ENVIRONMENTAL AND SOCIAL REVIEW SUMMARY (ESRS)
PROJECT: Africa Rural Climate Adaptation Financing Mechanism (ARCAFIM) project

1. Background:

Through its Private Sector Financing Program (PSFP), IFAD, jointly with a consortium of partners, has designed the Africa Rural Climate Adaptation Financing Mechanism (ARCAFIM) programme with two main objectives (i) increased Climate Change (CC) resilience of small producers and rural MSMEs active in the local food systems through Climate Change Adaptation (CCA) investments across agricultural value chains, and (ii) improved capacity of agriculture value chain participants to adapt to risks imposed by climatic changes. Overall, the ARCAFIM programme intends to reach 260,000 small-scale producers; 500 rural micro enterprises and agribusiness SMEs in East Africa.

The total project cost for ARCAFIM operations in East African regions will consist of US$ 90 million for on-lending and US$ 20 million of a Technical Assistance grant budget. The fund will be channelled through a Host Bank. The Host Bank is expected to invest a matching amount bringing the total ARCAFIM funds for on-lending to US$ 180 million.

This programme will be rolled out in four countries in East Africa i.e. Kenya, Rwanda, Tanzania and Uganda. This environmental and social review focuses on Equity Group Holdings Limited (EGHL), the Host Bank in the four East African countries. EGHL will receive a loan of US$ 90 million and thereafter will deploy this to subsidiary country banks for on-lending to small producers and rural MSMEs involved in food systems either directly or through their wholesale finance partners in the form of CCA loans.

Equity Group provides inclusive financial services aimed at transforming livelihoods, giving dignity and expanding opportunities. EGHL is working with six strategic pillars among them Food and Agriculture as Pillar 1a and Pillar 5 as Social and Environmental Transformation. The ARCAFIM programme is therefore in alignment with EGHL strategic outlook. Furthermore EGHL is committed to building capacity and driving financial inclusion in its countries of operation. EGHL has operational banking subsidiaries in seven countries in East and Central Africa i.e. Kenya, Democratic Republic of Congo (DRC), Uganda, Rwanda, Tanzania, South Sudan and Ethiopia. The ARCAFIM program will be rolled in four of these countries i.e. Kenya, Uganda, Rwanda and Tanzania.

Equity Group Holding Limited (EGHL) has in place an Environmental and Social Management System (ESMS) which is reviewed annually.

To support the enforcement of this management system, EGHL has developed ESG teams both at group and subsidiary levels.

Currently at group level, the following positions have been occupied. Group Director, Sustainability, Head ESG Risk, Head ESG Governance & Reporting and Manager Sustainability Strategy & Solutions. Recruitment for the Head of Sustainability Strategy & Solutions is on ongoing.

Head of ESG Kenya and Head of ESG DRC are currently in office whereas recruitment for ESG Heads in Uganda, Rwanda and Tanzania are at an advanced stage. In Kenya, the ESG team has been set up with ten staff as illustrated below with the exception of the secondee roles. The secondee roles are put in place to provide for internal ESG capacity building where staff from other departments/units are seconded to the ESG office to enhance their knowledge on a particular ESG aspect for a defined time period. This team provides ESG support to the banking subsidiaries in Uganda, Rwanda and Tanzania as they continue to develop their local teams.

ESG risk assessment is conducted during the credit application. All credit applications within agribusiness that are KES 5 million and above will go through an environmental and social due diligence assessment.

EGHL Sustainability department has on various occasions partnered with the Equity Group Foundation (EGF) through their existing programs to promote the conservation and smart use of natural resources among its customers as well as provide training on financial literacy.

This E&S review is based on the nine SECAP Standards, risk thresholds and IFAD exclusion list in response to the NSO approval process with particular reference to SECAP Standard 8 which focuses on IFAD financing of Financial Intermediaries (FIs). The three key requirements set out in Standard 8 for FIs and direct investments are (i) develop and maintain an ESMS for assessing, managing and monitoring risks and impacts of direct investment activities and the FI's subprojects; (ii) develop stakeholder engagement procedures; and (iii) develop monitoring and reporting procedures.

2. Overview of review & findings

Scope of ESRS:
This ESRS was conducted between December 2022 and March 2023. In addition to virtual and in-person meetings, various key documents from EGHL and IFAD were reviewed.

SECAP Standards 1-9: ARCAFIM is targeting the following value chains in East Africa: For subsistence crops - maize, millet, sorghum, sweet potatoes, cassava and beans. For export crops - tea, coffee and cotton. For livestock-dairy cattle, goat, sheep, layer & broiler poultry. For fish - Nile tilapia and African catfish. This programme triggers SECAP Standard 1 Biodiversity Conservation as it is agriculture including livestock, fisheries and aquaculture. Adherence to the EGHL environmental policy will ensure that the project is not implemented in critical habitats by working with the exclusion list.

