
Evaluating the Promotion of Environmental and Social Standards in DEG's Investments in Financial Intermediaries: Evaluation Report

Prepared for
DEG

TABLE OF CONTENTS

EXECUTIVE SUMMARY

LIST OF ACRONYMS

1. INTRODUCTION	9
1.1 BACKGROUND TO THE ASSIGNMENT.....	9
1.2 EVALUATION OBJECTIVES.....	10
1.3 THIS REPORT.....	10
2. METHODOLOGY.....	10
2.1 OVERALL APPROACH.....	10
2.2 DETAILED METHODOLOGY	11
2.3 KEY OUTPUTS.....	15
3. RESULTS OF THE EVALUATION	15
3.1 PORTFOLIO ANALYSIS.....	15
3.2 RESULTS FOR OBJECTIVE 1 - EVALUATE THE IMPLEMENTATION AND PRACTICAL USE OF ESMS BY DEG'S CLIENTS.....	16
3.3 RESULTS FOR OBJECTIVE 2 - EVALUATE THE EFFECTIVENESS AND IMPACT OF ESMS AT (I) CLIENTS; (II) SUB-PROJECTS	21
3.4 RESULTS FOR OBJECTIVE 3 - EVALUATE (I) THE FUNCTIONING OF DEG, AND (II) THE VALUE-ADDED OF DEG (IN PARTICULAR IN THE TA FRAMEWORK ON ESMS)	27
4. RECOMMENDATIONS AND CONCLUSIONS	32
4.1 KEY RECOMMENDATIONS	32
4.2 CONCLUSIONS	33
5. CLOSING STATEMENT	34

List of Annexes

Annex A: Evaluation Framework

Annex B: Portfolio Analysis – not publicly available

Annex C: Schedule of TA Clients for the Web Survey – not publicly available

Annex D: Schedule of Control Group Clients for the Web Survey – not publicly available

Annex E: Web Survey Proforma

Annex F: Selected Clients for Telephone Interviews – not publicly available

Annex G: Telephone Interview Proforma

Disclaimer

Citrus Partners LLP accepts no responsibility to any parties whatsoever, following the issue of the Document, for any matters arising outside the agreed scope of the work. This Document is issued in confidence to the Client and Citrus Partners LLP has no responsibility to any third parties to whom this Document may be circulated, in part or in full, and any such parties rely on the contents of the report solely at their own risk.

List of Acronyms

BSS	Business Support Services
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DFI	Development Finance Institution
E&S	Environment & Social
EHS	Environment, Health and Safety
EIA	Environmental Impact Assessment
ESAP	Environmental & Social Action Plan
ESMS	Environmental and Social Management System
ESIA	Environmental and Social Impact Assessment
FI	Financial Institution
FMO	Netherlands Development Finance Company
GHG	Greenhouse Gas
H&S	Health and Safety
IDA	International Development Association
IFC	International Finance Corporation
PEF	Private Equity Fund
TA	Technical Assistance
ToR	Terms of Reference

Executive Summary

Introduction

DEG, as a Development Finance Institution (DFI), promotes economic success and sustainable business practices through the provision of finance to private sector clients in developing and emerging economies. DEG understands that managing environmental and social issues, related to the activities of DEG's clients, is an essential part of good business practice.

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. As a result, DEG requires its clients to implement a structured E&S risk management process adapted to each client's activities and specific business context.

Monitoring compliance with E&S standards and promoting the opportunities for E&S improvement is challenging for DEG when providing finance indirectly via financial intermediaries – namely, Private Equity Funds (PEFs) and financial institutions (FIs). In particular, this is the case for commercial banks, which may have thousands of clients with diverse E&S risks.

The Evaluation

In order to better understand the challenges facing the financial intermediary portfolio, DEG commissioned Citrus Partners LLP to undertake an extensive evaluation of environmental and social risk management by financial intermediaries, with a particular focus on the implementation of Environmental and Social Management Systems (ESMS).

Financial intermediaries represent more than 40% of DEG's client portfolio and, hence, are a significant part of DEG's global operations:

- Within its EUR 7.2 billion portfolio, there are 238 intermediary financial clients (comprising 138 banks ('FIs') and 100 Private Equity Funds ('PEFs')) with a combined commitment volume of EUR 3.2 billion (~44% of DEG's portfolio)¹;
- The financial intermediary portfolio is regionally diverse with the largest shares, by value, in Asia and Latin America;
- The majority of committed finance of the overall portfolio comprises medium E&S risk clients (Category B, 53%), while a third are higher risk clients (Category A, 33%). The remainder comprises low E&S risk clients (Category C, 14%).

Managing E&S Risks: The focus of the evaluation is on the management of E&S risks through the adoption and integration of ESMS processes and procedures.

From DEG's perspective, the starting point is the inclusion of standard E&S requirements in contracts for all DEG financial intermediary clients. DEG requires its clients to structure these requirements into a formalised Environmental and Social Management System (ESMS). The objective is to identify, manage and monitor environmental and social risks adequately to ensure that DEG's standards of environmental and social performance are maintained.

An ESMS includes the use of a specific Exclusion List (for prohibited business activities) in the screening process, categorization of E&S risks, the appointment of a dedicated E&S Officer, and the provision of an annual report on E&S performance. The planning and implementation of ESMS at the financial intermediary level is central to the achievement of DEG's E&S requirements.

¹ Portfolio data from 31.12.2015. Data is slightly different to official DEG data as this analysis includes i) all Commercial Banks and Private Equity Fund clients in DEG's clusters "financial institutions" and "funds" ii) with cash exposure >0. The final list has been screened manually to further exclude clients belonging to the cluster due to their financing structure e.g. clients involved in leasing etc.

DEG also monitors and supports its clients with trained investment personnel and a dedicated sustainability department. In addition, DEG offers a Technical Assistance (TA) programme to support and enhance the development and uptake of ESMS through its Business Support Services (BSS).

Objectives of the Evaluation: The evaluation centred on the following three core objectives:

- Objective 1: Evaluate the implementation and practical use of ESMS by DEG’s clients;
- Objective 2: Evaluate the effectiveness and impact of the ESMS at the level of i) DEG’s clients and ii) clients of the FIs and PEFs;
- Objective 3: Evaluate (i) the Functioning of DEG, and (ii) the Value-Added of DEG (in particular in the TA framework on ESMS)

Methodology Used: The evaluation involved four key stages. Each stage served to inform the next through an increased understanding of the portfolio and E&S risks. The four stages comprised:

- A **desk-based Portfolio Analysis**, which was used to gain a broad understanding of the global portfolio, to select clients for the Control Group for the Web Survey and to cluster the portfolio to enhance the analysis going forwards;
- A **Web Survey** of 108 clients based on a clustered sample of DEG’s portfolio, representing different operating regions and levels of E&S enforcement, E&S risk categories, clients with SME activity etc. The clustering and the high response rate (57%) allowed feedback from a representative group of financial sector clients;
- A follow up **Telephone Survey** of 19 clients, which allowed deeper insights into specific issues raised in the Web Survey and to increase client representation in regions which had a lower response rate;
- **Evaluation Visits** to 8 Case Study clients across all regions of DEG’s portfolio: Africa (Mozambique, Namibia, South Africa), Asia (Cambodia, Vietnam), Latin America (Panama, El Salvador), and Europe (Georgia). The Case Studies are available online with this report and provide in-depth examples of ESMS implementation both in practice and on the ground.

General Findings

The following general findings can be drawn from the assignment:

Objective 1: Evaluate the degree of implementation and practical use of ESMS by DEG’s clients.

- All PEFs have most elements of an ESMS in place and so do most Category A FIs (>80% of web-survey respondent for each element);
- For PEFs, this is mainly because an ESMS is a contractual requirement prior to first disbursement of DEG’s investments and because its implementation is strongly supported by fund managers, who consider ESMS to be a core element of their business;
- Medium risk FIs (Category B) tend to face more challenges. The Web Survey suggests that up to a third of DEG’s Category B FI clients do not have an effective ESMS in place. For these Category B FIs, particularly in low income and low E&S enforcement environments and those with many SME clients, some aspects of ESMS implementation are proving challenging.

Objective 2: Evaluate the effectiveness and impact of the ESMS at the level of i) DEG’s clients and ii) clients of the FIs and PEFs.

- The study showed clearly that there are many direct business benefits from the effective use of an ESMS, including:
 - reducing portfolio risks, increasing returns on investments or attracting finance particularly from other development finance institutions;

- enhancing reputation and business brand and improving relationships with local communities.
- Highly relevant for business success, ESMS is also important for staff motivation and helps to attract and retain good loan officers and analysts;
- In some cases, where ESMS implementation has been completed and trained staff have been motivated to go “beyond compliance”, FIs are starting to target direct ‘green’ investments in sectors such as renewable energy, energy savings, recycling and reuse of waste and water etc. This next step is an important transition from compliance to enhancement and has been seen to have multiple benefits for the businesses involved, however, there is still a significant way to go before large numbers of FIs progress beyond compliance;
- For sub-projects of DEG’s clients, benefits are likely, however the specific impact of ESMS is harder to attribute. DEG clients indicate that application of the ESMS, and in particular due diligence and site visits by E&S Officers, is having a positive effect on sub-projects. Where Environmental and Social Action Plans (ESAPs) at the sub-project level have been produced, the ESMS process is driving improved E&S performance. Several sub-project clients also reported improvements in health, safety and working conditions directly as a result of ESMS implementation.

Objective 3: Evaluate (i) the Functioning of DEG, and (ii) the Value-Added of DEG (in particular in the TA framework on ESMS)

- The evaluation showed clearly that DEG’s clients value the relationship with DEG highly. There were very few negatives other than a few FIs which have not received comments on their E&S reporting submissions, have requested further training, are unclear about E&S risk categorisation and do not know where to go to get help – a guiding document on ESMS produced as part of the evaluation should help significantly with this issue;
- The Web-Survey highlights that clients see DEG as the DFI most committed to E&S performance and with the highest influence;
- DEG’s Technical Assistance covers a vast range of countries and is generally working well. Clients have emphasised the benefits of developing the ESMS together with an experienced consultant; the TA programme has been very well received – in some cases, however, the TA was provided several years ago and DEG’s clients would like refresher training or further access to tools and guidance and to good practice; a few clients have experienced difficulties with TA either due to the length of the process or the challenges faced by business interruption which has necessitated a more flexible approach and lends itself to more front-end consultation;
- Overall Findings: DEG has had a positive role in actively supporting structural change.
 - DEG’s E&S standards have been widely-adopted by its financial intermediary portfolio; moreover, implementation of an integrated ESMS is increasingly seen by DEG’s clients as integral to business rather than a separate requirement; through this process, DEG’s clients have been able to become market sustainability leaders or are actively contributing to banking round tables and other resource-sharing platforms in some cases and are able to avoid or remove projects which carry unacceptable risks from their portfolios;
 - The representative survey results show that a large majority of FIs and PEFs (>70%) in DEG’s portfolio of financial intermediaries have introduced an ESMS for the first time or improved their ESMS since DEG’s investment;
 - 25% of FIs and 39% of the PEFs in the Web Survey were actively supported by DEG’s TA programme in developing or improving the ESMS.

