

USING ENVIRONMENTAL AND SOCIAL CONSULTANTS

When should a financial intermediary seek the advice of an independent environmental or social expert?

- When considering lending to, or investing in, companies with activities with high levels of inherent environmental and social risk, so as to support the environmental and social risk assessment and management process.
- When considering support for projects involving medium levels of inherent environmental and social risk, if bank staff consider that there may be material environmental and social risk, but uncertainty remains as to the level of risk.
- Where preliminary investigations raise particular issues that might affect transaction risk (e.g. potential for contamination, ongoing compliance problems).

What services might be required from an independent environmental or social expert?

- Regulatory advice, where current or future environmental and social issues may have significant impacts on a customer (in both domestic and export markets).
- State Environmental Expertise – an opinion from a state institution legally required for many new or redeveloped industrial activities in former Soviet countries.
- Environmental investigations (environmental audits or valuations) at the discretion of the bank or customer, where the information so far collected is not adequate to give full assurance, for example:
 - An environmental review/audit e.g. where initial due diligence reveals potential contamination or a site with high environmental sensitivity.
 - An occupational health and safety review/audit, e.g. where initial due diligence reveals high accident/fatality rates.
 - A review of labour practices at the company, e.g. where the customer is subject to allegations of exploiting its workers or other bad labour practices. If recent reports from the labour inspectorate are available, the bank may ask the expert to review such reports and check how the customer is implementing any recommendations made by the inspectorate.
- Review of environmental investigations prepared by others, where these are to be relied upon by the bank
- Preparation of the Environmental and Social Due Diligence Report, where financial institution does not wish to carry out this work itself.

What types of environmental and social expertise are available, and what are the advantages and disadvantages of different options?

- Environmental and Social experts may belong to State institutions or private consultancies.
- Typically, as a market economy develops, more private consultancies arise and the role of State institutions reduces to a purely regulatory and academic function.
- State institutions have the advantage of good technical expertise and familiarity with regulatory requirements, and often their input is required by law, as when State Environmental Expertise is required for a new factory. However, there are disadvantages associated with using state institutions:
 - State experts may not have the same business perspective as private consultancies, which may be more likely to identify the legal, financial and reputational risks and opportunities associated with environmental and social issues, as opposed to providing a purely technical and regulatory opinion.
 - Assessments of social issues by State experts are often limited to health impacts and do not consider factors such as nuisance impacts on the local community and informal users of land.

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- State experts may be less experienced in writing reports that can be readily understood by non-technical readers such as bankers and fund managers.
- Private environmental and social experts can be individuals or companies and can be local businesses or branches of established Western consultancy firms.
 - Local firms are ordinarily cheaper than Western firms and have good knowledge of local regulatory requirements and enforcement practices, while Western firms are usually more expensive but often have greater resources and knowledge of international practices and requirements.

How should a financial intermediary engage an environmental or social expert?

- A bank or other financial institution will need to define the Terms of Reference or work that should be carried out by the expert. To assist with this, this manual sets out the typical contents of an Environmental and Social Audit report [include link here]. The audit report pro-forma will familiarise staff with the type of information that they might require from an audit carried out by an environmental and social expert, and also assist staff in setting or assessing the scope of an audit.
- In many cases, a full environmental and social review may not be necessary, and a restricted scope can be requested at reduced cost. This might be the case, for example, when a bank is concerned about one aspect only of a company's environmental and social performance, such as the ongoing costs, methods and legal compliance of waste water treatment methods. In this situation, an environmental and social expert could be commissioned exclusively to investigate and report on this area of the company's operations. In the majority of cases, a financial institution will expect the client/borrower to pay for any required external environmental and social work. The benefit of this approach is that while the client is required to commission the work directly, the financial institution can still rely on the report. However, this may not be appropriate; for example, where a major active equity investment is being considered, it may be the potential investor who pays for environmental and social expert work

How much will engaging an environmental or social expert cost?

- Engaging environmental and social experts does not have to be prohibitively expensive. A brief initial review of major issues and compliance for a medium-sized, medium environmental and social risk company can be completed in 1–2 days by a local expert at low cost. More comprehensive reviews or reviews that require measurement or sampling are more expensive. However, an initial review can often provide a financial institution with adequate assurance that environmental and social issues have been addressed, primarily by establishing compliance status and the risk of site contamination.