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

Disinvestment

Market loss

Increased cost

Loss of operating license

Strike, sabotage

Shutdown, delay

Campaigns

Negative publicity

Contract loss, boycott

Disinvestment

Shareholders

Employees

Government

NGOS

Media

Clients

Insurers

Financiers

Export market

Regulators

Company

Community

Increased cost

Loss of

Risks to the client
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.
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
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
- Closure
- Disbursement

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>
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<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>
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<tr>
<td>C</td>
<td>Minimal or no adverse social and environmental impacts.</td>
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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
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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>
<thead>
<tr>
<th>Category</th>
<th>Assessment</th>
<th>ESRA form</th>
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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>
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<tr>
<td>B</td>
<td>Environmental Audit or internal Environmental Management Analysis, Evaluation of Risks, Corrective Action Plan</td>
<td>ER008, ER009</td>
</tr>
</tbody>
</table>
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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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