
Evaluation of the Promotion of Environmental and Social Standards in DEG's Indirect Financing

Case Study Report – Multibank, Panama

Prepared for
DEG

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Citrus Partners LLP
180 Piccadilly
London W1Y 9HF
United Kingdom
www.citrus-partners.com

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Abbreviations

ANAM	National Agency for Environmental Management
ARAS	Administración de Riesgos Ambientales y Sociales
CO ₂	Carbon Dioxide
DEG	Deutsche Investitions- und Entwicklungsgesellschaft mbH
DFI	Development Finance Institution
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESMS	Environmental and Social Management System
FI	Financial Institution
HACCP	Hazard Analysis and Critical Control Point
H&S	Health and Safety
IFC PS	International Finance Corporation Performance Standards
IPs	Indigenous Peoples
MW	Megawatt electricity
MWh	Megawatt hour of electricity produced
PEF	Private Equity Fund
PPA	Power Purchase Agreement
RES	Renewable Energy
SARAS	Sistema de Administración de Riesgos Ambientales y Sociales (ESMS)
SME	Small and Medium-sized Enterprise
TA	Technical Assistance
WTG	Wind Turbine Generator

Executive Summary

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

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

DEG is carrying out an evaluation of its overall environmental and social (E&S) risk management for its investments through FIs and PEFs. The evaluation has included a Case Study on the implementation and impacts of DEG's E&S requirements associated with its loan to Multibank in Panama via the Holding Multifin Panama. DEG provided Technical Assistance (TA) for the design and implementation of an ESMS at Multibank. This Report provides a summary of the Case Study findings.

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

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

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

- *At this stage, the most important point for the ESMS implementation at Multibank is moving beyond risk management and compliance with national legislation and permitting requirements to a second phase of increasing performance to meet IFC standards, where appropriate, and to help clients improve environmental and social performance through green investments, particularly in renewable energy. Other opportunities have been identified by Multibank amongst its construction and commerce clients and the team has started to raise awareness of clients in the construction sector through a programme of seminars in 2016.*

1. Context: DEG's E&S Evaluation

1.1 DEG E&S Requirements

Due to the specifics of its portfolio countries and sectors, DEG has to promote and control Environmental and Social (E&S) standards proactively. Therefore, DEG requires its clients to implement a series of formalised E&S standards which are applicable to all of its clients.

These include, among other requirements:

- Screening projects against an Exclusion List;
- Using risk categorisation criteria for clients in different sectors;
- Developing and applying E&S procedures across the investment cycle;
- Assigning responsibility for E&S management;
- Training credit officers in E&S procedures;
- Monitoring E&S performance;
- Requiring annual E&S reporting from clients.

In its contracts with clients, DEG includes clear requirements for clients to structure these components into a formalised Environmental and Social Management System (ESMS).

1.2 Benefits of an ESMS

Implementation of an ESMS reduces the client's, as well as DEG's risk exposure, and strengthens the business performance of clients through:

- Achieving compliance with national regulations and international standards;
- Reducing the number and scale of environmental accidents and social incidents;
- Managing the risks to the reputations of the banks and the businesses in which they invest;
- Enhancing the opportunities for banks to gain access to international finance;
- Improving the motivation of employees at the banks, and meeting expectations of stakeholders related to environmental and social performance;
- Setting a framework to identify viable opportunities for environmental and social investments, such as in water resources management, energy efficiency, etc.

1.3 Purpose of this Evaluation

The purpose of this assignment is to evaluate both the progress and success in relation to the implementation of DEG's E&S requirements within the indirect financing portfolio. The evaluation covers both Financial Institutions (FIs) and Private Equity Funds (PEFs) and includes those that have received Technical Assistance (TA)¹ and those that have not (termed the 'Control Group').

The steps of the evaluation study include the following:

- a portfolio-wide data and document analysis;
- a representative web-based survey of clients;
- telephone interviews (19 clients);
- Case Study visits (8) within Europe, Latin America, Africa and Asia.

¹ The Technical Assistance (TA) programme is adapted to the client's needs. In its most general form it involves 5 stages: Phase 1: Initial Assessment; Phase 2: Supporting the development of policies, procedures, tailor-made tools, checklists etc.; Phase 3: Review of policies and procedures, on-site training of key staff; Phase 4: Evaluation of the implementation of E&S policies and procedures; Phase 5: Provision of on-going off-site support and final evaluation.

The objectives of the evaluation are provided in *Box 1*.

Box 1 - Objectives of the evaluation

- Objective 1 - Evaluate the implementation and practical use of ESMS by DEG's clients.
- Objective 2 - Evaluate the effectiveness and impact of ESMS at (i) clients; (ii) sub-projects.
- Objective 3 - Evaluate (i) the functioning of DEG, and (ii) the value-added of DEG (in particular in the TA framework on ESMS).

1.4 Purpose of this Report

This short-form Report summarises the evaluation visit to the Case Study FI: Multifin Panama.

The Case Studies have been selected in line with agreed criteria, so that they cover a mix of regions (Africa, Latin America, Asia and Europe), a balance of clients with E&S risk categories A (high risk) and B (medium risk), a mix of FIs and PEFs, and a focus on clients that work with SMEs.

