

FBN Merchant Bank Limited RC 264978

10 Keffi Street, Off Awolowo Road, S.W. Ikoyi, Lagos, Nigeria

Tel: +234 1 2798300, +234 1 2702290-4

www.fbnmerchantbank.com



# Environmental & Social Risk Policy

## June 2017

*This document has been classified as “**Confidential**” and has been issued strictly for internal business purposes of FBN Merchant Bank. Dissemination by any means thereof outside of the Bank is prohibited unless prior written approval is obtained from **Risk Management Department**.*

A part of the FBN Holdings Group

Confidential

**TABLE OF CONTENTS**

- 1 Terms & Abbreviations ..... 3**
  
- 2 Policy – Objectives, Scope, Coverage And Review ..... 5**
  - 2.1 Objectives ..... 5
  - 2.2 Scope ..... 6
  - 2.3 Coverage..... 6
  - 2.4 Associated Policies ..... 6
  
- 3 Guiding Principles ..... 7**
  - 3.1 Introduction to E&S Risk Management ..... 7
  - 3.2 E&S Risk Management Organisation ..... 7
  - 3.3 E&S Risk Management Process / ESMS ..... 7
  - 3.4 E&S Risk Management Philosophy ..... 8
  - 3.5 E&S Risk Management Strategy ..... 11
  - 3.6 CBN Guidelines on E&S Risk Management..... 12
  
- 4 Governance Structure – Roles and Responsibilities ..... 14**
  
- 5 E&S Risk Process Flow ..... 16**
  - 5.1 Risk Identification..... 16
  - 5.2 E&S Assessment ..... 18
    - 5.2.1 Determining the level of E&S assessment ..... 18
    - 5.2.2 Identifying E&S Impacts ..... 20
    - 5.2.3 Determining when E&S Impacts are adequately managed ..... 20
    - 5.2.4 Sector Guidelines ..... 21
    - 5.2.5 E&S Action Plans to address a shortfall in the client’s E&S risk..... 21
    - 5.2.6 Approach to third party management of E&S risks ..... 22
    - 5.2.7 Credit Submission ..... 22
  - 5.3 Credit Approval ..... 22
    - 5.3.1 Loan Agreements and Covenants..... 23
  - 5.4 Transaction Monitoring & Management ..... 24
  
- 6 E&S Risk Information Systems..... 24**
  - 6.1 Introduction ..... 24
  - 6.2 Data Requirements..... 24
  - 6.3 Risk Reporting..... 25
  - 6.4 Structure of Risk Reports ..... 25
  - 6.5 Coverage of Risk Reporting..... 26
  
- 7 Appendix: FBN Merchant Bank’s E&S Exclusion List ..... 27**

## 1 Terms & Abbreviations

<b>Term or Abbreviation</b>	<b>Definition or Explanation</b>
Business Activities	Provision of financial products and services including, but not limited to : corporate finance, investment banking (corporate advisory, structured lending, capital, trading), equity investments, project finance , structured commodity finance, trade finance, leasing and other forms of direct lending.
BOD	Board of Directors
CBN	Central Bank of Nigeria
CRO	Chief Risk Officer
E&S	Environmental & Social
E&S Impact	Any change, potential or actual, to (a) the physical, natural, or cultural environment, and (b) impacts on workers and surrounding community, resulting from a business or business activity. E&S impacts may be temporary or permanent, involving reversible or irreversible changes on the environment or society. Environmental impact can include changes to the atmosphere, water, and land due to human activities (e.g. Greenhouse gases, pollution, changes to ecosystems etc.). Social impacts can include impacts to a client’s workforce as well as to the surrounding community (e.g. Occupational health & safety, human rights & labour standards, land disputes, physical or economic resettlement, corruption etc.).
E&S risk	The potential for E&S impacts associated with one of the Bank’s existing or proposed clients or engagements that need to be taken into account when making business and risk management decisions
EP	Equator Principles
ESMS	Environmental & Social Management System
FBN MB or “the bank”	FBN Merchant Bank
FRN	Federal Republic of Nigeria

ILO	International Labour Organisation
Non-consumer client	Any client of Corporate Banking or Investment Banking
NSBP	Nigerian Sustainable Banking Principles
UNGC	United Nations Global Compact
UNEPFI	UN Environment Program Finance Initiative
UNESCO	United Nations Educational, Scientific, and Cultural Organisation

## 2 Policy – Objectives, Scope, Coverage and Review

### 2.1 Objectives

The objective of this Environmental & Social Risk Management Policy is to incorporate E&S risk into the credit procedures and decision-making of FBN MB in line with the NSBP.

The Bank recognises that the context in which its business decisions are made is characterised by complex and growing challenges related to population growth, urban migration, poverty, destruction of biodiversity and ecosystems, pressure on food resources and security, lack of energy and infrastructure, and the implications of a changing climate. The business activities of the corporate clients that the Bank funds can have potentially negative impacts on the environment or local communities where these clients operate. These negative impacts include air or water pollution, harm or destruction of biodiversity, threats to human health and safety, violations of labour rights, or displacement of livelihoods.

FBN MB does not want to be involved in enabling negative impacts on the environment or local communities and wishes to ensure that its business activities reflect the complex and growing challenges in this area. The purpose of the policy is therefore to:

- Provide the principles which FBN MB adopts in delivering banking services that take account of E&S issues;
- Ensure that FBN MB does not knowingly enable clients impose negative E&S impacts and the external costs associated with them and which in turn hinder the overall growth prospects of the economy and society;
- Create a systematic framework for engaging with clients on their E&S impacts, to understand what they experience, how they are responding, and to act where possible as a trusted advisor assisting clients to manage their E&S impacts and improve their performance;
- Manage the Bank's exposure to credit risk, reputational risk, and legal risk that may arise from negative E&S impacts and external costs;
- Define an approach that is predictable, transparent and accountable, supports consistent decision-making on E&S risks, and enables the Bank capture information and progressively learn from its experiences in this area.

