

»» DEG evaluation results



Evaluation of the Promotion of Environmental and Social Standards in DEG's Financing of Financial Institutions and Funds

Executive summaries of seven case study reports

For the full study see: <https://www.deginvest.de>

This report is a result of DEG's evaluation work regarding development effectiveness. DEG's monitoring and evaluating team checks at regular intervals whether the transactions it co-finances help to achieve sustainable development successes and points to ways of making further improvements for DEG and its customers. To ensure the independence of evaluation results, external consultants regularly support the work of the team.

This study was prepared by Citrus Partners LLP.

We thank all clients for the great cooperation while conducting this evaluation.

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Intro

DEG, as a Development Finance Institution, promotes economic success and sustainable business practices via the financing of private sector clients. DEG's investments extend to countries and sectors with different levels of Environmental and Social (E&S) regulations and standards as well as different degrees of enforcement thereof. In response, DEG requires its clients to implement a series of formalised E&S standards adapted to the clients' activities and context.

To ensure the implementation of E&S standards in its investments with Financial Institutions (FIs) and Private Equity Funds (PEFs), DEG includes requirements for these clients to implement a formal Environmental and Social Management System (ESMS) in its contracts. The ESMS includes the use of a specific Exclusion List in the screening process, the appointment of an E&S Officer to a dedicated role, and the provision of an annual report on E&S performance. The planning and implementation of ESMS at banks, including the appointment of an E&S Officer with responsibilities for management of the ESMS, is central to the achievement of DEG's E&S standards.

DEG is carrying out an evaluation of its overall environmental and social (E&S) risk management for its investments through FIs and PEFs. The evaluation has included Case Studies on the implementation and impacts of DEG's E&S requirements associated with its loan or equity participations.

On the following pages you find the summaries of seven case studies of the ESMS evaluation study.

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1. Bank Windhoek - Namibia

The loan to Bank Windhoek in Namibia was signed in September 2015. DEG is providing Technical Assistance (TA) for the design and implementation of an ESMS at Bank Windhoek.

In summary, Bank Windhoek is fully committed and on track to implement an ESMS. However, the bank is just starting the implementation and has yet to identify and appoint a new E&S Officer – a major obstacle to the ESMS development. Significant impacts at the client level have yet to be realised. DEG's support to the Bank has been strong, particularly through the TA programme which added impetus and showed where to start when developing the formal ESMS.

The main conclusions and lessons learned from this Case Study are::

- The senior management of Bank Windhoek is strongly committed to the management of E&S risks through implementation of its ESMS. The Case Study demonstrates that, when planning actions and requirements to influence the E&S risk management at clients, DEG should take into account that the commitment of senior management is a critical factor in the effectiveness of the ESMS.
- The ESMS has been developed and piloted at Bank Windhoek, but will still take additional time and resources to implement. The Case Study demonstrates that a pilot phase is an important part of implementation and that the pilot phase needs to be for long enough for the ESMS to be properly tested before full implementation.
- At this stage, a highly relevant point for the long-term ESMS implementation at Bank Windhoek is the appointment of an E&S Officer. Bank Windhoek has not been able to find an appropriate Namibian candidate with hands-on experience to replace the previous officer, who left in December 2015. Despite the creation of an efficient interim solution by Bank Windhoek through an E&S consultancy, there is a role for DEG to support the client in identifying an E&S Officer, for example through further TA support to build the capacity of a less experienced candidate, when appointed.
- The planned coverage of the ESMS by Bank Windhoek is considered to be too ambitious at this early stage. The bank is planning for the E&S screening tool to be used for individual clients; it would be better to focus initially on implementation for only the higher risk sectors and larger clients.
- Bank Windhoek has a portfolio with less than 20% of the total volume invested in higher-risk sectors, therefore the Category B rating for E&S risk by DEG is appropriate.
- The evaluation visit confirmed that there would be significant opportunities in E&S investments in Namibia, particularly in relation to the management of water resources and in solar power projects; which would add environmental value through the portfolio.

2. Metier Capital Growth Fund 2 - South Africa

Metier Capital Growth Fund 2 (MCGF2) ('Metier' is a regional fund covering Africa. DEG has worked with Metier since 2011, starting with the Lereko Metier Sustainable Capital (LMSC) fund, which focuses on renewable energy projects, mainly in South Africa. DEG then invested in MCGF2 in 2015. The fund currently has investments in four companies – a smaller number of sub-projects as per other PEFs. DEG provided Technical Assistance (TA) for the development and implementation of the Environmental and Social Management System (ESMS) for the MCGF2. This TA built on the ESMS that had already been developed under TA by the same consultant for the LMSC Fund.