IFC GMAP assessment tool was utilized to identify risks associated with coffee, tea and maize value chains in all four countries. Based on the IFC GMAP tool, either coffee, tea and maize value chains have in one or all four countries of ARCAFIM operations have been flagged as at risk of engaging in child labour[1]. Therefore there is risk of non-compliance with SECAP Standard 5 - Labour and Working conditions by the direct investments as well as sub-projects i.e. small-scale producers and MSMEs working with small-scale producers. This is also the case when on-lending by MFIs, microfinance banks, fintechs, financial cooperatives and other rural finance arrangements or aggregators, for small-scale producers and rural MSME clients.

Given the fact the access to programme finance will be demand driven therefore the programme specific areas have not been identified as yet, it is recommended that engagement of the different borrowers should be enhanced to allow for local identification and communication of climate related risk and available climate change adaptation opportunities.

SECAP standard 8 requires that an FI receiving support from IFAD must have an ESMS comprising of (i) environmental and social systems, procedures and capacities for assessing, managing and monitoring risks and impacts of direct investments and FI subprojects; and (ii) a portfolio risk-management framework that ensures a return on investment and sustainability.

3. IN SUMMARY:

This Environment and Social Review Summary (ESRS) is a tool for supporting the integration of environmental, social and climate change considerations in the governance and operational mechanisms of IFAD's Private Sector Non-Sovereign Operation (NSO) for the ARCAFIM programme.

ARCAFIM programme rationale and categorisation:
There exists significant barriers to debt financing for small-scale producers and MSMEs in food systems in East Africa, more so in climate change adaptation investments. This group has been struggling to attract significant financing that would enable them to make necessary investments to adapt and ensure resilience to climate change. In addition, small-scale producers and MSMEs in local food systems are disproportionately vulnerable to the effects of climate change. For this reason, dedicated and tailored climate change adaptation financing targeting small-scale producers and MSMEs in local food systems presents an opportunity to secure their livelihoods and associated jobs and income opportunities within the rural low-income population, while intensifying climate change adaptation efforts in the region. Africa Rural Climate Adaptation Financing Mechanism (ARCAFIM) provides an effective and sustainable approach to mainstream adaptation finance and transform the agricultural sectors in Kenya. Uganda,

[1] IFC Global Map of Supply Chain Risks in Agro-Commodity Production. Online available. https://gmaptool.org/tool

Rwanda and Tanzania, which are already experiencing climate change stress and have a substantial market of small-scale producers.

The overall development goal of ARCAFIM is “Livelihoods in rural communities across the target countries rendered climate resilient through increased CCA investments, CCA capacity, employment creation and rural incomes”. The key ARCAFIM objectives are (i) increased CC resilience of small-scale producers and rural MSMEs active in the local food systems through CCA investments across agricultural value chains, and (ii) improved capacity of agriculture value chain participants to adapt to risks imposed by climatic changes with specific targets on women and youth.

With a total budget of US$ 180 million leveraged by IFAD from a consortium of co-financiers, ARCAFIM will launch a catalytic mechanism of private sector climate change adaptation financing targeting small-scale producers and rural MSMEs active in the food systems. To enable IFAD to engage directly with the private sector stakeholders for ARCAFIM, and to mobilize private capital at scale for CCA financing in the regional financial markets, ARCAFIM will be structured as an NSO and the supplementary funding will be managed within PSTF. Overall, IFAD’s NSO pipeline is currently being developed with a special focus to address the effects on food systems caused by COVID-19 and the ongoing conflict between Russia and Ukraine. NSO is the selected vehicle to achieve the results of this project by providing demonstration effects to other agricultural actors and ensuring sustainable operations after project completion.

The international capital injection will consist of US$ 90 million for on-lending and US$ 20 million of TA grant budget. The on-lending amount will be invested by IFAD in the Host Bank covering the ARCAFIM operations in the East Africa region, Equity Group Holding Limited (EGHL). The Host Bank will invest a matching amount which brings the total ARCAFIM available resources for on-lending to US$ 180 million. In East Africa, the targeted number of clients directly accessing CCA lending is estimated at 260,000 small producers and 500 microenterprises and SMEs which directly and indirectly strengthens the resilience and income opportunities for about 208,000 households. The target group includes 50% women and 30% youth.

Based on SECAP’s environmental and social risk categorisation for financial institutions, ARCAFIM’s risk category is **substantial**[2]. This programme explicitly excludes investment in any category A/high risk subprojects. EGHL has experience working with MSME portfolio, small producers and rural MSMEs active in local food systems. The risk on portfolio is moderate as EGHL has experience working with several DFIs and has had an ESMS in place prior to this partnership[3]. The programme’s climate risk categorisation is **substantial** based on SECAP’s climate risk classification. This project targets small producers and rural MSMEs active in local food systems. Climate change has been identified to have a serious negative impact on agriculture-based livelihoods in Kenya[4], Uganda[5], Tanzania[6] and Rwanda[7]. It is therefore anticipated that the proposed future portfolio for EGHL supported by ARCAFIM includes exposure to activities that are substantially vulnerable to climate-related hazards.

