Photo: Golden Rose plantation, Addis Ababa, Ethiopia. ILO

From sustainability commitment to impact – how a **social** and **environmental** management system translates **intention into action**

The Sustainable Development Agenda 2030 of the United Nations puts a spotlight on the contribution of the financial sector stakeholders – public and private, international, and domestic – to sustainable development. For this agenda to succeed, financial sector stakeholders need to put sustainability at the heart of their thinking. We have seen, not least during the financial crisis in 2008, the far-reaching negative socio-economic effects if business strategies disregard people and planet in search of profit. Today, as the whole world is suffering from the severe socio-economic impacts of the Covid-19 pandemic, even more evidence is emerging that business operations with higher sustainability scores are performing better during this time of crisis (Prince, 2020). Is it that they publish sustainability slogans, is it their treatment of stakeholders including employees, is it their mind-set, is it their actions that limit exposure to fossil fuels? This article elaborates how social and environmental management systems (SEMS) support companies and their financiers to ingrain sustainability practices in their business activities, turning sustainability commitments into impact.

Framing sustainable finance

Financial institutions play a key role in transitioning the economy towards sustainable business models. On the one hand, they take decisions regarding which sectors to finance and thus support their growth and development, or conversely, may decide not to support growth. On the other hand, financial institutions are exposed to the social and environmental risks of the sectors and companies that they decide to finance. Such social and environmental risks relate, for example, to the health and safety of employees and nearby communities, the use of child labour or other unacceptable forms of labour, the resettlement of project-affected people, or the environmental degradation and pollution that may result from business operations. In the recent past, tragedies like the collapse of the Rana Plaza building[1] in

[1] The collapse of the building, which contained numerous clothing factories, claimed the lives of 1,134 people, injured many more and affected over 3,600 workers overall.

common fund for commodities

International Labour Organization

Dhaka in April 2013 or the disintegration of the Brumadinho dam[2] in Brazil in January 2019, have, sadly, illustrated the effects of not addressing social and environmental risks. When such social and environmental events materialise for clients, financial institutions themselves are affected as their social and environmental risk exposure increases which can trigger defaults or payment rescheduling (credit risk), devaluation of collateral (market risk), negative publicity (reputational risk) which might restrict access to capital or increase costs for funding, or liability transfer to the lender (liability risk).

However, financial institutions have an opportunity to address the above mentioned scenario. Banks, impact investing funds, and microfinance institutions, can all improve their portfolio resilience by including a model of sustainable finance, investment, and asset management in their strategies. An enabling (regulatory) environment is essential for financial institutions to mainstream sustainability in their operations and positively influence the social and environmental practices of the businesses they finance. Over the last two decades, several sustainable finance frameworks and initiatives have emerged both at international and national levels to enforce the financial sector's willingness and capability to deliver on sustainable outcomes. National examples include the Green Protocols in Brazil and Colombia, Nigeria's Sustainable Banking Principles, Kenya's Sustainable Finance Initiative, China's Green Credit Policy, and Indonesia's Green Banking Policy. Other examples that are guiding sustainability strategies of the financial sector globally are the Equator Principles (EP), the Principles for Responsible Investment, and most recently the Operating Principles for Impact Management (see Box 1 and 2).

Financial institutions adopting these sustainability frameworks need to consider the operational implications they trigger within their own institutions. While the frameworks offer codes and standards, the financial institution needs to translate these into its specific operating environment and concrete actions, otherwise, they will remain empty commitments. The development and implementation of a SEMS can help financial institutions to realise the full potential of sustainability inclusion and mitigate the negative effects of social and environmental risk exposure described at the beginning of this section.