Multibank was selected as a Case Study on the basis that it is a FI which DEG has assigned as a category B E&S risk (i.e. its sector portfolio overall is considered by DEG as medium-risk), operating in a country where national E&S regulations are increasingly being enforced but where very few national banks yet have a fully implemented ESMS in place.

Multibank received Technical Assistance (TA) from DEG on the design and implementation of its Environmental and Social Management System (ESMS) in 2013 and 2014.

This Case Study included a review of relevant documents (listed in *Appendix 1*), phone calls with the TA consultant and meetings at Multibank offices in Panama with those leading the implementation of the ESMS, and with several loan officers at head office and in one branch to get feedback on the ESMS concepts. In addition, visits were carried out to three clients of Multibank to assess E&S risks, impacts and opportunities at the sub-project level. A list of meetings and site visits is provided in *Appendix 2*.

2. Background on Country and Client

2.1 The Country: Panama

Panama is a small country in Central America with a population of 3.9 million in 2015. Over the past decade, Panama has been one of the fastest growing economies in Latin America (second only to Chile) and worldwide. Average annual growth was 7.2% between 2001 and 2013, more than double the regional average. From 2014 this fell slightly to below 6% but growth is now expected to continue at above 6% pa to 2018. Inflation is low at less than 0.1% pa.

The economy is relatively sophisticated and dominated by financial services with a large international banking sector, construction, agriculture, fisheries and forestry, light industry and increasingly tourism and services associated with the Panama Canal. While recent prosperity has had more impact in reducing inequalities than in other parts of Central America, there are still remote rural areas where subsistence farmers and Indigenous Peoples (IPs) experience extreme poverty and limited access to basic needs.

There is an increasingly strong culture of enforcement of E&S regulations in Panama. Separate permits are required for water abstraction, toxic solid waste handling and disposal, dangerous liquid wastes, incineration of solid waste, water and waste water treatments, and oil/chemical products. Unlike many other countries in Central America the National Agency for Environmental Management (ANAM) has been successful in imposing meaningful fines (US\$3.9m by 2012). There is a national requirement for Environmental Impact Assessment (EIA) and the preparation of an Environmental Impact Statement (EIS) for projects in the agriculture, fishing, food and drink processing, mining, textiles, wood and paper, recycling, energy, construction, tourism and waste disposal sectors. There are three categories of EIS and – depending on their category – a requirement for public hearings and surveys to inform the

community. An Environmental Management Plan identifies actions to mitigate, monitor and compensate for potential negative environmental impacts.

The main gaps relative to an IFC-compliant Environmental & Social Impact Assessment (ESIA) are the aspects of community impacts, stakeholder engagement and grievance mechanisms. In a few cases, green NGOs have highlighted cases where IFC Performance Standards have not been met including a high profile hydroelectric dam involving resettlement and displacement of Indigenous Peoples.

Investment in renewable energy (RES) has been encouraged in Panama with targets for RES production, and tax incentives and feed-in tariffs for commercial producers. However, off-grid RES production for own use is currently limited to 0.5 MW, with no opportunities to sell excess generation into the grid.

2.2 The Client: Multifin

Multibank is a mid-sized bank and the third largest of the national banks operating in Panama with an estimated market share of about 4.5% of loans. It is owned by the Multifin Holding, which remains largely family-owned (80.8%). The bank has some 1,400 employees with 28 branches in Panama. The Multifin group includes commercial, corporate and international banking, leasing and factoring, and activities associated with the Colon Free Trade Zone. Multibank is also starting to expand international lending into Peru, Ecuador, Costa Rica and elsewhere in Central America.

Since 2013, DEG has invested USD33m in Multifin Holdings, initially as a senior loan of USD15m which was then converted, with an injection of USD15m new capital into a 7% equity stake. A further USD3m of capital was considered and approved in 2016. In 2014, Multibank also secured financing from another Development Finance Institution (IFC) which provided an USD40m green credit line for SMEs and projects which seek to address climate change.

Multibank's portfolio is concentrated mainly in low and medium risk E&S sectors including: agriculture, fisheries and forestry (30%); commerce (22%); services (22%); construction (13%); and financial services (13%). The portfolio is dominated by SMEs (<USD15m turnover), with the 20 largest clients accounting for only 11% of loans. Three quarters of Multibank's clients in 2015 were categorised as low risk (77% in both 2014 and 2015) whilst most of the remainder are medium risk (22% in 2014 falling to 21% in 2015).

For the first quarter of 2016, 557 loans have been assessed of which 414 are categorised as low E&S risk, 141 are medium E&S risk and two are high risk, both in the industry sector. Neither of these projects involve land acquisition or resettlement issues.

Discussions with independent environmental consultants confirmed Multibank's view that it is one of very few Panamanian banks with a fully-implemented ESMS and could, therefore, be a leader in the domestic financial market in E&S for SMEs.

3. Results and Analysis

This section provides a summary of the key results and analysis from the Case Study. The results are presented against the specific objectives of the assignment as outlined in *Box 1* above.

3.1 Objective 1 - Evaluate the Implementation and Practical Use of ESMS by DEG's Clients

3.1.1 Compliance with DEG E&S Requirements

Table 1 provides an assessment of the progress in relation to implementation of DEG's E&S requirements by Multibank.

Since the Partner Agreement was signed in 2013, the client has designed an ESMS, with support from TA provided by DEG which has been fully implemented across all Group activities including, corporate, commercial banking, SME financing, factoring and leasing.

