UNEP FI 2009 Global Roundtable

*Environmental & Social Risk Analysis (ESRA)*
*Introductory Training Workshop*

*Wednesday 21st October, 2009*
Questions to consider:

• Do you think that environmental and social issues affect your business at the moment?

• Do you consider that environmental issues should be of relevance to the strategic interests of financial institutions? Why?
Introduction to E&S risk detection in practice
“Find the Bombs”

- *Project Finance*: Copper Mine
- *Property Finance*: Housing estate and golf course
- *Trade finance*: commodity trading
- *Corporate Finance*: Waste management company
- *Corporate Finance*: Eco-tourism company operating
- *SME lending*: Clothing manufacturer
Lessons learnt?

- Risk does not always come from obvious sources…
- Environmental/ social risk can pose financial risk not just reputational risk
- Reputation is hard to price until you have lost it
Case Study:

**CELCO, Chile – The 1,000 million dollar swans**

Read the case study.

Consider the following questions:

- What are the risks to the environment?
- What are the risks to the company?
- What risks would be posed to the FI lending to this company?
Analysing the Context:
The Changing Nature of Risk Assessment
Risks to the client

- Disinvestment
- Market loss
- Increased cost
- Loss of cover
- Loss of operating license
- Strike, sabotage
- Shutdown, delay
- Campaigns
- Negative publicity
- Contract loss, boycott

- Community
- Shareholders
- Employees
- Government
- NGOS
- Financiers
- Insurers
- Clients
- Media
- Company
- Export market
- Regulators
Risks to the FI

- **Credit Risk**
  - defaults
  - payment rescheduling

- **Market Risk**
  - sector-wide practices
  - market devaluation

- **Guarantee Risk**
  - defunct / devalued collateral

- **Legal Risk**
  - potential transfer of liability from borrower to lender

- **Funding Risk**
  - access to capital
  - cost of funds

- **Reputational Risk**
  - national
  - international
Analysing the Context

- Regulatory framework,
- Markets,
- Natural environment and;
- Society
Environmental Legislation

- Is evolving rapidly
- Strongly influenced by international agreements
- Legal requirements for companies are increasing even if enforcement is sometimes still a challenge
- Stakeholders such as neighbours exert pressure on companies indirectly via politics, legislation and enforcement
Benefits to the client

- Operating license
- Community
- Shareholders
- Employees
- Retention, Productivity
- Government
- Renewal, expansion
- NGOS/Media
- Co-operation
- Company
- Clients
- Analysts/raters
- Financiers
- Insurers
- Export market
- Regulators
- Long-term investors
- Open Markets
- Reduced cost
- Reduced premiums
- Stable markets, premium pricing
- Upgraded evaluations
- Insights to the client
- Insights to the company
- Insights to the market
- Insights to the society
- Insights to the environment
- Insights to the stakeholders
Analysing and Managing Risks:
Process Integration

Marketing
- S&E position in marketing material
- Information available on S&E risk analysis

Origination
- Information requests of initial project & client appraisal
- Presentation of financing proposal to Client, including S&E appraisal

Know Your Client
- Filter for anti-money laundering, terrorism

Technical/Due Diligence
- Categorisation
- S&E Assessment
- Independent reviews
- Process findings & establish deal conditions

Term Sheets/investment documentation
- S&E requirements included in loan documentation

Credit Approval & Review of Legals
- Deal review against internal S&E standards

Deal Conclusion Forum
- Presentation to Client
- Agree to final terms
- Closure
- Disbursement

Monitoring & Annual Reviews
- Client submits monitoring reports
- Engagement over non-performance
Project Classification

• A preliminary screening process to categorise a project based on the nature and magnitude of its potential impacts
  – sector, location, scale, type, related & associated activities, supply chain, client

• For the purpose of determining level of social and environmental risk assessment and management required
Managing Client Compliance

• Action plans
• Identify conditions for financing
  – approvals, disbursements
• Inclusions into loan documentation & provisions
• Monitoring
  – all category A and B should be monitored
  – independent verification of compliance