

# ***Social and Environmental Field Guide***

## ***for Micro Finance Institutions***



*Working with Clients on the Social and Environmental Aspects of Microfinance*

## ***PART A: OFFICE GUIDE***



# **FMO**

*Finance for Development*

**TRIPLE VALUE**  
STRATEGY CONSULTING



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## **Preface: Relevance of Social & Environmental issues for MFIs and their clients**

Although MFI(F)s have a considerably lower environmental and social risk level than most other financial institutions, they can play an important role in disseminating good environmental and social good practices and standards. The minimum standard that MFI(F)s need to comply with is the national law and legislation, however limited enforcement may be. In addition, the standards put forward by FMO need to be adhered to, especially the exclusion list. Most sector exclusions in the FMO list can be readily implemented, some others are harder to comply with. A good example is child labour. FMO strives for the absence of child in all financing that it provides, but it realizes that in many situations encountered by MFI(F)s, child labour is unavoidable. FMO's training aims to put workable standards in place for MFI(F), such as uncovering unacceptable situations, e.g. when child labour is at the expense of education.

Regarding the importance of social and environmental aspects for MFI(F)s the following points carry importance:

1. Internationally there is increasing attention for E&S aspects
  - Microfinance institutions (MFI) recognised as important players to contribute to social (and environmental) development
2. But the relevance of E&S aspects for an MFI is less clear cut
  - E&S risk for an MFI are typically rather limited
  - Although E&S aspects may add to financial sustainability of an MFI
3. But since development is the core business of an MFI there is a clear E&S role
  - This has been confirmed by many MFIs
  - It may even lead to business and financing opportunities
4. Development banks like IFC and FMO attach great value to MFIs integrating E&S aspects in their operations

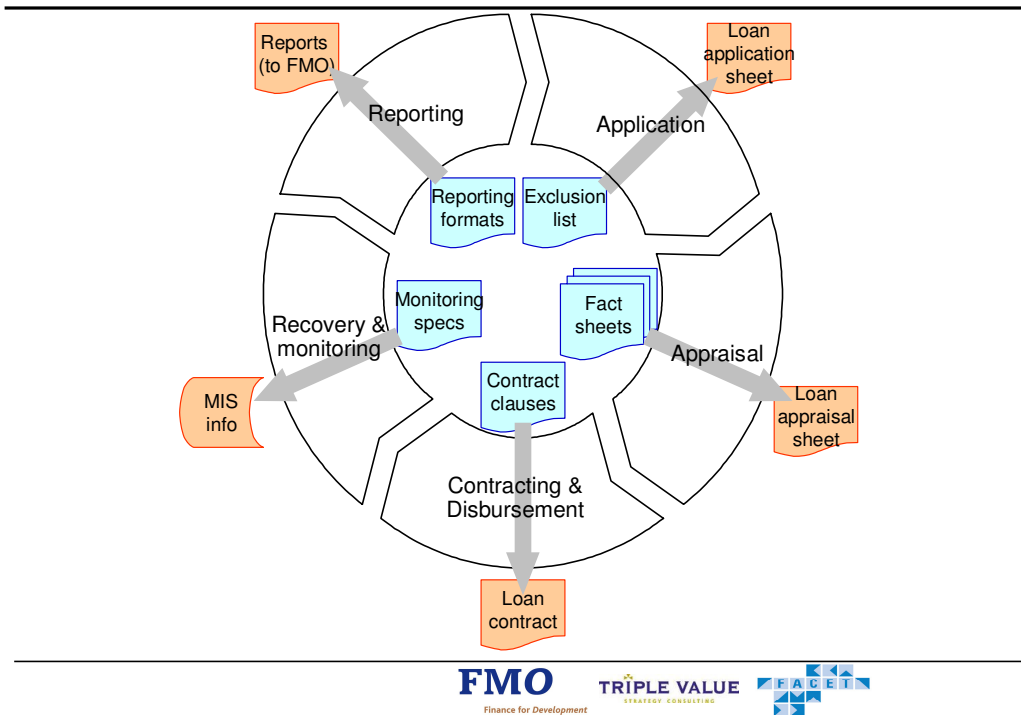
This Field Guide serves as a practical tool for Loan Officers to implement social and environmental aspects in their daily work. The elements of this field guide need to be integrated into the Standard Operating Procedures of individual MFI(F)s

# 1 Coupling Social and Environmental aspects to the loan cycle

Social and Environmental aspects must be considered in conjunction with the other aspects that are relevant for providing loans. For that reason the information in this Field Guide must be integrated into the standard operating procedures (SOPs) of an individual MFI.