The assessment after the final TA visit was that Multibank was performing satisfactorily on all five levels: organisational buy-in; E&S assessment; monitoring of portfolio/analysis; training and internal

communication; and documentation. The Environmental and Social Action Plan (ESAP), attached to the Partner Agreement, had clear actions and timescales and these have been fully implemented.

Table 1 - Assessment of the implementation of E&S requirements by Multibank

E&S requirements in Partner Agreement	Compliance	Assessment of Implementation
At all times comply with the DEG Environmental and Social Requirements.	✓	A signed policy has been in place since Jan 2014 which includes all aspects of DEG ESMS requirements (policy, Exclusion List, categorisation, risk assessment, conditions in contracts, monitoring and staffing).
Multi Fin and its subsidiaries should maintain and continuously improve an ESMS in accordance with the timelines agreed in the ESAP. (Annex 2 to Shareholders Agreement)	✓	An ESMS screening process with different levels of due diligence for three categories of risk was agreed in Oct 2013, rolled out during the pilot phase and has now been implemented since 2014. The ESMS initially applied to Panama only but, since mid-2016, was extended to international banking. Since late 2015 additional independent E&S resources have been available for due diligence against IFC standards, EISs for high risk projects and specialised training. Opportunities for green investments are now being identified through the ESMS assessment with existing clients.
Appoint a member of senior management to be responsible for all E&S issues and a suitably trained E&S compliance officer. Promptly inform DEG if they are replaced.	✓	The E&S risk committee reports to the General Manager (GM). A suitably-qualified E&S coordinator reports to both the GM and to the VP for Human Resources (training and staff development) and has been in place throughout. He has a team of two suitably experienced E&S officers who review all E&S assessments prepared by loan officers in corporate, commercial, construction and international sections.
Monitor compliance with DEG E&S requirements through a designated officer	✓	The E&S coordinator reports on progress to the E&S Risk Management Committee on numbers of projects reviewed, their risk categories and size, training delivered and other developments on an annual basis.
Neither the Company nor any of its Subsidiaries performs any of the Excluded Activities as set out in Annex 3	✓	Multibank uses a bespoke Exclusion List that has been adapted to cover the DEG exclusion categories. No loans have been granted for Excluded Activities although the analysis of clients for 2015/6 suggests at least one client with interests in casinos.

The components of the ESMS for Multibank include the following:

- A policy laying out the ESMS aims, procedures, Exclusion List and procedures for due diligence, monitoring and reporting;
- The Exclusion List covers all activities on the DEG Exclusion List (except gambling). In addition, it excludes production or trade in wood products from forests without a sustainable management plan or plantation projects that require the removal of non-degraded natural forest areas. The List also excludes production, trade, storage or transport of significant volumes of hazardous chemicals. Multibank adapted its Exclusion List before first disbursement, as required, and the list was approved by DEG;
- Credit procedures that integrate E&S risk management based on an Excel spreadsheet tool for categorising risks based on E&S activities, management and financial exposure, which then dictates the level of due diligence for E&S risks required. Detailed sectoral questionnaires are available for projects in the agricultural, livestock and fisheries, forestry, construction and industry sectors. IFC documents providing more information on potential risks by sector are embedded in the form;
- A requirement that the E&S assessment for all projects is signed off by the E&S team and a summary of E&S issues and recommendations is included in the report to the Investment Committee;

- Provision for a standard E&S condition to be included in the loan agreement requiring compliance with permissions and licenses from the National Agency for Environmental Management (ANAM), local government and other relevant agencies (health, labour, sectoral ministries etc.).

3.1.2 Management Commitment

The most important factor contributing to the good progress in implementation of the ESMS has been the strong management commitment to E&S risk management at the bank. Multibank senior management is strongly committed to Corporate Social Responsibility (CSR) and the bank is an active member of the United Nations Global Compact and has made visible commitments to human rights and labour standards, environmental standards and anti-corruption. Multibank submits regular reports which are available at its website.

Multibank is also an active member of SumaRSE – Panama’s leading CSR organisation and local chapter of the UN Global Compact and World Business Council for Sustainable Development. The bank has a strong social responsibility programme through a family foundation which invests USD0.3m pa in community and social projects. The bank also supports events such as World Earth Day.

The Management Board (MB) gave the go-ahead for the ESMS strategy in August 2012 and the Environmental and Social Committee signed off the ESMS developed with TA consultants in July 2013. The Board reviews progress with the ESMS at its quarterly meetings. Multibank considers high E&S standards not only as a risk and reputational issue but also part of their unique selling point as one of very few Panamanian banks known to rigorously apply an ESMS.

“Our business model is part of a framework of financial responsibility, seeking “due diligence” to mitigate, remediate and repair any potential negative impact of our activities In terms of our social performance, this year we continued our actions to strengthen and consolidate our support to small and medium-sized enterprises.... On the environmental side we have also maintained our commitment, ensuring that social and environmental aspects receive full attention in project financing. 2015 was a year of great success since we celebrated 25 years of financial experience in which we have managed to rank as the third bank in total assets with Panamanian capital” (Isaac Btsh, Chief Executive Officer, Communication on Progress, Multibank, 2015).

