Guidelines on
Environmental & Social Risk Management (ESRM) for
Banks and Financial Institutions in Bangladesh

Bangladesh Bank
Sustainable Finance Department

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Preamble

Sustainability has been increasingly being recognized as central tenant to the growth of emerging market economies including Bangladesh. New standards and codes of conduct have been developed towards Environment and Social Risk Management (ESRM) within the financial sector to promote corporate accountability and transparency on the impacts of businesses on environment and society. From the perspective of the financial sector, the role of Environmental and Social (E&S) Risk Management is aimed at reducing the Probability of Default (PD) for banks and Financial Institutions (FIs) in their credit/investment stemmed from environmental and social risk factors as well as ingraining the sustainability in the core business model of them.

With a view to integrating sustainability into overall credit management of banks and FIs, Bangladesh Bank issued Guidelines on Environmental Risk Management (ERM) in 2011 which has been the pioneering initiative from any central bank or financial sector regulator. The objective was to establish a minimum standard to incorporate the active evaluation of environmental and social issues in assessing PD of credit/investments of banks and FIs to promote sustainable business practices in Bangladesh. Guidelines on ERM focussed primarily on the environmental risks and included a few social risks. The approach remained qualitative towards rating the environmental risks. The applicability of the ERM Guidelines was defined based upon the quantitative thresholds of credit/investments and the loan categories included Small & Medium Enterprises (SME), corporate financing and real estate financing. One of the core principles of the ERM Guidelines was to acknowledge that the Guidelines are dynamic in nature and there is a need for updating the guidelines at least every 3 years/as and when required and hence contained a number of recommendations for future updates of the Guidelines.

This update to ERM Guidelines, titled as ESRM Guidelines, has been developed to address the recommendations of the ERM Guidelines and the outcomes of ESRM baseline survey for the financial sector through a long process of in-house study and research within BB, having technical support from IFC (International Finance Corporation), three tier consultation (Mail/E-mail based consultation, web-based consultation and live consultation) with banks and FIs, consultation with development partners working on E&S issues in financial sector

In particular, as the name suggests, the ESRM Guidelines expand the scope of social risk assessment and introduce a number of social parameters in addition to environmental parameters for risk assessment. The Guideline also exemplifies the sources of both environmental risks and social risks for banks and FIs and highlights the benefits of having an Environmental & Social Management System (ESMS) in place. Moreover, exhaustive approach has been introduced in this version to make the assessment of risks more objective.

Message from Governor

Bangladesh is one of the emerging economies of the World and has witnessed rapid industrial growth over the last two decades that has contributed significantly to the rise in the country's Gross Domestic Product (GDP). At the same time, it also needs to be noted that Bangladesh is vulnerable to risks related to environmental pollution and climate change impacts (in the form of natural disasters like floods, cyclones) that are enhanced by man-made activities. Some of the common Environmental & Social concerns include *converting paddy fields into industrial land, filling of water bodies for other purposes, encroaching into forest lands, pollution* that need to be discouraged for the sake of environmental and social sustainability of the country.

All these issues have significant adverse impacts on human health (from the perspective of both public health and health & safety of workers exposed to harmful chemicals) and flora and fauna. Severe health outbreaks, groundwater depletion, rapid degradation of natural habitat arising out of these irresponsible business practices pose significant threat to the continuity of these business activities, which in turn will adversely impact the loan portfolio of the banks and FIs if they invest in these activities without taking into account mitigation of these environmental issues.

Banks and FIs have a significant role to play while taking a decision if loans should be disbursed to businesses involving such activities. Moreover, banks and FIs need to manage the credit portfolio through active consideration of environmental and social vulnerabilities. Following the implementation experience of Guidelines on ERM since its issuance, an encouraging awareness and enthusiasm have been observed in financial sector both in context of risk management and sustainability. In the meanwhile, Sustainable Development Goals (SDGs) have been declared by United Nations and have already been fully adopted by Government of Bangladesh. As prime cornerstones of SDGs are environmental conservation and social protection, credit operations of banks and FIs must be conducted through proper addressing of environmental and social issues. 10 year Perspective Plan, National Sustainable Development Strategy and 7th Five Year Plan of Government of Bangladesh have been built upon the vision of green and sustainable economy by ensuring social stability. To facilitate these plans and strategies of the Government, to fortify the risk management structure of banks and FIs and to ingrain sustainability into the heart of financial sector, it's time move further. In this backdrop, Bangladesh Bank is officially releasing Guidelines on Environmental & Social Risk Management (ESRM) for Banks and Financial Institutions in Bangladesh. Like the Guidelines on ERM issued in 2011, Guidelines on ESRM is also a pioneering endeavor from the central bank. And hopefully, this will be effectively implemented by banks and FIs under the guidance and leadership of the central bank towards achieving sustainable development of the country.

Fazle Kabir

Foreword by Deputy Governor

As a part of the venture to ingrain sustainability into the business practices of banks and FIs, to expand the risk management horizon of them, to properly address the link between probability of default with the environmental vulnerabilities, Guidelines on ERM for banks and FIs was issued in 2011. This was the second initiative from Bangladesh Bank following the introduction of refinance scheme for renewable energy and green sectors in 2009 for heading towards green banking. In issuance of Policy Guidelines on Green Banking, ERM was established as one of core aspects of Green Banking. In 2012, monitoring of Environmental Due Diligence conducted by banks was started by Bangladesh Bank as a part of quarterly monitoring of Green Banking activities of banks. In 2013, a baseline study was conducted by Bangladesh Bank jointly with IFC to assess the implementation experience of Guidelines on ERM. The outcomes of the study indicated to expand the scope of this guidelines by incorporating social issues. In this light, Bangladesh Bank entered into a Cooperation Agreement with IFC for having technical support to formulate a comprehensive framework on ESRM for banks and FIs in light of the following context:

Typical examples of environmental issues in the country's industrial landscape include generation of highly polluted waste water due to lack of metering, reuse and recycling of water; sulphur-di-oxide emissions from burning low grade coal in outdated brick kilns; contamination of terrestrial and marine environment from leaching of toxic chemicals from scrapped ships due to improper cleaning of ships before beaching and lack of implementation of waste management practices by the ship breaking units; contaminated effluents and harmful fumes emitting from the steel re-rolling units. Coal fired power plants near ecologically sensitive areas can also be damaging to local biodiversity.

In terms of social issues related to labour practices and working conditions of the country's industry sector, the collapse of the eight storied "Rana Plaza" garment factory in 2013, Boiler burst in Tampaco Foils in 2016 and the fire incident at Tazreen Fashion in 2012 killing thousands of garment workers are consequences of gross negligence by the factory owners towards structural and fire safety, overlooking the poor working conditions in which the workers continued to work, producing the garments that earned the country's majority of the export revenue. The magnitude of these incidents has drawn attention of all the global retailing brands who are the major buyers of Bangladesh's products. Other common concerns related to social issues include child labour, discrimination and harassment, minimum wage etc. Consequently, the banks and FIs will have to take cognizance of the status of compliance, mitigation measures of a business activity in terms of national regulations and relevant international standards in this space before taking a decision on lending.

This guideline has come through a long process of drafting by experts of Bangladesh Bank and IFC, rigorous multi-step consultation with banks and FIs as well as development partners. Bangladesh Bank will be fully supportive as always in implementation of the guidelines along with capacity building initiatives. Moreover, based upon the implementation experience, scope for modification is always open. Let's foster the journey towards sustainability.

Shitangshu Kumar Sur Chowdhury

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List of Abbreviations

BDT	Bangladeshi Taka
CAMELS	Capital Adequacy Assets Management Capability Earnings Liquidity Sensitivity
CITES	Convention on International Trade in Endangered Species
CRMC	Credit Risk Management Committee
DoE	Department of Environment
E&S	Environmental & Social
EC	Executive Committee
ECR	Environment Conservation Rules
ERM	Environmental Risk Management
ESAP	Environmental and Social Action Plan
ESDD	Environmental & Social Due Diligence
ESIA	Environmental & Social Impact Assessment
ESMS	Environmental & Social Management System
ESRM	Environment and Social Risk Management
ESRR	Environmental and Social Risk Rating
ETP	Effluent Treatment Plant
FI	Financial Institution
GDP	Gross Domestic Product
GHGs	Greenhouse Gases
HoC	Head of Credit
IFC	International Finance Corporation
IMF	International Monetary Fund
IP	Indigenous People
MD	Managing Director
NGO	Non-Governmental Organization
ODS	Ozone Depleting Substances
PAH	Polycyclic Aromatic Hydrocarbons
PCB	Polychlorinated Biphenyl
PM	Particulate Matter
RMC	Risk Management Committee
RMG	Ready Made Garment
RO	Relationship Officials
SBN	Sustainable Banking Network
SFU	Sustainable Finance Unit
SME	Small & Medium Enterprises
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
VOC	Volatile Organic Compound

1. Overview of the Guidelines

The core objective of the ESRM Guideline is to make banks and FIs realize to integrate Environment & Social (E&S) risks and incorporate appropriate risk mitigation measures in overall credit management to be able for expanding the credit/investment portfolio rather than avoid investing in high E&S risks. Consequently, compared to the erstwhile ERM Guidelines, the ESRM Guidelines introduce the following features to be more streamlined, interactive and user friendly in nature:

- The ESRM Guideline provides a robust, auto generated, quantitative risk rating system to reduce the subjectivity of a qualitative risk assessment method that was present in the ERM Guidelines.
- The ESRM guideline has a bigger focus on social and climatic risks which are becoming relevant and crucial for Bangladesh.
- The generic and sector specific E&S Due Diligence (ESDD) checklists (Annex-2) in the ESRM Guideline incorporate guidance notes to assist the Relationship Managers (RM) in carrying out the due diligence process.
- The ESRM Guideline, in addition to investment threshold, define applicability based upon sector specific E&S impacts and the categories are expanded to include agriculture, retail, trade, microfinance, SME and, corporate financing and project financing.
- The organisational roles and responsibility defined in the ESRM Guideline are built upon the principles of integration of E&S risks into the bank or FI's overall credit policy. It clearly delineates the responsibility of different functions of a bank or FI in terms of E&S risk assessment and the decision-making process based upon E&S risk rating.
- The new ESRM Guideline includes one Generic ESDD checklist and 10 sector specific checklists for high risk sectors. Thus it is broad in scope but at the same time the process is much more streamlined for ease of use by the practitioners in the financial sector.

2. Typical E&S Risks for Banks and FIs in Bangladesh

Potential E&S risks may not seem significant or relevant at the time of approval of a financial transaction, but may become so during execution, for instance as a result of higher regulatory standards and increased levels of enforcement. In other cases, E&S risks, such as spills or explosions, may seem unlikely to occur, but when they do, the E&S impact is potentially extremely high. Please refer to E&S risks in detail (Annex-4) for explanation on some of the common E&S risks.

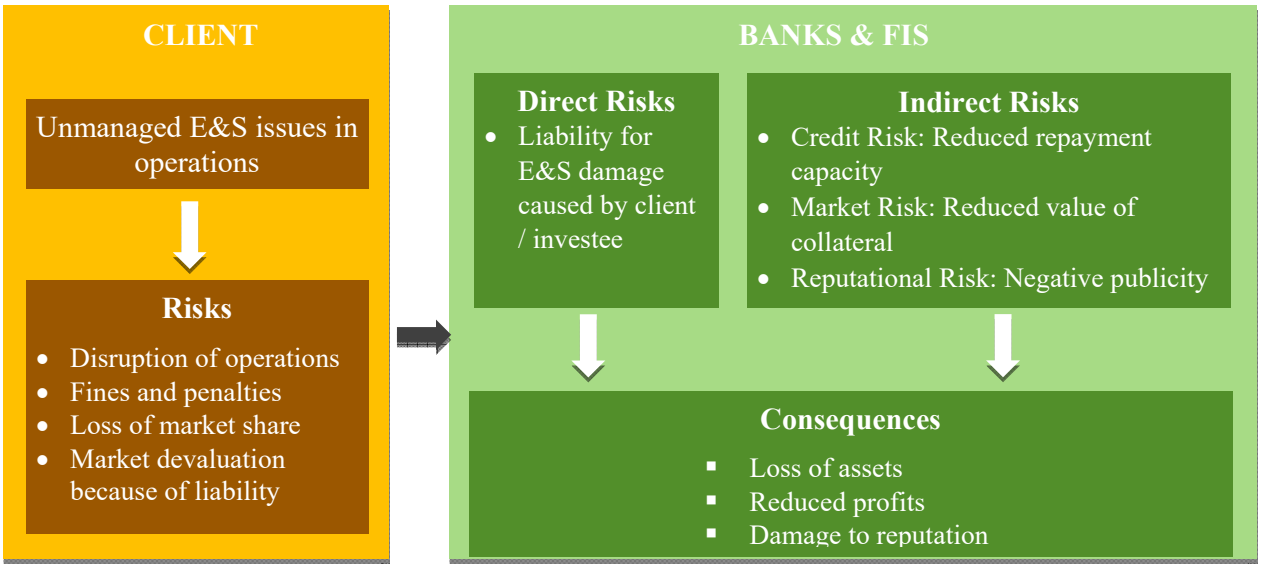
To reduce exposure to risk arising from the E&S risks of their clients, Bank/FIs need to ensure that their clients' financial and operational sustainability is not undermined by adverse impacts on the environment and surrounding communities. Bank/FIs need to have a clear understanding of potential E&S risks and implications for a client's operations prior to being linked to the client in the context of a transaction.

