

## **2. Development Bank of Southern Africa Environmental Assessment Policy and Procedures**

### **2.1 DBSA Profile**

The Development Bank of Southern African<sup>23</sup> (DBSA) is a development finance institution wholly-owned by the South African government. The Development Bank of Southern Africa was established in 1983 to perform an economic development function within the constitutional dispensation which then obtained. The roles and functions of the Bank have since been transformed, in line with the new constitutional and economic dispensation, in order to promote socio-economic development and growth in the southern African region within the integrated financial development system.

In terms of the Development Bank of Southern Africa Act, 1997<sup>24</sup> which provides for the continued existence of the Bank as a development finance institution, the main objectives of the Bank are: the promotion of economic development and growth, human resources development, institutional capacity building, and the support of development projects and programmes in the region. The Bank strategy is underpinned by two major themes:

- Generating investment in assets, hard and soft, that serve the poor, directly and indirectly, and that support broad-based wealth creation;
- Mobilising, developing, applying and sharing knowledge in support of greater development effectiveness, innovation and an enabling development environment.

The specific objectives of the DBSA are outlined in the above Act and regulations thereof.

In carrying out its operations, in line with the mandate, the DBSA is guided by the principles of additionality, development impact, financial and environmental sustainability, risk management, complementarity with other development finance institutions, partnerships, and knowledge management.

The DBSA covers the Southern African Development Community (SADC) region, which includes all SADC member countries. Its public sector operations in South Africa are executed through the following provincially aligned business units:

- Gauteng, Free State and North West;
- Eastern Cape; and
- KwaZulu-Natal and Mpumalanga;
- Limpopo.
- Western Cape and Northern Cape;

The Corporate Finance Unit, as well as the Project Finance and International Investment Finance units provide products and services across South Africa and Southern Africa. The International Finance Unit provides support to the other SADC countries, namely: Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe.

With regard to the financial structure, the Bank is a self funded institution and raises its funding from domestic and international capital markets, bilateral and multilateral institutions, and internally generated resources. The Bank has access to a callable

<sup>23</sup> In this chapter, the Development Bank of Southern Africa (DBSA) and the Bank are used interchangeably.

<sup>24</sup> Development Bank of Southern Africa Act, 1997, Act No. 13 of 1997.

capital facility of R4.8 billion as part of its capital structure. The Bank has an international rating, under the following agencies, namely: Fitch: AAA; Moody's: Baa1; and Standard and Poor's: BBB.<sup>25</sup>

In order to advance principles of good corporate governance, the Bank has constituted a board of directors in line with the statutory requirements.

## 2.2 Environmental Assessment and the Financial Sector

Today, the environmental challenges facing the financial sector<sup>26</sup> have grown in complexity and magnitude. These challenges are as a result of increasingly stringent environmental legislation, and the development of market policies and measures that seek to promote sustainable development, in particular the environmental dimension of sustainable development. The growing awareness by interested parties or the public, in general, on environmental and sustainable development issues is a major contributing factor. In response, the financial sector is required to develop a strategy to effectively address these environmental challenges in their day-to-day operations. Indeed, a number of financial institutions have put in place formal environmental management systems and procedures to effectively deal with environmental risks associated with their business operations and activities.

These environmental risks are either direct, meaning that the operations or actions of the financial sector cause problems to the environment or indirect, meaning that the financial institution is affected by the action of another party such as the borrower, mainly through its products and services. The latter is of more interest to the financial sector, and often represents a great risk, including reputational risk. As part of their traditional risk management systems and procedures, financial institutions are developing environmental risk assessment procedures in order to avoid and mitigate the indirect environmental risks related to their products and services. These environmental risk assessment and management procedures will, among other requirements, insist on full compliance with environmental legislative and regulatory requirements by the borrowers or clients. It is against this background that this handbook was developed.

As indicated in the preceding chapter, the handbook is targeted, among other stakeholders, at those responsible for investment approvals within the financial sector, mainly project managers and environmental assessment practitioners. These are the people with the responsibility of ensuring that all environmental obligations related to the projects under their review for approval, are fully complied with. Thus many of the major development banks have established environmental risk assessment policies and procedures to ensure that infrastructure development programmes or projects under consideration for support are legally compliant, environmentally benign and sustainable.

