

## Introduction

IN1. IFC is committed to developing the financial sector in emerging markets through institution building, use of innovative financial products, and mobilization, with a special focus on medium- and small-scale enterprises. To deliver on this commitment in a manner consistent with its strategic focus on sustainable development, IFC has adopted environmental and social (E&S) risk management policies and procedures. These include a risk-based approach to the assessment of E&S risks and impacts associated with the portfolio of its financial intermediary (FIs)<sup>IN1</sup> clients and the determination of associated E&S requirements for various asset classes<sup>IN2</sup> supported by IFC financing. A key aspect of IFC's approach to E&S risk management in the FI sector is to ensure that where FIs provide project or long-term (over 36 months) corporate finance to a borrower/investee to support a business activity that may include a) involuntary resettlement,<sup>IN3</sup> b) risk of adverse impacts on Indigenous Peoples, c) significant risks to or impacts on the environment, community health and safety, biodiversity, cultural heritage or d) significant Occupational Health and Safety risks (collectively, Higher Risk transactions<sup>IN4</sup>), the FI will appropriately assess and require its clients to mitigate these risks and impacts in line with the IFC Performance Standards<sup>IN5</sup>. In certain jurisdictions this list of activities of significant E&S risks and impacts will be supplemented by additional activities that are known to be of significant risk because of systemic issues in that particular jurisdiction.

IN2. The objectives of this Interpretation Note (IN) are to; (i) explain how IFC's E&S requirements stemming from the Sustainability Policy and Performance Standards apply to the activities and operations of FIs receiving IFC's support; (ii) guide the FIs in making necessary adjustments and enhancements in their operations to help them meet these requirements; and (iii) provide guidance to the FIs on reporting to IFC.

IN3. IFC evaluates all E&S risks associated with activities of FI clients as well as clients' capacity and commitment to manage those risks. The results of this assessment help IFC select suitable clients and define the type of financial products to be offered.

IN4. IFC does not undertake new investments with existing clients that have less than satisfactory E&S performance. IFC will not normally undertake new investments with existing clients that have partially unsatisfactory E&S performance. Any exception to this guidance requires approval of IFC's Chief Operating Officer (COO) or equivalent. In the case of clients with partially unsatisfactory E&S performance IFC will only undertake new investments if the FI client has demonstrated progress and commitment toward improvement. In such cases, IFC communicates the evidence of this progress and commitment when seeking project approval from IFC's Board.

IN5. This IN includes three sections. Section I provides a brief overview of the E&S risks associated with the lending/investment<sup>IN6</sup> activities of FIs. Section II explains how IFC's Sustainability Framework<sup>IN7</sup> is applicable to FIs. Section III addresses the FI's role and responsibilities in managing the E&S risks associated with its lending/investment activities in accordance with Performance Standard 1.

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<sup>IN1</sup>For the purpose of this Interpretation Note, the term "financial intermediary," or FI, refers to a variety of financial institutions such as universal banks, investment banks, private equity funds, venture capital funds, microfinance institutions, and leasing and insurance companies, among others.

<sup>IN2</sup>The asset class approach does not apply to Risk Sharing Facilities nor to short term Trade Finance products offered by IFC

<sup>IN3</sup>Including physical and economic displacement.

<sup>IN4</sup>Higher Risk Transactions are these sub-projects that would be considered category A or B projects if financed directly by IFC.

<sup>IN5</sup>For avoidance of doubt Higher Risk Transactions will be considered as restricted activities in cases of FI projects in which proceeds from IFC are used to support asset classes that are not subject to application of the Performance Standards. These restrictions will apply only to asset class(es) supported by IFC not to entire portfolio of the FI client.

<sup>IN6</sup>The terms "lending" (e.g., for banking institutions) and "investment" (e.g., for PE Funds) refer to the transactions between the FI and its clients (sub-project level for IFC).

<sup>IN7</sup>IFC's Sustainability Framework includes the Policy and Performance Standards on Environmental and Social Sustainability, and the Access to Information Policy.

IN6. References to additional resources and guidance are provided as footnotes throughout the IN. Users of this IN should also refer to other reference, guidance, and good practice materials made available by IFC through its website and FI client support portal.<sup>IN8</sup>

### I. E&S Risk in FI Lending/Investment Activities

IN7. Many FIs are exposed to some level of E&S risk through the activities of their borrowers/investees, which can represent a financial, legal, and/or reputational risk to the FIs. The E&S risks associated with the internal operations of an FI are typically limited to managing aspects related to labor and working conditions of employees, as well as ensuring the safety of employees and visitors within its premises.