This requires proactive identification, assessment, and management of E&S risks before they become significant or result in an adverse outcome on the client. A Bank/FI can best achieve this by

developing and implementing an Environmental and Social Management System (ESMS), to systematically assess the E&S risks and opportunities arising from their clients' operations and manage its exposure to risk.

3. Risks associated with E&S Risk in Credit Management

Banks and FIs are exposed to some level of E&S risk through their clients. If left unmanaged, these risks can lead to a decline in the Bank/FI's reputational image, costly litigation, or loss of revenue. The type, quantity and severity of E&S issues that present a risk to a Bank/FI for any given transaction depend on a variety of factors, including geographic context, industry sector, and the type of transaction: corporate, real estate, insurance, leasing, microfinance, project finance, retail, short-term finance, micro, small and medium enterprise and trade. Please refer to Credit Type Wise E&S Risks (Annex-5) for risks associated with different types of transactions.



- **Credit risk**: A Bank/FI is exposed to credit risk when a client is unwilling and/or unable to fulfil the contractual obligations associated with a transaction as a result of E&S issues. For example, if a client faces increased capital or operating costs of complying with E&S standards or if operating and emission/discharge permits are absent or expired resulting in regulatory fines or penalties, there is a risk that the client cannot meet its financial obligations to the Bank/FI. Again, a Bank/FI is exposed to credit risk stemming from a reduction in the value of collateral associated with a transaction due to E&S problems. For example, if a production site becomes contaminated, the market value of the underlying collateral will fall.
- **Legal risk**: By virtue of taking possession of collateral assets, a Bank/FI is exposed to liability risk stemming from a client's legal obligations. This includes fines, penalties, and costs for addressing third-party claims for damages due to negligence in managing E&S risks in a client's operations and clean-up of contamination. If the Bank/FI is a principal shareholder of a client's operations, it may also be directly liable for all E&S risks associated with a client's operations.

- **Operational risk**: A Bank/FI is exposed to financial risk stemming from potential disruption of client's operations as a result of E&S problems. If not managed properly, these problems can affect a client' stability to meet its financial obligations to the Bank/FI and/ or can drive down the value of a client's collateral in the context of a transaction. A client's failure to effectively address E&S considerations can jeopardize its business operations as well as the Bank/FI that is supporting the transaction.
- **Liquidity risk**: The Bank/FI will also face liquidity risks from E&S problems associated with collateral. For example, the Bank/FI will have to use up internal resources to meet government clean-up requirements or to clean the site up before it can be sold if collateral is contaminated.
- **Reputational risk**: A Bank/FI is exposed to reputational risk due to potentially negative publicity associated with a client's poor E&S practices. This harms a Bank/FI's brand value and image in the media, with the public, with the business and financial community, and even with its own staff. For example, if a client faces strong public opposition against its operations, the Bank/FI's reputation may be tarnished through its association with this particular client.

4. Applicability of the Guidelines

The loan categories for which the ESRM Guideline is applicable are agriculture, retail, trade, microfinance, SME, corporate finance and project finance. All loan proposals (New/Renewal/Rescheduling/Restructuring) for the above applicable sectors will have to be first screened against the exclusion list (Annex-1).

Agriculture: In the agriculture sector, if a loan application (New/Renewal/Rescheduling/Restructuring) involves farming/crop production activities, poultry and dairy then in addition to exclusion list, it is to be checked using the generic ESDD checklist (Annex-2), if there is any environmentally or socially adverse agricultural practices involved such as use of pesticides, agro-chemicals leading to top soil depletion, ground water contamination; use of nitrogenous fertilizers instead of organic fertilizers leading to nitrous oxide emissions etc. Agribusiness involving sorting, packaging, distribution and sales will not require completing ESDD checklist.

SME: In the small enterprise category sector, if the following activities are involved, then a loan application (New/Renewal/Rescheduling/Restructuring) worth above BDT 1.00 million (BDT 10.00 Lakh) will be subject to due diligence using generic ESDD checklist (Annex-2), in addition to exclusion list, even if the loan amount is less:

4.1) Washing, dyeing and finishing units of RMG sector (water, chemical pollution)
4.2) Small steel re-rolling mills (operational health and safety, thermal, air pollution)
4.3) Brick kilns (air pollution, child labour, burning of fossil fuel)
4.4) Units for tanning, dressing and dyeing of leather and fur (water, chemical, air pollution)
4.5) Pesticides, agrochemical and nitrogen manufacturing units (land contamination, water, air pollution)

4.6) Chemicals and chemical products manufacturing units (safety, pollution)
4.7) Rubber and plastic products manufacturing units (pollution)
4.8) Batteries and accumulators manufacturing units (chemical pollution)

All loan applications (New/Renewal/Rescheduling/Restructuring) in the medium enterprise sector will have to undergo E&S due diligence as per the generic or sector specific ESDD checklist.

Corporate Finance: All loan applications (New/Renewal/Rescheduling/Restructuring) for corporate finance will have to undergo E&S due diligence process using the generic ESDD checklist and where applicable, the sector-specific ESDD checklist (Annex-2).

Trade, Retail and Microfinance: For all trade, retail and microfinance only the exclusion list will have to be consulted. Any transaction in the Exclusion List will have to be terminated.

Project Finance: For all Project Finance transactions, apart from Exclusion List and Generic or sector specific checklist a third party Environmental and Social Impact Assessment (ESIA) will have to be conducted. ESIA will generally be arranged by the client at his/her/its own cost and submitted along with loan application. Bank/FIs will ensure that the third party will be qualified by the criteria set by Bangladesh Bank in this purpose.

Table 1: Applicability of the guideline by the transaction type

S. No.	Transaction Type	Exclusion List	ESDD checklist	Third party ESIA
1	Agriculture activities involving farming, crop production	✓	✓	
2	Other agricultural activities	✓		
3	Retail, Trade, Microfinance	✓		
4	Small sector falling in one of the categories listed above from 4.1) to 4.8)	✓	✓	
5	Small sector NOT falling in one of the categories listed above from 4.1) to 4.8)	✓		
6	Medium sector	✓	✓	
7	Corporate Finance	✓	✓	
8	Project Finance	✓	✓	✓

5. Applicable Standards

All national regulations pertaining to E&S governance will be applicable while carrying out E&S due diligence of a particular transaction. This means all relevant E&S permits, consents, licenses, and monitoring of E&S parameters as per the national regulations are to be considered as mandatory compliance requirements for evaluation of a loan application. A list of applicable national regulations and international treaties where Bangladesh is a signatory is provided as Annex 10 for reference.

If clients have management systems in place as per international frameworks such as ISO 14001for environmental management, OHSAS 18001 for occupational health and safety, SA8000 for socially acceptable practices in the workplace then it will be considered as good practices.

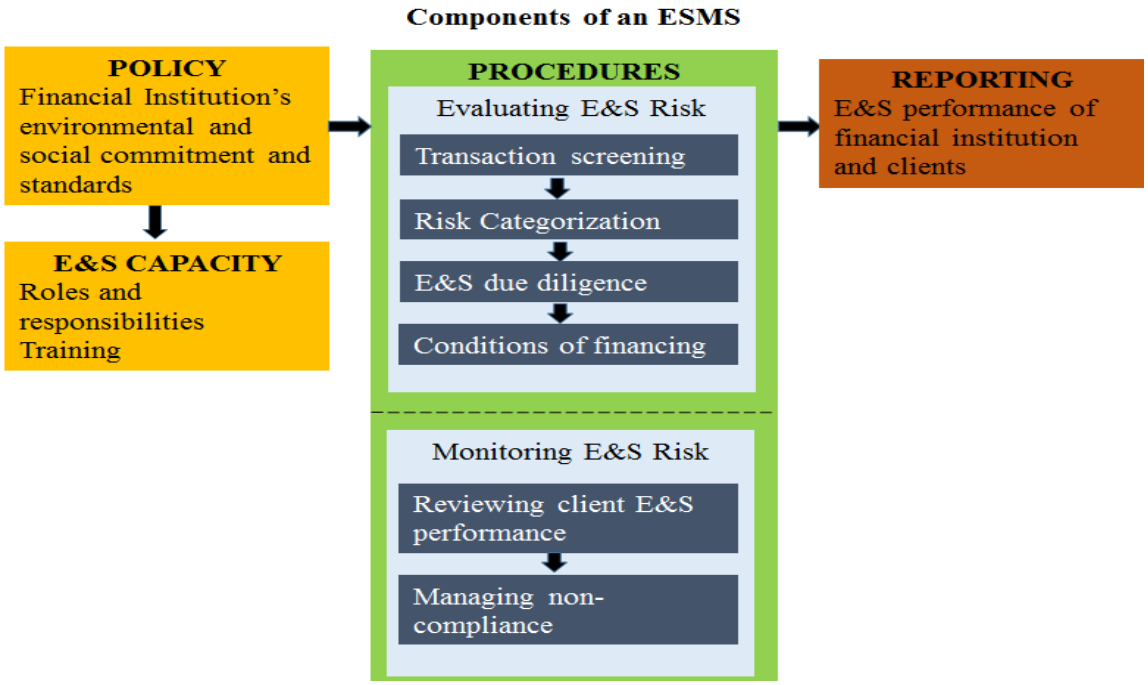
Adherence to IFC Performance Standards will be considered in case of large project financing as a good practice and optional requirement.

In order to identify, manage and mitigate E&S risks in lending, all banks/FIs need to develop a robust Environmental and Social Management System (ESMS).

6. Environmental and Social Management System (ESMS) for Banks/FIs

An E&S Management System is a set of policies, procedures, tools and internal capacity to identify, monitor and manage a Bank/FI's exposure to the E&S risks of its clients. An E&S Management System states a Bank/FI's commitment to E&S management, explains its procedures for identifying, assessing and managing E&S risk of financial transactions, defines the decision-making process, describes the roles, responsibilities and capacity needs of staff in doing so and states the documentation and recordkeeping requirements. It also provides guidance on how to screen transactions, categorize transactions based on their E&S risk, conduct E&S due diligence and monitor the client's E&S performance. The ESMS includes the financial institution's environmental and social policy and designated roles and responsibilities of its staff. It is implemented through a set of procedures for:

- Screening transactions,
- Conducting environmental and social due diligence,
- Categorizing transactions based on their environmental and social risk,
- Decision-making process,
- Monitoring the client's/investee's environmental and social performance, and
- Managing a client's/investee's non-compliance with the environmental and social standards of banks/FIs.



The procedures outlined in the ESMS need to be applied to each transaction as part of overall risk management framework of a bank/FI. For each transaction, this also requires a financial institution to formally document its environmental and social review as part of its record-keeping process, consider environmental and social findings during the decision-making process, and incorporate environmental and social requirements such as a corrective action plan as clauses in legal agreements with clients/investee.

To ensure the effective implementation of the ESMS across operations, the bank/FI needs to allocate the necessary resources for internal communication and training. As part of its commitment to good corporate practices, banks/FIs will need to periodically report on the environmental and social performance of transactions and measures taken to reduce overall exposure to environmental and social risk.

An ESMS helps a bank/FI to:

- Identify environmental and social risk associated with clients/investees and understand the potential impact on its portfolio;
- Systematically assess and manage environmental and social risks;
- Implement the necessary steps within its risk management system including documentation and recordkeeping;
- Monitor client/investee compliance with national environmental and social regulations and international best practices and standards;
- Require clients/investees to implement mitigation measures for identified environmental and social risk;
- Identify social and environmental business opportunities; and
- Develop a good reputation among clients/investees, investors and other relevant parties in the financial market.

Key components of an ESMS are described below.

A. E&S Policy

An E&S policy states a Bank/FI's vision and mission with respect to the environment, society and contributions to sustainable development. It is a short, written statement that articulates the Bank/FI's commitment to integrating E&S considerations into its business activities as well as contributions to sustainable development. It serves as the Bank/FI's foundation within which the objectives and procedures of the ESMS are anchored. The E&S policy should be approved and supported by senior management. It may include the following statements and commitments:

- Incorporating E&S risk considerations into all financing activities;
- Setting strategic E&S objectives, such as offering new products that address E&S sustainability;
- Excluding financing clients whose business activities do not meet the Bank/FI's principles;
- Establishing E&S requirements for clients such as complying with national E&S regulations and international standards;
- Communicating E&S expectations to all staff, clients and other external stakeholders;

- Committing to improving the overall E&S performance of its portfolio through enhanced risk management;
- Committing to continually building capacity of its staff to identify E&S risks, including E&S and investment officers/analysts.

There is no standard content for an E&S policy, however the same should be tailored to the specific objectives of the Bank/FI, reflecting key E&S priorities and concerns as well as the E&S standards that clients are required to comply with. The Credit officer can start developing an E&S policy by reviewing the Bank/FI's portfolio to gain an understanding of the E&S risks associated with its financing activities.

