

## ENVIRONMENTAL AND SOCIAL MANAGEMENT SYSTEM ARRANGEMENTS

### A. Introduction

1. Asian Development Bank (ADB) Trade Finance Program (TFP) transactions are for the shipment of goods and commodities that, due to their nature, are classified as Category C for environment, involuntary resettlement and indigenous peoples impacts and risks, in accordance with ADB's Safeguard Policy Statement (2009).<sup>1</sup> Accordingly, the TFP was approved as an FI Category C project, meaning that only Category C transactions can be supported. The TFP implements an environmental and social screening and categorization process to ensure it complies with ADB's Safeguards Policy Statement.

2. The TFP is asked by partner banks to support transactions that would more appropriately be categorized as Category B, because the transactions comprise core equipment of proposed projects and/or support activities that have environmental and social impacts. One such example was a request to the TFP to support the supply and installation of solar panel equipment, which would have been assessed by ADB as a transaction with Category B impacts and risks. This example transaction could not be supported by the TFP due to limitations in its approved scope. To accommodate these types of transactions, the proposed additional financing was recategorized as FI for environment and involuntary resettlement and will maintain its FI-C categorization for indigenous peoples impacts. The TFP will also be implementing additional activities and controls for Category B projects, as further detailed below. The program will enhance safeguards compliance and monitoring through: (i) implementation of specific safeguards guidelines; (ii) conduct of safeguards and other social requirements capacity training for program staff and partner banks; and (iii) support to partner banks through safeguards due diligence and to develop and implement their environmental and social management systems (ESMSs). Developmentally, the agreed support for transactions with Category B impacts and risks presents an opportunity for ADB to further strengthen TFP partner banks' ESMSs and practices, extend the reach of ADB's developmental goals, and fill a much-needed trade finance gap.

3. In addition, on occasion the TFP has had opportunities to support ADB's existing infrastructure clients in purchasing equipment for projects classified as Category A for environment. For example, a request for the TFP to support the supply of a power generation plant for a gas fired power plant project had to be rejected. The projects have been processed and approved by ADB prior to the request for the TFP support, and therefore compliance with ADB safeguards and social requirements is considered adequate to mitigate and manage the potential reputational and compliance risk of the TFP transactions. To support such transactions within this proposed additional financing scope, the TFP will coordinate with the respective project teams to confirm compliance prior to the TFP transaction, and in monitoring the project's environment and social safeguards compliance. If ADB can confirm that the project for which the equipment to be supported is compliant with ADB requirements, then by exception only, the TFP may support the transaction.

4. To ensure that the TFP mitigates and manages the potential reputational and compliance risk of its transactions, the TFP has strengthened its internal due diligence processes through the implementation of numerous controls, including: using system-automated flagging of goods against the ADB Prohibited Investment Activity List (PIAL), which is regularly updated; requiring internationally recognized industry certification for specific goods; closely coordinating with ADB's

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<sup>1</sup> ADB. 2009. [Safeguard Policy Statement](#). June. Manila.

non-sovereign operations safeguards team to review transactions that may not be Category C, or that may carry reputational risks; and training the TFP team on relevant safeguards issues.<sup>2</sup>

5. The TFP has led a number of external safeguards-related industry initiatives including: the development of transaction control standards and due diligence sustainability questionnaires, training on trade finance sustainability, the development of a taxonomy for sustainable trade finance, and financial incentives for sustainable practices (e.g. introduction of capital costs differentials for sustainable transactions). The TFP has also carried out a survey of environmental and social safeguards implementation at partner banks and provided safeguard training to over 100 partner banks.<sup>3</sup>

## **B. Safeguards Arrangements for Trade Finance Program Transactions**

### **1. Project Screening and Appraisal**

6. The TFP implements a project due diligence process comprising an automated system to identify ADB transactions that may fall under the PIAL, so that the investment team can consider and exclude them as appropriate. The transactions that do not fall under the PIAL are then categorized to confirm categorization and eligibility for the TFP support. The TFP has established internal guidelines to assist the TFP middle office team in project categorization and to identify projects with potential safeguards and reputational risks for which additional information is required to assist in the project appraisal process. For these projects, the TFP team works closely with the assigned Private Sector Transaction Support safeguards team in reviewing project information to consider project categories and potential environment and social safeguards risks.

7. In 2020, the TFP engaged an external consultant to assist in establishing transaction guides, which will further assist the TFP and its partner banks in identifying and mitigating transaction risks, including: (i) a child and forced labor guideline, which considers potential risks associated with child and forced labor associated with goods and countries of origins; (ii) a palm oil guideline, which provides additional guidelines for supporting palm oil transactions, including certifications; (iii) a climate change guideline, considering climate impacts associated with the transactions to be further developed in coordination with the ADB Energy Policy (currently under development, and scheduled for Board consideration by October 2021); and (iv) a guideline for Category B projects, detailing processes for approval of partner banks for transactions classified as Category B for environment and involuntary resettlement.

