

# **EBRD's Environmental & Social (E&S) Risk Management Procedures for Leasing Activities**

Any EBRD partner Financial Intermediary (FI) must have clearly defined environmental and social management systems in place, commensurate with the nature of the FI and the level of environmental and social risks associated with its business activities and consistent with EBRD's Performance Requirement 9.

## **Introduction**

The following Procedures apply to the portfolio of leases that are funded with the proceeds of the EBRD loan.

The objectives of the EBRD E&S risk management procedures for leasing are to:

- Support FIs to meet EBRD requirements to manage environmental and social risks in business activities; and
- Provide FIs with step-by-step guidance on identifying, assessing and managing E&S risks with respect to leases.

Any new E&S risk management procedures should be integrated into the FI's standard procedures for assessing leasing applications.

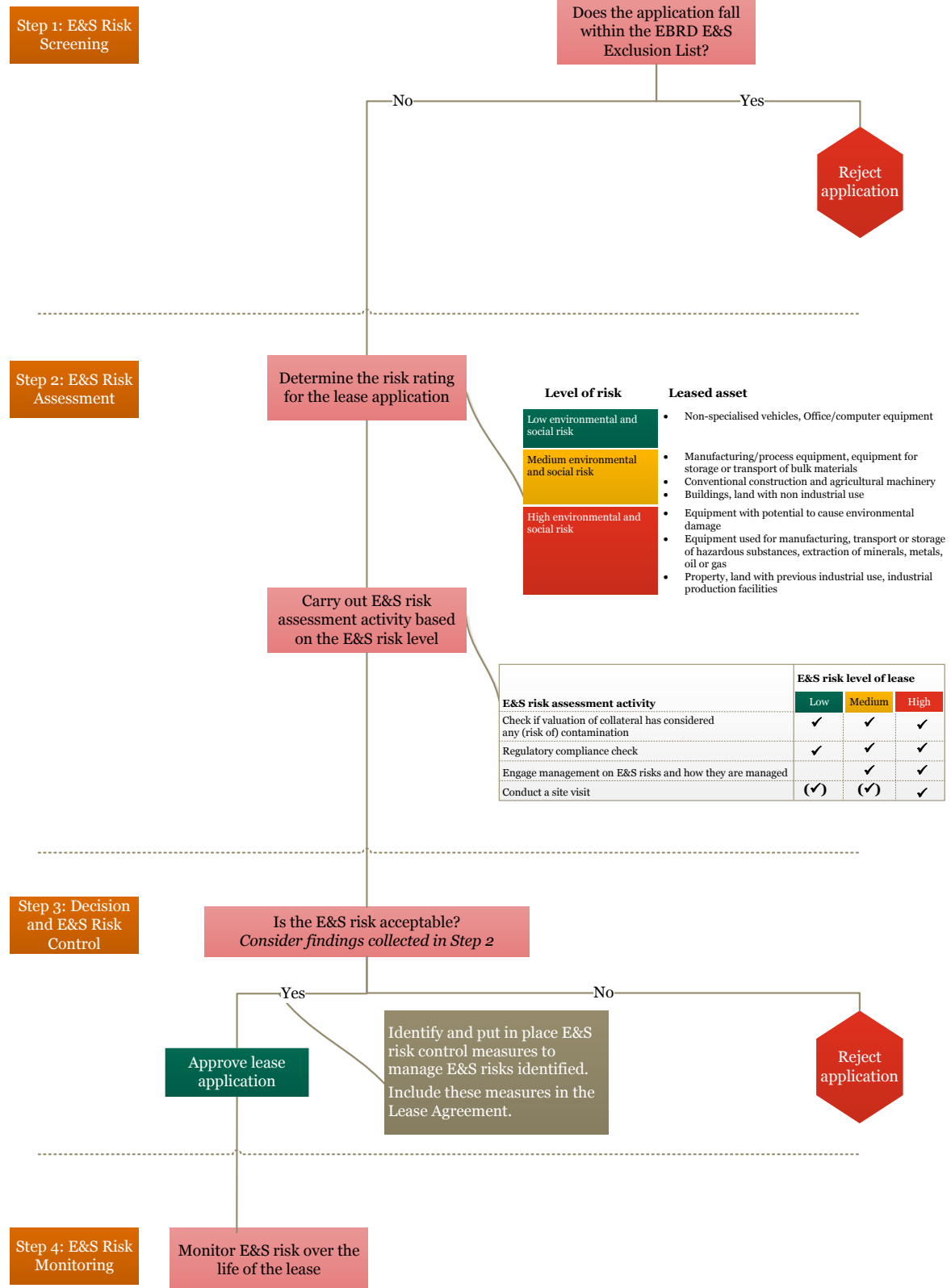
There are two types of leases- finance and operating leases: the level of E&S risk will likely range between these two, as discussed in Step 3 below. Typical leased assets include:

- Specialised or non-specialised vehicles;
- Manufacturing or process equipment;
- Construction and agricultural machinery;
- Extraction equipment such as large earth moving machinery, large scale quarrying/mining equipment; and
- Land or property for either industrial or commercial use.

## Summary

The diagram below summarises the E&S risk management procedures for leasing activities. Detailed guidance is provided for each step outlined below.

### Flow Chart Leasing Activities



## Step 1: E&S Risk Screening

### *Screen against EBRD's E&S Exclusion List*

- Screen the beneficiary's business activity against EBRD's E&S Exclusion List (attached as Annex I to this document).
- If the beneficiary is involved in any activity listed here, reject the application.

## Further Guidance

### *What is EBRD's E&S Exclusion List?*

- EBRD's E&S Exclusion List contains activities that are excluded under all circumstances because they are illegal or severely restricted under national or international law.

## Step 2: E&S Risk Assessment

### 2.1: Determine the E&S Risk Rating

- The main source of E&S risk for a lease is the leased asset itself.
- EBRD has provided guidance on the typical level of E&S risk associated with commonly leased assets. Using the table, identify the E&S risk rating for the leased asset.
- If the FI is considering a lease application for an asset that is not listed here, seek guidance from EBRD's Environmental and Sustainability Department.

Level of risk	Leased asset
Low environmental and social risk	<ul style="list-style-type: none"><li>▪ Non-specialised vehicles.</li><li>▪ Office/computer equipment.</li></ul>
Medium environmental and social risk	<ul style="list-style-type: none"><li>▪ Manufacturing/process equipment, equipment for storage or transport of non-hazardous bulk materials.</li><li>▪ Conventional construction and agricultural machinery.</li><li>▪ Buildings, land with non industrial use.</li></ul>
High environmental and social risk	<ul style="list-style-type: none"><li>▪ Equipment with potential to cause environmental damage.</li><li>▪ Equipment used for manufacturing, transport or storage of hazardous substances.</li><li>▪ Equipment for extraction of minerals, metals, oil or gas.</li><li>▪ Property, land with previous industrial use.</li><li>▪ Industrial production facilities.</li></ul>

## 2.2: Assess E&S Risks Associated with the Potential Leases

The table below summarises the E&S risk assessment activities to carry out for leases of low, medium and high E&S risk levels.

E&S risk assessment activity	E&S risk level of lease		
	Low	Medium	High
Check if the leased equipment has a contamination risk	√	√	√
Check regulatory compliance of the beneficiary	√	√	√
Engage management on E&S risks and how they are managed		√	√
Conduct a site visit	(√)*	(√)*	√

\* Site visits only need to be conducted at low and medium risk levels only if the FI cannot be confident that contamination risks have been fully considered across all properties considered for collateral.

### 2.2.1 Valuation of land (leased asset or security)

- If buildings or land will be taken as collateral, confirm that the property valuation has assessed any contamination or risk of contamination from current, past or neighbouring activities.
- If the FI cannot be confident that contamination risks have been fully considered across all properties considered for collateral, conduct a site visit. The site visit should be used to check for signs of contamination and risks for future contamination from the site's current or neighbouring activities. Investigate whether the site has been contaminated in the past through discussions with management.
- Make sure any E&S risks identified in the site visit are considered in the property valuation.
- In general, FIs should be wary of taking contaminated sites as security because clean-up costs could exceed the asset value.