Challenges, Solutions and Success Factors of ESMS Implementation

- *Additional information on challenges, solutions and key success factors for successful E&S management were identified through the Web Survey, Telephone Interviews and Case Studies, and are summarised below:*
 - **Challenges remain**, particularly in countries where E&S legislation and enforcement is at an early stage: Common challenges faced include finding and retaining adequately-qualified E&S staff, the application of appropriate risk categorization, and on-the-ground risk identification;
 - **Tailored solutions:** The study found that solutions to challenges always had to be adapted to the specific FI or PEF context and were developed in a collaborative effort by management and staff. The report shows how some of DEG's clients addressed the different challenges and what others may learn from it; in some cases, innovate solutions have been developed;

Keys to Success

- *Despite the need for tailored solutions, some general keys to success when implementing an ESMS could be identified: i) senior level commitment and strategic vision for ESMS, ii) supportive market conditions, iii) an appropriately-targeted ESMS tailored to the existing portfolio, iv) quick procedures for small loans with low E&S risk, v) experienced or fully-trained E&S Officer/Manager (vi) a flexible approach to ESMS implementation for new FIs or those operating in jurisdictions where more buy-in is needed for Senior Management to get started;*

Supporting Documents

- *Case Studies: The eight Case Studies complemented the quantitative survey results and provided the opportunity to learn about the specific experiences clients have had with ESMS. This allowed the evaluators to identify both innovative uses of ESMS – for example in the identification of 'green' investment opportunities in El Salvador – and areas where further action might be necessary – e.g. a bank in Mozambique exemplified the need for DEG to focus more on medium risk banks with large portfolios and systematic follow-ups on ESMS implementation;*
- *Guide for clients: Building on the information and insights gained through the evaluation, relevant content for an ESMS Guide was developed. This Guide highlights the benefits resulting from sound E&S risk management, explains DEG E&S requirements, and describes solutions to specific challenges as well as recommendations for the implementation and operation of a successful ESMS.*

Recommendations for Continuous Improvement:

- *The evaluation identified five principal areas where improvements could be made:*
 - *tailoring the ESMS TA offering to different clients depending on the country and client context;*
 - *providing feedback on E&S Reporting with increased emphasis on Category B clients;*
 - *providing accessible, central resources through the ESMS Guide on where to go for help and online E&S risk management tools;*
 - *improving data and information management to help FIs and PEFs to benchmark performance and overcome challenges;*
 - *helping existing clients to transition to the next ESMS stage through the identification of 'green' investment opportunities;*
 - *providing tailored training in E&S risk management and, in particular, E&S issues associated with different sectors.*
- *Specific emphasis is needed on medium risk banks – particularly those with large portfolios and/or those with SMEs. One of the common challenges faced by medium risk banks is the*

correct categorisation of E&S risk and allocation of appropriate resources. More guidance is needed to provide these clients with a proportionate approach so that limited staff resources may have the greatest impact.

Overall Conclusion

- *Overall, it is clear that DEG has a strong, positive E&S influence on its financial intermediary clients. DEG has made significant progress in the implementation of ESMS across the global intermediary portfolio. ESMS implementation is high and the business benefits are clear. There are challenges associated with the FI element of the portfolio and particularly those with medium risks and large portfolios;*
- *The evaluation has resulted in a number of clear recommendations for improvement which are documented in the Evaluation Report. Evidence to support the conclusions is provided in the Case Study Reports and other supporting documentation. Further development of the TA programme will help the portfolio clients to drive the transition from compliance to on-the-ground improvement, to become market leaders in E&S and to identify opportunities for green or social improvement investments.*

1. Introduction

1.1 Background to the Assignment

As a responsible Development Finance Institution (DFI), DEG promotes economic success and sustainable business practices through the financing of private sector clients in developing and emerging economies.

In 2016, over 40% of the global portfolio comprised intermediary financial institutions comprising national and multi-national Private Equity Funds (PEFs) and banks ('FIs'). The portfolio is diverse, both in terms of geographical location and in terms of scale, nature and number of investments and level of environmental and social (E&S) risk. As the portfolio continues to grow, DEG recognises the increasing need to implement standardised processes and procedures for E&S management in the form of an Environmental and Social Management System (ESMS) to support sustainable business development.

In order to know more about the challenges facing the intermediary portfolio, DEG commissioned via a tendering process Citrus Partners LLP ('Citrus') to undertake an extensive evaluation of environmental and social risk management across the intermediary portfolio with a particular focus on ESMS implementation.

1.1.1 DEG's ESMS Requirements

To promote efficient E&S management with its clients, DEG requires all of its FI and PEF clients to meet the following ESMS requirements:

- Develop an E&S policy signed off by Senior Management and Board;
- Allocate overall E&S responsibility to a senior manager or Board Member and ensure the availability of adequate resources;
- Screen all projects against an Exclusion List – compliant with DEG's requirements (although this may be based on or from another DFI);
- Implement ESMS procedures fully-integrated with the credit appraisal process;
- Identify and categorise E&S risk and allocate appropriate resources;
- Ensure compliance with national standards – and IFC performance standards for high risk projects including environment, health, safety, labour and working conditions and human rights. Conduct site visits and due diligence as appropriate;
- Include E&S commitments and requirements in loan agreements with FI clients;
- Prepare an Environmental and Social Action Plan (ESAP) for high risk projects where E&S risks need to be mitigated;
- Monitor and report on E&S performance and progress in implementation via an annual E&S Monitoring Report;
- Notify DEG of any environmental incidents or accidents;
- Appoint an E&S Officer responsible for E&S co-ordination;
- Train Credit/Investment Officers in E&S procedures.

These are effectively the core elements of an ESMS.

1.1.2 The Technical Assistance (TA) Support Programme

In order to increase and support the uptake of ESMS, DEG offers a staged Technical Assistance (TA) programme. This is implemented through a standardised 5-phase approach through DEG's Business Support Service (BSS) team.

The five stages of the TA comprise:

- Assessing the status quo;
- Supporting the development of policies, procedures, tailor-made tools and checklists;
- Review of policies and procedures and on-site training of key staff;
- Evaluation of the implementation of E&S policies and procedures;
- Provision of ongoing off-site support and final evaluation.

As per the evaluation objectives below, one of the key tasks of the assignment has been to assess the degree to which the TA programme has been successful in meeting DEG's ESMS objectives.

1.2 Evaluation Objectives

The assignment focussed on three core objectives as follows:

- **Objective 1:** Evaluate the implementation and practical use of ESMS by DEG's clients;
- **Objective 2:** Evaluate the effectiveness and impact of the ESMS at the level of i) DEG's clients and ii) clients of the FIs and PEFs;
- **Objective 3:** Evaluate (i) the Functioning of DEG, and (ii) the Value-Added of DEG (in particular in the TA framework on ESMS)

For each objective, the evaluation used a combination of quantitative and qualitative assessment methods to establish the degree to which portfolio clients had implemented and benefited from the adoption of an ESMS and integration of the ESMS into routine credit appraisal.

For the preparation of the Evaluation Report, Citrus has been guided by an Evaluation Framework (presented in *Annex A*) produced to help structure the assignment and assignment outputs. This framework reflects the original Terms of Reference (ToRs) and addresses which key questions need to be answered in relation to each of the three objectives and sub-objectives. The framework has been instrumental in the design of the survey, interview questions and Case Study protocols.

1.3 This Report

The Report provides DEG with the overall findings and conclusions of the '*Evaluation of the Promotion of Environmental and Social (E&S) Standards in DEG's Indirect Financing*'. The Report has been prepared by Citrus in accordance with the Agreement between DEG and Citrus signed on 14th December 2015 (the evaluation start date was agreed for May 2016) after a tendering process.

Citrus would like to thank DEG for their participatory approach throughout the assignment, in particular with the formation of the Reference Group comprising participants from several investment departments, the Sustainability team and the Business Support Service team. The Reference Group has provided useful insights and guidance at each stage of the evaluation process.

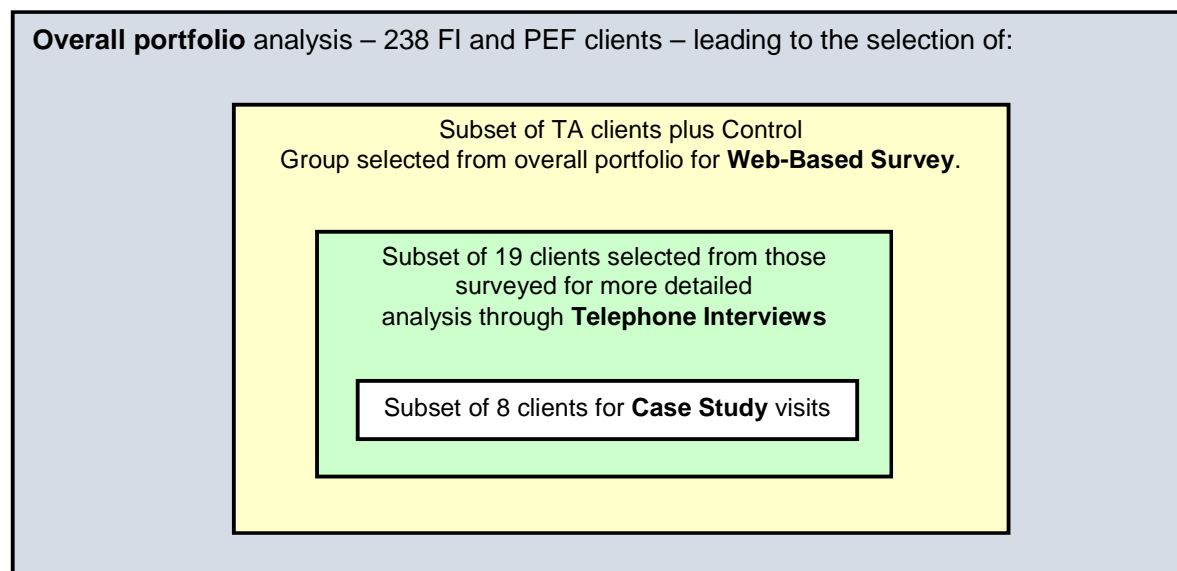
In addition, the last workshop with selected DEG management staff on tentative results and initial recommendations has provided a valuable step towards the practical use of the findings and identified several potential areas for improvement.

2. Methodology

2.1 Overall Approach

The evaluation involved four key stages with an iterative approach from one stage to the next. *Figure 1* below illustrates the overall approach.