This policy complements FBN MB's goal of providing appropriate financing to its clients and to maximising its shareholders' value by reducing exposure to:

- Reputation risks through association with harmful activities of clients
- Credit risks through reduced repayment capacity in the event of disruption to activities, fines and penalties, legal enforcement or closure
- Market risks through the reduced value of security and collateral
- Direct risks through the liability for E&S harm caused by clients

**2.2 Scope**

This E&S policy applies to:

- All Corporate Banking and Investment Banking clients of FBN MB. It seeks to enable FBN MB to manage the E&S risk exposure and management approach of its corporate clients and the business that the bank does with them;
- All financial services provided by FBN MB to its clients. This includes acceptance of deposits, provision of loans and the delivery of other financial products and services.

Within this scope, all previously approved and current business (in addition to all new business) will comply with the Exclusion List.

**2.3 Coverage**

The policy frames the overarching guidelines that govern the day to day management of E&S risks in the business development and risk management of Corporate Banking and Investment Banking, and the evolution of E&S risks within the banking book of FBN Merchant Bank. To this end, this policy shall cover the following:

- E&S risk management framework
- Roles and Responsibilities of the Board of Directors (BOD), and Chief Risk Officer
- The monitoring, evaluation of the performance and reporting on the E&S risk management framework
- Discussion on approaches to measuring the development of E&S risk with the loan portfolio

**2.4 Associated Policies**

This policy complements FBN MB’s other Risk policies as follows:

Document Name	Content Description
Enterprise Risk Management Framework	Enterprise Risk Management Framework policy for FBN MB
Credit Risk Principles and Policy	Credit risk principles, policies and risk appetite and tolerance levels of FBN MB
Market Risk Principles and Policy	Market risk principles, policies and risk appetite and tolerance levels of FBN MB

Liquidity Risk Principles and Policy	Liquidity principles, policies and risk appetite and tolerance levels of FBN MB
Operational Risk Principles and Policy	Operational risk principles, policies and risk appetite and tolerance levels of FBN MB

### 3 Guiding Principles

#### 3.1 Introduction to E&S Risk Management

E&S Risk Management can be defined as a mechanism to address the risk exposure faced by a Bank arising from mismatches between the E&S impacts confronted by the Bank's clients in the course of their business activities, and the ability of these same clients to avoid, minimise or otherwise manage these impacts.

#### 3.2 E&S Risk Management Organisation

This E&S Risk Policy is approved by the BOD.

Risk Management will be responsible for:

##### *Implementation of E&S Risk Policy*

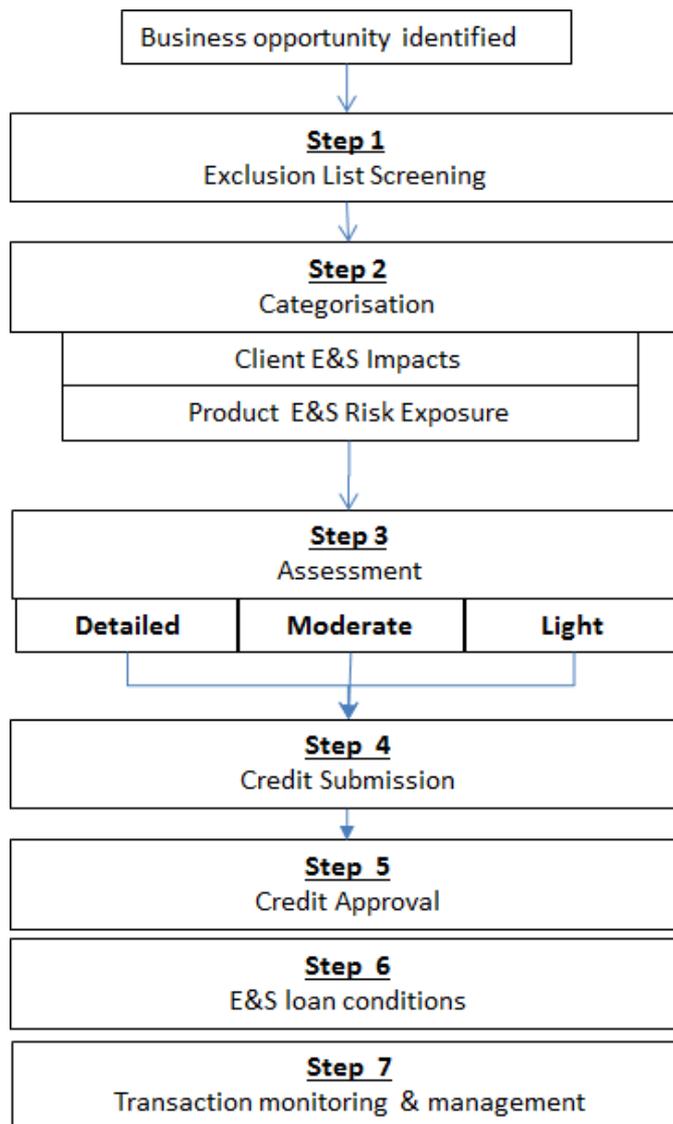
- I. Ensure Risk Appetite/E&S Risk Policy in line with bank activities
- II. Establish risk guidelines for specific sectors
- III. Ensure compliance with CBN requirements
- IV. Manage data generation for reporting to CBN/shareholders

##### *E&S Risk Analytics*

- I. Establish industry best practices and checklists to support identification and management of E&S risks
- II. Establish methods and processes for capturing data on E&S risk exposure and measuring outcomes

#### 3.3 E&S Risk Management Process / ESMS

The E&S Risk Process (also known as ESMS) involves seven steps.



The ESMS is essentially the same for both Corporate Banking and Investment Banking activities, although categorisation and assessment may be supported by different tools.