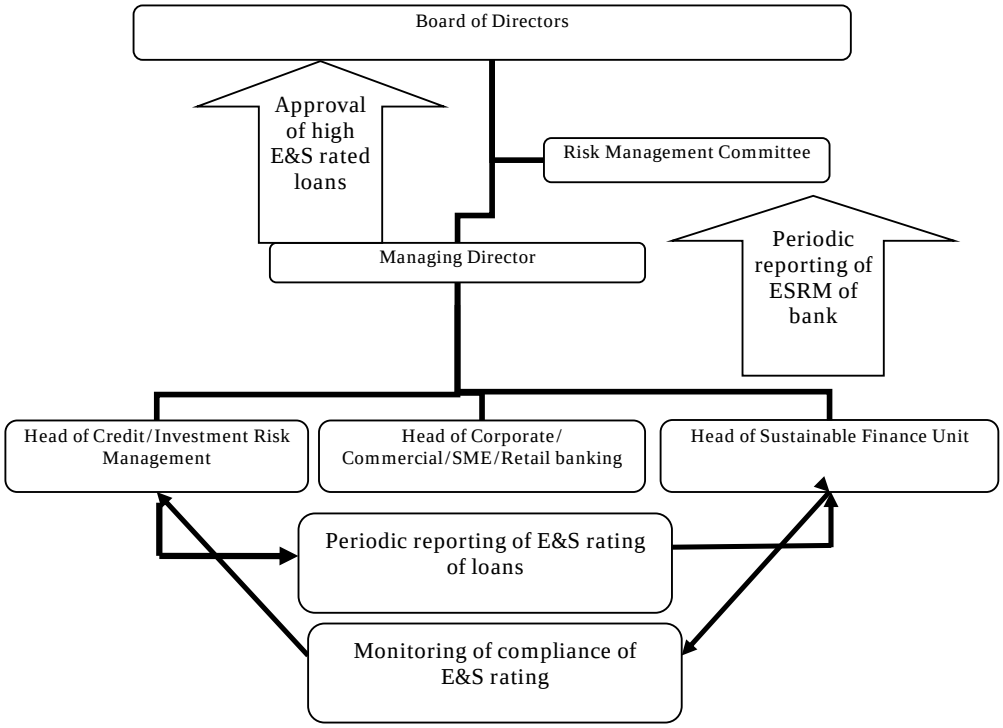
B. Organization structure

For an ESMS to function properly, it is essential that roles and responsibilities for carrying out the necessary procedures and making decisions are clearly defined. The following staff of a Bank/FI will be involved with implementing different aspects of the ESMS:

- ***Relationship Officials (Officials in Corporate or Retail or SME or Agri. Credit Division):*** ROs are responsible for identifying E&S risks in a client's operation by talking to the client/ relevant officials, site visits, collecting documents, permits relevant for the proposed transaction. ROs are responsible for filling out the ESDD checklist in consultation with the client at approval stage, collect additional information and respond to credit queries if necessary also follow up with client if there are any pre disbursement actions to be completed. ROs also negotiates with the client in finalising action plans and timelines where necessary.
- ***Official in CRM Division:*** Official in Credit/Investment Risk Management (CRM/IRM) Division in Head Office/Branch (depending on centralized or decentralized credit management system) is the first point of contact for any transaction once the ESDD has been conducted by the ROs (Banks and FIs conducting credit/investment risk grading for SME/Agri./Retail credit through respective divisions will perform ESRM functions through those divisions for those credits.). Based upon the risk rating the official escalates the transaction to Head of CRM/IRM. There must be a separate unit within CRM/IRM division for ESRM with at least 01 (one) dedicated official.
- ***Head of CRM***: Head of CRM/IRM is responsible for ensuring that in each transaction no critical E&S issues were overlooked, there is adequate documentary evidence to support client's E&S performance and to ensure enough measures have been taken to manage identified risk.
- ***Senior Management / Board of Directors***: The Senior Management should be responsible for the Bank/FI's overall commitment to E&S objectives. For Banks/FIs in Bangladesh the Managing Director (MD) and the Board represents the senior management. Senior Management establishes the Bank/FI's E&S requirements and conditions for clients. In cases of unresolved E&S issues or non-compliance associated with a transaction that cannot be resolved by the Head of CRM/IRM, Senior Management determines the appropriate course of action to follow to reduce the Bank/FI's potential exposure to E&S risk, which may include taking legal action against the client. Board/EC (Executive Committee) is responsible for deciding if E&S risks in high risk projects are acceptable to the Bank/FI's overall exposure to risk before proceeding with a transaction. The Board in certain cases may decide to terminate

a transaction based upon the level of risk of the project. Risk Management Committee (RMC) of Board will review, monitor and supervise the overall ESRM activities of bank/FIs.

- ***Legal Department***: The Legal Department ensures that the Bank/FI's E&S requirements are incorporated in legal agreements for each transaction. The Legal Department may advise if a client's non-compliance with E&S clauses constitutes a breach of contract and is considered an Event of Default under the terms of the legal agreement that requires follow up by Senior Management.
- ***Sustainable Finance Unit (SFU):*** SFU (Please refer to SFU Circular No. 02/2016 issued by BB on December 01, 2016) of every Bank/FI in Bangladesh is responsible for coordination with different departments, branches of the Bank/FI for ensuring the compliance of ESRM and proper implementation of ESMS. This unit is responsible for updating the Board/RMC through Sustainable Finance Committee on the current status of the Bank/FI's portfolio regarding ESRM, facilitating the Board/RMC's decision making process where there are unresolved E&S issues or non-compliance. The unit is also responsible for periodic reporting to Bangladesh Bank and as/when required. Head of the SFU may be called upon by the Board to opine on critical E&S issues of a particular transaction. The SFU is also responsible for tracking latest E&S issues in the media and support transaction teams in identifying and managing E&S risks in lending.



C. Screening Transaction

At the initial stage of evaluating a potential financial transaction, RO should screen the activities of the potential client to determine if it is an excluded activity. If the activity falls on the Bank/FI's list of excluded activities, the financial transaction should not be considered. During the initial screening the RO should consider the Department of Environment (DoE) categorization as it gives a

sense whether the transaction is in a high risk sector. DoE categorization is important to understand sectoral risk, but Banks/FIs will be required to complete the ESDD to identify transaction specific risks.

D. Categorizing Transaction

To determine the extent of E&S due diligence which will be required for a particular transaction, an E&S risk category should be assigned to each transaction. The level of E&S risk will vary greatly for different types of financial transactions and by industry sectors. To help a Bank/FI to determine the extent of E&S due diligence that will be required for a particular transaction, Bank/FI staff should assign an E&S risk category to each transaction. This provides an initial assessment of the E&S risk associated with the transaction. Together with the findings of the E&S due diligence, this E&S risk category can be incorporated into the overall risk assessment of a transaction and factored into the decision-making process. This initial categorisation can be done by considering DoE categories of Green, Orange A, Orange B and Red. A list of business categories is available in the Environment Conservation Rules (ECR), 1997. Bank/FI can also assign financial intermediary as a risk category to those transactions involving clients such as banks, microfinance institutions, private equity funds, and leasing and insurance companies, which act as financial intermediaries in making financing available to other clients. By assigning the financial intermediary category, the environmental and social risks related to these types of transactions can be managed accordingly.

An environmental and social risk categorization system enables a Bank/financial institution to monitor and evaluate its exposure to environmental and social risk aggregated at the portfolio level. A Bank/financial institution can set internal threshold levels for its overall exposure as a function of environmental and social risk category or by exposure to industry sector or transaction type as a function of environmental and social risk category. This allows the financial institution to better manage and track changes in the overall risk profile of its portfolio and the associated environmental and social impacts of its clients/investees. This information can also be used by the Bank/Financial Institution to report internally to Senior Management and externally to stakeholders on overall environmental and social performance.

E. Conducting ESDD

Conducting ESDD on transactions is a critical component of a Bank/FI's ESMS and its outcome should be factored in to the decision-making process for proceeding with a transaction. The purpose of the E&S due diligence is to review any potential E&S risks associated with the business activities of a potential client ensure that the transaction does not carry E&S risks, which could present a potential liability/risk to the Bank/FI. The purpose of the E&S appraisal is to:

- Identify and assess potential E&S impacts and issues, both adverse and beneficial, associated with a proposed investment project;
- Conduct a gap analysis to define areas of project noncompliance with the requirements of the national laws
- Assess the commitment and capacity of the client to manage identified impacts and define remedial measures as needed;
- Assess the quality and adequacy of the client's E&S management systems and practices to avoid, minimize, or mitigate adverse impacts, and define remedial measures as needed;

- Identify measures to avoid, minimize, mitigate, or offset/compensate for adverse impacts on workers, affected communities, and the environment;
- Design an Environmental and Social Action Plan (ESAP or Action Plan) addressing all deficiencies and non-compliances discerned during the appraisal containing specific tasks designed to close all significant gaps;
- Ensure that the investment contracts (e.g., loan documentation) include appropriate definitions, covenants, clauses and associated elements to obligate the client to comply with all E&S laws and regulations, the ESAP, and applicable sections of general and sector-specific checklists; and stipulate progress and performance reporting obligations;
- Identify opportunities (e.g., clean production and energy efficiency) to improve E&S performance and
- Conceptualize specific reporting needs for the supervision phase to ensure Banks/FIs clear understanding of client performance, behaviour, and achievement of sustainability in operations.

E&S due diligence involves the systematic identification, quantification and assessment/evaluation of E&S risks associated with a proposed transaction. This process also helps identify the mitigation measures that are necessary to reduce any E&S risks that are identified. The extent of the E&S due diligence and level of detail is based on the transaction's E&S risk category and will vary by transaction type.

Banks and FIs need to refer to the generic ESDD checklist for sectors where a sector specific ESDD checklist is not available. For sectors where a sector specific ESDD checklist is available, the Banks and FIs need to refer to the respective sector ESDD checklist only for carrying out the ESDD. The ESDD checklists (both generic and sector specific) will auto generate the E&S risk ratings – high, medium and low based on the responses provided to the questions in the checklist.

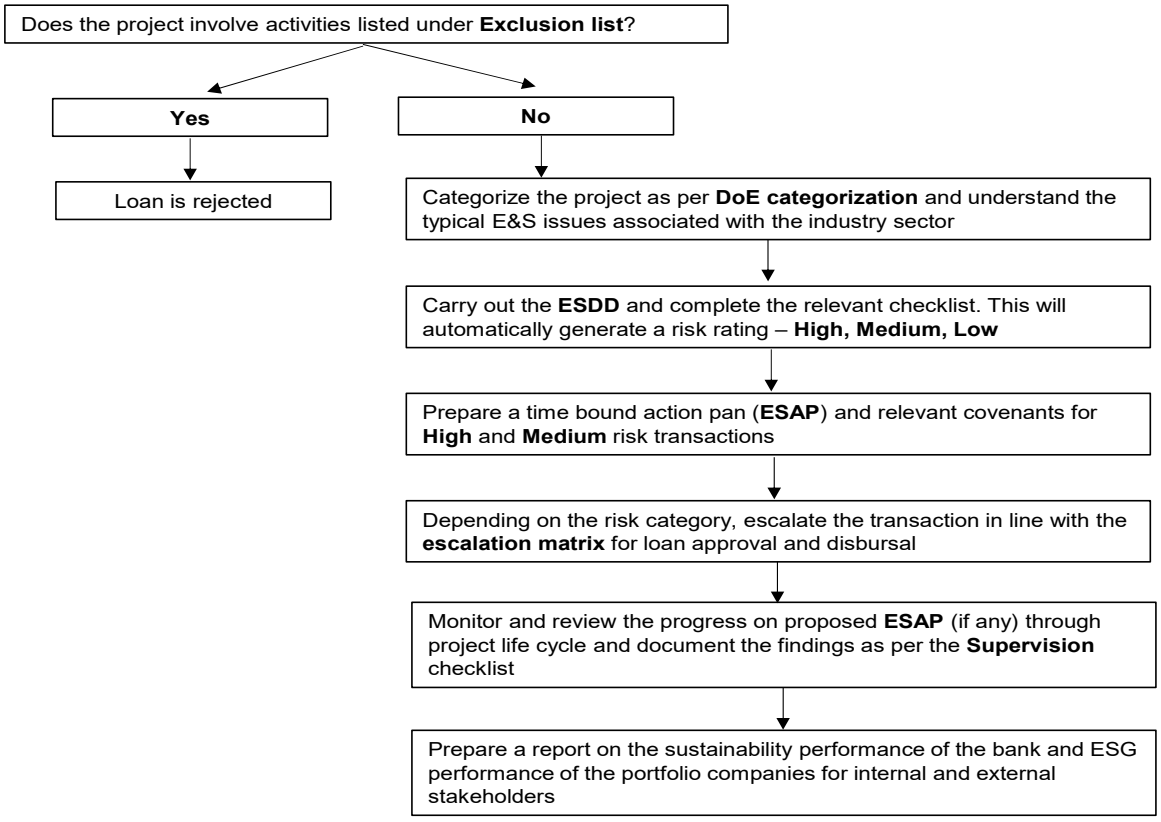
The process of E&S due diligence, filling in the ESDD checklists can involve a simple desktop review or may require a site visit with the use of technical experts, if necessary, to understand potential E&S risks associated with business activities and review a client's compliance with the Bank/FI's E&S requirements. Relevant documents will have to be collected to support E&S findings. The ESDD checklist has relevant guidance for bankers to assist in collecting proof points. Below are typical steps for conducting ESDD.

- **Step1: Exclusion List:** Screening of the project against a list of excluded activities adopted by the financial institution;
- **Step 2: DoE Categorization:** Review of industry sector and environmental and social issues that are typically associated with this type of operation;
- **Step 3: ESDD:**
  - Review the project's compliance with applicable national environmental and social regulations;
  - Review the project sponsors' track record on environmental and social issues, in terms of potential non-compliance with national regulations or negative publicity;
  - Review the project's compliance against international standards or industry best practice regarding environmental and social issues; and
  - Documenting all required information. Every loan file should have a fully completed E&S checklist, copies of all permits, clearances (DoE clearance certificate, fire license, buyer's

audit report), ESAP, E&S Covenants in loan agreement and after disbursement subsequent supervision reports.

