

AFRICAN DEVELOPMENT BANK GROUP



PROJECT: FSDH Merchant Bank Limited (FSDH) NIGERIA (TFLOC)

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ASSESSMENT REPORT OF FSDH MERCHANT BANK (FSDH) ENVIRONMENTAL AND SOCIAL RISK POLICY AND PROCEDURE MANUAL (E&SRPPM)

March 2022

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TABLE OF CONTENTS

1 Project Description 1

2 Presentation of FSDH and its E&SRPPM..... 2

3 Review of FSDH’s E&SRPPM by AfDB 3

4 Areas of improvement of FSDH’s E&SRPPM 4

5 Environment & Social Action Plan (ESAP)..... 5



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)
March 2022

1 PROJECT DESCRIPTION

1.1. Project Background

A USD 25 million Trade Finance (TF) Package consisting of: (i) a USD 15 million Trade Finance Line of Credit (TFLOC) to support SMEs and indigenous corporates and (ii) a USD 10 million Transaction Guarantee (TG) facility to support confirmation of trade finance transactions of FSDH is being sought from the African Development Bank. The TG Facility will allow the Bank to provide up to 100% guarantee to Confirming Banks (CBs) for the non-payment risk arising from the confirmation of letters of credit and similar trade finance instruments issued by FSDH. This facility is sequel to the satisfactory performance, and full repayment, of an earlier TFLOC of USD 50 million granted to FSDH in 2016.

FSDH intends to grow its TF portfolio by circa 15% annually for the next 3 years. Various funding instruments including the proposed TF package, internally generated funds, trade lines from other international commercial banks, as well as lines of credit from other DFIs would finance this growth.

1.2. Development Objectives of the Trade Finance Package

The proposed facility will contribute to mobilizing significant financial resources for SMEs as well as for indigenous firms in manufacturing and industrial sector ultimately enhancing deepening of value chains and diversifying productive capacity in the targeted countries and ultimately stimulating growth.

The TFLOC will help to ease FSDH's FX needs amid growing demand and inadequacy of trade lines. FSDH also has relatively limited access to medium- and long-term FX funding. The facility will hence provide it with a vital source of stable funds. Backed by the Bank's AAA rating, the TG will provide a risk-covered strategic platform to enable confirmation of trade transactions originating from FSDH.

1.3. E&S Categorization and Due Diligence of the TFLOC Package

FSDH TFLOC and TG supports diverse operations in different sectors. All sectors including Oil and Gas, Real Estate, Power, Heavy manufacturing with the exception of mining and quarrying are supported by FSDH. The activities in the subprojects within these sectors are likely to result in occupational health and safety incidents and injuries, air pollution, water and soil pollution, noise and dust emissions, waste generation among others.

To ensure that all E&S risks emanating from project activities in all transactions of FSDH are properly managed, the Bank has developed an Environmental and Social Risk Policy and Procedure Manual.



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)

March 2022

At this stage, the specific subprojects that will be supported under this TFLOC package has not been determined but are within the sectors listed above with the exception of mining and Quarrying. As such, FSDH's Environmental and Social Risk Policy and Procedure Manual is the principal Environmental and Social Risk Management tool. The application of the due diligence procedures contained in the E&S Risk Policy and Procedure Manual will ensure that E&S risks in subprojects to be supported are appropriately managed.

Thus, the Bank's Safeguard and Compliance Department (SNSC) completed a detailed due diligence (ESDD) on FSDH's Environmental and Social Risk Policy and Procedure Manual (E&SRPPM) to verify its compliance with country systems and the Bank's ISS requirements. The assessment included the review of the following:

- FSDH's E&S policy;
- E&S risk management procedures in projects and FSDH's monitoring and reporting mechanisms;
- FSDH's institutional capacities including resources (human and financial) for E&S risk management in projects.

This report presents the review of FSDH's Environmental and Social Risk Policy and Procedure Manual and recommended actions for its improvement. The updated E&SRPPM shall be disclosed both by FSDH and the Bank for at least 60 days before board consideration.

This assessment report presents a summary of SNSC's due diligence and establishes an environmental and social action plan (ESAP) which will be detailed during the appraisal mission.

