UNITED NATIONS ENVIRONMENT PROGRAMME FINANCE INITIATIVE (UNEP FI)

ESRA WORKSHOP NAIROBI

WHY ENVIRONMENTAL & SOCIAL RISK ANALYSIS?

www.unepfi.org
Contents of the Presentation

• Sustainability and the new operating world

• Impacts on and responsibilities of Financial Institutions

• Equator Principles and Environmental and Social Risk Analysis (ESRA)

• The FirstRand ESRA Framework
What makes a company/client sustainable for the future?
Our new operating world

**Resource Scarcity**: Lack of Coal, Water, Electricity and Oil;

**Strengthening legislation**, best practices, regulation and enforcement frameworks e.g. King III, Equator Principles;

**Unethical business practices** are being punished, delays in operating licenses due to social actions against a company;

**Stakeholder Awareness**: Shareholders, investors, clients, and the public want to know where the money is going, and what it is being used for;

**Increased recognition** of reputational risk to the financing bank responsible lending is required;

**Credit Crisis** – Defaulting clients, poor debt ratios
These costs will rise

- Cost of water
- Cost of *treating* water (effluents)
- Cost of waste disposal
- Cost of cleaning up contaminated land
- Cost of controlling air pollution
- Environmental fines
- Cost of indemnities to employees and customers
- *Number* of indemnities to employees and customers
- Damage caused by a campaign by an NGO
- Cost of emitting CO₂
Environmental Management

Risks that are caused directly

Direct Impacts

Indirect Impacts

Stakeholder Engagement

Risks to company from clients

Representing company as a brand

Reputation and Risk Management
Direct Environmental Issues

- Waste Management
- Energy Management
- General Environmental Commitment
- Stakeholder Engagement and Employee Awareness
- Water Management
- ISO 14001
- Climate Change / Carbon Impacts
- Greening the Supply Chain and New Builds
Indirect Environmental Issues

- Responsible Lending
- Reporting and Performance
- Pre-empting legislative impacts on the bank
- Reputation Management
- Risk management of portfolios e.g. climate change
- Stakeholder Engagement
- Product Development
“The Lightbulb Moment!”

We as financial institutions, can play a key role in ensuring social issues and environmental issues are being dealt with correctly at our clients through our significant influence over our clients behaviour.

This influence can be expressed at a lending opportunity where we as the financial institution can influence our customers behaviour regarding how they are managing the social and environmental impacts associated with their businesses. These requirements form part of the lending criteria to that client.
The History - ESRA and Equator

- The Equator Principles were created in 2006 by Citi Bank, the IFC, the World Bank and numerous other international commercial banks
- 72 financial institutions from 27 countries
- These financial institutions operate in over 100 countries
- The EP’s have become the project finance industry standard for addressing environmental and social issues in project financing globally
- All 4 of the large banks in South African are members: ABSA, FirstRand, Standard Bank and Nedbank

What is an Equator Principles Signatory:

This means that for all our project finance activities specifically, which have capital costs amounting to or exceeding $US 10 million, will have to go through a environmental and social risk review process as defined by the international guidance of the Equator Principles.

- June 2003 – EP’s developed and launched
- July 2006 – EP’s revised
- November 2005 – Nedbank EP Signatory
- June 2009 – FirstRand EP Signatory
- Feb 2009 – Standard Bank EP Signatory
- 2006 – EP’s revised
- 2009 – ABSA EP Signatory
So why extend this to other forms of lending?

Risk 1 – Reputational Damage
• Reputational Risks www.banktrack.org

Risk 2 – Lender Liability
The potential for direct financial loss through lender liability:
• Remediation and rehabilitation; fines; reputational risk
• (a) any person who is or was responsible for, or who directly or indirectly contributed to, the pollution or degradation or the potential pollution or degradation;

Risk 3 – Direct Environmental Costs
Indirect Risks caused by our clients, which by default concern the banks:
• Loss of capital investment,
• Production delays or stoppages which may impact cash flow.
• Directors personal liability in terms of NEMA,
• Fines and liabilities to be paid by the clients which may affect cash flow.
ESRA- What is ESRA and what is its purpose?

ESRA is the acronym used for an ‘Environmental and Social Risk Assessment’.

ESRA is the review of the direct environmental and social risks that may be associated with the proposed activities of a client, in order to determine what indirect environmental and social risks might be face by lending to the client and in turn, how well the client manages these risks.