### 3.4 E&S Risk Management Philosophy

The E&S Risk Management philosophy shall set out the broad goals and objectives of the Bank's approach. The E&S Risk Management philosophy shall always address the following principles:

**“Do no harm”:** E&S impacts refer to any change, potential or actual, resulting from business activities to (i) the physical, natural, or cultural environment; and (ii) workers and surrounding communities. Central to FBN MB's E&S approach is the intent to “do no harm” to people and the environment, and where possible to contribute to enhancing the sustainability of clients and their

activities. In pursuit of this goal, the Bank aims to avoid knowingly contributing to adverse E&S impacts through the activities of its clients.

**Complying with laws and regulations:** These include Nigerian E&S laws and regulations, industry standards, international treaties, and internationally- accepted standards and agreements relevant to the company's activities.

**Respecting human rights:** The Bank recognises the responsibility to respect human rights independently of the state's duties to respect, protect, and fulfil human rights and to avoid complicity in the abuse or violation of internationally proclaimed human rights standards. This includes recognizing the responsibility of clients to respect human rights, to act with due diligence, to avoid infringing these rights and to address adverse impacts to the extent to which they bear responsibility for them.

**Standards and Guidelines:** The Bank's E&S risk policy is guided by Nigerian environmental and social laws. This includes the Constitution of The Federal Republic of Nigeria (1999) which recognizes the importance of improving and protecting the environment, and makes it an objective of the Nigerian State to improve and protect the air, land, water, forest and wildlife of Nigeria. It also establishes implicitly that international treaties (including environmental treaties) ratified by the National Assembly should be implemented as law in Nigeria. It also includes guidance from the Ministry of Environment under the National Environment Standards and Regulation Enforcement Agency (NESREA) Act of 2007 which is the embodiment of laws and regulations focused on the protection and sustainable development of the environment and its natural resources.

This Policy is also guided by the Nigerian Sustainable Banking Principles as well as Nigeria's commitments to international agreements and treaties relating to E&S impacts.

Application of the policy will be further guided by good international industry practice. This is a judgement defined as the exercise of professional skill, diligence, prudence, and foresight that would reasonably be expected from skilled and experienced professionals engaged in the same type of undertaking under the same or similar circumstances globally or regionally. International frameworks relevant to sustainable finance include UN Global Compact ("UNGC"), UN Environment Program Finance Initiative ("UNEPFI"), Equator Principles ("EP") and the IFC Performance Standards.

**Responsibility:** While managing E&S impacts in a manner consistent with Nigerian law and international standards is ultimately the responsibility of the client, FBN MB seeks to ensure that the business activities that it finances are implemented in accordance with these standards. As a result, the outcomes of FBN MB's E&S assessment are an important factor in its approval process and will determine the scope of any E&S conditions to be required by the Bank financing.

**Understanding the scale of E&S impacts and level of E&S risk exposure:** For clients of FBN MB, E&S impacts are a combination of the probability of certain hazard occurrences and the severity of impacts resulting from the occurrence. The key considerations in the Bank's E&S risk exposure arise from it providing loans, products and services to its clients and comprise:

- The type of transaction
- The activities of the client
- The location of the client's activities with respect to pristine environments, protected areas, cultural heritage, and international borders
- The client's ability/commitment to manage its E&S impacts and risks

**Commensurate approach:** The Bank's E&S risk management approach will be commensurate with the nature and scale of the client's activities, and the nature of the client's E&S impacts. With respect to any particular activity, the level of FBN MB's engagement will be determined by the nature and scope of the proposed product or service, and the specific circumstances of the collaboration and relationship with the client. Different procedures will be developed to reflect the different levels of E&S risks - in essence, the higher the level of E&S risk, the greater the level of attention and management required from the bank.

**Responses expected of clients:** This policy allows for a range of responses by clients to managing their E&S impacts. These stated in order of preference are:

- Avoidance of impact: In the first instance the bank will seek to understand how the client has avoided the E&S impacts. The Bank will look more favourably on clients that manage their activities in ways that seek to avoid E&S impacts.
- Minimisation of impacts: If E&S impacts cannot be avoided, the bank will seek to understand how clients have acted to minimise them. This is carried out as part of the E&S assessment aimed at identifying the individual E&S impacts and determining the extent to which these are minimised and appropriately managed by the client.
- Compensating for impacts: If E&S risks are avoided and minimised, and residual impacts still exist then the bank will allow clients to offset these through purchase of assets, tradable permits or philanthropic activities. Any such offsetting will be accompanied by a clear demonstration that the value of the offset is equivalent or better than the scale of the specific E&S impact or risk, and that (as far as possible) the beneficiaries of the offset are the same as those affected by the particular E&S impact or risk.

***The client's management of E&S impacts as a condition for extending products & services:***

The Bank will only provide products & services to activities that meet the required standards, or which are expected to meet the requirements within a reasonable period of time. Persistent delays by the client in meeting these requirements will lead to the withdrawal of financial support and access to the products & services of FBN MB. Similarly, if the client fails to comply with E&S commitments as expressed in the legal agreements and associated documents, FBN MB will work with the client to bring it back into compliance. If the client fails to re-establish compliance, the Bank will exercise its rights and remedies as appropriate.

***Systematic and consistent decision-making:***

The Bank will incorporate E&S risks in its decision-making in ways that are systematic, predictable, informed, and equitable. It is important to the bank that E&S risks are addressed in a rational and

consistent way, informed by the specific issues in each case and guided by any relevant prior experience of the bank. The bank recognises that it has a duty to its clients to apply standards and make decisions on a consistent basis.

***Ongoing implementation:***

Evolution of E&S impacts continues beyond the initial engagement and approval of a transaction and the bank will monitor the development of E&S risks through its client relationships, credit approval procedures, transaction monitoring, and the issuing of financing agreements.