IN8. The E&S risk associated with an FI's lending/investment activities depends on factors such as contextual risk<sup>IN9</sup> associated with the country and region where the FI operates and directs funding, the specific E&S circumstances associated with the borrower's/investee's<sup>IN10</sup> sector and operations, the borrowers'/investees' track record, capacity, commitment to address these risks, as well as type of financing provided by FIs among others.<sup>IN11</sup> The FI's approach to addressing these risks will depend on the existing regulatory framework, level of perceived risk, the type of financing undertaken, and the ability of the FI to obtain mitigation measures from its borrowers/investees.

IN9. Considering and integrating E&S risk within the transaction review is part of an FI's overall risk management efforts.<sup>IN12</sup> Doing so requires undertaking individual transaction screening and, where necessary, due diligence and monitoring. FIs are expected to develop and maintain sound E&S management practices through implementing an environmental and social management system (an ESMS) that is commensurate with the E&S risk profile of the portfolio supported by IFC financing. This also requires that the FI is committed to developing and maintaining the requisite organizational capacity for E&S risk management and allocating appropriate human and financial resources for this function.

### II. Application of IFC's Sustainability Framework to FIs

IN10. IFC's FI clients are engaged in a diverse range of financial activities including, but not limited to: corporate finance; project finance; operations in capital markets, lending to micro, small, and medium enterprises; trade finance; housing; and consumer finance, providing risk sharing guarantees, investing in private equity among others, each with different E&S risk profiles as well as different levels of leverage or influence. Consistent with its Sustainability Policy, IFC reviews the business activities of prospective FI clients to identify areas where the FI and IFC could be exposed to E&S and associated risks such as credit or reputational risks as a result of the borrowers/investees in the FI's portfolio and/or prospective business. The FI is required to undertake E&S risk assessment and management for its new lending/investment activities supported by IFC financing commensurate with the level of E&S risk, access to information tenor,

<sup>IN8</sup>FIRST (Financial Institutions: Resources, Solutions and Tools) for Sustainability provides information for financial institutions to learn about the benefits of E&S risk management, and how to identify and take advantage of environmental business opportunities, <https://firstforsustainability.org>.

<sup>IN9</sup>Contextual risks -from a private sector, E&S perspective – are defined as risks in the external environment [at a country, sector or sub national level] that the client does not control but which could negatively impact the ability of a project or private sector client to meet IFC's E&S requirements. Examples of contextual risks include among others land disputes as a result of internal displacement or conflict; systemic issues such as minority discrimination, lack of freedom of association, wide spread use of child labor; historical government actions related to land contamination, forced evictions, etc.

<sup>IN10</sup>The terms "borrower" and "investee" refer to the FI's clients (sub-project level for IFC).

<sup>IN11</sup>The tenor of financing influences the leverage of a FI to apply E&S requirements (particularly within the loan term) but does not change the underlying E&S risk. In the case of short term financing that is not intended to be renewed such leverage can be limited.

<sup>IN12</sup>Additional guidance for FIs on managing E&S risk in transactions is available at FIRST for Sustainability, [https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2\\_2](https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2).

and the FI's influence on borrower actions (the FI's leverage), ranging from review against IFC's Exclusion List<sup>IN13</sup> to application of the Performance Standards.

IN11. In accordance with IFC's Sustainability Policy, IFC categorizes its investments using an approach based on the relative magnitude of E&S risks and impacts. Investments involving FIs or delivery mechanisms involving financial intermediation are classified as "FI". This category is further divided into FI-1, FI-2, and FI-3 to reflect the E&S risk profile of the existing and proposed portfolio of investments/financing activities associated with IFC's financing. IFC considers the type, size, and sector exposure of the FI's existing and proposed portfolio in determining the categorization. The three sub-categories are defined as follows:

- **Category FI-1:** when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
- **Category FI-2:** when an FI's existing or proposed portfolio comprises, or is expected to comprise, business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
- **Category FI-3:** when an FI's existing or proposed portfolio includes financial exposure to business activities that predominantly have minimal or no adverse environmental or social impacts.

