

State Bank of Pakistan
Financial Inclusion and Infrastructure Project

**ENVIRONMENTAL AND SOCIAL RISK
MANAGEMENT
POLICY AND PROCEDURES**

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ABBREVIATIONS

| | |
|-------------------|--|
| AC&MFD | Agricultural Credit & Microfinance Department |
| CDNS | Central Directorate of National Savings |
| EA | Environmental Assessment |
| ESMP | Environmental and Social Management Plan |
| E&S | Environmental and Social |
| EIA | Environment Impact Assessment |
| GoP | Government of Pakistan |
| LoC | Line of Credit |
| MFIs | Microfinance Institutions |
| MSMEs | Micro, Small and Medium Enterprises |
| MFBs | Microfinance Banks |
| PFI s | Participating Financial Institutions |
| PPAF | Pakistan Poverty Alleviation Fund |
| RSF | Risk Sharing Facility for SMEs |
| SBP | State Bank of Pakistan |
| FOIRA | Federal Ombudsman Institutional Reforms Act 2013 |

INTRODUCTION

Project Description

The Financial Inclusion and Infrastructure Project (the Project) aims to contribute to increasing access and usage of digital payments and other financial services for households and businesses in Pakistan. This will be done through investments, pilots, capacity building and analyses aimed at improving the financial infrastructure and the ecosystem for Digital Transaction Accounts (DTAs), besides capacity building of the NFIS secretariat.¹

At the firm level, the project aims to improve access to financial services for micro, small and medium enterprises (MSMEs), through component 3. In this regard, the State Bank of Pakistan is offering a line of credit (LOC) to participating financial institutions (PFIs) for on-lending to micro borrowers and micro enterprises. Due to the involvement of productive private sector activities, this component involves environmental and social (E&S) risks and impact.

Types of Participating Financial Institutions

In the case of both LOC and RSF, the Participating Financial Institutions (PFIs) will be financial institutions licensed to operate in Pakistan. Under the LOC, the majority of the final beneficiaries that will be supported are expected to be microfinance borrowers/ microenterprises.² There are two types of PFIs that can benefit from the LOC managed by SBP:

Retail PFIs: E&S risk management approach covers the LOC to microfinance institutions and banks in Pakistan that will use these funds for microfinance borrowers including microenterprises.

Wholesale PFIs: It is also possible that SBP will channel funds to wholesale financial institutions who will, in turn, on-lend to others or to microfinance banks (MFBs) and microfinance institutions (MFIs).

E&S risk management approach in this document covers the LOC to participating financial institutions (PFIs) including microfinance institutions and banks in Pakistan that will use these funds for microfinance borrowers including microenterprises.

SBP views its “PFIs”, which will be implementing partners, in achieving sustainable project development objectives in an efficient manner. Therefore, SBP strives to work with PFI who carry forward its E&S commitment and who wish to improve their ability to manage E&S issues within their operations. To that extent, PFIs - both retail and wholesale - will be required by SBP, besides other conditionalities, to develop and maintain their own Environmental and Social Management Systems (ESMS).

Further, SBP has committed institutional capacity to implement E&S risk management arrangements, as well as raise awareness on E&S issues among PFIs through development of the SBP Green Banking Guidelines for financial institutions in Pakistan (<https://propakistani.pk/2017/10/10/sbp-issues-guidelines-green-banking-pakistan/>). This initiative is led by the same SBP department that is implementing FIIP. Provisions of the Green Banking Guidelines are not yet mandatory for the financial institutions in Pakistan

¹ Component 2 of the project is implemented by the Central Directorate of National Savings (CDNS) and supports modernization and automation of the National Savings Schemes (NSS). In addition, various technical assistance activities for SME lending are also supported under component 3.

² The project’s operations manual defines microenterprise under the project as follows: Microenterprise is a self-employed micro-entrepreneur or a business entity employing up to 10 employees which are typically served by microfinance banks and microfinance institutions with loan sizes up to PKR 500,000.

and currently do not cover the microfinance sector. However, they will be built upon as good practice in the process of SBP's engagement with PFIs under FIIP and information about them will be disseminated as part of PFI capacity building activities and training.

Environmental and Social Management System (ESMS)

"ESMS" is a systematic approach for financial institutions to manage the E&S risks and impacts arising from financing business activities and managing exposures. This system enables financial institutions to comprehensively consider E&S risks in their financing, and by so doing, move beyond compliance with regulations to taking advantage of increased sustainability of their operations.

With regard to LoC funding, primary activity at the SBP level is to be a vehicle for lending to microfinance service providers (i.e. PFIs). SBP recognizes that the primary responsibility for management of E&S risks and impacts rests with PFIs. SBP also believes that given their direct involvement in the local markets within which they operate, PFIs are best positioned to create values for this overall E&S management system through putting in place adequate E&S screening, assessment, and management measures.

At SBP level, the ESMS is anchored in the following elements:

- E&S Policy statement, endorsed by senior management and publicly disclosed, outlining SBP's approach and applicable E&S requirements for the LoC under Financial Inclusion and Infrastructure Project.
- E&S Procedures (internal) for assessment of systems and capacity of PFIs to manage E&S risks and impacts.
- Supporting elements of (i) reporting; (ii) organizational capacity, including roles and responsibilities for environmental and social risk management within the organizational structure of the FIIP PIU; (iii) resources for implementation such as budget; (iv) adequate training, technical assistance and capacity building for relevant SBP staff. All of these are also integral parts of the ESMS.

At the level of PFIs, the ESMS will include the following key elements:

- (i) E&S policy (stating applicable E&S requirements),
- (ii) E&S screening procedures for identification, assessment, mitigation, and monitoring of E&S risks³,
- (iii) Consistent reporting process and formats; and
- (iv) Adequate capacity for implementation, including training of credit staff on the applicable requirements and E&S screening process of final borrowers against them.

SBP will assist PFIs with supplementary Guidance and Tools, which are practical resource materials, such as E&S screening checklists (with accompanying instructions) and well recognized Microfinance sector practices for implementing E&S risk management measures by PFIs. These tools are developed and improved on an on-going basis.

³ Such procedures will include environmental and social categorization, record keeping, and disclosure.

PART 1: ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT POLICY

A. Vision and Policy Approach

1. SBP recognizes that, despite its positive impacts on economic development and poverty reduction, microenterprise business can also have adverse impacts on local communities and the physical environment within which they live or upon which they depend for their livelihoods.
2. SBP strives for positive development outcomes in the business activities⁴ it supports. These business activities are financed by SBP through the Line of Credit under Financial Inclusion and Infrastructure Project (FIIP) to Participating Financial Institutions (PFIs) engaged in provision of microfinance to end borrowers. This model is intended to overcome limitations in access to finance, reduce volatility, and increase the contribution of the financial sector to national economic development.
3. SBP believes that an important component of achieving positive development outcomes is the environmental and social sustainability of these activities, which SBP expects to achieve through the application of this Policy.
4. SBP strives to ensure that at a minimum the business activities to be financed are environmentally friendly and socially acceptable. SBP will, therefore, not finance projects that do not comply with the country's E&S laws and regulations (including federal, provincial, and local), as well as those not meeting Pakistan's obligations under international law, and will ensure that certain environmentally and socially harmful activities are excluded from financing.⁵ Further, SBP will ensure that the microfinance services provided under the FIIP follow the principle of non-discrimination and pay particular attention to inclusion of women and vulnerable groups.
5. Managing such risks means that SBP and the PFIs must develop and maintain adequate systems, procedures, and capacity for identifying, managing, and monitoring environmental and social (E&S) risks and impacts of business activities financed as commensurate with the types, scope, and nature of financing provided.
6. SBP, therefore, supports the capacity development of the PFIs to manage environmental and social risks. This is achieved primarily through the development and implementation of an Environmental and Social Management System (ESMS) by the PFIs.
7. SBP is committed to ensuring that the cost of compliance with E&S standards is commensurate with the size of borrower's business and the magnitude of E&S impact. Hence, the cost should not fall disproportionately on microfinance clients.

B. Policy Objectives

8. Through the application of this policy SBP will seek to ensure through its E&S due diligence and monitoring processes that all business activities financed by PFIs are designed and implemented in compliance with applicable regulatory requirements of Pakistan and good international practices and standards.
9. The main objectives of this Policy are:
 - a. To set out applicable E&S requirements for all business activities financed through PFIs;

⁴ 'Business activities' is a general term used to mean various activities carried out by clients of PFIs (micro-enterprises and microfinance borrowers).

⁵ This will be ensured by requiring PFIs to apply the List of Excluded Activities.