***Management of client relationships:***

Under this policy E&S risk management is seen as a part of the on-going relationship between the bank and its client. FBN MB wishes to collaborate with clients who identify and manage E&S impacts and who pursue sustainability related opportunities and outcomes in their business activities. In cases where material E&S risks are identified FBN MB will, to the best of its ability, assist clients in identifying measures to avoid, minimize or mitigate these specific impacts and in improving their overall ability to manage their E&S issues. During the life of a client relationship, and as a minimum, the Bank will need to be informed of material changes in the business of any client or when they enter into a new business area that is materially different to that last represented to FBN MB for approval. In such circumstances, the Bank will assess the E&S risks of the new business area and may require the client to adjust its E&S management in a manner consistent with this policy.

### **3.5 E&S Risk Management Strategy**

Policy constraints on the nature and scale of E&S risk have to be established so as to minimise risk exposure and maximise the potential for growth with client with manageable E&S risk. This is informed by the following:

**Strategy 1: Exclusion List:**

The bank shall establish an exclusion list that provides guidance on client characteristics, behaviours and activities that it would prefer not to be associated with. FBN MB will take due care to inform itself of any client excluded under the terms of this list, and they will not knowingly provide financial services to projects and activities that are featured on the exclusion list.

**Strategy 2: Avoiding unnecessary E&S risks:**

In situations where the client has high or medium levels of E&S impacts and (i) is unable to demonstrate its capability to manage these risks; or (ii) is unable to show sufficient commitment to clear and time-bound actions, the Bank shall not proceed with this transaction.

**Strategy 3: Conditional approval of clients with potential to demonstrate their ability to manage their E&S impacts:**

In situations where the client is not currently able to demonstrate it can manage its E&S impacts, but is able to meet undertake clear and time-bound actions that would enable it to do

so, the bank may agree an E&S Action Plan (ESAP) which will be a condition of lending. In this case, one solution is to agree an Environmental & Social Action Plan (ESAP) with the client, which represents a set of actions aimed at closing the gap within a fixed and reasonable length of time.

**Strategy 4: Growing with clients who are able to manage their E&S impacts:**

The bank will favour clients who are able to demonstrate the capability and commitment to manage their own E&S impacts. Demonstrating the ability to manage E&S impacts involves:

- The client being able to identify its own E&S impacts;
- The client having set up appropriate procedures and management systems to manage its E&S impacts;
- The client being able to show that it has the organisational capacity and competency to implement its procedures and management systems.

**Strategy 5: Providing support (Professional & Technical) to clients to meet prescribed E&S Standards**

### 3.6 CBN Guidelines on E&S Risk Management

Nigerian Sustainable Banking (NSBP) Principle 1 commits banks to “integrate environmental and social considerations into decision-making processes relating to business activities to avoid, minimise or offset negative impacts.” CBN’s circular on the NSBP contains the following guidelines on implementation:

- **Development of appropriate E&S policies**  
This should include specific E&S policy application to different financial products and services. If a Bank provides finance to sectors and geographies that are deemed more sensitive, additional sector or location specific E&S policies may need to be developed. Policy approaches should be appropriate for financial products & services the Bank provides and give attention to its priority sectors. At a minimum, Banks’ E&S policies must commit to strictly review and potentially decline clients or engagements that do not comply with local E&S laws and regulations.
- **Development of appropriate E&S procedures**  
A Bank should develop appropriate E&S management procedures as a formal part of its client engagement and approval process to implement its E&S policies.
- **Screening for potential E&S risks**  
This should include identification of potential E&S risks which require further due diligence or risk management or exclusion of activities that the Bank will not finance.
- **Categorisation of potential E&S risks**

A Bank should have in place a system to consistently categorise the potential E&S risks associated with its engagements and clients.

- **Articulation of E&S governance/approval authority measures**  
Effective implementation of a Bank’s E&S policies and procedures requires a defined governance structure with clearly articulated roles and responsibilities, structure and staff to implement E&S policy commitments.
- **Monitoring E&S risks and reviewing E&S conditions**  
It is important to monitor the client’s on-going E&S performance to ensure that its E&S risks are being properly managed over time. Where conditions are not met, the issue should be escalated to the appropriate authority for consideration.
- **Provision of client engagement guidance on E&S issues**  
Training should be provided to the Bank’s client relationship managers and risk staff on how to engage clients on E&S issues.
- **E&S reporting criteria**  
A Bank will need to report on its E&S risk assessment processes including but not limited to:
  - Total number of clients and engagements assessed for E&S risks
  - By risk category,
  - Sector
  - Financial product type
- **Support for investment in sustainable, innovative business opportunities**  
In addition to E&S risk management, Banks should develop processes to identify and invest in business opportunities, clients or sectors that promote the use of advanced E&S risk management practices, new technologies, low carbon activities, entrepreneurial SMEs, in line with extant banking laws and which aim to achieve a positive impact.

**Nigerian Sustainable Banking Principles**

<b>Principle 1</b>	Our Business Activities": Environmental and Social Risk Management	We will integrate environmental and social considerations into decision-making processes relating to our Business Activities to avoid, minimise or offset negative impacts.
<b>Principle 2</b>	Our Business Operations: Environmental and Social Footprint <sup>3</sup>	We will avoid, minimise or offset the negative impacts of our Business Operations on the environment and local communities in which we operate and, where possible, promote positive impacts.

<b>Principle 3</b>	Human Rights	We will respect human rights in our Business Operations and Business Activities.
<b>Principle 4</b>	Women's Economic Empowerment	We will promote women's economic empowerment through a gender inclusive workplace culture in our Business Operations and seek to provide products and services designed specifically for women through our Business Activities.
<b>Principle 5</b>	Financial Inclusion	We will promote financial inclusion, seeking to provide financial services to individuals and communities that traditionally have had limited or no access to the formal financial sector.
<b>Principle 6</b>	E&S Governance	We will implement robust and transparent E&S governance practices in our respective institutions and assess the E&S governance practices of our clients.
<b>Principle 7</b>	Capacity Building	We will develop individual institutional and sector capacity necessary to identify, assess and manage the environmental and social risks and opportunities associated with our Business Activities and Business Operations.
<b>Principle 8</b>	Collaborative Partnerships	We will collaborate across the sector and leverage international partnerships to accelerate our collective progress and move the sector as one, ensuring our approach is consistent with international standards and Nigerian development needs.
<b>Principle 9</b>	Reporting	We will regularly review and report on our progress in meeting these Principles at the individual institution and sector level.