### 2.2.2 Check E&S regulatory compliance (corporate customers only)

Carry out an E&S regulatory compliance check to confirm that the lessee is meeting relevant E&S laws, regulations and standards, including environmental and health and safety regulations, planning permissions, operating licences and permits.

### 2.2.3 Engaging management on E&S risks (corporate customers only)

- Where indicated in the activity table, engage in discussions with the lessee company management team to assess:
  - Commitment to managing E&S issues relevant to the lessee's business.
  - Presence of effective systems to manage E&S issues, including accountability.

- Past record of regulatory breaches, fines, lawsuits, negative media or stakeholder protests/complaints that demonstrate how well the lessee company has been managing E&S issues.
- What purposes the leased asset will be used for.
- What training is provided for safe and appropriate use of the asset.
- What health and safety measures are provided for workers operating the asset as well as other employees and members of the public that may be affected by the use of the asset.
- What programs are in place for maintenance and repair of assets.
- A potential loss of value of the asset due to E&S factors - FIs should consider what maintenance programmes the lessee company has in place to keep its leased assets well maintained and safe for use. The FI may consider including maintenance, insurance and other upkeep obligations in the terms of the Lease.

#### *2.2.4 Conduct a site visit*

Where indicated in the activity table:

- Conduct a site visit to the lessee company's operations to further evaluate E&S risks identified during management discussions and investigate how the lessee company's E&S management systems are applied in practice.
- If appropriate, speak to site managers and employees on how E&S risks are managed.
- FIs can conduct site visits themselves or commission an E&S expert to do so on their behalf.
- If the FI has access to previously commissioned E&S due diligence reports on the lessee company's operations, the FI may choose to rely on these instead of carrying out a new site visit (see below for guidance on when the FI may be able rely on such reports).

#### *2.2.5 How can the FI assess whether an existing E&S due diligence report can be relied upon?*

Consider the following:

- Is the report recent enough to be relevant to the lessee company's business?
- Does it cover all material issues identified through the assessment thus far?
- Is the organisation which carried out the due diligence reputable, competent and impartial? Does it have sufficient professional indemnity insurance cover?
- Who is the report is addressed to? Can the FI seek legal recourse?

#### *2.2.6 What key tools are available to help the FI understand and assess E&S risks?*

- EBRD's Sub-Sectoral E&S Guidelines for Leasing can help the FI understand the E&S issues relevant to businesses in different sectors and good practice measures for managing them.
- EBRD has guidance to help FIs prepare for site visits.
- Refer to EBRD's web-site for further guidance  
[http://www.ebrd.com/pages/about/principles/sustainability/intermediaries/implementation\\_tools.shtml](http://www.ebrd.com/pages/about/principles/sustainability/intermediaries/implementation_tools.shtml)

### *2.2.7 Do any other risks need to be taken into account?*

- There could be additional risks through ownership of a highly visible asset such as heavy machines that are used for land clearance or logging. Leased assets that act as emotive symbols can lead to reputational risk if linked to the FI's ownership.

## **Step 3: Decision and E&S Risk Control**

- Consider the findings of the E&S risk assessment in deciding whether to approve or reject the lease.
  - If E&S risks are acceptable and/or the lessee agrees to manage any E&S risks, consider approving the leasing application.
  - Consider declining the application if E&S risks are significant and/or the lessee is unable or unwilling to mitigate the risks.
- If the lease application is approved, decide what, if any, controls are needed to manage and minimize E&S risk to the lessee company and to the FI.

### *3.1 What kinds of E&S risk control measures can be employed?*

- Identify actions for the lessee company to manage E&S issues, agree them with the lessee and incorporate them into the Lease.
- Consider placing restrictions on the allowed use of an asset.
- Consider taking additional security or decreasing the term of the lease.

