Training Workshop

Identification and Evaluation of Environmental and Social Risks in Credit Processes

Melissa Makwarimba

Nairobi, 23rd September 2011
Introduction

• Part of UNEP FI’s support to build capacity within the FI sector to facilitate sustainable development
  www.unepfi.org
• Taste of the UNEP FI ESRA course
• Share experience
Contents

I. Identification of S&E risks
II. Categorisation
III. Assessment of social and environmental risks
IV. Managing client compliance
Questions to consider

1. Do you think social and environmental issues affect your business at the moment?

2. Do you consider that social and environmental issues should be of relevance to the strategic interests of financial institutions? Why?
Find the Bombs

• Project finance – new opencast Gold mine, Ghana
• Corporate finance – waste management company, KZN, South Africa
• Working capital facility – commodity trading, Singapore
• Project finance – afforestation and carbon credit project, DFI finance, Tanzania
• Corporate finance – wig manufacturer
Sign up to protest against proposed US goldmine in Ghana

Posted August 30th, 2008 by Diet Simon

International activist organisations are appealing for your email protests against a vastly destructive new US-owned goldmine planned in Ghana, West Africa.

If the project is approved, about 9,270 people would lose their land, 1,330 of them are to be relocated. Most of the people living in the area are small-scale farmers and fear for their livelihoods.

When farmers demonstrated in 2005, police and military fought with them, killing one demonstrator and seriously wounding three more. In mid-2006 the Newmont Mining Corporation withdrew its application but refiled it last January along with an environmental impact statement. In response, a Concerned Farmers Association petitioned Ghana's president but have had no reply. The mining minister has said a licence is likely to be approved by the end of the year. The Concerned Farmers Association alleges that many village leaders have been paid substantial sums by Newmont and...
Trading Company

- Assorted investments and financial services to commodity trading company in Singapore
- Interests in coffee, dairy, cotton
THE CLEAN DEVELOPMENT MECHANISM
Recycling Carbon? - Recolonising Africa?


TIMBERWATCH
Africa: Unclean Development Mechanism

7 October 2010

'The funding of climate change adaptation and mitigation-oriented programmes in Africa has opened up new forms of resource imperialism, extractive investment and land grabbing opportunities, in particular for European and Chinese companies,' writes Blessing Karumbidza.

Land-intensive projects negatively affect the livelihoods of people who rely on land for food and other resources. The case of Idete village in Tanzania, the site of a plantation by Norway-based Green Resources AS, is an example of how supposedly 'clean development' projects don't always benefit the community.

Tuition fee from $20,000
Project Management Master's or PhD. 100% Online, 100% Supported!
WaldenU.edu/Project-Manag...
U.S. Wigs Made by Falun Gong Practitioners Turned Slaves

Import-Export Henan Style: implementing new torture techniques while manufacturing hair products

TORONTO (FDI) - Hair product giant Henan Rebecca Inc. is in cahoots with notorious Chinese labor camps that are buying Falun Gong practitioners as slave labor, sources in China say. Labor camps such as Shibailihe and Xuchang buy these people for 800 RMB each (almost $100 US), force them to work day and night, and torture them to death as part of the "reeducation" program.

The labor camps are located in Henan Province, where hair products are the province's number-one export. Henan Rebecca describes itself as "the largest hair product company in China and one of the biggest in the world," including the U.S. Its products are sold worldwide under many brand names, including Shake-N-Go Hair and Royal Imex, Inc.

"Many of these wig product factories don't hire a lot of employees outright," says a source in China who is familiar with forced labor contracts. "Instead, they rely heavily on the slave labor of detainees in forced labor camps, jails and detention centers, including many illegally detained Falun Gong practitioners."

"In the face of such horrific brutality, with the world's most powerful authoritarian regime turning the full force of its repressive apparatus against them, Falun Gong practitioners ... have responded with one of the largest, most innovative nonviolent movements the world has ever seen."

"Today, Falun Gong adherents remain among those most severely persecuted in China."

-- Amnesty International Press Release
China Labour Bulletin appears in the following article. Copyright remains with the original publisher.