#### 4 Governance Structure – Roles and Responsibilities

## Roles and Responsibilities

This section of the framework summarises roles and responsibilities of the BOD and participants in the ESMS.

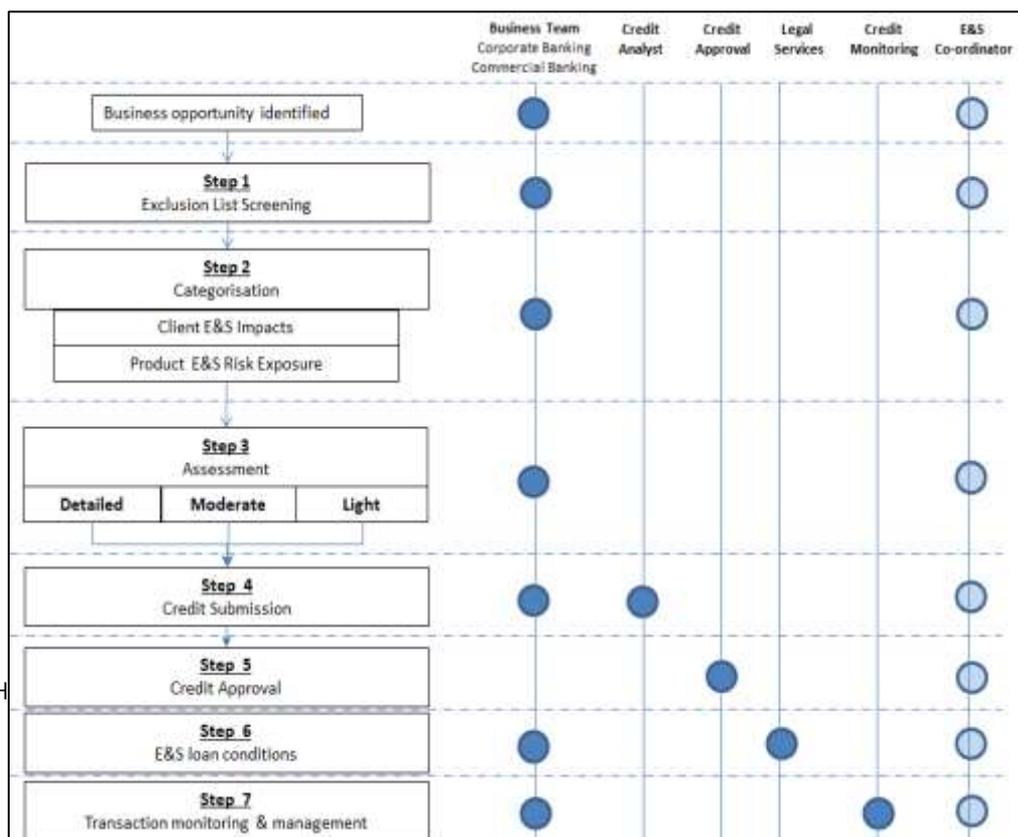
### I. Policy Functions

#### The Board of Directors (BOD)

- The Board shall perform the following roles with respect to E&S Risk:
  - Approve and periodically review the risk management framework for E&S Risk Management
  - Oversight of the implementation and operation of the ESMS;
  
- **Chief Risk Officer (CRO)**
  - The Chief Risk Officer performs the following roles in E&S Risk:
    - Daily oversight of the implementation and operation of the ESMS;
    - Reporting to BOD, CBN and Executive Leadership Committee on ESMS indicators.
  
- **Head of E&S Risk Management function**
  - The Head of E&S Risk Management will be responsible for:
    - Implementing the E&S Risk Policy;
    - Monitoring and controlling the Bank’s exposure to E&S risk.

### II. Implementation Functions

**Figure 2: Roles in Implementing E&S Risk Management**



- **Functions of E&S Risk Management Desk**
  - Supports the Head of E&S Risk Management
  - Provides day-to-day operational support on E&S matters to business teams and risk management
  
- **Business Units**
  - Carrying out of initial screening on the clients
  - Categorising clients and transactions
  - Undertaking E&S assessment
  - Alerting, reporting and escalating any material E&S risks as they occur
  
- **Credit Analysts**
  - E&S appraisal in the course of credit appraisal of clients and transactions
  - Recommending on E&S risks, client assessments and E&S action plans
  
- **Credit Approval Authorities**
  - Consideration of E&S characteristics in the course of approving clients and transactions
  - Recommending on E&S risks, client assessments and esaps
  
- **Monitoring**
  - Undertaking regular review of clients & transactions
  - Reviewing changes in E&S categorisation,
  - Checking for compliance with E&S covenants

## 5 E&S Risk Process Flow

### 5.1 Risk Identification

This E&S Policy is implemented by way of an Environmental & Social Management System (ESMS) that is integrated into the business development and risk management & control procedures of the Bank. Within this system, FBN MB recognises that its clients operate under significantly different conditions. It will be reasonable and pragmatic in applying standards, giving due consideration to each client's specific circumstances and the market in which it operates.

FBN MB has established an ESMS which is implemented for all new client and transaction approvals consisting of:

**1. Exclusion List Screening**

FBN MB has established tools to enable the business team or individual responsible for the client relationship and/or product development to screen the client against the FBN MB Exclusion List. Where clients or transactions are identified as being on the Exclusion List the default position will be that further consideration of financing/investment in the project will be terminated in line with this E&S Policy.