3.1.3 Implementation of ESMS

The ESMS was piloted in 2013 and expected to go live in April 2014. It was effectively applied to all commercial and SME clients from early 2014. The ESMS now applies to Multifin’s commercial, corporate, international, construction banking operations and to activities in the Zona Libre de Colón and Multibank’s factoring and leasing activities.

The E&S team reports that, despite early reservations, there is now no resistance from loan officers (30+ arranged in commercial, construction and international teams) or from credit analysts (about 10). For many loan officers, their portfolio is dominated by low risk projects (SMEs and low E&S risk categories), which means that they only fill in the classification sheet. This takes about 5 minutes for existing clients or in sectors where the permit and license requirements are well known.

For high risk projects and all construction projects, a site visit is also required and this increases the time to complete the assessment to up to four hours or even a day (e.g. for projects in the extreme West of Panama). Multibank staff estimate that 90% of all industrial clients are visited by the financial analyst and an E&S officer. When the E&S team requires independent advice they can call on external consultants (such as DELCA Environmental Consulting).

Quality control is enforced by the E&S team: no proposal can go to the Investment Committee without a signed-off E&S assessment (high and medium risk) or categorisation form (low risk). The E&S team reviews an estimated 20 international and 40 local projects each month. All reports include a paragraph with E&S conclusions and recommendations.

The ESMS also includes an Action Plan template for E&S risk mitigation but no action plan has so far been required for a project that has been through the system since 2014, although an ESAP is in place for a high risk project (see a windfarm client in Box 5) co-financed with other banks.

The TA consultants audited the components of the ESMS in April 2014 and found it to be working well. The audit confirmed that assessments had been completed appropriately. The only outstanding issue was the inclusion of a legally-binding E&S clause in contracts. All clients are required to meet national environmental standards.

During the site visits for this evaluation a DELCA consultant accompanied the team and carried out three due diligence audits against IFC PS. This is understood to be part of a monitoring process to identify any gaps or room for improvement amongst existing clients that are meeting national legal and permitting requirements.

The ESMS was designed to be flexible enough to also apply to Multibank's international lending and from May 2016 applies to lending in Colombia, Ecuador, Peru and other countries in Central America as applicable. A recently-appointed E&S team officer is allocated to support implementation of ESMS to these projects. The team recognises that standards and processes for licensing and EIA will be different in these countries and that international projects may be more complex and are also likely to involve higher E&S risk categories and sectors such as industry (textiles, food processing, recycling, larger scale agricultural production, coffee) and larger construction projects.

3.1.4 Resources for ESMS

The overall budget for implementation of the ESMS in 2016 was USD 48,000 for staff costs and training. A suitably-qualified E&S manager, with a professional background in agro-engineering has been in place since the ESMS system was first introduced. He is supported by two E&S officers with strong academic qualifications and experience of local and international banking sectors. Their experience with E&S issues has been gained through on-the-job training. There are no further plans to expand the team. The E&S team reports to the Assistant Vice President (VP) for credit management. The E&S manager also reports to the VP for Human Resources and is responsible for training and professional development.

During the last year the team have taken part in an international Environmental Management workshop for the financial sector and attended an International Conference "Environmental and Social Management for Industry".

Initially, training for credit officers, analysts and branch and department managers was provided through the TA consultants with 89% of all relevant staff trained in 2014. Training presentations covered the relevance of sustainable finance for the financial sector, Multibank's ESMS, a case on "E&S risk identification and evaluation" and a factsheet on E&S Risk Management in the hydro energy sector.

Since 2014, the E&S coordinator has run induction training for all relevant staff and refresher training was provided in 2015. During 2016, a new induction course for those involved with international projects is being developed in recognition that these projects will be more complex and involve different environmental permitting processes and standards. 12.5% of the overall ESMS budget in 2016 is for training internal staff.

Since September 2015, backstopping support has also been available on a call-off basis from a pool of four external E&S consultancies. So far the team have worked with DELCA Environmental Consultants who have expertise in the construction sector and in carrying out due diligence against IFC Performance Standards. DELCA have provided support on reviewing E&S assessments, carrying out due diligence monitoring for existing loans and delivering training.

From June 2016, Multibank identified the opportunity to work with its key client sectors to raise their E&S performance and increase their own reputation and portfolio of green investments. Multibank has started to provide external training seminars in the construction sector delivered by the E&S manager with DELCA consultants. The first two half day seminars on sustainable construction were attended by nearly 100 client participants, illustrating the significant level of interest in E&S. The E&S training of clients/client organisations may be a future consideration for other FIs. Currently 30% of the ESMS budget is allocated for client training.

3.1.5 E&S Risk Categorisation

E&S risk categorisation is based on ANAM categories (I, II and III covering 33 activity groups) together with the size of the loan requested. The spreadsheet automatically generates a heat map identifying the overall risk level (low, medium or high) and the additional reports and due diligence questionnaires that the loan officer will need to complete.

In August 2014, the ESMS was reviewed by Multibank and minor adjustments were made at the request of the Risk Department. Initially there had been three different levels of financial exposure in the risk categorisation (<USD500k, USD500-1000k, >USD1000k) but this was reduced to two (<USD500k and >USD500k) changing the risk matrix from a 3x3 to a 3x2. This effectively means that only category III E&S risk projects over USD500k investment are considered high risk, but these make up a very small percentage of Multibank's current portfolio.