### *3.2 Different approaches to finance and operating leases*

- The type of lease the FI is considering can influence the level of E&S risk exposure for the FI – this is particularly important for medium and high E&S risk lease transactions.
- In a finance lease, E&S risks from use and maintenance of the asset are likely to rest with the lessee, unless the FI accepts specific risks in the lease agreement.
- In an operating lease, ownership of the asset rests with the FI, so it has greater exposure to E&S risks associated with the asset.
- The specific rights and obligations of the FI and lessee may vary depending on the regulatory framework in the country concerned. Where in doubt, the FI should take legal advice.

### *3.3 Duty of care of FIs*

- As lessors, FIs are likely to have E&S related obligations towards the lessee. It is important to consider what duty of care the FI may owe.
- E&S related duties of care may include obligations to ensure that:

- The leased asset is supplied in a safe condition;
- The lessees are provided with all relevant information to enable safe operation of the asset;
- Reasonable steps are taken to confirm that the lessee is competent to operate the leased asset appropriately; and
- The leased asset is suitable for its intended purpose and without unexpected hazards when operated correctly.
- If an FI does not meet its obligations, it could be held liable for any damage to human health, property or the environment that resulted from this breach.

### 3.4 *Obligations of the lessee*

- Consider what standard obligations related to E&S matters need to be included in the Lease.
- At a minimum, the Lease should require that all leased equipment be operated in compliance with applicable national environmental and health and safety laws and regulations.
- FIs may also wish to specify that the asset should be used for its intended purpose and operated safely.

### **Step 4: E&S Risk Monitoring**

- Monitor the Lease and the leased equipment for E&S risks as they may change during the life of the Lease.
- Monitoring of E&S risks can take place alongside regular Lease reviews.
- There are two areas to consider when monitoring E&S risks:
  - Events or changes that could present new or increased E&S risks.
  - The lessee's progress in meeting agreed E&S risk control measures.
- FIs are required to notify EBRD as soon as they are aware of any such material environmental or social incidents related to a leased asset.

#### *What events or changes should FIs look out for when monitoring investments for E&S risk?*

Events or changes that could raise E&S risks include:

- Change in use of the leased assets
- Change in the beneficiary's business activities (e.g. changes to products sold, raw materials, wastes emitted).
- Regulatory investigations, fines or penalties imposed on the lessee.
- Public complaints or adverse media reports.
- Accidents or incidents [involving the leased asset which] causing significant damage to the environment or human health and safety.
- Amendments to relevant E&S laws and regulations, or to the level of enforcement.

## **Further Guidance**

*What is considered a “material incident” where FIs are required to inform EBRD?*

A material incident involving the leased asset is one that involves any one or more of the following:

- Fatality or multiple injuries requiring hospitalization;
- Significant pollution;
- The applicable law requires notification of the incident to a government authority; or
- The incident has become public knowledge through media coverage or otherwise.

*What should FIs do if a lessee is not meeting agreed E&S risk control measures?*

- Engage in discussions to address areas of non-compliance.
- Potentially make changes to the Lease to manage new or heightened E&S risks.
- Consider terminating the Lease if necessary.

## **Reporting to EBRD**

Under the requirements of PR 9, an FI is required to report annually to EBRD on the implementation of its Environmental and Social Management System (ESMS) and the E&S performance of its portfolio.

The level of reporting required on a FI’s portfolio depends on the nature of the contractual relationship with EBRD.

- If EBRD has an equity stake in the FI, the FI is required to report on the E&S risk management of its full portfolio of business activities.
- If EBRD does not have an equity stake in the FI, but provides, for example, a credit line, the FI is required to report on the E&S risk management of transactions carried out using EBRD financing.

EBRD recommends that FIs document E&S risk management activities on an ongoing basis in order to have easily accessible information for reporting.

## **Reporting format**

The EBRD FI Sustainability Index is an online tool designed to help FIs understand and report on how they are responding to the E&S risks in their own operations and business activities, as required by EBRD’s PR 9. The Index should be completed by the FI’s Authorised Representative and submitted to EBRD. FI’s should e-mail: [ebrdindex@ebrd.com](mailto:ebrdindex@ebrd.com) for access to the Index.



