

Environment & Social Procedures for Wholesale Lending



**KENYA
DEVELOPMENT
CORPORATION**

Table of Contents

1	INTRODUCTION.....	3
1.1	BACKGROUND.....	3
1.1.1	ABOUT DRIVE.....	3
1.1.2	ABOUT SAFER.....	4
1.2	E&S REQUIREMENTS FOR PFIS	4
2	E&S PROCEDURES	5
2.1	STEP 1: E&S SCREENING.....	7
2.2	E&S DUE DILIGENCE (ESDD) OF PFIS:.....	8
2.2.1	REVIEW E&S POLICIES AND COMMITMENTS:	8
2.2.2	ASSESS ORGANIZATIONAL STRUCTURE AND RESOURCES:	8
2.2.3	EVALUATE E&S MANAGEMENT SYSTEMS AND PROCESSES:	8
2.2.4	ANALYSE E&S RISK ASSESSMENT AND MANAGEMENT:	8
2.2.5	EVALUATE E&S TRAINING AND CAPACITY BUILDING:.....	8
2.2.6	ASSESS MONITORING AND REPORTING SYSTEMS:	8
2.2.7	EVALUATE STAKEHOLDER ENGAGEMENT:	8
2.3	LEGAL DOCUMENTATION	9
2.4	E&S MONITORING.....	9
	ANNEX 1: ESDD FORM.....	10
	ANNEX 2: ESAP TEMPLATE.....	13
	ANNEX 3: ANNUAL E&S MONITORING REPORT FORMAT.....	14

1 Introduction.

Under the DRIVE and SAFER project, KDC will lend the World Bank funds to Participating Financial Institutions (PFIs) for on-lending to subprojects. This is the addendum to the KDC's Environment & Social Management System (ESMS) approved by the Board on 28th September 2022 and was published in the KDC website on 4th November 2022. This addendum describes the Environment & Social (E&S) procedures for indirect lending under the DRIVE and SAFER projects of the World Bank. This addendum must be read in conjunction with the ESMS.

By implementing a robust E&S management framework, the KDC can ensure that their indirect lending practices support sustainable development, minimize E&S risks, and contribute to positive impacts in the sectors or industries they finance.

1.1 Background.

1.1.1 About DRIVE.

The World Bank project De-Risking, Inclusion And Value Enhancement Of Pastoral Economies (DRIVE) is designed with the objective to protect pastoralists against drought with enhanced access to financial services, include them in the value chains, and facilitate the livestock and livestock products trade in the Horn of Africa (HoA).

Component 2 of the DRIVE project is focused on livestock value chains and trade facilitation. Under this component, the pastoralist groups would be linked to investment opportunities. The DRIVE project, under this component will support private investment in the livestock value chains so that pastoral producers can be linked to reliable markets and extract greater value addition from their livestock-rearing activities; the project will target pastoralist groups already formed.

Three types of intervention are contemplated to be supported under the DRIVE project:

- **Upgrading quality infrastructure** such as testing facilities, traceability systems, certification services, inspection services, and quarantine systems. It is critical to enable formal trade and enhance the quality of livestock and livestock products, to export higher value processed products (such as meat and leather goods).
- **Trade facilitation and trade logistics** to strengthen quarantine facilities and their efficient linkages to ports with the digitization of export and sanitary certificates; it will also improve the logistics on the transit of live animals.
- **De-risking facility to support private investment in the value chains.** The project will set up a de-risking facility to support private investments into the livestock value chains, focusing on a few demonstration investments to show that sustainable business models can emerge to benefit pastoralists. Investments will have to be private sector driven, commercially viable, and benefit pastoral producers. The de-risking facility will provide financial support through two windows, one window for significant investments with substantial demonstration effects (i.e., that can be replicated and scaled-up), and a second window that will focus on women and youth business enterprises in pastoral areas, which

could support livelihood diversification. The supported investments will be required have to strong adaptation or mitigation climate Co-Benefits. The de-risking facility will not support enterprises with strong negative impact to climate for example, industrial livestock production.

The State Department of Livestock (SDL), Kenya has signed a subsidiary agreement with the KDC for the implementation of activities related to the private sector under the DRIVE project of the World Bank as mentioned under (c) above. Under the agreement with SDL, the KDC will facilitate private investment in the livestock value chain through de-risking facility. The objective is to link pastoral producers to reliable markets and ensure they extract greater value addition from their livestock-rearing activities.