3.1.6 E&S Monitoring and Reporting

Multibank regularly reports on its environmental and social performance to external stakeholders through its Communication on Progress to the Global Reporting Initiative (GRI), of which it has been a member since 2003. The reports are available online and have been shared with DEG. The report outlines Multibank's social and environmental goals and performance and describes the ESMS and breakdown of loans by sector. The E&S team reports annually (PowerPoint presentation) to the bank's Environmental and Social Risk Management Committee on progress, the breakdown of the portfolio and training activities.

The ESMS is communicated internally through the bank's internal product communication and through lectures and trainings to employees involved in the process.

Multibank carries out general monitoring visits to higher risk clients (category A and construction) on an annual basis, and clients would be expected to report to Multibank if there were a serious environmental incident or labour issue, but this has not been required.

The E&S coordinator reported to DEG and another DFI in a single report on its E&S performance for 2015 in 2016.

3.2 Objective 2 - Evaluate the Effectiveness and Impact of ESMS at (i) Clients; (ii) Sub-projects

3.2.1 Effectiveness and Impact at the Client

Senior management has been committed to raising its own and clients' environmental and social performance since before DEG's involvement and is still committed to continuous improvement. The E&S policy makes it clear that in addition to focusing on prevention which favours the environment (meeting national legislative requirements), the role of the ESMS is also to undertake initiatives which lead to greater environmental responsibility and to favour development and uptake of technologies which respect the environment. The ESMS is expected to help promote a growth in financial products with a positive impact on the environment and / or society in general and developing new business opportunities tied to the E&S issues faced by Multibank's clients as key objectives of its policy.

In the first phase from early 2014, the ESMS has been

Box 2: The International Banking Unit is preparing to manage Environmental and Social Risks

Implementación de Política

Banca Internacional se prepara para sus operaciones de Gestión de Riesgo Ambiental y Social

A partir del 1º de Junio del 2016, inicia la inclusión del portafolio de Banca Internacional, en el fiel cumplimiento de la política y debidos procedimientos de la Gestión de Riesgo Ambiental y Social, lo cual es de especial interés de nuestros corresponsales y las empresas calificadoras.

Este departamento procurará que se cumplan los procesos que van encaminados a impulsar el desarrollo sostenible, con parámetros de calidad y resguardo del entorno ambiental, como social en nuestras operaciones, fortaleciendo así la imagen y reputación de Multibank, beneficiando las nuevas iniciativas de negocios, que nos permitan crecer de manera más competitiva.

Los documentos están disponibles en la sección de arquitectura Multibank, para el acceso de los colaboradores.

[Clic aquí](#)

applied to all activities in Panama and focussed on compliance with national legislation as a risk management issue. The E&S team consider that this has contributed to the bank's investment rating BBB- (Fitch 2015) and AA nationally, and low Non-Performing Loans ratio (1%). Having a strong ESMS in place has also helped Multibank develop its corporate environmental and social practices and improved its own performance in recycling and waste management, energy efficiency and H&S. These are specific, tangible business benefits which help to illustrate the positive impact of ESMS.

The evaluation visit suggests that Multibank is now in a second phase of raising standards and applying its ESMS outside Panama. From May 2016, standards have also applied to its international banking division (see Box 2). Senior management has ensured the E&S team and credit analysts have the additional resources they need for more complex projects through access to external E&S consultants and further training.

There is now a growing focus on working with existing clients to help them reach higher E&S standards (e.g. water, energy and waste efficiency measures in the construction sector) and investing in renewables. Since 2014, Multibank has been working with another DFI on a credit line to promote activities to address climate change in SMEs. Reportedly, having an implemented ESMS made it easier to attract such finance from another DFI.

3.2.2 Effectiveness and Impact at Sub-Projects

The immediate benefits to Multibank clients from the ESMS requirements are in ensuring that they comply with national laws, are able to secure licenses to operate and that they avoid potential fines and/or temporary or permanent suspension of activity. There have been no cases of clients being fined or having their licenses removed by ANAM since the ESMS has been in place. However, it is still difficult to quantify these benefits as, in theory, clients should have met these standards even if there was no ESMS in place. However, Multibank is judged to be more rigorous in its requirements than other domestic banks and may have had a role in pushing clients to go a little further. In addition, as Multibank has worked more closely with clients on ESMS, it has started to identify opportunities for green investments and helped to guide clients to other banking products such as green loans for renewables and resource efficiency provided from credit lines with IFC. Unfortunately we were unable to collect data on how many loans have so far been made under this facility.

The evaluation visit included site visits to three Multibank clients. Boxes 3, 4 and 5 provide a summary of the findings for a retrofit of solar photovoltaic panels on a supermarket (low E&S risk); a modern production line for juice processing (medium risk) and a large onshore wind farm (high risk). Overall, the companies were observed to be operating to appropriate standards of E&S management, to have all the necessary licenses and permits in place and to be complying with national E&S regulations. Management teams for all three projects showed a high level of environmental and social awareness and an interest in meeting the required standards. Good relationships with the bank and potential for future green and social investments are a wider impact of the ESMS approach that Multibank has applied, although difficult to quantify. Two of the three projects have involved investment in renewables with clear financial benefits to the clients and for reducing climate impacts. Although these environmental benefits cannot be directly attributed to having an ESMS in place, they are indirectly related to increased awareness of Multibank's loan officers and E&S team and the bank's success in securing another DFI's credit lines for climate mitigation investments.