- **Step 4: Generate Risk Rating:** Upon completion of the relevant checklist a risk rating (High, Medium, or Low) will be generated automatically.
- **Step 5: ESAP:** For High and Medium Risk transaction, a time bound action plan and relevant covenants will have to be included in the loan documentation.
- **Step 6: Escalation:** Depending upon the risk rating, the transaction will have to be escalated to the relevant authority. Please refer to the escalation matrix (Annex-3) for the process to be followed.
- **Step 7: Monitoring**: Review of the proposed actions (if any) to mitigate potential environmental and social issues associated with the project throughout all phases of the project life cycle.
- **Step 8: Reporting:** The Banks/FIs will have to report both internally to senior management and also externally to Bangladesh Bank, shareholders on their sustainability performance.

The financial institution should document all findings from the due diligence, which will be considered during the decision-making process before proceeding with a transaction. For transactions that have been categorized as high risk project finance, the financial institution may require the services of an external expert/consultant to conduct the environmental and social due diligence. To do so effectively, it is critical that the financial institution communicates to the external expert/consultant the environmental and social requirements that clients/investees are required to comply with. The financial institution also needs to ensure that the findings are reviewed and factored in to the decision-making process. The following flow chart summarizes the steps to be followed while conducting ESDD.



F. Decision making process

Once the ESDD is completed the checklist will auto generate a risk rating- High, Medium or Low.

- **High Risk**: Transactions typically involve clients with business activities with significant adverse E&S impacts that are sensitive, diverse, or unprecedented. A potential impact is considered sensitive if it may be irreversible (such as loss of a major natural habitat), affect vulnerable groups or ethnic minorities, involve involuntary displacement and resettlement, or affect significant cultural heritage sites.
- **Medium Risk**: Transactions typically involve clients with business activities with specific E&S impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures and international best practice. Potential adverse environmental impacts on human populations or environmentally important areas are less adverse than those of High Risk transactions.
- **Low Risk**: Transactions typically involve clients with business activities with minimal or no adverse E&S impacts.

All the low risk transactions can be approved by the Credit Officer. All the medium risk transaction will be escalated to the Head of Corporate/SME/Retail for approval. All the high risk transactions will be escalated to the Board, after review by the MD, for approval. In absence of the Board, the high risk transactions can be approved by the Executive Committee.

G. Corrective Action Plan and Covenants:

For Medium and High Risk projects there will be identified risks which will have to be mitigated. A corrective action plan can be developed identifying the risk, mitigation measure, timeline for implementation and who should be responsible for implementation. Transaction specific corrective action plan and covenants can be part of the legal loan documents. A template of the corrective action plan is provided in Annex-7 and different types of covenants are outlined in Annex 10-6.

H. Monitoring:

The purpose of monitoring a client's E&S performance is to assess existing and emerging E&S risks associated with a client's operations during the transaction. Once a transaction has been approved, the Bank/FI needs to monitor the client's ongoing compliance with the E&S clauses stipulated in the legal agreement. E&S risks or compliance status may change from the time of transaction approval.

From the time of transaction approval, E&S regulations may become more stringent, the client may modify its operations or production processes in a way that exacerbates previously identified risks or present new E&S risks. Managing emerging E&S risks at the transaction level ensures effective E&S risk management at the portfolio level.

A Bank/FI's ESMS should explain the process for systematic monitoring on a periodic basis, such as by implementing procedures for verifying compliance with E&S requirements including implementation of any corrective action plans to resolve non-compliances. The frequency and extent of monitoring will depend on the complexity of E&S issues associated with a client's operations.

The monitoring process generally involves a review of periodic E&S performance reports submitted by the client and regular site visits of the client's operations. Special attention should be paid to:

- Assessing implementation of any mitigation measures specified in the corrective action plan
- Monitoring for valid E&S permits or licenses
- Any fines and penalties for non-compliance with E&S regulations
- Recent reports from the relevant regulator or inspection authority confirming compliance with specified laws, including any emissions measurements proving that emissions are below the permitted limits
- E&S occurrences including major accidents or incidents associated with a client's operations such as worker injuries and spills
- Media attention to E&S issues related to the client
- Any complaints submitted by stakeholders about a client

If Bank/FI staff identifies E&S issues, such as a client's non-compliance with the E&S clauses stipulated in the legal agreement, they should follow up with the client to resolve these in a reasonable timeframe. Depending upon the complexity of the E&S issues associated with a client's operations, Bank/FI staff should require a new corrective action plan and/or periodic reports on E&S performance throughout the duration of the transaction. The reporting frequency should be tailored to each individual transaction and should be based on self-monitoring by the client or monitoring by independent third parties and/or regulatory authorities.

Banks and FIs need to refer to the monitoring checklist (Annex 10-8) for documenting their findings during the monitoring process.

I. Managing Eventualities in Investment Projects:

Non-routine events do occur in conjunction with business development, with consideration of new clients and investments, during appraisal, and in the post-commitment supervision cycle. Some common eventualities may include:

- Direct complaints made to the bank for investing in environmentally or socially harmful projects.
- Negative media report/ Non-Governmental Organization (NGO) campaign about a particular transaction which the Bank/FI has financed
- Serious accidents, incidents including fatalities
- Worker unrest, riots, demonstration on the roads

As soon as the RO knows about any such occurrence, the RO will immediately inform Head of Corporate/SME/Retail, collect factual information about the event, conduct a site visit and develop an action plan to mitigate the occurrence of such event in the future and communicate to the client what implication there might be due to the event. There might also be requirement of re visiting the risk rating in light of the recent event.

J. Internal/External Communication:

A Bank/FI's ESMS should include periodic reporting on the E&S performance of transactions and measures taken to reduce its overall exposure to E&S risk.

Bank/FI staff should compile all E&S findings from monitoring clients and aggregate findings at the portfolio level. By analysing this information, the Bank/FI can have a better understanding of its overall exposure to E&S risk through its portfolio.

E&S performance reports typically include information on:

- Portfolio breakdown by business line, industry sector and E&S risk category
- Overall exposure to E&S risk and performance
- High-risk transactions and E&S due diligence process prior to transaction approval
- Major E&S risks of individual transactions, including cases of non-compliance
- Significant E&S accidents or incidents related to a transaction
- Implementation and changes in the Bank/FI's ESMS

A Bank/FI may have internal and external reporting requirements regarding the E&S risks and impacts associated with its portfolio.

7. Implementing ESMS

Once the ESMS has been developed and formally approved by Senior Management/Board, it can be institutionalized and rolled out across the Bank/FI.

To implement the ESMS, the Bank/FI should develop an implementation plan, including an ESMS testing phase, with a time schedule for completing each task and the designated staff responsible for doing so. Tasks should include a review of the E&S regulations of the country in which the Bank/FI operates, testing phase, communications and training plan for staff, assigning responsibilities to applicable staff, review of international best practice that apply to clients and review of the ESMS on a periodic basis for continuous improvement.

When properly designed and implemented, the additional workload for staff and transaction costs associated with the ESMS are limited, especially when E&S risk management procedures are fully integrated into the Bank/FI's existing risk management framework.

Senior Management should be kept informed of challenges, successes and other important issues associated with the implementation of the Bank/FI's E&S Management System. The SFU of each bank in consultation with relevant business teams and credit related departments can take a lead on implementation. Bangladesh Bank also monitors sustainability related progress of each bank. Thus Bank/FIs need to implement required changes for a robust ESMS and report on progress every quarter to Bangladesh Bank.

8. Provision of Incentives and Disincentives

On the basis of the performance of the borrower(s) and banks and FIs dealing with transactions with high ESRR, incentives and disincentives need to be considered for the following.

8.1. High ESRR at transaction/application/proposal level

The board of the bank or FI is authorised to consider the provision of incentives and disincentives for projects that have high pre-disbursal ESRR. During post-disbursal monitoring of the performance of the project, if change in ESRR is observed, the following options may be considered, provided any change to the interest rate and repayment term has to be incorporated as part of the loan agreement linked with changes in ESRR.

Table 2: Options for incentives and disincentives

Sl. No	Particulars	Probable option(s)
1	Incentive(s) if change in ESRR is positive	• Issuance of appreciation letter and upload the name of project on bank's website • Reduction in interest rate • Higher debt-equity ratio for borrowers • Flexibility in loan conditions • Favourable loan to value ratio for borrowers
2	Disincentive(s) if change in ESRR is negative	• Increase in interest rate • Lower debt-equity ratio for borrowers • Tougher loan covenants/conditions • Tougher loan to value ratio for borrowers

8.2. High ESRR at portfolio level

The purpose of these Guidelines is to encourage banks and FIs to better understand E&S risks and incorporate appropriate risk mitigation measures to be able to expand the lending portfolio rather than avoid investing in high E&S risks.

Bangladesh Bank will monitor the share of high ESRR transactions of individual banks or FIs in total loan profile and actions taken by the boards for high ESRR transactions. Bangladesh Bank will consider the following options with respect to the performance of banks and FIs towards meeting the sanction target for high ESRR projects:

- Impact in CAMELS rating;
- Impact on liquidity and capital requirements;
- Impact on credit growth;
- Impact on profit distribution.

Annex-1: Exclusion List

Sl. No.	Sector / Activities
1	Production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international bans, such as pharmaceuticals, pesticides/herbicides, ozone depleting substances, PCB's, wildlife or products regulated under the Convention on International Trade in Endangered Species (CITES). Links: United Nations (UN) list of banned chemicals and products: http://www.un.org/esa/coordination/Consolidated.list-13FinalFinal.pdf CITES list of endangered species: http://www.cites.org/eng/app/E-Apr27.pdf.
2	Ship breaking/ trading activities which include: 1. Ships with prevalent asbestos use (for e.g. passenger cruise); 2. Ships listed on the Greenpeace blacklist*; 3. Ships not certified "gas free" for hot work
5	Drift net fishing, deep sea bottom trawling, or fishing with the use of explosives or cyanide
6	Operations impacting UNESCO World Heritage Site and/or Ramsar site
8	Illegal logging, and logging operations or conversion of land for plantation use in primary tropical moist forests
10	Production or activities involving forced labour/ child labour
11	Production or trade in: 1. Weapons and munitions 2. Tobacco 3. Gambling, casinos 4. Pornography (goods/stores/web-based)
12	Production or activities that impinge on the lands owned, or claimed under adjudication, by Indigenous Peoples, without full documented consent of such peoples

* http://www.greenpeace.org/international/en/campaigns/oceans/pirate-fishing/Blacklist1/

Annex-2: ESDD Checklist

Please refer to the excel based E&S Risk Assessment Tool.

Annex-3: Escalation Matrix

Risk rating	Proposing Stage	Approval Stage	Disbursement Stage
Low	• ESDD Checklist is to be completed by RO, approved by official(s) of CRM/IRM in head office/branch and processed as per normal credit process for both existing and new clients • If all (d -Not Applicable) are checked, state reasons why		
Medium	RO & ESRM Unit Head of to sign off jointly for new or existing clients with proposals to: • PROCEED with ESDD submission (despite (b) being checked) but proper justification is to be provided	Escalation Process if CRM/IRM official feels the transaction needs to be escalated: 1. CRM/IRM official will be the first point of review 2. If identified risk(s) is unresolved, proceed for review by Sustainable Finance Department and approval by Country/ Region Head of Credit 3. Credit approval can only be granted subsequent to resolution via above steps 4. Time-bound action plan to mitigate risks may form part of approval conditions	If there are any conditions to be fulfilled as part of approval, Credit Risk Management Committee (CRMC) will check for the same before disbursing
High	RO & ESRM Unit Head to sign off jointly for new or existing clients with proposals to: • REJECT (with reasons documented for record); or • PROCEED with ESDD submission (despite (c) being checked) but proper justification is to be provided	Escalation Process: 1. CRM/IRM official will be the first point of review 2. If identified risk(s) is unresolved, proceed for review by Country/ Region Head of Credit and Head of Sustainable Finance Department 3. All high risk projects are to be escalated to Board/ EC with a recommendation from Head of Credit. 4. Credit approval can only be granted subsequent to resolution via above steps 5. Time-bound action plan to mitigate risks may form part of approval conditions	If there are any conditions to be fulfilled as part of approval, CRMC will check for the same before disbursing

Annex-4: E&S Risks in Detail

Air emissions and Air Quality - Emissions of air pollutants can occur from a wide variety of activities during construction, operation and decommissioning of a client's operations.

Air emissions are typically associated with processes such as combustion, storage of materials or other industry-sector specific processes and can be:

- *Point sources*: These are discrete, stationary, identifiable sources of emissions (such as a specific stack, vent or other discrete point of emission) that release pollutants to the atmosphere. They are typically located in manufacturing or production plants. Point sources are characterized by the release of air pollutants typically associated with the combustion of fossil fuels, such as nitrogen oxides (NOx), sulfur dioxide (SO2), carbon monoxide (CO), and particulate matter (PM), as well as other air pollutants including certain volatile organic compounds (VOCs) and metals that may also be associated with a wide range of industrial activities.
- *Fugitive sources*: These are emissions that are distributed spatially over a wide area and originate in operations where exhausts are not captured and released through a stack. Fugitive emissions have the potential for much greater ground-level impacts than stationary source emissions, since they are discharged and dispersed close to the ground. The two main types of fugitive emissions are Volatile Organic Compounds (VOCs) and Particulate Matter (PM). Other contaminants (NOx, SO2 and CO) are mainly associated with combustion processes designed to deliver electrical or mechanical power, steam and heat.
- *Mobile sources*: These are emissions associated with vehicle use and include CO, NOx, SO2, PM and VOCs. Emissions can be reduced by implementing a regular vehicle maintenance and repair program, instructing drivers on better driving practices that reduce both the risk of accidents and fuel consumption, replacing older vehicles with newer, more fuel efficient alternatives, converting to cleaner fuels and installing emissions control devices such as catalytic converters.

