

EBRD's Environmental & Social (E&S) Risk Management Procedures for Passive Equity Investments

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 objectives of the E&S risk management procedures for equity investments are to:

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

These procedures should be integrated into FI's standard process for assessing equity investments.

Scope of Application

Different procedures apply depending on whether the investment is active or passive. For active investments refer to EBRD's E&S Risk Management Procedures for Active Equity Investments.

What is a passive investment?

- The investor takes a small stake in the company's share capital, typically less than 5%.
- The investor is unlikely to have influence over the company's strategy or management.
- Examples of passive investments include mutual funds, pension funds and funds invested in listed securities.

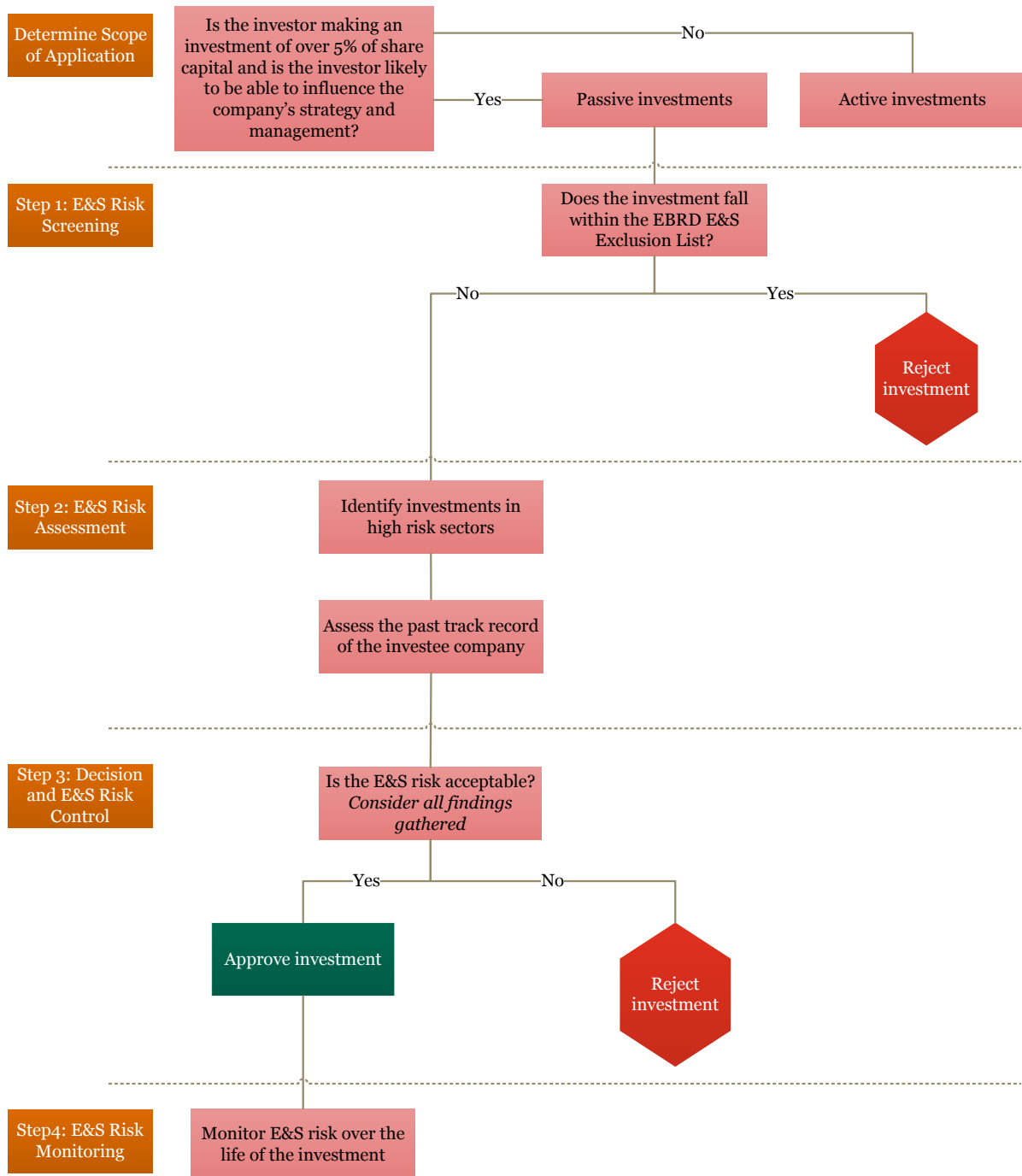
The procedures for passive equity investments are explained in detail below.

Passive Equity Investments

- There are more constraints to assessing and managing E&S risks in the case of a passive investment compared to an active investment.
- A different approach needs to be taken for passive investments, since:
 - The investor has less influence on the investee company.
 - There is often no direct dialogue with the investee company.
 - The investment divestment cycle can be quite rapid.
 - The cost of due diligence needs to reflect the size of the investment.
- The following E&S risk management approach should be applied where the investment is in one business or a limited number of companies.

Summary

The diagram below summarises the E&S risk management procedures for **passive** equity investments. Detailed guidance is provided for each step outlined below.



Step 1: E&S Risk Screening

Screen against EBRD's E&S Exclusion List

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

Step 2: E&S Risk Assessment

Identify investments in high E&S risk sectors

- Check if the potential investment is in a sector considered to have high levels of E&S risk. Refer to the E&S Risk Categorisation List to identify the E&S risk levels associated with various sectors.
- FIs are advised to limit their overall exposure to sectors with high E&S risks in those countries where the regulatory environment is not stable, and/or E&S legislation is immature or poorly enforced.

Assess past track record

- Conduct a search of publicly available information online to identify any past history of E&S incidents, liabilities, fines, regulatory breaches, lawsuits, stakeholder protests/complaints or negative media.

Step 3: Decision and E&S Risk Control

- Consider the findings of the E&S risk assessment when deciding whether or not to invest.

Step 4: E&S Risk Monitoring

- Monitor publicly available information on the investee company for indications of material E&S risks, as described in step 2.
- Where E&S risks or performance issues are identified, investors can take action to lobby companies for change if possible, at investor meetings, bilateral engagements or annual meetings.
- Where significant E&S risks are identified, investors may also choose to divest.

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: ebrdsusindex@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.¹
 - (ii) Production of or trade in pharmaceuticals, pesticides/herbicides and other hazardous substances subject to international phase-outs or bans.²
 - (iii) Production of or trade in ozone depleting substances subject to international phase out.³
 - (iv) Trade in wildlife or production of or trade in wildlife products regulated under CITES.⁴
 - (v) Transboundary movements of waste prohibited under international law.⁵
- (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.⁶
- (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.⁷
- (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.

¹ 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.

² 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.

³ 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.

⁴ 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.

⁵ 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.

⁶ 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.

⁷ 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.