Box 3 – A fruit juice factory (medium risk): Effective ESMS leading on to new opportunities

The visit to this factory is a good example of a medium risk project appropriately managed according to agreed E&S plans. The ESMS due diligence process confirmed that opportunities for appropriate water treatment and upgrading old boilers have been taken. Ongoing site visits by Multibank officers continue to identify opportunities for further E&S improvements such as capturing the value of solid waste residues and for investment in renewable energy production to feed into the grid.

This orange and pineapple fruit processing plant is located in western Panama. The factory now processes about 8,500 tonnes of fruit from its own plantations a year during a seven month season (November to May). They produce high quality not-from-concentrate (NFC) fruit juice and citric acid with a total turnover of about USD3m pa. Produce is packaged in wholesale tetrapaks and shipped to local retailers or exporters. The factory has 14 full time employees, rising to 26 during full season and this provides welcome off-farm employment in an isolated rural area.

Multibank has provided a 6 year loan of USD340, 000 for a state of the art plant to increase processing capacity and efficiency. Since this was an existing factory, the overall project categorisation was medium risk reflecting the low financial exposure and medium E&S risk. A general E&S due diligence assessment was carried out and signed off by the E&S team and the loan approved in late 2015. The company has the necessary permits in place on the basis of an independent environmental report on environmental mitigation measures carried out in 2012. The report covers



the potential risks and mitigation measures for managing solid waste disposal (fruit residues and plastics), water effluent treatment, fuel and oil storage, health and safety, air and noise impacts. The three water treatment ponds are appropriate to settlement of effluent containing nutrients but no chemicals. Residues are dried during the off season and then used on the plantation as fertiliser. The report included 16 mitigation measures and was submitted to the District Authority to secure the necessary permits. The factory is also HACCP (Hazard Analysis & Critical Control Points) certified. The benefits solely as a result of having an ESMS in place are difficult to quantify, since the business would have met national standards even if

the loan had been provided by another local bank.

However, the site visit illustrated that the owner and manager are keen to keep improving their environmental performance and would look to Multibank for further loans to do this. During the site visit the E&S team discussed opportunities for further environmental and energy efficiency improvements. The owner expressed interest in improving solid waste management to increase the value of waste as by-products or possibly through co-generation and in installing solar panels for off-grid electricity production during the dry season which also coincides with peak processing times. Grid electricity in this rural area is reported to sometimes be unreliable necessitating a back-up generator. Such future investments would reduce CO₂ emissions, reduce risks of business and could generate additional cash revenues for the business when Panama renewables law allows for small producers to feed electricity back into the grid.



Box 4 –Windfarm (High risk): Applying IFC PS allowed a major national project to go ahead without any opposition from the local community

This is an example of a well-managed high risk project with major benefits to the Panamanian economy in terms of renewable energy produced and CO₂ emissions avoided. Multibank is one of a consortium of banks providing financing and was not responsible for E&S due diligence on the overall project. However, Multibank's assessment of the EIA prepared by the client and ongoing monitoring shows that E&S risks are being managed appropriately. The project demonstrates to lenders and operators the benefits of applying international E&S standards which have helped to minimise potential negative social and environmental impacts and secure the support of the local community for a project that might otherwise have met local resistance. This experience will be useful to Multibank in carrying out E&S due diligence on larger and higher E&S risk projects through its International Banking business. In future the developers are interested in developing carbon credit trading to increase profitability and also investing in Phase IV although plans are currently constrained by low global oil prices.



The windfarm is the first of a four phase project in the West of Panama which, when completed, will be the largest in Central America and provide 10% of Panama's energy.

Multibank was one of a syndicate of five local and international banks financing Phase I with a loan of USD10m (13%) of a total of USD74.5 m. The Multibank investment part-financed the installation of 22 Wind Turbine Generators (WTGs) with total capacity of 55 MW. Following the success of Phase I, other banks and lenders have gone on to lend for Phases II and III which together add a further 108 WTGs at a cost of USD570m. Phase I produces electricity fed into the grid under an agreed Power Purchase Agreement (PPA). The area is a fast growing agricultural production and tourism area with a need for reliable electricity supply. Phase I provides the equivalent of supply for 20,000 homes. Outside the windy season output can vary from 35 to 3000 MWh a day and is sold on the spot market, currently about 50% of the PPA.

The project's high E&S risk (III) and Multibank's high financial exposure make this one of the bank's high risk corporate projects. An EIA for the whole site (phases I to IV) was commissioned by developers and submitted to Environment and Natural Resources Ministry (ANAM) standards. Multibank was not directly involved in the EIA for the project but has since commissioned its external consultants to undertake due diligence monitoring against IFC standards to ensure there are no gaps in E&S performance. As a co-funder for phase II, IFC has also carried out its own gap analysis to identify where additional studies would be required to meet IFC PS and this is available at their website and confirms Multibank's external consultant's view that there are no real gaps.

The windfarm was built on existing farmland, is not visible from a National Park and does not affect a high landscape value area. There were no Indigenous People on the land and no resettlement was required. 15 local landowners agreed to 25 year leases for the land for each turbine (0.55ha per site). Since landowners are still allowed to crop and graze their other land within the site there has been no net loss of livelihoods, no displacement and no conflict with the local community. The Phase I development provides about 20 jobs for local people in maintenance, security and energy trading. Operational health and safety, emergency and fire risks, and chemicals and used oil are appropriately managed according to agreed plans.