The diagram below summarizes the generic steps that need to be taken to successfully integrate social and environmental aspect in the SOPs of an MFI. The following chapters in this Field Guide will deal with these steps

## Coupling Social and Environmental aspects to the loan cycle



## 2 Loan Application

### ***Exclusion List***

An exclusion list defines what activities may not be financed. Each MFI will need to develop an exclusion list.

An exclusion list includes:

- Activities which are regulated or prohibited under international agreements and by national laws
- Activities which may give rise to significant environmental/social problems, or that lead to significantly adverse public reaction
- In your contract with FMO it is agreed that you can not finance activities that are on the FMO exclusion list

MFIs financed by FMO are legally obliged to include all the sectors and activities of the FMO exclusion list:

- Production or activities involving forced labour<sup>1</sup> or child labour<sup>2</sup>.
- Production of or trade in any product or activity deemed illegal under host country legislation or regulations or international conventions and agreements.
- Production of or trade in weapons and munitions<sup>3</sup>.
- Trade in wildlife or wildlife products regulated under CITES<sup>4</sup>.
- Production or use of or trade in hazardous materials such as radioactive materials<sup>5</sup>, unbounded asbestos fibers, products containing PCBs<sup>6</sup> and chemicals subject to international phase-outs or bans.
- Commercial logging operations or the purchase of logging equipment for use in any primary forest or forest areas with a high biodiversity value, or any other activities that lead to substantial clear cutting of such forests<sup>7</sup>.
- Production of or trade in pharmaceuticals subject to international phase-outs or bans.
- Production of or trade in pesticides/herbicides subject to international phase-outs or bans.
- Production of or trade in ozone depleting substances subject to international phase-out<sup>8</sup>.
- Drift net fishing in the marine environment using nets in excess of 2.5 km in length.

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<sup>1</sup> Forced labour means any work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty.

<sup>2</sup> Employees may only be taken on who are aged 15 or older, unless local legislation specifies a higher age for compulsory school attendance or as the minimum age for working. In such cases the higher age shall apply.

<sup>3</sup> This does apply to clients who are substantially involved in these activities.

<sup>4</sup> CITES: Convention on International Trade in Endangered Species of Wild Fauna and Flora.

<sup>5</sup> This does not apply to the purchase of medical equipment, quality control (measurement) equipment and any equipment where the radioactive source is trivial and/or adequately shielded.

<sup>6</sup> PCBs: Polychlorinated biphenyls, a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switchgear dating from 1950-1985.

<sup>7</sup> "Substantial" refers to any degree of deforestation which leads to the disappearance of the essential functionalities of the forest, though surface reduction under a critical minimum. With "essential functionalities" defined as carrying capacity for biodiversity, watershed management, erosion control and indigenous inhabitation.

<sup>8</sup> Ozone Depleting Substances: Chemical compounds, which react with and deplete stratospheric ozone, resulting in "holes in the ozone layer". The Montreal Protocol lists ODSs and their target reduction and phase-out dates.

## ***Loan application sheet***

In the loan Application sheet, typically client and loan information is included such as:

- Photo
- Address
- Name
- Repeat borrower
- Loan number
- amount of loan
- purpose,
- sources of earnings
- present sources of credit
- co-obligant / mutual guarantors
- assets/security/savings
- family details
- basic household expenditure
- Education level
- religion
- caste
- urban/rural
- electric connection
- independent toilet
- cooking gas
- own house
- roof type
- land ownership
- housing index score
- poverty status
- migration status
- literacy etc

Application of the Exclusion List should be included in the Loan Application sheet. This allows monitoring of rejected applications, based on the Exclusion List, and justification of loans that are accepted for appraisal.

