# USING IA AS AN ENVIRONMENTAL RISK MANAGEMENT TOOL IN THE DEVELOPMENT BANK OF SOUTHERN AFRICA.

Cornelia Rosina Heydenreich Environmental Analyst 5303 Thornton Road N.W; Thorncliffe; Calgary, Alberta; T2K 2B8; Canada Tel/Fax: 403-274 7076 E-mail: <u>cornelia\_heydenreich@hotmail.com/</u> <u>neliah@hotmail.com</u>

Deryl Barlow-Weilbach Development Bank of Southern Africa PO Box 1234 Halfway House 1685 South Africa Tel: +27-11-313 3049 Fax: +27-11-313 3086 E-mail: derylw@dbsa.org

## ABSTRACT

The Development Bank of Southern Africa (DBSA) is a development finance institution, the key objective of which is to address socio-economic imbalances and to improve the quality of life of the people of South and Southern Africa. The DBSA's core operational activity is providing or arranging finance for infrastructure projects and programmes. Selection, that is, acceptance of a project into the DBSA pipeline, is based on criteria linked to defined organizational objectives and performance areas, operation interpretation and articulation of the Bank's vision and mission.

The DBSA's project appraisal is a key input into informed project selection. Project appraisals are therefore undertaken to firstly provide decision-makers with the necessary information regarding the fit to the three main criteria, namely development impact, sustainability and additionality. Secondly, to add value where possible on all the dimensions considered during appraisal, which include financial, institutional, economic, environmental, social and technical.

The environmental project appraisal more specifically focuses on three main issues, namely: 1) The environmental impact and risks of the project, 2) legal compliance, and 3) the environmental institutional capacity of the borrower. The overarching purpose of this appraisal is therefore to ensure that projects are environmentally sound and sustainable.

Impact assessments (IA) are one of the main documents that the DBSA not only uses as an information source for the project appraisal, but also to ensure legal compliance. IA furthermore ensures that the environmental risks associated with the project are being addressed throughout the whole life-cycle. This paper will provide an overview of the DBSA's environmental management approach, the role IA plays within it as well as the lessons learnt regarding the utilization of IA as a risk management tool within a regional development finance institution.

## **KEY WORDS**

Development Bank of Southern Africa, DBSA, Environmental Impact Assessment, EIA, Environmental Risk

## INTRODUCTION

The Development Bank of South Africa (DBSA), has, as part if its mandate, the financing of sustainable development. In order to achieve environmental sustainability, the DBSA has to date focused on two main activities, namely 1) The environmental appraisal of all projects and programmes it funds, and 2) the provision of technical assistance to improve the environmental capacity of both its clients and of various stakeholders at local, provincial and national government level.

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This paper will provide an overview of the DBSA's environmental management approach, the role that Impact Assessments (IA) plays, as well as the lessons learnt through the application of this approach.

#### BACKGROUND

The Development Bank of Southern Africa (DBSA) is a development finance institution with the key objective of addressing socio-economic imbalances and of improving the quality of life of the people of South and Southern Africa. The DBSA strives to be a leading change agent for accelerated and equitable socio-economic development in South Africa.

The DBSA's primary mandate is to invest in infrastructure and facilitate the provision of infrastructural development, finance sustainable development in partnership with the public and private sectors, and to respond to development demands and act as a catalyst for investment. The DBSA is a South African parastatal (the South African Government is its only shareholder) and is attempting to fulfill the South African Government's mandate to address infrastructure backlogs. However, there are great capacity constraints especially in the public section (a large part of its client base) to implement projects both technically and environmentally.

In fulfilling its mandate, the DBSA is committed to promoting the concept of Sustainable Development in its activities, as well as building the capacity of its borrowers as part of the developmental initiative. The three core operating principles for achieving maximum development impact, sustainability and additionality can be summarized as follows: Ensuring sustainable development and maximize development impact.

