

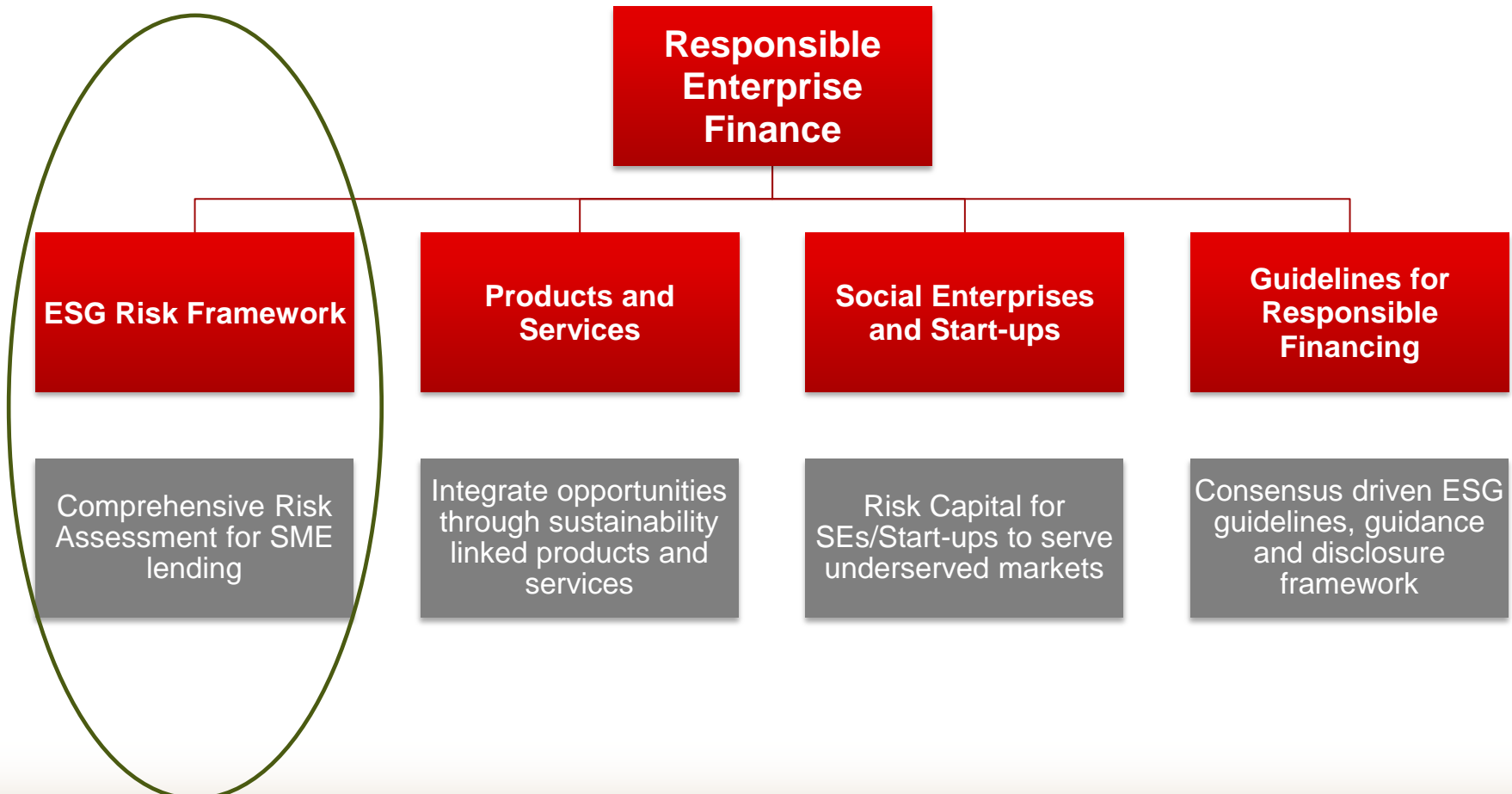


GIZ-SIDBI Responsible Enterprise Finance Programme

12 April 2017



Design of GIZ-SIDBI Project





Tools to identify ESG Risks & Opportunities

- Guidelines/Principles for Responsible Financing
- Framework for ESG Risk Assessment





NATIONAL VOLUNTARY GUIDELINES FOR RESPONSIBLE FINANCING



Principles

1. Ethical Conduct and E&S Governance

- Financial institutions should develop sound governance systems to oversee environmental and social performance of their business activities and disclose accordingly.

2. Integration of E&S Risk Management in Business Activities

- Financial Institutions should integrate the analysis of environmental and social factors into their investment, lending and risk-management processes across business lines to minimise adverse impact on its own operations and on society.