The need for a Bird and Bat Monitoring Plan to assess the impacts on bird flight paths and biodiversity was identified by ANAM and additional studies were undertaken by an independent environmental consultancy which identified 93 species of birds and developed an Impact Index which is monitored regularly with annual reporting to ANAM. Annual site monitoring investigations were underway during the case study visit and the experts confirmed that there has been very limited impact on mammals and very few bird hits recorded.

Box 5: A Supermarket with Solar PV (low risk) – Responding to Green Investment Opportunities

This client is an example of Multibank’s ESMS approach moving beyond simply implementing an ESMS to actively seeking opportunities to help its clients improve their environmental performance. The loan was for a solar array on one of the company’s three supermarkets. The opportunity was identified by bank officers working closely with a long established client. Given the success of the project the borrowers are now keen to invest in solar panels on their two other sites but are awaiting changes in Panama’s Solar Power Law to raise the thresholds for prosumer capacity and allow them to sell excess electricity into the grid at agreed feed-in-tariffs. The client is a family-run supermarket chain with three stores, all in Panama. The family has been a Multibank client since 1995 and in 2015 a loan of USD1.1m was approved for a 500 KW solar array, back-up diesel generator and structural improvements to the roof to support solar panels and access. The project was a retrofit on an existing roof and so categorised as low E&S risk and high financial exposure (>USD500k) resulting in an overall low risk categorisation by Multibank. As part of the E&S due diligence process the credit officer and E&S team confirmed that the client complies with national legislation in its wider operations and that it has in place the necessary permits for Occupational Health and Safety, hygiene, liquid waste (septic tank), solid waste (organic and packaging collected and sorted by a local waste management company) and labour and working conditions. The client has an HR policy which includes E&S as a part of regular staff training.



The site visit showed that the senior management team at the client is very interested in improving their environmental and social performance and have a well-developed programme with the local community including supporting youth clubs and activities in local schools. The Multibank loan has resulted in environmental improvements since the solar panels were installed and have so far reduced the average monthly electricity bill by 44% (an estimated financial saving of USD14,000 pcm) with a payback period of about 5 years. During the first eight months the panels have been in operation they have generated 558 MWh of electricity equivalent to savings of 295t CO₂ and reduced the client’s reliance on the national grid which can be unreliable during the dry season. As soon as national energy laws allow, the clients report that they will be looking for further Multibank support to make similar green investments on their other two sites



Solar panels and Digital display showing actual capacity (KW), energy production (Kwh) and CO2 emissions avoided

As part of the E&S due diligence process the credit officer and E&S team confirmed that the client complies with national legislation in its wider operations and that it has in place the necessary permits for Occupational Health and Safety, hygiene, liquid waste (septic tank), solid waste (organic and packaging collected and sorted by a local waste management company) and labour and working conditions. The client has an HR policy which includes E&S as a part of regular staff training.

Solar panels and Digital display showing actual capacity (KW), energy production (Kwh) and CO2 emissions avoided

3.3 Objective 3 - Evaluate (i) the Functioning of DEG, and (ii) the Value-Added of DEG (in Particular in the TA Framework on ESMS)

The client had good feedback overall on the TA support from DEG. At the time of the planning of the loan, the E&S requirements and the role of TA consultants were explained clearly and understood by Multibank and the E&S Risk Committee was closely involved in developing and approving the policy and the ESMS system. Communications with DEG are reported to have been good and the E&S team have always felt confident that DEG would be able to help and provide advice on any problems encountered. The DEG E&S risk rating is appropriate to Multibank’s current portfolio of projects.

In June 2016, an ESMS report was prepared and submitted for also another DFI covering ESMS processes and budget allocations for 2016. This seems to be the first report to DEG despite the ESMS having been in place for two and a half years. The E&S team felt that some of the process questions are very open and they were not entirely clear what was required. Some feedback and guidance on what is expected by DEG (e.g. with examples) would be appreciated.

The team are also starting to carry out some due diligence assessments of existing clients with their external E&S consultants. They report that it would be useful to have an assessment of national requirements against IFC standards to identify where there may be gaps. This resource may also be useful to other banks in Panama with whom DEG is working.

Multibank would also be interested in sharing experience and learning from other IFC-compliant banks in the Central America region and this could include helping to support the other five clients (FIs and PEFs) that DEG works with in Panama, particularly if they are not direct competitors in the domestic market.

3.3.1 Value-Added of DEG

DEG provided the impetus to develop a formal ESMS which has helped with management of a number of potential risks in the market.

The TA provided by DEG to support the design and implementation of the ESMS started with appointment of Steward Redqueen (Netherlands) in 2013 and a five phase TA programme was implemented during 2013/14 including the design of the ESMS with the E&S risk committee. The consultant returned to Multibank for training of 80 staff in April 2014. The consultants worked alongside the E&S coordinator who has been in place throughout the process.

Overall there was very good feedback from the client on the work of the TA consultant. The TA consultants were reported to have been very helpful in providing clear parameters and the knowledge for developing the ESMS. Excel spreadsheets developed by the consultants are now used by loan officers and copies stored in a central filing system accessible to the E&S team. This system is felt to be practical and easy to use and highly relevant to the way the bank operates and its portfolio of SMEs and low and medium risk projects.