1.1.2 About SAFER.

The objective of the Supporting Access to Finance and Enterprise Recovery (SAFER) SAFER project is to increase access to financial services, enhance the capabilities, and support the post Covid-19 recovery of MSMEs in Kenya.

- The project funds will be used to finance working capital needs for MSMEs which will include (i) salaries to employees and (ii) rent expenses among other uses.
- The Project will achieve its objective through a mix of market instruments, channeled via the private sector and Government.
- The funds will be channeled from the National Treasury to an apex financial institution (KDC) which will on-lend to several Participating Financial Institutions (PFIs) including Licensed Micro Finance Institutions, CBK Licensed Digital Lenders and SACCOs who in turn will on-lend to MSMEs.
- Lines of credit will be provided using digital channels operated through commercial banks and Mobile Network Operator(s) (MNOs).

The project has three components, namely:

- Innovation and Liquidity support to MSMEs through Registered Community Based Financial Institutions and digital channels
- liquidity support to MSMEs through regulated financial intermediaries
- support will target MSMEs that were previously financed but are now facing constraints in addition to those that are considered bankable but have not been able to access credit.
- The indicative size of loans to individual microenterprises will range between KES 5,000 and KES 150,000 and for small enterprises will range between KES150,001 and KES 250,000.
- Tenor for microloans is expected to not exceed 18 months, and for small loans to not exceed three years.
- De-risking lending to MSMEs; and
- Technical assistance to build resilience.

1.2 E&S Requirements for PFIs.

Each PFIs will put in place and maintain an ESMS to identify, assess, manage, and monitor the E&S risks and impacts of subprojects on an ongoing basis. The ESMS will be

commensurate with the nature and magnitude of E&S risks and impacts of subprojects, the types of financing, and the overall risk aggregated at the portfolio level.

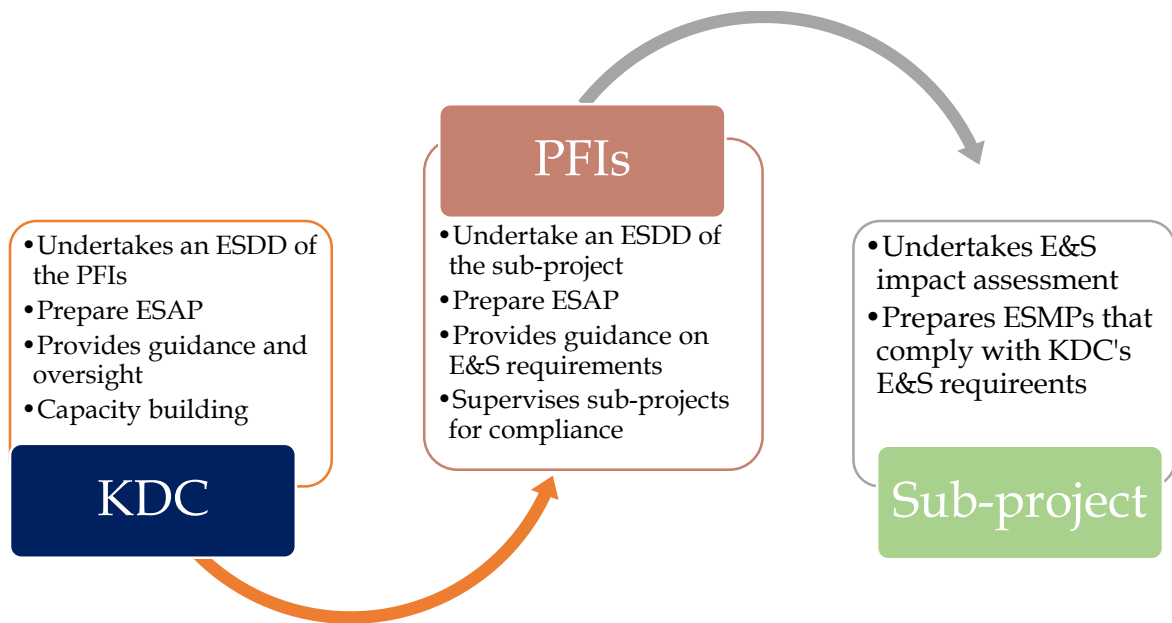
The ESMS will include the following elements: (i) E&S policy; (ii) clearly defined procedures for the identification, assessment and management of the E&S risks and impacts of subprojects; (iii) organizational capacity and competency; (iv) monitoring and review of E&S risks of subprojects and the portfolio under DRIVE and SAFER; and (v) external communications mechanism.