"It has been recognized that a healthy and productive environment is a prerequisite for the New Partnership for Africa's Development. It is further recognized that the range of issues necessary to nurture this environmental base is vast and complex, and that a systematic combination of initiative is necessary to develop a coherent environmental programme. This will necessitate that choices be made and particular issues be prioritized for initial intervention.

It is also recognized that a core objective of the Environmental Initiative must be to combat poverty and contribute to socio-economic development in Africa. It has been demonstrated in other parts of the world that measures taken to achieve a healthy environmental based can contribute greatly to employment, social and economic empowerment, and reduction in poverty."

NEPAD: The New Partnership for Africa's Development, October 2001.

The DBSA supports NEPAD through its commitment to sustainable development. Sustainable development requires meeting the basic needs of all and extending to all the opportunity to satisfy their aspirations for a better life for this generation and future generations. Progress towards sustainable development rests on the simultaneous achievement of poverty alleviation, social justice and environmental rights.

#### ENVIRONMENTAL APPRAISAL PROCESS

The DBSA recognizes that the integrated and sustainable management of the environment, now and in the future, is the essential basis of sustainable development in all areas of human activity. In order to ensure that this commitment is an integral part of the Bank's activities an environmental appraisal is done on all programmes and projects that the Bank proposes to support. The over-arching purpose of this appraisal is to ensure that programmes and projects which the Bank supports are environmentally sound and sustainable, to identify and evaluate the environmental risks associated with them and to ensure that mitigation measures to address such risks are implemented by the borrowers.

In doing this, the DBSA follows a life cycle approach to its projects by assisting borrowers in designing an appropriate environmental management system and by helping build the capacity of borrowers to fulfill their environmental obligations.

In the appraisal process, the DBSA aims to achieve the following objectives:

- Find opportunities within projects to maximize their developmental and environmental benefits through the promotion of sustainable development;
- Assist the DBSA in deciding to support a project or not on the basis of the environmental risks identified and evaluated;
- Minimize environmental risks and liabilities to the DBSA and its clients;

- Assist borrowers in ensuring the necessary environmental permits required by legislation are obtained;
- Identify ways to prevent, minimize, mitigate or compensate for the environmental risks associated with projects and programmes; and
- Assist in the development of conditions to be included in the loan agreement with borrowers.

The environmental appraisal module is therefore a decision-making tool that supports the DBSA in managing its business risks and having a positive developmental impact.

# ENVIRONMENTAL RISK ASSESSMENT AND SUSTAINABLE DEVELOPMENT

The assessment and management of environmental risks associated with particular activities is integral to the implementation of sustainable development, especially in terms of its formalization of the precautionary principle. It also assists the DBSA in its risk management by ensuring that the environmental risks identified in the appraisal process are mitigated. This reduces the possibility of infrastructure being degraded, borrowers defaulting on loans, incurring environmental liabilities and/ or the DBSA itself incurring liabilities.

The following definition for environmental risk is used in the environmental appraisal process:

**Environmental risk** is a measure of the potential threats to the environment that activities may have. It combines the probability that events will cause or lead to degradation of the environment and the magnitude of the consequences of that degradation.

Environmental Risk (R) can be expressed quantitatively as a product of the magnitude of the consequences of environmental degradation (M) and the probability of it occurring (P). i.e.  $R = M \times P$ . The problem with environmental risk is that it is often difficult to put accurate and comparable figures to the magnitude and probability associated therewith. The DBSA's approach is therefore to follow a more qualitative approach whereby the magnitude and probability of each environmental risk is rated on a scale of high, medium and low. These ratings are then used to give an overall individual risk rating, both taking into account risks that have not been mitigated and risks after mitigation measures have been agreed upon and implemented by the borrower. On the basis of the individual environmental risk ratings, the overall risk of the project is evaluated both with and without the mitigation measures identified.