Figure 1: Overall Approach



2.2 Detailed Methodology

For each stage, a group of portfolio clients was evaluated with further verification provided through follow-up interviews and Case Study visits. The four stages comprised:

- A desk-based **Portfolio Analysis**, which was used to gain a broad understanding of the global portfolio, to select clients for the Control Group for the Web Survey and to cluster the portfolio to enhance the analysis going forwards; the full Portfolio Analysis is presented in *Annex B*;
- A **Web Survey** of 108 clients based on a clustered sample of DEG's portfolio, representing different operating regions and levels of E&S enforcement, E&S risk categories, clients with SME activity etc. The clustering and the high response rate (57%) allowed feedback from a representative group of financial sector clients;
- A follow up **Telephone Survey** of 19 clients, which allowed deeper insights into specific issues raised in the Web Survey and to increase client representation in regions which had a lower response rate;
- Evaluation visits to 8 **Case Study** clients across all regions of DEG's portfolio: Africa (Mozambique, Namibia, South Africa), Asia (Cambodia, Vietnam), Latin America (Panama, El Salvador), and Europe (Georgia). The Case Studies are available online with this report and provide in-depth examples of ESMS implementation both in practice and on the ground.

The methodology was presented to DEG at a Kick-Off Meeting held in Cologne on 12th May 2016. A further description of each of the key tasks and outputs is given below.

2.2.1 Design of the Web Survey

The aim of the **Web Survey** was a) to obtain feedback from a representative group of financial sector clients on the degree of ESMS implementation in line with DEG's expectations for E&S management, b) to receive feedback from clients that received support under the ESMS Technical Assistance (TA) programme and c) to receive feedback from a Control Group of clients who had not received TA from DEG. *Annex C* presents the schedule of clients which had received Technical Assistance (TA) from DEG for the Web Survey; *Annex D* presents the selected Control Group clients. The Web Survey proforma is presented in *Annex E*.

The Survey was issued to 108 clients comprising 33 TA clients and 75 Control Group clients.

The Survey was designed using a secure survey tool that had been used before by the Citrus team and by DEG. The Survey covered a number of aspects, including progress in relation to compliance with DEG requirements on ESMS, and the perceptions of clients on the impacts on the E&S risk management at their investments. The design of the Survey took into account the fact that many clients have already provided E&S information in the DEG due diligence survey and in their annual E&S monitoring reports. The Survey was therefore structured and the questions planned so that the exercise did not repeat the information requested previously by DEG.

It was agreed that the Survey would be sent by DEG to clients in order to manage communications and provide more influence in terms of trying to get a high response rate. The principal aim was to generate a robust data set with sufficient representation across the portfolio to be able to draw meaningful conclusions.

The Survey questions covered the areas presented in *Box 1* below.

Box 1: Key Aspects Covered in Web Survey Design

- Characteristics of the organisation: FI/PEF (e.g. SME involvement, number of staff, number of branches, number of clients, etc.);
- Status of ESMS (covering main DEG E&S requirements such as: ESMS in place, E&S Officer in place, number of people trained in E&S, ESAP prepared etc.);
- Whether external TA has been received in developing the ESMS (from DEG or other DFIs);
- Challenges identified in developing an effective ESMS;
- Feedback on DEG support, if received;
- Lessons learned on ESMS implementation;
- Examples of potential outcomes for FI/PEF in terms of compliance with international and national legislation, ability to manage E&S risks, reputation and sustainability;
- Examples of positive impacts at clients, e.g. E&S risks managed, E&S opportunities identified, increased interest of other investors, etc.;
- Willingness to be considered as a Case Study.

2.2.2 Selection of Clients in the TA Group

48 clients were identified, initially, that had applied for the TA support from DEG. In several cases, the TA was not started (for different reasons), and in some cases investment projects were annulled. Therefore, some clients were excluded from the TA Group and could not be issued with the Survey. The final TA Group included **33 clients** that had received ESMS TA (29 of these clients were still in the DEG portfolio).

2.2.3 Selection of Clients in the Control Group

The purpose of the Control Group was to provide an objective comparison with those DEG clients who have not received TA in terms of risk identification, risk categorisation, management and reporting of E&S risks etc. The Control Group also provided a wider statistical selection in terms of geographical coverage, types and size of investment and organisation.

The Control Group was selected based on a series of criteria as discussed with DEG and as follows:

- Representative distribution of clients across different geographical regions;
- Representative mix of client type (FI/PEF);

- Representative mix of Category A (portfolios including high risk projects) and Category B projects (medium risk), with a strong focus on Category A, but some focus on Category B following feedback that some of these clients might have higher risks but receive less monitoring by DEG. Category C clients were excluded from the Control Group because of the lower risks;
- Focusing on SME projects for the FI clients at least in a similar proportion to the SME projects in the total FI portfolio;
- Inclusion of a similar proportion of regional projects (mostly funds) as in the total portfolio.

In addition, the selection of the proposed Control Group took into account advice received at meetings with DEG staff in the FI and PEF teams, and in the Sustainability team.

The proposed number in the Control Group was decided based on the predicted response rate, with the aim of ending up with a similar number of responses from the Control Group as the forecast number of responses from the TA group.

It was predicted that a Control Group of 60 to 80 clients would result in a similar number of responses to the number of forecast responses from clients that received TA, (it was expected that a higher proportion of those that received TA would respond to the survey than from the Control Group).

2.2.4 Web Survey Response

The response rate for the Survey was significantly higher than expected (57%) although it varied by both region and type of client. The Control Group response was higher than expected (see note above). The TA Group was lower, potentially due to the fact that the TA Group already have a relationship with DEG and are already reporting on E&S compliance. Equally, the Control Group may see this as a vehicle for inclusion in future ESMS programmes.

The overall response rate is illustrated in *Table 1* below.

Table 1: Web Survey Response Rate by Region/by Client

Region	TA Group Survey Responses	Control Group Survey Responses	Total Response Rate
Africa	8	12	54%
Asia	4	14	78%
Europe	0	7	50%
Latin America	4	12	48%
Global	1	0	100%
Total:	17	45	57%

Results of the Survey have been used to populate the Evaluation Framework (included in *Annex A*) and to assess progress in relation to ESMS implementation against the specific evaluation objectives.

2.2.5 Selection of Clients for the Telephone Interviews

A total of 20 clients were selected for Telephone Interviews. 19 of the 20 interviews were successfully completed (one client did not agree to an interview due to the volume of recent inquiries). The schedule of selected clients for the Telephone Interviews is presented in *Annex F*. The proforma for Telephone Interviews is provided in *Annex G*.

The Telephone Interviews were seen as a valuable tool to gain deeper insight into some of the key issues arising such as the use of DEG's Exclusion List, E&S categorisation, E&S reporting, failure to follow through all stages of the TA, specific lessons from sub-projects, etc.

Selection criteria were as follows:

- Several clients that have seemingly high risk portfolios but are classed as Category B and who have identified challenges in certain aspects of E&S management such as categorisation or identification of E&S risks;
- Some that have been critical of DEG requirements or TA provided;
- Several that appear to have good systems in place (*possibly higher than DEG requirements*);
- Clients with TA provided by another DFI but which identified the lack of consistency in reporting across FIs as an issue (*good comparators for DEG TA*);
- Several that have cited specific examples of how E&S systems deliver benefits at the corporate level and/or for their clients (*which provide useful 'mini' Case Studies*);
- Several that have identified ways in which they would like DEG to help them in the future (*which can help DEG to develop ideas on future needs for both the TA and non-TA group*).

2.2.6 Pilot Case Study

To gain a deeper understanding of the degree of ESMS implementation at the client level, the next stage in the evaluation involved a Pilot Case Study. The Pilot Case Study visit was carried out to three clients in Southern Africa in July 2016 covering a mix of characteristics:

- One PEF and two FI projects;
- One regional client and two covering one country;
- Clients in different types of countries in terms of overall development, and the level of enforcement of regulations;
- ESMS TA assignments implemented by two different consultancies.

The Pilot Case Study visit was used to assess the effectiveness of the method, the evaluation framework and Case Study protocol, and to produce detailed Case Study reports against the three evaluation objectives.

2.2.7 Full Case Studies

The other Case Studies were then planned based on the results of the Survey, on feedback from the FI/PEF teams at DEG, results of the Pilot Study and travel/logistics considerations. The remaining Case Study visits were conducted to Asia, Latin America, and Europe making 8 Case Studies as follows:

- FIs in: Cambodia, El Salvador, Georgia, Mozambique, Namibia, Panama, Vietnam;
- One Regional Fund in South Africa.

The pilot Case Studies and the Web Survey indicated that FIs have significantly more of a challenge to implement ESMS than the PEFs. Therefore, the remaining five Case Studies focused on FIs. The Case Study reports are available online with this study report.

2.2.8 Visits to Sub-projects

During the 8 Case Studies, 12 sub-projects were reviewed, all of which were visited except two which involved detailed phone interviews as site visits were not possible. The sub-project visits provided a very useful insight into the context, the drivers for E&S improvement, and some feedback from the sub-projects on the E&S requirements of the clients. However, it must be noted that the number of sub-projects covered in the evaluation is very small and the mix of sub-project types and sectors could not be representative of the total portfolios of sub-projects.

2.3 Key Outputs

The key outputs from the evaluation have been as follows:

- Portfolio Analysis;
- Completed Web Survey (proforma completed by the clients);
- Completed Telephone Interviews (interview proforma completed by the consultants);
- Case Study Reports;
- Evaluation Report (this Report); and
- ESMS Guide for DEG clients.

3. Results of the Evaluation

3.1 Portfolio Analysis

3.1.1 Structure of the Analysis

The portfolio analysis was one of the first stages of the evaluation and was designed to provide a comprehensive and verified data set for the remainder of the process and to ensure sufficient representation of the different client groups.

Data was provided to the Evaluation Team correct to 31st December 2015, which represented the cut-off date.

The portfolio was analysed for the following characteristics:

- Investment volume (EUR);
- Type of client: FI or PEF;
- Regional spread of clients and commitments;
- E&S risk category by client number and commitments;
- Clients who have received external consultancy support under the TA framework; and
- Clients with SME activities.

A summary of results is presented below; the full report is presented as *Annex B*.

3.1.2 Summary of Findings

In December 2015, the intermediary financial portfolio comprised **238 clients** (138 banks 'FI' clients and 100 Private Equity Funds ('PEFs')) with a total value of **EUR 3,159 million of committed financing (~44% of DEG's portfolio)**². The portfolio is split EUR 2,184 million (69%) between 138 FIs and EUR 975 million (31%) between 100 PEFs. Some clients have more than one DEG loan or investment.

The portfolio is regionally-diverse with the largest shares, by value, in Asia and Latin America. The majority of the overall portfolio comprises medium E&S risk clients (Category B, 53%), while a third is Category A (higher risk, 33%). The remainder comprises Category C (low E&S risk clients, 14%).