2 PRESENTATION OF FSDH AND ITS E&SRPPM

a. Presentation of FSDH

FSDH Merchant Bank Limited was incorporated in June 1992 as a private limited liability company under the Companies and Allied Matters Act (CAMA). It started operations in July 1992 and was granted license to carry on discount house business on February 1993. Approval was granted to convert to a Merchant Bank on November 2012 and officially changed its name to FSDH Merchant Bank Limited from First Securities Discount House Limited in December 2012. The Bank commenced banking and financial services in January 2013 and restructured into a holding company in 2019. FSDH's principal activity is to provide merchant banking services to its customers. The services principally involve transactional products and structuring of finance, money market activities including trading and holding of marketable securities such as treasury bills, government bonds, commercial bills and other eligible instruments. FSDH has a centralized operation with branches in strategic locations in Nigeria namely, Abuja, Port Harcourt and Lagos (headquarters). FSDH has strong corporate governance due to shareholding and board involvement of the International Finance Corporation (IFC) and five local banks. Specifically, the distribution of FSDH's shareholding was as follows: the IFC (9.4%); five local banks (FSDH, Ecobank, FSDH staff Cooperative; Unity Bank, and Skye Bank) 29.1% and seven indigenous non-banking financial institutions (61.5%).

The link to FSDH's website is <https://fsdhmerchantbank.com>.



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)
March 2022

b. FSDH Corporate E&S Responsibility

FSDH recognizes that taking environmental and social aspects into account is part of good business and leads to sound environmental sustainability and conducive social responsibility. Therefore, the bank has centralized the operational supervision of E&S activities under the Chief Risk Officer (CRO). At the branch level, E&S activities are coordinated by the Branch Manager, who is responsible for activities at the Branch level and reports to the Chief Risk Officer.

FSDH has identified E&S risks mitigation as a key component of its overall Risk Management Framework. It has therefore put in place and is implementing an Environmental, Social Risk Policy and Procedure Manual which includes sound objectives, states its commitment in managing E&S risks and opportunities, and includes well defined policies, procedures and responsibilities.

In achieving this, FSDH:

- i. Ensures that all lending activities undertaken are consistent with the processes and procedure outlined in the E&SRPPM and subsequent directives from senior management.
- ii. Ensures that all qualifying transactions, particularly projects financed by the Bank, are reviewed against the E&S assessment guidelines.
- iii. Finances projects that are expected to be designed, built, operated and maintained in a manner consistent with the policy guidelines of the Bank, and those of partner institutions who have supported such activities.
- iv. Makes best efforts to ensure that all projects are operated in compliance with the Bank's policy on an ongoing basis, during the financing tenor.
- v. Ensures transparency in the E&S assessment process by maintaining accurate and consistent records and making these available for review by the internal audit as well as regulatory authorities who have the right to review the Bank's practices, and representatives of Development Finance Institutions (DFIs).
- vi. Ensures that the management and shareholders of the client companies share the policy commitments made by the Bank in this area by inserting appropriate clauses in loan agreements.
- vii. Monitoring the activities and commitment made by clients on an ongoing basis.
- viii. Provides periodic E&S implementation reports to the AfDB for review and technical support and guidance where required.

3 REVIEW OF FSDH'S E&SRPPM BY AFDB

The E&S Risk Policy and Procedure Manual is a simple and concise document which defines the organization's subscription to environmental sustainability with senior Management's commitment. An E&S risk policy was adopted by the Bank's Board of Directors in October 2013. The policy affirms the Bank's commitment to the promotion and preservation of a safe environment for the members of staff, the customers and the general public in all areas of operations. It called on all members of staff to adhere to the environmentally sound policy and



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)

March 2022

promptly advise management of any situation that may result in potentially negative environmental and social impacts.

