Training Workshop

Identification and Evaluation of Environmental and Social Risks in Credit Processes

Melissa Makwarimba

Accra, 22nd April 2013
Introduction

• Part of UNEP FI’s support to build capacity within the FI sector to facilitate sustainable development

[www.unepfi.org](http://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
- Trade finance – oil and gas commodity broker
- Working capital facility – commodity trading, Singapore
- Project finance – biofuel project carbon credit project, DFI finance, Tanzania
- Investment – wig manufacturer
How UK oil company Trafigura tried to cover up African pollution disaster

- Trafigura offers payout to 31,000 victims of toxic dumping
- Secret email trail exposes truth behind £100m legal battle
- Read the emails here

David Leigh
The Guardian, Wednesday 16 September 2009 22.08 BST

Guardian gagged from reporting parliament

David Leigh
The Guardian, Monday 12 October 2009 20.31 BST

The Guardian can reveal evidence today of a massive cover-up by the British oil trader Trafigura, in one of the worst pollution disasters in recent history.

The only fact the Guardian can report is that the case involves the London solicitors Carter-Ruck. Photograph: John D McHugh/AFP

The Guardian has been prevented from reporting parliamentary proceedings on legal grounds which appear to call into question privileges guaranteeing free speech established under the 1688 Bill of Rights.

Today's published Commons order papers contain a question to be answered by a minister later this week. The Guardian is prevented from identifying the MP who has asked the question, what the question is...
Twitter claims new scalp as Trafigura backs down

Paul Farrelly (Newcastle-under-Lyme): To ask the Secretary of State for Justice, what assessment he has made of the effectiveness of legislation to protect (a) whistleblowers and (b) press freedom following the injunctions obtained in the High Court by (i) Barclays and Freshfields solicitors on 19 March 2009 on the publication of internal Barclays reports documenting alleged tax avoidance schemes and (ii) Trafigura and Carter-Ruck solicitors on 11 September 2009 on the publication of the Minton report on the alleged dumping of toxic waste in the Ivory Coast, commissioned by Trafigura.

Trafigura fined €1 million for Ivory Coast toxic waste

Trafigura, the multinational company, has been fined €1 million (£845,000) for transporting toxic waste to the Ivory Coast.

Frans Bauduin, presiding judge, said in the Amsterdam district court that the Swiss-based company was guilty of breaking European waste export laws.

It was also found guilty of concealing what the charge sheet referred to as the "harmful nature" of the waste on board the Probo Koala ship that arrived at the port of Amsterdam in July 2006, but was redirected to the Ivory Coast.
Burning Old Computers Threatens Ghana's Health

Not far from the heart of one of Africa’s biggest cities, Accra, Ghana, black clouds of toxic smoke rise from an outdoor recycling operation that is converting America’s used computers into copper, gold and other useful materials.

The Agbogbloshie Market is also poisoning thousands of people who work and live at the outdoor inferno as well as many more of the city’s 2.3 million people downwind of the smoke. The city’s largest outdoor food market lies directly in the path of the smoke, adding to concerns.

But now a team of American researchers and experts has come up with a simple plan to end the burning and help 4,000 young people who depend on the recycling market for income continue their jobs without creating health hazards for themselves, their neighbors and future generations. The recycling is feeding thousands of people.

The smoke contains “significant” traces of arsenic, copper, chromium and the “scary” carcinogens dioxins, according to Hunter College public health professor Jack Caravanas. He recently visited Accra where he said a project has begun to test the blood and urine of people living near Agbogbloshie Market’s inferno of smoldering laptops, printers and CD boom boxes.

The site has “extensive lead contamination in both ambient air and topsoil,” Caravanas wrote in a published report. “Given the urban nature of this site as well as the large adjacent food distribution market, the potential for human health impact is substantial both to workers and local residents.”
Trading Company

- Assorted investments and financial services to commodity trading company in Singapore
- Interests in coffee, dairy, cotton

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CARVING UP THE CONGO

CONNING THE CONGO
Hershey Accused Of Using Cocoa Suppliers That Employ Child Labor

By Tom Hals

* Pension fund could sue Hershey, directors
* African cocoa sector uses forced labor, children - study
* Whole Foods dropped Hershey artisan brand
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.

Tuition fee from $20,000
Project Management Master's or PhD. 100% Online, 100% Supported! WaldenU.edu/Project-Manag...

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.

The use of plantations as a climate change mitigation strategy was heralded in some quarters as an innovative means of addressing the problem while leading to development in areas where such activities were rolled out. Unfortunately, the jury is out on the issue and the judgement is not as exciting. Preliminary results indicate that the plantation strategy is doomed to fail and cause more problems than it solves.
U.S. Wigs Made by Falun Gong Practitioners Turned Slaves

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

05 Feb 2004

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 Shibalihe 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

After 12 Years, Falun Gong's Peaceful Resistance Brings Hope Amidst Repression
Falun Gong News Bulletin: July 12, 2011
Nine New Falun Gong Deaths Recorded in June
Jiang Zemin, Architect of Falun Gong Persecution, Rumored Dead
South China Morning Post: Banks buy into jail-labour firm

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 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
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I. Identification of S&E risks
II. Categorisation
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Process Integration

Risk acceptance/Marketing
- Target market
- 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

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Group Work
Asamoah Textiles: 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 Client

- Shareholders
- Export market regulators
- Clients
- Community
- Financiers
- Insurers
- Employees
- Government
- NGOs
- Media
- Company

Loss of operating license
Strike, sabotage
Shutdown, delay
Campaigns
Negative Publicity
Contract loss, boycott
Loss of cover
Increased cost
Market Loss
Disinvestment
Risks to the FI

• Direct Risk (lender liability)
  – bank deemed a responsible party to a borrower’s polluting activities, or
  – bank enforces a possession order for an asset with environmental liabilities

• Credit Risk
  – fines for non-compliance, cleaning up, shifts in market perception, supply chain pressures.

• Guarantee Risk
  – Defunct/devalued collateral

• Market Risk
  – Sector wide practices; Market devaluation

• Funding Risk
  – Access to capital, Cost of funds

• Reputational Risk
Risks to the Client

- Shareholders
- Export market regulators
- Financiers
- Insurers
- Clients
- Community
- Employees
- Government
- NGOs
- Media
- Company

- Operating license
- Retention
- Renewal, expansion
- Cooperation
- Reputational benefits
- Stable markets, premium pricing
- Reduced cover
- Reduced cost
- Open markets
- Long-term investors
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
• UNEP FI’s Banking & Sustainability Guide
• www.firstforsustainability.org
Contents

I. Identification of S&E 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

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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</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>
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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
LUNCH BREAK
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I. Identification of S&E risks
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S&E Assessment

• Due diligence of the S&E risks
• Against a standard
  – Minimum compliance – national law
  – For higher risk – IFC Performance Standards
  – Avoid, minimise, mitigate and compensate
  – Increase positive impact
• Make recommendation
  – Identify areas of concern and way forward
# S&E Assessment Tools

<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</td>
<td>ER006, ER007, ER008A, ER010A</td>
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<tr>
<td></td>
<td>Independent Review</td>
<td></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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Group Work
Evaluation & management of risks
Evaluation tool for Category B

• Read Asamoah Ltd. Part 2
• Using form ER009 evaluate the 3 unjustified risks you identified with form ER002.
• 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.
• 45 minutes analysis
Contents

I. Identification of S&E risks
II. Categorisation
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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
• Next English ESRA online course
  6 – 24 May 2013
  29 July to 16 August
  28 October to 15 November
Thank you!

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