EGHL has identified climate-related risks as having potential to impact a business and subsequently EGHL portfolio. This has been covered within the ESRM transaction screening procedure for all transactions above KES 5M and subsequent working tools e.g. *the Rapid E&S Assessment checklists; Simplified E&S Assessment Checklist; Enhanced E&S Assessment checklist.*

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[2] Substantial Risk FIs: An FI’s existing or proposed future portfolio (IFAD-supported and other projects) includes – or is expected to include in the future – significant exposure to activities that are substantially vulnerable to climate-related hazards. The FI’s existing or proposed future portfolios include clients and projects categorized as Substantial Risk, as defined by IFAD’s climate change categories for direct investments (with only a limited number of High Risk clients and projects, as defined by IFAD’s climate change categories for direct investments). Significant exposure to clients and projects within an FI’s portfolio occurs when more than 80 per cent of the total portfolio value rests with these clients and projects. Limited exposure to clients and projects within an FI’s portfolio occurs when less than 20 per cent of the total portfolio value rests with these clients and projects.

[3] Climate Investment Committee-Pre Meeting Comment Sheet

[4] World Bank 2021. Climate Risk Profile Kenya. Online available: https://climateknowledgeportal.worldbank.org/sites/default/files/2021-05/15724-WB_Kenya%20Country%20Profile-WEB.pdf

[5] [6]World Bank 2021. Climate Risk Profile Uganda. Online available: https://climateknowledgeportal.worldbank.org/sites/default/files/2021-05/15464-WB_Uganda%20Country%20Profile-WEB%20%281%29.pdf

[6] World Bank 2021. Climate Risk Profile Tanzania. Online available.https://climateknowledgeportal.worldbank.org/country/tanzania/vulnerability

[7] World Bank 2021. Climate Risk Profile Rwanda. Online available. https://climateknowledgeportal.worldbank.org/sites/default/files/2021-09/15970-WB_Rwanda%20Country%20Profile-WEB.pdf

Approach to managing ESG risks:
The nature of financial intermediation means that FIs assume delegated responsibility for environmental and social assessment, risk management and monitoring, and overall portfolio management. The effectiveness of EGHL's environmental and social risk management has been evaluated based on documentation provided. To further EGHL's social and economic transformation plan dubbed "Africa Recovery and Resilience Plan" the Bank will through the ARCAFIM program continue working within it's environmental, social, governance and climate risk management framework to provide innovative financial products that enable climate change adaptation, targeting small-scale producers and rural MSMEs.

EGHL has in place procedures for identifying, assessing managing and monitoring environmental, social and climate risks and impacts of subprojects. These procedures are reviewed on an annual basis. The Bank has put in place in-house expertise to carry out environmental and social due diligence for transactions and manage the E& S risks of subprojects. Plans are underway to strengthen the existing in-house team.

Banking subsidiaries in all four countries of interest have Board approved environmental and social policies with respective grievance redress mechanisms and exclusion lists. These are supposed to be reviewed on an annual basis. EBKL which is the designated benchmark in developing the ESMS has included an exclusion list within its credit policy, in addition to the having an exclusion list detailed in its environmental and social policy. EGHL has committed to communicate externally on environmental and social performance through its annual sustainability report and its integrated Annual Report.

Description of actions to pre-empt and address Environmental, Social and Climate risks:
To achieve ARCAFIM's key objectives, the programme intends to target 70% of the invested funds to small producers and 30% to rural MSMEs. For this reason it is anticipated that small producers will significantly inform the environmental, social and climate risks encountered if any. EGHL should through its ESMS track the environmental, social and climate performance of subprojects within the ARCAFIM programme. The main challenges identified within the ESMS are: a) Need to continue building organisational capacity at subsidiary level. There is current support from Group and from the Kenya ESG team in the countries were team have not been set-up. In Uganda, a country ESG Head has been recruited and is set to commence work in March 2023. In Tanzania, recruitment is ongoing for the country ESG Head and the process is currently at offer stage. In Rwanda recruitment discussions have now commenced. (b) Train all staff involved in implementing the Environmental and Social Risk Management procedures. (c) Have in place a system to undertake environmental, social and climate screening for small producers with an average loan amount of USD 1500, who form the largest investment category (70%) for ARCAFIM programme. (d) Report to IFAD of any significant increase in risk profile for approved subprojects and submit annual monitoring reports.

Overall EGHL has an environmental and social management system in place to allow for identification and management of E&S risk in most of its subprojects within agribusiness in accordance with the requirements of the SECAP standards. Implementation of the Environmental and Social Action Plan detailed above will ensure that E&S risks faced by small producers are included in EGHL's ESMS and therefore contribute to the achievement of ARCAFIM's development goal.