A client should estimate and monitor air emissions associated with operations through qualitative or quantitative assessments and atmospheric dispersion models to assess potential ground level concentrations and environmental impacts. At a facility level, air emissions should not result in pollutant concentrations that exceed the ambient air quality standards set by national authorities, which would result in fines and/or penalties if concentrations are in violation of national legislation. Pollutant concentrations can also be compared to international best practice and standards to identify any deviations, which would indicate poor performance of an operation. Air emissions of concern typically include:

- *VOCs*: Emissions of VOCs are associated with industrial activities that produce, store and use VOC-containing liquids or gases in particular where the material is under pressure. Typical sources include equipment leaks (from valves, fittings and elbows), open vats and mixing tanks, storage tanks, unit operations in wastewater treatment systems and accidental releases. Emissions can be reduced by modifying equipment, regularly monitoring equipment to detect and repair leaks, using less volatile substances such as aqueous solvents and collecting vapours through air extractors.

- *PM*: Dust or PM is released during certain operations such as the combustion of fossil fuels, open storage of solid materials, and from exposed soil surfaces, including unpaved roads. Emissions can be reduced through dust control methods such as covers, water suppression, or increased moisture content for open materials storage piles, or controls (such as a baghouse or cyclone).
- *Ozone Depleting Substances (ODS)*: Ozone depleting substances (ODSs) include chemicals, which have been scheduled for phase-out under the Montreal Protocol on Substances that Deplete the Ozone Layer. Systems or processes using chlorofluorocarbons (CFCs), halons, 1,1,1-trichloroethane (methyl chloroform), carbon tetrachloride, hydrochlorofluorocarbons (HCFCs), hydrobromofluorocarbons (HBFCs), and methyl bromide should be gradually phased out or not used at all as determined by national regulations. These chemicals are typically used in a variety of applications including refrigeration, air conditioning, manufacturing foam products, solvent cleaning, aerosol propellants, fire protection systems and as crop fumigants.
- *Greenhouse Gases (GHGs)*: GHGs, as defined under the Kyoto Protocol to the United Nations Framework Convention on Climate Change, include carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF6). GHGs can be generated by a facility's production processes as well as from the production of power (on-site or off-site) for use by the facility. Emissions can be reduced through mechanisms such as carbon financing, energy efficiency, sustainable forms of agriculture and forestry, use of renewable forms of energy, carbon capture and storage technologies, recovery and use of methane in waste management and energy distribution.
- *Sulfur dioxide (SO2)*: Sulfur dioxide (SO2) is mainly produced by the combustion of fuels such as oil and coal and as a by-product from some chemical production or wastewater treatment processes. Emissions can be reduced through the use of alternate fuels such as low sulfur coal, light diesel or natural gas, emissions control technologies.
- *Toxics (mercury)*: Mercury exists as elemental mercury, inorganic mercury compounds (primarily mercuric chloride), and organic mercury compounds (primarily methyl mercury). All forms of mercury are toxic and each form exhibits different health effects. A major source of exposure to elemental mercury is through inhalation in the work place. Sources of inorganic mercury compounds are generally low as their use has mostly been banned but limited exposure can occur through the use of old cans of latex paint. Sources of methyl mercury include fungicide-treated grains and meat from animals fed with treated grain.

Where possible, a client's operations should avoid, minimize and control adverse impacts to human health, safety and the environment from emissions to air. The generation and release of air emissions can be managed through a combination of energy use efficiency, process modification, selection of fuels or other materials and application of emissions control techniques. A Bank/FI can help a client to identify areas for reductions in air emissions and to identify environmental business opportunities.

Water use and conservation - A client's operations use water in various production processes, which vary by industry sector. Typically, water use at the facility level is associated with processes such as described here.

- *Process water*: Processes that typically use large quantities of water include washing machines, rinsing, water jets or sprays to keep conveyors clean or to cool product, and the use

of tanks, which are refilled to control losses. Opportunities for reducing water use exist through water reuse, improved equipment maintenance and better process design.

- *Building facility operations*: Consumption of building and sanitary water is typically less than that of industrial processes. Areas for reducing water use include repairing leakages and installing water-saving devices.
- *Cooling systems*: Once-through cooling systems with cooling towers use large quantities of water and can be replaced by closed circuit cooling systems. Fresh water use can also be reduced by replacing it with treated water.
- *Heating systems*: Closed heating systems based on the circulation of low or medium pressure hot water may consume large quantities of water if they leak and are poorly maintained. In some cases, large quantities of water may be used by steam systems but water use can be reduced through steam recovery systems and improved systems operations.

Where possible, a client's operations should reduce overall water use at the facility level by managing the water consumption associated with specific production processes to avoid excess costs. A Bank/FI can help a client to identify areas for reductions in water use and new environmental business opportunities.

Wastewater and water quality - A client's operations generate wastewater, which is treated on site and/or discharged either to the municipal sewage system for treatment or directly to the environment (surface water) without prior treatment.

Wastewater includes process wastewater, wastewater from utility operations, storm water and sanitary wastewater. Wastewater will vary in quality and quantity by industry sector and typically includes:

- *Process wastewater*: Pollutants may include acids, bases, and many others. These include soluble organic chemicals, suspended solids, nutrients (phosphorus and nitrogen), heavy metals (such as cadmium, chromium, copper, lead, mercury, nickel and zinc), cyanide, toxic organic chemicals, oily materials and volatile materials. The costs of treating process wastewater can be significant.
- *Wastewater from utilities operations*: Utility operations such as cooling towers and demineralization systems may result in high rates of water consumption, as well as the potential release of high temperature water containing high dissolved solids, residues of biocides and residues of other cooling system anti-fouling agents.
- *Storm water*: Storm water includes any surface runoff and flows from process and materials staging areas resulting from precipitation or drainage. Typically storm water runoff contains suspended sediments, metals, petroleum hydrocarbons, Polycyclic Aromatic Hydrocarbons (PAHs) and coliform. Rapid runoff, even of uncontaminated storm water, also degrades the quality of the receiving water by eroding stream beds and river banks.
- *Sanitary wastewater*: This may include effluents from domestic sewage, food service and laundry facilities serving site employees and can also include other sources such as from laboratories, medical infirmaries, equipment maintenance shops and water softening.

A client should monitor the quality, quantity, sources and discharge points of liquid effluents by type (process, utilities operations, storm water and sanitary). At a facility level, discharges of wastewater should not result in contaminant concentrations in excess of the effluent discharge quality standards of national regulations to avoid liability for fines and/or penalties. Discharge

quality can also be compared to international best practice and standards to identify any deviations, which would indicate poor performance of an operation. The generation and discharge of wastewater should be managed to reduce the volume of water requiring specialized treatment by improving water use efficiency, modifying production processes (including the use of hazardous materials that contaminate water), and treating wastewater on-site prior to discharge in order to reduce the load of contaminants.

Where possible, a client's operations should avoid, minimize and control adverse impacts to human health, safety and the environment from wastewater generation through wastewater management, water conservation and reuse. A Bank/FI can help a client to identify opportunities for preventing or reducing wastewater generation through water conservation and recycling/reusing within operations and to identify environmental business opportunities.

Wastes - A client's operations may generate, store, or handle any quantity of hazardous or non-hazardous waste across a range of industry sectors.

Waste can be solid, liquid, or contain gaseous material that is discarded by disposal, recycling, burning or incineration. It can be a by-product of a manufacturing process or an obsolete commercial product that can no longer be used for its intended purpose and requires disposal. Inappropriate waste disposal practices can lead to contamination of ground water or potential fines and/or penalties as stipulated in national regulations.

Solid (non-hazardous) waste generally includes domestic trash, inert construction/demolition materials, metal scrap and empty containers (except those previously used to contain hazardous materials, which should be managed as a hazardous waste), and residual waste from industrial operations.

Hazardous waste shares the properties of a hazardous material (such as ignitability, corrosiveness, reactivity, or toxicity), or other physical, chemical, or biological characteristics that may pose a potential risk to human health or the environment if improperly managed. When a hazardous material is no longer usable for its original purpose and is intended for disposal, but still has hazardous properties, it is considered a hazardous waste. Typically, hazardous wastes include solvents, fuels, and asbestos in building materials, PCB oils in electrical equipment, most pesticides, and ozone depleting substances in refrigeration systems. Wastes may also be defined as "hazardous" by local regulations or international conventions, based on the origin of the waste and its inclusion on hazardous waste lists or based on its characteristics. Hazardous wastes should always be segregated from non-hazardous wastes.

Facilities that generate and store wastes need to consider issues linked to waste minimization, generation, transport, and disposal. Typically, approaches to waste management include:

- *Waste management planning*. Facilities that generate waste should characterize their waste according to composition, source, types of wastes produced, generation rates, or according to local regulatory requirements. This information can be used to identify opportunities for pollution prevention, such as source reduction, reuse, and recycling.
- *Waste prevention*. Processes can be designed and operated to prevent, or minimize, the quantities of wastes generated and hazards associated with the wastes generated. This can be accomplished by substituting raw materials or inputs with less hazardous or toxic materials, or with those where processing generates lower waste volumes, and improving manufacturing processes to convert materials more efficiently.

- *Recycling and reuse*. The total amount of waste can be significantly reduced through the implementation of recycling and reuse plans. This entails identifying and recycling products that can be reintroduced into the manufacturing process or industry activity at a site or in industrial processing operations located at other facilities. It also includes identifying materials that can be reused, saving both costs and disposal needs.
- *Treatment and disposal*. If waste materials are still generated after the implementation of feasible waste prevention, reduction, reuse, recovery and recycling measures, waste materials should be treated and disposed of while considering all measures to avoid potential impacts to human health and the environment. Typical treatment and disposal methods include on-site or off-site biological, chemical, or physical treatment of the waste material to render it non-hazardous prior to final disposal; and treatment or disposal at permitted facilities specially designed to receive the waste.
- *Hazardous waste storage*. Hazardous waste should be stored so as to prevent or control accidental releases to air, soil, and water resources. This requires the need for storage in closed containers away from direct sunlight, wind and rain; secondary containments; and the provision of adequate ventilation where volatile wastes are stored.
- *Hazardous waste transportation*. On-site and off-site transportation of waste should be conducted using appropriate protocols to prevent or minimize spills, releases, and exposures to employees and the public. All waste containers designated for off-site shipment should be secured and labelled with the contents and associated hazards, and be properly loaded on the transport vehicles before leaving the site.
- *Hazardous treatment and disposal*. In the absence of qualified commercial or government-owned waste vendors, facilities generating waste should have the technical capability to manage the hazardous waste or install on-site waste treatment or recycling processes in a manner that reduces immediate and future impacts to the environment. This may also require the need for applicable permits, certifications, and approvals.
- *Small quantities of hazardous waste*. Hazardous waste materials are frequently generated in small quantities by many projects through a variety of activities such as equipment and building maintenance activities. Waste storage collection and storage areas should be visually inspected on a regular basis for evidence of accidental releases and to verify that wastes are properly labelled and stored. These types of wastes include spent solvents and oily rags, empty paint cans, chemical containers; used lubricating oil; used batteries (such as nickel-cadmium or lead acid); and lighting equipment, such as lamps or lamp ballasts.

Where possible, a client's operations should implement sound waste management practices at the facility. A Bank/FI can help a client to identify environmental business opportunities.

Land contamination - Land can become contaminated due to releases of hazardous materials, wastes, or oil, including naturally occurring substances.

Releases of these materials may be the result of historic or current site activities, including accidents during their handling and storage, or due to poor management or disposal. Land is considered contaminated when it contains hazardous materials concentrations, including oil, above baseline and/or naturally occurring levels.

Contaminated lands may involve topsoil or subsurface soil that, through leaching and transport, may affect groundwater, surface water, and adjacent sites. Where subsurface contaminant sources

include volatile substances, soil vapour may also create potential for contamination through infiltration of indoor air spaces of buildings.

Land contamination is a concern when hazardous materials, waste, or oil are present in any environment at potentially hazardous concentrations and the potential for contact with humans, wildlife, plants, and other living organisms exists. This may occur when a contaminant migrates from its point of release (e.g., leaching into potable groundwater) and humans or other living organisms are exposed to it (e.g., through ingestion or skin absorption). This has potential risks to human health(e.g., risk of cancer) and ecology and represents a liability to the polluter/business owners (e.g., cost of remediation, damage of business reputation and/or business-community relations) or affected parties (e.g., workers at the site and nearby property owners).

Land contamination should be avoided by preventing or controlling the release of hazardous materials, hazardous wastes, or oil to the environment. When contamination of land is suspected or confirmed during any project phase, the cause of the uncontrolled release should be identified and corrected to avoid further releases and associated adverse impacts. Contaminated lands should be managed to avoid the risk to human health and ecological receptors. This requires clean up reducing the level of contamination at the site while preventing human exposure.

In cases of land contamination representing an immediate risk to human health and the environment, appropriate risk reduction should be implemented as soon as practicable to remove the imminent hazard. Risk mitigation strategies should be developed based on site-specific conditions and target contaminant source reduction, taking into consideration technical and financial feasibility. To protect human health, access to a contaminated site should be limited or prevented, for example through signage, fencing, or site security. This may also require capping contaminated soil with clean soil to prevent human contact, introducing certain plants into contaminated soils or paving them over as an temporary measure to prevent direct contact.

A client's operations should implement the necessary measures to prevent releases of hazardous materials, waste, or oil to the ground. A Bank/FI can help a client to identify environmental business opportunities.