The rationale in this regard is early identification of environmental issues, including environmental legislative and regulatory requirements applicable to the project, and early incorporation of these environmental considerations into the project in the

<sup>25</sup> Development Bank of Southern Africa, 2006, Annual Report.

<sup>26</sup> In this chapter, the terms financial industry, financial sector and financial institutions are used interchangeably, and include the following: Retail Banks, Investment Banks, Insurance Institutions, Asset Management Institutions, and Development Finance Institutions.

design phase. Among the major development finance institutions, for example - the World Bank, International Finance Corporation (IFC), the African Development Bank (AfDB), these environmental assessment requirements are well defined and applied. The DBSA, being a major development finance institution in the SADC region, has also established environmental risk assessment and management policies and procedures.<sup>27</sup>

These procedures are consistent with international best practice, and are designed to ensure easy and consistent application of the environmental assessment module in all Bank supported programmes and projects.

This chapter aims to provide a brief overview of the DBSA's environmental assessment and management procedures.

### 2.3 Brief Overview of the Environmental Appraisal Process at the DBSA

The environmental appraisal policies and procedures for programmes and projects under consideration for DBSA support have been in place for nearly two decades. As with other operational policies and procedures within the Bank, the environmental appraisal procedures have evolved with time, keeping pace with the development of international best practice. Development finance institutions, such as the World Bank and its private sector arm, the IFC, have been key in driving the development of best practices with respect to environmental risk assessment and management disciplines. As a result, the different environmental assessment policies and procedures that many financial institutions apply and implement in their operations are underpinned by the same framework. However, the support mechanisms required for the implementation of the environmental assessment procedures tend to vary.

At the DBSA, the environmental appraisal is an integral part of the whole investment appraisal process, which comprises six appraisal modules, namely: financial, institutional, economic, social, environmental and technical. The decision on whether to finance a programme or project depends on the favourable appraisal of all these modules. An independent review of each module provides for a comprehensive appraisal of the programme or project under consideration.

Generally, the process through which applications or requests for financial assistance are processed and products and services are rendered can be divided into seven steps or sub-processes, namely process application, mobilising project resources and information, recommending an investment proposition, processing investment decision, delivering implementation assistance, and conducting project completion.<sup>28</sup> These steps are briefly explained below.

#### Step 1 – Process application

The processing of applications starts with the receipt of a formal application or verbal request for financial assistance. This process is conducted in order to recommend the acceptance or rejection of a request for financial assistance in line with the mandate. The responsibility in this regard rests with the business unit administrator, the designated project manager and core team members, and the business unit manager.

<sup>27</sup> Development Bank of Southern Africa, 2006, Procedures for Environmental Appraisal at the DBSA, Midrand, DBSA.

<sup>28</sup> Development Bank of Southern Africa, Guidelines for Institutional Borrower Appraisals and Institutional Risk Assessment Frameworks, Midrand, DBSA.

**Step 2 – Mobilising project resources and information**

The mobilisation of project resources and information involves preparatory work before the actual appraisal of the application or request. This step follows the acceptance of the application or request into the pipeline for consideration. The key activities in this regard include a thorough review of the application, agreement on the scope and assistance required from the DBSA, the mobilisation and briefing of the appraisal team, inclusive of all six modules, and the gathering of the information needed to appraise the sustainability of the programme or project. Risk identification and assessment is also undertaken at this stage.

**Step 3 – Recommending investment**

This entails appraising the sustainability of the programme or project. At this stage the respective modules have been appraised and the mitigation measures for the identified risks are proposed. The key activity in this step is a set of findings and recommendations on the investment, providing justification for the investment and providing recommended terms and conditions for the transaction. To assist with the appraisal of various modules, the DBSA has developed a comprehensive set of guidelines and procedures. This chapter will only provide an overview of some of the procedural requirements for the application of the environmental appraisal module.

