

Sustainability – Risks and Opportunities for Polish Financial Institutions

Zrównoważony rozwój – ryzyko i korzyści dla polskiego sektora finansowo-bankowego

Sheraton Hotel, Warsaw
March 16, 2005



UNEP **Finance Initiative**
Innovative financing for sustainability



EBRD 's Experience in CEE – Environmental Risks and Opportunities

**Dr. Dariusz Prasek
Robert Adamczyk**

Environment Department

European Bank for Reconstruction and Development



Presentation Structure

- Introduction to EBRD
- EBRD Environmental Procedures & Policy
- EBRD Risk Management
- Invest needs in Poland and sources of funding
- Impact of environmental issues on decision making



What is the EBRD?

- An Investment Bank with Public Shareholders:
 - owned by 62 countries and supranational shareholders (EU; EIB)
 - AAA-rated international financial institution founded in 1991
 - 1000 employees
- Mandate: facilitate the transition to market economies
- Capital base of €20 billion and Business Volume of €24.1 billion to date - €3.7 billion (119 projects) in 2003:
 - Largest single investor in the region
 - 75% debt / 25% equity
 - 72% private sector/privatisation projects



32 offices in 27 countries



EBRD and Environmental Guiding Principles

- Environmental and Sustainable Development Mandate – Responsibility as a public institution
- Core Business Issues – legal, financial and reputation-based- Private sector orientation
- Revised Environmental Policy (2003) and Public Information Policy (2003) and new Independent Recourse Mechanism (2004)



Definition of Environment

- Ecological aspects
- Worker health and safety
- Core labour standards
- Community issues (e.g. cultural property)
- Involuntary resettlement
- Impacts on indigenous peoples



Wide Range of Projects and Environmental Issues



Implementation of the EBRD Environmental Mandate

- financing projects in sectors such as environmental infrastructure and energy efficiency
- applying environmental requirements to all of the Bank's operations
- including environmental components in operations to reduce atmospheric emissions and industrial wastewater discharges, to promote energy, resource efficiency, waste recovery, recycling, and clean technologies
- providing technical assistance to promote environmentally pro-active measures



Key sustainable development challenges pursued by the EBRD

- Support market transition and provide access to capital
- More efficient use of energy and other resources
- Replacing obsolete with modern technologies and processes
- Introducing best industrial and resource extraction practices
- Improving environmental, health and safety management systems
- Improving public participation in decision making
- Supporting development of economic instruments for reform



Other Challenges for EBRD and its Clients

- Sustainable development perceived as expenditures that do not generate revenue
- sustainability is often seen to slow down progress towards competition goals
- an abundance of legislation but poor enforcement
- legislation changing rapidly



Other Challenges for EBRD and its Clients

- harmonisation with EU standards and Directives
- management continues to remain unengaged in a company's environmental matters (reactive vs proactive)
- environmental liabilities unclear (lack of clean-up standards)
- a typical large industrial plant in Central and Eastern Europe or the CIS continues to consume considerably more energy than its western counterpart for a given level of production



EBRD Approach and Initiatives

- The EBRD commits on average around €3 billion in new projects every year
- Nearly 20 per cent of this commitment is devoted to environmental improvements
- Half of this is accounted for by municipal and energy efficiency projects
- The other half is associated with environmental improvements on industrial and infrastructure projects



EBRD Approach and Initiatives

- Promoting SMEs and fostering entrepreneurship (private sector 70% of €20.2 billion investment portfolio; 200,000 loans to SMEs through FIs)
- Transfer of Environmentally Sound Technologies and processes
- Investing in Municipal and Environmental Infrastructure (€ 1.2 bln commitment supporting total investment € 2.6 bln)
- Developing Energy Sector Initiatives (energy efficiency, addressing Climate Change, supporting renewable energy)
- Supporting nuclear safety (NSA - pledged more than € 1.5 bln)
- Improving Transport Infrastructure



EBRD Approach and Initiatives

- The EBRD requires environmental due diligence on all of its projects under preparation (audits, EIA, risk assessment)
- Environmental Action Plans (EAPs) are developed to bring a company's operations into compliance with applicable regulatory requirements (national, EU, WB)
- Heavy industrial modernisation and other projects in environmentally significant sectors undertaken once the Bank is satisfied with clients' environmental management capacities



Environmental Due Diligence (EDD) - A Tool for Business Decisions-

- Decide if a proposed project should be financed and if so, the way in which environmental issues should be incorporated in the project.
- Identify risks, their magnitude and mitigation measures (e.g. past contamination, liabilities, legal compliance, potential impacts, reputation) and opportunities (e.g. energy efficiency, environmental performance).
- Identify public concerns, disclose information, consult with stakeholders and the public



Criteria to Determine Classification

- Use of Bank funds (project financing, corporate loan, working capital, convertible loan, equity investment, guarantee)
- New facilities or modification to existing ones with associated risks
- Will the use of Bank's funds result in environmental impacts
- Are these impacts significant and can they be readily identified and mitigated
- Is the project high risk from social or labour standards perspective (country, sector, client, resettlement, redundancies)
- Stage of the environmental approval by the host country and the due diligence of other financing institutions (when it comes to the Bank)
- Validity of the host country approval (a gap analysis)
- Environmental record of the Sponsor and the other involved parties



