# Guideline on Environmental and Social Risk Management

Environmental and social risk management process adds a new dimension to the existing risk management approach that already focuses on assessing risks such as credit risk, market risk and operational risk etc. Environmental and social risks associated with the CBL's lending operations are systematically addressed in the procedure for identifying and assessing risks, in the assessment tools and through internal capacity to identify and manage these risks. In order to manage E&S risks and opportunities, a structured management approach is needed. Such a management approach is called Environmental and Social Management System (ESMS). The objective of an ESMS is to support the Bank in better understanding of the environmental and social risks related to its portfolio, and to (1) evaluate, mitigate and monitor these risks on a structural basis, (2) maximize opportunities for environmental and social benefits that arise from the obligation of its borrowers to comply with national standards and applicable international covenants and (3) establish a good reputation among clients, investors and other relevant stakeholders.

## ENVIRONMENTAL AND SOCIAL RISK DUE DILIGENCE PROCESS

The Bank has developed an environmental and social risk due diligence process for assessing and monitoring commercial lending transactions it provides. The objective of applying these Procedures is to focus upon the environmental and social issues associated with commercial lending and investments in order to maximize the opportunities for environmentally and socially responsible and sustainable economic development, and to minimize the Bank's exposure to environmentally or socially derived financial, reputational, legal risks and liabilities associated with its financial transactions.

Credit risk and E&S risk are two different types of risks that have different sources, mitigation measures, criteria and procedure for assessment and management. While assessing a credit proposal a Bank needs to consider both credit and E&S risks. Bank needs to include E&S risk related due diligence process in the credit appraisal and monitoring process.

### *Initial Screening*

*Goal:* Transaction screening

*Step:* After receiving a credit proposal, Relationship Manager (RM) first for E&S risk management purpose conduct initial E&S screening against list of *"Excluded Loan Types & Industries"* mentioned both in the Bank's Credit Policy Manual and Guideline on Environmental and Social Risk Management. If the proposed credit is on the list, credit proposal is not processed. If not, RM proceeds with the credit application to the next step; where unsure whether to reject or proceed, consult with the E&S Officer for further clarification.

*Tool:* List of Excluded Loan Types & Industries

### *Risk Categorization*

*Goal: Determine the required E&S due diligence*

*Step:* If the credit proposal qualifies after verification with the "Excluded Loan Types & Industries" RM will identify the type & level of E&S risks and required due diligence for the proposed transaction, as the level of E&S risk will vary greatly for different types of financial transactions and by industry sectors. Before making a visit to the client's premises RM determine by the using *"E&S Categorization List"* the overall level of E&S risk associated with the client's activity depending on the nature of the business activity (sector) carried out by the potential borrower. This initial categorization can be done by considering DoE (Department of Environment) categories of Green, Orange A, Orange B and Red. A list of business categories is available in the Environment Conservation Rules (ECR), 1997.Before making a visit to the client's premises, RM determines by the use of the E&S Categorization List the overall level of environmental and social risk (Green = low risk, Orange A and B = medium E&S risk, Red = high E&S risk) associated with the client's activity depending on the nature of the business activity (sector) carried out by the potential borrower. The categorization helps RM to judge how much subsequent environmental and social (E&S) appraisal may be necessary.

After identifying the level of required E&S due diligence RM jointly with PIAD will visit the business and factory/project and prepare a visit report. Project Inspection & Assessment Department (PIAD) will make project visit in case of project financing or financing to any manufacturing concern where the funded facility is more than BDT 5 crore and in cases where IFC Performance Standard (PS) is applicable. In any special case, if RM needed technical support from PIAD member than RM and PIAD may jointly visit where Head of CRMD recommendation is needed. Based on the visit PIAD will also prepare a "Project Visit Report" where all the technical aspects will be mentioned for the support of E&S risk assessment.

*Tool:* E&S Categorization List & Performance's Standard Screening Form

### *E&S Due Diligence*

*Goal: Identify and assess potential E&S impacts and issues*

*Step:* After categorizing associated E&S risk, it is necessary to conduct the required due diligence in line with the applicability to mitigate the risk. The RM will conduct the Environmental & Social Risk Rating (ESRR) using the generic or sector specific checklist. If a transaction is in a sector which is covered by BB sector specific guidance notes then corresponding sector specific checklist will have to be used. For all other sectors the Generic Checklist will have to be used. If a transaction triggers IFC Performance Standard then the Performance Standard Screening Checklist will have to be completed in addition to either the generic or sector specific checklist provided by BB. The outcome of the ESRR helps in the assessment of the E&S risk and in the decision making.

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.