IN12. IFC requires its FI clients to develop and operate an ESMS in instances where the activities that are supported by IFC financing present E&S risks.<sup>IN14</sup> The scope and complexity of the ESMS should be commensurate with the level of E&S risk associated with the asset class supported. The ESMS should incorporate relevant principles of Performance Standard 1 on Assessment and Management of Environmental and Social Risks and Impacts (see Section III of this IN). Typically, project finance and long-term corporate finance transactions carry higher E&S risks than SME lending, microfinance, mortgage finance, and non-commercial insurance. Under IFC's Sustainability Policy, FI subprojects with higher E&S risks, which for avoidance of doubt includes all Higher Risk transactions, are required to apply the Performance Standards. The level and scope of Performance Standards application at the subproject level will vary depending on the FIs' level of leverage and access to information.<sup>IN15</sup>

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<sup>IN13</sup> The IFC Exclusion List defines the types of projects that IFC does not **normally** finance or support only in limited circumstances, <http://www.ifc.org/exclusionlist>. The Exclusion List refers to "substantially involved" test applied to Production or trade in weapons and munitions; production or trade in alcoholic beverages (excluding beer and wine); production or trade in tobacco; gambling, casinos and equivalent enterprises. An FI client will not be regarded as substantially involved if the FI client has a cumulative portfolio exposure below 5% to investees/borrowers which generate more than 20% of their respective revenues from an Excluded Activity. The 5% exposure cap does not apply to Private Equity Funds. The Exclusion List also refers to a "reasonableness" test. Any IFC investment in an FI client engaged directly or indirectly in any Excluded Activity specified will be disclosed in the Board paper or report, together with the factors on the basis of which such investment/support was determined to be reasonable. The Exclusion List can be extended by adding more excluded activities, as part of the E&S risk management efforts. For instance, in case of any targeted products IFC will exclude coal related sub-projects including coal mining, coal transportation or coal-fired power plants, as well as infrastructure services exclusively dedicated to support any of these activities. In case of projects involving collective investment vehicles such as PE Funds, the coal related investments will be either excluded up front or when this is not feasible IFC will opt out from such investments.

<sup>IN14</sup> FI-3 clients will be required to implement a simple E&S screening procedure. Such screening is considered to constitute an ESMS that is commensurate with the minimal level of E&S risk in these transactions.

<sup>IN15</sup> An FI's leverage can be limited in capital market where there may be no bilateral relationship between the FI and sub-project e.g. secondary market transactions, distressed assets acquired through auctions, etc. In such cases the FI will not be able to require application of the Performance Standards at the sub-project level. The E&S performance of the sub-project will be verified against

IN13. All FI clients <sup>IN16</sup>, regardless of the categorization of the investment as FI-1, FI-2 or FI-3, must also agree to manage the working conditions of their workforce in accordance with relevant aspects of Performance Standard 2 on Labor and Working Conditions. In the case of the financial sector this typically relates to employment practices and working conditions. For avoidance of doubt, the requirements of Performance Standard 2 addressed in paragraphs: 7, 11, 12, 23, 27, 28 and 29 of the Performance Standard 2 would be unlikely to apply to FIs however it should be confirmed by the FI's own assessment. To learn more of those requirements applicable to FIs please refer to the Guidance Note 2 on Labor and Working Conditions.<sup>IN17</sup> In addition, in cases where there is public access to the FI's buildings, FIs must agree to manage the life and fire safety risks in accordance with the WBG Environment, Health and Safety General Guideline (section 3.3).

IN14. All FI clients must avoid supporting activities on the IFC Exclusion List (except in the limited circumstances described in footnote IN12) and must review the operations of borrowers/investees, where they present E&S risks, for compliance with national E&S laws and regulations where they exist and are applicable.

IN15. IFC implements an annual program of supervision of FI investments categorized as FI-1 and FI-2 and requires such FIs to provide performance reports annually. Typically, for FI-3 clients IFC monitors changes in portfolio. In case of material changes in business activities of supported FIs, including FI-3 clients, IFC will assess the portfolio E&S risks affected by the change, and client's capacity to manage E&S risks and, if needed, require improved E&S risk management and enhanced reporting to IFC.

IN16. IFC will also periodically review the process and the results of the environmental and social due diligence and monitoring conducted by the FI for its lending/investments. IFC supervision include visits at the FI level and, where possible and relevant, to selected subprojects to assess and support implementation of the FI's ESMS, particularly in case of Higher Risk Transactions. The frequency and focus of supervision visits is commensurate with the identified risks and the E&S performance of the FI. IFC works with its FI clients, particularly these exposed to the Higher Risk Transactions, to help in clients' ESMS implementation.

### III. Applying Performance Standard 1 on Assessment and Management of E&S Risks and Impacts to FI Lending/Investment Activities

IN17. As indicated in the previous section, for FIs, application of Performance Standard 1<sup>IN18</sup> requires the development of an ESMS to identify and manage the E&S risks associated with the portfolio, supported by IFC financing, on an ongoing basis. The complexity of the ESMS will vary according to the risk exposure that the FI is expected to manage. This requirement applies to new financing by the FI, not assets in the portfolio prior to IFC's investment.