## Annex I: EBRD Environmental and Social Exclusion List

EBRD will not knowingly finance, directly or indirectly, projects involving the following:

- (a) the production of or trade in any product or activity deemed illegal under host country (i.e. national) laws or regulations, or international conventions and agreements, or subject to international phase out or bans, such as:
  - (i) Production of or trade in products containing PCBs.<sup>1</sup>
  - (ii) Production of or trade in pharmaceuticals, pesticides/herbicides and other hazardous substances subject to international phase-outs or bans.<sup>2</sup>
  - (iii) Production of or trade in ozone depleting substances subject to international phase out.<sup>3</sup>
  - (iv) Trade in wildlife or production of or trade in wildlife products regulated under CITES.<sup>4</sup>
  - (v) Transboundary movements of waste prohibited under international law.<sup>5</sup>
- (b) Production or use of or trade in unbonded asbestos fibres or asbestos-containing products.
- (c) Activities prohibited by host country legislation or international conventions relating to the protection of biodiversity resources or cultural heritage.<sup>6</sup>
- (d) Drift net fishing in the marine environment using nets in excess of 2.5 km. in length.
- (e) Shipment of oil or other hazardous substances in tankers which do not comply with IMO requirements.<sup>7</sup>
- (f) Trade in goods without required export or import licenses or other evidence of authorization of transit from the relevant countries of export, import and, if applicable, transit.

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<sup>1</sup> PCBs: Polychlorinated biphenyls are a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switchgear dating from 1950-1985.

<sup>2</sup> Reference documents are Council Regulation (EEC) No 2455/92 of 23 July 1992 Concerning the Export and Import of Certain Dangerous Chemicals, as amended from time to time; United Nations Consolidated List of Products whose Consumption and/or Sale have been Banned, Withdrawn, Severely Restricted or not Approved by Governments; Convention on the Prior Informed Consent Procedures for Certain Hazardous Chemicals and Pesticides in International Trade (Rotterdam Convention); Stockholm Convention on Persistent Organic Pollutants; World Health Organisation Recommended Classification of Pesticides by Hazard.

<sup>3</sup> Ozone Depleting Substances (ODS): Chemical compounds which react with and deplete stratospheric ozone, resulting in the widely publicised 'ozone holes'. The Montreal Protocol on Substances that Deplete the Ozone Layer lists ODSs and their target reduction and phase out dates. A list of the chemical compounds regulated by the Montreal Protocol, which includes aerosols, refrigerants, foam blowing agents, solvents, and fire protection agents, together with details of signatory countries and phase out target dates, is available from the United Nations Environment Programme.

<sup>4</sup> CITES: The Convention on International Trade in Endangered Species of Wild Fauna and Flora. A list of CITES listed species is available from the CITES secretariat.

<sup>5</sup> Reference documents are: Regulation (EC) No 1013/2006 of 14 June 2006 on shipments of waste; Decision C(2001)107/Final of the OECD Council concerning the revision of Decision C(92)39/Final on the control of transboundary movements of wastes destined for recovery operations; Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal.

<sup>6</sup> Relevant international conventions include: Convention on the Conservation of Migratory Species of Wild Animals (Bonn Convention); Convention on Wetlands of International Importance, especially as Waterfowl Habitat (Ramsar Convention); Convention on the Conservation of European Wildlife and Natural Habitats (Bern Convention); Convention Concerning the Protection of the World Cultural and Natural Heritage; Convention on Biological Diversity.

<sup>7</sup> This includes: tankers which do not have all required International Convention for the Prevention of Pollution from Ships (MARPOL), International Convention for the Safety of Life at Sea (SOLAS) certificates (including, without limitation International Safety Management Code compliance), tankers blacklisted by the European Union or banned by the Paris Memorandum of Understanding on Port State Control (Paris MOU) and tankers due for phase out under MARPOL regulation 13G. No single hull tanker over 25 years old should be used.

