Introductory Training Workshop (ITW) on

Identification and Evaluation of Environmental and Social Risk in Credit Processes

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S&E Risk Management

1. Identification of S&E risks
2. Categorisation
3. Assessment of social and environmental risks
4. Managing client compliance
“Find the Bombs”

- **Project Finance**: Pulp and Paper Mill, Argentina
- **Trade finance**: Dutch registered commodity trader
- **Corporate Finance**: Wind farm developer, Europe
- **Property Finance**: Apartments in Sao Paolo, Brazil
- **SME lending**: Russian confectionary manufacturer
Lessons learnt?

• Risk does not always come from obvious sources
• Environmental and social risks can be a financial risk and not just a reputational risk
• Reputation is hard to price - until you have lost it.
S&E Risk Management

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Analysing the Context:

The Changing Nature of Risk Assessment
"I've been nominated 'Industrialist of the Year' and the Dept of Environment are going to prosecute me for pollution."
Risks to the client

- Market loss
- Loss of operating license
- Disinvestment
- Loss of cover
- Contract loss, boycott
- Negative publicity
- Campaigns
- Shutdown, delay
- Strike, sabotage
- Export market
- Regulators
- Increased cost
- Shareholders
- Media
- Government
- Clients
- Insurers
- Financiers
- Company
- Community
- NGOS
- Employees
- Increased cost
- Loss of
- Contract loss, boycott
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
Purpose of analysing the context:

• To detect and assess possible environmental and social risk that the project/ company activities might generate
• To establish the company’s E&S performance against appropriate standards
• It is a general enquiry to establish the need for further follow up and research.
Benefits to the client

- Long-term investors
- Open Markets
- Reduced cost
- Reduced premiums
- Stable markets, premium pricing
- Operating license
- Export market Regulators
- Financiers
- Insurers
- Clients
- Community
- Shareholders
- Employees
- Government
- NGOS/Media
- Analysts/raters
- Co-operation
- Renewal, expansion
- Upgraded evaluations
- Retention, Productivity

- Stable markets, premium pricing
- Open Markets
- Reduced cost
- Reduced premiums
- Long-term investors
- Operating license
Aspects to Analyse

• Type & scope of the project – associated & related facilities
• Sector Risk
• Market
• Location
  – Policy & regulatory framework, capacity to regulate, governance
  – Prevailing natural and social environment, trends
  – Levels of stakeholder activity in the sector
  – Existing/ past impacts on the environment
  – Impacts associated with inputs & raw materials/ supply chain
• Third party risk
• Client commitment and capacity
Challenges

• Access to information
• Client willingness, resistance
• Reliability of information
• Benchmarks for performance
  – National standards
  – EU directives and standards
  – IFC Performance Standards and EHS guidelines
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
S&E Risk Management

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

Loan documentation Approvals & Disbursement
- S&E requirements included in loan documentation
- Credit review & approval
- Presentation to client
- Agree to final terms
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Monitoring & Annual Reviews
- Client submits monitoring reports
- Independent verification
- Engagement over non-performance
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Project Categorisation

• A screening process to categorise a project based on the nature and magnitude of its potential impacts

• For the purpose of determining level of social and environmental risk assessment and management required
## Definitions

<table>
<thead>
<tr>
<th>Category</th>
<th>Characteristics</th>
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<tbody>
<tr>
<td>A</td>
<td>Potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented. No standard mitigation measures.</td>
</tr>
<tr>
<td>B</td>
<td>Potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through standard mitigation measures.</td>
</tr>
<tr>
<td>C</td>
<td>Minimal or no adverse social and environmental impacts.</td>
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</tbody>
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Categorising Projects

The category of a project would depend on:

- Type and sector
- Location
- Sensitivity
- Scale
- Nature and magnitude of potential impacts
- Related and associated activities
- Supply chain
- Client profile
Tools

- ER002 form: an environmental screening and categorisation form
- ER003: economic activities according to risk criteria
- ER003A: project selection according to risk criteria
- National social and environmental impact assessment regulations
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S&E Assessment

• The duration, depth and type of E&S assessment required depends on the nature, scale and potential impact of the project, company activities.
• Area of influence
• Alternatives
• Avoid, minimise, mitigate and compensate
• Increase positive impact
## S&E Assessment

<table>
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<tr>
<th>Category</th>
<th>Assessment</th>
<th>ESRA form</th>
</tr>
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<tbody>
<tr>
<td>A</td>
<td>SEIA and/or audit, Action Plans, Public Consultation &amp; Disclosure, Independent Review</td>
<td>ER006, ER007, ER008A, ER010A</td>
</tr>
<tr>
<td>B</td>
<td>Environmental Audit or internal Environmental Management Analysis, Evaluation of Risks, Corrective Action Plan</td>
<td>ER008, ER009</td>
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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
Thank you!

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