Of the EUR 1,039 million of the total portfolio with Category A institutions, nearly 40% (EUR 412 million) sits with PEFs and 60% (EUR 626 million) with FIs. Category A clients are evenly spread over the operating regions. PEFs have no C-rated clients and 42% of A-rated clients; for FIs, only 29% are Category A and 20% Category C.

² Portfolio data from 31.12.2015. Data is slightly different to official DEG data as this analysis includes i) all Commercial Banks and Private Equity Fund clients in DEG's clusters financial institutions and funds ii) with cash exposure >0. The final list has been screened manually to further exclude clients belonging to the cluster due to their financing structure e.g. clients involved in leasing etc.).

64% of the 138 FI clients (EUR 1,397 million) have significant SME activity. Data on PEFs' involvement with SMEs is less clear. Most of the PEFs tend to have a small number of sub-projects (typically less than 20) which mostly reach from mid-size to large SMEs, up to Corporates.

The following sub-sections describe the evaluation results by objective.

3.2 Results for Objective 1 - Evaluate the Implementation and Practical use of ESMS by DEG's Clients

3.2.1 Description of the Objective

Objective 1 of the evaluation framework was designed to assess the compliance of DEG clients with DEG's core E&S requirements together with progress in relation to ESMS implementation. Key aspects for the detailed research questions are presented in the Evaluation Framework (*Annex A*) and key findings are summarised below.

3.2.2 Key Findings

The Web Survey, Telephone Interviews and Case Studies have highlighted a number of differences in the extent of ESMS implementation between different client groups, with all PEFs and most Category A FIs having most elements of an ESMS in place. For some Category B FIs, particularly in low income and low E&S enforcement environments and those with many SME clients, some aspects of ESMS implementation are proving challenging.

The sections below provide an overview of ESMS implementation for PEFs and FI clients based on the results of the Web Survey, Telephone Interviews and Case Study Visits.

ESMS Implementation at PEFs:

- The Web Survey was sent to 39 out of DEG's total portfolio of 100 PEFs. Of these, 27 responded (27% of the overall PEF portfolio). Responses were broadly representative of both Category A (11 respondents) and Category B (16) clients. The Survey showed that the majority (93%) of PEFs have all elements of a **compliant ESMS** in place (see *Table 2*) and are applying this across their whole portfolio. E&S procedures are being fully integrated from the start by PEFs because they are a DEG requirement prior to first closure;
- The Survey, Telephone Interviews and the African PEF Case Study highlighted the strong **strategic interest** PEFs have in strengthening the companies in which they are investing, intending to increase the value of the companies over a number of years before they exit.
- In a number of the markets covered, stringent ESMS standards are relatively new and investment companies which meet these standards are seen as a quality mark that will increase the sales value at time of exit;
- Strong E&S performance is considered an integral **part of company value**. Therefore, the added value of ESMS is easy for management to understand at PEFs and **management commitment tends to be high**; TA can add further value to this by helping the PEFs to identify opportunities for 'green' or social investment and to provide the basis for information sharing on lessons learned and how to overcome challenges;
- PEFs also tend to have **smaller numbers of sub-projects** (typically less than 20) in their portfolios and longer due diligence processes, therefore they have found it relatively straightforward to set up or integrate an ESMS with existing procedures. The teams at the Funds also tend to be small, therefore it is easier to ensure that systems are being applied consistently and efficiently;
- Although 93% of survey respondents (25 of 27 respondents) have an E&S Officer in place, 37% (7 PEFs) reported that their **staff resources are limited in relation to the number and risk level of their projects**. In a number of cases, the E&S position is not a full-time job: in a few cases the position is rotated amongst a small Senior Management team.

- Internal resources are sometimes stretched in coping with larger or long-term projects with heavy E&S requirements such as an environmental and/or social impact assessment (ESIA). One client, a Chinese PEF, has addressed this bottleneck by retaining E&S consultants to assist with specific types of projects (by sector). Several others envisage taking this approach in the future. In addition, there is a clear role for DEG and the TA framework to support E&S Officers in developing their E&S skills and knowledge on the job by facilitating their access to more resources and regional training courses and events;
- A number of PEFs have gone **beyond system compliance to report on sustainability performance** and are using resource sharing platforms to drive improved E&S performance such as a Singapore-based regional PEF which has representation in multiple Asian countries.

ESMS Implementation at FIs:

- As shown in *Table 2*, the majority of **Category A FIs have most ESMS elements in place** (>80% for most elements) however the remaining FIs, a **sizeable minority of Category B FIs**, are deficient in some key aspects;
- Medium risk FIs (Category B) tend to face more challenges. The Web Survey suggests that up to a third of DEG's Category B FI clients do not have an effective ESMS in place. For these Category B FIs, particularly in low income and low E&S enforcement environments and those with many SME clients, some aspects of ESMS implementation are proving challenging, details of which are given below:
 - 10 do not yet implement an ESMS across their entire portfolio;
 - A similar proportion of FIs (9) are also not using E&S contractual clauses in client contracts;
 - Follow-on Telephone Interviews found that the FIs concerned were facing challenges in implementing their systems properly throughout their organisations because it is such a significant change in approach in many countries. Countries where these challenges were proving greatest were countries where E&S legislation is at an earlier stage of development and is not necessarily being enforced by government. In these countries – mainly IDA countries³ – general E&S awareness is low and ESMS is a relatively new concept in the financial sector. In several markets, the DEG client is one of small handful that are trying to apply such standards (as is the case of Vietnam);
 - In some specific cases, the ESMS design and implementation process was reported to be too long and it took too long to integrate requirements in lending documents (e.g. an FI in Armenia); for a Ghanaian FI, the ESMS process also took too long and was not commensurate with the level of national E&S awareness and local market factors; a Turkish FI reported a lack of understanding in relation to application of DEG requirements to the whole portfolio or just DEG investments;
- 10 (40%) Category B clients are not yet carrying out due diligence of E&S risks at the sub-project level and also do not require an ESIA for high risk projects, although most report that they are planning to implement these elements. In many countries, the initial ESMS focus of DEG clients tends to be on ensuring that all clients comply with national E&S regulations and permitting requirements. Telephone Interviews and the Asian Case Studies found that loan officers sometimes only have the resources to check that the necessary permits and licenses are in place but do not have the resources to carry out site visits and check whether their clients are complying with national legislation in practice. The main concern of loan officers in relation to ESMS seems to be the difficulty in persuading their clients of the need for better E&S management and the amount of additional time an ESMS will take. However, when the ESMS procedures are proportionate, practical and quick to complete, loan officers quickly adapt and buy-in to the system;

³ IDA refers to the World Bank's International Development Association, which provides support to the 77 poorest countries in the world by GDP per capita, of which 39 are in Africa.

- The Web Survey implied that about 20% of all FI clients (Category A and B) had not yet started to use the **DEG Exclusion List**. However, the interviews and Case Studies explored this issue further and it became clear that, in practice, it is more likely that all clients (19 out of 19 Telephone Interviews) *do* use an Exclusion List which meets DEG's requirements. Those interviewees who had stated in the Survey that they are *not* using the "DEG Exclusion List" either have a list from another DFI and had misunderstood the Survey question (i.e. answered 'no' if they had an Exclusion List from another DFI) or have adapted the DEG list to add further exclusions which reflect local conditions. For instance, the two Case Study FIs in Central America extended their exclusion lists to also exclude damage to tropical forest and unsustainable timber harvesting;
- Telephone Interviews and Case Studies in Asia showed that ESMS implementation can be a significant challenge for FIs with a **large number of SME clients** which may be distributed over large geographical areas. Typically, these banks have thousands of clients and dozens of loan officers operating across many branches. Many of those that are struggling with consistent implementation of their ESMS report difficulties in developing a system which can be consistently rolled out across all branches, all clients and all loan officers; this needs, effectively, a proportionate approach whereby early screening of risk can enable an FI to appoint the appropriate level of resource to further investigation; for example, a Central-American FI has developed an easy-to-use proportionate screening exercise whereby Category C appraisal is carried out quickly and with minimal resources; Category B reviews are undertaken in 1-2 hours of desk study supported by a field visit; Category A projects require full due diligence;
- Understanding compliance needs and collecting **evidence of compliance** (permits and certificates) is one of the most time-consuming ESMS tasks for both those FI clients with largely paper-based systems (Asian Case Studies) and those with more proportionate systems (Latin American Case Studies). Annual monitoring of clients to ensure that their licenses and permits are up to date is also a huge task for FIs with many SME clients. The Case Studies found that this was an ESMS challenge that clients are still grappling with but it may be an area in which clients are interested in sharing lessons and best practice;
- The Georgian and Central American Case Studies also demonstrated the benefits **of tailoring the detail and coverage of the ESMS to the national context** and to the stage of development and experience of the FI in E&S risk management. Several of the FIs interviewed deliberately started with a cut-off so that the ESMS applies to clients receiving a loan >1m US\$, for example, and they will expand the ESMS to more clients later by reducing the cut-off;
- 20% of FIs in the Web Survey suggest that they have problems in **categorising the E&S risks** of individual loans. Clients are using different approaches to E&S risk categorisation, based on checklists or tailored tools from DEG, from other DFIs or from national environment ministries. The key to success, as demonstrated by Case Studies in Latin America and Europe, is developing a proportionate system. Several Case Study and Telephone Interview clients are using a risk matrix tool developed with TA consultants, which incorporates both E&S risk and financial exposure to determine the appropriate level of due diligence and reporting required. This was found to be the most effective method for the appropriate allocation of resources;
- An additional limitation, as encountered in several FI Case Study clients, is the **lack of understanding of E&S risks** associated with different industry categories. Several FIs have requested additional training in sector risks, which would provide significant support to those FIs who are experiencing challenges. The **lack of E&S experience** at FIs – often the result of the challenge of finding experienced E&S staff – is important because an E&S Officer is an essential point of enquiry for loan officers when they have questions on potential E&S risks and solutions, particularly at the time when the ESMS is launched; training will have a major benefit in terms of strengthening capacity in the FIs and to help with decision-making at the various stages of project appraisal;
- The Web Survey indicated that nearly 30% of all FIs have not submitted an **Annual E&S Report** to DEG on time. The Case Studies in Africa suggest that this may be due to a misunderstanding on when the first report is required – two Case Studies considered that the first report was not required

until the ESMS had been fully implemented, although their loan agreements state that a report was required much sooner. A few other Case Studies showed some misunderstanding of reporting requirements even amongst FIs that do regularly submit reports, and some disappointment amongst FIs, particularly Category B FIs, (from the survey, Telephone Interviews and Case Studies) that they do not receive more feedback from DEG on whether they are reporting correctly and how the information is being used. There is scope to improve the current reporting practice either through web-based reporting or, at a minimum, ensuring that feedback is provided to clients who have submitted reports to DEG;

- In the Web Survey, 6 (10%) of FI and 7 (37%) of PEF respondents reported that DEG reporting requirements were not consistent with those of other **DFIs**. In the follow up Telephone Interviews and Case Studies both FIs and PEFs working with other DFIs reported that they have been able to use the same reporting format and data for several clients. In practice, the differences between DFIs now seem to be minor (e.g. definitions of what constitutes an SME etc.).

