

## FINANCIAL INTERMEDIARY: ENVIRONMENTAL AND SOCIAL MANAGEMENT SYSTEM ARRANGEMENTS

### A. Introduction

1. The proposed Vietnam Investment Fund III (“Fund”) will focus on investing in growth stage middle-market companies, which are mostly small and medium enterprises (SMEs) primarily in Viet Nam but also envisages such investments in Cambodia, Lao PDR, and Myanmar.

2. The first fund (VI Fund I) handled by the VI Group was established in 2006. VI Fund I established a Social and Environmental Management System (SEMS) that was later adopted in VI Fund II. The Fund’s SEMS was updated in March 2016 and released as the Environmental, Social and Governance Management System (ESGMS). This was subsequently reviewed as part of ADB’s due diligence.

### B. Findings and Recommendations

3. **Policy.** The Fund’s ESGMS ensures that investee companies are reviewed and evaluated against the IFC Exclusion List, applicable national environmental and social (E&S) laws, E&S categorization, IFC Performance Standards and World Bank Group Environmental, Health and Safety (EHS) Guidelines. The Fund also ensures transparency in its activities and that client companies are committed to the Fund’s ESG Policy.

4. **Screening, Planning, and Review.** The Fund’s three-tier Investment process includes corresponding ESG requirements. The initial ESG risk screening is conducted during deal origination. Potential deals are reviewed against the Exclusion List and all subprojects in the list are excluded from financing. The second step uses the ESG Toolkit which is based on the IFC Performance Standards and is used to enhance the business performance of investments. It has been programmed quantitatively for associated impacts for each of IFC Performance Standards on different sectors and based on country E&S risks. The overall score determines the E&S Risk Category (i.e. Low, Medium, High) and categorizations/ratings are proposed to the Deal Lead and reported to the Investment Committee (IC). Based on the initial assessment of ESG risk, the Rapid Assessment Form is completed for an investment as input to the Management Angle Price Sector Structure (MAPSS) memo which is submitted to the Managing Directors to obtain approval for inclusion in the deal processing followed by site visits. Category B projects (Medium Risk) will only require internal ESG assessment using the ESG Due Diligence (DD) Checklist which covers assessment of compliance with local laws and key E&S issues based on IFC Performance Standards. All category A subprojects require a full ESG DD which will be done by an external consultant. During the deal execution stage, a gap analysis between the identified ESG risks and opportunities and ESG risk management system will be conducted. Corrective action plan (CAP) is developed by the ESG Officer and the Deal Lead to close the gap and the commitment of the client to implement the CAP is required before closing the deal. The ESG Officer, as supported by Deal Lead, reviews the progress against the CAP on a quarterly basis until compliance on all items has been achieved. A CAP monitoring template is used to report the ESG status of portfolio companies after the auditing.

5. **Monitoring and reporting.** The ESG annual performance report is prepared by the ESG officer and based on site visits to the investee companies, discussions with investee ESG officers and, if necessary, discussion with stakeholders (i.e. community members). For Category B and C investment/subprojects, the ESG officer checks compliance with national and local

regulations as well as IFC's Performance Standards 1 and 2. During the investment period, if additional adverse ESG impacts are identified, a CAP will also be prepared to address these issues. Site visits for Category A subprojects are required annually and mandatory every 2 years for Category B. However, the frequency of site visit is flexible and depends on ESG issues as they arise in the portfolio companies and the relative ownership share of the fund.

6. **Organizational Structure and Staffing.** The ESG Officer has the oversight for all ESG issues of the Fund and coordinates closely with the Deal Lead to ensure that all investments comply with the Fund's ESMS requirements. Major tasks of the ESG Officer include (a) preparation of ESG due diligence reports, CAP, and monitoring reports; (b) review of the same documents prepared by external consultant for Category A investments; (c) preparation of ESG Annual Reports; and (d) conduct of ESG Training and update of ESG Toolkit. It is also her responsibility to ensure that resources are available for ESG risk management activities. The present ESG Officer has a technical background on environment and worked for an international E&S consulting firm prior to joining the Fund. The ESG officer also attended several social and gender training courses upon joining VI Group. ESG related covenants are incorporated into the equity agreements and finalized by the legal counsel.

7. **ESMS Improvements.** The ESGMS follows IFC's Performance Standards and was revised in March 2016 with IFC's assistance. The existing ESMS has the key elements required under the ADB SPS which include among others the policy, procedures for screening, categorization and due diligence, monitoring, organizational responsibilities and resources and capabilities. The following enhancements are required to meet the requirements of ADB SPS.

8. The applicable ESG requirements, under the foundations of the ESGMS will include ADB Safeguards Policy Statement (SPS) 2009, ADB's Social Protection Strategy (2001) and ADB Policy on Gender and Development (1998). The existing Exclusion List is aligned with ADB Prohibited Investment Activity List (PIAL).

9. The project categorization definition will be updated to include ADB SPS definitions, particularly since the ESGMS does not have separate categorization definition for environment, involuntary resettlement (IR) and Indigenous Peoples (IP). Separate categorization for environment, IR and IP will be prepared for investments and/or subprojects which will be funded by ADB. In order to do this, ADB rapid environmental assessment checklist, IR and IP checklists will be adopted in the ESGMS and will be included as part of the requirements during the preliminary approach stage. All Category A subprojects on environment, IR or IP will be excluded from ADB funding. The client will also submit to ADB for review prior to internal approval the ESG Rapid Assessment Checklist and Full ESDD Report for all subprojects categorized as B under its ESGMS (a) with potential adverse environmental impacts, (b) will require land acquisition, (c) cause displacement/resettlement of people and (d) subprojects that will impact on Indigenous Peoples (IP).

10. Additional training will be provided to the ESG Officer to strengthen her understanding of the ADB SPS requirements 1 to 3 as well as ADB Social Protection Strategy. This will increase her capability in dealing with various types of projects and ensure that project investments implementation and monitoring will be in accordance with ADB requirements.