There are three sources of environmental risk that the DBSA considers in the environmental appraisal process:

- Environmental Impacts: Risks emerge from the nature and impacts of the project itself.
- Legal Requirements: The legislative regime a project operates under is a significant source of risk especially with regard to non-compliance.

Institutional Capacity: The capacity of the borrower to implement any environmental requirements during the full life-cycle of the project can be a significant concern with regard to risk. Lack of capacity refers not only to human and financial resources, but also a lack of understanding and commitment to address environmental issues. The emphasis is more on delivery at all costs and although there are good environmental laws or guidelines in place, little attention is paid to it.

All these sources need to be addressed during the appraisal as not only can they lead to negative impacts on the environment, but they can also pose significant risks to and generate liability for the DBSA.

The purpose of the environmental appraisal is not only to address environmental risks, but also to ensure that the environmental benefits associated with a project is maximized and to ensure that sustainable development is achieved. The appraisal process should actively consider ways to enhance the environmental benefits of projects and programmes. Environmental sustainability is one of the cornerstones of the DBSA's approach to project financing. In order to assess whether a project is environmentally sustainable, the following rules for sustainability should be borne in mind. For renewables, the harvest rates must be equal to the depletion rates. For non-renewables, the depletion rates should equal the rates at which renewable substitutes are developed. Waste emissions should remain within the assimilative capacity without unacceptable degradation of the capacity to absorb future waste. There should be no net loss of habitat or biodiversity and irreversible changes to the environment should be avoided. Lastly, future options must be maintained and social equity promoted.

## ENVIRONMENTAL APPRAISAL PROCEDURE AND IMPACT ASSESSMENTS

The environmental appraisal procedure is initiated as soon as a project is identified. It is at such a time that an environmental analyst is allocated to the project, and the following requirements are communicated to the potential borrower:

• Legal compliance: The DBSA requires environmental legal compliance on all its projects and funding does not occur without such compliance being achieved. This requirement is included as a suspensive/ precedent condition in the loan agreement.

Within South Africa, environmental legal compliance is primarily guided by the following three acts, namely 1) The National Environmental Management Act, No. 107 of 1998, 2) The National Water Act, No. 36 of 1998, and 3) the Environmental Impact Assessment (EIA) Regulations promulgated in terms of Section 21(1) and 22(1) of the Environment Conservation Act, No 73 of 1989. Most other countries in Southern Africa have either legislation or guidelines pertaining to EIAs, Environmental Management and Water Management. In the absence of either legislation or guidelines, the World Bank requirements are applied.

- New projects: The Integrated Environmental Management process is required on all new projects. This usually encompasses an IA.
- Existing projects: Environmental Due Diligence is required for all projects where refinancing occurs.

• Environmental Management: All projects require an appropriate formalized environmental management mechanism. This can either take the form of an Environmental Management Plan or a fully development Environmental Management System.

Impact Assessments (IA) or EIA reports form the main source of information with regard to the achievement of the DBSA's requirements. As previously discussed, the DBSA identified three sources of environmental risks, namely impacts, legal compliance and institutional capacity. Taking into account the above-mentioned requirements, IAs is the only process that the DBSA can use whereby sufficient information can be gathered from all relevant stakeholders in order to assist within the decision-making process.

Due to the fact that most countries within Southern Africa either have promulgated IA legislation or draft legislation, the DBSA usually has a country internal system whereby it can address environmental issues. The DBSA is not responsible for the conducting of the IA, but will usually become involved as in Interested and Affected Party (I&AP) and will through the formal process ensure that environmental risks and liabilities are addressed in an acceptable manner. The DBSA will however always reserve the right to require an IA to be conducted even if it is not legally required.

## CAPACITY OF BORROWERS FOR ENVIRONMENTAL MANAGEMENT

Although there usually is a legal or international mandate on environmental management encapsulated either within Southern African legislation or requirements, it is usually peripheral and lack both human and financial resources. This is further exacerbated by the fact that environmental management is usually seen either as a so-called "new" or "unnecessary" mandate and very few borrowers, including public and private sector, have the necessary institutional arrangements that can support even the rudimentary implementation of this mandate. Where arrangements exist, they are usually informal, unclear and poorly coordinated and largely driven by individuals who see the implementation of this mandate as a personal commitment to environmental issues, without the definite support of the institution.

