



**Review and Update of the World Bank's Environmental and
Social Safeguard Policies
Phase 3
Expert Focus Group on Financial Intermediaries (March 3, 2016)**

Meeting Summary

Venue: IFC Office, Rua James Joule, 65 - 19o. andar, Edifício Torre Sul, Cidade Monções, São Paulo, SP, Brazil

Participants

Name	Organization
Rodomarque Tavares Meira	Brazilian Central Bank
Enrico Della Riva	Brazilian Central Bank
Vania Borgerth	BNDES
Márcio Macedo da Costa	BNDES
Eduardo Lima	HSBC
Paulo Mouzinho	Banco da Amazonia
Annelise Vendramini	Fundação Getulio Vargas (FGV)
Bianca Zambão	Itau Unibanco
Rafael Mol	Itau Unibanco
Wagner Siqueira Pinto	Banco do Brasil
Beatriz Secaf	Febraban
Silvia Chicarino	Santander
Anna Paula Secco	ING

Summary of Discussion and Key Points

Issue	Key points and feedback
World Bank's work in the financial sector and	<ul style="list-style-type: none"> - Participants highlighted that more clarity needed from World Bank on what type of operations the Financial Intermediary standard (ESS9) would apply to.

<p>relevance for commercial banks</p>	<ul style="list-style-type: none"> - Participants asked for more information about WB project structure(s) for Financial Intermediary projects and whether WB projects involve commercial financial institutions to establish clear relevance of the proposed ESF for commercial banks. - Furthermore, participants inquired about the potential impacts of the proposed ESF on commercial banks vis-à-vis their interactions with state-level financial institutions/ development banks such as BNDES in Brazil and the degree of E&S responsibilities commercial financial institutions would have in such scenarios. - Participants highlighted the need to clearly explain the scope of application of the ESS9 standard: Is it for projects that use resources from the World Bank? Would it be applied only in relation to this WB-financed portfolio? - Participants identified a challenge regarding their role in determining development priorities in the country; development is a decision of the Brazilian government and society, and banks are brought into macro-decisions on development often at a later stage to serve as vehicles for financing already defined priorities, however are also expected to manage environmental and social (E&S) risks associated with such decisions. - In relation to the above, participants highlighted that state development banks together with the government often determine country and regional development priorities for financing, such as those in the Amazon region, and distribute funds accordingly Experience of the Bank – regional development bank in Amazon; the process is discussed with government of Amazon development.
<p>National policies / frameworks for E&S risk management in the financial sector</p>	<ul style="list-style-type: none"> - Participants shared Brazilian experience with implementation of regulations on environmental and social issues adopted for the financial sector, and more specifically Resolution 4327 on Social and Environmental Responsibility for Financial Institutions¹ implemented after 2 years of consultations, including with civil society. This Resolution required Brazilian banks to have an Environmental and Social Management System (ESMS). - Participants further inquired whether such national regulations and, in particular, ESMS would be sufficient for the World Bank to satisfy requirements under the proposed ESS9 standard.

¹ In 2014, the Brazilian Central Bank (BCB) published a mandatory Resolution 4327 on Social and Environmental Responsibility for Financial Institutions. The Resolution strengthens E&S risk management and introduces the concept of relevance and proportionality of E&S risks. It requires banks to develop and execute a Social and Environmental Responsibility Policy, aimed at managing E&S risks, preventing losses from both environmental damages and social issues, and engaging with affected stakeholders.

	<ul style="list-style-type: none"> - Participants noted that commercial financial institutions serve as vehicles to implement the regulations but at the same time cannot be accountable for public policy. - Participants highlighted the evolving nature of the relationship between regulators (the Central Bank) and commercial financial sector with regard to determining liability for environment and social risks and impacts. In particular, participants noted that the emerging trend is to hold commercial financial institutions responsible for harm caused by their customers while environmental licensing, as well as social issues where a lot of licensing institutions may be involved, remains under the authority of public institutions (meaning that commercial banks have limited control over this process, especially in large projects). This inevitably leads to reluctance of the commercial sector to finance large development projects. - Participants stated that the issue of competitiveness for commercial banks is important and World Bank requirements may result in additional costs that the banks will need to internalize.
<p>General challenges of implementing E&S risk management in the financial sector</p>	<ul style="list-style-type: none"> - Participants shared that in Brazil banks are advanced in E&S techniques, regulations, and policies; however, this primarily applies to banks that have larger portfolios and focus on larger projects. In these circumstances, E&S risk management is more challenging and complex in “retail” banking (e.g. MSME financing), where there are no established methodologies and techniques. World Bank proposed ESF, as well as IFC Performance Standards, are geared towards big projects. If the World Bank (and IFC) can help create such methodologies, it will be significant value-add to what exists now. - Participants further noted that the insurance and asset management are lagging behind in terms of the evolution for E&S risk management in this type of financial products. - Participants highlighted that due diligence for smaller operations is a big challenge due to lack of internal capacity; this is being addressed by establishing E&S risk management function within the banks as an internal training and awareness raising function for credit and lending staff. - Participants emphasized that the regulatory efforts on the E&S for the financial sector by the Central Bank in Brazil is a good way to put all banks on the same pathway. However, implementation challenges involve the need for more guidance and tools around specific financial products.
<p>E&S risk and categorization</p>	<ul style="list-style-type: none"> - Participants stressed that E&S requirements must always take into account the level of risk with various activities and financial products.