IN18. In cases where funds provided by IFC are targeted to a specified end use (e.g., a credit line for a specific asset pool, the "asset class"), the requirements for E&S risk management will cover only specified asset class. An asset class is that class of financing or investment activities of the FI, including prospective business activities, relating to a specific line of business, sector, industry, practice, region, client or other distinctive characteristic. If IFC funds are only used to finance a certain asset class, the E&S risk management requirements will be applied only to the asset class, and not to the FI's other activities outside of that asset class. However, if the FI supports the same asset class as that supported by IFC funds from

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requirements of the Performance Standards based on publicly available information and the FI will make go or no-go decision based on that assessment.

<sup>IN16</sup> Except limited cases of hybrid projects as defined in footnote 13.

<sup>IN17</sup> Please see [www.ifc.org/ps2](http://www.ifc.org/ps2).

<sup>IN18</sup> See paragraph 5 of Performance Standard 1.

its own account, the E&S risk management approach will apply to the entire asset class as originated from the time of IFC support. For example, if IFC finances a credit line for small and medium enterprises (SME), then the FI's entire SME operations that are originated after IFC's funding will also apply the agreed E&S requirements. The FI may choose, nevertheless, to expand the application of its E&S risk management practices to manage such risk across its entire operations. IFC encourages this for interested FI clients and will support such FI clients in operationalizing and implementing such a portfolio wide approach.

IN19. Although IFC requires FIs to apply E&S risk management practices to their portfolio developed after IFC's investment, IFC reserves the right to decline to invest in an FI with a particularly high E&S risk portfolio at the time of IFC's E&S due diligence.

IN20. In cases where IFC's investment consists of equity or general purpose financial support with no specified end use, the approach to E&S risk management will apply to the entire portfolio that the FI originates from the time IFC becomes a shareholder or lender. In case of sub-debt (Tier II) IFC tries to target the use of proceeds where it is allowed by respective country regulations. In cases where it is not allowed IFC follows the same approach as in the case of equity or general-purpose lending.

IN21. If changes in the FI business supported by IFC financing result in E&S risks that differ from those identified at the time of IFC's investment, the FI will be required to adjust its ESMS in a manner consistent with the E&S risk profile resulting from the new business activities.

IN22. The ESMS should be tailored to fit the needs of the FI and should also influence investment selection and management. Ideally it should be integrated into the FI's existing risk management systems for credit, operational risk, finance, legal, compliance, or any other relevant system operating within the FI, which may already consider E&S risk.<sup>IN19</sup> Where the FI already has an ESMS, its elements may meet, or may need to be modified to meet, the requirements of IFC's Sustainability Framework.<sup>IN20</sup>

IN23. An FI's ESMS should typically consist of the following elements established by Performance Standard 1 (PS1): (i) an E&S policy; (ii) internal organizational capacity; (iii) E&S due diligence (ESDD) processes/procedures to identify risks and impacts of borrowers/investees; (iv) monitoring and review of portfolio; (v) external communications mechanism; and (vi) emergency preparedness and response.<sup>IN21</sup> Each ESMS element is discussed in more detail below.

### **E&S Policy**<sup>IN22</sup>

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IN24. PS 1 requires IFC clients to establish and maintain in place an overarching policy defining the E&S objectives and principles to guide sound E&S performance. The E&S policy should state the E&S requirements and standards that apply to the FI's lending/investment activities and that will be used to manage the E&S risk associated with the FI's portfolio of borrowers/investees.<sup>IN23</sup>

IN25. E&S policies for FI-2 clients should refer to a list of excluded or restricted activities that the FI will not support, including, at a minimum, the IFC Exclusion List, and should require compliance with applicable

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<sup>IN19</sup> Examples of existing E&S risk management practices are verification of valid E&S permits and authorizations in compliance with national E&S regulations.

<sup>IN20</sup> Additional guidance for FIs on how to establish and maintain an ESMS is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/establish-and-maintain-an-esms>.

<sup>IN21</sup> Additional guidance for FIs on how to develop an ESMS is available at FIRST for Sustainability, [https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2\\_2/developing-an-esms](https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2/developing-an-esms).

<sup>IN22</sup> See paragraph 6 of Performance Standard 1.

<sup>IN23</sup> Additional guidance for FIs on how to develop an E&S policy and examples of E&S Policies are available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/environmental-and-social-policy>.

national E&S laws and regulations of the host country/countries where the FI operates and provides financing. In addition, FIs categorized as FI-1 and those FI-2 clients that support Higher Risk Transactions should reference the Performance Standards as the underlying risk management standard for addressing risks in Higher Risk Transactions and any other relevant standards, such as international protocols, industry-specific codes of practice, and other voluntary standards (e.g., Equator Principles, UNEP-FI, Global Compact, UN-PRI, etc.), where applicable. The policy should also specify the scope of application of the E&S requirements and relevant E&S requirements for different businesslines supported by IFC financing.