**Step 4 – Processing investment decision**

This entails administrative work that is conducted to present, consider and approve the investment proposition. The key activities include: finalising the project scope, including the product and service to be delivered, the terms and conditions to be recommended for consideration in the investment decision and compiling and presenting the consolidated appraisal report.

**Step 5 – Conclusion of contract**

The conclusion of the contract involves the preparation and presentation of the draft contract to the client or borrower, the negotiation of the contract, including the agreement on the project scope, the product and services to be delivered and the terms and conditions for the transaction and the signing of the contractual agreement.

**Step 6 – Delivering implementation assistance**

This entails disbursement of funds required for the implementation of the project in line with the loan agreement. Generally, it involves the monitoring of progress and performance, receipt and processing claims and disbursements and the closeout of the contract.

**Step 7 – Conducting project implementation completion**

The project completion step is conducted to give account of the implementation performance results in line with the terms and conditions, particularly the ones related to the implementation phase of the project. This step entails the initiation of project completion, quantification and assessment of the implementation performance, the review and recording of lessons learnt and the presentation of the findings and recommendations through a project completion report.

The DBSA environmental appraisal guidelines were recently reviewed and revised, and in line with the recently approved DBSA environmental policy, the environmental guidelines were changed to environmental appraisal procedures. These procedures

are reviewed bi-annually in order to keep pace with international best practice for environmental assessment, particularly in the financial sector environment. These procedures outline the procedural requirements for step 2 and 3 of the process flow as briefly outlined above. The next section provides a brief overview of the procedural requirements with regard to the application of the environmental appraisal module.

### 2.4 Environmental Assessment Procedures

This section provides an overview of the risk assessment methodologies applied to appraisal in the Bank. Firstly, it provides an outline of the key steps in conducting an appraisals, and then reflects procedural requirements for environmental risk assessment and management. These environmental appraisal procedures apply to all DBSA loans and credits except for technical assistance grants to undertake studies such as feasibility or EIA studies.

As indicated below, the appraisal process comprises three key steps, namely – project screening, the site visit and the environmental appraisal process. The environmental appraisal process being primarily a qualitative assessment involves planning, gathering and validating information, evaluating the information, and reporting on the appraisal results.

In the implementation of this process in the Bank, there are four sources of environmental risk that are considered.<sup>29</sup> These are:

*Environmental impacts* – risks emerging from the nature and effects of the project itself. These could include, for example, a waste disposal site's potential to pollute groundwater or the use of hazardous substances in the mining industry without proper handling and storage facilities leading to toxic run-off.

*Legal requirements* – the legislative and regulatory requirements applicable to the project under consideration are a significant source of risk, particularly with regard to compliance.

*Institutional capacity* – the capacity of the borrower to implement any environmental requirements throughout the life cycle of the project, particularly during implementation can present significant risk.

*Public and political concern* – with regard to environmental issues, there is always the potential for reputational risk.

#### 2.4.1 Initial screening

The initial environmental screening process starts upon the acceptance of the programme or project into the pipeline in line with the DBSA policies and priorities. The main aim of the initial environmental screening is to determine, among other requirements, the risk category of the project. The categorisation of the project also directs the information required for its appraisal. This screening or project categorisation is based on the early review report prepared by the project manager, the borrower's project proposal, and any other information at the disposal of the environmental specialist on the project team.

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<sup>29</sup> Op. Cit. Footnote 27.

The Bank's potential projects are classified into three categories based on the nature of environmental impacts related to the project. These categories are:

*Category 1 or high-risk category* – programmes and projects in this category are likely to cause significant adverse environmental impacts that are irreversible in the social and bio-physical environment. For this category, the DBSA requires an EIA process<sup>30</sup> to be undertaken regardless of EIA legislative and regulatory requirements.

*Category 2 or medium-risk category* – programmes and projects under this category are likely to induce adverse environmental impacts but less than those associated with the above category. In this category, the country's EIA legislative requirements apply. In cases where there is no EIA legislation, an environmental due diligence study must be undertaken.