	<p>It should also be recognized that some types of financing are not considered as presenting an E&S risk for a bank.</p> <ul style="list-style-type: none"> - Participants stated that each financial institution should be permitted to have its own system for E&S risk scoring, even though the proposed World Bank ESF mentions 4-levels of risk categorization. - Participants further noted that banks would be interested to maintain the same type as IFC’s categorization they are used to (A, B, C), which is also the risk categorization system used under the Equator Principles. - Participants also shared an approach used in the financial sector, which is a combination of categorization and a sustainability risk rating (the latter changes over time, during project supervision/ monitoring). - Participants further noted that risk categorization and scoring in the financial sector is closely linked to the type of financial products and the loan term. Additionally, sectoral risk considerations are important, however they are not the only variable and should be balanced with other considerations. - Participants requested that, in the case of the financial sector, World Bank proposed ESF should have definition of a “project” and associated risk that is linked to various financial products.
Capacity for implementation	<ul style="list-style-type: none"> - Participants stressed that financial institutions have to make difficult choices internally about significance of risk vis-à-vis available capacity to manage it; the nature of the business is such that banks do not have full access to information and must nevertheless make quick decisions. - Participants emphasized that it is important for the World Bank to build knowledge and tools at the sector level to help financial institutions manage E&S risks; a good example from Brazil is the cattle sector where IFC invested in developing a process to evaluate knowledge and risks by analyzing the value chain. - Participants inquired about World Bank proposed ESF provisions regarding capacity of financial institutions for management of E&S risks; they specifically stated that in cases of limited in-house capacity, it is feasible to engage external consultants for large projects but not for smaller transactions that are often large in number and shorter-term. Would the World Bank require developing in-house capacity in such cases? - Participants noted a potential challenge associated with the nature of World Bank projects in the financial sector; they specifically pointed out that World Bank is more likely to define developmental objectives of its projects in a way that reaches “bottom of the pyramid” clients to fulfil its mandate to reduce global poverty. If this is the case, World Bank funding will likely be allocated to smaller banks and this may

	<p>create a distortion in the market in terms of the level playing field on E&S risk management as smaller banks have poor capacity and consequently do less rigorous due diligence. Participants inquired whether the government would be expected to channel funding to such banks even if they have poor E&S practices as compared to the larger financial institutions in the country.</p>
<p>Harmonization with IFC, Equator, other initiatives</p>	<ul style="list-style-type: none"> - Participants expressed concerns about addressing differences in requirements with IFC, other MDBs, and the Equator Principles framework. - Participants stated that the Equator framework is a well-structured system that is adopted by several largest Brazilian financial institutions; additionally there are other country-level initiatives such as Febraban committee on social responsibility and environment, all establishing good practices. - Participants inquired how World Bank will apply its ESS9 requirements in cases of co-financing and whether financial institutions would be allowed to develop a common approach; in particular if a leading financial institution in a syndicate follows the Equator Principles. - Participants expressed concerns about differences between the proposed ESF and IFC Performance Standards (beyond ESS9); these differences will also have an impact on the application of Equator Principles, which cover most of the project finance globally today, and may generate conflicts in negotiation of environmental requirements. - Participants raised a concern on the possibility in the near future that the new ESF/ESS should be applied by the entire World Bank Group, including the IFC.
<p>Stakeholder engagement by Financial Intermediaries</p>	<ul style="list-style-type: none"> - Participants expressed concerns regarding ESS9 requirements for stakeholder engagement conducted by financial intermediaries and inquired if these requirements could be revisited. - Participants stressed that commercial financial intuitions - as opposed to development banks that do large projects - are not well positioned to play a role in stakeholder engagement similar to that of the World Bank (i.e. engaging directly with civil society around specific projects). - Participants pointed out that Brazil has big projects where stakeholder engagement by the client is all part of environmental license that banks also require for their due diligence. - Participants agreed that it may be necessary to have stakeholder engagement in high risk projects; however, they expressed doubts that banks can take initiative on stakeholder engagement as opposed to ensuring/ encouraging their clients to do so.

	<ul style="list-style-type: none"> - Participants further stated if banks engaged with communities directly, this may cause confusion as communities may not understand that bank is not able to make commitments on behalf of its client. - Participants stated that paragraphs 17 and 18 of ESS9 are unclear as to what they apply to, as well as on the level of engagement; participants suggested these two paragraphs be revised. - Participants further inquired what stakeholder engagement requirements under ESS9 would mean for smaller operations; would banks need to launch a nation-wide as a form of stakeholder engagement for a credit line to MSMEs? Microcredit? - Participants furthermore emphasized that financial institutions normally do not have adequate knowledge and capacity to conduct stakeholder engagement, especially in more complex cases where resettlement and compensation may be involved.
Disclosure	<ul style="list-style-type: none"> - Participants highlighted that while banks in Brazil increasingly look into supporting greater transparency in their operations, there are confidentiality laws in Brazil - and, to their knowledge, in other countries - that limit banks' ability for disclosure. Bank can only speak publicly about projects they finance if explicitly permitted to do so by their clients. - Participants further inquired whether World Bank would consider financial intermediaries non-compliant with the ESS9 disclosure requirements in cases where banks are not allowed to disclose such information by law. - Participants suggested that financial institutions may potentially be able to disclose their own Environmental and Social Management System, but not that of their clients.