**ENVIRONMENTAL AND SOCIAL MANAGEMENT POLICY**

**INTRODUCTION**

Environmental and social sustainability is an essential component of MUSCCO's commitment to responsible financing. The environmental and social risk management policy and procedures of MUSCCO lay out the general principles and processes underlying the effective implementation of MUSCCO's commitment to environmental and social sustainability. These principles cover provisions relating to the inclusion of environmental and social risk management (ESRM) into its refinancing activities. MUSCCO's mandate is to mobilize long-term financing for its affiliates to refinance housing loans granted to their customers. To this end, it provides financial intermediation on the Malawi financial services sector. It also mobilizes concessional resources from development partners that can spur production and domestic revenue generation. MUSCCO only refinances its Affiliates (SACCOs). The policy and procedures documents seek to introduce a systematic approach to the management of environmental and social challenges and risks associated with the processes and operations of MUSCCO.

This document is also consistent with MUSCCO's mandate of providing financial and responsible solutions to its affiliates and, as such, is an integral part of MUSCCO's overall risk management framework. MUSCCO also strives to assist its affiliates (SACCOs) to maintain appropriate environmental and social standards based on the following benchmarks:

• World Bank standards

• Standards of the Reserve Bank of Malawi

• ISO 14000.

This document underscores MUSCCO's commitment to sustainable finance in its operations, the implementation of appropriate procedures and development programs to ensure that MUSCCO complies with environmental and social standards and regulatory requirements in Malawi, as well as with those of the international financial institutions that support it. This document outlines MUSCCO's approach to the implementation of an Environmental and Social Risk Management (ESRM) to reduce the Environmental and Social (E&S) risks and associated effects related to its refinancing activities. The environmental and social risk management policy and procedures are an integral part of the Environmental and Social Management System (ESMS). The Environmental and Social Risk Management is committed to implementing and promoting an appropriate Environmental and Social Management System (ESMS) for The Union - but also for the SACCOs to which it on-lends funds - in order to effectively assess and control E&S risk exposures. The ESMS is a framework for lending operations supported by MUSCCO.

**ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT POLICY**

**Policy approach**

1. MUSCCO’s main objectives are to increase liquidity of the financial market and availability of varied credit products, reduce borrowing and related costs, and make credit more accessible. MUSCCO's primary role is to act as a financial intermediary for SACCOs, as a source of long-term liquidity and as a link between SACCOs and MSMEs. The loans are intended to refinance the enterprises by MSMEs.

2. MUSCCO strives to promote the development of its activities and considers that the environmental and social sustainability of its activities is an important component in achieving a positive impact on the development of the economies of the Union. It considers that the application of this policy contributes to this objective.

3. MUSCCO recognizes that with its core refinancing operations, it could potentially be exposed to environmental and social (E&S) risk associated with the lending activities of the Affiliates(SACCOs), including the Affiliates (SACCOs), which may constitute a financial, legal and reputational risk for MUSCCO. The E&S risk associated with MUSCCO's refinancing activities through its SACCOs depends on factors including the E&S circumstances associated with various loan operations. E&S issues may present risks and negatively impact (i) the quality of the collateral attached to the assets in the loan portfolio submitted by the SACCOs for refinancing by MUSCCO and (ii) the ability of MSMEs to repay these loans.

4. MUSCCO therefore supports the SACCOs to institutionalize and put in place appropriate policies, procedures and practical tools to determine the environmental and social risk of the various loans that they approve and subsequently propose to MUSCCO for refinancing.

5. MUSCCO approach recognizes that identifying and managing E&S risks is a shared responsibility between MUSCCO and the SACCO. This policy is therefore intended to clearly define the scope, applicable requirements and actions to be taken by the SACCO to foster effective E&S risk management.

In accordance with MUSCCO's operating model, these loans are secured by a pledge of a portfolio of loans. The SACCO retains the loan portfolio on its balance sheet, but any loan that becomes impaired must be replaced by a performing loan. Thus, the credit risk is borne by the SACCO.

MUSCCO is committed to working with the SACCO and other stakeholders in the financing to fulfil its role as a catalyst for sustainable enterprises financing in Malawi.

The specific policy objectives include the following;

• Incorporate ESRM reflections into the decision-making process for refinancing/guarantee taking of the MUSCCO.

• Implement and comply with international requirements for E&S risk management in the financial sector (the Principles for Sustainable Banking), and those of the MUSCCO's bilateral and multilateral lenders.