Managing social and environmental risks and impacts makes business sense

As described earlier, the strength of sustainability management for financed businesses transcends to the financial institution's credit, market, reputational, and liability risk. There is increasing evidence that shows that financial institutions benefit from implementing a SEMS . For example, comparing more than 650 companies in its portfolio, the IFC found that those with a higher social and environmental performance were also performing better financially (IFC, 2020). Another study in German banks found that the inclusion of sustainability criteria helped as a predictor for credit risk and improved credit risk classification by 7.7% (Weber et al., 2010). A subsequent study of Bangladeshi banks found that sustainability criteria improved the prognostic validity of the credit rating process. This means that by considering sustainability, financial institutions can better avoid credit defaults and provide financing to more sustainable businesses (Weber et al., 2015).

Looking at the financed businesses, there is ample evidence of the benefits of improving social and environmental performance: a study by SustainAbility et al. (2002) examined 240 companies, specifically in emerging markets, that were taking steps towards sustainability improvements in their businesses. The study looked at the specific actions each company imple-

Box 1: Equator Principles

*The **Equator Principles** (EP) is a risk management framework for financial institutions for determining, assessing, and managing social and environmental risk in projects. Since its launch in 2003, 105 financial institutions in 38 countries have adopted the EP, covering the majority of international project finance debt within developed and emerging markets.*

As part of their membership responsibilities, EP financial institutions publicly report on their activities on an annual basis. The fourth revised set of the principles, effective from July 2020, acknowledges that the EP contribute to the Sustainable Development Goals (SDGs), and underline the responsibility to respect human rights in line with the United Nations Guiding Principles on Business and Human Rights. EP financial institutions also support the 2015 Paris Agreement.

On the practical side, the principles provide high level guidance on social and environmental categorisation of projects, applicable standards, risk assessment, management system and action plans, stakeholder engagement, grievances, independent reviews, loan covenants, and monitoring.

[2] The dam, operated by mining company Vale, collected waste from an iron ore mine. When it burst, it released a stream of mud that flooded a vast area, killing 270 people and releasing 12 million cubic meters of tailings into the environment.

Box 2: Operating Principles for Impact Management

Together with a group of asset owners, managers, financial institutions and other industry stakeholders, the International Finance Corporation (IFC) developed and launched a set of ***Operating Principles for Impact Management*** *in 2019. Within one year, 93 stakeholders have become signatories.*

The principles suggest five main elements that constitute an impactful management process: strategy, origination and structuring, portfolio management, exit, and independent verification. By including the management of potential negative impacts of the investments within origination and portfolio management processes, the principles recognise that even when investments have good intentions there are still social and environmental risks and impacts that need to be addressed.

Strategic Intent

1 Define strategic impact objective(s) consistent with the investment strategy

2 Manage strategic impact on a portfolio basis

Origination & Structuring

3 Establish the Manager's contribution to the achievement of impact

4 Assess the expected impact of each investment, based on a systematic approach

Portfolio Management

6 Monitor the progress of each investment in achieving impact against expectations and respond appropriately

5 **Assess, address, monitor and manage potential negative impacts of each investment**

Impact at Exit

7 Conduct exits considering the effect on sustained impact

8 Review, document, and improve decisions and processes based on the achievement of impact and lessons learned

Independent Verification

9 Publicly disclose alignment with the principles and provide regular independent verification of the alignment

Modified from IFC OPIM.

mented and the resulting benefits. Compared to the baseline conditions, the study observed higher sales, cost savings, improved corporate governance and stakeholder relations, better environmental practices, and human resources development, as well as reputation building, and improved access to capital. One of the businesses analysed was a sugar mill in Brazil. By producing organic sugar, the company received a 60% premium on the product and due to reduced use of input, i.e. agrochemicals, it reduced costs compared to producing sugar traditionally. A different study shows that improved working conditions in factories are linked to higher levels of productivity and profits. Employees in factories with better working conditions reach daily production targets about 40 minutes faster than employees in factories with worse conditions and factories with better working conditions also generate higher profits than their peers by as much as 8% (ILO Better Work, 2016).