Status of Compliance

Based on the review of the E&SRPPM, the document is considered **acceptable**. It contains 3 out of 4 main pillars of a well-defined ESMS, including:

- i) High level E&S policy statement with exclusion list approved by senior management;
- ii) Existing E&S management procedures for identifying and managing E&S risks in projects. FSDH integrates E&S Due Diligence into its credit appraisal, approval, disbursement processes in line with CBN's Sustainable Banking Principles;
- iii) Institutional capacity: FSDH has a Risk unit which performs the E&S risk management functions dedicated to E&SRPPM implementation. FSDH provides a permanent budget line for the operations of the Risk Unit in carrying out ESDD. FSDH has monitoring and reporting mechanisms (internally and externally), and has also developed a Bank-wide E&S trainings for its internal stakeholders.

4 AREAS OF IMPROVEMENT OF FSDH'S E&SRPPM

Although FSDH's E&SRPPM is rated **acceptable**, there are aspects of the policy manual that require improvement for optimal result. The key observations of SNSC's due diligence are detailed below:

4.1. Commitment to external parties:

Commitment to external parties in section 3.2.1 of the manual should be further developed to cover Grievance Redress Mechanism (GRM). Having external GRM in the manual will help FSDH to request their clients to set up their own GRM and this will generate information on different kinds of grievances associated with subprojects supported by FSDH. It will also generate data that can be shared with the AfDB and other lenders in the periodic monitoring reports or when such request is made.

4.2 Annual 3rd party E&S Audit

FSDH does not carry out annual 3rd party E&S Audits on all its clients to assess their compliance level to the E&SRPPM. This activity should be incorporated into the manual with budget provisions.

4.3 E&S Human Resource:

FSDH has Sustainable Banking Committee that ensures sustainability while the operational supervision of E&S activities is under the Chief Risk Officer and at branch level under the Branch Manager. SNSC's observation here is that the Chief Risk Officer may have dual focus (financial Risk and E&S Risks). If the CRO is not a core E&S safeguards professional, some aspects of E&S risk will not be properly captured in the entire portfolio of FSDH. The E&S



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)

March 2022

Risk operational structure needs to be expanded to accommodate E&S officers whose primary responsibilities will be ESDD and monitoring of transactions.

4.4 E&S Covenants in Client's agreement

FSDH needs to commence inserting E&S covenants into client's loan agreement. This is one of the ways by which E&S compliance by clients can be achieved. It will also mandate the clients to implement mitigation measures already identified during ESDD and in the E&S instrument prepared by the clients.

5 ENVIRONMENT & SOCIAL ACTION PLAN (ESAP)

Following the review of FSDH's E&SRPPM, the following recommendations are made for the improvement of the manual and the establishment of mechanisms for monitoring and reporting the performance of its clients.

Measures	Responsibility	Timeline
<u>Improvement of the E&SRPPM and its implementation</u> Update the E&S Risk Management Framework taking into consideration the Bank's comments. Then share with the Bank for review and clearance and disclose.	FSDH	Immediately
Ensure that appropriate E&S due diligence is conducted for all players expressing interest to benefit from the Trade Finance Package – applicable E&S studies should be required for high and medium risk transactions	FSDH	During implementation
<u>Budget line of the E&S Unit:</u> Allocate a budget line for E&S activities (monitoring, reporting, training) and 3 rd party annual E&S compliance Audits for all the players benefiting from the TF Package.	FSDH	During appraisal
<u>E&S Human Resource:</u> Recruit qualified E&S officers who will be 100% dedicated to E&S to support the E&S Risk Unit	FSDH	Before first disbursement
<u>Capacity building on ESMS procedures</u> Maintain the current efforts at improving the E&S capacity of FSDH Risk Management Team	FSDH	First quarter after first disbursement
<u>Grievance Redress Mechanism:</u> Develop the commitment to external parties to include external Grievance Redress Mechanism to have a track on external grievances associated with FSDH's supported projects.	FSDH	During implementation
<u>Monitoring and reporting</u> Monitor the E&S performance of all clients and request for periodic E&S monitoring reports from the clients while FSDH will also report to the Bank Monthly.	FSDH	During implementation



Assessment report of FSDH Merchant Bank (FSDH) Environmental and Social Risk Policy and Procedure Manual (ESRPM)

March 2022

Report any incident to Bank 24hours within occurrence of the incident		
<u><i>E&S compliance Audit:</i></u> Undertake annually 3 rd party E&S compliance Audits for all FSDH's clients.	FSDH	During implementation