The training provided was good at covering E&S risks, describing the ESMS and identifying opportunities for green investments. At the end of the first phase of implementation – which has very much focused on compliance with national standards – the E&S team now feel that the focus of support materials (embedded in the Excel spreadsheets) and the training was too focused on IFC performance standards, which are only applicable to a handful of clients in the bank's portfolio. During the early stages it would have been helpful to have more information on Panamanian rather than international standards. Now that Multibank is working more with international clients it would also be useful to have access to this information for other Latin American countries if it is available.

4. Conclusions and Lessons Learned

Based on the analysis that is summarised in Section 3, this section lists the conclusions and lessons learned for this case study.

Objective 1 - Evaluate the implementation and practical use of ESMS by DEG's clients

- **Senior management is committed** and has allocated the E&S function sufficient staff, budget, external support (consultancies) and responsibility to ensure the ESMS is robustly implemented. No proposals can now go to the Investment Committee for approval without an E&S assessment signed off by an E&S officer.
- A clear understanding of what is required and the ability to commit resources to it have been considerable factors in the success of the ESMS and should be recognised as a critical factor when considering loans to other DEG clients.
- **An Excel-based screening tool has been fully integrated from the earliest stages of the credit assessment process** – Steward Redqueen's Excel tool is being applied to the whole commercial portfolio from the first enquiry stage. The tailored risk categorisation process is easy to use and for much of the bank's portfolio of existing clients and low risk projects takes about five minutes to complete. Buy-in from loan officers and risk analysts is therefore high. DEG should ensure that ESMS systems developed are proportionate to risk and tailored to a client's portfolio.
- **Reviewing and modifying tools after they have been fully tested.** After the pilot phase Multibank reviewed its risk categorisation so that there are now only two financial exposure thresholds (effectively a 3x2 risk matrix) and few high risk projects. This is appropriate to the portfolio. The focus during the first phase of implementation has been on compliance with national standards and permitting requirements and this experience is common in countries without a mature regulatory and enforcement environment. For future TA it would make sense to focus first on national standards and then IFC standards. TA consultants could help in developing the supporting materials. Sharing resources and experience between other DEG-supported FIs and PEFs in a region would also be helpful.
- **Recruitment of E&S officers.** E&S officers with banking experience are not easy to recruit in Central America but Multibank has successfully expanded its team by appointing an experienced financial analyst and providing on-the-job E&S training. This approach could also be applicable to other DEG clients facing difficulties in recruiting experienced E&S officers.
- **Access to external resources.** Multibank has now appointed local external E&S consultants who can assist the E&S team with independent assessments, due diligence monitoring and specialist training. This is a valuable resource for the second phase of implementation for this bank, giving the team confidence to press towards IFC PS for high risk projects and to identify opportunities for clients to make green investments. DEG officers could suggest such an approach with senior management during loan negotiations or where clients face difficulties recruiting an experienced E&S coordinator.

Objective 2 - Evaluate the effectiveness and impact of ESMS at (i) clients; (ii) sub-projects.

- **Corporate benefits of an ESMS.** Effective implementation of the ESMS has helped access other DFI funds (IFC) and is certainly considered a USP in the Panamanian market where other national banks are less advanced. The ESMS due diligence approach which includes visits to all construction and high risk clients also provides in-depth knowledge of standards in key portfolio sectors and is helping bank staff identify opportunities for new products to support E&S improvements. As a result, Multibank is starting to identify key sectors within its portfolio – such as construction – where its clients could be assisted to improve their performance.
- **Environmental and social investment opportunities.** IFC is also an investor in Multibank providing a line of credit for climate mitigation and SMEs. The clients visited were able to point to

financial savings from clean technologies and energy investments and also social corporate responsibility actions. Loan officers are also actively looking for opportunities to improve resource efficiency and support renewables (e.g. retrofitting solar panels, wind energy, water treatment etc.). The evaluation visit confirmed that there are significant opportunities for renewables investments in Panama which would add environmental value through the portfolio and that clients are keen to do this where the legislative and market incentives are supportive.

Objective 3 - Evaluate (i) the functioning of DEG, and (ii) the value-added of DEG (in particular in the TA framework on ESMS).

- **TA consultancy** - This case study shows that it would be very helpful during the first phase of ESMS implementation in a country where legislative enforcement is quite recent to focus resources (such as embedded guidance documents) and training provided by TA consultants on national standards rather than the current focus on IFC standards.
- **Clarification of E&S reporting requirements** - Multibank has provided one annual E&S report to DEG which is also used for reporting to IFC. This is the one area where the E&S team did not seem clear on what the requirements were. Even though the report was not in DEG format the team had received no feedback. DEG should make reporting requirements clearer and follow up to ensure that reports are produced which are useful to both DEG and the client.
- **Future support from DEG:** Opportunities to exchange lessons and good practice with other E&S coordinators in the region would be welcomed. Multibank would also find it very helpful to have access to information on E&S standards in other countries that it is starting to do business in (Colombia, Ecuador, Peru and Costa Rica) and thinks that other companies may also find it useful to have a gap analysis between national and IFC standards. There is a role for DEG in providing such materials and/or including more on these requests in the scope of work for the TA.