General Challenges in Relation to ESMS Implementation:

- The most widely-cited ESMS implementation challenge for survey respondents of all types (FIs and PEFs) is in **recruiting and retaining experienced E&S Officers**;
- Several FI respondents reported having added the function of E&S Officer to the role of a loan officer, and therefore the E&S function is not a full-time role as would be expected for FIs. This issue was further explored through Telephone Interviews and Case Studies. Two Case Studies had E&S staff issues – one with a vacant E&S post and one with very inexperienced E&S staff – while two FIs had recently lost experienced officers to other international financial institutions.
- Finding **qualified E&S Officers** with banking experience and sufficient hands-on experience of E&S issues is a challenge mostly in IDA/post-conflict and emergent markets, but can also be difficult in more developed markets. Box 2 shows how one Case Study client has chosen to focus on internally promoting senior analysts and building their E&S knowledge through distance learning courses. There is a clear role for DEG and the TA framework to support E&S Officers in developing their E&S skills and knowledge on the job by facilitating their access to more resources and regional training courses and events;
- The Case Studies indicated that for all types of clients, **Senior Management commitment** is a key factor in successful ESMS implementation. Case Studies with FIs, in both Southern Africa and Asia, indicated that Senior Management teams do not necessarily fully understand what ESMS means in practice (e.g. the resources needed, timescales involved, implications for their clients, etc.) when they sign up with DEG, despite ESMS conditions being included in their contracts. Even when procedures have been signed off, feedback indicates that many managers did not properly understand the resources needed. More effort may be needed with Senior Management, including credit risk directors, before financial agreements are signed to explain DEG's understanding of why ESMSs are relevant, the implications and benefits of ESMS requirements and the preliminary stages of ESMS implementation;
- Many clients identified finding **external advice on E&S risks** as a challenge. For example, in one Telephone Interview (Chinese PEF) and in one Case Study (Central American FI), DEG clients have recruited external resources to support their E&S staff including by reviewing E&S Assessments, carrying out due diligence assessments of projects in new sectors or delivering specialist E&S training;
- Some DEG clients are **unsure where to go for general information on best practice and advice. With regard to DEG they are unsure whom to ask for advice on the ESMS implementation/TA programme**. Some clients do their own research on the internet or use IFC resources, while a few have access to external E&S consultants (e.g. for reviewing an ESIA for a Category A project). Clients need more information on best E&S practices and further guidance on preparing ToRs and identifying suitable E&S consultants, particularly with sector expertise.

Table 2 summarises how far the key elements of an ESMS are being applied according to Survey respondents for both FIs and PEFs and further differentiated for Category A FIs.

Table 2: Extent of Implementation of Key ESMS Elements amongst PEFs and FIs, based on Representative Survey Responses

Aspects of ESMS	FI		PEF
	All	Cat A	All
ESMS implemented for entire portfolio	67%	82%	96%
Use of DEG Exclusion List ⁴	79% ⁴	82% ⁴	100%
E&S Officer in place	91%	100%	93%
Senior Manager or Board Member with overall E&S responsibility	88%	100%	93%
E&S Contractual obligations included in loan agreements	71%	91%	100%
E&S training provided to investment managers	83%	100%	74%

Box 2: Examples of how Case Study clients are addressing ESMS challenges

- A proportionate Due Diligence Assessment approach.** Several telephone interviewees and the two Case Study clients in Central America are using a risk matrix approach to categorise loan applications based on sectoral risk (low, medium and high reflecting national Environment Agency categories) and the financial value of the project or extent of bank exposure (e.g. as a % of the bank's total capital). This results in an overall risk category (low, medium or high) which dictates the extent of due diligence required, the types of screening materials used and reports required before approval. Both banks report that this system allows them to prioritise their staff resources and cover their whole portfolio. Typically, a loan officer spends 5-10 minutes looking at E&S issues for the lowest risk projects and minimum half a day for higher risk projects, which always require a site visit and may also need follow up calls or internet research on emerging E&S issues. In both cases, this approach has increased buy-in from loan officers and analysts because in most cases it does not add significantly to their workload.
- A 'light touch' pilot phase for ESMS implementation.** For two of the relatively new bank clients (in Asia) the ESMS process is being tailored to include a 'light' or pilot phase until the FI is more confident in its approach. For two other Case Studies (Africa), the ESMS has been set up to be too ambitious at the start (i.e. covering too many clients and sectors rather than just high risk clients), which makes it harder to get the buy-in of loan officers because of the significant extra effort required in their day-to-day tasks underlining the importance of a proportionate initial approach.
- Addressing E&S staff recruitment and retention.** One Case Study in an immature E&S market (Central America) had experienced problems recruiting a senior E&S Officer to fill a vacancy. Senior Management concluded that it was more important to recruit staff with a good understanding of the FI's systems and portfolio, able to command the respect of loan officers and analysts and able to ask the right questions rather than those with a professional background in E&S who are very hard to find in their market. They promoted a senior analyst with an interest in E&S who undertook several distance learning courses. They have also developed a cadre of financial analysts with additional E&S responsibilities who have been trained in-house. The bank's approach of bringing on internal staff with a high level of commitment and enthusiasm to raise E&S standards and providing on-the-job training has been very effective.

⁴ Note that the Web Survey indicated a number of clients who were not using the DEG Exclusion List. From further evaluation, i.e. through the telephone interviews, the clients indicated that (a) they were either using an Exclusion List from another DFI or b) had adapted their own Exclusion List to include DEG's requirements or c) in two cases had not understood the Survey question and were, in practice, using an Exclusion List.

- **Expanding E&S knowledge of the E&S team.** One Case Study FI (Central America) has retained four environmental consultancies on a call-off contract. To date, the E&S team have worked with one consultancy which has expertise in the construction sector to develop a sustainability awareness raising programme for their clients in the sector. They have also used the consultants to help carry out due diligence gap analysis against IFC Performance Standards as part of their monitoring of existing clients. Consultants are also able to provide support in reviewing E&S assessments and ESIA's for new projects.

3.2.3 Objective 1: Key Challenges and Opportunities

Overall, the key challenges reported in relation to Objective 1 are mostly related to FIs and are as follows:

- Identification, recruitment and retention of a qualified and/or competent E&S Officer;
- Getting buy-in from Senior Management in jurisdictions where FIs have strong competition from other lenders and ESMS could be perceived as a competitive disadvantage;
- Difficulties in persuading sub-project clients of the benefits of improved E&S performance and the rationale of the E&S requirements included in the contracts with sub-projects;
- Designing the ESMS to cover the whole portfolio, particularly for lending to SMEs, which might include thousands of clients;
- Tailoring the ESMS to the levels of E&S awareness at the FI (i.e. considering the inclusion of a pilot phase in ESMS implementation);
- Applying the correct risk category to projects in the absence of a strong understanding of E&S risks associated with different sub-sectors i.e. use of a consistent risk categorisation tool;
- Lack of advice and available good practice examples to help with implementation of ESMS.

Key opportunities, again most for FIs, relate to:

- Implementation of a 'light' touch approach or pilot phase to the ESMS to sensitise the organisation to the full requirements;
- Design and implementation of a smart/proportionate categorisation tool, taking into account financial exposure and industry E&S risk to allow the appropriate allocation of resources;
- Providing tailored training to increase the confidence of internal E&S staff in environmental decision-making;
- Helping FIs to identify qualified external E&S resources, potentially with key sector experience.

For PEFs there are fewer challenges, however this needs to be weighed up against the higher risk category and complexity of larger and longer-term investment projects. One of the key challenges is allocating appropriate resources to deal with complex Category A projects which may take months or years to get fully permitted and go through the full due diligence or ESIA process. Similar to FIs, DEG may be able to provide assistance through the provision of benchmarking data or best practice information/Case Studies, through sector-specific training and the identification of qualified third party resources.

3.3 Results for Objective 2 - Evaluate the Effectiveness and Impact of ESMS at (i) Clients; (ii) Sub-Projects

3.3.1 Description of the Objective

Objective 2 is to evaluate the effectiveness and impact of ESMS on DEG clients' own performance and on the performance of their borrowers or investments (hereafter referred to as sub-projects). Key aspects

for the analysis are presented in the Evaluation Framework (*Annex A*) and key findings are summarised below.

3.3.2 Effectiveness and Impact of ESMS at clients

- In general, the **Senior Management teams at PEFs are very supportive** of putting an effective ESMS in place: it is recognised as a core requirement before any investments can be made and the links to overall business performance and returns on their investment portfolio are very clear;
- **For PEFs:** Web Survey results indicated that 28% (7 PEFs) implemented an ESMS as a result of DEG's involvement (i.e. since signing a loan agreement with DEG); a further 52% (13 PEFs) improved their ESMS to meet DEG's requirements; 31% of the Web Survey respondents (8 PEFs) confirmed that their ESMS had improved as a result of DEG's TA programme;
- With regard to benefits, 92% (23 PEFs) indicated that the ESMS has improved their environmental and social risk management with 60% indicating that the ESMS has helped them to identify environmental and social opportunities; 72% (18 PEFs) indicated that the ESMS had led to measureable improvements in health, safety and working conditions;
- **For FIs:** 68% (23 FIs) of Web Survey respondents indicated that they had either introduced an ESMS for the first time after signing the loan agreement with DEG or improved their existing ESMS to meet DEG's requirements; 61% (20 FIs) indicated improvement in their ESMS due to TA provided either by DEG or another DFI;
- The positive feedback is that the DEG requirements have had a significant impact by ensuring the structured development and implementation of E&S procedures, documentation, responsibilities, etc. Web Survey results suggest that for those at earlier stages of ESMS implementation, **impacts have so far been quite general in terms of raising E&S awareness** of loan officers and improved confidence that the high E&S risks are being better managed;
- As indicated clearly in the Survey responses, the **DEG ESMS approach has led to significant structural improvements in ESMS management at the client level**; this has either been through improvements to existing processes and procedures, or implementing an ESMS where none existed before – this latter case is expected to have had the strongest impact on DEG's clients;
- 76% of PEFs and 100% of FIs indicated that the ESMS has led, directly, to the exclusion of projects which might incur an unacceptable level of environmental or social risk or cause reputation risks to the institutions;
- As the ESMS procedures are rolled out at FIs, there is evidence of increased impact (see *Box 3* below). The most common feedback from FI clients, in terms of impacts of the DEG requirements, was that they have assisted the clients to **formalise the ESMS process and procedures**. Several Telephone interviewees reported that they had previously only taken E&S risks into account on an informal basis. For example, one Case Study FI in Southern Africa reported that DEG's E&S standards and expectations have given them the necessary impetus to formalise their procedures and start to apply them consistently;
- Overall, most PEF and FI clients (90% according to the Survey) perceive the **corporate benefits** of an ESMS as risk management helping to **exclude projects that might cause reputational risks**. One FI Telephone Interviewee from West Africa reports that their ESMS has helped them reject applications from higher risk clients who were not willing or not able to adopt appropriate measures to manage these risks. Another FI in Latin America reported that the bank approved a 'risky' investment in the palm oil sector with stringent E&S conditions attached via an ESAP and contractual clauses. The client initially accepted the conditions but ultimately paid the loan back early because they were able to find a less stringent bank to borrow the funds from. An Asian FI rejected an investment in the brick-making industry on the basis of the reported use of child labour;
- The effectiveness of the ESMS at FIs, including the management commitment, appears to be linked to the **development status of the countries** in relation to E&S legislation and enforcement. In

many IDA countries and emerging countries, the management of E&S risks is a fairly new concept in the financial sector. Telephone Interviews and Case Studies suggest that, in many cases, DEG clients are one of only a small handful of FIs or PEFs that are applying DFI-compliant E&S standards. In a few Case Studies (East Africa, Southern Africa and South East Asia) this was seen as a competitive disadvantage. But elsewhere, even in IDA countries, an ESMS is also seen as setting the FI positively apart in the market. A Chinese PEF and an African FI interviewed both felt that adopting high international standards had helped them to become leading financial institutions in their countries;

