March 13, 2023

Proposed Revisions to the U.S. DFC Environmental and Social Policy and Procedures

The U.S. International Development Finance Corporation ("DFC") is in the process of updating its Environmental and Social Policy and Procedures ("ESPP"), which help guide DFC's investment decisions. As part of this effort, DFC has recently published a draft of the revised ESPP for public review and comment, which is accessible here. Comments are to be submitted before April 28, 2023.

Launched in 2019 (by combining elements of USAID with what was formerly OPIC), DFC is a U.S. governmental organization that seeks to promote American economic and foreign policy interests through its support of private investment in other countries. DFC's product offerings include (i) direct debt and equity investments in specific projects and emerging market investment funds; (ii) political risk insurance coverage; and (iii) feasibility studies and technical assistance. DFC considers applications from the private sector for its products on the basis of several factors, including a project's benefits to marginalized populations, its ability to mobilize private capital and its environmental impact.

If adopted, applications received after the effective date of the revised ESPP will be assessed by DFC according to the new policy. Applications that are received by DFC before the effective date will continue to be assessed against the ESPP in effect on the date of the relevant application so long as DFC approval for the application is granted within one year after the effective date of the revised ESPP. If approval is not granted within one year after such effective date, the project will be subject to the revised ESPP.

Key Proposed Revisions to the DFC's ESPP

Applicants seeking DFC support for their projects should take note of the following proposed changes:

- **Project Risk Categories.** Consistent with current DFC policies, the Equator Principles and the IFC Performance Standards, the proposed ESPP categorizes projects depending on their environmental and social risks from Categories A through C, with Category A projects being the riskiest and facing the strictest requirements. Under the proposed ESPP, some formal requirements would be lifted for lower-risk projects. In particular, there would be greater flexibility for Category C projects, such as financial services or software development projects that do not involve physical impacts. For example, the current policy requires all applicants to establish a formal Environmental and Social Management System ("ESMS") to guide the DFC's environmental and social review.[1] The revised policy would exclude Category C projects from the formal ESMS requirement, requiring only that "appropriate" environmental and social policies to guide the project be put in place.[2]

- **Updated Provisions for Financial Intermediaries.** The proposed ESPP contains a distinct section with guidance for Financial Intermediaries ("FIs"). The ESPP defines FIs as "vehicles or entities that provide debt to, make equity investments in, or provide financial services to eligible companies (which are referred to as 'Subprojects')."[3] The new section would establish distinct categories to classify FIs depending on the environmental and social risks of their proposed investments. The categories, which range from Categories FI-A to FI-C, would help determine FIs' eligibility for DFC support and the extent to which FIs may delegate compliance with their environmental and social risk management and monitoring requirements to the Subprojects. For example, FIs investing in low-risk Category FI-C projects, which include tech-enabled investments with no significant physical assets, would be eligible for full delegation, whereas Category FI-A projects would not.[4]
- **Contextual Risk is added as an assessment factor.** The proposed ESPP would add "Contextual Risk" as a factor to be considered in DFC's risk assessment of projects. The proposed ESPP defines the term to include risks in a project's external environment beyond a client's control, such as political or social conflict, elevated risks of gender discrimination or biodiversity considerations.[5]
- **Emissions reporting requirements are expanded.** DFC has committed to achieve net-zero emissions in the DFC lending and investment portfolio by 2040 and will track and annually report on its portfolio emissions in conformance with the Partnership for Carbon Accounting Financials (PCAF) Standard widely used by financial institutions. The proposed ESPP would clarify that, as a condition to DFC support, all projects would have to quantify and annually report to DFC on the direct and significant indirect emissions related to the project.[6] Under the current ESPP, the reporting requirement for direct emissions is limited to projects that are expected to produce direct emissions exceeding 25,000 metric tonnes of CO_{2eq} per year.[7] Direct emissions (Scope 1) are emissions coming from project-related sources that are owned or controlled by the applicant, such as stationary and mobile combustion emissions.[8] Indirect emissions (Scope 2) are defined as those associated with off-site production of electricity, steam, heating, or cooling used or purchased by the project.[9]
- **The Office of Accountability is recognized.** Established in September 2020, the DFC's Office of Accountability ("OOA") addresses complaints and conflicts raised around DFC-backed projects. In particular, it provides local communities an opportunity to have their concerns heard and addressed by the DFC. The proposed ESPP would recognize the establishment of the OOA, and provide that all of DFC's clients must disclose DFC's participation and the OOA's existence as a dispute resolution mechanism to constituencies affected by DFC-backed projects.[10]

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ENDNOTES

1 U.S. Int'l Dev. Fin. Corp., *Environmental and Social Policy and Procedures*, § 3.7 (July 2020).

2 U.S. Int'l Dev. Fin. Corp., *Updated Environmental and Social Policy and Procedures for Public Comment*, § 4.1.3 (February 2023); https://www.dfc.gov/what-we-offer/eligibility/our-investment-policies.

3 *Id*. at § 8.0.1.

4 *Id*. at § 8.1.2.

5 *Id*. at § 3.1.3.

6 *Id.* at § 9.1.3. In contrast, the Equator Principles 4 require reporting only of projects whose operational Scope 1 and 2 emissions exceed 25,000 metric tonnes of CO_{2eq} per year. It should also be noted that it is currently not clear whether this reporting requirement would apply to both the construction and operations phase of a project or just the latter.

7 *Environmental and Social Policy and Procedures* (July 2020) at § 8.14.

8 *Updated Environmental and Social Policy and Procedures for Public Comment* (February 2023) at Appendix C.

9 *Id*. at § 9.1.3.

10 *Id*. at § 1.4.

Questions regarding the matters discussed in this publication may be directed to Olivier de Vilmorin, Craig Jones, Jon Hannah or Sam Saunders*, or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. Additional S&C resources about energy transition matters may be found here.*