Status of E&S Risk Management for FIs

Presentation to the Civil Society Organizations
April 10th 2014
Outline of Presentation

1. Recap of why we work with FIs and profile of our portfolio

2. IFC Action Plan. Key areas of focus

3. IFC’s Progress on implementation of the Action Plan:

4. Open session for questions and discussion
IFC’s FI Network - Depth and Breadth of Market Penetration

FIs are a key channel to expand IFC’s reach and development impact in our target markets. It enables IFC to deliver financial resources to millions of SMEs, microenterprises and individuals that it would never be able to reach directly. This engagement has strengthened the capabilities of FIs to fund activities in vital economic sectors such as agriculture, housing, manufacturing, infrastructure and social services. Our work with these clients has supported an estimated 100 million jobs.

897 clients, 1,320 projects, $18.6 billion total portfolio*

<table>
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<tr>
<th>692 Financial Institutions, 1,106 projects</th>
<th>205 Private Equity Funds</th>
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as at June 30, 2012

- **Eastern Europe & Central Asia**: 192 clients, 315 projects, $4.6 billion portfolio
- **Middle East & North Africa**: 90 clients, 125 projects, $1.5 billion portfolio
- **East Asia & Pacific**: 121 clients, 189 projects, $3.2 billion portfolio
- **South Asia**: 89 clients, 115 projects, $1.4 billion portfolio
- **Sub-Saharan Africa**: 176 clients, 242 projects, $2.3 billion portfolio

*Includes PE Funds and FMV of equity and quasi-equity
The chart below shows IFC’s FI portfolio broken down by E&S risk. As can be seen from the chart, the Higher risk FIs where, Category A and B projects are expected, represent a small minority of IFC’s FI investments and the predominant focus is on access to finance to SMEs and microfinance clients. IFC’s does not believe there is, or claim additionally on E&S risk management, for the Low/No risk FIs as well as some of the Medium Risk FI clients.

- **Higher Risk** - Financial Institutions that are substantially exposed to high - medium high risk and are required to apply Performance Standards to select sub-projects
- **Medium Risk** - SME funds and FIs that are required to comply with host country requirements.
- **Low Risk/No Risk** - clients with Exclusion List requirement
- **No Risk** - clients with no E&S risk in their portfolio

Notes
1. Projects processed prior to the 2006 Sustainability framework
2. The analysis is of clients as of June 2012. To enable comparison across the portfolio, FIs before 2012 have been conservatively reclassified given the absence of the FI-1,2,3 classification prior to 2012.
Since the adoption of the FY06 framework, IFC has significantly strengthened its E&S appraisal and supervision of FIs, resulting in and qualitative and quantitative improvements. The chart below shows the increase in field supervision visits for FI clients. As the supervisions visits are scheduled annually for FI-1s but over 2-3 years for other FIs, the graph shows both the cumulative as well as the annual supervision visits. Also note that not all of the FM portfolio clients have E&S risks or E&S supervision. The table below the chart shows the IEG assessment of IFC’s E&S appraisal and supervision work quality over the years.
IFC today actively supervises over 400 clients on E&S risk management and has conducted over 700 field supervision visits to FIs. In addition to ramping up the FI level field visits, IFC has introduced validation of the FI’s ESMS through a review of the FI’s loan files and sub-client field visits. IFC has, to date (cumulative) reviewed over 1200 loan/investment files and visited over 300 sub-clients as part of this validation process, focusing on higher risk FIs and their ESMSs.
IFC’s Knowledge of What is Happening on the Ground

IFC estimates its own knowledge of the situation on the ground with the FI and its implementation of the ESMS. The portion of the FI portfolio where IFC does not have current reports or information about the client’s ESMS implementation where applicable, is referred to as the knowledge gap. As also noted in the CAO report, the concerted strengthening of IFC’s capacity and implementation over the years (shown below the chart) has resulted in significant improvements in IFC’s knowledge of the E&S risks in its portfolio and its resultant ability to manage these and focus on problem areas.
The second aspect of IFC’s approach to the E&S risk in its portfolio is the performance gap, given that the knowledge gap (previous slide) is now <2%. The performance gap is the status of the shortcomings/gaps in E&S implementation by the FI. IFC E&S specialists score the risk adjusted performance of our FI portfolio (409 clients who have E&S risks and are being supervised).

As the chart below shows, around 90% of our higher risk FIs and 79% of our medium risk FIs have either already met or are on a trajectory to meet IFC’s E&S requirements. Around 12% of our total portfolio is considered unsatisfactory and steps are being taken to remedy these with options that are available.

Notes:
• To enable comparison across the portfolio, FIs before 2012 have been conservatively reclassified given the absence of the FI-1,2,3 classification prior to 2012.
• Current Supervision Universe includes 409 clients that are actively supervised
• Other includes projects that: a) have not completed a supervision cycle yet and b) situations that impair IFC or the client’s ability to apply the requirements.
What are we Learning and Doing about Financial Intermediaries?

What we are learning

• Effective E&S Risk Management Systems are key
• Time lag: From system to results
• Need for enhanced IFC supervision (esp. for high risk)
• Sample of sub-projects
• Clients need capacity building

What we are doing

• Implementing the Action Plan approved by CODE
• Increased supervision of high risk FIs
• Expanded capacity building for FI clients
• Engagement with broader stakeholder groups, strengthening of authorizing environment
THE ACTION PLAN IMPLEMENTATION AND STATUS OF IMPLEMENTATION
IFC Action Plan: Key Areas of Focus

In response to the CAO audit report IFC had developed an Action Plan with the commitment to the three key areas:

1. Formalize a Continual Improvement Framework for managing the E&S performance of the FI business. The objective here would be to focus on strengthening implementation of the 2012 policies and promoting best practices where feasible and required.