In cases where PS is applicable RM will use the *Performance Standard Screening Form* to review the client's operations to determine whether or not any of the eight PSs are applicable to the proposed transaction. If so, RM will inform the client of the relevant E&S issues and the requirements arising from the relevant PS, and ensure that the client complies with any relevant PS.

*High Risk:* Transactions typically involve clients with business activities with significant adverse environmental and social 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 environmental and social 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/investees with business activities with minimal or no adverse environmental and social impacts.

*Tool:* E&S Due Diligence Risk Assessment Tools

### *Review and Approval*

*Goal:* Credit decision based on the risk appetite.

*Step:* RM will submit the Application for Limit (AFL) and Credit Memorandum (CM) to the Risk Manager. Along with credit documents AFL and CM will be supported by the E&S related documents fully completed E&S checklist along with project visit report, copies of all permits, clearances (Department of Environment clearance certificate, fire license, boiler license, buyer's audit report in case of RMG and other export industries etc.). On receiving the documents Risk Manager review the summary findings of the E&S risk assessment prepared by the RM. The key objective is to check that the RM has followed appropriate process in identifying the important E&S risks and ensuring that they will be adequately mitigated and managed. Based on its review, the Risk Manager then writes his/her recommendation and places the same for approval. The approver reviews the recommendation of the Risk Manager and makes the credit decision. It is to be mentioned that all High E&S risk credit must be approved by the Board of Directors and Low and Medium risk credit will be approved by following Bank's standard credit approval authority. In absence of the Board, the high risk transactions can be approved by the Executive Committee.

*Tool:* Escalation Matrix

### *Risk Mitigation & Control*

*Goal:* Due Diligence to mitigate the E&S risk.

*Step:* Based on the assessment made earlier the Bank than determine the appropriate procedures to mitigate and control the risks e.g. inclusion of covenants and clauses in the credit agreement. If approved, the credit agreement should then include relevant E&S Covenants or Action Plan where applicable. The recommendation in the credit agreement should also make mention of a frequency of monitoring and how to signal any deterioration in the ESRR.

In case of identified non-compliances with the PS, depending on the severity of the issue, Risk Manager will develop an E&S Action Plan (ESAP) with the support of PIAD members or with the support of third party consultant for addressing the issues within a reasonable timeframe. RM should communicate the content of the ESAP with the client.

*Low Risk:* If the ESRR outcome is "*Low*" then in-depth assessment is not required. However, it is the responsibility of the RM to ensure the E&S compliance. RM has to ensure the regular compliance throughout the whole credit tenor.

*Medium Risk:* If the ESRR is "*Medium*", then the RM will identify the gaps and with the consent of the borrower will develop an Action Plan to minimize the gap. The Action Plan must have specific timeline for each of the required action. The Action Plan will be a part of the Credit Memo or Loan Agreement as an E&S covenant. Risk Manager will ensure the compliance of these covenants with the support of the RM.

*High Risk:* For *High* ESRR, in-depth assessment is required, if necessary with the use of qualified external consultants. Where external assessments (e.g. ESIA) are required by law or regulatory authorities, these should be collected and reviewed. Recommendation and summary findings, including any remedial actions to be agreed with the borrower for closing the gaps on identified non-compliances should become a part of the Credit Memo or Loan Agreement as an E&S covenant. Therefore for the transaction of ESRR "High", CRM should always draft an E&S Action Plan (ESAP) and additional covenants/conditions to be used to mitigate the identified problems.

For High Risk customers if the borrower fails to meet the action plan mentioned in the sanction advice within the agreed time line then borrower's written statement needs to be collected clarifying the reasons for the delay with a request to extend the time. After analyzing, if the Head of SF Unit finds it rational only then the time can be extended. If the borrower requires further time extension on the same action plan then it has to be place before MD & CEO with recommendation of Head of SF Unit. For additional time extension it has to be accelerated to the Board and recommendation with proper justification of the Head of SF Unit and MD & CEO is required. The Board may consider gradual discontinuation of business relationship only if ESRR is high for not having DoE Clearance Certificate.

In cases, where Bank's exposure to High risk borrower is accommodated by Bank's Risk Appetite in this regard, the Head of SF Unit of the Bank may recommend the Board to consider gradual discontinuation of business relationship considering the severity of the non-compliance. The signs of severity may be derived through borrower's persistent failure to meet the action plan time line or evidence of stakeholder grievances, negative media or NGO protest etc.