IN26. The E&S policy should be endorsed by the FI's senior management and Board and include a commitment to develop and maintain the necessary internal capacity and structure for its implementation. The policy should be actively communicated to employees at all levels and functions. Good practice also recommends external communication of the policy through public disclosure, presenting it in corporate statements and reports, and publishing it on the FI's website.

### Internal Organizational Capacity and Competency<sup>IN24</sup>

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IN27. Performance Standard 1 outlines the need for IFC clients to establish and maintain an organizational structure that defines roles, responsibilities, and authority to implement the ESMS.

IN28. For FIs, this means designating qualified personnel with E&S responsibilities and ensuring that human and financial resources are available for the effective implementation of the ESMS across the organization, and properly incorporating E&S risk in decision-making.<sup>IN25</sup>

IN29. An FI's organizational capacity needs will vary depending on the E&S risk profile of its portfolio. The FI may use qualified in-house staff and/or retain external experts to conduct the necessary Environmental and Social Due Diligence (ESDD) for transactions (as described in IN34–IN40) with the intent of meeting all applicable requirements of national E&S laws and regulations and, where applicable, the Performance Standards.

IN30. While day-to-day operations of the ESMS can be delegated,<sup>IN26</sup> the FI's senior management is ultimately responsible for E&S risk management and should allocate sufficient resources to implement the ESMS. This requires designating and communicating E&S responsibilities to relevant personnel to conduct the necessary ESDD, incorporating ESDD conclusions into the investment decision making processes monitoring at both the transaction and portfolio levels, and providing appropriate incentives for doing so. The Board, where it exists, is expected to play an oversight role in monitoring of ESMS implementation, including reporting on E&S risk management.

IN31. The FI should ensure that responsible staff has sufficient knowledge for managing the E&S risks, as well as implementing and maintaining the ESMS. Training programs are an important component to ensure that all relevant personnel understand their E&S responsibilities.<sup>IN27</sup>

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<sup>IN24</sup>See paragraphs 17–19 of Performance Standard 1.

<sup>IN25</sup>Additional guidance for FIs on the roles and responsibilities of E&S personnel is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/responsibilities-and-decision-making>.

<sup>IN26</sup>Additional guidance for FIs on designating an ESMS Officer is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/designate-an-esms-officer>.

<sup>IN27</sup>Additional guidance for FIs on E&S training is available at FIRST for Sustainability, <https://firstforsustainability.org/resources/training>. IFC offers two free online training courses: E-Learning Course on Managing Environmental and Social Performance and Sustainability Training and E-Learning Program (STEP), <http://www.ifc.org/step>.

### E&S Due Diligence Processes to Identify E&S Risks of Borrowers/Investees<sup>IN28</sup>

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IN32. Performance Standard 1 requires IFC clients to establish and maintain a process to identify the E&S risks and impacts of their operations, as well as to develop Environmental and Social Action Plans (ESAPs),<sup>IN29</sup> which supplement borrower's/investee's mitigation and performance measures, including actions that are necessary to address identified E&S risks and impacts to meet Performance Standards.

IN33. For an FI, this requires identifying the E&S risks and impacts associated with its lending/investment activities. This means conducting an ESDD at the individual transaction level to identify the environmental, social, labor, occupational health and safety, and security risks and impacts associated with the business operation considered for financing. As an outcome of the ESDD process, the FI should also identify mitigation and/or corrective measures as necessary (as described in IN39–IN44) for borrower/investee operations.

IN34. IFC FI-1, FI-2 and select FI-3<sup>IN30</sup> clients must review proposed transactions against the IFC Exclusion List, and national E&S laws and regulations where they exist and are applicable,<sup>IN31</sup> requiring at a minimum that FIs check if borrowers/investees comply with all applicable laws and have all necessary permits. FI clients that have been categorized as FI-1 and those FI-2 clients that support Higher Risk Transactions are required to assess E&S risks and impacts against the Performance Standards (as described in IN36).

IN35. It is good practice for FIs applying Performance Standards to categorize individual transactions according to the level of the E&S risks and impacts in order to monitor overall portfolio E&S risk effectively.

