Training session 1: Environmental and Social Risk Management Training for Microfinance Institutions (MFIs)

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Anton van Elteren, Senior Environmental specialist, FMO, Anton Van Elteren focused his training on Environmental and Social risks that Financial Institutions can encounter, with a specific focus on financing small and medium enterprises (SMEs). He aimed to present the easiest way to integrate environmental and social risk factors into the financing process of any financial institution (FI). He began by presenting the reasons why sustainability matters for a financial institution.

Several risks related to FIs can be related to environmental and social issues i.e. pure credit risks (a company is closed down or heavily fined because of its negative environmental performance), systemic risks (if some activities are prohibited by the government), security risks (if the security of a loan is based on property that is polluted, the value of the security depreciates), legal risks (when an FI is sued), funding risks (only liable and responsible companies must be financed) and reputational risks. If a company is working in an eco-inefficient way, the cost of its activities will be higher.

FIs have started to evaluate their clients against environmental and social benchmarks; banks like Citi for instance have already set voluntarily standards on environmental performances and more and more institutions have become UNEP FI signatories. Complying with environmental requirements, a bank helps its clients to be aware of environmental and social risk issues; of ways to reduce their costs and risks; and of potential new green business opportunities. Studies show that productivity can be improved thanks to environmental and social risk management.

When investing in companies and projects, FMO requires its clients to develop an environmental and social risk policy and a management system complying with International Finance Corporation (IFC) standards. FMO also makes sure that they have sufficient capacities to enforce those principles. However, FMO will not reject financing a project, provided that the company is willing to develop an action plan to meet these requirements. If after a few years, the company still does not meet the requirements, FMO will withdraw its loan or at least, not refinance the company.

FMO has different approaches, whether the company is an FI, a fund or an MFI.
MFIs are important actors in sustainable development on a cumulative whole. The impact of numerous small businesses for example, can easily equal that of the biggest industries.

Environmental and social risk management must be integrated in from the start of the financing process, to make these requirements clear to the client. The application form must state that the loan is not related to any of the activities which the bank is not willing to finance (i.e. when child labor and/or the use of highly dangerous chemical products are involved). During the appraisal process, environmental and social performances of the client must be assessed with IFC guidelines and FMO fact sheets being used as benchmarks.

To help MFI loan officers, FMO has set up a table containing the principal SME activities and the environmental and social risks they imply, using IFC sectors guidelines. For bigger projects, an external expert is needed; but regarding medium projects, the loan officer can conduct the environmental and social risk assessment. IFC requirements and details of a realistic action plan to set an environmental and social risk policy must be integrated in the contract clauses of the loan agreement.

Performances of the client must be monitored frequently. A follow up regarding the action plan should be undertaken. FMO asks its clients for an annual environmental and social report. The reporting phase of the financing process should also contain environmental and social risk concerns.

On a local level, a bank has to take several concrete steps to adapt the FMO requirements to the local context. Such a project needs commitment from senior managers. The bank can start with pilot projects with few clients, with one branch or with one or two loan officers who are aware of environmental issues.

Regarding environmental issues, the bank policy would have to be adapted and some statements must be issued about the new mission and vision that the bank is willing to promote. This new policy must be clearly stated to internal staff and to external customers and contributors. Some activities will not be financed (i.e. projects involving child labor, or the use of highly chemical products etc.) and some environmental and social requirements are to be met prior to obtaining the loan. Environmental impact assessment procedures are to be developed to meet the expectations raised by the new policy in place.

For these procedures to be implemented, it is essential to train the commercial staff about the reasons for these new environmental and social requirements. One member of the Executive Board has to become Environmental and Social Manager and will be responsible for these issues on the board level. In addition, one coordinator is to be appointed to work on developing the steps of the action plan to set a proper environmental and social policy and implement it.