**2. Categorisation**

FBN Merchant Bank has established a process of categorisation which addressed the identification of the E&S risk exposure of the Bank as follows.

a. **Client Related Risks:** The process comprises a series of questions that establish the level of E&S risk associated with each client or transaction:

- **High E&S Impact:** The guiding principle for High E&S impact is:

“the presence of a E&S impacts or risks that extend beyond the boundaries of the sites where the activities are taking place, with the potential for irreversible harmful consequences, or of an unprecedented nature or scale”.

- **Medium E&S Impact:** The guiding principle for Medium E&S impact is:

“the presence of potentially adverse E&S impacts and/or risks that are few in number, generally contained within the boundaries of the sites where the activities are taking place, and can be readily addressed through avoidance, minimisation or mitigation measures”.

- **Low E&S Impact:** The guiding principle for Low E&S impact is:

“absence, or minimal impact, of adverse E&S risks”.

b. **Product Related Risks:** The process comprises establishing the level of E&S risk associated with products or services offered by the Bank:

The categorisation stage also requires a determination of the E&S risk exposure of the transaction as follows:

- **High to Medium E&S Risk Exposure**

“Long-term corporate lending, project finance and advisory, investment banking (corporate advisory, structured lending, and capital, other debt and equity

investments), structured commodity or trade finance with an ownership stake, private equity with majority ownership”

- **Medium to Low E&S Risk Exposure**

“Short term corporate lending, other forms of short term lending, private equity with a minority ownership”

- **Low E&S Risk Exposure**

“Short term financing, trade finance, leasing, research and advisory”

## 5.2 E&S Assessment

The overall purpose of E&S assessment is to establish the scale and nature of E&S impacts and the reliance that FBN MB can place on its client to manage these impacts. The type, scale and location of the project are all factors in guiding the scope and level of effort devoted to the identification of the client’s E&S impacts.

### 5.2.1 Determining the level of E&S assessment

Determining the level of E&S assessment is a function of:

- The client’s E&S impacts;
- The Bank’s E&S risk exposure of FBN MB related to the products & services offered.

This is addressed through the calculation of the E&S Risk Rating, This measure helps in determining the level of E&S assessment and is also used for monitoring and measurement purposes.

**Table 1: E & S Risk Rating Matrix**

The following table outlines the framework for determining the E&S Risk Rating:

E&S Risk Rating	High E&S Impact	Medium E&S Impact	Low E&S Impact
<b>High E&amp;S Exposure</b>	9	6	3
<b>Medium E&amp;S Exposure</b>	8	5	2
<b>Low E&amp;S Exposure</b>	7	4	1

<b>E&amp;S Risk Rating</b>	<b>Level of Assessment</b>
9	Detailed
8	Detailed
7	Moderate
6	Moderate
5	Moderate
4	Light
3	Light
2	Light
1	Light

**Detailed E&S Assessment comprises:**

- I. **Activity/Transaction Assessment:** comprising the E&S impacts associated with a client’s activities, and the specific actions being taken by the client to mitigate or improve its ability to manage these E&S impacts.
- II. **Client Assessment:** The client’s track record of managing E&S impacts, and its commitment and capacity managing such E&S impacts in the future.

These clients require more detailed E&S assessment across a broader range of factors, and addressing the most acute factors, and may need external consultant support and more detailed actions.

**Moderate E&S Assessment comprises:**

- I. **Activity/Transaction Assessment:** Comprising the E&S impacts associated with a client’s activities, and the specific actions being taken by the client to mitigate or improve its ability to manage these E&S impacts.
- II. **Client Assessment:** The client’s track record of managing E&S impacts, and its commitment and capacity managing such E&S impacts in the future.

These clients and transactions generally require E&S assessment based on one or two aspects of their E&S risk exposure, external consultant support is unlikely and E&S action plans are less detailed or extensive.

**Light E&S Assessment comprises**

- I. A check on the ability of the client to manage general E&S risks.

### **5.2.2 Identifying E&S Impacts**

The process of identifying E&S risks impacts will consider all relevant E&S impacts of the client or the specific transaction or project. This may be based on an Environmental Impact Assessment, a focused Environmental & Social Assessment, or application of environmental siting, pollution standards, design criteria, construction standards or applicable E&S laws and regulations. It should also take into account the findings and conclusions of related and applicable plans, studies or assessments prepared by relevant government authorities or other parties that are directly related to the client or project and its area of influence.

E&S impact identification also includes determining the individuals and groups that may be directly and differentially or disproportionately affected by the client or the project because of their disadvantaged or vulnerable status. This may stem from an individual's or group's race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.

Where the proposal is to provide lending to a company, the process of identifying E&S impacts will take into account the activities of the client, facilities owned or operated or managed by the client, the location of facilities and the areas affected by the clients operations and transportation of inputs and goods, and impacts from unplanned but predictable developments.

Where the proposal is to finance a specific project with identified physical elements, aspects and facilities that are likely to generate E&S impacts and risks these will be identified in the context of:

- I. The project's area of influence (comprising facilities owned or operated or managed as a component of the project, predictable developments, and indirect impacts on ecosystems and affected communities);
- II. Third party actions where these are central to the completion of the project, commensurate with the client's control and influence over these third parties and with due regard to conflict of interest;
- III. Primary supply chains, where the client can reasonably exercise control.

### **5.2.3 Determining when E&S Impacts are adequately managed**

The bank will support clients who are able to demonstrate the capability and commitment to manage their own E&S risks. Demonstrating the ability to manage E&S impacts involves:

- I. The client being able to identify its own E&S impacts;
- II. The client having set up appropriate procedures and management systems to manage its E&S impacts;
- III. The client being able to show that it has the organisational capacity and competency to implement its procedures and management systems.

The preferred option is for clients to anticipate and avoid E&S impacts.