Banks buy into jail-labour firm
Six financial giants among top shareholders of China’s largest wig manufacturer which uses prisoners to make its products

By JAMIL ANDERLINI in Xuchang
17 August 2005

Six of the world’s largest financial institutions have bought shares in a Chinese wig manufacturer that could be barred from the United States, its biggest market, because it uses forced labour to make some of its products. Deutsche Bank, HSBC, ING, Merrill Lynch, Morgan Stanley and UBS have all bought Shanghai-listed A shares in Henan Rebecca Hair Products, China’s largest wig maker, through the qualified foreign institutional investor (QFII) scheme, according to the mainland company’s half-year financial statement. The banks are all among Henan Rebecca’s top 10 shareholders.

Their presence on the company’s share register highlights some of the unique pitfalls overseas investors face as foreign capital pours into China’s capital markets. This is especially true for big international banks, which often buy shares on behalf of clients.

On Saturday, guards at Henan No3 Labour Re-education Camp and the Xuchang County Labour Re-education Camp told the South China Morning Post that inmates were employed in making half-finished products for Henan Rebecca.
Lessons Learned

• 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
Contents

I. Identification of S&E risks
II. Categorisation
III. Assessment of social and environmental risks
IV. Managing client compliance
Process Integration

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

Origination
- Initial project & client screening & appraisal
- Exclusion lists
- 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
Contents

I. Identification of S&E risks
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Group Work
Asamoah: Part 1

• Read the case study, Part 1
• Consider the following questions:
  – To what environmental and social risks do you think Asamoah Textiles might be exposed as a result of its activities?
  – What risks could these present to your FI, in the event that you finance them?

• 40 minutes reading and analysis
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
Risks to the Client

- Shareholders
- Export market regulators
- Clients
- Community
- Employees
- Government
- NGOs
- Financiers
- Insurers
- Media
- Cooperations
- Company
- Retention
- Renewal, expansion
- Stable markets, premium pricing
- Operating license
- Long-term investors
- Open markets
- Reduced cost
- Reduced cover
- Reputational benefits
Purpose

• To detect and assess possible environmental and social risk that the project/company activities might generate
• To establish 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 and 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 environment
  – Impacts associated with inputs and raw materials, supply chain
• Third party risk
• Client commitment & 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
Using Form ER001

- Section 1 – project sector and scope
- Section 2 – location
- Section 3 – management controls
- Section 4 – inputs and raw materials
Contents

I. Identification of S&E risks
II. Categorisation
III. Assessment of social and environmental risks
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Categorisation

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

• For the purpose of determining level of social and environmental risk assessment and management required
  – Also consideration of client capacity, commitment and track record
### 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</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 mitigation measures</td>
</tr>
<tr>
<td>C</td>
<td>Minimal or no adverse social and environmental impacts</td>
</tr>
</tbody>
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Reference: *IFC Policy on Social and Environmental Sustainability, April 2006*
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 & environmental impact assessment regulations**
Group Work
Categorisation Tool

• Screen and classify project using form ER002

• Identify 3 issues of potential concern to your financial institution?

• 15 minutes
Contents

I. Identification of S&E risks
II. Categorisation
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S&E Assessment

• The duration, depth and type of S&E 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 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>
</tr>
<tr>
<td>Project Risk/Client Risk</td>
<td>High Risk Client</td>
<td>Medium Risk Client</td>
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</tr>
<tr>
<td><strong>Category A</strong></td>
<td>Full SEIA/Audit, APs, Independent Review</td>
<td>B+ ? Level of risk SEIA/Audit, APs Independent Review</td>
</tr>
<tr>
<td><strong>Category B</strong></td>
<td>B+ ? Level of risk SEIA/Audit, APs Independent Review</td>
<td>Environmental Management Analysis, Evaluation of Risks, Action Plan</td>
</tr>
</tbody>
</table>
Group Work
Asamoah Textiles: Part 2
Evaluation tool for Category B

• Read Asamoah Part 2
• Using form ER009 evaluate the 3 unjustified risks you identified with form ER002.

• 20 minutes analysis
Group Work
Asamoah Textiles: Part 2

• You are responsible for the financing for Asamoah Textiles.

• What measures would you take to mitigate the risks to the bank from the company’s social and environmental impacts?

• Establish conditions for approval or give reasons for which the credit request is denied.

• 40 minutes reading & analysis in groups
Contents

I. Identification of S&E risks
II. Categorisation
III. Assessment of social and environmental risks
IV. Managing client compliance
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
Final Reading and Reflection

Asamoah Textiles: Part 3
Next ESRA online course
3 – 21st October 2011 - French
7 - 25th November 2011 - English
Thank you!

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