3. Minimising Environmental footprint in internal operations

- Financial institutions should minimise the negative impacts of their business operations on the environment in which they operate and, where possible, promote positive impacts.

4. Environmentally friendly products, services and investments

- Financial institutions should invest in environmentally friendly products and businesses that enhance positive environmental impact.



Principles contd...

5. Enabling inclusive human and social development

- Financial institutions should support inclusive and equitable human and social development.

6. Stakeholder Engagement

- Financial institutions should develop an understanding of their stakeholders' needs, interests and expectations to inform and guide their strategy and decision-making.

7. Commitment to human rights

- Financial institutions should respect and promote human rights.

8. Disclosure

- Financial institutions should regularly review and report on their progress in meeting the Principles contained in these Guidelines



ESG Risk Assessment Framework & Toolkit

The objective of this framework is to help investors/lenders analyze the ESG risks in financing an asset or a company, in a systematic manner



ESG Risk Assessment (Principle 2)

Stakeholder consultations brought out the need for an ESG Risk Assessment Framework :

- 1.Appropriate for SME credit assessment
- 2.Easy to use (automated excel tool)
- 3.References to Indian E&S laws & International best practices

The resultant ESG Risk Assessment Framework developed by experts is supported by an Excel based toolkit with 4 distinct tools that mirror the investment/credit process of Banks / FIs:



Tool 1: brief description



Tool 1: Initial Screening (check for acceptability of risk to pursue detailed analysis)

Exclusion List:

- **A sound exclusion list includes:**
- Activities regulated or prohibited under international agreements and national laws.
- Activities which may give rise to significant environment / social problems, or that lead to significantly adverse public reaction.

Initial risk based categorization

- Screening mechanism to determine the level of risk based on social, environmental and governance (ESG) related impacts resulting from the investment /project.
- Tool categorizes E, S & G risks separately based on the business sector
- Simple tool obtaining results on its E, S & G sensitivities based on sectors
- This helps determines the due diligence intensity required in Tool 2.





...Tool 1 (cont): Risk Classification of Investment

Classification of investments into high, moderate and low risk

Parameters	High Risk	Medium Risk	Low Risk
Environment	Likely to have significant adverse environmental impacts	Potential adverse impacts on environmentally important areas.	Minimal or no adverse environmental impacts. (per the <u>MoEF classification</u> Detailed in Annexure 2)
Social	Likely to have significant adverse impacts on human populations	potential adverse impacts on human populations	Minimal or no adverse impacts on human populations. (Annexure 3)
Governance	does not have any elements of good corporate governance <ul style="list-style-type: none">• The CIBIL score (50-60%).• Show cause notice or negative publicity / brand.• The company has no transparency and ethics policy.	has only some elements of good corporate governance. <ul style="list-style-type: none">• The CIBIL score (60-75%).• The company has weak transparency and ethics policy.	has strong elements of good corporate governance. <ul style="list-style-type: none">• CIBIL score (>75%)• The company has a robust transparency and ethics policy





Tool 2: Due Diligence (automatically selected checklists)

Due diligence to evaluate performance of company on E, S and G parameters. It also checks compliance with international and national standards.

2 checklists have been devised:

- a. General Checklist- For High, Medium and Low Risk investments
- b. Sector specific checklists for the 8 identified sectors:

Agriculture and food processing, Education, Healthcare, Infrastructure, Information Technology, Motor vehicles & transport, Utilities, Telecommunications





Tool 3: Scoring

Parameters	0	1	2	3
Environment				
Social Development				
Governance				

Note: 0= unsatisfactory; 1= satisfactory;
2= v. good; 3 = excellent.

Explanation of rating

Rating 0

Does not meet minimum ESG standards

Rating 1

Fully compliant with all applicable laws & regulations

Rating 2

Goes beyond legal requirements & follows additional ESG best practices

Rating 3

Incorporates international best practices in its procedures





Tool 4: Terms and Conditions and Monitoring Measures

1 The assessment done evaluates if the project /company is in accordance with the ESG Framework. **Gaps** , if any are identified. An **action plan** for bridging gaps is agreed between bank and company.