Overall, the ESMS at MCGF2 is appropriate for the level of E&S risk with strong commitment from the management team; the relationship with DEG is strongly positive, particularly in relation to the TA programme, however more support would be beneficial in relation to examples of good practice and the identification of green investments as experienced by other PEFs.

The main specific findings and lessons learned from this Case Study are:

- Senior management at Metier are highly committed to E&S risk management and the ESMS is integrated into activities of the fund management team.
- The current ESMS at Metier is appropriate to manage the risks in the portfolio of MCGF2. At present, the E&S risk Category B is appropriate for MCGF2, but DEG will need to track the potential risks if the fund invests in companies in other countries.
- MCGF2 has a particular interest in strengthening the companies in which it invests, including the E&S performance at the companies, so that their value increases by the time the fund exits.
- Metier has required each client in the MCGF2 portfolio to set up a Social and Ethics Committee. These committees meet at least quarterly and Metier provides the chairperson. This is a useful mechanism for Metier to monitor E&S risk management.
- The main area that could be improved at the MCGF2 relates to the Environmental and Social Action Plans (ESAPs) that Metier requires the companies to implement. The ESAPs are high-level, focusing on actions such as review of policies and setting up committees. These actions would benefit from being more detailed and specific, with timelines and more precise end-points.
- The client had particularly positive feedback on the hands-on approach by DEG overall, including in relation to the ESMS, and positive feedback on the TA.
- The client and the sub-projects that were consulted all requested case studies on good practices in E&S management, and there might be a role for DEG to facilitate this process. In addition, DEG might take more actions to influence funds to identify more opportunities for E&S investments, such as in energy efficiency.

3. Banco Internacional de Moçambique S.A. - Mozambique

DEG's loan to Banco Internacional de Moçambique S.A. (BIM) in Mozambique was signed in November 2013. DEG is providing Technical Assistance (TA) for the design and implementation of an ESMS at BIM.

It is important to evaluate the implementation of E&S risk management systems in line with the context in Mozambique, where environmental and social risks are generally not taken into account in banking sector activities.

BIM has so far not implemented an ESMS in line with DEG's E&S requirements, despite TA support. At the time of the case study, the Management Board still had to decide when and how the ESMS pilot would be started. BIM has experienced significant and high level personnel changes and will require guidance from DEG to recommence the ESMS design and implementation process. To date, the relationship related to ESMS implementation has remained largely with the TA Consultant rather than DEG. In order to get the process back on track and to strengthen its role as promoter of E&S standards, DEG needs to be more active in discussing progress with the client and in pushing for the implementation of the contractually-agreed ESMS and openly discuss and address possible constraints.

The main conclusions and lessons learned from this Case Study are::

- BIM's portfolio of investments is reported to be mainly in lower risk sectors. The bank has been assigned an E&S risk category B by DEG, which is considered appropriate for the current portfolio, based on the information provided by BIM. Examples of BIM investments in potentially higher risk sectors are mining, the funding of oil imports, construction, transport, utilities and agriculture.
- BIM has not implemented its ESMS as required by the conditions of the Loan Agreement with DEG, and is over 12 months behind schedule. While the implementation of the ESMS pilot is expected in the next months, there is potential for significant further delays.
- Since the Loan Agreement was signed with DEG, there was a major restructure of the BIM Board in late 2014, with over 80% of Board positions being changed. At the time of the case study visit, the client stated that it needed more time before starting to implement the ESMS due to the reshuffle of the Management Board in late 2014: E&S staff needed to get the new Management Board members on board by explaining the benefits of the ESMS. Management commitment will be essential to the successful implementation of the ESMS.
- BIM has not had an E&S Officer in the role for over 12 months. This is another important requirement of DEG, and the appointment and training will be an essential component of ESMS implementation. The perception from the evaluation is that the E&S role, if assigned, would just be added by BIM to the responsibilities of an existing position, rather than being a stand-alone specific position. This approach is unlikely to be sufficient given the challenges with ESMS implementation.
- The current situation (July 2016) is that BIM is planning to start an ESMS pilot in 2016, assuming the Board approves the ESMS policy. Although it is important for DEG to find a balance between a strong relationship with the client and enforcing the conditions of contract, the situation would benefit from more regular communication from DEG with senior management at the client on E&S requirements. This communication should involve more regular dialogue with senior management at the client to keep raising the profile of E&S risks and the benefits of ESMS, through reminders of commitments, advice, and case studies of good practices. This strategic approach of soft communication and drip-feeding advice and support is more likely to strengthen management commitment over time.

4. Banco Promerica – El Salvador

DEG's loan to Banco Promerica in El Salvador (BPSV) was signed in 2012. DEG provided Technical Assistance (TA) for the design and implementation of an ESMS during 2012-13. This has been used as a blueprint for roll-out to the other eight Promerica group banks across Central America: BPSV is responsible for mentoring two of these banks in implementing their ESMSs and training staff.