### **2. Knowledge and capacity building**

8. The TFP has been working on the development of customer due diligence and transaction controls for environmental and social risks in high volume trade transactions. The TFP led an industry initiative to standardize an environmental, social and governance (ESG) customer due diligence questionnaire with the International Chamber of Commerce and SWIFT. The questionnaire provides a standard for ESG disclosures that will help set a minimum standard for the industry and ensure inclusion of emerging market banks. The TFP is partnering with the World Wildlife Fund (WWF) and the International Finance Corporation to enhance transactional controls for “soft commodity” transactions (those involving agricultural products that are grown rather than extracted or mined) in the Global Map of Environmental and Social Risks in Agro-Commodity

<sup>2</sup> [ADB Prohibited Investment Activities List](#) is accessible from Appendix 5 of SPS 2009 (footnote 1).

<sup>3</sup> International Chamber of Commerce. 2019. [Sustainable Trade Finance: Customer Due Diligence Guidelines](#). Paris.

Production to extend the system to cover ADB DMCs.<sup>4</sup> The TFP plans to train the partner banks in using this tool to improve their own controls of high-risk transactions.

9. The TFP is running a pilot program with a United Kingdom-based fintech company to promote the establishment of social safeguards by connecting high work standards to favorable financing costs in the supply chain. The pilot is focused on the garment industry in India and, if successful, ADB could evaluate further applications on additional industries and DMCs.

10. The TFP partnered with a training provider to distribute free online training in sustainable trade finance to all partner banks. TFP team members also undertook the training, which focuses on highlighting potential ESG risks in trade finance and on ways to mitigate them.

11. The TFP is supporting DMC banks in the development of ESMSs to enhance ESG controls and allow the banks to work on Category B transactions with the TFP.

12. Finally, the TFP is also leading the International Chamber of Commerce's efforts to (i) create commonly approved definitions for sustainable trade finance to be adopted by the banking industry and accepted by regulators; and (ii) explore links between sustainability and capital treatment, which would make sustainable trade finance transactions systemically less expensive and therefore incentivize the adoption of sustainable practices in the production of goods.

## **C. Additional Arrangements and Controls to Participate in Category B Transactions**

### **1. ADB Safeguard Policy Statement requirements**

13. For the TFP to participate in transactions with Category B impacts and risks, additional activities and controls will be implemented.<sup>5</sup> Partner banks seeking ADB participation in Category B-type transactions will need to comply with requirements for financial intermediaries set out in Safeguard Requirement 4 of ADB's Safeguard Policy Statement (footnote 1). Partner banks will therefore be required to have in place or establish an appropriate ESMS to be maintained as part of their overall management system to meet national laws and ADB's requirements for financial intermediary projects. Safeguard Requirement 4 requires that all partner bank ESMSs approved by ADB for Category B transaction support have the following elements: (i) environmental and social policies; (ii) screening, categorization, and review procedures; (iii) organizational structure and staffing, including skills and competencies in environmental and social areas; (iv) training requirements; and (v) monitoring and reporting of ESMS implementation and the transaction's environment and social safeguards compliance. Screening activities during transaction appraisal by partner banks will also include an assessment of the reputational risks of potential transactions.

### **2. Strengthening institutional capacity**

14. The TFP will develop capacity in its partner bank network by selecting partner banks in multiple DMCs to engage in a pilot program for implementing ESMSs. This capacity will be developed prudently with the expectation that about five partner banks will each develop an

<sup>4</sup> International Finance Corporation. [Global Map of Environmental and Social Risks in Agro-Commodity Production](#).

<sup>5</sup> Transactions with Category A impact and risks and transactions with any impact on indigenous peoples will not be supported, except those that are for equipment that is part of an existing ADB-financed project, and for which ADB can confirm the project's compliance.

adequate ESMS in the first year of implementation.<sup>6</sup> The TFP engaged an internationally recognized consulting firm to assist each partner bank develop an appropriate ESMS. ADB will work closely with the consulting firm to help ensure that each ESMS developed is robust enough to meet ADB requirements.

### **3. Monitoring compliance with the Safeguard Policy Statement**

15. ADB will apply the equivalent level of due diligence it currently applies for investments in financial intermediaries when reviewing financial intermediaries' ESMSs, particularly focusing on the institutional capacity of the partner bank. Only partner banks with an ADB-approved ESMS will be eligible for TFP support for Category B type transactions.

16. Partner banks will carry out the appropriate level of due diligence on Category B-type projects when seeking TFP participation. The TFP will not support a transaction if a partner bank cannot demonstrate it has carried out the necessary due diligence. ADB will closely monitor the performance of each partner bank in the early stages of implementing its ESMS to help ensure that the partner bank has the necessary capacity to properly assess transactions; ADB will work with the international consultant to provide further advice to partner banks if controls and procedures require strengthening.

17. Although the TFP will be aware of all partner banks' trade finance transactions, partner banks will be required to report annually on their trade finance activities and on the implementation of their ESMS.

18. ADB currently conducts a risk-based periodic audit program to review financial intermediary performance. This program will be extended to review the activities of TFP partner banks applying ESMSs to trade finance activities as described, such that all partner banks with newly approved ESMSs will be audited in their first year of operations at a minimum and then on a risk-based approach in subsequent years.

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<sup>6</sup> Some partner banks already have an ADB-approved ESMS required for an existing ADB financial intermediary loan facility.