Key gaps identified

Mitigation actions or recommendations

Budget or cost for corrective actions

Responsibility for action
(investee/ Associated Party/ contractor)

Deadline for completion of the corrective actions

2 Potential **opportunities** are identified during assessment process.

Potential opportunities

Measures recommended

Review period

Implementation Timeframe

Support required from FI

Financial implication

ESG Impact

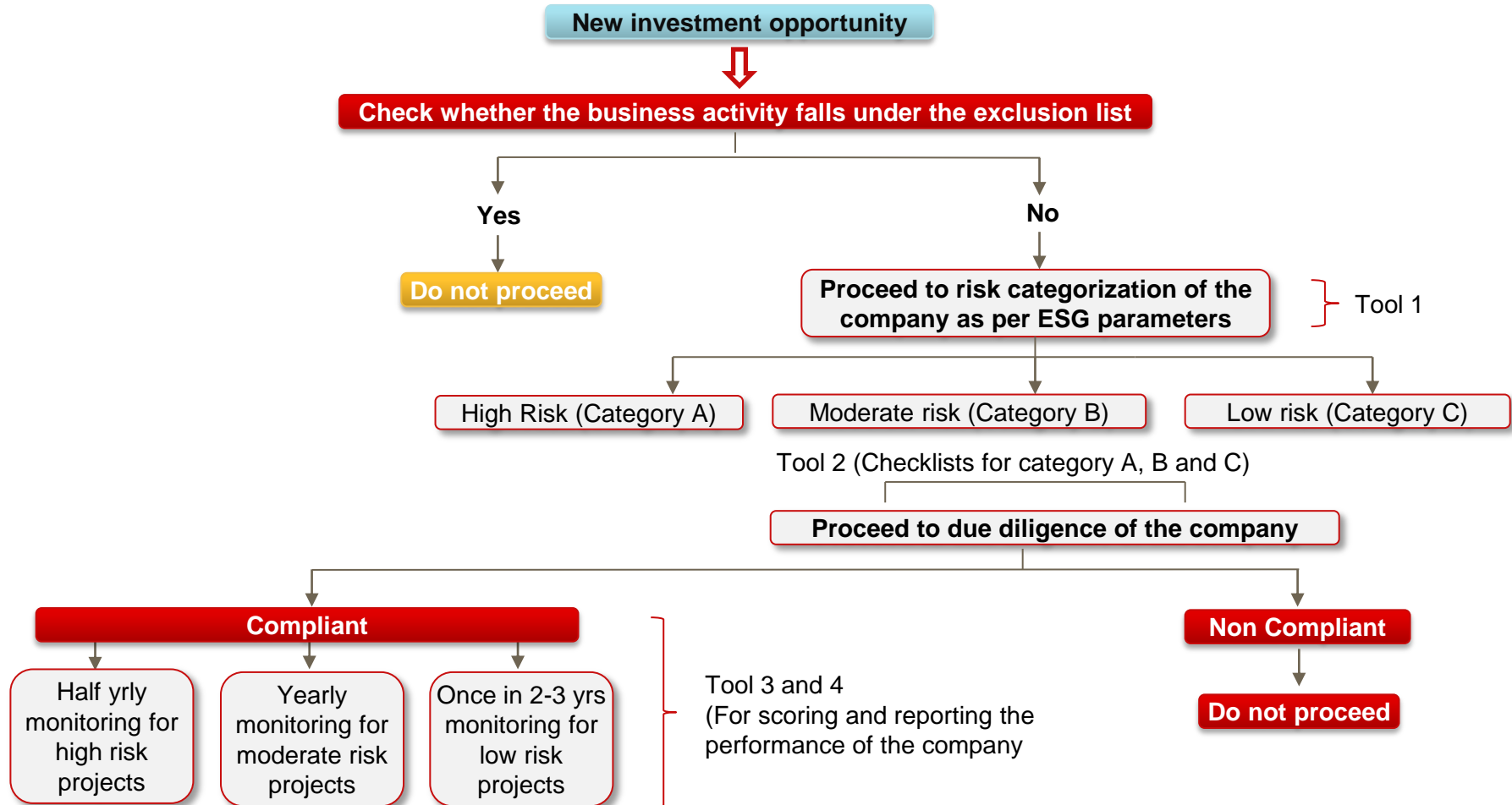


Microsoft Word Document



Summary: Implementation of ESG Framework

Procedures to be followed using the ESG Toolkit



Toolkit Usage

- **Trainings** have been conducted in 5 public and private sector banks for almost 500 SME bankers (around 400 were of AGM grade and above).
- 16 Credit Managers in 2 banks have **tested** the toolkit while doing their regular credit assessments.

_from training workshops and live testing shows :

- Over 99% agreed that the training workshop helped improve their understanding of ESG Risks and should be held regularly
- 95% reported back that the ESG risk assessment framework and toolkit will be useful/applicable in their work
- Around 90% agreed that the excel based toolkit is easy to understand and use
- Other feedback included (a) recommendation for simultaneous adoption by all banks (IBA –RBI meeting) (b) banks can incentivise good ESG practices by rewarding clients with good ESG ratings as per toolkit
- 2 banks have put in place internal policies for **adoption** of ESG risk assessment