Where avoidance is not possible, the second best option is for clients to minimise E&S impacts through:

- Abatement: where action is taken to terminate, suppress or reduce the E&S impact;
- Rectifying: where action is taken to correct the E&S impact as it occurs;
- Repairing: where action is taken to reverse specific E&S impacts once they have occurred;
- Restoring: where action is taken to replace or reconstruct the environmental or social asset that has been affected by the E&S impact

Where minimising is not possible (for instance, where residual impacts remain), the last and third best option is to compensate for impacts to workers, affected communities and stakeholders in environmental assets.

#### **5.2.4 Sector Guidelines**

Client activities in certain sectors result in higher E&S impacts, for instance because of the physical scale of the activity, the potential for impacting local communities, destruction of areas of high conservation value, or because a combination or accumulation of factors increases the overall E&S impact. Such sectors include oil & gas, mining, infrastructure, power, agriculture, and forestry. The Bank's business activities may be supported by the development of specific sector guidelines to assist in identifying E&S impacts and assessing the extent to which the client is able to manage them.

Under the Nigerian Sustainable Banking Principles, the Bank is required by CBN to develop sector specific E&S approaches for relevant business units consistent with the sector guidelines which form a part of the Nigerian Sustainable Banking Principles. These relate to the following sectors:

- Oil & Gas
- Power
- Agriculture

Where relevant, these and any other sector-specific E&S approaches that are developed will be used as an additional guide in conducting the E&S assessment.

#### **5.2.5 E&S Action Plans to address a shortfall in the client's E&S risk**

There is potential E&S risk exposure for FBN MB in any transaction where the client is not able to manage the underlying E&S impacts in their business. In situations where the client is not currently able to demonstrate it can manage its E&S impacts, but is able to meet undertake clear and time-bound actions that would enable it to do so, the bank will agree an E&S Action Plan (ESAP) which will be a condition of lending. In this case, one solution is to agree an Environmental & Social Action

Plan (ESAP) with the client, which represents a set of actions aimed at closing the gap within a fixed and reasonable length of time.

### 5.2.6 Approach to third party management of E&S risks

At times, the client's ability to achieve E&S outcomes consistent with the principles and standards of this Policy will be dependent on third party actions. Such third parties may be a government agency in a regular capacity or acting as a contract party, a contractor, or a primary supplier with whom the client has a substantial involvement, or an operator of an associated facility. FBN Merchant Bank will, as part of its assessment, determine the extent to which third party E&S impacts have been identified by the client, whether and under what conditions such risks are manageable. These may be the subject of an ESAP. Certain risks may require FBN MB to refrain from supporting the proposed client or business activity.

### 5.2.7 Credit Submission

Discussion of the E&S risks to the Bank will be included in the credit submission process and subject to review and comment by the relevant Credit Analyst. Credit submissions will include the overall categorisation of the client's E&S impacts and the bank's risk exposure through the products and services offered.

Credit appraisal will take the form of:

- I. Overview of the E&S categorisation;
- II. Overview of the E&S risk exposure arising from the products & services offered;
- III. The extent to which the E&S assessment is consistent with client and product E&S risk;
- IV. The outcomes of the E&S assessment;
- V. Any actions to be agreed with the client.

## 5.3 Credit Approval

The level at which approval are made on the basis of E&S risks is determined by the categorisation of the client's E&S impacts as follows:

- **High E&S Impacts:** The additional advice of the E&S Officer should be obtained before the credit is submitted for approval. High E&S Impact clients/transactions will be approved by the Management Credit Committee being the highest level of approval within the credit approval chain.
- **Medium E&S Impacts:** The additional advice of the E&S Officer is recommended before the credit is submitted for approval. Medium E&S Risk clients/transactions will be approved at

the level defined for the transaction in the Delegated Lending Authority. In the event disagreement between the E&S Officer, business team and/or credit analyst the approval will be escalated one level above that required by the Delegated Lending Authority.

- **Low E&S Impacts:** Approval is at the level as defined for the transaction in the Delegated Lending Authority.

The nature of the approval and the need for conditions is informed by the E&S assessment and the extent to which it can be demonstrated that the client is able to manage its E&S impacts.

The following framework provides guidance on decision-making.

**Figure 3: E&S Decision Matrix**

Client E&S Impacts Outcome of Assessment	High E&S Impacts	Medium E&S Impacts	Low E&S Impacts
Above Average Management of E&S Impacts	Approve Conditional on... Positive external opinion Covenants	Approve	Approve
Adequate Management of E&S Impacts	Approve Conditional on... Positive external opinion Covenants	Approve	Approve
Insufficient Management of E&S Impacts	Probable Decline unless... Positive external opinion Strong ESAP Strong Covenants	Approve Conditional on... Strong ESAP Strong Covenants	Approve Subject to... Compliance checks
Poor or Absent Management of E&S Impacts	Almost Certain Decline unless... Positive external E&S opinion Very Strong ESAP Very Strong Covenants	Probable Decline Very Strong ESAP Very Strong Covenants	Approve Subject to... Compliance checks

### 5.3.1 Loan Agreements and Covenants

All investment/borrowing agreements will contain appropriate E&S representations, warranties, and covenants requiring that projects are in compliance in all material respects with host country environmental, health, safety and social requirements embodied by state general laws and implementing agencies and conducted in accordance with any Applicable Requirements.

As determined by categorisation and E&S assessment, investment/borrowing agreements will contain representations, warranties and covenants that address the level of E&S risks, the commitment and capacity of the client to manage the E&S risk, and any required ESAP.