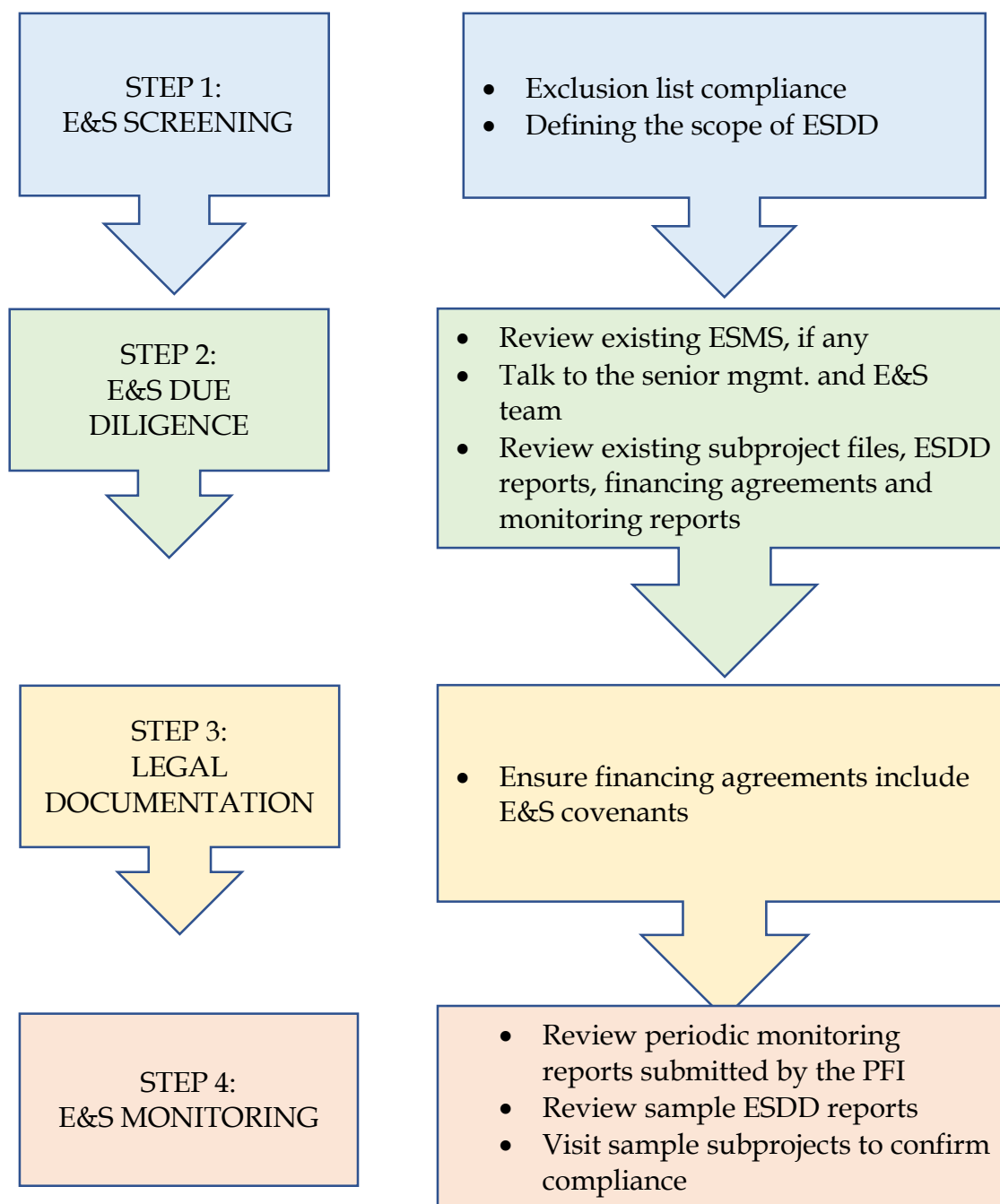
Other requirements include:

- (i) The PFIs will review and adjust, in a manner acceptable to the KDC, its ESMS from time to time, including when the E&S risk profile of its portfolio changes significantly.
- (ii) The PFIs will comply with any exclusions in the legal agreement and apply relevant national law for all subprojects and World Bank ESSs as relevant.
- (iii) The PFIs will monitor the E&S performance of the subprojects in a manner proportionate to the risks and impacts of the subprojects and provide regular progress reports to its senior management.
- (iv) The PFIs will promptly notify the KDC of any significant accidents or incidents associated with subprojects.
- (v) The PFIs will submit to the Bank annual E&S monitoring reports on the implementation of its ESMS, including E&S performance of its portfolio of subprojects.
- (vi) The PFIs will require the subprojects to conduct stakeholder engagement in a manner proportionate to the risks and impacts.
- (vii) The PFIs will put in place procedures for external communications on E&S matters proportionate to the risks and impacts of the subprojects.
- (viii) The PFIs will disclose through their website their ESMS.
- (ix) The PFIs will have in place and maintain appropriate labor management procedures, including procedures relating to working conditions and terms of employment, nondiscrimination and equal opportunity, employee grievance mechanisms and occupational health and safety. The PFI will provide adequate documented evidence of such procedures to the KDC.

2 E&S Procedures.

E&S management for indirect lending involves integrating E&S considerations into the lending practices of the KDC. In indirect lending the E&S responsibilities are cascaded down to the PFIs as shown in the following figure.





2.1 Step 1: E&S Screening.

The objective of the E&S screening is to ensure the proposed activities of the PFI meet the project exclusion lists for the DRIVE and SAFER projects. As a priority, the PFIs should not undertake any activities on the exclusion list. If the proposed activities for which the PFI is seeking funding are on the exclusion list, the concerned PFI will be informed, and the investment will be rejected from further consideration.

2.2 E&S Due Diligence (ESDD) of PFIs:

When conducting Environmental and Social Due Diligence (ESDD) of PFIs, KDC must review the E&S capacity of the PFI. Reviewing the E&S capacity of PFI involves assessing its policies, practices, and performance in managing E&S risks and integrating sustainability considerations into its operations. While undertaking the ESDD, the following steps should be implemented:

2.2.1 *Review E&S Policies and Commitments:*

- Evaluate the PFI's E&S policy, guidelines, and commitments.
- Assess the comprehensiveness and alignment with international standards and best practices.

2.2.2 *Assess Organizational Structure and Resources:*

- Evaluate the PFI's organizational structure and presence of dedicated E&S teams or personnel.
- Assess the adequacy of staffing levels, expertise, and access to external E&S consultants or specialists.
- Determine if there are clear roles, responsibilities, and reporting lines for E&S management.

2.2.3 *Evaluate E&S Management Systems and Processes:*

- Assess the PFI's E&S management systems, procedures, and processes.
- Evaluate how E&S considerations are integrated into overall risk management frameworks.
- Review the effectiveness of E&S due diligence processes, including screening, assessment, and monitoring through review of existing subproject files, ESDD reports, financing agreements and E&S monitoring reports on sample basis. .

2.2.4 *Analyse E&S Risk Assessment and Management:*

- Review the PFI's approach to identifying, assessing, and managing E&S risks.
- Assess the institution's strategies and practices for mitigating and monitoring identified E&S risks.

2.2.5 *Evaluate E&S Training and Capacity Building:*

- Assess the PFI's efforts to provide E&S training and capacity-building programs for staff at all levels. Ask for training records.

2.2.6 *Assess Monitoring and Reporting Systems:*

- Evaluate the PFI's systems for monitoring and reporting on the E&S performance of subprojects.
- Review the adequacy of reporting templates, and processes for reviewing E&S performance on an ongoing basis.

2.2.7 *Evaluate Stakeholder Engagement:*

- Evaluate the effectiveness of mechanisms for soliciting feedback, addressing grievances, and incorporating stakeholder perspectives into decision-making.

As part of the ESDD, conduct meetings and interviews with key personnel responsible for E&S management within the PFI. Seek clarifications, gather additional information, and address any gaps identified during the review process.

Following the ESDD, an E&S Action Plan (ESAP) should be developed to address the identified gaps in the E&S capacity and procedures. The ESAP should define the timeline for each action item.