- A few clients are also poised to improve their market share through enhanced understanding of clients' businesses and new economic sectors. For instance, Case Study FIs with advanced ESMS implementation are finding that the process of analyzing the E&S issues in key investment sectors and the requirement to visit all higher risk clients on site has helped them to better **understand their markets and improve their services** and product offering to clients in key sectors;
- Over 70% of Web Survey responses report that a DEG-compliant ESMS will or already has helped them **attract finance** from other DFIs and other investors such as impact investors or commercial banks. Many of the clients interviewed by telephone, and half of Case Studies cited examples of how a DEG-compliant ESMS has advantages for them, especially in securing financing from other DFIs more easily and quickly than if they did not have an ESMS in place. *"By applying our ESMS and E&S principles it enhances our brand value and our reputation so we can obtain direct access to international financing markets and subordinated loans from ADB and the World Bank"* (Telephone interview, FI, Asia);
- The Telephone Interviews also identified examples of where **DEG clients are taking a leading role** in raising E&S standards at the national level. For instance, banking round tables have been set up and are in the early stages of standardising national E&S requirements in Kenya, Paraguay and Sri Lanka. DEG and other DFIs have played an active part in encouraging this and provided expert support;
- There is a common request at clients for DEG to provide more **Case Studies on good E&S practices and standards**. One driver for this request is so that these can be used to demonstrate the benefits of ESMS to Senior Management.

Specific examples of the benefits of ESMS implementation are given in *Box 3* below.

Box 3: Examples of the benefits of an ESMS for DEG clients

- **Reducing risks and potential future liabilities.** Applying E&S due diligence helped one PEF to identify unmanaged fire risks, areas needing upgrading and to ensure a regular regime of inspections and drills at an investee company. This has avoided potential financial risks to the Fund of property loss in the event of a fire, or plant closure and penalties in a context of more stringent government enforcement. (Telephone Interview, China, PEF). Similar benefits were reported by FIs in Latin America. One Latin American FI, which specialises in loans in the livestock sector, reported that an ESMS leads to better overall land management and reduction of E&S risks such as forest fires on land which it has taken as collateral against loans. Recognising common E&S issues across the sector the client now provides its own clients with forest fire warnings through its subscription to Global Forest Watch (Telephone Interviews, FIs, Latin America).
- **Strengthening reputation, brand and market share.** A PEF reported that "the advantages of implementing an effective ESMS from the corporate point of view are strengthening the value of the project investment and the Fund's reputation" (Telephone Interview, Latin American PEF). The Latin American Case Studies also illustrated how loan officers appreciate the additional information they collect about individual client operations and key investment sectors through site visits as part of their due diligence system. In both cases, this market intelligence is now providing the basis for identifying opportunities to improve client service and identify opportunities for further loans, including for improving E&S performance (e.g. through investment in renewables). One FI has undertaken training for its clients in the construction sector having identified this as a medium risk part of its portfolio but a sector with significant scope for improving sustainability, reducing resource use, lowering costs and improving business performance (Case Study, FI, Latin America).

- **Attracting investment from other DFIs.** 76% of PEFs and 79% of FIs reported that a DEG compliant ESMS has helped them to attract finance from other DFIs, impact investors or commercial banks. Both Telephone Interviews and Case Studies provided examples of clients getting access to green credit lines for banks with robust ESMS implementation. A telephone interviewee (PEF, Asia) reported now being in a very strong competitive position in China and attracting lots of interest from investors (several DFIs and other investment funds). A Case Study FI in Central America had been told by several DFIs that the process of approving a loan had been much quicker and smoother because they already had a robust ESMS in place. Furthermore, they did not require a TA phase, which they would normally have required in a national market with relatively low E&S awareness. One FI client reports that, as a result, it is able to offer its borrowers access to preferential interest rates through a new line of credit (another DFI) at 5% instead of 11% in the national market (Telephone interview, FI, Asia).
- **Generating information needed for other reporting purposes.** An FI reports that the Chilean Government has started to require all companies to include sustainability performance as part of their annual reporting and the ESMS will help the bank generate useful data on E&S compliance amongst their clients. (Telephone Interview, FI, Latin America).
- **Meeting the expectations of international stakeholders.** International E&S standards allowed a Central American high risk wind farm project to proceed smoothly. Funded by a syndicate of local and international FIs, the wind project's operators carried out an IFC-compliant EIA selecting a site with no resettlement requirements, which did not affect indigenous people and engaged more actively with locally-affected persons than might otherwise have been expected. The project proceeded smoothly without attracting any negative criticism of the operators or the FIs from international NGOs. (Case Study, FI, Latin America).
- **Taking a leadership role in raising E&S standards in their country.** Several telephone interviewees, having implemented their ESMS, are now taking a leadership role in their country to raise E&S standards in the financial sector. In Kenya, Paraguay and Sri Lanka, DEG clients are part of national roundtables to help standardise national E&S requirements. In Central America a Case Study bank is now taking a role in helping sister banks across the region implement similar systems. The risk director and E&S coordinator are training counterparts and supporting them with implementation challenges (Case Study, FI, Latin America). As the profile and brand strength of the FIs increase, they will have better access to higher quality E&S clients and are likely to perform better in the market place in terms of competition from other banks.

3.3.3 Effectiveness and Impact of ESMS at Sub-Projects

- The Web Survey findings found that, currently, more than 80% of FIs and 85% of PEFs require **evidence of compliance with E&S legislation** from their clients prior to investment;
- 92% of PEFs report that they proactively encourage good labour, H&S and E&S policies amongst all their clients. The majority of PEF survey respondents already see improvements in H&S (79%), social performance (71%) and environmental performance (63%) at the sub-project level. Positive benefits of improved E&S performance at the sub-project level were also identified through Telephone Interviews and Case Study visits (see *Box 4*). Specific examples included ones where FIs have had an **influence on managing labour, health, safety and environmental permitting requirements and avoiding fines**;
- Several telephone interviewees and Case Studies in IDA or post-conflict countries reported that **strict ESMS requirements put them at a competitive disadvantage** and that the standards were not affordable for their SME clients. The lessons from the Case Studies in more developed markets suggest this perception can change quite quickly. In one of the Central American Case Studies, the E&S team reported that clients initially questioned the stringency of their due diligence assessment process but, as the national context has changed, with more rigorous enforcement of requirements by government, they have come to appreciate the thoroughness of the system;
- Case Study visits to sub-projects found that, overall, companies were **operating to appropriate standards of E&S management**, and had the necessary licenses and permits in place. It may be assumed, however, that there may be other cases where clients are not operating accordingly. It is not possible to attribute improvements in E&S performance solely to DEG clients' requirements since

– in theory – these improvements would also have been necessary to meet national legislative requirements if loans had been provided by other domestic banks. However, in practice – since in these markets very few other banks are currently implementing a DFI-compliant ESMS and national legislation is not always actively enforced – it is likely that DEG clients’ ESMS requirements have made a significant contribution to raising E&S performance at the sub-project level. Part of the issue is that the ESMS influence can only go ‘so far’ – at the ground level, the focus may well be on compliance only and, in the absence of enforcement, this may be limited solely to the provision of environmental permits; H&S inspections may not be conducted due to government professional resource scarcity;

- In general, the consultations indicated that there has been **limited focus on wider social issues other** than labour and working conditions. However, in the Latin American sub-project visits, management teams showed a high level of social awareness and in many cases had invested in community facilities and employment schemes since taking on a loan from the DEG client;
- Several of the PEFs interviewed have an **environmental and resource management focus** and are having significant positive environmental impacts through their investment portfolios; in some cases, the sub-project portfolio is focussed on the ‘green’ sector such as energy efficiency;
- Most FIs that responded to the Web Survey or took part in Telephone Interviews are not yet actively looking for **opportunities to improve resource efficiency** or mitigating climate change – even where water or energy are major national environmental issues – and have limited awareness of ‘green’ investment opportunities. The Case Studies found a few examples of positive environmental improvements, however it is not possible to attribute these directly to the ESMS; for Category A projects, where an ESAP is prepared, the ESMS clearly drives improvement on the ground. For SMEs and Category B projects, improvements were seen to be driven more by operational necessity (e.g. through the reduction of waste generation which may cost the business or use of more efficient and cheaper fuels or improved wastewater treatment systems which may allow faster production). One Latin American FI Case Study is specifically investing in renewables projects (wind and photovoltaic solar) and is looking for future opportunities as part of their own business culture;
- During visits to sub-projects, the evaluators observed good relationships between bank staff and borrowers and that bank staff initiated conversations about potential future green and social investments. Retrofitting of renewable energy schemes was of particular interest to clients in rural areas affected by energy security issues. Sub-project visits with African and Asian FIs, identified several opportunities for **green financing** (e.g. renewable projects, water resources management etc.) but noted that these opportunities are being missed by the DEG clients and that further training and awareness is needed in this area;
- Where FI clients are starting to proactively encourage **investment in renewables and improving resource efficiency** (e.g. Panama and El Salvador) this is through green credit lines from other DFIs rather than DEG. DEG’s influence in this area would be greatly improved through the provision of targeted credit lines such as renewables, energy efficiency or social investment for example.

Box 4 gives examples of ESMS benefits at the sub-project level.

Box 4: Examples of the Benefits of an ESMS at the Sub-Project Level

- **Avoiding social conflict and developing an EIA for a high-risk investment:** an Indonesian bank’s ESMS expectations helped a toll road project to get built on time without social conflict. The FI required that the client set up an E&S team responsible for the EIA and for stakeholder engagement and a Grievance Mechanism. The project established good relations with the local community and set up a Livelihood Restoration Programme for those who had to be resettled.
- **Strengthening reputation, brand and market share:** a Central American FI client has successfully implemented a practical and easy to use ESMS across its portfolio of SME loans. The bank has identified the construction sector as a key area where it can help improve clients’ E&S performance. Working with local E&S consultants, they have provided training on sustainable construction to 100 clients. The next step is to identify ‘green’ investment opportunities, particularly in the fast-growing renewable energy sector.