Labour and Working Conditions - The pursuit of economic growth through employment creation and income generation should be balanced with protection for basic rights of workers. For any business, the workforce is a valuable asset, and a sound worker-management relationship is a key ingredient to the long-term sustainability of the enterprise. Failure to establish and foster a sound worker-management relationship can undermine worker commitment and retention, result in labour strikes, and can jeopardize a client's operations. Conversely, through a constructive worker-management relationship, and by treating the workers fairly and providing them with safe and healthy working conditions, clients may create tangible benefits, such as enhancement of the efficiency and productivity of their operations.

A client's commitment to establishing a sound worker-management relationship encompasses the following aspects:

- *Human resources policy*. A client should adopt a policy appropriate to its size and workforce, which sets out its approach to managing employees. The policy provides information regarding their rights under national labour and employment law, including their rights related to wages and benefits.

- *Working conditions and terms of employment*. A client should document and communicate to all employees and workers (including contract workers) their working conditions and terms of employment. These include their entitlement to wages and benefits, hours of work, overtime arrangements and overtime compensation, and leave for illness, maternity, vacation or holiday, that at a minimum comply with national law. This includes respecting a collective bargaining agreement with a workers' organization if there is such an agreement.
- *Workers' organizations*. Where permitted by law, employees should be granted the right to associate freely and to bargain collectively, by forming and joining workers' organizations or through alternative means. A client should not discourage workers from forming or joining workers' organizations and should not discriminate or retaliate against workers who participate in such organizations and bargain collectively.
- *Non-discrimination and equal opportunity*. A client should not make employment decisions on the basis of personal characteristics unrelated to inherent job requirements but rather on the principle of equal opportunity and fair treatment.
- *Retrenchment*. If a client anticipates the elimination of a significant number of jobs or a layoff of a significant number of employees, it should develop a plan for managing the adverse impacts on employees.
- *Grievance mechanism*. A client should provide all employees with a mechanism to raise reasonable workplace concerns, confidentially or anonymously if needed, so that concerns can be addressed promptly at the management-level without any retribution.
- *Child labour and forced labour*. A client cannot employ children in a manner that is economically exploitative, or is likely to be harmful to the child or to interfere with the child's education. A client cannot employ forced labour, which consists of any work or service not voluntarily performed by an individual but executed under threat of force or penalty.
- *Supply chain*. A client should pay attention to unfair labour practices of its suppliers, especially in instances where low labour cost is a factor in the competitiveness of supplies, and ensure that this is not due to harmful labour practices.

Respecting international standards with regard to labour and working conditions benefits a client's operations by encouraging positive worker-management relationships that lead to more productive and stable operations, including a reduced likelihood of strikes, and provides a reputational advantage that comes from enhanced public recognition that good international standards are being followed.

Community Health, Safety and Security - A client's operations can increase the potential for community exposure to risks and impacts arising from accidents, structural failures, and releases of hazardous materials. A client's operations often bring benefits to communities including employment, services, and opportunities for economic development. However, these operations can also increase the potential for community exposure to risks and impacts arising from accidents, structural failures, and releases of hazardous materials. Communities may also be affected by impacts on their natural resources, exposure to diseases, and the use of security personnel.

While acknowledging the public authorities' role in promoting the health, safety and security of the public, it is also the client's responsibility to avoid or minimize these risks and impacts that may arise from operations. This includes implementing the following actions:

- *Consultation and grievance channels*. Where appropriate, the client should conduct consultations and establish a line of communication with the impacted community in order to understand and monitor potential impacts. An appropriate consultation and grievance mechanism can help manage and minimize potential risks, avoid reputational issues and reduce the risk of conflicts with the community.
- *Infrastructure and equipment safety*. The client needs to ensure that operations are conducted to prevent potential injury to the surrounding community, especially if aspects of the operations are accessible to the community. If the client's operations involve operation of moving equipment on public roads, the client needs to ensure that the necessary safety measures are in place to prevent the occurrence of any incidents and accidents.
- *Hazardous materials safety*. The client needs to prevent or minimize the potential for community exposure to hazardous materials that may be released during operations. If there is a potential for life-threatening hazards, the client needs to modify operations or substitute or eliminate substances causing the hazard. The client also needs to control the safety of deliveries of raw materials and of transportation and disposal of wastes.
- *Environmental and natural resource issues*. The client needs to avoid or minimize the exacerbation of impacts caused by natural hazards, such as landslides or floods that could arise from land use changes due to operations. This also includes avoiding or minimizing adverse impacts due to operations on soil, water, and other natural resources used by the affected communities.
- *Community exposure to disease*. The client needs to prevent or minimize the potential for community exposure to water-borne or vector-borne disease, and other communicable diseases that could result from operations. This also includes preventing or minimizing the transmission of communicable diseases that may be associated with the influx of temporary or permanent labour associated with the client's operations.
- *Increase in traffic*. Traffic, especially movement of heavy vehicles increases especially during construction phase. This can lead to possible accidents/incidents which need to be minimized. There is a need for traffic management plan and training of staff to manage and minimize accidents/incidents.
- *Emergency preparedness and response*. The client needs to inform surrounding communities of potential hazards associated with operations and collaborate with the community and local government agencies in preparing to respond effectively to emergency situations.
- *Use of security personnel*. A client may retain security personnel to safeguard its operations, which may pose risks to the surrounding community if not managed properly. This includes ensuring that security personnel have not been implicated in past abuses, have been adequately trained in the use of force (including firearms, if necessary) as well as in the conduct toward workers and the local community. The client will also provide a mechanism to allow the surrounding community to express concerns about security personnel and will investigate any allegations of unlawful or abusive acts of security personnel to take the necessary action to prevent recurrence.

If the impacts of a client's operations on the surrounding community are not appropriately managed, this can create conflict and objections to the client's presence in the community. This

represents a reputational risk to the client at the local level, and if not addressed, may escalate to reputational risk at the regional and even international level.

Land Acquisition and Resettlement - Involuntary resettlement refers both to physical displacement and to economic displacement due to land acquisition associated with a client's operations. Involuntary resettlement refers both to physical displacement (relocation or loss of shelter) and to economic displacement (access to resources for income generation or means of livelihood) due to land acquisition (including rights-of-way) associated with a client's operations. Resettlement is considered involuntary when affected individuals or communities do not have the right to refuse displacement. This occurs in cases of: i) lawful expropriation or restrictions on land use based on eminent domain; and ii) negotiated settlements in which the buyer can resort to expropriation or impose legal restrictions on land use if negotiations with the seller fail.

Displaced persons may be classified as persons who:

- have formal legal rights to the land they occupy;
- do not have formal legal rights to land, but have a claim to land that is recognized or recognizable under the national laws; or
- have no recognizable legal right or claim to the land they occupy.

Unless properly managed, involuntary resettlement may result in long-term hardship and impoverishment for affected persons and communities, as well as environmental damage and social stress in areas to which they have been displaced. For these reasons, involuntary resettlement should be avoided or at least minimized. However, where it is unavoidable, appropriate measures to mitigate adverse impacts on displaced persons and host communities should be carefully planned and implemented with appropriate disclosure of information, consultation, and the informed participation of affected persons. This includes implementing the following actions:

- *Compensation and benefits for displaced persons*. When displacement cannot be avoided, the client will offer displaced persons and communities compensation for loss of assets at full replacement cost and other assistance to help them improve or at least restore their standards of living or livelihoods.
- *Grievance mechanism*. The client needs to ensure that a grievance mechanism is in place to receive and address specific concerns about compensation and relocation that are raised by displaced persons or members of host communities.
- *Social impact assessment, resettlement planning and implementation*. Where involuntary resettlement is unavoidable, the client will conduct a census to identify the persons who will be displaced by the project, understand the likely impacts on the affected persons and community, develop entitlement framework and determine who will be eligible for compensation.
- *Physical displacement*. If people living on the site of a client's operations must move to another location, the client will: i) offer displaced persons choices among feasible resettlement options, including adequate replacement housing or cash compensation; and ii) provide relocation assistance suited to the needs of each group of displaced persons, with particular attention paid to the needs of the poor and the vulnerable. New resettlement sites built for displaced persons will offer improved living conditions.
- *Economic displacement*. If land acquisition for the client's operations causes loss of income or livelihood, the client will promptly compensate these persons, for example by compensating affected business owners for the cost of re-establishing commercial activities elsewhere, for lost

net income during the period of transition, and for the costs of the transfer and reinstallation of their business operations.

- *Government-managed resettlement*. Where land acquisition and resettlement are the responsibility of the government, the client needs to collaborate with the responsible government agency to the extent permitted by the agency to achieve outcomes that are consistent with best international practice.

If a client's operations involve land acquisition and resettlement, this should be carefully managed to prevent the likelihood of hardship and impoverishment for affected persons and communities. Given that a displaced community will not be entirely satisfied with its new situation unless there is noticeable improvement in standards of living or livelihoods, this will remain a reputational risk for the client.

Indigenous Peoples - Indigenous Peoples (IPs) are recognized as social groups with identities that are distinct from dominant groups in national societies and are often among vulnerable segments of the population. Indigenous Peoples may be referred to in different countries by such terms as "Indigenous ethnic minorities", "aboriginals", "hill tribes", "minority nationalities", "scheduled tribes", "first nations", or "tribal groups".

IPs typically self-identify as members of a distinct indigenous cultural group and are recognized as such by others; have a collective attachment to geographically distinct habitats or ancestral territories, making use of natural resources in these habitats and territories; have customary cultural, economic, social, or political institutions that are separate from those of the dominant society or culture; and communicate in an indigenous language, often different from the official language of the country or region.

Indigenous Peoples are often closely tied to their traditional or customary lands and the natural resources on these lands. While these lands may not be under their legal ownership as defined under national law, the use of these lands by communities of IPs for their livelihoods or for cultural purposes is often recognized under customary law. However, the economic, social and legal status of Indigenous Peoples often limits their capacity to defend their interests and rights to lands and natural and cultural resources. Indigenous Peoples are particularly vulnerable if their lands and resources are transformed, encroached upon by outsiders, or significantly degraded. Their languages, cultures, religions, spiritual beliefs, and institutions may also be under threat. These characteristics expose Indigenous Peoples to different types of risks and severity of impacts, including loss of identity, culture, and natural resource-based livelihoods, as well as exposure to impoverishment and disease.

A client should ensure that during the course of operations, the identity, culture and natural resource-based livelihoods of Indigenous Peoples are respected and exposure to impoverishment and disease is prevented. This includes implementing the following actions:

- *Avoid or minimize adverse impacts*. When a client cannot completely avoid impacts on Indigenous Peoples, the client needs to mitigate or compensate for these impacts in a culturally appropriate manner and with the informed participation of affected Indigenous Peoples.
- *Consultation*. The client needs to establish an ongoing relationship with the affected communities of Indigenous Peoples, which should be culturally appropriate. If there are adverse impacts, the consultation process needs to ensure the free, prior, and informed consultation of

the Indigenous Peoples and facilitate their informed participation with respect to proposed mitigation measures and sharing development benefits.

- *Sharing development benefits*. The client needs to identify opportunities for development benefits for affected Indigenous Peoples. This should aim at improving their standard of living and livelihoods in a culturally appropriate manner, including the long-term sustainability of the natural resource on which they depend.
- *Impacts on traditional or customary lands*. If a client's operations are located within traditional or customary lands or involve the commercial use of natural resources located on these lands, this will generate adverse impacts on the livelihoods or cultural identity of the community of Indigenous Peoples. The client needs to inform affected communities of their rights under national laws, including the recognition of customary rights; make efforts to avoid or at least minimize the size of the impacted land; and offer land-based compensation as well as culturally appropriate development opportunities to affected communities.
- *Relocation of Indigenous Peoples*. The client should avoid the relocation of Indigenous Peoples from their traditional lands. If relocation is unavoidable, the client needs to enter into a good faith negotiation with the affected communities and ensure that any relocation complies with best international standards.

If a client's operations are initiated and conducted without the involvement of Indigenous Peoples, this can lead to misunderstanding and conflict. Given worldwide concern for the well-being of Indigenous Peoples, there are significant reputational risks for a client if Indigenous Peoples issues are not managed appropriately.

Cultural Heritage - Cultural heritage encompasses properties and sites of archaeological, historical, cultural, artistic and religious significance as well as unique environmental features and cultural knowledge, and practices of communities protected for future generations. Cultural heritage encompasses properties and sites of archaeological, historical, cultural, artistic and religious significance as well as unique environmental features and cultural knowledge, innovations and practices of communities embodying traditional lifestyles, which are protected for current and future generations. Consistent with the requirements of the Convention Concerning the Protection of the World Cultural and Natural Heritage, a client is required to avoid significant damage to cultural heritage due to their business activities.

Impacts on cultural heritage typical involve the following:

- *Chance finds*. During the construction of a client's facility(s), there may be physical impacts on previously unknown or undocumented resources that were fully or partially buried prior to the start of construction.
- *Community input*. Where a project may affect cultural heritage, the client will consult with affected communities who use, or have used, the cultural heritage for longstanding cultural purposes to identify cultural heritage of importance. A client should incorporate the views of the affected communities on cultural heritage into the decision-making process.
- *Removal of cultural heritage*. Most cultural heritage is best protected by preserving it in its place, since removal is likely to result in irreparable damage or destruction of the cultural heritage. Cultural heritage should only be removed if the client can demonstrate that the overall benefits of operations at a particular site outweigh the anticipated loss of cultural heritage.