Other Environmental and Social factors that could be inserted in the loan appraisal sheet

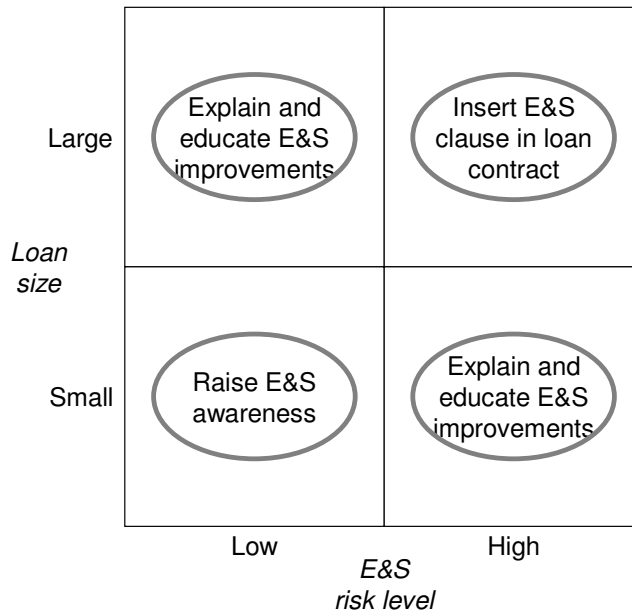
### 3 Loan Appraisal

In the appraisal phase decision is taken whether a loan will be granted. In addition to the existing assessments, social and environmental consideration should be included in the phase. There are three possible outcomes of social and environmental appraisal:

- Raise awareness of client about social and environmental impacts
- Train / educate the client regarding social and environmental improvements
- Included specific clauses in the loan contract to mitigate specific social and environmental risks

The three outcomes depend on the social and environmental risk of the loan and the size of the loan, as is indicated in the diagram below

Three generic possibilities how to treat a loan are based on the E&S risk level and the size of the loan



The information based on which the social and environmental appraisal can be conducted must be included in the loan appraisal sheet

## ***Loan appraisal sheet***

A loan appraisal sheet usually includes information such as:

- Economics of the proposal (volume, income, expenditure, timing of activity, persons employed)
- Requested loan (amount, purpose, repayment period and installment)
- Investment
- Strengths/weaknesses
- available/requested Technical Assistance
- Credit record
- Particulars of the applicant (name, address, level of education, training attended)
- Performance (repayment, meeting attendance, savings consistency)
- Particulars of business (ownership)
- Market assessment (location, customers, marketing, other services, suppliers, competition, seasonality)
- Business assessment (type, nature, capital, employees, sales, purchases, expenses, turnover, profit/loss)
- Securities (character, business, cash collateral, pledges)

And/or In case of group lending:

- Group assessment (constitution/objectives, activities, records, meetings, elections)
- Group Recognition Test Information

These appraisal forms should contain, in addition to the items mentioned above, information about: occurrences/incidents of Environmental / Health and Safety / Labour Risks or Defaults. The source for these defaults or remarks lays in the activity appraisal tool or the sector factsheets. Whenever a risk is detected, it should be included in the appraisal form. Information can include tick boxes for application of the sector fact sheet, or actual occurrence of Environmental, Health and Safety a/o Labour issues, or instances of defaults or even rejections based on these risk evaluations.

The Loan appraisal sheet could have space for inclusion of most relevant risks (or number of occasions, awareness raising/training/clauses) for



**[E]** (Environmental)



**[H&S]** (Health and Safety)



**[L]** (Labour)

In addition, the appraisal form could include information such as:

'A loan of .... Is sanctioned / recommended for sanction under the following terms and conditions: .....

- Approved
- Approved with conditions .....
- Rejected (reason .....
- Pending (reason .....

## Activity assessment tool

The overview on the next page indicates a number of sectors (Agriculture, Service, and Production), and client activities. Based on what kind of activities a client is involved in, the situation can be regarded as undesirable or even creating a risk involving negative environmental impact, health and safety and/or labour issues.