Environmental Standards

- National law (generally in line with international good practice in EBRD COO)
- EU environmental standards as applicable at a project level
- Good international practice including WBG guidelines
- Applicable international conventions
- IFC Safeguard Policies (indigenous peoples, involuntary resettlement, cultural property)
- FIs – minimum national standards



Environmental Action Plans (EAP, ESAP, EMP, EMAP)

- Key issues and actions, implementation schedule, associated costs, prioritisation of actions,
- Where safety risks or serious non-compliance agreement with regulatory authorities
- Phased approach but generally ahead of EU accession schedule
- Recently emphasis on environmental management systems



Public Disclosure

- Guided by EBRD Public Information Policy and Environmental Policy
- Meaningful consultation
- Diversity of implementation methods and tools



Project Communication and NGOs

External Communication

- Affected stakeholders
- Local NGOs
- National and international NGOs

Responsibilities

- Client communication
- EBRD communication



EBRD Communication

- Goal to respond within 10 working days of external communication
- Complaints/communication typically is sent to the client to make them aware of what is being said about their project and/or for detailed information on issue
- Direct response to questions regarding policy/requirements/status of project in Bank, PSD or other Bank requirements
- Complainant may be referred back to client for specific technical issues or information release beyond policy, and EBRD will track response



Monitoring during Project Implementation

Why?

- Ensures EBRD operations continue to accord with:
 - Environmental Policy
 - Environmental Requirements
- Provide advice/guidance to address deficiencies
- Encourage realisation of environmental upside



Monitoring during Project Implementation

Client/Operation Environmental Performance is mainly documented through:

- Periodic environmental reports (AERs)
- Independent audits (at specified intervals)
- Monitoring reports
- Site visits by ED staff or consultants
- Exceptions Reports (reported to management)
- Press/NGO information



Financial Institutions and Environmental Issues

POLAND



Outline

- Investment needs in Poland and sources of funding
- Impact of Environmental issues on financing
 - Direct
 - Indirect
- Case Studies



Investment needs in Poland

- Infrastructure:
 - Roads,
 - Railways
 - Airports
- Private sector;
 - Power
 - Service sector
 - Industry (new and old)
 - other



Sources of Funding in Poland

- European Union
 - ISPA now EU Structural and Cohesion Funds
 - European Investment Bank (EIB). Over € 4 bln of loans since 2001
- Commercial Banks,
 - Since 2001, 31 loans with a total € 6.5 bln.
- Venture Capital and Equity Investors
- IFI (IFC, World Bank, EBRD etc).
 - EBRD – approx 2.7 bln EUR in Poland
- Domestic Funds – NFOS etc
 - Future of NFOS?



Environment and investment decisions

- Investors and funding agencies whether private or public will look into environmental issues as part of project appraisals.
- Different drivers for:
 - Public Funding Bodies
 - EU standards, public participation
 - Private Investment,
 - Risk and liability



Risk issues for Financial Institutions

- Corporate Loans
- Working Capital
- Project Finance
- Equity Investment
- Guarantees
- Portfolio management



Banks and Environment – Equator Principles

- Leading Commercial Banks and IFC have signed up to the Equator Principles
- Environmental assessment on all project finance deals over 50 mln USD
- Many commercial lending institutions very sensitive to environmental issues
 - Liability; and
 - Reputation



Internationally driven changes

- New IFRS standards
 - applicable to all publicly quoted companies in EU
 - e.g. IAS 37 clear investigation of provisions and liabilities
- EU Modernization and Prospectus Directives
- Additional national requirements, such as UK OFR system
- Emission Trading (EU ETS) –
 - new reporting and accounting requirements could affect P&L account
 - opportunities for financial institutions



EU Funding

- **Indirect risk to financing projects for instance due to poor transposition of EU Acquis.**
- **E.g. Inappropriate transposition of EU EIA Directive in Poland:**

“Komisja Europejska nie przekaze Polsce 1,5 mld EUR z Funduszu Spójności, jeśli nie otrzyma raportów na temat oddziaływania na środowisko planowanych inwestycji.....Chociaz KE zaakceptowała już w ubiegłym roku 22 projekty inwestycji miejskich, na które miała przekazać ponad 0,5 mld EUR, na razie tylko Kalisz dostanie pieniądze...”. (Rzeczpospolita, Marzec 2005).



EBRD examples

- A loan to an electronic goods manufacturer in the Czech Republic. Security package included pledge on land. The client went bankrupt and EBRD became the owner of the land, which turned out to be contaminated. The contamination was not properly assessed at the due diligence stage. The National Property Fund requested that the land should be cleaned up. The cost of the clean up exceeded the value of the land and as a result the Bank made loss.



EBRD examples

- Equity investment in a white goods manufacturing in country X. Due diligence did not identify soil and groundwater contamination. When a strategic investor wanted to buy the company several years later, they brought their own consultants who detected the contamination and the investor asked for a significant reduction of the selling price. As a result the Bank made a loss selling below the level of the original investment.



Poland

- Fast changing market
- On-going privatization
 - Complex sectors remaining (chemical, coal)
- Major investment needs
- Substantial losses for financial institutions as a result of technical issues
- No major reported environmental liability claim to date.



Conclusion

- Financial Institutions will only invest in the best projects
 - Environmental standing often reflects overall performance
- Environmental Risk is one of the issues more and more institutions look at.
 - Stakeholder issues
- Transparency and public consultation are a major focus of many international institutions and EU
 - Poor consultation can result in major delay to projects.
- Polish financial sector needs to consider broader European issues.