Annex 1 and 2 provide the ESDD checklist and ESAP template respectively.

2.3 Legal Documentation.

The objective of this step is to ensure that the financing agreements incorporate all E&S requirements as defined in section 1.2 of this addendum, E&S warranties and covenants, compliance requirements and the ESAP is included to be legally binding. It is important to ensure that the PFIs understand and agree to implement the ESAP. The ESAP is to be appended to the financing agreement.

2.4 E&S Monitoring

PFIs are required to monitor and manage the E&S risks and impacts of their portfolio and subprojects, and monitor portfolio risk, as appropriate to the nature of financing.

Each PFI should submit an annual E&S monitoring report (ESMR) to the KDC as per the format presented in Annex XX. The monitoring report should provide information on the subprojects- their E&S category and compliance status. The report should provide information on the grievances and enquiries received through the external communication mechanism of the PFI.

In addition to the annual ESMR, the KDC team will undertake supervision and review E&S documentation prepared by PFIs on sample basis.

Annex 1: ESDD Form

1. E&S Procedures and Capacity

Name of Financial Institution/ SACCCO:	
Date of the assessment:	
ESDD form filled by (name and designation):	
Does the FI/SACCO have an ESMS policy and management commitment – check all that apply:	
<ul style="list-style-type: none"> Policy regarding Environmental and Social (E&S) risk management 	
<ul style="list-style-type: none"> The E&S Policy is approved by Senior Management (mention the date of approval) 	
<ul style="list-style-type: none"> ESMS specifies types of investments/loans and activities it applies to (e.g., entire portfolio/investment type) 	
<ul style="list-style-type: none"> The E&S Policy and the ESMS disclosed on FI's website 	
Does the ESMS process and procedures include – check all that apply:	
<ul style="list-style-type: none"> Documented process to assess E&S impacts and risks of its projects 	
<ul style="list-style-type: none"> ESMS specifies applicable requirements (e.g., Exclusion List/national laws/IFC Performance Standards) 	
<ul style="list-style-type: none"> E&S due diligence process integrated with risk assessment procedures 	
<ul style="list-style-type: none"> Project site visits conducted as part of risk assessment procedures 	
<ul style="list-style-type: none"> Review of borrower's applicable environment, health and safety permits 	
<ul style="list-style-type: none"> Loan agreements contain covenants requiring ongoing compliance with applicable requirements (e.g., national laws) 	
Does the ESMS include a process for E&S monitoring and record keeping – check all that apply:	
<ul style="list-style-type: none"> Process for monitoring ongoing compliance with applicable requirements 	
<ul style="list-style-type: none"> Borrowers required to report accidents/incidents within reasonable timeframe 	
<ul style="list-style-type: none"> Borrowers required to provide periodic reports pertaining to E&S performance of projects 	
Does the ESMS have an internal feedback and continuous improvement mechanism – check all that apply:	
<ul style="list-style-type: none"> Process for periodically reporting Environmental and Social performance information internally to senior management 	
<ul style="list-style-type: none"> Continuous improvement process in place to revise and update ESMS (e.g., changes in national law/international best practices) 	
Is there provision for E&S external reporting – check all that apply:	
Annual reporting on E&S performance to lenders	
Are the ESMS roles and responsibilities defined – check all that apply:	
<ul style="list-style-type: none"> Designated ESMS Officer 	
<ul style="list-style-type: none"> Designated ESMS Environmental Coordinator(s) 	

• Description of ESMS responsibilities of different roles	
ESMS capacity and resources – check all that apply:	
• Process for communicating ESMS policy and procedures across Financial Institution	
• ESMS includes tools (e.g., checklists/ guidance notes) for its implementation.	
• Budget allocated for ESMS training	
• Training plan for ESMS implementation	

Note: Please review sample ESDD and monitoring reports for types of projects envisaged under DRIVE. If such projects are not there in the existing portfolio, review ESDD and monitoring reports for any 2-3 projects.

2. Portfolio

Product lines for lending to the livestock and animal husbandry sector ¹	Description	Total exposure outstanding for most recent FY year end (in US\$)
Long term		
Short term	Transaction with tenor less than 12 months	
ST Corporate finance		
ST Trade finance		
Other		

What proportion of existing portfolio constitutes livestock and animal husbandry portfolio:

Exposure by types of project sponsors (private, public, pastoralists' groups, women groups, etc.)

