EBRD 's Experience in CEE – Environmental Risks and Opportunities

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Presentation Structure

- Introduction to EBRD
- EBRD Environmental Procedures & Policy
- Environmental Risks for the Banks
- EBRD Risk Management
- Invest needs in Croatia 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 pubic 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 waste-water 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

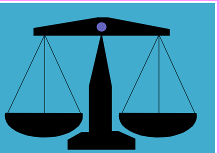
How environmental issues affect banks

- Environment in credit appraisal?
- Why do environmental issues matter for banks and other financial institutions?
- What are financial institutions doing about it?

Why do environmental issues matter for banks?

BANK

Financial 

Legal 

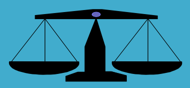
Reputation 

Environmental risks for banks

Financial

- Inability to make payments due to environmental costs
- Loss of value of collateral/assets as a result of contamination or non-compliance

Legal



- Direct liability of bank through control of client company or possession of assets

Reputation

- Damage to reputation through association with polluting customer

➢ Environmental risk should also be considered at a portfolio level

➢ A bank should avoid overexposure to particular industries sensitive to environmental pressures

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

CROATIA

Outline

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

Investment needs in Croatia

- Infrastructure:
  - Telecommunications
  - Energy
  - Transport (including Railways)
  - Municipal operations
- Private sector;
  - Tourism
  - SME Finance
  - other

Sources of Funding in Croatia

- European Union
  - Phare for institution-building and economic and social cohesion
  - ISPA now EU Structural and Cohesion Funds.
  - SAPARD
  - European Investment Bank (EIB). Over €491million of loans since 2001
- Commercial Banks
- Venture Capital and Equity Investors
- IFI (IFC, World Bank, EBRD, IMF etc).
  - EBRD – approx 1.3 bln EUR in Croatia.

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

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.

CROATIA

- Faces important structural challenges over next two years.
- Restructuring and privatisation of remaining state owned utilities and small enterprises in the tourism sector
- Reforms in the public administration and judiciary

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.
- Croatian financial sector needs to consider broader European issues.