- b. Stipulate measures to be taken by PFIs to develop and/or strengthen their Environmental and Social Management Systems (ESMS);
- c. Fully implement and comply with national requirements for E&S risk management in Pakistan, including those that may be issued by SBP specifically for financial institutions, as well as World Bank funding requirements;
- d. Integrate E&S risk management considerations into SBP's LoC funding criteria to PFIs⁶;
- e. Promote greater transparency and accountability on E&S issues internally and externally through a well-functioning grievance handling mechanism as well as disclosure and reporting requirements.

C. Scope of Application

- 10. The requirements of this Policy apply to the LoC facility, established by SBP, to PFIs (in the Micro financing sector) and the ultimate micro-borrowers, as described under AC&MFD Circular No. 01 dated June 14, 2018.

D. Applicable Requirements

- 11. SBP will only finance business activities that are expected to meet Applicable Environmental and Social (E&S) Requirements within a reasonable period of time. Persistent delays and gaps in meeting these requirements shall lead to loss of financial support to the PFI from SBP.
- 12. As a condition of eligibility to receive financing from SBP, the PFIs will put in place and maintain an Environmental and Social Management System (ESMS) to identify, assess, manage, and monitor E&S risks and impacts associated with business activities they finance. The system should be commensurate with the nature and magnitude of 'risks and impacts' at the individual transaction level as well as the portfolio⁷ level. Where the PFI can demonstrate that it already has an ESMS at the time of SBP's due diligence, it will provide adequate documentary evidence to that effect. The PFI's ESMS will be commensurate with the nature of their business (lending to final borrowers or on-lending to other PFIs).
- 13. All **retail PFI's ESMS** shall be endorsed by the PFI's Board of Directors, and have adequate resources dedicated to its implementation and must include⁸:
 - (i) An environmental and social policy, expressing overall commitment to managing E&S risks in their operations and clearly stating Applicable E&S Requirements⁹ for transactions with microfinance borrowers as follows:
 - a. All relevant environmental and social, national and local, laws and regulations of Pakistan (Annex 1 details relevant national laws and regulations).
 - b. Any activity on the List of Excluded Activities set forth in Annex 2 will not be financed by PFIs.

⁶ Once RSF modalities are developed, E&S considerations will be integrated into that process.

⁷ For the purposes of this Policy, portfolio means the portfolio of current and/ or proposed sub-projects to which this Policy applies and originated from the time SBP signs a legal agreement with the PFI.

⁸ The PFI's ESMS will be tailored and scaled to the nature of their lending activities (size of the transactions, sectors of operation, size of the micro-enterprises supported etc.) and be commensurate with the magnitude of anticipated risks and impacts of their portfolio, which are generally low for microfinance at the individual transaction level.

⁹ The applicable E&S requirements have been prepared keeping in mind the small size of loans. The average loan sizes for microfinance are currently about \$400. Overall, they can be \$200-1,500, using an up-to-date nationally representative survey data.

- (ii) Clearly defined internal E&S procedures for risk identification, assessment, and management focusing on the process and specific tools (e.g. borrowers' questionnaire, sector guidance) and roles and responsibilities of PFIs' staff for interacting with their borrowers with regard to E&S issues.
 - (iii) An E&S risk categorization system for transactions with microfinance borrowers with clearly defined risk categories.¹⁰
 - (iv) Organizational capacity and competency for formulation and implementation of the ESMS.
 - (v) Monitoring and review of E&S risks at transaction level and portfolio level.
 - (vi) Reporting mechanism of the E&S risks.
 - (vii) Grievance handling mechanism.
14. Wholesale PFI's ESMS shall be endorsed by the PFI's senior management, have adequate resources dedicated to its implementation and must include:
- (i) An environmental and social policy, expressing overall commitment to managing E&S risks in their operations and clearly stating requirements for both transactions with retail PFIs and for microfinance borrowers to be financed by the retail PFIs as follows:
 - a. Retail PFIs will be required to establish and maintain an ESMS that incorporates elements described in paragraph 13 of this Policy. Wholesale PFIs ESMS will also include E&S risk rating for retail PFIs as described in paragraphs 17-18 of this Policy.
 - b. Applicable E&S Requirements for microfinance borrowers to be financed by the retail PFIs:
 - Relevant environmental and social national and local laws and regulations of Pakistan (Annex 1 details relevant national laws and regulations).
 - Any activities on the List of Excluded Activities set forth in Annex 2 will not be financed by PFIs.
15. SBP will require all PFI's to maintain labor management procedures in line with national laws and World Bank Performance Standard 2 on Labor and Working Conditions.¹¹
16. SBP will require all PFIs to promptly notify SBP, of any social, labor, health and safety, security or environmental incident, accident or circumstances which may have any material impact on the compliance of the Applicable Environmental and Social Requirements.

E. E&S Risk Rating for Participating Financial Institutions

17. Each PFI considered for SBP line of credit will be assigned an E&S risk rating according to the PFIs' risk profile that can change over time. The risk evaluations for rating purposes will be conducted by Internal Auditors and certificates in this effect should, directly, be submitted to AC&MFD, SBP along with detailed report. Where SBP provides financing to retail PFIs through wholesale PFIs, the

¹⁰ A typical categorization system used by PFIs may consist of three risk categories, which correspond to high, medium, or low risk. It should, therefore, be noted that the main purpose of a categorization system is to help PFIs prioritize their due diligence and supervision activities with a focus on higher risk and larger transactions (as compared to other transactions of the PFI) within a PFI's portfolio. In case of a microfinance institution, the categorization system is designed to be relative to the nature of the transactions in the portfolio. Such categorization system can include internal thresholds that help classify transactions based on such parameters as amount of loan, tenor of loan, size of enterprise/ borrower and sectors of operation etc.

¹¹ http://www.ifc.org/wps/wcm/connect/2408320049a78e5db7f4f7a8c6a8312a/PS2_English_2012.pdf?MOD=AJPERES

wholesale PFI will be responsible for assigning the ratings to retail PFIs as part of its ESMS. The risk ratings are as follows:

RR-1 (High Risk): When a PFI's proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse E&S risks or impacts.¹²

RR-2 (Moderate Risk): When a PFI's proposed portfolio includes, or is expected to include, business activities that have potential limited adverse E&S risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.

RR-3 (Low Risk): When a PFI's proposed portfolio includes, or is expected to include, financial exposure to business activities that predominantly have minimal or no adverse E&S impacts.

18. E&S risk rating assigned to each PFI will be based on the outcomes of SBP's E&S screening (through Internal Auditors) and further due diligence of the PFIs, where required, including portfolio of business activities and PFI's E&S competency and capacity. PFIs' risk rating will determine the resulting SBP requirements for the PFI's ESMS and the degree of supervision required by SBP.

F. Environmental and Social Due Diligence and Supervision

19. In order to appropriately identify the E&S risks associated with providing support to PFIs, SBP will review the existing and proposed business activities of the PFIs to identify risk and impacts associated with business activities financed, whether directly or through other PFIs. SBP will also review the capacity of the PFIs to manage E&S risks and impacts.
20. During the PFI assessment, SBP will take into consideration (a) the types of products and services provided by the PFI; (b) size and tenor of financing¹³; (c) the nature of the PFIs portfolio, including sectors and locations; (d) adequacy of PFI's E&S policies and procedures; (e) organizational capacity and commitment of the PFIs to identify, evaluate and manage E&S risks and impacts.
21. Where necessary, SBP will require the PFIs to strengthen their ESMS as well as organizational capacity (including training), responsibilities, and accountability for implementing the ESMS to be commensurate with SBP's assessment of the PFI's E&S risk profile.
22. SBP will develop and maintain a regular program and procedures for supervision of its investments. SBP will periodically review adequacy and implementation effectiveness of the PFIs' ESMS, including the processes and the results of the E&S screening and mitigation activities conducted by the PFIs. In addition, SBP will periodically review a sample of PFIs' investments, especially for PFIs rated as RR-1 (High Risk).

G. Disclosure and Reporting

23. This approved SBP FIIP E&S Policy is publicly disclosed on SBP's website. The implementation/ compliance provisions of this Policy are made part of the financing agreement with the PFIs.
24. PFIs are required to disclose the following key elements of their ESMS:
 - (a) The PFI's policy statement which describes specific objectives, implementation matrix, and aspirations that the Financial Institution has set with regard to its environmental and social performance;
 - (b) The PFI's procedures for screening and assessing risks and impacts of sub-projects or individual transactions; and

¹² Given that micro-enterprises often lack capacity for management of such risks, proposed investments that involve certain high risk activities are excluded from financing as per the List of Excluded Activities (Annex 2).

¹³ In general, longer tenors of the loans and larger loan sizes indicate higher exposure to financial / credit risk for a PFI, and E&S risks are a factor of credit risk and have an impact on it.