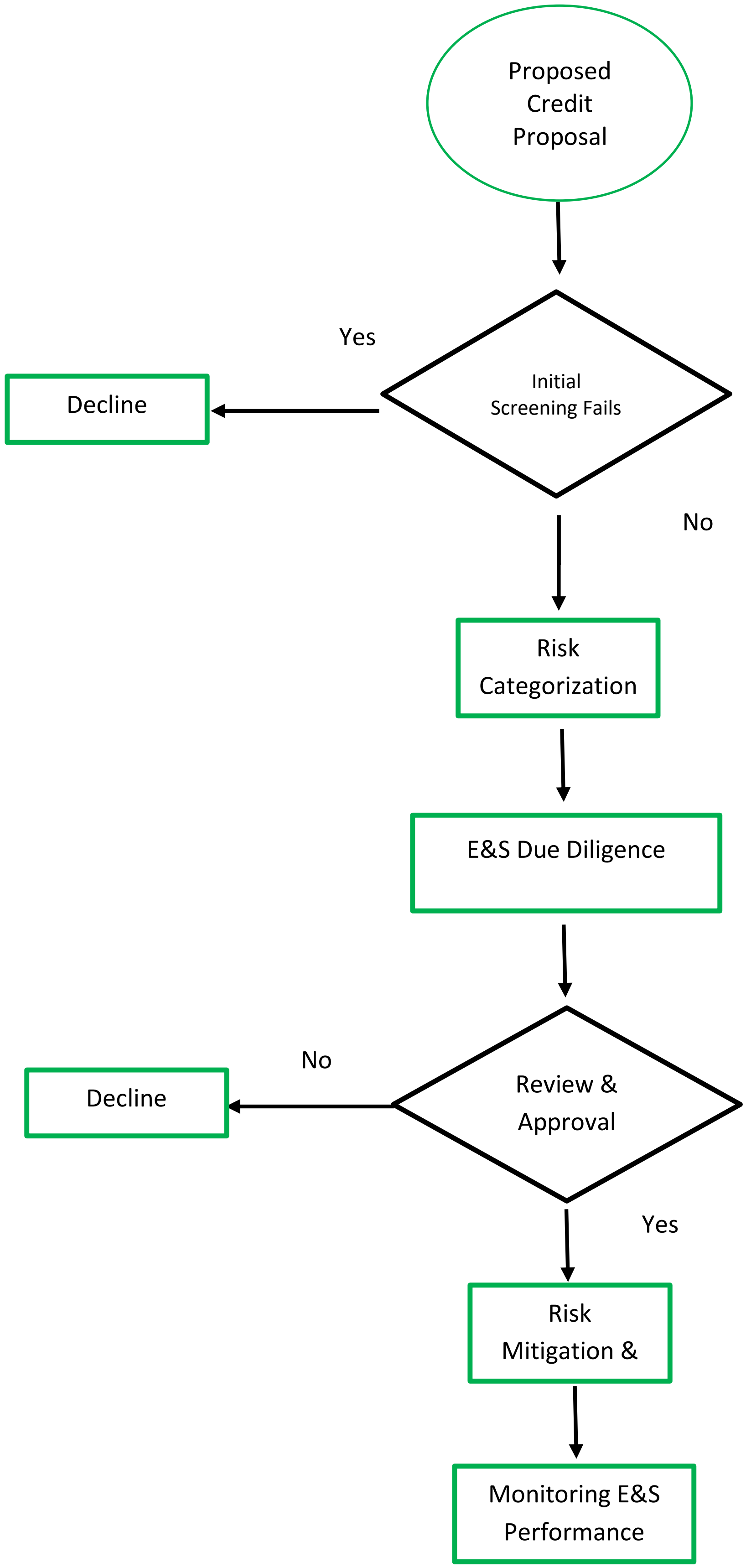
*Tool:* E&S Covenants and Corrective Action Plan

### ***Monitoring & Supervision of E&S Performance***

*Goal:* Managing E&S risks

*Step:* Monitoring and supervision of borrower's E&S risk related activities will be conducted by the RM. For High Risk clients, RM needs to conduct on-site monitoring by visiting at least half yearly basis and in case of Medium or Low risk at least on yearly basis. In case of High Risk at the time of visit RM will be accompanied by a member of PIAD. Like any other financial covenants the agreed E&S covenants will be registered in the system and monitored by Credit Administration Department (CAD) based on the follow up visit and documents collected by RM. Based on the follow up RM may re-conduct the ESRR and report it to Risk Officer and CAD. In case of making any improvement or downgrade in ESRR, E&S Officer recommendation is necessary.

*Tool:* Monitoring Checklist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Credit
Proposal
Yes
Decline
Initial
Screening Fails
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Risk
Categorization
E&S Due Diligence
No
Decline
Review &
Approval
Yes
Risk
Mitigation &
Monitoring E&S
Performance