• Require the SACCOs to comply with standards for the control of environmental and social risk associated with mortgage lending.

• Promote greater transparency and internal and external accountability for E&S issues through the publication and reporting system.

**Scope of application**

This policy applies to MUSCCO's refinancing activities as set out in the statutory framework, the rules of intervention and supervision of the SACCOs.

**Applicable environmental and social standards**

Affiliates will be asked, as part of the process of evaluating the refinancing granted to them, to integrate the E&S requirements applicable to MUSCCO, with the following three components:

1. Applicable local laws and regulations of the refinanced SACCO's.
2. MUSCCO’s list of exclusions of loans that are not eligible for refinancing, given the negative environmental and social impacts
3. MUSCCO's environmental and social control criteria

Among other criteria, MUSCCO will ensure that;

* Each SACCO verifies that loan applications contain queries on the conditions. E&S monitoring in accordance with MUSCCO requirements.
* The SACCO has adopted an E&S policy and procedure that reflects the E&S requirements of MUSCCO;
* The SACCO designates personnel with clearly identified responsibilities for E&S risk management;
* The SACCO develops internal capacity to perform E&S monitoring.
* MUSCCO will request the SACCOs to develop and maintain personnel management procedures for their staff in accordance with existing laws.
* Environmental and Social Prudence and Supervision
* MUSCCO will incorporate due diligence and supervisory functions in its refinancing activities.
* A high-level structure for the due diligence process is presented.
* MUSCCO will perform its E&S due diligence towards the SACCO at an institutional level and also on the loan profile to be refinanced.
* As part of its E&S due diligence at the institutional level, MUSCCO will review the policies, procedures and capacities of the SACCOs to conduct E&S monitoring
* If MUSCCO considers that the SACCO does not have the requisite systems and capacity described in this policy, that SACCO will not be eligible for refinancing by MUSCCO, unless a time-bound remedial action plan is put in place and approved by MUSCCO.
* The prudential requirements for the loan portfolio submitted by the SACCO's for refinancing/collateralization will be met as follows:

(a).An E&S check will be incorporated into the SACCO's prudential obligations/assessment process, based on MUSCCO's applicable E&S requirements. Such provisions will be formalized as an integral part of the conditions of the refinancing granted by MUSCCO to the SACCOs. In particular, for each instalment of the refinanced mortgage loan, the SACCO will be required to provide MUSCCO, together with the refinancing request, with a confirmation letter describing: (i) the measures taken for an appropriate implementation of the E&S prudential requirements and (ii) the results of the E&S monitoring process of the mortgage portfolio. SACCOs will be required to maintain appropriate documentation of the process and results related to the E&S prudential requirements and E&S controls.

(b). MUSCCO will review and verify the E&S information provided by the SACCOs in the confirmation letter and take it into account as part of the acceptance criteria of the loan portfolio prior to refinancing. This may require additional safeguards specific to the risk profile of each mortgage portfolio. MUSCCO will incorporate the SACCO's E&S control processes into its supervision and control procedures.

This program will include periodic visits to SACCOs to verify the policies, procedures, capacity and documentation that support the SACCOs' confirmation of appropriate E&S precautionary and control measures. The SACCOs will be asked to prepare and submit an annual environmental and social performance report to MUSCCO.

**Communication and publication**

MUSCCO will ensure transparency of its activities through the publication of its E&S policy and requirements, but also of all its commitments to support sustainable financing. A summary of the E&S policy and procedures will be prominent on the MUSCCO website and will be included in its annual report. MUSCCO also undertakes to declare its E&S activities in accordance with its obligations and the requirements of investors. MUSCCO's policies and procedures are reviewed and approved by senior managers. MUSCCO will update its ESRM policy every two years to ensure its relevance, reflecting changes in its activity, and in accordance with national laws and alignment with bilateral or multilateral lender financing and investor requirements, if necessary. This review will also ensure that the overall approach to E&S risk assessment and management remains relevant and consistent with national and international best practices and standards. MUSCCO may, if necessary, also develop complementary E&S policies, procedures and tools to respond more comprehensively to specific risks.

**MUSCCO EXCLUSION LIST**

The purpose of this list is to present the criteria based on which MUSCCO will not refinance a portfolio proposed by a SACCO, when the loans in this portfolio are deemed by MUSCCO to be associated with:

1. Enterprises that adversely affect the environment

2. Illegal building construction or construction that does not comply with applicable national and local laws and regulations.