25. The PFIs will prepare and submit to AC&MFD, SBP, an Annual E&S Performance Report on the implementation of their ESMS that will include summary information on E&S risk profile of their portfolio.

H. Accountability and Grievance Handling Mechanism

26. SBP recognizes the importance of accountability and that stakeholder concerns should be addressed in a manner that is fair, objective, and constructive. The purpose of a grievance handling mechanism is to establish a way for affected individuals, groups or communities to communicate their concerns or formal complaints.
27. SBP has established a fully operative grievance handling mechanism at its Banking Conduct and Consumer Protection Department (BC&CPD). There exists a three-tier consumer grievance redressal hierarchy for the consumers of microfinance banking sector. BC&CPD, in consultation with AC&MFD will address consumers concerns and complaints promptly:
- i. First tier of grievance handling mechanism is the PFI itself. All PFI should have adequate mechanisms to address the grievances related to their E&S responsibilities for the society at large. SBP has also put in place a Consumer Grievance Handling Mechanism issued by SBP (BC & CPD Circular No. 01 dated February 29, 2016) which are also applicable to MFBs. All the PFIs especially the NBMFCs should follow these guidelines for the purpose loans under LoC facility.
 - ii. Second tier of the grievance redressal mechanism for MFBs is complaint to BC &CPD giving reference of the complaint registered under the first tier. BC&CPD will redress the complaints in consultation with AC&MFD. The complaint resolution process at SBP is comprehensible and transparent for both the parties. The process is kept gender neutral, culturally appropriate, and readily accessible to all segments of the affected parties and at no cost and without retribution to the group/individual that raised the complaint or concern. In case of complaints relating to NBMFCs operations under the LoC, the complainant should directly address the Director, AC&MFD SBP Karachi.
28. The Process flow in the grievance handling mechanism specific to FIIP is as follows:
- i. The affected individual or party/ community should register their complaint with the relevant PFI that will have a grievance handling mechanism established as part of its ESMS. The PFI should resolve the complaint within the stipulated time under their internal policy.
 - ii. If the complaint is not responded to the satisfaction of the affected party, the complainant may register their complaint through UAN 111-727-273 to the BC&CPD at SBP giving reference of the previous complaint number. In case of NBMFCs, the complainant should directly contact the Director, AC&MFD SBP giving reference to the previous complaint.
 - iii. BC&CPD will pass on the complaints to AC&MFD for further necessary action.
 - iv. AC&MFD will make all efforts to resolve the complaint within a reasonable period of time after the initial contact. The parties to the complaint will receive a written response from AC&MFD SBP.
 - v. The data on complaints and their outcomes will be kept by the AC&MFD for 5 years' time and will be made part of the annual review reports of the project.
29. Additionally, SBP is also open to accepting grievances from groups or individuals affected by the operations of final borrowers who may have E&S impacts on surrounding communities (e.g. pollution of local water sources etc.). It is required by this Policy that each PFI implement and maintain a procedure for external communications / grievance mechanism that includes methods to receive,

register, screen and assess, track, respond to, and act upon external inquiries and complaints from the public regarding their operations. Where the PFI has a financial consumer grievance mechanism, it may choose to integrate process for registering a complaint from both financial consumers and those who may be affected by the PFI's operations.

30. As part of their accountability mechanism, PFIs should conduct an annual review/ audit on compliance with applicable E&S requirements through the internal auditors of the PFI alongside the routine audit of the LoC. The report thus prepared should be made part of the LoC audit report and should be submitted to the Fund Management Committee at SBP within the time limit specified for submission of Internal Audit Report.

I. Amendment

31. This Policy may be amended by SBP, based upon feedback obtained from PFIs and other stakeholders as deemed necessary. However, the amendment of the Policy should not affect the essence of the provisions stated in it.

ANNEX 1. OVERVIEW OF RELEVANT NATIONAL ENVIRONMENTAL AND SOCIAL LAWS AND REGULATIONS.

Relevant national E&S laws and regulations are as follows:

- Pakistan Environmental Protection Act, 1997
- Sindh Environmental Protection Act, 2014
- National Conservation Strategy (NCS), 1992
- Punjab Environmental Protection Act, 2012
- Balochistan Environmental Protection Act, 2012
- Employment of Child Act, 1991
- Workers Welfare Fund, 1969
- Protection of Women (Criminal Laws Amendment) Act, 2006
- The Khyber Pakhtunkhwa Child Protection and Welfare Act, 2010.
- The Factories Act, 1934
- Pakistan Penal Code, 1860
- The Worker's Compensation Act, 1923
- The Children (Pledging Of Labor) Act, 1933
- Khyber Pakhtunkhwa Environmental Protection Act, 2014

Pakistan Environmental Protection Act 1997

The Pakistan Environmental Protection Act, 1997 (PEPA 1997) is the basic legislative tool empowering the government to frame regulations for the protection of the environment. The PEPA 1997 is broadly applicable to air, water, soil, marine and noise pollution. Penalties have been prescribed for those contravening the provisions of the Act. Under the provisions of the Act, federal and provincial EPAs have been formed which ensure enforcement of the Act in their respective areas of power. However, after the 18th amendment this act is now limited to federally administered territories and the provinces have their own environmental acts.

Sindh Environmental Protection Act 2014

The SEPA 2014 is the basic legislative tool empowering the government for the implementation of the regulations for the protection of the environment. The SEPA 2014 is largely applicable to air, water, soil, marine and noise pollution. Penalties have been prescribed for those who are violation the provisions of the Act.

National Conservation Strategy (NCS)

The National Conservation Strategy (NCS) is the primary Policy document of the Government of Pakistan on national environmental issues. The Policy was approved by the Federal Cabinet in March 1992. The Strategy also attained recognition by international donor agencies, principally the World Bank. The NCS identifies 14 core areas including conservation of biodiversity, pollution prevention and abatement, soil and water conservation and preservation of cultural heritage and recommends immediate attention to these core areas in order to preserve the country's environment.

A National Environmental Policy has been approved by the Federal Cabinet in its meeting held during June 2005. This policy has already been endorsed by the Pakistan Environmental Protection Council during 2004. The new policy has total 171 guidelines on sectoral and cross-sectoral issues. The objectives of new policy include assurance of sustainable development and protect of the natural wealth of country.

Punjab Environmental Protection Act 1997 (Amended up to Act 35 of 2012)

The Punjab Environmental Protection Act, 1997 (PEPA 1997) is the basic legislative tool empowering the government to frame regulations for the protection of the environment. The PEPA 2012 is broadly applicable to air, water, soil and noise pollution. Penalties have been prescribed for those contravening the provisions of the Act.

The two primary deliberations of the Act are the conduct of projects only after approval of environmental assessments from the PEPA and adherence with Punjab Environmental Quality Standards (PEQS).

Balochistan Environmental Protection Act 2012

The BEPA 2012 is the basic legislative tool empowering the government for the implementation of the regulations for the protection of the environment. The BEPA provide protection, conservation, rehabilitation and improvement of the environment, for the prevention and control of pollution and promotion of sustainable development. The BEPA 2012 is largely applicable to air, water, soil, marine and noise pollution. Penalties have been prescribed for those who are violation the provisions of the Act.¹⁴

Employment of Child Act, 1991

Article 11(3) of the Constitution of Pakistan prohibits employment of children below the age of 14 years in any factory, mines or any other hazardous employment. In accordance with this Article, the Employment of Child Act (ECA) 1991 disallows the child labor in the country. The ECA defines a child to mean a person who has not completed his/her fourteenth years of age. The ECA states that no child shall be employed or permitted to work in any of the occupation set forth in the ECA (such as transport sector, railways, construction, and ports) or in any workshop wherein any of the processes defined in the Act is carried out. The processes defined in the Act include carpet weaving, biri (kind of a cigarette) making, cement manufacturing, textile, construction and others). The project proponent, participating farmers and their contractors will be bound by the ECA to disallow any child labor at the project sites.

Workers Welfare Fund, 1969

This law established in 1969 called the Employees Welfare Fund. In this law all contributions received under section 6 from Government servants; the contributions made to the Fund by Government, the Government Servants Benevolent Fund or the Police Welfare Fund; and any interest or profit accruing on such contributions. The Welfare Fund shall be divided into two parts: Part I for gazetted Government servants and Part II for non-gazetted Government servants and each such part shall be maintained and administered separately in accordance with the provisions of this Ordinance. The contributions from gazetted Government servants received under section 6 shall be credited into Part I of the Welfare Fund and the contributions received from non-gazetted Government servants shall be credited into Part II of the Fund. The moneys credited into the Welfare Fund shall be kept in such bank or banks as may be prescribed. The Welfare Fund shall be utilized for meeting the expenses on arrangements to be made with an insurance company or other insurer for the insurance of Government servants.¹⁵

¹⁴ https://www.elaw.org/system/files/balochistan_environment_protection_act_2012-1.pdf

¹⁵ <http://punjablaws.gov.pk/laws/225.html>

Protection of Women (Criminal Laws Amendment) Act, 2006 & The Protection Against Harassment of Women at Workplace Act, 2010.