- *Legally protected cultural heritage areas*. When a client's proposed operations are located within a legally protected area or a legally defined buffer zone, the client is required to take additional measures to promote and enhance the conservation of the area.
- *Use of cultural heritage*. If a client makes commercial use of a community's cultural heritage, such as embodiment of traditional lifestyles, the client is required to enter into a good faith negotiation with the affected local communities and to provide fair and equitable sharing of benefits from the commercialization of their cultural heritage.

If a client's operations are initiated and conducted without consideration for cultural heritage, there are significant legal and reputational risks. A systematic approach concerned for cultural heritage issues throughout a client's operations, including additional investments in the enhancement of cultural heritage, can bring significant reputational advantage to a client at both the local and international level.

Annex-5: Credit Type Wise E&S Risks

Risk in Trade - The E&S risks of trade finance are associated with the production of those goods being traded and vary by industry sector and location. Companies selling to foreign markets are required to comply with local and international social and environmental regulations and in many cases also face public scrutiny. Importing and exporting companies are therefore exposed to some level of reputational risk.

Given the short-term nature of trade finance, a Bank/FI will have limited leverage to manage E&S risks once it has approved a transaction. However, a Bank/FI can have simple transaction screening procedures to avoid supporting the trade of products and substances that are subject to bans and international phase-outs.

Risk in SME - Investments in small and medium enterprises focus on a particular set of clients, usually defined by annual sales but also by loan amount. Small and medium enterprises have specific funding needs in terms of their business growth. The monetary cut-off for classifying a company as a small and medium enterprise generally varies greatly by country, by market, and by Bank/FI.

Although less complex than for large corporate and project investments, the E&S issues associated with small and medium enterprises can be quite significant and are primarily related to worker health and safety and pollution. These E&S issues may not be closely monitored and the risks will vary depending on company size and its capacity to manage E&S risks, as well as by industry sector, and location.

Bank/FIs that lend or invest in small and medium enterprises generally try to develop long-term relationships, which may further expose lenders/investors to E&S issues associated with the enterprise, posing financial and liability risks. Due to the visibility of small and medium enterprises in a community, reputational risk is also a factor.

Risk in Retail - E&S issues associated with retail transactions that target individuals are generally non-existent, although there may be concerns associated with mortgage finance and potentially certain investment options that may involve controversial or high-risk projects/companies.

There is usually no credit, liability or reputational risks due to E&S issues for Bank/FIs involved in retail banking. However, in some cases, there may be concerns with corporate accounts that are linked to companies or individuals whose activities are viewed as harmful, such as arms manufacturing, money laundering, and terrorism, which may represent a legal and reputational risk to the Bank/FI.

Risk in Microfinance - These transactions are typically of smaller amounts and shorter tenure than corporate loans and target small business owners or commercial clients whose operations are generally small.

The E&S risks associated with microfinance are typically low partly due to the small size of the operation and the industry sector. However, in some cases clients may be involved with handling dangerous substances such as pesticides that can pose health or environmental risks, but frequently they lack the necessary E&S management capacity to do so safely.

Although at the individual transaction level the E&S risks associated with microfinance are low, given the smaller size and shorter tenure of transactions, there are credit or liability risks for the microfinance institution in cases where E&S issues, such as an accident, affect a micro-

entrepreneur's ability to repay a loan. Microfinance institutions often consider the E&S impacts associated with their transactions in the context of the developmental role they play in their communities and are therefore concerned with reputational risks. In addition, many see the promotion of good E&S practices as part of their role in the community.

Risk in Corporate Finance - Loans (debt) can be used by the commercial operation to finance a specific aspect of the operation, such as the purchase of equipment, or for renovation/expansion of the operation. Equity investments in a commercial operation provide operating capital for an operation in exchange for shares (equity) in the company/project.

The E&S risks associated with a corporate transaction will vary greatly and can be significant as a function of the operation's industry sector, size, location, and company commitment and capacity to managing E&S risks. E&S risks will be more significant for medium and high-risk industry sectors and large-scale operations such as mining, oil and gas, and heavy manufacturing, which may result in loss of life, health impacts, and water contamination, among others, if not managed properly. For low-risk industry sectors such as retail operations and other services, the E&S risks will usually be low and mainly related to labour standards and life and fire safety, which can readily be addressed. Regardless of the industry sector, there may also be E&S risks, especially related to labour and working conditions, in the supply chain of raw materials and goods.

E&S issues may threaten the financial and operational viability of a commercial operation. For a commercial operation, the source of repayment of a loan or payment of dividends on an investment is from the operation itself, backed by its entire balance sheet, rather than a specific asset. A corporate transaction exposes a Bank/FI to the entire commercial operation of the client's company, which presents a liability, reputational, and credit risk. When a loan is backed by a specific asset as collateral, the liability risk for the Bank/FI may be increased if there are associated E&S issues.

Risk in Project Finance - The financing is usually secured by the project assets such that the Bank/FI providing the funds will assume control of the project if the sponsor has difficulties complying with the terms of the transaction.

Project finance is generally used for large, complex and sizable operations, such as roads, oil and gas explorations, dams, and power plants. Due to their complexity, size, and location, these projects often have challenging E&S issues, which may include involuntary resettlement, loss of biodiversity, impacts on indigenous and/or local communities, and worker safety, pollution, contamination, and others. Because these projects generally face high scrutiny from regulators, civil society, and financiers, the project's sponsoring companies allocate more resources to managing E&S risks.

If not managed properly, the E&S risks can result in disrupting or halting project operations and lead to legal complications and reputational impacts that threaten the overall success of the project. Because anticipated project cash flows typically generate the necessary resources to repay the loan, any disruption to the project itself, regardless of the financial standing of the sponsoring companies involved, poses a direct financial risk to the Bank/FI.

Annex-6: Covenants

E&S clauses can be incorporated into legal agreements with clients. This helps reduce a Bank/FI's exposure to potential E&S risks associated with a client's operations.

Bank/FI staff can incorporate E&S clauses into legal agreements with clients to require clients to comply with the Bank/FI's E&S requirements. Doing so helps a Bank/FI reduce its exposure to the E&S risks associated with a client's operations throughout the lifetime of a transaction and gives the Bank/FI legal recourse in the case of non-compliance.

A Bank/FI's E&S Management System should state the circumstances under which specific E&S conditions such as the need for a corrective action plan should be inserted into the legal agreement for a proposed transaction.

The Legal Department should be involved in developing and inserting the necessary clauses on E&S matters into legal agreements. The specific language will depend on the type of transaction and potential E&S risks identified during the due diligence process but generally addresses the following areas:

- **Positive Covenants**: Measures or actions to be taken by the client. These may include the requirement for compliance with national E&S regulations and international standards, and periodic reporting on E&S performance. In the event of significant accidents and incidents, with potentially adverse E&S effects such as spills or workplace accidents resulting in death, serious or multiple injuries or major pollution, the client is required to notify the Bank/FI in a timely manner, such as within 3 days.
- **Negative Covenants**: Actions that the client should refrain from undertaking. These include the Bank/FI's E&S requirements.
- **Conditions Precedent**: Conditions and requirements that the client has to fulfil prior to disbursement of funds by the Bank/FI. These may include proof of valid permits and licenses, preparation of government-requested reports and delivery of completion of mitigation actions stipulated in the corrective action plan.
- **Event of Default**: An event that entitles the Bank/FI to cancel a transaction and declare all amounts owed by the client to become immediately due and payable. For transactions that involve complex E&S issues, this may include specifying a time period such as 30 days during which the client can resolve the issue after notification by the Bank/FI.
- **Corrective Action Plan**: The Plan is typically included as an annex to the legal agreement, outlining the specific mitigation actions to be taken by the client according to an agreed timeframe for implementation.

To assess compliance with the E&S clauses stipulated in the legal agreement, Bank/FI staff should periodically monitor clients and, as necessary, require the preparation of a periodic E&S performance report for review by the Bank/FI. The Bank/FI should consider material non-compliances with the E&S clauses as a breach of contract, which constitutes an Event of Default under the terms of the legal agreement.

In case of such an event, Bank/FI staff needs to work with clients to resolve non-compliance issues in order to ensure that any potential exposure of the Bank/FI to the client's E&S risks is mitigated. Where resolving the non-compliance issue is not possible, the Bank/FI may be required to take

legal action against the client to reduce its exposure to the E&S risks associated with the transaction.

Annex-7: Corrective Action Plan

Bank/FI staff may develop a corrective action plan with a timeframe for the client to implement appropriate mitigation measures to comply with the Bank/FI's E&S requirements.

Depending on the nature of E&S risks associated with a client's operations, Bank/FI staff may develop a corrective action plan with a timeframe for the client to implement appropriate mitigation measures to comply with its E&S requirements. The purpose of a corrective action plan is to mitigate potential E&S risks in the context of a transaction to an acceptable level for the Bank/FI.

Bank/FI staff should tailor the scope of a corrective action plan to each client according to the specific risks identified during the E&S due diligence process or during subsequent transaction monitoring. Corrective action plans range from simple mitigation measures to detailed management plans with actions that can be measured quantitatively or qualitatively. The corrective action plan should include a description of the specific mitigation actions to be taken by the client, a timeframe for implementation and a reporting requirement to inform the Bank/FI on the status of completion.

Bank/FI staff will need to discuss the corrective action plan with the client and agree on its scope and timeframe for completion. If the corrective action plan is developed as part of the transaction appraisal process, it should be included in the legal agreement. The timeframe for implementation of specific mitigation measures will vary according to the E&S risk and may range from being a condition of transaction approval to a reasonable timeframe from disbursement or when E&S issues were identified during transaction monitoring.

The following template can be used for documenting the corrective action plan agreed with the client. The template also contains few examples for guidance.

Table-I: Corrective Action Plan template with examples

Area of E&S concern as identified through ESDD	Corrective Actions required	Timeframe	Action completion indicator	Responsibility (Client staff, management or board)	Cost involved
Evidence of land pollution due to discharge of untreated effluent	Action plan may include: • Removal and treatment of contaminated ground soil • Construction of sewage system for industrial wastewater • Construction of wastewater treatment facility and discharge system for treated water	6 months	• Installation of Effluent Treatment Plant (ETP). The ETP should be operational and the qualitative parameters of treated effluent should be within limits • The discharge of treated effluent should be through the constructed discharge system and no other modes of discharge and leakages • Qualitative parameters of treated contaminated ground soil should be within limits	Board	
Absence of grievance redressal mechanism	Establish a grievance redressal mechanism	3 months	Well established grievance redressal mechanism which is appropriately communicated to the external stakeholders	Board	
Displacement of community structure	Restoration of community structure for common benefits	3 months		Management	
Loss of trees, crops, perennials	Compensating for standing crops and trees	1 year	Plantation of trees	Management	

Annex-8: Monitoring Checklist

Sl. No.	Question /Issues to check	Response
Project Summary Information		
1	Reporting period covered by this supervision report	
2	Specification of project stage (design, construction, operation or closure stage)	
3	Key developments and any major changes in project location and design, if any from the time of loan disbursement or from the last supervision period.	
General Information		
4	Status of implementation of covenants/corrective action plan. Is it in line with the agreed timeframe? (i.e.,if all covenants are implemented or partially implemented or not implemented or delayed implementation). If partially implemented or not implemented or delayed implementation, RO to please mention the reason in the response column along with a timeline for completion of implementation as committed by the client during supervision.	
EHS Management		
5	If there was any incidence of accidents, spills, leakages, explosionetc. during the reporting period. If yes, what was the scale of damage (e.g. if there was any fatality, monetary loss etc.)? What was the action taken in response to the incident?	
6	If there were any recent fines or penalties issued by the regulatory body. If yes, RO to please mention the nature of violation, amount of fine/penalty paid, action taken by the client to address the issue to avoid any such fine/penalty in future.	
7	If there was any health & safety incident. If yes, what was the extent of injury – minor, major or fatal? What was the action taken in response to the incident?	
8	If there are any new E&S risks or adverse impacts observed due to client's operation. RO to please mention the types of new E&S risks, the reason for such new E&S risks, mitigation measures undertaken by the client to address the E&S risks.	
Permits and Compliance Certificates		
9	All the required permits, licenses and clearances in place. RO to please mention the issuance dates and duration of validity of	

Sl. No.	Question /Issues to check	Response
	all such permits, licenses and clearances.	
10	Other international management systems (for e.g. ISO 14000, OHSAS 18001, SA8000) followed by the client and if they have valid certifications for those management systems?	
Grievance Redressal		
11	If there have been any recent complaints, grievance or protest received from local communities. If yes, RO to please specify the nature of grievances; actions taken by the client to resolve grievances and if there any outstanding issues and measures proposed by the client to resolve them.	
12	If there were concerns raised during the stakeholder consultations carried out by the client during the reporting period. If yes, what was the approach undertaken by the client to address those concerns?	
Other Information		
13	Any other information pertaining to environmental matters, management approach, community, media or NGO coverage that need to be mentioned. If there are any environment friendly initiatives, energy saving equipment etc. that might be relevant for the Bank/FI.	

Annex-9: Developing an ESMS

Developing an ESMS requires senior management support and needs to be integrated with the Bank/FI's existing risk management framework. Developing an ESMS is most effective and efficient if it is supported by senior management and integrated with the Bank/FI's existing risk management framework. A Bank/FI can initiate the process for developing an ESMS by establishing a Working Group.

An ESMS includes a policy, a set of procedures to identify, access and manage E&S risks in financial transactions and internal capacity of staff responsible for E&S management and investments.

It should be designed to manage the level of E&S risk that the Bank/FI is exposed to through its portfolio, both in terms of the industry sector of its clients and the type of financial transactions. The management of these risks should be tailored to the organizational needs of each Bank/FI, which are different for banking institutions, leasing companies, microfinance institutions, and private equity funds.