- **Using the ESMS to respond to developing legislation:** in response to increasingly stringent safety standards, a China-based regional PEF identified the need for external expertise to assess fire risks and advise on workshop upgrading therefore reducing the risk of property loss in the event of fire and the risk of penalties.
- **Improving resource use and reducing costs:** the ESMS at an Indian PEF client highlighted opportunities to adapt the boilers at a food processing factory to use organic waste from nearby cotton farms, reducing fuel costs by 30%, reducing air pollution and providing an additional income source for local farmers.
- **Assisting with project permitting and avoiding resettlement costs:** The application of international E&S standards allowed a Central American high risk wind farm project to proceed smoothly. Funded by a syndicate of local and international FIs the wind projects operators carried out an IFC compliant EIA selecting a site with no resettlement requirements.
- **Licence to operate:** A fish-meal processing factory was closed by the Central Environmental Authority as a result of complaints from the public due to odour. The customer came to the bank, asking finance for an odour control system. However, equipped with the ESMS knowledge, the Bank was able to ask for a full environmental assessment and suggested a total pollution control system. The customer will be able to extract fish oil from the effluent as a result, which will give him an additional income.
- **Developing wider CSR programmes.** Four sub-projects reviewed in Central America have gone beyond simply managing E&S risks and complying with legislation. All four also invest in social responsibility activities such as local hiring, developing apprenticeship schemes for local young people and supporting community development (schools' projects and sporting or cultural facilities). Two of the companies are also investing in afforestation and habitat improvement around their sites. While these social and biodiversity investments are hard to attribute directly to the ESMS, they are evidence of wider unanticipated benefits of the ESMS approach and increasing E&S awareness amongst local businesses (Case Studies, FIs, Latin America).

Table 3 summarises the extent to which ESMS procedures have been applied to individual clients and sub-projects.

Table 3: ESMS Application to Clients or Sub-Projects, based on representative survey responses

Aspects of E&S risk management– already in place	FIs		PEFs
	Category B	Category A	All
Initial screening of each project by our investment managers against our E&S categories/guidelines	82%	91%	100%
Due diligence on environmental or social risks carried out by FI/PEF or with DEG Technical Assistance (TA)	60%	82%	100%
An environmental and/or social impact assessment (ESIA) for high-risk projects carried out by the client (or their consultants)	60%	82%	85%
Environmental or Social clauses in the loan agreement/contract	69%	91%	96%
Annual reporting by clients in relation to key social and environmental risks	30 %	64%	96%
Special (one-off) reporting by clients on any environmental or social incidents	31%	91%	89%

3.3.4 Objective 2: Summary of Key Challenges and Opportunities

The main challenges at clients and sub-projects include:

- In general, clients of DEG have not yet moved from a **risk management approach** for E&S performance and focusing on compliance with E&S legislation to realising additional E&S benefits 'beyond compliance' and identifying opportunities for green investment;

- Many sub-projects are small companies and these often only have the funds and resources available to **focus on E&S compliance** with national regulations, and not to make additional E&S investments and actions, despite their awareness and commitment to improved performance;
- In many countries of operation, there are **low levels of E&S awareness**, and even H&S management is quite a new concept. Changes in practices may therefore take time to implement but – based on Case Study lessons – deliver benefits when they do.

The evaluation also identified the following opportunities to add value through an ESMS:

- Over time, there is a visible shift in perception at clients from ESMS being driven solely by the need to comply with DFIs' E&S requirements to an understanding that it can add value to a business. For advanced PEFs in particular, a functioning ESMS **is used as a sales pitch** to their prospective customers;
- **Case Studies identified some interest in promoting** uptake of environmental opportunities and developing 'green finance' and specialised credit lines (e.g. for energy efficiency or climate change adaptation) with other DFIs. But FIs generally lack the experience or knowledge for marketing this type of opportunity to their clients.

3.4 Results for Objective 3 - Evaluate (i) the Functioning of DEG, and (ii) the Value-Added of DEG (in particular in the TA framework on ESMS)

3.4.1 Description of the Objective

Objective 3 was designed to evaluate the functioning of DEG and value-added particularly in relation to the TA framework. Key aspects for the analysis are presented in the Evaluation Framework (*Annex A*) and key findings summarised below.

3.4.2 The Functioning of DEG

Survey respondents were asked how far they agreed with a number of statements about DEG's E&S requirements. Overall, some 80% of FI and PEF clients who responded to the survey were positive about most aspects of DEG's expectations. The majority of findings from Telephone Interviews and Case Studies in relation to the functioning of DEG in relation to ESMS were also positive.

The majority of PEFs and FIs report a **good, positive relationship with DEG in relation to ESMS**; and DEG was regarded by many respondents as the **most committed DFI to E&S performance**.

Additional, specific results are summarised below:

- Since working with DEG, nearly 88% of FIs and 85% of PEFs that responded to the Survey have **improved their ESMS** (through DEG or other DFI involvement or, in some cases their own business development). Of these, 31% of PEFs and 33% of FIs have done so as a direct result of TA received from DEG (see *Table 4* at the end of this section);
- For PEFs, DEG seems to have a **unique selling point (USP)** in providing value-added through the TA programme. However, Survey questions were not disaggregated by co-invested DFIs, therefore the results could be biased and some more PEFs could actually receive TA from other DFIs. Overall, however, the large difference in PEF's receiving TA from other sources (1 PEF, 3%) compared to FIs receiving TA from other sources (9 FIs, 27%) points to a clear USP;
- The **TA programme is appropriately targeted by DEG to Category A clients**; 12 of 33 clients that have received TA are PEFs. Given the challenges described above, the future proportion of FIs receiving TA could be increased further as for DEG's risk management. TA is particularly useful for FI clients in jurisdictions where enforcement is poorly-developed or investment portfolios are particularly large and, therefore, require a more proportionate, stepped approach. For PEFs, DEG support in E&S particularly with TA could be more a value-add activity, as core ESMS elements are already established;

- Several interviewees and Case Study clients also expressed interest in getting more value-added out of their E&S effort e.g. **by getting certification** including GIIRS and ISO which would help them to attract further investors and **by developing green credit lines** to offer clients the opportunity to increase resource efficiency and investment in renewables at lower interest rates;
- The E&S specialists at DEG in the Sustainability team now only get involved in Category A projects. The E&S requirements for B clients are managed and monitored by the trained FI/PEF teams (i.e. the Investment Managers), unless they ask for specific support from the Sustainability team. Category B clients do not receive the same level of monitoring at DEG relative to Category A clients. The Web Survey and some Case Study visits picked up some disappointment amongst **Category B FIs about the lack of feedback** given to those that are reporting regularly. More DEG resource is needed to assist this client group, given the ESMS implementation challenges identified for SME-focused Category B FIs (to account for the higher level of E&S risk within the FI Category B sector as described in the sections above);
- The only areas in the Web Survey where there was criticism of DEG was in relation to timely feedback on reports submitted to DEG and in knowing who to contact if they required more information (PEFs) and on the clarity of reporting requirements and the appropriateness relative to portfolios (FIs);
- In addition, internal DEG checking with the **EaSI system is partly inconsistent or outdated** because clients use different sector classification systems. Moreover, checking of annual E&S reports for Category B clients, and inclusion of information from these reports into the EaSI system, carries some uncertainty and is partly late, most likely because the Sustainability team is not involved;
- **Overall, the data quality for DEG's TA projects is inconsistent.** This is demonstrated by the difficulty in securing an accurate list of clients that had received TA on ESMS at the outset of this evaluation; improved data management would be highly useful for DEG's clients in terms of business benchmarking and sharing best practice ideas and solutions among other reasons;
- **Use of data** that DEG collects from clients is also weak in some areas:
 - In some cases, annual E&S reports are not followed up (as reported by several Case Study clients);
 - Data on high-level Key Performance Indicators (KPIs) related to E&S performance in the sector is not being collated by DEG. Simple indicators such as '% of clients that submit the annual E&S report on time' aggregated by FI/PEF, risk category or by region could provide a very useful benchmark to DEG in differentiating the support it offers to different client groups;
 - Data is not being fed back to clients and so they are unable to use it in their branding and marketing.
- Considering the challenge of E&S risk management in the financial sector, **the resources in the DEG** Sustainability team are considered to be low, but are currently supplemented by consultants. The TA programme is handled by the BSS team with expert support by the Sustainability team;
- **Communication from DEG on ESMS** - For those clients that are not implementing the ESMS, or where the implementation has been delayed, it is uncertain whether DEG is following up and reminding clients of their commitments on ESMS. In one Case Study, of a B Category client that is not implementing its commitments and has not provided any annual E&S reports, there has been no active follow-up on E&S aspects by DEG investment staff over several years. However, following the Case Study visit and meeting with Senior Management there seems to have been some improvement and renewed commitment from Senior Management, which appears to demonstrate the importance of DEG taking an active interest in progress. Particularly for B risk clients, DEG needs to rethink its balance between ensuring commitments are implemented and maintaining its business relationship with the clients;

- The feedback from the majority of clients, however, is that **DEG communication is good**;
- For clients that are not committed to ESMS, an approach by **DEG of regular communication and regularly feeding small pieces of information**, case studies, offers of support etc. is a recommended approach in order to raise the commitment of Senior Management over time. Communication and relationships are therefore important, and the DEG local offices play an important role.

Box 5 below provides some specific examples of DEG's relationship with its FIs and PEFs.

