfolio management
- Different approaches for FIs, Funds and MFIs
- Training + follow-up
4. Focus on MFIs

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 E&S risk management field guide & training course for MFI loan officers
It all starts with: awareness raising
Identify the risks (all 5)
## Sector table with main risks per sector

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### A1 Agriculture – Crop Growing

#### Observe

**The Client is** ...

- **... using (a) machine(s)**
  - H&S: Machines look unsafe, ill maintained, have dangerous parts
  - H&S: No safeguards are available and/or used when necessary
- **... using chemicals/lubricants/pesticides/fertilizers**
  - H&S: No safeguards are used when necessary
  - H&S: No relevant Material Safety Data Sheets (or other safety leaflet) are available
  - H&S: Storage is unsafe, since unlocked, near sleeping/eating
- **... clearing forest for land cultivation**
  - E: Forest is managed unsustainable (illegal and/or without reforestation plan)
- **... employing children**
  - L: Children are being employed

#### Analyse

**There is a risk if** ...

- **... using (a) machine(s)**
  - H&S: Machines look unsafe, ill maintained, have dangerous parts
  - H&S: No safeguards are available and/or used when necessary
  - E: Leaks, disposals, liquid waste or wastewater drains to stream/river/pond/drain
- **... using chemicals/lubricants/pesticides/fertilizers**
  - H&S: No safeguards are used when necessary
  - H&S: No relevant Material Safety Data Sheets (or other safety leaflet) are available
  - H&S: Storage is unsafe, since unlocked, near sleeping/eating
- **... clearing forest for land cultivation**
  - E: Forest is managed unsustainable (illegal and/or without reforestation plan)
- **... employing children**
  - L: Children are being employed

#### Explain

**What is important** ...

- **... using (a) machine(s)**
  - Well maintained machines are safe, not dangerous and cheaper in use
  - Operating a machine with proper safeguards prevents accidents
  - Machines can leak oil/lubricants and that will spoil drinking water
  - Malfunctioning Electricity is dangerous and create fallout
- **... using chemicals/lubricants/pesticides/fertilizers**
  - Applying/handling toxic substances with proper safeguards prevents illness
  - Safe storage prevents from chemical reactions, explosions, fire, leakages and intoxication
- **... clearing forest for land cultivation**
  - Deforestation, if not performed carefully and in a sustainable way causes land erosion and degradation, and eventually mud streams and water floods
- **... employing children**
  - Children should receive education, proper nutrition and health care. They should be protected from abuse and discrimination, able to play and enjoy their childhood

#### Act

**Suggest the client to** ...

- **... using (a) machine(s)**
  - Take up maintenance routine, follow strict maintenance and lubrication practices for the moving parts of equipment
  - Keep machines in good shape and clean
  - Experience operators only
  - Provide and use safeguards (goggles, gloves, mask)
  - Re-use scrap / disposals
  - Stop leakages
  - Stop draining liquid waste
  - Establish contingency plans for accidents
  - Have fire fighting equipment available
  - Provide and use safeguards when working with chemicals (mask, goggles, gloves, overall)
- **... using chemicals/lubricants/pesticides/fertilizers**
  - A separate storage is created, locked away from children and living/eating rooms
  - Establish contingency plans for accidents
  - Have fire fighting equipment available
- **... clearing forest for land cultivation**
  - Agree only on permitted and sustainable forms of use of pristine land
- **... employing children**
  - Have no children working
  - Have children help with light duties only
  - Only outside school hours and pupils must have time and designated place to do homework
  - Children do not operate hazardous machines

### Background, relevant legislation, minimal requirements

- Waste (water/disposal without permit (e.g. Prevention and Control of Pollution Act, 1974)
- 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 services
5. How to integrate environmental and social risk management in your financing process

- Reports
- Reporting formats
- Exclusion list
- Application
- Monitoring specs
- Fact sheets
- Contract clauses
- Contracting & Disbursement
- Loan contract
- Loan application sheet
- Loan appraisal sheet
- Recovery & monitoring
- MIS info
- Appraisal
6. Elements of an action plan

- Choose a pilot project
- Write a policy
- Develop procedures to fit your own financing procedures
- Manage change/convincing colleagues
- Train commercial staff
7. Possibilities for cooperation?

• What can NGOs / Government do?
• Awareness raising – ‘spread the word’
• Training
• Consultancy
• Other?
THANK YOU