ESMS Template

An ESMS is anchored in a banks/FIs environmental and social policy and depends on the environmental and social management capacity of its staff and, as applicable, external experts. The ESMS includes the banks/FIs environmental and social policy and designated roles and responsibilities of its staff. It is implemented through a set of procedures for:

- Screening transactions,
- Categorizing transactions based on their environmental and social risk,
- Conducting environmental and social due diligence,
- Decision-making process,
- Monitoring the client's environmental and social performance, and
- Managing a client's non-compliance with the banks/FIs environmental and social standards.

The procedures outlined in the ESMS should be applied to each transaction as part of a banks/FIs overall risk management framework. For each transaction, this also requires a bank/FI to formally document its environmental and social review as part of its record-keeping process, consider environmental and social findings during the decision-making process, and incorporate environmental and social requirements such as a corrective action plan as clauses in legal agreements with clients.

To ensure the effective implementation of the ESMS across operations, the bank/FI needs to allocate the necessary resources for internal communication and training.

As part of its commitment to good corporate practices, a bank/FI can periodically report on the environmental and social performance of transactions and measures taken to reduce overall exposure to environmental and social risk.

A standard ESMS template is provided below for the guidance which can be customized as per organization's requirements.

1. Background

This Environmental & Social Management System (ESMS) details the policy, procedures and workflow that will be followed for investments made by ("the Company") under the management and administration of ("the Environmental Coordinator (or other designated officer)").

2. Environmental & Social Management System

2.1. Policy

The Company continually endeavors to ensure effective Environmental & Social management practices in all its activities, products and services with a special focus on the following:

- Ensuring that all activities undertaken by the Company are consistent with the Applicable Requirements outlined later in this document
- Ensuring that all projects are reviewed against the Applicable Requirements
- Financing projects only when they are expected to be designed, built operated and maintained in a manner consistent with the Applicable Requirements
- Making best efforts to ensure that all projects are operated in compliance with the Applicable requirements on an ongoing basis, during the currency of the Company's financing
- Ensuring transparency in its activities
- Ensuring that the management and the shareholders of the client companies understand the policy commitments made by the Company in this area.

This Policy will be communicated to all staff and operational employees of the Company.

Signed Effective Date

_____ _____

2.2. Applicable Requirements

The Company will ensure that all projects are reviewed and evaluated against the following Environmental & Social requirements

- The Exclusion List for all projects
- The applicable national laws on environment, health, safety and social issues and any standards established therein
- The IFC Performance Standards

2.3. Procedures

- At an initial stage of inquiry, the Environmental Coordinator (or other designated officer) will apply Exclusion List to the project. If the project involves an excluded activity, the prospective client will be so informed, and further consideration of financing for the project will be terminated. Otherwise, the Environmental coordinator will indicate the Applicable Requirements for the project.
- When the Environmental Coordinator (or other designated officer) indicates that the project does not involve an excluded activity, the prospective client will be informed that the Company will undertake (if required) an Environmental & Social Due Diligence (ESDD) as part of the appraisal process.

- The Environmental Coordinator or other designated officer will undertake (or appoint a consultant to undertake) an ESDD. Depending on the complexity of the project, the ESDD can be a desk review, based on a credit officer's site visit or require a full scale review conducted by a technically qualified person or consultant.
- The client company must be able to demonstrate compliance to the Applicable Requirements. Demonstration of compliance must be to the Environmental Coordinator (or other designated officer)'s satisfaction, although the opinion of third parties such as regulatory agencies can be sought. Where compliance cannot be demonstrated, a Corrective Action Plan must be agreed to in order for the investment to proceed. The plan must specify all of the necessary actions to bring a project into compliance. A target completion date for each specified action must also be agreed.
- Prospective clients must provide all requested information and Environmental Coordinator (or other designated officer) must have concluded that the Project is expected to meet the Applicable Requirements (with Corrective Action if required) prior to the Company's decision to make an investment.
- Environmental and Social performance will be evaluated on an annual basis, including status of implementation of the Corrective Action. The benchmark for performance will be the ongoing compliance against the Applicable Requirements. Performance evaluation will be undertaken by:

  a) The Company's client companies, who will provide annual reports to the Environmental Coordinator (or other designated officer), who may follow up as required with further queries or site visits; and

  b) The Environmental Coordinator (or other designated officer), who will provide Performance Reports to the Management, to be prepared on the basis of the Client annual reports provided to the Environmental Coordinator (or other designated officer) and the ESDD and supervision conducted.
- All investment agreements will contain appropriate environmental representations, warranties, and covenants requiring that projects are in compliance in all material respects with host country environmental, health, safety and social requirements embodied by state general laws and implementing agencies and conducted in accordance with any Applicable Requirements.

2.4. Organization and Responsibilities

- [FIRST AND LAST NAME] is the Environmental Manager. The Environmental Manager will have oversight for environmental and social issues, will ensure resources are made available for environmental management, and will sign the Company's annual environmental performance report.
- The Environmental Coordinator is [FIRST AND LAST NAME].
- The responsibilities of the Environmental Coordinator include:
  a) During due diligence, the evaluation of environmental compliance of a target client company with Applicable Requirements;
  b) Supervising projects in the portfolio against on-going compliance with the Applicable Requirements.
  c) The preparation of an annual environmental performance report, based on the annual performance report prepared by the client companies.

- The Environmental Coordinator will ensure that these procedures are implemented for each project, and that records of environmental reviews are maintained.
- The Environmental Coordinator (or other designated officer) will ensure that all investment decisions are supported by appropriate due diligence documentation (including, but not limited to, an environmental section in each final Investment Memorandum).
- Legal Counsel will ensure that appropriate environmental representations, warranties, and covenants are incorporated in each stock purchase agreement.

2.5. Resources and Capabilities

- The Environmental Manager will work with management to ensure that adequate Company resources have been committed to allow for the effective implementation of the environmental policy and procedures of the Company.
- The Environmental Coordinator (or other designated officer) will need to be technical qualified to be able to carry out the due diligence or review work carried out by a consultant.
- The Environmental Coordinator will maintain a file of qualified environmental consultants who can be called upon to assist in conducting environmental reviews.

2.6. Records to be maintained

- Environnemental& Social Due diligence (ESDD) - This is the record of the Company's E&S review of a project at the time of considering of the project for investment and forms
- E&S Supervision records for projects being supervised
- Reports to be provided to Company management

3. Annexure

3.1. Exclusion List

4. IFC performance Standards

(Available at the IFC Website)

5. Carrying out the Environmental & Social Due Diligence (ESDD)

An ESDD is the record of the Company's review of a project at the time of appraisal that ensures that a project is meeting and is expected to continue to meet the Applicable Performance Requirements. An ESDD is based on all or some of the following:

- Review of information in the public domain to check for any social and/or environmental controversies/news related to the project
- Review of project and environmental and social documents of the project
- Discussions with the Project Officials
- Site visit and discussions there
- Some technical/and E&S knowledge will be required along with knowledge of the technical issues in the project's industrial sector and may require the use of an external consultant if the project is large and complex. Industry sector-wise E&S information in available at the following locations
  - World Bank Pollution Prevention and Abatement Handbook
  - IFC Sector guidelines

6. Suggested ESDD report outline

Cover issues as applicable

- Background: Project Description, Site and Environment Setting, Land requirement,
- Compliance with Applicable Requirements: Exclusion list, National Regulatory requirements, (Performance Standards if required)
- Environment Issues: Air Pollution, Water Pollution, Solid and Hazardous Wastes, Noise, Site Health and Safety, Chemical Hazards and Emergency Management,
- Resources Utilization : Water, Construction material, Other
- Sensitive Receptors: Local Human settlements, Local Ecologically sensitive areas, Sites of cultural importance
- Social Issues: Land Acquisition, Rehabilitation and Resettlement, Indigenous Peoples, Impact on local livelihood, Public Opinion and Consultation
- Labor Relations: No Child or forced labor, Compliance with national labor laws
- Project consultation and local Disclosure
- Other project specific issues
- Environnent Management /Corrective Action Plan
- Summary and Recommendations
- Financing Covenants/Conditions

Annex-10: List of Relevant National Regulations and International Treaties

Key E&S Areas	Relevant local regulation	Relevant international treaties and conventions for which Bangladesh is a signatory
Assessment and management of E&S risks and impacts	• National Environmental Policy, 1992 • Environment Pollution Control Ordinance, 1977 • Environmental Quality Standards for Bangladesh, 1991 • National Environment Management Action Plan (NEMAP), 1995 • Environment Conservation Act, 1995 and amended in 2002 • Environment Conservation Rules, 1997 and amended in 2003 • EIA Guidelines For Industry, 1997	
Management of labour related issues such as recruitment, wages, occupational health and safety and others	• Labour Policy 2012 • Bangladesh Labour Act, 2006 • Labour Welfare Foundation law 2006 • Bangladesh Labour (Amended)Law, 2013 • Labour Relations under Labour Laws, 1996 • National Child Labour Elimination Policy, 2010 • Bangladesh Factory Act, 1965 • Bangladesh Factory Rules, 1979 • OSH Policy, 2011 • The Employees State Insurance Act, 1948 • The Employer's Liability Act, 1938 • Maternity Benefit Act, 1950 • Workmen's Compensation Act, 1923 • The Employment of Children Act, 1938 • Bangladesh Industrial Act 1974	• Occupational Hazards Due to Air Pollution, Noise and Vibration (Geneva), 1977 • Prevention and Control of Occupational Hazards (Geneva), 1974 • Occupational Safety and Health in Working Environment (Geneva), 1981 • Occupational Health Services (Geneva), 1985
Resource efficiency and pollution prevention	• The Environment Pollution Control Ordinance, 1977 • National 3-R Strategy, 2010 (3R: Reduce, Reuse and Recycle) • Ship-Breaking and Hazardous	• International Convention on Climate Change (Kyoto Protocol), 1997 • UN Framework Convention on Climate

Key E&S Areas	Relevant local regulation	Relevant international treaties and conventions for which Bangladesh is a signatory
	Waste Management Rules, 2010 • Biomedical Waste Management Rules, 2008 • Draft National Solid Waste Management Rules, 2010 • Draft National River Conservation Act, 2011	Change (New York), 1992 • International Convention on Civil Liability for Oil Pollution Damage (Brussels), 1969 • Convention on Oil Pollution (London), 1990 • UN Convention on the Law of the Sea (Montague Bay), 1982
Community health, safety and security	• Disaster Management Act, 2012 • Public Health Emergency Provisions Ordinance, 1994 • Biomedical Waste Management Rules, 2008 • Climate Change Act, 2010 • Draft National Solid Waste Management Rules, 2010 • National Plan for Disaster Management 2010-2015 • Sound Pollution Law, 2006 • Ship Breaking and Hazardous Waste Management Rules, 2010 • Water Supply and Sewerage Authority Ordinance, 1963 • Noise Control Rules • National Health Policy, 2011	• International Convention on Climate Change (Kyoto Protocol), 1997 • UN Framework Convention on Climate Change (New York), 1992 • International Convention on Civil Liability for Oil Pollution Damage (Brussels), 1969 • Civil Liability on Transport of Dangerous Goods (Geneva), 1989
Land acquisition and Involuntary resettlement	• National Land Use Policy • The Land Acquisition Act, 1894 • The Acquisition and Requisition of Immovable Property Ordinance, 1982	
Biodiversity conservation and sustainable management of living natural resources	• National Biodiversity Strategy and Action plan (2004) • Bangladesh Wildlife Conservation and Security Act, 2012 • Bangladesh Wild Life (Preservation) Act, 1974 • Bio Safety Rules, 2012 • Forest (Amendment) Act, 2012 • Forest Policy, 1994 • Social Forestry Rules, 2004 • National Forest Policy and Forest	• Protocol on Biological Safety (Cartagena Protocol), 2000 • UN Framework Convention on Climate Change (New York), 1992 • International Plant Protection Convention (Rome), 1951 • International Convention on Climate Change (Kyoto Protocol), 1997 • Convention Relative to

Key E&S Areas	Relevant local regulation	Relevant international treaties and conventions for which Bangladesh is a signatory
	Sector Review (1994,2005) • Draft Tree Conservation Act, 2012 • The Private Forests Ordinance Act, 1959 • Forest Transit Rule, 2011 • Climate Change Act, 2010 • Deer Rearing Policy, 2009 • The Protection and Conservation of Fish Act 1950 • Draft Wetland Policy, 1998 • The Protection and Conservation of Fish Rules (1985) • The Protection and Conservation of Fish Act, 1950 • National Conservation Strategy, 1992 • Private Fisheries Protection Act 1889 • Marine Fisheries ordinance 1983 • Revised National Conservation Act, 2010	the Preservation of Fauna and Flora in Their Natural State (London), 1933 • International Convention for the Protection of Birds (Paris), 1950 • Convention on Wetlands of International Importance Especially as Waterfowl Habitat (Ramsar), 1971 • Convention on The Conservation of Migratory Species of Wild Animals (Bonn), 1979 • Convention on Biological Diversity (Rio de Janeiro), 1992 • Convention on International Trade in Endangered Species of Wild Fauna and Flora • UN Convention on The Law of The Sea (Montague Bay), 1982
Indigenous peoples	• Social Forestry Rules, 2004 • The Acquisition and Requisition of Immovable Property Ordinance 1982 • The Land Acquisition Act, 1894	
Cultural heritage	• The Antiquities Act, 1968	• World Cultural and Natural Heritage (Paris), 1972