IN36. For Higher Risk Transactions within the scope of category FI-1 and FI-2 projects, the ESDD process<sup>IN32</sup> typically consists of (i) reviewing all relevant documents and information provided by the borrower/investee, including information on risks related to the particular industry<sup>IN33</sup> sector and technical aspects of the borrower's/investee's activities to be supported by the FI client; (ii) reviewing risks and potential impacts of the activity to be supported against pre-determined criteria such as the IFC Exclusion List, national E&S laws and regulations, and the relevant Performance Standards; (iii) conducting site visits, as appropriate, to facilities and meetings/interviews with relevant stakeholders; and (iv) reviewing the borrower's/investee's track record on E&S issues in terms of potential non-compliance with national regulations or negative publicity. As part of an FI's ESMS, requirements for conducting the ESDD are integrated at various stages of the FI's lending/investment cycle.

IN37. If the initial review concludes that a proposed lending/investment activity will have minimal or no potential E&S risks or adverse impacts, the FI should document this conclusion as part of its decision to proceed with the transaction.

IN38. Additional in-depth due diligence will be required should the initial review process indicate the existence of E&S risks or potential impacts that require further analysis. For Higher Risk Transactions the FI will engage external qualified expert(s) should adequate in-house capacity to manage E&S risks and impacts associated with these transactions not be in place. The ESDD should also identify corrective

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<sup>IN28</sup> See paragraphs 7–16 of Performance Standard 1.

<sup>IN29</sup> While FIs more commonly use the term “corrective action plan,” the term “action plan” is used in this IN to keep it consistent with the language of Performance Standard 1.

<sup>IN30</sup> FI-3 projects involved exclusively is support retail clients, such as student loans, mortgages for individuals and alike will not be required to screen against the IFC Exclusion List.

<sup>IN31</sup> Typically, E&S laws and regulations are not applicable to most activities financed by FI-3 clients.

<sup>IN32</sup> Additional guidance for FIs on the ESDD process is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/environmental-and-social-due-diligence>.

<sup>IN33</sup> See World Bank Group EHS Guidelines, [www.ifc.org/ehsguidelines](http://www.ifc.org/ehsguidelines).

actions to be reflected in the ESAP and to be implemented by the borrower/investee to comply with the FI's E&S policy.

IN39. The FI should document the findings of the ESDD in a report or internal records, including recommendations on whether to proceed with financing and any conditions of investment, such as ESAPs items agreed with the borrower/investee to mitigate identified E&S risks and impacts within their operations.

IN40. The ESAP<sup>IN34</sup> should outline key E&S performance gaps in a borrower's/investee's operations identified during the ESDD or monitoring (as described in IN48–IN51), as well as proposed mitigation measures and a timeline to ensure compliance with applicable national E&S laws and regulations and the Performance Standards (where required). ESAPs may range from basic mitigation measures to detailed management plans, with actions that can be measured quantitatively or qualitatively.

IN41. If at the time of the FI's transaction with a borrower/investee the physical assets to be developed, acquired, or financed have yet to be defined, the ESAP should require the borrower/investee to develop an E&S risk management process at the operations level to ensure that E&S risks and impacts will be adequately identified in the future when the physical assets are defined.

IN42. The FI should discuss the ESAP as part of general E&S requirements with the borrower/investee and agree on its scope and timeframe for completion. If an ESAP is developed as part of the transaction review process, its fulfillment should be referenced in the legal agreement. Standard E&S terms are typically represented as general E&S definitions, representations and warranties, disbursement conditions, and/or covenants regarding compliance with requirements defined by the FI's E&S policy. ESAPs including mitigation measures to address identified performance gaps as well as requirements on annual reporting on E&S performance should also be included in the FI's legal agreement with the borrower/investee<sup>IN35</sup> In the event that the investment agreement does not reference such an ESAP, the FI should document the reason.<sup>IN36</sup> The timeframe for implementing specific mitigation measures will vary according to the E&S risk and may range from being a condition of transaction approval to a condition of disbursement or post investment condition.

IN43. The FI should require its borrowers/investees involved in Higher Risk Transactions to submit regular E&S performance reports describing progress made with respect to the ESAP (if there is one) and effectiveness of ESMS implementation based on portfolio reviews. The frequency of reporting will vary according to the E&S risk and potential impacts of each transaction. Reporting should be done at least annually.

IN44. The FI should require borrowers/investee to notify it about material changes in their operations that may result in changed E&S risks and impacts.

IN45. To support the ESDD process, the FI should develop the necessary supporting guidance documents and check lists<sup>IN37</sup> for use by its staff. These should reflect E&S issues that will be reviewed, as well as other factors that will be considered to review compliance with the FI's E&S policy. A good starting point for

<sup>IN34</sup> Additional guidance for FIs on preparing E&S action plans is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/corrective-action-plan>.