The above examples are opportunities for financial institutions to engage. If identified during the institution's initial social and environmental assessment, the financial institution could even offer financing to the company for the above illustrated improvements in operations. In turn, the benefits for the financial institution of effectively managing social and environmental effects can improve relationships with stakeholders (e.g. NGOs and other lenders) and thus reputation. Targeting social and environmental improvements in financed companies, and offering added value, can also increase resilience and competitiveness of financed companies through accompanying technical assistance. For example, BMCE Bank of Africa, a universal banking group present in 31 countries throughout Africa, Europe, North America, and Asia, received several financing facilities from international financial institutions to finance energy efficient and small-scale renewable energy projects in Morocco (UNEP, 2016). The facilities included a technical assistance window funded by donors that supported the bank to design business development tools and the clients to receive assistance for project implementation as well as incentives to encourage them to make sustainable energy investments.

In summary, giving life to sustainability commitments through a robust management system for social and environmental matters creates several positive outcomes for a financial institution:

Photo: Adobe Stock

Protective clothing minimizes exposure to chemicals and is part of sound risk management

Mitigating overall risk exposure

Identifying and addressing social and environmental risks and impacts reduces credit, market, reputational, and liability risks. This is achieved by promoting the financing of law-compliant businesses and by implementing social and environmental risk management in the financial institution's own business operations.

Enabling employee value

Safe and healthy staff, that are offered adequate training and career opportunities with appropriate remuneration, are likely to be more motivated to contribute to the business success of both financial institutions and businesses they finance. In addition, the millennial generation is attracted by purpose-driven institutions and financial institutions can promote themselves as a provider of sustainable finance and creator of positive social and environmental impacts.

Leveraging returns on capital

Social and environmental management results in sustainable operations that embrace efficient resource use and responsible management of supply chains. Both elements could reduce costs and also improve product value proposition, making supply chains more sustainable and resilient. Proving that products are sustainably produced could also carry price premiums, and allow businesses to access other markets which would increase shared value.

Allowing sustainable growth

Financial institutions could access new sustainability market segments like renewable energy, climate change resilience, health, education, employment-generating sectors, and/or new geographies. Innovation in service delivery channels, embracing technology, and creating new products to finance sustainable enterprises or projects could also grow their sustainability portfolio. Lastly, sustainable growth strategies also increase the capacity of the financial institutions to attract like-minded clients and investors.

Social and Environmental Management System (SEMS) in detail[3]

A SEMS is a **management system that allows a financial institution to identify and assess social and environmental risks and impacts (adverse and beneficial), to avoid, minimise, and compensate adverse impacts as well as to seize beneficial impact opportunities, and to ensure stakeholder engagement across all.** As such, a SEMS allows a financial institution to implement its sustainability commitment while managing the social and environmental risks and impacts of its clients' activities and improve those of its own operations in branch offices. It also provides a framework to systematically track and measure (quantitatively and qualitatively) both adverse and beneficial im-

[3] This chapter summarises and updates SEMS considerations illustrated in Korth and Richter 2016a and 2016b.

pacts and inform corrective actions in case of non-compliance or sustainability mission drift.

A SEMS is not a stand-alone system, but it needs to be integrated across management systems, for example in the credit and human resources functions, within the financial institution. As such, it needs the complete buy-in from senior management and sufficient resources (staff and funds). However, a SEMS should always be designed to add value and align to business needs (Cox, 2015). It should be 'fit for purpose' considering all three sustainability elements: society, environment, and business.

Typically, a SEMS consists of six components that interact with one another, as illustrated in Figure 1.

Component 1: Sustainability Policy

A *Sustainability (or Social and Environmental) Policy* is the foundation element of the SEMS. It discloses the financial institution's commitment to sustainable development and should be publicly available. It elaborates the financial institution's approach towards sustainability – such as risks, impact and opportunities related to labour conditions, environmental pollution, or stakeholder engagement – and should equally address social and environmental matters. It should also clearly describe which activities it does *not* finance (exclusion list). The policy should be regularly reviewed to reflect new developments and stay relevant to the institution's mission. Moreover, the policy identifies the legal and regulatory framework applicable to the financial institution, its clients, and other stakeholders. This framework should be further articulated in the second component, Social and Environmental Standards.