*Category 3 or low-risk category* – programmes and projects in this category do not present a significant risk in terms of the environmental impact. They have no adverse impact on the social and bio-physical environment, and therefore can be readily appraised with limited environmental information.

In order to facilitate project categorisation, an illustrative list identifying projects in different categories, as reflected above, forms part of the Annex section of the environmental appraisal procedures document. The table below provides a sample of projects for each category.

**Table 2.1: List of a sample projects under different risk categories**

Category 1 or HRC <sup>31</sup>	Category 2 or MRC <sup>32</sup>	Category 3 or LRC <sup>33</sup>
Large dams and reservoirs	Water supply projects	Health services projects
Water transfer schemes	Medium to small wastewater treatment projects	Institutional development and capacity building projects
Major oil and gas developments	Water purification plants	Advisory assignments
Thermal and hydropower developments	Reservoir for public water supply	Technical assistance, excluding studies
Tourism (hotel and resort developments)	Renewable energy projects	Internal reticulation at existing urban developments
Large scale wastewater treatment plants	General manufacturing	
Projects affecting tribal or indigenous populations	Telecommunication projects	
Roads, railways, airfields and associated infrastructure	Electrical transmission projects	
Textile industry		
Manufacture, transportation and use of hazardous materials		

Source: DBSA Environmental Appraisal Procedures, 2006

<sup>30</sup> Environmental Impact Assessment (EIA) is defined as a procedure for evaluating the likely impact of a proposed activity on the environment.

<sup>31</sup> HRC - High-Risk Category.

<sup>32</sup> MRC - Medium-Risk Category.

<sup>33</sup> LRC - Low-Risk Category.

### 2.4.2 Project site visit

The DBSA environmental appraisal procedures require the project team, with regard to this module, i.e. the environmental specialist, to undertake a site visit at least once prior to the appraisal of the project to categorise it and assess the types of environmental risks that are likely to be encountered before and after mitigation. The site visit also provides for the assessment of the institutional capacity of the client with regard to the environmental management of the project, particularly during implementation. Generally, the site visit will entail discussions and interviews with environmental consultants, where EIA is required, project designers, engineers, management, and local communities, and other interested parties.

### 2.4.3 Environmental Risk Assessment Procedures

This section briefly outlines the risk assessment methodologies applied to environmental appraisals in the Bank. On the basis of a review of all relevant information, including environmental impact assessment studies, and where relevant, environmental authorisations, the project team identifies environmental risks associated with the programme or project and the phase in which these environmental risks are likely to materialise. In cases where the documentation provided by the borrower is inadequate, the environmental specialist assigned to the project team will arrange for additional information in consultation with the project manager.

For the project team to conduct a comprehensive appraisal, it is imperative that there is an adequate information base. To this end, the Environmental Appraisal Procedures document<sup>34</sup> provides guidelines with regard to the review of the environmental impact assessment report and the required environmental information for the purposes of the initial environmental screening.

In the implementation of these environmental appraisal procedures, it is a requirement that an environmental risk<sup>35</sup> table is produced for all projects. To fulfil this requirement, the following methodology is applied in all environmental appraisals. For each risk identified, the magnitude of its consequences is assessed and given a rating of low, medium or high. To guide judgement, the following criteria are used, namely:

- Nature of the impact or sensitivity of the environment involved;
- Extent of the impact;
- Intensity of the impact;
- Duration of the impact;
- Potential for cumulative impacts;
- Potential for non-compliance with legislative and regulatory requirements;
- Potential for lender liability; and
- Potential for reputational risk.

The table 2.2 identifies possible ways of making this decision.

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<sup>34</sup> Op. Cit. Footnote 27.

<sup>35</sup> Environmental Risk is defined as a product of the magnitude of the impact or risk and the probability of the impact occurring.