The objective of this act to create a safe working environment for women which is free of harassment, abuse and intimidation with a view toward fulfillment of their right to work with dignity. It will also enable higher productivity and a better quality of life at work. Harassment is one of the biggest hurdles faced by working women preventing many who want to work to get themselves and their families out of poverty. This Act opens the path for women to participate more fully in the development of this country at all levels.

This Act builds on the principles of equal opportunity for men and women and their right to earn a livelihood without fear of discrimination as stipulated in the Constitution. This Act complies with the Government's commitment to high international labor standards and empowerment of women. It also adheres to the Human Rights Declaration, the United Nation's Convention for Elimination of the forms of Discrimination against Women and ILO's convention 100 and 111 on workers' rights. It adheres to the principles of Islam and all other religions in our country which assure women's dignity.

The Khyber Pakhtunkhwa Child Protection and Welfare Act, 2010

The Khyber Pakhtunkhwa Child Protection and Welfare Bill, 2010 having been passed by the Provincial Assembly of Khyber Pakhtunkhwa on 21st September 2010. This Act expedient to provide for the care, protection, maintenance, welfare, training, education, rehabilitation and reintegration of children at risk in the Khyber Pakhtunkhwa, an institution or organization for the admission, care, protection and rehabilitation of children at risk, established or recognized under this Act or the rules made thereunder, which shall include a "Kafalat Ghar" or "Children Home" or "Orphanage".¹⁶

The Factories Act, 1934

The Factories Act provides that no adult worker shall be allowed or required to work in a factory for more than 48 hours in a week; if the factory is seasonal, 50 hours a week and if the work is of continuous nature, he may work for 56 hours in a week. As for the daily hours, these may not be more than 9 hours a day. (In case of seasonal: 10 hours)

Pakistan Penal Code

The Pakistan Penal Code (1860) authorizes fines, imprisonment or both for voluntary corruption or fouling of public springs or reservoirs so as to make them less fit for ordinary use. It also provides for fine for making atmosphere noxious to health.

The Worker's Compensation Act, 1923

This law deals with the payment of compensation by the employer to worker or workman (not officer) when he meets with an accident during his working period. Natural disabilities are excluded from the compulsory payment of compensation. Occurrence of accident after the working hours in outside the working premises is also excluded from the payment of compensation. Only such accident is covered under this law which occurs due to work for which worker is employed.

Generally the person who attains the age of eighteen in general or twenty one in case where Court appoints guardian for person or his property becomes adult. But so far as the Workmen's Compensation Act is concerned, the minor is below than fifteen (15) years of age and adult is the person who has attained the age of fifteen (15) years. This is a special law and where special law provides other than of general law, provisions of the special law prevail. Special law suspends the general law.

The Sindh Worker's Compensation Act, 2015 (Sindh Act No. VII of 2016) in section 2(1)(h) defines minor who has not completed fourteenth years of age whereas in section 2(a) defines adult is a person who has completed eighteenth years of age.

¹⁶ <http://www.ombudsmankp.gov.pk/act.pdf>

The Children (Pledging Of Labor) Act, 1933

"An agreement to pledge the labour of a child" means an agreement, written or oral, express or implied, whereby the parent or guardian of a child, in return for any payment or benefit received or to be received by him, undertakes to cause or allow the services of the child to be utilized in any employment: Provided that an agreement made without detriment to a child, and not made in consideration of any benefit other than reasonable wages to be paid for the child's services, and terminable at not more than a week's notice, is not an agreement within the meaning of this definition; "child" means a person who is under the age of fifteen years; and "guardian" includes any person having legal custody of or control over a child.

Khyber Pakhtunkhwa Environmental Protection Act, 2014

KPEPA, 2014 emphasises that no person shall discharge or emit or allow the discharge or emission of any effluent or wastes or air pollutant or noise, load, concentration or level which is in excess of the Khyber Pakhtunkhwa Environmental Quality Standards or, where applicable, the standards established highlights that no person shall discharge effluents, emissions or wastes in excess of load permitted in the conditions of environment permit or environmental approval or license.

ANNEX 2. LIST OF EXCLUDED ACTIVITIES

SBP is working with a broad array of financial institutions (FI) engaged with the provision of microfinance services to low end market, not only for the purpose of regulation but also for the sectoral development. The List of Excluded Activities, given below, is applied to all the financings under the FIIP for the purpose of LoC by SBP to PFIs. The implementation of this List of Excluded Activities to end-borrower is the responsibility of the PFI. The LoC funds under the FIIP, shall, under no circumstances, be provided for the following activities:

1. Production or trade in any product or activity deemed illegal under Pakistan's laws or regulations or international conventions and agreements
2. Production or trade in pharmaceuticals, pesticides/herbicides, ozone depleting substances, polychlorinated biphenyls (PCBs) subject to international phase outs or bans
3. Trade in wildlife or wildlife products regulated under Convention on International Trade in Endangered Species
4. Production or trade in weapons and ammunitions¹
5. Production or trade in alcoholic beverages¹
6. Production or trade in tobacco¹
7. Gambling, casinos, and equivalent enterprises¹
8. Production or trade in radioactive materials (this does not apply to the purchase of medical equipment, quality control measurement equipment, and any equipment where the radioactive source is considered to be trivial and/or adequately shielded.)
9. Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations
10. Production or trade in or use of unbounded asbestos fibers
11. Unsustainable fishing practices, such as drift net fishing in the marine environment using nets in excess of 2.5 km length, electric shocks, or explosive materials
12. Production or trade in wood or other forestry products other than from sustainably managed forests²
13. Production or activities involving harmful or exploitative forms of forced labor³ or harmful child labor⁴
14. Activities involving land acquisition and/or restrictions on land use resulting in involuntary resettlement or economic displacement⁵
15. Any activities involving significant degradation or conversion of natural⁶ and/or critical habitats⁷ and/or any activities in legally protected areas

16. Production, trade, storage, or transport of significant volumes of hazardous chemicals, or commercial scale usage of hazardous chemicals (gasoline, kerosene, other petroleum products, textile dyes, and so on)
17. Production or activities that have adverse impacts, including relocation, on the lands, natural resources, or critical cultural heritage subject to traditional ownership or under customary use by Indigenous Peoples⁸
18. Activities involving significant adverse impacts on critical cultural heritage⁹
19. Production or trade in or use of non-biodegradable packaging material such as polythene bags and styrofoam.

Notes:

1. This does not apply to enterprises that are not substantially involved in these activities. ‘Not substantially involved’ means that the activity concerned is ancillary to an enterprise’s primary operations.

2. Sustainable forest management may be demonstrated by the application of industry-specific good practices and available technologies. In some cases, it may be demonstrated by certification/ verification or progress towards certification /verification under a credible standards system.

3. Forced labor means all work or service, not voluntarily performed that is extracted from an individual under threat of force or penalty.

4. Harmful child labor means the employment of children that is economically exploitive, or is likely to be hazardous to, or to interfere with, the child’s education or to be harmful to the child’s health, or physical, mental, spiritual, moral, or social development.

5. Land acquisition and/or restrictions on land use may result in the physical displacement of people (involuntary resettlement), as well as their economic displacement (as loss of assets and/or means of livelihood, regardless of whether or not the affected people are physically displaced). Land must be bought on willing-buyer, willing-seller basis.

6. Natural habitats are areas composed of viable assemblages of plant and/or animal species of largely native origin, and/or where human activity has not essentially modified an area’s primary ecological functions and species composition. This includes HCV forests. HCV areas do not directly correspond with definitions for modified, natural, and critical habitat. The HCV Resource Network, an internationally recognized group, provides information and support on the evolving usage of HCV to ensure a consistent approach. <https://www.hcvnetwork.org/>.

7. Critical habitat is a subset of both natural and modified habitats that deserves particular attention. Critical habitat includes areas with high biodiversity value that meet the criteria of the World Conservation Union (IUCN) classification, including habitats of significant importance for required for critically endangered or endangered species as defined by the IUCN Red List of Threatened Species; habitats of significant importance for endemic or restricted-range species; habitats supporting globally significant concentrations of migratory species and/or congregatory species; and areas with unique assemblages of species or which are associated with key evolutionary processes. Primary forests or forests of High Conservation Value (HCV) shall be considered Critical Habitats.