Component 2: Social and Environmental Standards

The *Social and Environmental Standards or safeguards* are the benchmark that a financial institution uses to assess social and environmental performance of its activities. Often, financial institutions adopt existing international frameworks like the **IFC Performance Standards on Environmental and Social Sustainability**, the **EBRD Environmental and Social Performance Requirements**, or the **AfDB Operational Safeguards**. In order to be relevant, it is important that the financial institution adapts these more general standards to the specific local context in which it operates.

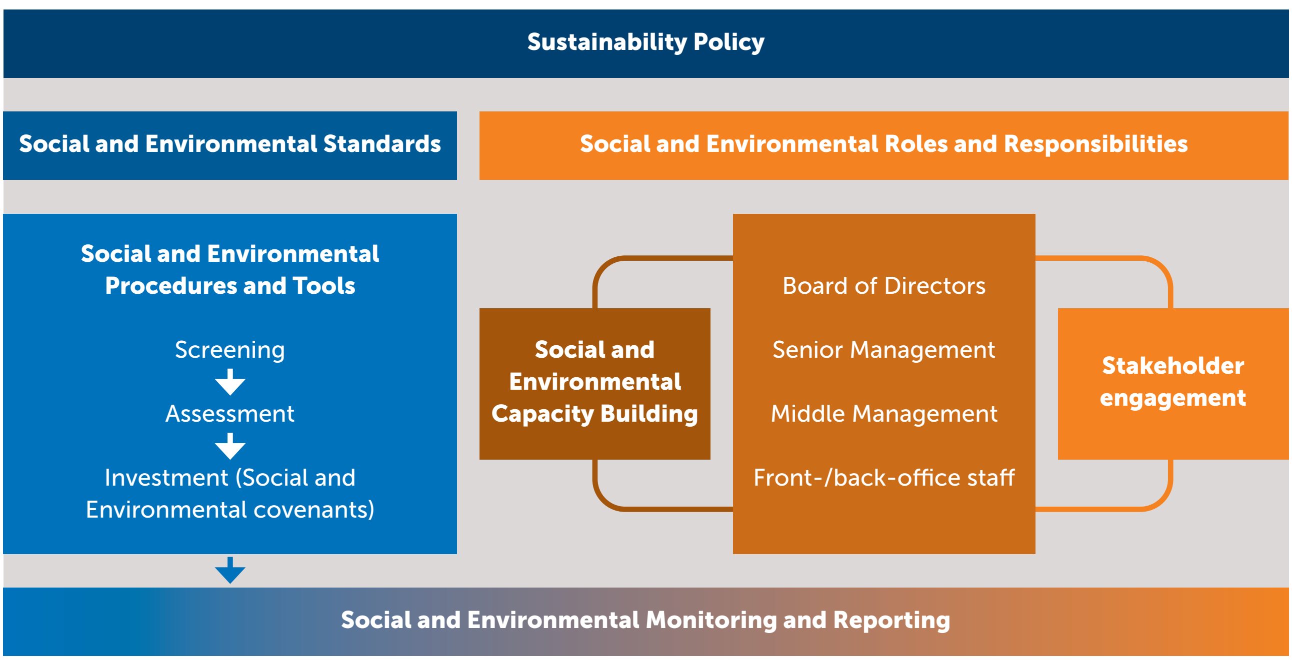
The subsequent components give guidance on how to implement both the Social and Environmental Policy as well as the Standards.

Component 3: Social and Environmental Procedures

The *Social and Environmental Procedures* define the practices to identify, assess, manage, and monitor the social and environmental performance of the financial institution's activities. They should be aligned with the credit function to facilitate implementation.