**Table 2.2: Qualitative measures of magnitude**

Rating	Scale of impact	Sensitivity of the environment involved	CRITERIA			
			Potential for cumulative impacts	Non-compliance with regulatory requirements	Potential for lender liability	Potential for reputational risk
Low	Localised, on site	Not in a sensitive environment	None	Full compliance	Little or none	Little or none
Medium	Fairly extensive, Regional	In a sensitive environment but impacts localised and not irreversible.	Limited	Applications in place	Some	Some
High	National, International	Sensitive environment, damage or impact irreversible.	Extensive	Non-compliance	Significant	Significant

Source: DBSA Environmental Appraisal Procedures, 2006

The probability of the risk materialising is then assessed. The table below provides guidance with regard to making a decision.

**Table 2.3: Qualitative measures of probability**

RATING	DESCRIPTION
High	The risk will probably materialise in most circumstances
Medium	The risk could occur at some time
Low	The risk may only occur in exceptional circumstances

Source: DBSA Environmental Appraisal Procedures, 2006

The results from the assessment on the magnitude of the consequences of the risk and the likelihood of the risk occurring are used to obtain an overall risk for each risk identified. This is illustrated in the table below.

**Table 2.4: Qualitative risk assessment matrix or level of risk**

Probability	Magnitude of Consequences		
	Low	Medium	High
A (High)	High/Low	High/Medium	High
B (Medium)	Medium/Low	Medium	Medium/High
C (Low)	Low	Low/Medium	Low/High

Source: DBSA Environmental Appraisal Procedures, 2006

## DBSA PROFILE

To assist the project team with the interpretation of the results, the descriptive notes for each category of the result are presented in the environmental appraisal procedures document.<sup>36</sup>

Within the Bank, the above risk assessment is firstly done without mitigation measures in place. Mitigation measures are then identified, the probability and magnitude, and the overall risk are then re-assessed on the basis of the effectiveness of the proposed mitigation measures, as illustrated in the table below.

**Table 2.5: Summary table for project environmental risk assessment results**

Environmental Risk	Magnitude	Probability	Risk Rating (without mitigation)	Proposed Mitigation Measures	Magnitude	Probability	Risk Rating (with mitigation)
Specify environmental risk	H,M,L	H,M,L	H;M;L; H/L; M/H;L/H etc.	Detailed Mitigation Measures	H,M,L	H,M,L	H;M;L; H/L; M/H; L/H etc.

Source: DBSA Environmental Appraisal Procedures, 2006

In facilitating the integration of the environmental risk assessment into overall investment decision-making process, a point system is used as shown in Table 2.6 below. The point allocation is done after the borrower has agreed in principle with the proposed mitigation measures.

**Table 2.6: Application of the loan risk spread for overall project environmental risk rating**

Overall Project Environmental Risk Rating	Risk Rating Points Allocated	Risk Spread	Risk Rating Class
High	0	Unacceptable	
High/Medium	3	Doubtful	HIGH
High/Low	5	Weak	
Medium/High	9	Vulnerable	
Medium	11	Acceptable	MEDIUM
Medium/Low	13	Satisfactory	
Low/High	15	Good	
Medium/Low	17	Very Good	LOW
Low	20	Excellent	

Source: DBSA Environmental Appraisal Procedures, 2006

This in short, is the environmental appraisal process applied to all DBSA programmes and projects under consideration for support. As indicated earlier, the process followed may differ from those applied by other financial institutions. It should be noted that the quality of the review process depends largely on the quality of the information provided in the EIA reports. Reports which have a strong scientific basis will result in a more objective, quantitative review process, whereas those reports which fail to provide sound factual information will necessarily be subjected to a more qualitative and subjective appraisal by the Bank's review team.

<sup>36</sup> Op. Cit. Footnote 27.

## 2.5 Project Implementation Process

Following the conclusion of the contract with the borrower, the next phase is the delivery of the product and services as per contract, meaning that the project goes into the implementation stage. The project implementation process comprises three distinct sub-processes, namely project monitoring, project completion and project evaluation. Broadly, project implementation tests the quality of the environmental impact assessment for the development and the effectiveness of the Bank's environmental appraisal process. Furthermore, with the project completion and evaluation steps, key learning experiences and recommendations are generated to inform the project appraisal team. At an operational level, these processes reveal the extent to which the EIA report accurately identifies, assesses and evaluates the environmental impacts of the development. It further reveals the effectiveness of recommended mitigation measures and the environmental management plans, in terms of avoiding, minimising or compensating adverse environmental impacts related to the development.