8. The term ‘Indigenous Peoples’ is used in a generic sense to refer to a distinct social and cultural group possessing the following characteristics in varying degrees:

- Self-identification as members of a distinct cultural group and recognition of this identity by others
- Collective attachment to geographically distinct habitats or ancestral territories in the project area and to the natural resources in these habitats and territories
- Customary cultural, economic, social, or political institutions that are separate from those of the mainstream society or culture
- A distinct language or dialect, often different from the official language or languages of the country or region in which they reside.

In Pakistan, Indigenous Peoples meeting the above definition are found in the Chitral Valley in Pakistan. Where financing schemes involve Indigenous Peoples (e.g. they are one of the key target groups for lending), such groups will be meaningfully consulted and

their special concerns taken on board. Screening criteria will include IPs location as an indicator and ensure that if they are involved, requisite IP Plan is developed for the involved SMEs.

9. Critical cultural heritage consists of (a) the internationally recognized heritage of communities who use, or have used, within living memory the cultural heritage for long-standing cultural purposes and (b) legally protected cultural heritage areas, including those proposed by host governments for such designation.

Additionally, borrowers will not engage in cultivation, processing, and sale of poppy and/ or other illegal addictive substances (for example, heroin, hashish, opium, bhang, alcohol). Sale of addictive substances such as tobacco, gutka, niswar, cigarettes, beeri, hukka, paan parag, sheesha and any other products containing such substances to persons under the age of 18; Illegal wood extraction; hunting, poaching and fishing in protected areas; informal cross-border trade; smuggling or sale and handling of smuggled goods.

PART 2: ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT PROCEDURES

1. Background and Purpose

In its lending activities to microfinance borrowers through PFIs, SBP shall pursue its objective of sensitization about E&S risks through creating awareness amongst PFIs and the microfinance clients that PFIs work with.

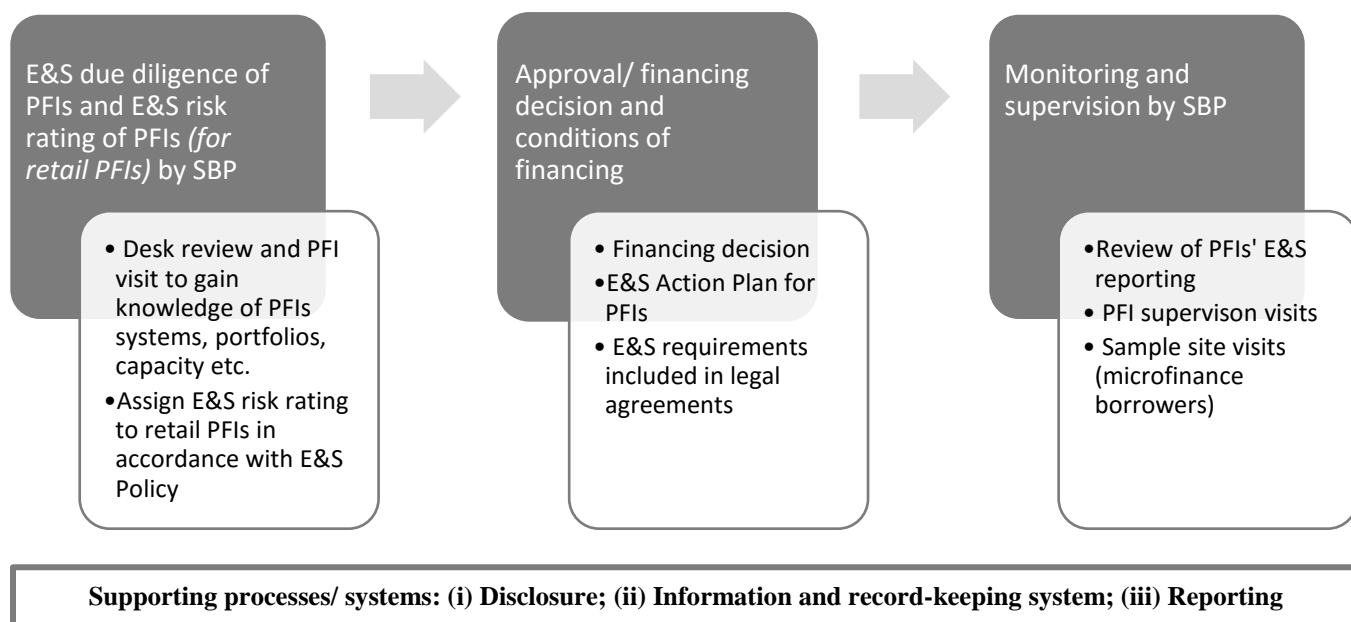
These procedures are embedded in the overall investment screening and appraisal process, and form part of SBP's decision-making for providing LOC to PFIs. E&S Procedures are based on the principle of continuous improvement. The objective of these E&S Procedures is to facilitate and promote:

- Proper implementation and institutionalization of E&S risk management measures;
- Identification and mitigation of E&S risks involved in SBP's lending to PFIs;
- Fulfillment of E&S legal and multilateral lender's requirements;
- Measuring, monitoring, reviewing and reporting E&S risks of the FIIP portfolio.

2. Structure of SBP E&S Procedures

The E&S Procedures are comprised of three distinct components (Figure 1). Visual flow for transaction-level decision-making process is provided in Annex 1.

Figure 1. Structure of E&S Procedures



3. Environmental and Social Due Diligence and Risk Rating

This procedure outlines steps required for transaction screening for E&S risks when a new PFI is identified for a financing opportunity by SBP. These steps and compliance requirements have been prepared keeping in mind average size of loans and the impact such a support has on the physical environment and the social fabric in question.

Environmental and Social Due Diligence for the Retail PFIs

Due diligence of the PFIs will be performed in the following manner:

- Review the relevant information collected from the PFI. The review will include assessment of the PFI's current portfolio and lending activities against List of Excluded Activities, the expected portfolio to be supported, and the overall E&S systems and capacity (per criteria in Annex 2), including PFI's commitment to comply with national and local laws and regulations and SBP E&S requirements. Minimum eligibility criteria for PFI's E&S systems and capacity are as follows:
 - Written E&S policy and procedures in place for E&S screening, as commensurate with the nature and scale of the PFI's lending activities;
 - PFI designates staff with clearly defined responsibilities for E&S risk management;
 - Commitment to taking part in E&S training and capacity building activities.
- Complete **PFI E&S Screening Questionnaire** (Annex 3), including E&S Action Plan for the PFI where necessary.
- Assign an E&S risk rating to the PFI taking into account the provisions of the SBP E&S Policy and document the summary of the E&S risk due diligence and risk rating in the E&S Risk Rating Memorandum (Annex 4).
- File all relevant documentation in a systematic manner.

PFIs will have to exhibit their capacity as well as willingness to meet all the E&S requirements **within one year** of the approval of the credit line. Afterwards, based on the results of E&S screening, a PFI will not be eligible for financing/ continuity of the credit line by SBP where (i) PFI has high to moderate exposure to activities on the List of Excluded Activities; (ii) PFI does not meet minimum eligibility criteria for its E&S systems and capacity (ESMS).¹⁷

Environmental and Social Due Diligence for Wholesale PFIs

SBP will complete the following steps:

- Review the relevant information collected from the PFI. The review will include assessment of the wholesale PFI's lending activities to other PFIs. The review will focus on the expected portfolio to be supported, and the overall E&S systems and capacity (per criteria in Annex 2). If the wholesale PFI is able to provide information on the portfolios supported by retail PFIs, this will be reviewed as well and assessed against List of Excluded Activities.¹⁸ Minimum eligibility criteria for PFI's E&S systems and capacity are as follows:
 - Written E&S policy and procedures in place for assessment of systems and capacity of retail PFIs as commensurate with the nature and scale of the PFI's lending activities;
 - PFI designates staff with clearly defined responsibilities for E&S risk management;

¹⁷ Until such minimum systems and capacity are developed by PFIs.

¹⁸ If PFI is not able to provide such records, this will be included in the PFI E&S action plan.

- Commitment to taking part in E&S training and capacity building activities.
- Complete wholesale PFI E&S Screening Questionnaire (Annex 5), including E&S Action Plan for the PFI where necessary.
- File all relevant documentation in a systematic manner.

Based on the results of E&S screening, a wholesale PFI will not be eligible for financing by SBP where the PFI does not meet minimum eligibility criteria for its E&S systems and capacity (ESMS) within one year of the approval of credit line.¹⁹,

3.1. Considerations for E&S Risk Rating by SBP of the Retail PFIs

E&S risk rating for the PFI takes into account various considerations detailed in Table 1 below. These considerations should be used together in each risk rating decision and will require exercising reasonable judgment. E&S risk rating will take into account type, tenor, sector, location, specific E&S risks and impacts associated with a PFI's portfolio, and PFI's capacity to manage E&S risks.