The first step to identify possible social and environmental risks and impacts is screening new applications against the exclusion list of activities that cannot be financed, and applying a classification tool to assign a preliminary social and environmental risk

Figure 1: Components of a SEMS



category. The risk category defines the scope of the subsequent social and environmental assessment, for example documentation requirements. The actual social and environmental assessment needs to critically analyse findings from the screening and includes a material due diligence which eventually defines the final risk category, social and environmental management and improvement measures, and performance indicators all of which need to be discussed and agreed with the client. Ideally, these measures are included as covenants in the loan agreement and reflected in a social and environmental action plan, which indicates responsibilities and timelines for implementation. Implementation and effectiveness of the actions needs to be regularly monitored to measure impact and propose corrective actions if needed.[4]

It is interesting to note that often social and environmental assessments are biased towards environmental issues and social issues receive less attention (Korth and Richter, 2016b). The reasons are multi-fold. On the one hand, there is a general assumption that social issues are common sense. Thus, more efforts are put into understanding the (perceived) more complicated environmental matters. Furthermore, social issues are difficult to quantify, and thus financial institutions are less familiar with measurement methodologies. The reality that social risks materialise is illustrated by the 2019 account of the IFC Compliance Advisor Ombudsperson which revealed that 52% of the complaints it received were related to stakeholder engagement, 52% to economic displacement, 36% to labour issues and 36% to vulnerable groups (CAO, 2019). All of these are social aspects that should be considered when assessing business operations. In cases where the social and environmental assessment of client activities is difficult, or requires expert knowledge due to project complexity and/or sector, the financial institution should engage an external expert to evaluate the social and environmental risks of the project.

Component 4: Social and Environmental Roles and Responsibilities

While the Procedures are the heartbeat of the SEMS, the system can only function if it is well anchored in the financial institution's governance systems. The financial institution needs to define clear roles and communication lines within the organisation, from board to senior management, middle management, and front and back office staff. Assigning a lonely sustainability officer will not ensure that informed strategic decisions are taken. Furthermore, adequate human, technical and financial resources need to be provided to take on social and environmental responsibilities.

The board and senior management should take the lead towards sustainability. To do so, they need to be knowledgeable about the social and environmental risk exposure and

A landscape of soil degradation after the floods, Nsanje District, Malawi

Photo: ©FAO/Luca Sola

[4] The social and environmental resource centres of the IFC, European Bank for Reconstruction and Development (EBRD), or CDC Group provide ample inspiration.

Case study 1: Landbank of the Philippines

***Landbank** is a government financial institution that has the mandate to promote inclusive growth and development in unbanked and underserved areas. It was established by the government of the Philippines in 1963, to serve as the financing arm of the government's Comprehensive Agrarian Report Programme. Landbank provides financing to the agricultural sector, specifically to small farmers and fishers, micro, small and medium enterprises, rural financial institutions, local government units and government agencies, while promoting sustainable development anchored in good governance. The bank is present in the 81 provinces of the country with more than 9,800 employees (67% women).*

In 2005, Landbank established its SEMS following its commitment to support environmental protection and sustainable development. Since, the system has developed into a comprehensive, well-staffed, and rigorous management system, including innovative features such as providing awards to clients for outstanding environmental action. The SEMS is very strong on the environmental side.

In terms of coverage, Landbank's SEMS does not only apply to lending operations with clients but also within the institution where it measures resource consumption like energy and water use, as well as CO_2 emissions, effluents, and waste.

The bank has a clear governance structure and actively engages with the bank's stakeholders. It maintains a well-staffed environmental department with officers and technical staff and embraces a comprehensive and inclusive training approach for staff.

Furthermore, the bank has a transparent and detailed reporting system, using the Global Reporting Initiative metrics. It bases its social and environmental standards on the Philippines Environmental Impact Statement System and thus very much reflects local context, even though with a focus on environmental matters.

As an industry leader in climate finance in the Philippines, Landbank was accredited as the country's first direct access entity to the Green Climate Fund (GCF) in 2018 and will manage GCF projects from development, implementation, monitoring and evaluations using the bank's own systems including its strong SEMS (Landbank, 2018).