A series of Factsheets is available, indicating per sector the most relevant 'hints' for a loan officer to check or discuss with the client. In the overview below, these 'most relevant' issues are indicated with an **X**.

Other possible risks per sector are indicated with a dot, but these are not included in the sector factsheets.

An overview of all possible observations, attached risks, explanations and interaction with the client is given in Part B: Field Guide

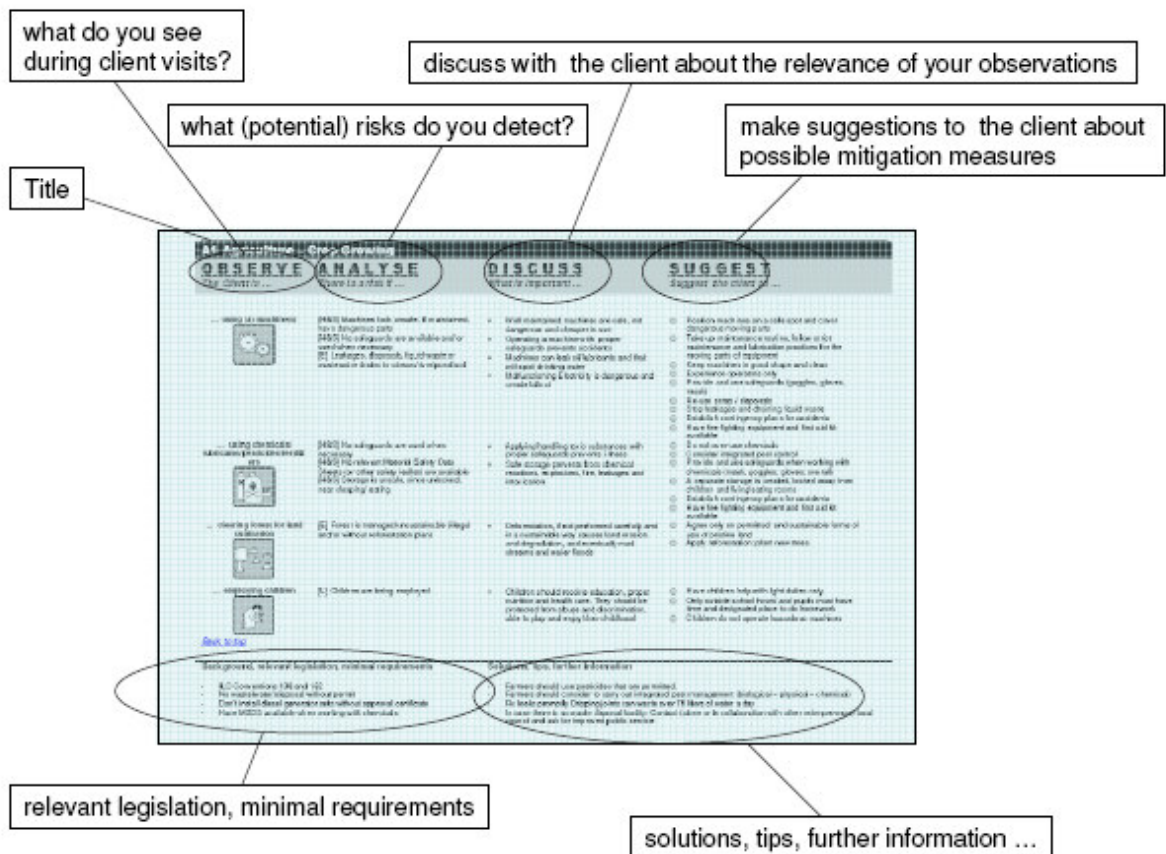
... when the Client is ...	Environment Health and Safety Labour			Sectors																						
	A1	A2	A3	S1	S2	S3	S4	S5	S6	P1	P2	P3	P4	P5	P6	P7	P8	P9	P10	P11	P12	P13	P14	P15		
... using (a) machine(s) [E] [H&S]	X							X							X	X								X	X	
... using chemicals/paint/solvents/ lubricants/pesticides/fertilizers [H&S]	X	X	X					X							X	X	X	X								
... employing children [L]	X	X	X	X	X	X	X								X	X	X	X	X	X	X	X	X	X	X	X
... working in bad conditions [H&S] [L]										X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
... disposing of organic / production / chemical waste [E] [H&S]				X	X			X		X				X	X	X										
... causing emissions to air [E] [H&S]									X					X	X	X										
... polluting water [E] [H&S]													X	X	X	X				X	X					
... processing food [H&S]																										X
... clearing forest for land cultivation [E]	X	X															X							X		
... extracting clay or minerals [E]																					X		X			
... catching fish [E]				X																						
... keeping animals [H&S]	X																									