Through the use of ESRA policies and processes, we can:

• **Identify** environmental and social risks and opportunities associated with the clients activities

• **Assess** how significant those risks are

• Determine how **legally compliant** the client represents themselves to be

• **Evaluate** the clients ability to manage the identified risks and

• Help the client **improve** their **business practices** whilst managing exposure to high risks.
ESRA and The Equator Principles

USD 10 Million project finance deal = Equator Principles Review

External Review

In-house Review

Commercial loans

Less than USD 10 million project finance deal

Corporate loan where destination of 50% of funds is known

Working capital/overdraft where destination of 50% of funds is known
ESRA and Equator Process

Client Application → Thresholds → Categorisation

Covenants → Environmental Review → Referral to Environmental

Monitoring → Reporting
Client Application

- Determine project’s feasibility

Gain high-level background information from the client on their application and perform exclusion check against the ‘deal exclusion checklist’.

The exclusion checklist ensures that FirstRand does not finance projects that are involved in illegal or unethical activities, for instance, forced labour, prostitution or trade in endangered species.
Once the dealmaker has got the background information from the client, determine if the potential deal is an ESRA or Equator Principles deal by comparing it to the following thresholds:

- **ESRA process applies to all corporate loans and working capital (where it is known what 50% of the loan is being used for).**

- **If the deal is project finance and USD10 million or more OR corporate finance and USD 50 million or more then Equator Principles apply**
The dealmaker needs to complete the ‘Environmental Screening and Classification’ form by using the relevant guideline documents. The outcome of the assessment will determine if the deal falls into ESRA or Equator Project Category A/B/C.

The dealmaker needs to confirm the outcome of assessment against A/B/C project definitions.

If the deal is an ESRA or Equator Category C, no further environmental analysis will be required by the bank.
The Categorisation Definitions

**Category A**
Activities with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented.

A full environmental risk review is required, to address the relevant social and environmental impacts and risks of the proposed project. The review should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

**Category B**
Activities with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.

In this category, a full environmental risk review will not be required by the bank, but an environmental analysis focusing on the anticipated impacts is required.

Note, however, that the laws of the country concerned may require a full environmental risk review.

**Category C**
Projects with minimal or no social or environmental impacts.

No further environmental analysis will be required by the bank.

Again, some level of environmental risk review may be required by the laws of the country concerned.
If ESRA Category A or B, dealmaker needs to request standard environmental documentation from the client. Dealmaker can also request guidance from the FirstRand EHS Department on additional documents required per specific projects.

If Equator Principle deal Category A or B, dealmaker to submit independent compliance review to FirstRand EHS Department.

If ESRA Category C or Equator Category C, no further environmental analysis will be required by the bank.
If ESRA Category A or B deal, FirstRand EHS Department to review environmental documentation received.

If Equator Principles Category A or B deal, FirstRand EHS Department to review independent compliance review report.

For ESRA and Equator Principles Category A or B, FirstRand EHS Department to compile an ‘Environmental and Social Risk Opinion’ for internal use by dealmakers and credit committee. Opinion also details individual review steps followed for the deal concerned.
FirstRand EHS Department will suggest covenants to dealmakers.

Once the deal has gone through the relevant approval process, these covenants then need to be included in the final loan agreement.
Monitoring

• Monitoring of Project and Covenants

Transaction Manager to load monitoring requirements (covenants) onto ‘TaskView System’ for both ESRA and Equator Principles Category A and B deals.

For Equator Category A & B deals, client to supply a report compiled by an independent consultant to review the project against actions plans and covenants. This report to be sent on to FirstRand EHS Department by the dealmaker for review (esra@firstrand.co.za).
The Number, Type (ESRA or Equator), Category (A/B/C) and Sector of all deals need to be reported on a quarterly basis to the FirstRand Board and included in the FirstRand operational risk and compliance reports.

Therefore, this information needs to be entered into the ‘Deal Database’ once the deal is approved.
## Equator Principles Reporting

<table>
<thead>
<tr>
<th>EP Category</th>
<th>Projects receiving review at Marketing or Appraisal stage</th>
<th>Projects fully executed</th>
<th>Funded or executed</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (high risk)</td>
<td>5</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>B (medium risk)</td>
<td>2</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>C (low risk)</td>
<td>4</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11</strong></td>
<td><strong>5</strong></td>
<td></td>
</tr>
</tbody>
</table>

![Map of Africa]
RMB ESRA and Equator Statistics

Number of RMB Deals Screened

Break down per categorisation

- Cat A
- Cat B
- Cat C

Number of deals

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Innovative financing for sustainability
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