Photo: Shutterstock

Indigenous fishing craft of the Philippines

performance of the financial institution's portfolio, and advance strategic changes aiming at de-risking and/or maximising potential positive impact. The middle management typically coordinates between the strategic guidance mandated by senior management and actual implementation of actions. This is done by a social and environmental or sustainability manager. Specifically, the position provides advice and support to loan officers involved in client social and environmental assessments and monitoring. The position also improves the tools and procedures based on feedback from the daily users within the institution. On an operational level, loan and credit officers are in charge of assessing and monitoring social and environmental performance of individual clients.

Lastly, the human resources function plays an important role as the entity responsible for the recruitment of new staff. As part thereof, the human resources function needs to align job descriptions of staff with social and environmental responsibilities and the performance management framework with sustainability objectives and related incentives.

Component 5: Social and Environmental Capacity Building

The SEMS will only function well if staff across different management and operational functions are capacitated to fulfil the social and environmental responsibilities assigned to them. The *Capacity Development* of staff should be guided by a strategy, which in turn needs to be integrated in the overall capacity building framework of the financial institution and its performance management system. The content and delivery channel of capacity building activities should be based on the needs and role of the particular staff members, and reflect the social and environmental realities of the institution's clients. To achieve this, the human resources and the social and environmental function need to work together and continuously update strategy and content, and seize opportunities for additional learning.[5]

[5] A number of international organisations offer capacity building that could be consulted: IFC's First for Sustainability, group-based online learning like UNEP-FI sustainable finance courses, or face-to-face and distant learning sessions on specific themes offered through the ILO International Training Centre.

Component 6: Social and Environmental Monitoring and Reporting

Last but not least, Social and Environmental Monitoring and Reporting is what will help control the social and environmental performance of the financial institution's activities and take necessary corrective action. Information resulting from the regular monitoring against loan covenants should be analysed and shared internally with those entities that can take necessary decisions. For example, the social and environmental manager can identify and compile activities and methods that have helped clients to improve social and environmental practices as lessons learnt, and report to senior management for integration into the SEMS. The same should apply if procedures are not delivering the expected results. Information about the support provided by the institution and social and environmental improvements of clients can also be used for external reporting. This will increase transparency and promote engagement with interested stakeholders.

In theory, a SEMS sounds neat and straightforward to implement, but real-life cases are never as straightforward as planning may suggest. SEMS frameworks are, by necessity, flexible and can be used by different types of financial service providers. Two case studies, of a development bank from the Philippines and an agricultural impact investment fund in Africa, explore particular facets of their sustainability management system.

The development, full roll-out, and smooth operation of a SEMS requires time and patience. The subsequent section dives into some challenges.

Case Study 2: Africa Agriculture and Trade Investment Fund

Striving to unleash the potential of agriculture on a sustainable basis, the German government, together with KfW and Deutsche Bank, set up the Africa Agriculture and Trade Investment Fund (AATIF) in 2011. The Fund is an innovative public-private partnership dedicated to uplift Africa's agricultural potential for the benefit of the poor. It aims at improving food security and creating employment and income for farmers, entrepreneurs, and labourers alike by investing patiently and responsibly in efficient local value chains. Increasing productivity, production, and local value addition by investing in efficient value chains and providing knowledge transfer are paramount.

Appreciating the need for sustainability advice, including on social and environmental risk and impact in its projects along the agricultural value chain, the Fund approached the International Labour Organization (ILO) to advise on the implementation of the Fund's sustainability commitment. As the Fund's compliance advisor, ILO together with UN Environment have developed, and are jointly implementing, a sustainability management framework. The framework includes a social and environmental policy that contains an exclusion list and commitment to apply IFC Performance Standards. Furthermore, the policy clearly describes social and environmental responsibilities including for the board of directors and investment committee, investment advisor, compliance advisor, and technical assistance facility manager. A separate social and environmental capacity building strategy has been in place since 2016 through which the compliance advisor has implemented numerous trainings across functions ranging from broad themes like sustainable finance to specific topics of social and environmental risks and impacts in trade finance.*