S. No	Industrial Sector	No. of projects	% of portfolio
	Private sector entities		
	Pastoralists' groups		

¹ Such as grass-fed red meat, live animal export and auxiliary value chains like feed production, camel milk production, meat processing facilities, slaughterhouses, live animal export, etc.

	Women groups		

Details of long-term project finance/corporate finance (longer than 12 months tenor)

Borrower name	Type of loan (large corporate/SME/trade finance)	Tenor of loan (months)	Value of exposure (US\$ mn)	Description of Project

Annex 2: ESAP template

PFI name			
Date of ESAP/ date of compliance review			
Description of the E&S action	Responsible Person	Due date	Evidence for completion of the action

Annex 3: Annual E&S Monitoring Report Format

Name of the PFI	
Reporting period (month/year-month/year)	
Report completed by (name and designation)	
Contact e-mail address and phone number	
Date of the Report	

1. ESMS Implementation and E&S Capacity

Policies & Processes		Description
Have there been any updates to the E&S Policy and ESMS adopted by your organization?	Yes/No	If yes, please provide a copy of the updated policy including date when it was issued and reasons for the same.
Has senior management signed off on the updated policy/procedure?	Yes/No	If yes, please provide the date and internal communication indicating the same.
Please describe any activities for the last FY for staff training and other internal communication		
Give details of any transactions rejected on environmental, health, safety or social grounds		
State any difficulties and/or constraints related to the ESMS implementation		
Did you conduct site visits to MSMEs facilities and PFIs?	Yes/No	If yes, please provide % of projects (PFIs and SMEs) that are covered
Capacity		
Please provide current staffing of the core E&S people as well as list other people in the organization involved with the ESMS implementation		
Has the E&S team undergone any training during the reporting period?	Yes/No	If yes, please provide details
Do you need more guidance on ESMS implementation? Please describe	Yes/No	

II: Portfolio information for SME investments

1. MSME exposure by product

Product line	Description	Total exposure outstanding for most recent FY year end (in US\$)
Factoring		
Longer term loan		
Working Capital		

2. Exposure by Industry Sub-sectors

Please provide an indicative % of portfolio that these sectors represent of the total SME portfolio (under the project).

Industrial Sector	% of total SME exposure
Agribusiness	
Livestock	

3. Longer tenor MSME lending

Please provide information for the MSME loans with tenor more than 12 months

SME name	Type of financing	Tenor of loan (months)	Value of exposure (US\$ mn)	Industry Sector	E&S category	E&S issues at appraisal (list key issues)	ESAP agreed (Y/N and mention the key ESAP items)	Current status of compliance (provide the latest supervision date)

Note: Please attach copies of 2 ESDD reports with ESAPs for new SME investments made over the reporting period and 2 E&S monitoring reports

Please provide the following information for the MSME portfolio

Issue	Yes	No	Development
Non-compliance with national legislation and regulations			
Non-compliance with KDC's E&S standards			
Non-compliance with ILO and/or UN Conventions			
Non-compliance with covenants in the Facility Agreements			
Non-compliance with ESAP			
Complaints from regulatory agencies, interest groups, or local communities			
Fatalities or serious injury			
Strikes (with or without violence) or other labour disputes			
Legal action			
Fines, penalties or increased permit charges			
Negative attention on the part of the media or NGOs (non-governmental organizations)			

4. Compliance with the Exclusion List and Restricted Activities

Activities on Exclusion List	
If any, please indicate the dollar percentage of loans or investments (under the project) out of your total outstanding exposure provided to clients who are substantially involved in excluded activities.	%
If the percentage is not zero, please explain these exposures and any steps having been taken to reduce such exposure.	

Sustainable finance		
Have you made any investments in projects that have E&S benefits such as investing in management systems, energy efficiency, renewable energy, cleaner production, pollution management, supply chain greening, corporate social responsibility, community development etc? Please list these in the format provided below:		
Project Name	Value financed (US\$ million)	Type of environmental and social benefit ²
•		

² Examples are cleaner production, energy efficiency, renewable energy, carbon finance, management system improvement, sustainable supply chain, corporate social responsibility etc.

•		
•		