### 2.5.1 Project Monitoring

This involves monitoring of the project during the implementation and operational phase of the project. The importance of this monitoring to the Bank is three-fold. Firstly, it ensures that the borrower complies with the environmental conditions and other environmental requirements of the project set out in the loan agreement. The project legal compliance monitoring and evaluation steps are part of the exercise. Secondly, the process allows for the effectiveness of the EIA-derived mitigation measures to be monitored, and for corrective actions to be implemented in cases where such measures are ineffective or inadequate. Lastly, the DBSA project team, as part of the project monitoring committee, will offer assistance in building the institutional capacity of the borrower with respect to environmental performance of the project. The loan agreement with the borrower, in this regard, will include the environmental terms and conditions, and other related environmental requirements, such as, EIA and EMP (mitigation measures) for the identified environmental impacts. It also ensures that the conditions of approval contained in the various environmental authorizations, are identified for monitoring and are reflected in the monitoring plan of the project. For all project monitoring site visits undertaken, a project monitoring report is produced to inform future monitoring inspections. For Category 1 or high-risk projects, periodic internal and external audits of the EMP and EMS are carried out. In the case of external audits, these are conducted by third-party auditors and may be a condition in the loan agreement with the borrower.

### 2.5.2 Project Completion

This process commences after the loan is fully disbursed or upon closure of the Bank's contractual obligations. The Completion Report aims to consolidate the implementation performance results and it provides recommendations for the continued surveillance of the project. The inclusion of environmental performance issues in the Project Completion Report, to specifically reflect the level of compliance with the environmental conditions set out in the loan agreement, is highly recommended for Category 1 and Category 2 projects.

This will assist in the identification of environmental performance criteria for surveillance of the project when it goes into the operational phase.

### 2.5.3 Project Evaluation

Further to the project completion process reflected above, the Bank through its Operations Evaluation Unit commissions independent assessments and evaluation of projects, including their environmental performance. The aim is to generate lessons learnt which find their way into a consolidated report on key learning experiences and recommendations for consideration in future interventions. The inclusion of the environmental specialist in post-project evaluation is highly recommended for Category 1 and Category 2 projects.

## 2.6 Conclusion

Among the major development banks, environmental assessment has become a standard procedure for programmes and projects under consideration for their support. It is important to note that the primary responsibility for environmental impact assessment lies with the borrower, and that the banks will only provide advice and ensure that their requirements with respect to their environmental risk assessment policies and procedures are adhered to. As established in the DBSA procedures for environmental risk assessment and management briefly outlined in this chapter, the environmental requirements from the development banks will include, as a minimum, compliance with legislative requirements. This includes compliance with the environmental assessment legislative and regulatory requirements. In the SADC region, most countries have legislation on environmental management that includes provisions for the conduct of an EIA on certain developments or projects. These developments are in line with the principles of sustainable development, particularly with respect to the enactment of effective legislation and the application of EIA as a national instrument for addressing environmental consequences of development.

The financial sector, given its role as an intermediary in the allocation of capital for development, has a major role to play in advancing sustainable development. At an operational level, the development of effective environmental risk assessment and management policies and procedures will assist in shaping development, rather than preventing development from taking place, as perceived by many within the financial sector. Indeed, a number of financial institutions internationally have moved beyond traditional environmental risk assessment practices or compliance, to embracing an integrated approach to sustainability. This is mainly due to the realisation that it is not only the financial markets and political developments that direct their business operations, but to a large degree, the environmental and social issues as well. The sustainability approach, which by its nature is integrated, anticipates long-term opportunities and risks.

This handbook aims to facilitate the review of one of the key sources of environmental risk to the financial sector, the environmental legislative and regulatory requirements applicable to the project. It aims to provide those tasked with the responsibility of project appraisals with information regarding EIA legislative requirements in various SADC member countries. The overall goal of this handbook is to ensure full compliance with the EIA and related statutory requirements in support of sustainable development.