<sup>IN35</sup> Additional guidance for FIs on inserting E&S provisions into legal agreements is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/environmental-and-social-covenants-in-legal-agreements>. As an example, also see "Guidance for EPFIs on Incorporating Environmental and Social Considerations into Loan Documentation," [http://www.equator-principles.com/resources/ep\\_guidance\\_for\\_epfis\\_on\\_loan\\_documentation\\_march\\_2014.pdf](http://www.equator-principles.com/resources/ep_guidance_for_epfis_on_loan_documentation_march_2014.pdf).

<sup>IN36</sup> These may include for instance: PE funds taking majority stake that guarantee managerial control over the investee; PE Funds investments through auction processes; certain capital market transactions, etc.

<sup>IN37</sup> Additional guidance for FIs on developing ESDD guidance documents is available at FIRST for Sustainability, [https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2\\_2/managing-environmental-and-social-risk-2\\_2/guidance-for-managing-environmental-and-social-risk/](https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2/managing-environmental-and-social-risk-2_2/guidance-for-managing-environmental-and-social-risk/).

generating such guidance documents and check lists is a review of the E&S issues associated with those industry sectors to which the FI is the most exposed to in its portfolio (sectoral issues are widely covered in the World Bank Group industry specific Environmental, Health and Safety Guidelines). Also, the FI should appoint or hire personnel and/or contract qualified external experts to develop a comprehensive understanding of relevant national E&S laws and regulations of the countries in which it operates. When an FI client is required to apply the relevant Performance Standards to higher risk transactions, the FI should review the requirements of the relevant Performance Standards against those of applicable national E&S laws and regulations to identify requirement gaps.

### Monitoring and Review of Portfolio<sup>IN38</sup>

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IN46. Performance Standard 1 requires IFC clients to establish monitoring procedures to review progress with ESAPs and compliance of operations with any legal and/or contractual obligations and regulatory requirements. This should include periodic review of the effectiveness of the FI's own ESMS in managing the E&S risks.

IN47. For an FI, this requires monitoring each borrower's/investee's E&S performance against the FI's E&S policy, the ESDD findings, and E&S contractual obligations including the ESAP (if required). The extent and frequency of monitoring should be commensurate with the E&S risk and potential impacts of the transaction as identified through the ESDD. Depending on the monitoring outcome, the mitigation measures in the ESAP may need to be supplemented by additional activities.

IN48. The monitoring<sup>IN39</sup> process is conducted as part of the FI's ESMS implementation, and typically involves the use of qualified internal resources to review E&S reports received from borrowers/investees, review of relevant activities of respective national authorities such as factory inspections (where available) and conducting periodic site visits as appropriate. In the case of borrowers/investees involved in Higher Risk Transaction support from external qualified experts is necessary unless the FI client has sufficient qualified and experienced in-house capacity to manage E&S risks and impacts associated with the activities financed. Monitoring of outcomes and ESAP implementation process should be documented, and the FI should work with borrowers/investees to provide guidance on the implementation of proposed corrective actions.

IN49. FI senior management and where relevant the Board should be informed regularly of the E&S risks of individual borrowers/investees as well as aggregated E&S risks at the portfolio level.<sup>IN40</sup> This information gives an FI a better understanding of its overall exposure to E&S risk, and allows the FI to focus on transactions and borrowers/investees that may require additional resources to manage E&S impacts.

IN50. FIs should periodically review<sup>IN41</sup> the implementation effectiveness of their ESMS, and adjust or update procedures, as needed, to enhance practices and efficiency, address potential changes in the E&S risk profile of their portfolio, and respond to changes in the E&S regulatory environment.

IN51. FI clients, except those categorized as FI-3, will be required to submit annual E&S performance reports to IFC. The scope of such reports will vary depending on the risk of the portfolio supported by IFC.

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<sup>IN38</sup>See paragraphs 22–24 of Performance Standard 1.

<sup>IN39</sup>Additional guidance for FIs on the monitoring process is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/monitoring-client-investee-se-performance>.

<sup>IN40</sup>Additional guidance for FIs on managing portfolio risk is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/risk-categorization-and-managing-portfolio>.

<sup>IN41</sup>Additional guidance for FIs on reviewing the effectiveness of ESMS implementation is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/esms-review-and-continuous-improvement>.

For an FI, E&S performance reports<sup>IN42</sup> to IFC should typically include:

- Portfolio breakdown by industry sectors and product lines, Higher Risk Transactions and sample ESDD reports;<sup>IN43</sup>
- Cases of non-compliance and significant E&S accidents or incidents related to a transaction; and
- Information on the implementation of any changes to the FI's ESMS;
- Where relevant, the FI clients' exposures to high risk activities (e.g. coal related activities, palm oil, etc.)