Box 5: Feedback on clients' relationship with DEG

- "DEG has been very supportive and the TA support provided was invaluable. Support received from the DEG Business Support Services department for a client has also proved very useful". (Web Survey, FI)
- "We do not receive feedback on the monitoring report and it is unclear who to contact for advice; we would benefit from refresher training" (Telephone Interview, Asia Regional PEF)
- "No TA received to develop our ESMS. However, 3 of our investee companies received very valuable TA support from DEG." (Web Survey, PEF)
- "We hired the E&S consultant that DEG used in providing TA on a retainer." (Telephone Interview, FI)
- "We have multiple textile clients looking to improve energy and water efficiency but we need IFI support – would be happy to work with DEG" (Telephone Interview, Asian FI)

3.4.3 The Value-Added of DEG (in particular in the TA framework on ESMS)

- The survey, interviews and the 5 Case Studies which have received TA together provide **very positive feedback on all aspects of TA**. Of Web Survey respondents that have improved their ESMS since signing a contract with DEG, 31% of PEFs and 33% of FIs have done so with TA received from DEG. A further 27% of FIs have done so with the help of other DFIs;
- Overall, the influence of the TA programme has been stronger for PEFs than for FIs; in terms of ESMS implementation, the **TA programme has been very useful in terms of driving** change however it is not clear whether this is fully attributable to DEG, other DFIs or the combined influence of several; what is clear is that the added impact of a strong relationship with DEG, through the TA process and through the role of TA consultants, has been strongly beneficial in helping clients to understand and implement ESMS; therefore, and although the Survey results are inconclusive (numerically), the qualitative data indicates a strong correlation between the TA programme and strong ESMS performance;
- In some cases, **the TA has been delayed**, and has taken up to 4 years (demonstrated by one of the African FIs which has struggled to implement the ESMS phases and would benefit from a more flexible approach). A flexible approach is also needed if there is an interruption to business;
- **Commitment to ESMS development under the TA** - the required approach for the TA is for the ESMS policy and procedures to be prepared by the client under coaching by the TA consultant. This approach is appropriate because it would strengthen the understanding of the client, the ownership of the ESMS, and commitment to ESMS implementation. Of the 5 Case Studies which had received TA, this approach appeared to have been used in all cases. However, the approach does not work if the client is not committed, and in some cases the consultants had to develop most of the ESMS documents. This lack of involvement in developing the ESMS has proved to be a strong indicator of an overall lack of commitment to implementing the ESMS;
- **Tailoring the ESMS for the client** - Linked to the point above, the Latin American Case Studies showed the benefits of an ESMS which has been carefully tailored to be relevant to the client's

existing risk assessment strategy and the size and nature of its portfolio. These systems were seen as concrete, practical and easy to implement and readily accepted by bank staff. In other cases, (Southern Africa) where the ESMS was more "off-the-shelf", clients appear to have struggled more with applying the ESMS across their whole portfolio;

- Minor criticisms were provided on the **quality of the training materials** and the extent to which materials were tailored to the clients' national context or specific portfolio. Several clients reported that the training they had received was too process-driven and did not equip them to evaluate sector E&S risk. One telephone interviewee suggested that **TA consultants carry out client visits** with bank staff as part of the training on E&S due diligence tools and help develop protocols for interviews. This was explored further during Case Studies and was welcomed as a way of staff getting more hands-on experience. Overall, the role of the TA consultants has been very positive with appropriate support provided at appropriate times in the process; there is potential, however, for the TA materials and resources to include more local or regional case studies on E&S practices and to use projects from the banks' own portfolios as training exercises;
- **Reporting by TA consultants to DEG** - Some of the TA progress reports are quite large and formats are not always consistent. This is a minor issue;
- As noted above, the targeting of TA towards PEFs and Category A FIs so far has been appropriate but since PEFs and Category A FIs sampled are now largely meeting DEG's ESMS requirements **more TA effort could now be focused on support to Category B FIs** and – if necessary – over a longer time period;
- The more recent TA framework has included a **component on 'green financing'**, which was a gap in the previous TA;

In summary, DEG's TA programme has had a significant influence on the update of ESMS processes and procedures at the FIs and PEFs; in some cases, this has been directly through the introduction of an ESMS and in others through structural improvements.

Table 4 below illustrates the structural improvements as a result of the TA programme (sourced from the Web Survey respondents).

Box 6 provides a sample of Web Survey comments and testimonials on the value-added of DEG.

Table 4. Structural Improvements as a Result of DEG's TA

If you have improved your E&S procedures, was this with the help of DEG's Technical Assistance (TA)? (please tick one option)		
Answer Options	FI	PEF
We have not improved our procedures.	12%	15%
We have improved our procedures, but not as a result of TA.	27%	50%
We have improved our procedures as a result of TA from another DFI.	27%	4%
We have improved our procedures as a result of TA from DEG.	33%	31%

Box 6 below summarises views on the value added by DEG.

Box 6: Web Survey Views on TA received

Several organisations with fully implemented ESMS (mainly PEFs) are now looking for further value added:

- *“A TA facility dedicated to E&S improvements is needed and will be valuable to the SMEs” (Web Survey, PEF)*
- *“We believe that the E&S focus needs to also be turned into something more. I would like to ask DEG to assist us in becoming GIIRS members / certified...” (Web Survey, PEF)*
- *“We would like support on E&S management into the supply chain. That would be helpful for our portfolio companies and new investments” (Web Survey, PEF)*
- *“Several types of support could be of interest in our industry (fund management) where the human resources are few and the number of assets potentially large. It includes some form of “automated” or online reporting by plant managers in a format adapted to their exact activity sector, and lessons learnt from the same sector elsewhere so as to know where exactly to expect issues, carry out monitoring, or require regular information from the plant managers”. (Web Survey, PEF)*

Those that are starting to fully apply their ESMS (mainly FIs) report that more training and resources for their E&S teams would also be helpful:

- *“As the E&S Officer, I would like to receive information of trainings, and information from other countries to improve ours” (Web Survey, FI)*
- *“Training support is always welcome”. (Web Survey, FI)*
- *“Help with capacity building of our staff” (Web Survey, FI)*
- *“Training with DEG officials preferably at DEG’s office can really help in understanding DEG’s view point on the expectation of DEG on ESMS risks” (Web Survey, FI)*

3.4.4 Objective 3: Summary of Key Findings

Key findings in relation to Objective 3 are as follows:

- Varied feedback has been provided on DEG but the majority is positive;
- TA was found to be very useful particularly with the emphasis on the ‘train the trainer’ approach;
- DEG is regarded as the most committed DFI in relation to E&S performance and has brought about significant structural changes in the FIs through the ESMS process;
- As sector risk is poorly understood by some FIs, more training and guidance could usefully be provided by DEG and TA consultants on risk categorisation, E&S risks in different industry sectors and screening tools to optimise the resources allocated to different types of projects; and
- Delays due to the establishment of banks and their infrastructure may mean that TA can take a long time to complete – in these situations, a flexible approach is warranted with regular dialogue.

4. Recommendations and Conclusions

4.1 Key Recommendations

Despite the overall positive findings in this study, several recommendations would allow DEG to improve promoting ESMS, particularly through a stronger focus on banks with medium risks and large portfolios. Recommendations are given, by ESMS topic, below.

Supporting ESMS Implementation

1. ESMS procedures phased/tailored to reflect country, market and FI context e.g.:
 - a. phased/pilot approach in emergent or IDA countries
 - b. ESMS-light (i.e. a tailored approach for Category B FIs with large SME portfolios which might include an initial consultation session with Senior Management) and/or allow flexibility between stages to allow the FI to integrate the procedures in a stage approach in line with their own development.
2. Design of a standardised E&S risk categorisation matrix/tool which allows the client to rapidly assign a risk category and aids in the appropriate allocation of resources. Potentially to include a guide on the likely E&S risk associated with different industry sectors.
3. Use of data to offer clients differentiated support e.g.:
 - a. Struggling clients – more TA support on developing proportionate procedures
 - b. Mid-range clients – regular feedback on risks in key/emerging sectors, how to use third parties, how to overcome staff recruitment/retention issues, refresher and other training available
 - c. High-performing clients – help identify green and social investment opportunities in their portfolios, set up green credit lines, take on E&S leadership roles, provide benchmarking data on good practice
 - d. More active monitoring of Category B client reporting to identify problems
2. Assess and develop tailored training which, hopefully, could be provided to groups of clients and would cover E&S risk categorisation, risks associated with different industry sectors and a refresher on DEG's E&S requirements and how they are applied; where possible, and subject to time allowance, best international practice could be covered.
3. Provide advice to FIs and PEFs on sourcing third party/consultancy support, potentially sector experts, to supplement internal resources as required.
4. Introducing and providing a document explaining the reasons for ESMS implementation, DEG's requirements, success factors and where to go for support (i.e. the ESMS Guide).

Management of E&S Data within DEG

1. Develop quick internal notification system for clients to ensure follow up on annual E&S reporting with a particular emphasis on Category B FIs:
 - a. Share numbers of outstanding reports and reminders on E&S reporting with all relevant staff (investment managers) but also the Sustainability Department
 - b. DEG could also try to change its reporting towards a web-based or Excel-based system to use efficiency gains for putting more effort in actual data validation instead of collection.
2. Greater DEG analysis of ESMS data collected from annual E&S reports:

- a. Constant reporting on figures aggregated by FIs (Category A & B) & PEFs (Categories A & B) and for regions or types of countries (newly industrialised, emergent, IDA) available for all management staff
- b. Feed results back to clients so they can benchmark themselves against other similar PEFs or FIs or other organisations within their operating region (and use as a USP)

Promoting 'Green' Investment Opportunities

1. Consider further development of a specific credit line supported by training to recognise and invest in 'green' opportunities, renewables, energy efficiency etc. As further awareness and guidance is needed in this area, part of the training could cover environmental additionality (i.e. how to look for opportunities for improvement).

Potential Improvements to the TA programme

1. Implementation of a flexible TA approach to include a front end pre-phase to increase Senior Management buy-in and a light touch pilot phase for FIs in challenging jurisdictions.
2. Adaptation of future TA to have increased emphasis on:
 - a. Category B FIs
 - b. High SME number portfolios
3. Including/developing a training TA which covers risk screening/categorisation, sector E&S risk, E&S due diligence, benchmarking and resource sharing e.g. of good examples
4. For the TA initial stages, increase the emphasis on Senior Management training to highlight ESMS benefits
5. Include due diligence training for E&S Officers (potentially to include site visits) in the TA and, in particular, make available Case Studies of good practice (success stories)

4.2 Conclusions

Overall, it is clear that DEG has a strong, positive E&S influence on its financial intermediary clients, including Private Equity Funds, national and multi-national banks. DEG has made significant progress in the implementation of ESMS across the global intermediary portfolio.

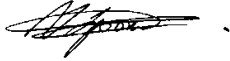
ESMS implementation is high and the business benefits clear. There are, however, challenges associated with the FI element of the portfolio, namely those in the medium risk category and those with large portfolios, particularly with SMEs.

We see that DEG, with a growing portfolio of intermediary clients in a diversified geographical setting, is aware of the need to implement standardised E&S procedures. The general E&S-related contractual procedures and the TA support provided by DEG through its BSS team has provided a focal point for ESMS implementation across the portfolio.

The evaluation has resulted in a number of clear recommendations for improvement which are documented in the Evaluation Report. Evidence to support the conclusions is provided in the Case Study reports and other supporting documentation. Further development of the TA programme will help the portfolio clients to drive the transition from compliance to on-the-ground improvement, to become market leaders in E&S and to identify opportunities for green or social improvement investments.

5. Closing Statement

Citrus would like to thank DEG for the opportunity to work on this interesting and challenging assignment. We hope that the recommendations contained herein will help DEG to achieve its sustainable development objectives in 2017 and to continue to drive improved E&S performance across the FI and PEF portfolio. Thank you for the opportunity to work on this assignment.



Nicky Spooner
Tel. +44(0)7773 394728
E. nicky.spooner@citrus-partners.com