Although various financial resources - including technical assistance from the DBSA –for environmental capacity building are available, the actual utilization of such resources is slow and time-consuming. The lack of human resources and appropriate institutional arrangements impacts negatively on borrowers' ability to absorb funding for capacity building and often leads to limited results being achieved.

## EXISTING ENVIRONMENTAL FOCUS AREAS

The main role that IAs play within the DBSA's decision making process and the lack of borrowers' capacity to ensure the implementation of IAs, has largely been responsible for directing present and future environmental focus areas within the DBSA. The existing environmental focus areas are:

- Consolidation of the environmental appraisal process
- Technical assistance to local authorities, specifically for capacity building.

- Building internal coordination and capacity.
- Supporting regulatory direction in the Bank's operation work and managing environmental risks and liabilities.

Future focus areas will largely ensure the improvement of both internal and external capacity to address environmental risks. This will include the development of sector specific guidelines, but more importantly, will focus on the successful implementation of IAs through the development of Environmental Management Plans and Environmental Management Systems.

#### LESSIONS LEARNT

Although the DBSA has been using IAs for more than 10 years, the bulk of its experience has been obtained since 1997 when IAs was legislated in South Africa. Using IAs as a risk mitigation measure has also been implemented since 2001. Experience has identified gaps both within the DBSA as well as externally. Lack of capacity, both internally as well as externally, has also required a level of flexibility not common in financial institutions.

- The main constraints being experienced when attempting to ensure environmental sustainability are lack of management capacity to internalization procedures. These two form an integral part of an IA and the lack thereof will severely impact on the success of the IA.
- Ensuring environmental sustainability requires time. This is not something that will be achieved in the short term and any time frames associated therewith need to focus on the medium to long term.
- It is very important to know what level of capacity the borrower has. All interventions, both at a project and institutional level need to take this into account.
- Due to the high level of human resource movement, especially capacitated resources, interventions with regard to environmental sustainability needs to be repeated.
- The best document in the world does not guarantee success. A good IA on paper will not ensure the achievement of sustainability on the ground without the necessary human and financial resources to implement its recommendations.
- In order to ensure that environmental risks are being addressed in such a manner that the DBSA's liability is addressed, it is important to continuously build relationships and to ensure that the borrower is well aware of the DBSA's requirements and also understands the need thereof.
- Always assist in finding solutions, but never undermine the Bank's minimum requirements. Due to the lack of capacity, the DBSA's minimum requirements are usually seen as very strenuous and achieving even these goes hand in hand with quantum leaps for borrowers.
- The use of IAs as a risk management tool and for addressing environmental sustainability requires formalized environmental management systems. Due to the fact that the DBSA usually builds up long term relationships with most of its clients,

the implementation of a formalized environmental management system not only provides the benefits for the DBSA, but also ensures that implementation of interventions continue after project implementation.

• There is a need to clearly understand the implications of internal requirements. This is reflected in the need to ensure legal compliance. Lack of capacity for both borrowers and regulators, impacts negatively on project implementation and hampers development.

## CONCLUSION

The inclusion of environmental risk within the DBSA's risk management process has ensured that the achievement of environmental sustainability impacts on both the DBSA's as well as the borrower's bottom line. However, lack of capacity, both internal and external, is and will for a long period of time be a major factor. IAs proved to be an excellent source towards the DBSA's decision making procedures, but the actual implementation thereof through environmental management plans and environmental management systems are still lacking.

The improvement of this capacity will however be a long term process and it is important not to try to do too much at once. The achievement of environmental sustainability through the use of IAs, although very important, does not yet receive the necessary attention in Southern Africa.

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