SBP would use this categorization to be able to prioritize its supervision activities to focus on PFIs with riskier portfolios which are yet to improve their capacity to manage such risks. Based on the PFI's risk rating, SBP may ask the PFI to put in place a time-bound action plan (as per section 3.2 below) for improving its ESMS to be commensurate with the E&S risk profile of its portfolio. This action plan will be agreed with the PFI and monitored by SBP on the basis of the PFI's annual E&S reporting, as well as visits to PFIs, where deemed necessary by SBP.

Table 1. Key Considerations for PFI E&S Risk Rating

| E&S Risk Rating | Nature of financing to final borrowers (tenor, amount) – indicative | Sectors and locations | Activities on SBP List of Excluded Activities | PFI's Systems and Capacity for E&S Risk Management |
|--------------------|--|---|---|--|
| RR-1 (High Risk) | Longer-term loans (e.g. over 36 months); average loan size over Rs.120,000 | Substantial part of PFI's portfolio is in higher risk sectors ²⁰ Highly sensitive locations (e.g. densely populated urban areas, industrial zones with high cumulative impacts of pollution etc.) | PFI's portfolio includes some exposure to such activities that can be eliminated over a reasonable period of time | Overall weak E&S systems and capacity based on criteria in Annex 2 |
| RR-2 (Medium Risk) | Medium-term loans (e.g. between 12 and 36 months); average loan size between Rs.120,000 and Rs.100,000 | Most of PFI's portfolio is in sectors not considered high risk | PFI's portfolio includes no exposure to such activities | Overall moderate to strong E&S systems and capacity |

¹⁹ Until such minimum systems and capacity are developed by PFIs.

²⁰ To determine examples of higher risk sectors, SBP may use guidance developed by international organizations, as relevant to the operations of PFIs' microfinance borrowers. For example, industry factsheets developed by the International Finance Corporation: <https://firstforsustainability.org/risk-management/risk-by-industry-sector/> or FMO E&S Guidance for MFIs – Sector Guide.

| | | | | |
|-----------------|--|--|---|--|
| RR-3 (Low Risk) | Shorter-term loans average loan size below Rs. 100,000 | Most of PFI's portfolio is in lower risk sectors | PFI's portfolio includes no exposure to such activities | E&S systems and capacity are well in excess of minimum required capacity |
|-----------------|--|--|---|--|

3.2. E&S Action Plan for PFIs

Based on the results of the E&S due diligence that will help determine the level of E&S risks in the PFI's portfolio and the PFI's capacity to manage them, SBP will require the PFI to develop and /or maintain an ESMS commensurate with the risks and impacts and in accordance with SBP E&S Policy. Where the PFI's ESMS must be strengthened in order to be acceptable to SBP, the PFI will put in place a time-bound action plan as a condition of financing, which will be included in the financing agreement.

E&S Risk Management Focal Point for FIIP at SBP will:

- Identify key gaps in the PFI's ESMS and institutional capacity (*depending on the PFI's risk rating and as per criteria in Annex 2*) and will document proposed measures and actions to address the gaps in the PFI's E&S Action Plan in the E&S Risk Rating Memorandum (Annex 4).
- Discuss and approve the Action Plan with the PFI (where such plan is necessary).
- Ensure it is included in the investment decision-making and subsequently in the financing agreement with the PFI.

Significant gaps in the E&S performance (including outstanding E&S Action Plan items) of existing clients/ PFIs must be closed through the process of commitment as conditions of commitment or as conditions of subsequent disbursements. If a PFI is consistently not able to meet the requirements set out in the E&S Action Plan, and any subsequent remedial actions, SBP may decide to terminate its financing to the PFI.

Additional considerations and raising awareness and PFIs' capacity suggest that ESMS requirements should be part of disclosures and client awareness mechanisms, where each microfinance client must be made aware of his/ her environmental and social responsibility. This awareness, and in turn the covenants that the client signs will ensure compliance with ESMS requirements at the PFI level. Therefore, PFIs shall ensure that their microfinance clients are made aware of all environmental and social risks.

3.3. New transactions with existing PFIs

The starting point for the review of any new transaction of existing PFIs is the results of the previous assessment and current E&S risk rating (in case of retail PFIs). Existing clients undergo E&S assessment annually or at the time of requesting a new transaction, whichever is sooner. At that time, the PFI's E&S Action Plan, if one was prepared and is included in the financing agreement for the previous transaction, will be reviewed. If the PFI has fulfilled all actions in the plan, the new transaction may proceed. PFI's E&S risk rating may be adjusted, if necessary, based on the results of the new assessment.

4. Approval and Conditions of Financing

This procedure outlines applicable requirements and performance commitments formalized in loan covenants as part of the approval process.

E&S loan covenants should cover the following:

- Use all reasonable efforts to ensure the E&S performance of the borrowers is in compliance with the PFIs' Environmental and Social Policy, including applicable requirements of SBP.

- Implement the E&S mitigation and management measures specified in the PFI's Action Plan.
- PFI to provide annual E&S reporting to SBP based on an agreed format.
- Within three days of occurrence, PFIs will require their borrowers to notify them, and in turn, will notify SBP of any social, labor, health and safety, security or environmental incident, accident or circumstance having, or which could reasonably be expected to have, any material impact on compliance of a PFIs transaction/ borrower with applicable E&S requirements.

Environmental and Social Risk Management for FIIP at SBP is responsible for proposing, reviewing, and verifying that E&S covenants are included in each loan agreement between SBP and PFIs.

5. Monitoring and Supervision

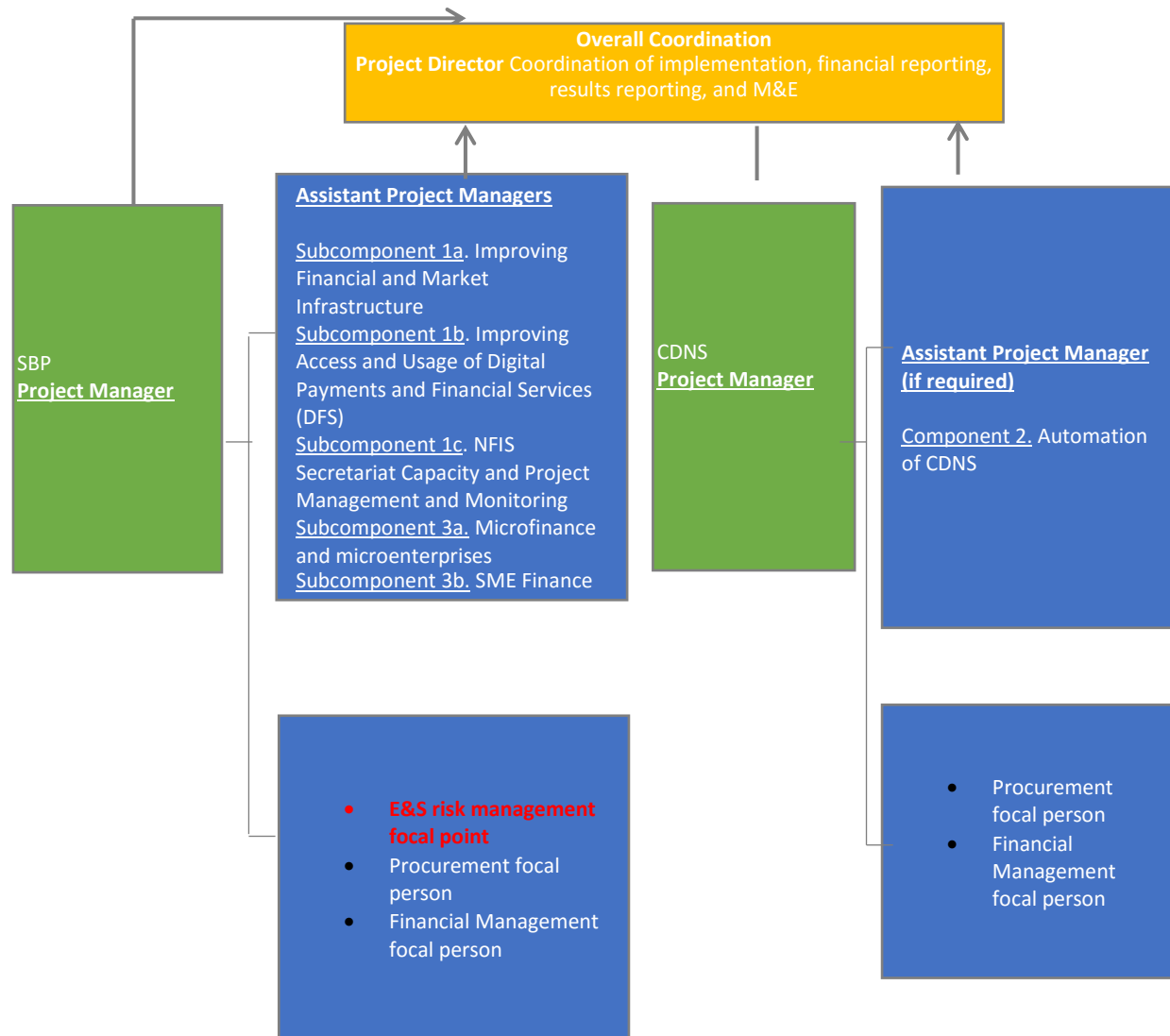
This procedure outlines ongoing monitoring that evaluates PFIs' progress over the life of the investment. The procedure also provides a mechanism to consider exiting relationships with PFIs that continually fail to improve their management of E&S issues. Environmental and Social Risk Management FIIP Focal Point at SBP will;