Overall the ESMS at Banco Promerica is at an advanced stage, with full management support, and has been replicated across the bank's portfolio. The ESMS is well adapted to the risk profile (FI-B) and the stage of development of the clients in relation to E&S compliance. The ESMS has improved the quality of the bank's portfolio and should help to secure additional Development Finance Institution (DFI) credit lines – potentially a direct commercial benefit to the bank. DEG's role has been well received, particularly in relation to TA, however there are a number of specific areas where further feedback and support could add further value.

The main conclusions and lessons learned from this Case Study are:

- The senior management of Banco Promerica is strongly committed. They saw the benefits of an ESMS in terms of risk and reputation management and as part of their corporate sustainability approach from the outset. The advantage of having the ongoing involvement of a senior individual who has energetically championed the ESMS and provided leadership in the roll-out to other banks is very evident.
- The ESMS has been developed and robustly implemented at Banco Promerica in El Salvador. The case study illustrates the importance of a concrete and practical system, which is proportionate to the E&S risk profile and average loan size and is integrated into the commercial loan assessment process from the earliest stages. For the first three years the focus has been on ensuring that clients meet national E&S regulatory and licensing requirements rather than International Finance Corporation Performance Standards (IFC PS). This is appropriate given BPSV's categorisation as FI-B and the very limited number of high risk projects in its portfolio.
- BPSV has taken a pragmatic approach to recruiting E&S Staff as it is difficult to find experienced E&S professionals in the domestic market. They have instead provided on-the-job E&S training to an experienced senior analyst promoted to the E&S coordinator position, and to young enthusiastic financial analysts who will be able to carry out more complex E&S due diligence assessments and support others. The choice of an individual who understands the bank's procedures and clientele as well as E&S issues has made her an effective gate-keeper to make sure that E&S requirements are fully met.
- Based on its successful ESMS implementation, BPSV is now working with two other banks in the Promerica group to help them adopt the same policies, procedures and tools, adapted where necessary for their own contexts. This group-wide approach will have advantages in helping Promerica clients export and invest in other Central American markets and will help the bank to bring in lines of credit from other DFIs.
- There are significant opportunities in E&S investments in El Salvador which could improve the resource efficiency in the bank's key investment sectors including sugar cane, plastics, public transport and freight and other light industrial processes. Banco Promerica group is exploring a Green Line of credit to address some of these opportunities with another DFI.

BPSV and the Promerica group have very good feedback about the support they have received from DEG and its TA Programme. They would very much also appreciate: feedback on their E&S Annual report; further advice and support in developing a central database for E&S assessments and good practice which could be shared across the group; access to useful resources on best practice and legislative requirements in sectors which are new to the bank; and opportunities to take part in training or workshops to exchange good practice and deepen knowledge about green investment opportunities such as renewable energy and resource efficiency with other E&S officers in Central and Latin America

5. Multibank - Panama

Multibank in Panama is financed with a loan via the Holding Multifin Panama. DEG provided Technical Assistance (TA) for the design and implementation of an ESMS at Multibank.

Overall, Multibank is one of very few Panamanian banks with a fully-implemented ESMS and, with its strong corporate commitment to sustainability, is one of the market leaders in E&S for SMEs. To date the emphasis has been on compliance and the bank are now keen to address improved performance and the identification of green investment opportunities, particularly in the renewables area. Multibank received Technical Assistance (TA) from DEG on the design and implementation of its Environmental and Social Management System (ESMS) in 2013 and 2014. The ESMS has led to direct, tangible business improvements in terms of energy savings, cost savings and the attraction of additional credit lines. The bank has used its ESMS to improve its own environmental performance also leading to increased recycling and decreased energy costs etc. Multibank's relationship with DEG has always been strong and they are confident about the resources to turn to if additional advice is needed.

The main conclusions and lessons learned from this Case Study are:

- The senior management of Multibank is strongly committed to the management of E&S risks through implementation of its ESMS and has driven the development of the ESMS initially as part of its risk management procedures but increasingly as a means of improving the environmental performance of its clients;
- A practical and proportionate ESMS has been developed and fully implemented at Multibank. Projects are screened against an Exclusion List, categorised according to their specific E&S risk (three categories low to high risk) and the bank's financial exposure (above or below USD500,000 loan). All high risk projects and construction sites are visited and an E&S assessment is signed off by an E&S officer before approval by an Investment Committee. By the end of 2015, there had been no high risk projects in the commercial portfolio and hence no requirement for Environmental and Social Action Plans (ESAP) attached to loans;
- Multibank's category B rating is appropriate as the portfolio includes investments in some industrial processes and increasingly in renewables (small hydro, solar and one wind farm) but remains mainly small-scale agriculture, livestock and forestry, construction, retail and services;
- Since mid-2016 the ESMS also applies to Multibank's international operations which are likely to involve larger and higher risk E&S projects. Appropriate measures are in place to address potentially higher risks including an additional E&S officer dedicated to international loans, supported through access to external consultancy resources (with competences in industry, construction and energy), and delivery of more specialised E&S training for loan officers and analysts;
- At this stage, the most important point for the ESMS implementation at Multibank is moving beyond risk management and compliance with national legislation and permitting requirements to a second phase of increasing performance to meet IFC standards, where appropriate, and to help clients improve environmental and social performance through green investments, particularly in renewable energy. Other opportunities have been identified by Multibank amongst its construction and commerce clients and the team has started to raise awareness of clients in the construction sector through a programme of seminars in 2016.