The AATIF also has a Technical Assistance Facility that offers investment-specific support to investee companies including capacity building with the goal to improve social and environmental practices and promote compliance with the Fund's Social and Environmental Policy. ***Since its inception, it has been managed by the Common Fund for Commodities (CFC).***

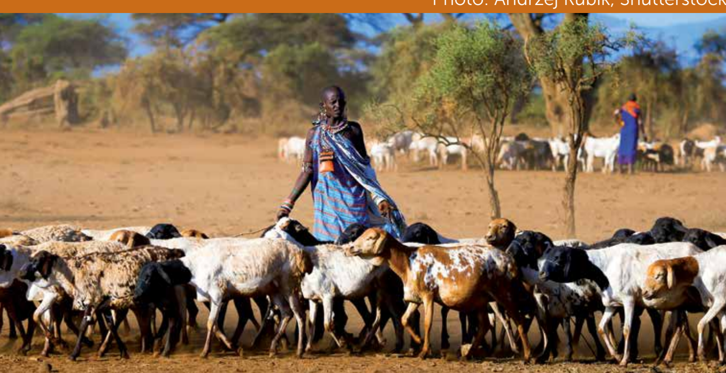
The AATIF implements an impact measurement framework which tracks change in its investee companies over time along five key indicators to learn and inform future investments:

- *agricultural production and productivity levels;*
- *additional employment opportunities;*
- *outreach to smallholder farmers;*
- *farm and overall household income; and*
- *changes in living and working conditions (e.g. in farms, processing facilities).*

Since 2018, the Fund has included an explicit poverty tracker, i.e. Poverty Probability Index, as part of the data collected under changes in living and working conditions. Data is collected and analysed through i) annual self-reporting of investee companies, ii) rapid appraisals that are implemented twice at the beginning and end of each investment with the support of external researchers, and iii) impact evaluations that can be implemented for high-impact investments like outgrower schemes with the support of external researchers. The results are publicly shared through the Fund's annual report plus a dedicated impact space on AATIF's website.

** The Collaboration is implemented by* ***ILO's Social Finance Programme.***

Photo: Andrzej Kubik, Shutterstock



Masai shepherdess, Kenya

Photo: Richard Carey, Adobe Stock

Aerial drone view of deforestation, environmental problem in Malaysia

Challenges when developing a SEMS, and a way forward

The development and implementation of a new management system always brings challenges and the case of a SEMS is no different. The six components related to operationalising the system typically appear challenging. A study that assessed the state of development of SEMS across development finance institutions in Africa concluded that most institutions had a social and environmental policy in place (Korth and Richter, 2016a). The policies were committed to sustainable development and referred to relevant sustainability standards. However, nine out of 13 were in the early stages of SEMS implementation or had no formal system in place meaning that subsequent components like procedures and tools, clear descriptions of roles and responsibilities, capacity building and monitoring and reporting were far less developed. Similarly, a study from Asia and the Pacific that explored the implementation of environmental credit risk management systems found that banks had more implementation gaps compared to the establishment of a policy or framework (Mengze, 2013).

Some other challenges include:

- Obtaining real commitment, including resources within the institution for the development of a SEMS, and communication within the institution.
- Integration of the SEMS within other existing management systems and procedures.
- Having the perfect system on paper, but being impossible to implement (Cox, 2015).
- Difficulty in seeing the added value of implementing a SEMS when regulation does not require it and competitors are not following suit.
- Small size of the institution.
- Resource constraints.

How can a financial institution address these challenges before they appear? First and foremost, it is important to clearly set out the main objective(s) that the institution wants to achieve with the SEMS and, accordingly, define the scope of the SEMS that the institution requires. The system should be fit for purpose to avoid unnecessary and complicated procedures that will frustrate the implementers and will not add value to the institution. The system will be different from institution to institution.

Second, when a financial institution decides to develop and implement a SEMS, it has to assign the necessary resources, create the right capacities by upskilling existing staff and/or recruiting new staff with social and environmental roles, and make sure that the system is aligned to other processes taking place. This may be particularly difficult for smaller institutions but can be overcome when the system is smartly designed.