An FI may have additional reporting requirements to additional stakeholders (internal and external) regarding E&S risks and impacts associated with its activities.

IN52. In the case of FI clients exposed to Higher Risk Transactions IFC, where possible, will require such FI clients to publicly disclose summary of their ESMS.

### External Communications Mechanism<sup>IN44</sup>

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IN53. Performance Standard 1 requires IFC clients to implement and maintain a procedure for external communications that includes methods to receive, register, screen and assess, track, respond to, and act upon external inquiries and complaints from the public regarding their operations. In addition, where the project involves specifically identified physical elements— aspects and facilities that are likely to generate adverse E&S impacts on Affected Communities—a grievance mechanism is required. Unless an FI's own operations generate adverse E&S impacts on Affected Communities or the environment (e.g., when an FI sponsors construction of its own new office building(s)), a grievance mechanism<sup>IN45</sup> is not required as an element of the FI's ESMS. However, the FI should require a sub-project sponsor to establish and maintain a grievance mechanism if the sub-project in question meets the criteria under PS1 (i.e. has adverse impacts on Affected Communities).

IN54. Those FIs required to apply IFC's Performance Standards to their financing and investment activities will establish and maintain an External Communications Mechanism (ECM). An ECM involves implementing a process for receiving, analyzing, recording, and responding (if deemed necessary) to views, opinions, concerns (real or perceived), and requests for information from third parties—e.g., concerns related to the FI's investment activities and/or a borrower in its portfolio.<sup>IN46</sup> The complexity of such a process may vary and may be simple for some FIs—e.g., those with limited exposure to higher risk transactions. The ECM should provide publicly available and easily accessible channels (e.g., phone number, website, e-mail address) to receive communications and requests from the public for information regarding E&S issues. It is recommended that such channels be devoted exclusively to receiving information on E&S issues, but general channels that also allow for E&S communication are acceptable as well. The FI will assess the relevance of the external communication received and determine the level of response required, if any.<sup>IN47</sup>

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<sup>IN42</sup>Additional guidance for FIs on preparing annual E&S performance report for IFC is available at FIRST for Sustainability, <https://firstforsustainability.org/risk-management/report-annually>.

<sup>IN43</sup>Private Equity Funds will provide names, locations and sectors of high-risk subprojects that have been supported with IFC funding, subject to regulatory constraints and market sensitivities.

<sup>IN44</sup>See paragraph 34 of Performance Standard 1.

<sup>IN45</sup>Clients of FIs (borrowers/investee companies) that are required to apply Performance Standards should develop ECMs and grievance mechanisms commensurate with the level of E&S risks and impacts associated with their operations. For more information, please see GN1, paragraphs 108–111: [http://www.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN\\_English\\_2012\\_Full-Documents.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN_English_2012_Full-Documents.pdf?MOD=AJPERES).

<sup>IN46</sup>Also subject to provisions of a confidentiality agreement between an FI and its borrowers/investees.

<sup>IN47</sup>FIs required to apply Performance Standards should verify if information about any sub-project financed was appropriately consulted upon with Affected Communities by the sub-project sponsor as required by Performance Standard 1 paragraph 29-31. In the case of capital market transactions such verification may not be possible. In such cases the FI will be required to verify if there is publicly available information on any Affected Community's opposition to the project.

### Emergency Preparedness and Response<sup>IN48</sup>

IN55. Where an IFC client's operations involve activities and facilities that are likely to generate impacts, Performance Standard 1 requires clients to establish and maintain an emergency preparedness and response system to respond to accidental and emergency situations.

IN56. For an FI client, this means ensuring that the necessary emergency preparedness and response plans are in place within its premises to protect the health and safety of its employees and visitors. Effective emergency preparedness and response plans should identify responsibilities and procedures for communicating different types of emergencies (e.g., fire, earthquake or robbery) to the appropriate authorities and for safe evacuation. Plans should also include specific training and practice requirements (i.e., simulations and drills).

IN57. Buildings that are owned or rented/leased by the FI that are accessible to the public should be designed, constructed, and operated in compliance with local building codes, local fire department regulations, and local legal requirements. In the case of construction of new buildings or major reconstruction of existing buildings accessible to the public by FI equity clients these buildings should be designed, constructed and operated in compliance with applicable local requirements and in accordance with internationally accepted life and fire safety standard.

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<sup>IN48</sup>See paragraph 20 of Performance Standard 1.