6. Techcombank - Vietnam

Techcombank received a loan by DEG in 2011. The bank has an ESMS in place based on IFC procedures. Whilst the system itself is in place, it is compliance-focussed. Due diligence is minimal and limited to a desk review of sub-project files against national E&S regulations. Site visits are currently not possible for the E&S team; E&S Officers were recruited from professional investment staff. Training received to date from IFC has also been process driven. In short, the management team are concerned about ESMS as a potential barrier to banking competitiveness and the current system arrangements are considered unlikely to control risks at the sub-project level.

The main conclusions and lessons learned from this Case Study are:

- An ESMS has been developed in line with IFC requirements and the system itself is compliant in terms of key elements;
- The E&S team, consisting of three assessment officers who have moved over from Credit Appraisal, focuses on reviewing necessary permits and overall compliance with national regulations; client visits are beyond the current scope of work of the ESMS team. The E&S team has some difficulties in defining and assessing the specific E&S risks associated with different industry sectors;
- For Techcombank, E&S assessment beyond checking necessary permits is considered potentially challenging in the local financial sector as clients do not yet see the necessity to adhere to stricter standards, which is not required by their competitors
- As site visits are not undertaken impact on the ground is limited;
- Techcombank report that DEG requirements are all clear – and are in line with IFC’s procedures which they have been trained in through TA by IFC including annual refresher training
- Techcombank does undertake annual reporting in accordance with the loan conditions. The final loan repayment was due during the course of the Evaluation Assignment therefore it is not clear to what extent DEG can exert future influence. Should the loan be extended, Techcombank would benefit from a TA programme and/or much a closer relationship with DEG. In particular, it would be useful to train the E&S Officers further in risk categorisation and risk assessment for the higher risk part of the banking portfolio (at a minimum).

7. TBC Bank - Georgia

DEG first signed a loan with TBC Bank in 1998, and became an equity partner from 2000, increasing its equity provision at several stages after that. DEG sold the majority of its shares in the initial public offering (IPO) in 2014 and sold the remaining shares in 2015. DEG continues to carry out business with TBC Bank and currently has three outstanding loans, with two subordinated loans and one of the remaining loans focusing on SME credit.

Overall, the ESMS at TBC is at an advanced stage with strong management commitment. No areas of non-compliance were identified. The relationship with DEG is strongly positive but further value could be added through additional training and the further development of the green investment programme.

The main specific findings and lessons learned from this Case Study are:

- Senior management commitment - The ESMS is being implemented to a high standard at TBC. One of the main factors in ensuring buy-in to the ESMS from loan officers at TBC Bank has been strong senior management commitment. The lesson for DEG is that a focus on increasing the commitment of management by explaining the benefits of ESMS, and ongoing dialogue with senior management of banks, will strengthen implementation.
- Experienced E&S Officer - At TBC Bank, the E&S Officer is proactive in supporting the loan officers, visiting clients for monitoring, providing support to clients and leading regular E&S training of loan officers, etc. Her activities are a contributory factor to the successful implementation of the ESMS. However, the dependency on a single E&S Officer is the main risk for the ESMS going forward and an E&S team would be preferred.
- Adopting a co-operative approach with clients - One of the main reasons for the growing commitment of TBC's clients to E&S risk management has been the co-operative approach adopted by TBC for addressing E&S issues at client operations. TBC helps clients to identify and address corrective actions; moreover, the E&S Officer provides regular support and advice to the client.
- Opportunities for green investments - Several examples have been identified during this case study visit of E&S improvements at sub-projects as a result of the influence of TBC Bank. During the evaluation meetings with TBC, there was discussion on what might be the next steps to build on the high standard of ESMS as the system does provide an excellent basis for a more proactive strategy to identify specific E&S investment opportunities.

Future DEG support to TBC - There was excellent feedback from TBC on the relationship with DEG and the value added by DEG. Based on the evaluation, one focus of future support from DEG would be the further training of loan officers (and the E&S Officer) in the identification of E&S investment opportunities (e.g. energy efficiency, resource efficiency).