3. Properties or land resulting from unlawful forced evictions of owners or occupants.

4. Properties built on land from which local communities (including squatters and other untitled occupants) have been involuntarily relocated/housed without proper compensation by government agencies or builders.

5. Properties involving a previously identified land dispute. Properties constructed in places and/or in a manner that involves significant degradation or conversion of critical habitat and/or legally protected areas

6. Properties built in places and/or in ways that imply significant negative impacts on essential cultural heritage

7. Expositions. Unauthorized construction, housing construction in areas not designated as residential, encroachment on public or governmental or private land ownership,

8. The permanent or temporary forced eviction without adequate legal or other protection, of individuals, families or communities from their homes or the lands they occupy. The prohibition of forced evictions does not, however, apply to those carried out in accordance with the law and in conformity with the provisions of the International Conventions on Human Rights. This criterion will apply only to evictions carried out specifically in anticipation of or in preparation for housing construction activities for which mortgages have subsequently been granted by the SACCOs.

9. Resettlement must follow a process that can limit negative social and economic impacts by; (i) providing compensation for the loss of assets at the replacement price defined as the market value of the assets plus transaction costs and (ii) ensuring that resettlement activities are accompanied by appropriate information provision, informed consultation and participation of affected persons.

10. Exclusion of disadvantaged gender, i.e. women and youth

**MUSCCO'S INTERNAL PROCESS FOR EVALUATING PROPOSED PORTFOLIOS**.

**The internal process;** SACCO seeking refinancing proposes the portfolio for refinancing

**Initial checks by MUSCCO (per the form submitted by the SACCO);** Debtor in MUSCCO's Exclusion List? Yes, Not eligible, must be replaced. No Approval by the Commitments Committee (legal requirements, including the Exclusion List and ESMS by SACCO)

**Supervision by MUSCCO;** Internal Audit (including annual reports of the SACCOs and documents - e.g. a questionnaire - E&S of refinanced debtors by sampling)

**E & S PERFORMANCE CRITERIA**

**System and capacity E&S staff and capacity;** Staff formally designated to manage E&S issues, internal training developed and implemented to raise the awareness of the staff in charge of this area on the required E&S control processes, criteria and documentation.

**E&S Policy and Procedures Development;** A written E&S policy and procedures to internalize the E&S control processes within the SACCO and formally adopted by Senior Management of the Institution Management Committee Level of management commitment to incorporate E&S aspects into risk management practices at the SACCO including resourcing and approval conditions.

**Implementation Compliance with applicable requirements appropriate;** Implementation of the E&S monitoring process, including application of the MUSCCO E&S requirements,

**Documentation;** The SACCO keeps appropriate documentation and is available at the request of MUSCCO financing agreements and other appropriate documentation to the final borrower.

**INDICATIVE CRITERIA FOR ENVIRONMENTAL AND SOCIAL CONTROL OF AFFILIATES (SACCOs)**

**Criteria control issues**

1. Have the properties been constructed in compliance with appropriate national and local laws and regulations, including work regulations regarding occupational health and safety, child labor, and forced labor?
2. Are the properties located in areas clearly designated as residential?
3. Have additional measures deemed necessary by the SACCO relating to the duty of care been put in place and implemented consistently?

**Sites prone to natural disasters**

1. Does the SACCO assess the susceptibility of its properties to natural disasters?
2. Are measures in place to mitigate the associated risks?

**Sites dangerous for human habitation**

1. Does the SACCO assess the risks associated with enterprises dangerous for human beings?
2. Does the SACCO exclude financing such undertakings?

**Access to basic services (e.g. water and sanitation**)

1. Does the SACCO take into account basic services in the financed projects?
2. Does the SACCO exclude the financing of properties located in areas without access to basic services?

**Properties constructed on sites and/or in such a way that they adversely affect land, natural resources, or critical cultural heritage that are used as livelihoods by vulnerable and/or historically disadvantaged traditional local communities**

1. Are the SACCOs conducting assessments of whether such effects exist (as in some places where SACCOs are highly concentrated in mortgages such as new large-scale housing programs)?

**Household activities hazardous to the environment and/or human health and safety**

1. Does the SACCO take into account domestic activities hazardous to the environment and/or human health and safety (such as the storage of hazardous chemicals), in its assessment process? 15
2. Has the SACCO put in place measures to mitigate potential risks (e.g. including documentation in the appropriate language for final borrowers)?

Approved by MUSCCO Management on 4th March, 2020



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**MUSCCO CHIEF EXECUTIVE OFFICER**