Third, management needs to act as an example and show full support for implementing the system. Management needs to communicate clearly with all stakeholders of the institution that the SEMS implementation is a priority. Including social and environmental targets in staff performance management could also motivate staff to be more active within the system.

Fourth, managing social and environmental risks reduces the likelihood of risks materialising. However, positive effects will only occur over time. Therefore, and in order to communicate clearly to staff, financial institutions could use existing research showing that a portfolio with better social and environmental performance is also a portfolio with better economic performance than one with unattended or high social and environmental risks and impacts.

Fifth, financial institutions could seek advice from the industry and join relevant sustainability networks to inform their own sustainability approach and tap into new markets and differentiate from their peers. This will help financial institutions to overcome the fear that implementing a SEMS will take up scarce resources and could support it along the process, as the benefits could be difficult to achieve at the beginning. This challenge can be more profound if central banks do not require the industry to develop these systems and, more importantly, do not promote and support adequate implementation.

Sustainability is a journey that has just begun – and in view of the world in 2020 is more important than ever before. Many financial institutions have decided to pursue increased positive impact because they deem it to be their contribution to what society is requesting; others still need to see the business sense. No matter where on the journey they are, a pure commitment to a framework is not enough but needs to be translated into action.

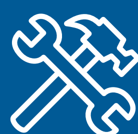
The Executive Board of the CFC in its 69th meeting adopted the Sustainability Policy of the CFC to serve as anchor for the SEMS of the CFC.

Box 3: CFC's journey to sustainability performance

The CFC's mandate is to improve the social economic development of commodity producers and contribute to society as a whole. To achieve this goal, CFC provides financing to small and medium enterprises (SMEs) in commodity supply chains, to grow and strengthen their businesses. In 2018, CFC developed a new Impact Management Strategy, adopting the Sustainable Development Goals (SDGs). While the strategy included some sustainability safeguards and eligibility criteria for investments, it did not contain a systematic approach towards managing social and environmental risks.

At first sight, CFC investments in SMEs may seem as to have low social and environmental risks. However, while a proposed project may create new jobs, the workers may be in vulnerable forms of employment. Recognising this gap, CFC partnered with ILO in 2019 to upgrade the existing and develop missing elements of a SEMS tailored to the CFC and accompany the process with capacity building for designated CFC staff.*

As a first step, CFC underwent a SEMS diagnostic, as well as a capacity gap assessment of staff in charge of assessing project proposals. The assessment confirmed that CFC had policies and procedures in place that partially addressed social and environmental risks and impacts. CFC staff were aware of, and engaged in, identifying social and environmental risks as part of the project appraisal processes. Based on the findings, CFC developed an action plan to address the recommendations of the diagnostic. CFC became an active part of the process; the joint development created ownership and empowered CFC staff to make recommendations for continuous improvement.



As a second step, ILO and CFC jointly developed new tools and updated existing templates by integrating social and environmental risks and impacts sections. In an interactive capacity building session, the CFC investment process was mapped and associated social and environmental responsibilities of each CFC entity elaborated.

In a third step, ILO mentored the CFC team in assessing social and environmental risks and impacts during joint due diligence visits of two potential projects. The learnings from the site visits allowed CFC and ILO to adjust the toolkit which now covers all stages of the investment process. In parallel, CFC included social and environmental responsibilities for the team along the investment process, updated reporting and decision templates for governing bodies to include social and environmental information, and developed a procedures manual. With the guidance of the Executive Board, with proper policies, procedures and tools in place, the CFC intends that its investment practice will be more transparent and consistent with international good practices in achieving the SDGs. The SEMS will help the CFC to pursue sustainable development impact in its Member Countries, while mitigating any unintended negative effects of the projects supported by the Fund.

** The Collaboration is implemented by **ILO's Social Finance Programme.***

Photo: Adobe Stock

Coffee bushes in a shade-grown organic coffee plantation

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Photo: Woman cutting hay for cattle. ILO