## 5.4 Transaction Monitoring & Management

FBN Merchant Bank recognises that the nature of E&S risks can change during the life cycle of a transaction or a client relationship. In the period after approval, FBN MB undertakes the following activities:

- a. **Approved transactions:** During project life-cycle, the Monitoring Unit will:
  - I. Review the Categorisation of the transaction for material changes;
  - II. Review client's management of E&S risks as per the loan conditions;
  - III. Review compliance and performance against specific indicators;
  - IV. Agree with the borrower and communicate, through feedback the key deficiencies identified and request for corrective action in specified time limits.
- b. **Completed transactions:** At the end of the loan, and during the writing of a project completion report that consolidates among others lessons learned, provision should be made for reporting on the environmental and social issues that may have emerged and lessons learned for enhancing future appraisals.
- c. **Legacy transactions:** The E&S Risk Policy is not intended to be implemented retroactively, and does not apply to legacy issues in continuing engagements to which the Bank has committed prior to the entry into force of the Policy. Nevertheless, where monitoring identifies the emergence of High E&S impacts FBN MB will seek to address these issues to the best of its ability.

## 6 E&S Risk Information Systems

### 6.1 Introduction

The E&S Risk Process is required to generate two types of report:

- I. Performance reporting for internal MIS, and for declaration to shareholders, CBN, and to inform any other external communications on the ESMS;
- II. Risk Trends information for monitoring and control of E&S risk exposure.

### 6.2 Data Requirements

- a. Performance Measures will include:

- Number of transactions entering the ESMS
  - The status of each transaction
  - The outcomes of submissions and approval discussions
- a. Risk Trends Information will include:
- Categorisation of E&S client impacts
  - Categorisation of E&S risk exposure from products & services, location, sector
  - Number of detailed, moderate and light assessments
  - Number of E&S action plans submitted and approved
  - Number of E&S projects discontinued
  - Number of E&S project declined

### 6.3 Risk Reporting

Risk reporting is essential to facilitate internal oversight of the implementation of the ESMS, to communicate information on the risk trends within the Bank, and to support reporting requirements to CBN, shareholders and its lending and supporting partners.

### 6.4 Structure of Risk Reports

Risk reports relating to E&S Risk Management will comprise:

- E&S Risk Dashboard

The E&S Risk Dashboard will cover all proposals in the ESMS and will include:

- Total number & value of transactions
  - Total number & value of transactions across sectors
  - Total number & value of transactions across locations
- Total no. & value of transactions submitted for approval
  - % of no. Transactions submitted
  - % of value transactions submitted
  - No & value of Detailed Assessments
  - No & value of Moderate Assessments
  - No & value of Light Assessments
  - No. Approvals by risk rating
  - No. Conditional approvals by risk rating
  - No. Declined by risk rating

- **E&S Risk Overview**

In addition to the information on the Dashboard, the E&S Risk Overview will include:

- No & value of submissions in Corporate Banking
- No. & value of submissions in Investment Banking
- Risk categorisation by financial product type

- Risk categorisation by industry sector
- Risk categorisation by branch location
- Shareholders & Development Finance Institutions E&S Risk Report
- Annual Report
- Total Assets, Net Income, Employees, Branches
- Involvement with Development Financial Institutions on a financial basis
  
- **E&S Risk Management Systems:**
  - Confirm E&S Risk Policy is complete
  - E&S Manager: Name & Function
  - E&S Co-Ordinator: Name & Function
  - Number staff trained on E&S management in reporting period
  - Number of staff trained on E&S management (cumulative)
  - Changes in E&S management in reporting period
  
- **E&S Risk Implementation**
  - Any loans on the portfolio that are on the Exclusion List
  - Number of clients rated category A (E&S Risk Rating 7-9)
  - Number of clients rated category A (E&S Risk Rating 4-6)
  - Number of clients rated category A (E&S Risk Rating 1-3)
  - Projects & clients experiencing environmental and/or social issues and/or incidents; measures taken to manage issues and/or incidents
  
- **Portfolio information**
  - Breakdown of portfolio by industry sector
  - Loan assets longer than 12 months tenor OR larger than USD 1mln outstanding exposure
  - Number of clients rated category A (E&S Risk Rating 7-9)
  - Number of clients rated category A (E&S Risk Rating 4-6)
  - Number of clients rated category A (E&S Risk Rating 1-3)

## 6.5 Coverage of Risk Reporting

Risk Reporting shall cover the tasks / functions performed in the following segments of E&S Risk Policy:

- Categorization of exposures into Banking book
- Risk Identification process
- Risk Measurement
- Validation Methods
- Exposure and Risk Limits
- Risk Monitoring and Control

## 7 Appendix: FBN Merchant Bank's E&S Exclusion List

FBN MB will not finance any activity, production, use, distribution, business or trade involving:

1. Forced Labour: meaning all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty as defined by ILO conventions.
2. Child Labour: where persons may only be employed if they are at least 14 years old, as defined in the ILO Fundamental Human Rights Conventions (Minimum Age Convention C138, Art. 2), unless local legislation specifies compulsory school attendance or the minimum age for working. In such cases the higher age shall apply.
3. Any product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans, such as:
  - Ozone depleting substances, PCB's (Polychlorinated Biphenyls) and other specific, hazardous pharmaceuticals, pesticides/herbicides or chemicals;
  - Wildlife or products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES); or
  - Unsustainable fishing methods (e.g., blast fishing and drift net fishing in the marine environment using nets in excess of 2.5 km in length).
4. Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations.
5. Destruction of High Conservation Value areas: Where destruction means the (1) elimination or severe diminution of the integrity of an area caused by a major, long-term change in land or water use or (2) modification of a habitat in such a way that the area's ability to maintain its role is lost.
6. Radioactive materials: This does not apply to the purchase of medical equipment, quality control (measurement) equipment or any other equipment where the radioactive source is understood to be trivial and/or adequately shielded
7. Un-bonded asbestos fibres
8. Pornography or prostitution
9. Racist and anti-democratic media
10. In the event that any of the following products form a substantial part of a company's primary operations:
  - Tobacco;
  - Weapons and munitions;
  - Gambling, casinos and equivalent enterprises.

Where "Substantial" means more than 10% of a financed institution's/company's consolidated balance sheet or earnings. "Substantial" means more than 10% of a Financial Institution's underlying portfolio volume.