## Sector factsheets

Sector Factsheets are available for all 24 sectors mentioned in the previous section. In case factsheets are missing or sectors that are important a particular MFI they need to be developed. Other factsheets can serve as the basis here. In case the factsheets do not include factors that are important for the business of a particular MFI, modifications need to be made.

You'll find all Factsheets in Part B: Field Guide.

In the overview below, the content and lay-out of the factsheets is being explained.



## 4 Loan contracting

Example of standard clauses to mitigate social and environmental risk:

I, ....., undertake to carry out my business in a way that avoids, reduces, and compensates for damage to nature, public services, or the well-being of the individuals who work with me and who live in the vicinity, by continuing with or taking the following actions:

- Operate and maintain machines and equipment professional and with proper (safety) measures
- Don't employ children
- Use (toxic) chemicals with proper safeguards and store them properly
- Comply with accepted standards and regulations regarding land cultivation
- Reduce the amount of waste by improving the process or recycling
- Prevent land erosion or degradation
- Take precautions in waste disposal, not dump liquid or solid waste in public places
- Avoid, reduce, control processes that pollute the air
- Take steps to protect my own health and that of my employees / clients / neighbours
- Comply with municipal regulations on environmental protection, health and safety, hygiene, labour
- Comply with government regulations

I have been informed that entity granting me the loan may take a visit to evaluate my activities from the environmental, health and safety, and labour standpoints and that I may only obtain a new loan if, in addition to complying with the financial conditions, I also comply with my environmental, health and safety, and/or labour commitments.

In addition to these standard clauses one may formulate specific loan clauses to mitigate risks that are specific for a loan. In most cases these clauses can be simple adaptations from the standard clauses

## 5 Documentation of E&S issues in management systems

The social and environmental aspects of a loan / client must be logged into the Management Information System (MIS). Examples of this are:

- Whether an E&S appraisal has been performed
- What the most important E&S aspects of a client or a loan are
- What clauses have been added to the contract
- If a client has made the necessary improvements this can be logged in the MIS as well

The modifications that need to be made depend on the MIS and no specific guidance about that can be given here

Having the relevant E&S information in the MIS has a number of advantages:

- Loan officers can use information from MIS to monitor progress and compliance
- In case loan officers change information is not lost
- Status and progress information can be used during subsequent loans to the same client

Logging the basic E&S info related to a client or to a loan is important to

- Develop a cross loan-book view on what are the main E&S risks
- Learn what works and what does not

Based on knowledge of the E&S aspects of the portfolios MFIs can

- Customize activity and sector factsheets to reflect the local circumstances
- Customize the loan appraisal process

With this information cross loan-book overviews can be generated about nature and magnitude of the E&S risks

- This can be used for reporting to investors and other capital providers

## 6 Monitoring of E&S issues

The Monitoring of E&S issues is a matter of making effective use of indicators and information. FMO will produce a specific set of indicators and monitoring system, based on the experiences of the MFI(F)s using this method, as well as on their existing FI monitoring systems.

Environmental and social indicators under consideration include:

Total Number of Loans

Number of Loans screened

Number of rejections based on Exclusion List

Number of interventions leading to

- a) Awareness raising
- b) Explain & educate
- c) Contract Clause

Most frequent risks encountered

Number of instances with risks related to:

- a) Environmental aspects
- b) Health and Safety aspects
- c) Labour aspects

Sectors with most risks