- Obtain and review PFIs' E&S Annual Report, prepared according to a standardized reporting format developed by SBP.
- Document outcomes of periodic E&S performance review based on PFIs' reporting and the E&S Performance Criteria (Annex 2).
- Review the PFI's reporting information and conduct further E&S monitoring and supervision activities in a manner commensurate with the level of risk (based on the assigned E&S risk rating).
- Record the outcomes of E&S monitoring and supervision, including progress on the E&S Action Plan, where applicable, and site visits if needed, etc.
- Periodically review the E&S management status and issues if there are any of the high risk operations supported by PFIs.
- Maintain a record-keeping system that captures E&S information of each PFI.
- In case of substantial increase or decrease in a PFI's E&S risk profile, update E&S Risk Rating Memorandum (Annex 4) with the new risk rating and provide justification for the change.

6. Implementation Capacity, Roles, and Responsibilities

This section describes the roles and responsibilities of SBP staff within FIIP PIU in charge of implementing and maintaining oversight of the various parts of the E&S Policy and E&S Procedures. SBP's implementation arrangements are shown below and include E&S capacity within the PIU (Figure 2).

Figure 2: Implementation Arrangements



Key characters with accountability for implementation are listed below in Table 3.

Table 3. Roles and Responsibilities

| Unit/ Individual | Roles and Responsibilities |
|--|--|
| SBP Senior management for FIIP | <ol style="list-style-type: none"> 1. Review and formal approval of SBP-FIIP E&S Policy and Procedures. 2. Allocation of the resources and budget for implementation. 3. Oversight and overall accountability for E&S risk management to external stakeholders, Government of Pakistan, and the lenders. 4. Overall responsibility for E&S risk management and its integration in the overall risk management process for FIIP. |
| E&S Risk Management FIIP Focal Point at SBP (AC&MFD) | <ol style="list-style-type: none"> 1. Day-to-day management and oversight of E&S risk management, in line with SBP E&S Policy and Procedures for FIIP, including E&S due diligence and supervision. 2. Developing and improving tools to support implementation by PFIs (e.g. checklists, supplemental guidance), including training materials and arranging training workshops. 3. Monitoring PFIs compliance with E&S requirements, including those in the E&S Action Plan for PFIs. 4. Ensuring quality, completeness, and timeliness of PFIs E&S reporting to SBP. 5. Periodically review the E&S management status and issues if there are any of the high risk operation supported by PFIs (according to PFI's E&S risk categorization system and SBP's guidance on what would be considered high risk in the context of microfinance). 6. Preparing and providing regular E&S reporting to SBP Senior Management and other stakeholders. 7. Preparing revisions to the SBP E&S Policy and E&S Procedures, and presenting them for approval by Fund Management committee for LoC. 8. Ensuring that E&S Procedures are integrated into SBP's guidelines for Line of Credit fund under FIIP. 9. Ensuring that E&S covenants are included in financing agreements with PFIs. |
| LoC Fund Management Committee | Ensuring that E&S considerations are integrated in the overall on-lending decision-making process. |
| Internal Audit | Conduct E&S screening of PFIs according to the criteria in FIIP E&S Policy and the corresponding procedures, assign E&S risk rating and pass the details to AC&MFD for further due diligence, as needed. |

7. Revision Process for Environmental and Social Procedures

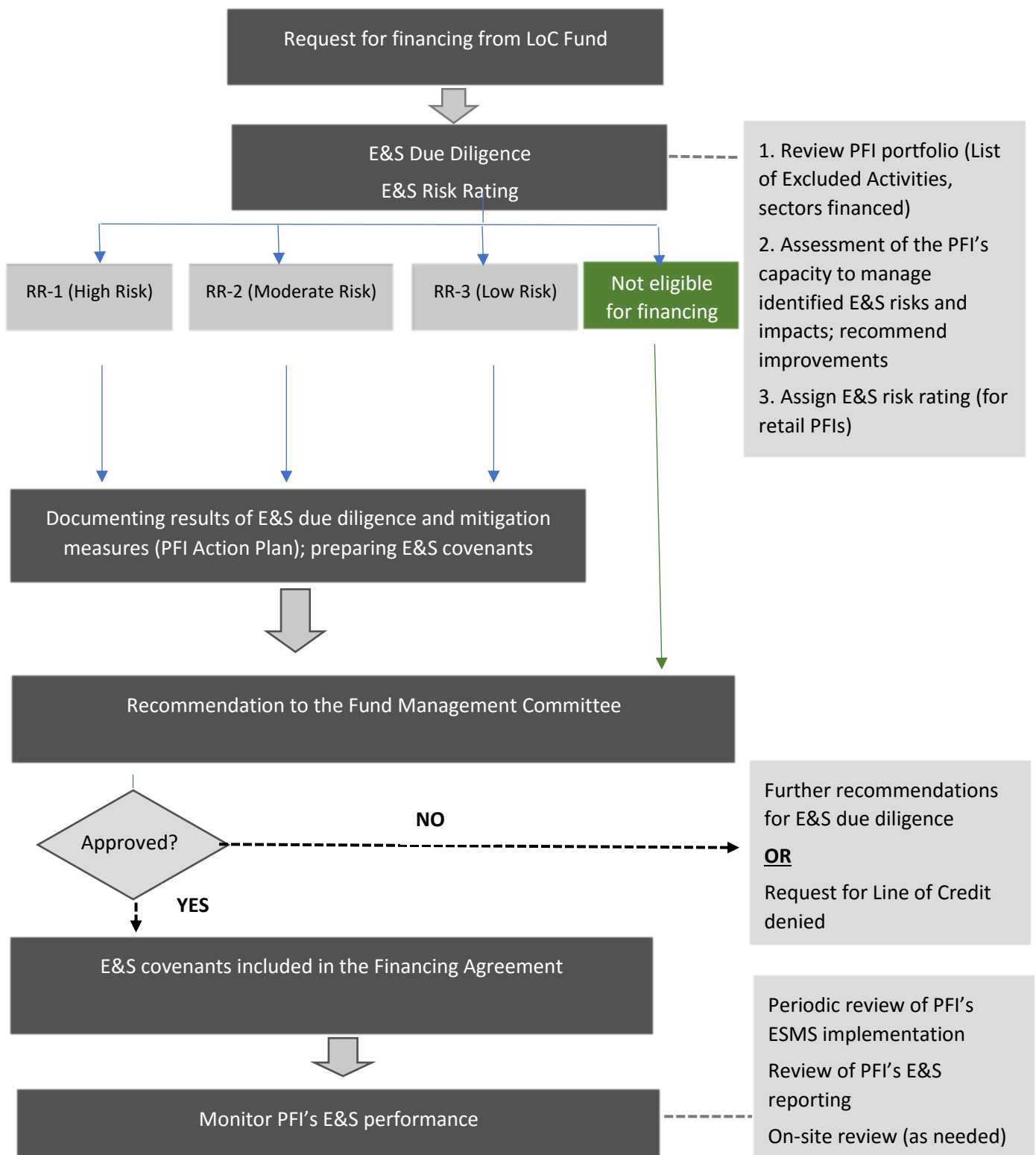
SBP E&S Procedures need to be reviewed periodically to ensure that it remains relevant and effective over time and incorporates SBP's and PFIs' evolving needs. The review involves the following:

- Identifying potential difficulties with operational aspects of the E&S Procedures implementation and making changes as necessary;
- Reviewing the scope of the E&S Procedures to ensure that emerging E&S risks are detected and identified during the due diligence process;

- Reflecting any changes in roles and responsibilities;
- Updating E&S Procedures to reflect revisions in SBP E&S Policy and any other supporting documents that form part of the ESMS, and applicable national laws of Pakistan.