2. Establish a formal ongoing process of outreach, consultation and dialogue with key stakeholders on IFC’s FI business.

3. Strengthen IFC’s advisory services to support regulatory, market and client level capacity building to help raise the standard of E&S risk management in the Financial Sector in emerging markets.

- The Board accepted the IFC Action Plan as an acceptable way forward to address the deficiencies identified in the CAO report.
Key Steps and Specific Actions to be Taken

The following steps that are necessary to carry out commitments outlined in the key areas of the Action Plan have been identified and are currently being implemented:

1. Continual improvement framework
   - Capacity and commitment assessments
   - Increased supervision
   - E&S provisions for PE funds
   - Sub-project reviews
   - Performance tracking system enhancements

2. Stakeholder outreach and dialogue
   - Ongoing engagement with civil society organizations
   - Continuous work in partnership/leadership with DFIs

3. ESRM for FIs - Advisory Services
   - Support the development of market and regulatory drivers
   - Support market capacity development
   - Direct engagement with FIs to help build their management systems and capacity
# IFC’s progress on implementation of the Action Plan

## 1. Continual improvement framework

<table>
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<tr>
<th>Key steps proposed in the Action Plan</th>
<th>Specific actions to be taken</th>
<th>Status</th>
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| Capacity and commitment assessments  | • Develop guidance for FI Specialists to assess capacity and commitment of clients and have it approved by CES management  
• Revise ESRP to include capacity and commitment as key areas of appraisal and IRM input by CES  
• Develop a coaching session for FI Specialists | Completed |
| Increased supervision                | • Increase coverage of FI level site visits to cover all FI-2 clients with PS requirements | In progress (to be enhanced by June 2015) |
| E&S provisions for PE Funds          | • CES and LEG to revise the set of standard E&S provisions for PE funds to enhance legal provisions control over investments in higher risk business activities  
• Start annual disclosure of all sub-projects for projects to which new covenants apply | Completed  
In progress (based on the current implementation, the results will likely be available around April 2015) |
IFC’s progress on implementation of the Action Plan (continued)

1. Continual improvement framework (continued)

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<td>Sub-project reviews</td>
<td>• Develop a guideline for the basis of sub-project sample selection, have it approved by CES management and included in the draft updates to the ESRP</td>
<td>Completed</td>
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<td>• Develop a Guidance Note on sub-project reviews</td>
<td>In progress (to be completed by the end of May 2014)</td>
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<td>Performance tracking system enhancements</td>
<td>• Prepare list of changes required for portfolio tracking sheets, ESRD II and iDesk to enable better data management.</td>
<td>Completed</td>
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<td>• Set up a program that will include an ongoing internal communication initiative to deliver key messages from Financial Institutions Group (FIG) department’s senior management to staff on E&amp;S issues</td>
<td>In progress (to be in place by June 2014 as an ongoing process)</td>
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<td>• Develop guidance materials and training for IOs</td>
<td>In progress (to be in place by June 2014 and rolled out on an ongoing basis)</td>
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## IFC’s progress on implementation of the Action Plan (continued)

### 2. Stakeholder outreach and dialogue

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<td><strong>Ongoing engagement with CSOs</strong></td>
<td>• Post CODE IFC had a meeting with CSOs in October 2013 during Annual Meetings in Washington, DC</td>
<td>Completed</td>
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<td>• Two more meetings with CSOs are planned for spring 2014 - one in Washington, DC during Spring Meetings and one is being planned for Asia in May 2014</td>
<td>In progress <em>(DC meeting is scheduled for April 10, Asia for end May/early June. Expected to be on-going)</em></td>
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<td><strong>Continuous work in partnership / leadership with DFIs</strong></td>
<td>• Draft a Concept Note for Analysis and Coordination of DFI E&amp;S Requirements for FI clients</td>
<td>Completed</td>
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<td>• Develop a report based on the desktop analysis of IFC and DFI standards/procedures benchmarking and interviews with DFIs</td>
<td>In progress</td>
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<td>• Once the analysis is completed, this will be tabled at the regular DFI coordination meetings for moving the harmonization process forward</td>
<td>In progress</td>
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# IFC’s progress on implementation of the Action Plan (continued)

## 3. ESRM for FIs - Advisory Services

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| **Support the development of market and regulatory drivers** | • Establish the Sustainable Banking Network (SBN) for regulators and central banks to encourage a wider adoption of E&S risk management  
• Organize second International Sustainable Banking Forum together with Central Bank of Nigeria  
• Work with banking regulators to develop E&S implementation guidelines, tools and M&E mechanisms | Completed  
Completed  
In progress |
| **Support market capacity development** | • Adapt and roll-out the Train the Trainer (TOT) program for pilot testing in selected markets: China, Vietnam, Bangladesh, and Mongolia  
• Deliver 4-5 trainings for multiple FIs in each market by consultant firms and trainers | In progress (to be completed by October 2014 for the pilot markets)  
In progress (to be completed by December 2015) |
### IFC’s progress on implementation of the Action Plan (continued)

#### 3. ESRM for FIs - Advisory Services (continued)

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<td>Direct engagement with FIs to help build their management systems and capacity</td>
<td>• Develop a strong articulation of the business case for E&amp;S risk management for FIs</td>
<td>In progress <em>(to be completed by the end of June 2014)</em></td>
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<td>• Develop and pilot Environmental and Social Management System (ESMS) diagnostic services with clients over FY14.</td>
<td><strong>In progress (5 completed and 4 additional will be completed by June 2014, exceeding the target of 8. Roll out in scale in the following years).</strong></td>
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Open space for discussions, questions and suggestions

THANK YOU