Environmental and Social Risk Management FIIP Focal Point at SBP shall be formally responsible for the review process and its completeness, adequacy, and alignment to business imperatives (current and future) on an annual basis or as necessary. All amendments, additions or deletions should be properly documented and authorized/approved by ED DFG prior to implementation.

Annex 1. SBP-FIIP Environmental and Social Procedures Flowchart



Annex 2. PFIs Environmental and Social Performance Criteria

These general performance criteria serve as a guideline for SBP to assess PFIs' performance with regard to various aspects of their ESMS. The extent of the PFI's ESMS will be commensurate with the level of E&S risks and impacts in its portfolio, as assessed by SBP.

| Area | Description |
|--------------------------------------|--|
| 1. Systems and capacity | |
| E&S Staffing and Capacity | <p>Staff with clearly designated roles and responsibilities to manage E&S issues (e.g. a staff member assigned to provide an oversight of E&S screening and prepare annual E&S reports to SBP)</p> <p>Internal training developed and implemented to sensitize relevant investment staff on the required E&S screening process, criteria, and documentation</p> |
| E&S policy and procedures | <p>Written E&S policy and procedures for screening as commensurate with the nature and scale of the PFI's lending activities:</p> <p>PFIs E&S policy would be built around commitment to have its borrowers to comply with the national laws and not to undertake activities on the List of Excluded Activities. E&S procedures would be designed around proper application of key tools for PFIs to enable them to conduct E&S screening. These tools can be comprised of an E&S questionnaire for borrowers to enable PFIs to determine key E&S risks and impacts, sector guidance that provides examples of key risks and mitigation measures by sector and the associated undertaking form for the borrowers with a Corrective Action Plan to improve its management of the identified risks and impacts.</p> <p>E&S categorization system is in place and formally adopted by PFI's Senior Management. This can incorporate such criteria as loan sizes, loan tenors, sectors financed, micro-enterprise sizes etc.</p> <p>E&S screening process is adequately internalized within the PFI (e.g. credit/relationship staff who interact with borrowers are familiarized in the E&S screening process and preparing the E&S questionnaire, as well as preparing and monitoring, as needed, corrective action plans for borrowers).</p> |
| Management Commitment | <p>Level of management commitment to incorporate E&S aspects into the PFI's risk management practices including resource provision and endorsement (e.g. PFI acknowledges that E&S screening is an important part of interactions with borrowers and is beneficial for overall risk management of the PFI's lending).</p> |

| 2. Implementation²¹ | |
|--|--|
| Compliance with applicable requirements | <p>Adequate implementation of the E&S screening process, including evidence of application of SBP E&S requirements (e.g. this can be evidenced by properly filled-in E&S questionnaires that conform to SBP requirements).</p> <p>Corrective action plans for sub-borrowers are developed and documented (e.g. this can be evidenced by adequately filled-in borrower E&S undertaking forms that conform to SBP requirements such as proper exclusion of activities on the List of Excluded Activities).</p> |
| Documentation | <p>Adequate documentation is maintained by the PFIs (e.g. E&S questionnaires and borrower undertaking forms are filed together with loan documentation) and available upon request from SBP.</p> <p>Appropriate language is incorporated in financing agreements and other relevant documentation with end borrowers.</p> <p>Annual E&S reports are prepared and submitted in a timely manner to SBP.</p> |

²¹ These criteria will be assessed during monitoring and supervision of PFIs by SBP.

Annex 3. Environmental and Social Screening Questionnaire for Assessment of PFIs' E&S Systems and Capacity

Environmental and Social Screening Questionnaire for Assessing Systems and Capacity of Participating Financial Institutions

[date]

Section A. Financial Institution's Details

Financial Institution Name:

Financial Institution Type:

Financial Institution Address:

Website (if any):

Contact person for E&S issues:

Name and title of the person filling the Questionnaire:

Section B. Financial Institution's Portfolio

Total number of transactions approved over the last year:

Total value of transactions:

Number of transactions screened / assessed for E&S risks (if any):

Value of transactions screened / assessed for E&S risks (if any):

Number of transactions not approved for E&S reasons (if any):

Number of transactions exited due to poor E&S performance, non-compliance with agreed Corrective Action Plans, or breach of loan documentation covenants/conditions (if any):

(Please attach a summary of PFI's portfolio by E&S risk category, where available, sector, size)

Please also attach risk screening results for transactions classified as "high risk" according to PFIs' E&S categorization system)

Section C. Exposure to Activities on the List of Excluded Activities

Does the financial institutions have investments / borrowers with exposure to activities on the List of Excluded Activities **(Yes/ No)**

(If yes, please attach a summary of transactions with exposure to such activities)

Section D. Environmental and Social Management System

Does the financial institution have an Environmental and Social Management System (ESMS)? **(Yes/No)**

If yes, please attach any documents that can serve as evidence of an ESMS, including E&S policy and procedures, and its approval by the FI's Senior Management.

Does the financial institution have an E&S categorization system? **(Yes/No)**

If yes, please briefly describe the system below:

Does the financial institution require E&S risk mitigation measures from borrowers? **(Yes/ No)**

If yes, describe measures (e.g. provide number of corrective action plans developed over the past year and attach examples, where available):

Does the financial institution require covenants from borrowers on E&S issues? **(Yes/ No)**

If yes, describe and attach examples of E&S covenants:

Does the financial institution have staff with clearly designated roles and responsibilities for E&S risk management? **(Yes/ No)**

Does the financial institution conduct regular E&S monitoring visits with borrowers? **(Yes/ No)**

Does the financial institution maintain E&S records? **(Yes/ No)**

Section E. Other Relevant Information

Please provide any other relevant information below

Date _____

Signature _____ (E&S Risk Management Focal Point)

Annex 4. Environmental and Social Risk Rating Memorandum

Environmental and Social Risk Rating Memorandum (Participating Financial Institutions)

[date]

Section A. Financial Institution Details

Name:

Reference number:

Financial Institutions' contact information:

Description of SBP Investment:

Section B. PFI Eligibility for Financing

Is the PFI eligible for SBP financing based on E&S criteria? Yes No

Justification:

Section C. Environmental and Social Risk Rating

E&S category: RR-1 (High)

RR-2 (Moderate)

RR-3 (Low)

Justification for E&S risk rating:

(Tenor and size of loans, exposure to activities with potential significant E&S risks and impacts, activities on the List of Excluded Activities, PFI's systems and capacity)

Section D. E&S Issues Identified during E&S Due Diligence:

Section E. Action Plan to Improve ESMS

Section F. Risk Rating Change

Date of risk rating change:

Reasons:

Signature _____ (E&S Risk Management Focal Point)

Annex 5. Environmental and Social Screening Questionnaire for Assessment of Wholesale PFIs' E&S Systems and Capacity

Environmental and Social Screening Questionnaire for Assessing Systems and Capacity of Wholesale Participating Financial Institutions

[date]

Section A. Financial Institution's Details

Financial Institution Name:

Financial Institution Type (*e.g. commercial bank; microfinance institution*)

Financial Institution Address:

Website (if any):

Contact person for E&S issues:

Name and title of the person filling the Questionnaire:

Section B. Financial Institution's Portfolio

Total number of financial institutions approved over the last three years (if any):

Total value of lending:

Number of financial institutions screened / assessed for E&S risks (if any):

Number of financial institutions found ineligible for E&S reasons (if any):

(Please attach a summary of wholesale PFI portfolio of lending to financial institutions)

Section C. Exposure to Activities on the List of Excluded Activities

Does the wholesale financial institutions have retail financial institutions in its portfolio with significant exposure to activities on the List of Excluded Activities **(Yes/ No)**

(If yes, please attach a summary of transactions with exposure to such activities)

Section D. Environmental and Social Management System

Does the financial institution have an Environmental and Social Management System (ESMS)? **(Yes/No)**

If yes, please attach any documents that can serve as evidence of an ESMS, including E&S policy and procedures, and its approval by the FI's Senior Management.

Does the financial institution have an E&S risk rating system for retail financial institutions? **(Yes/No)**

If yes, please briefly describe the system below:

Does the financial institution require ESMS from financial institutions? **(Yes/ No)**

If yes, describe current requirements:

Does the financial institution require E&S covenants in financing agreements from financial institutions? **(Yes/ No)**

If yes, describe and attach examples of E&S covenants:

Does the financial institution have staff with clearly designated roles and responsibilities for E&S risk management? **(Yes/ No)**

Does the financial institution conduct regular E&S monitoring visits with financial institutions to review their E&S systems, capacity, and portfolio information? **(Yes/ No)**

Does the financial institution maintain E&S records? **(Yes/ No)**

Section E. Other Relevant Information

Please provide any other relevant information below

Date _____

Signature _____ (E&S Risk Management Focal Point)