

EvD Assessment of EBRD's Activities in the West Bank and Gaza (2017-2022)

Management Comments

Executive Summary

- Management welcomes EvD's positive evaluation of the EBRD's activities in the West Bank and Gaza ('WB&G') over the strategy period (2017-2022). Management would like to thank EvD for accommodating its request to prepare this report on an accelerated time frame, in conjunction with the extension of the Bank's operations in the WB&G (2022-2027).
- Management endorses and agrees with the three key EvD recommendations. Management notes that strengthening of our local presence in the WB&G suggested under the first recommendation would require approval of the Board of Directors due to statutory limitations in the 'Agreement Establishing the EBRD'.
- The EvD report highlights only one key message related to the Bank's operational engagement. It states that in spite of being relatively new in the WB&G 'the EBRD has been effective at strengthening the capacity of financial intermediaries under Theme 2' adding 'the numerous ASB activities on the ground have also been highly appreciated by SME clients'. Management believes that this does not fully reflect the Bank's operational track record and would like to highlight the following:
 - In spite of being new to the WB&G, the Bank was able to develop a number of highly relevant policy and TC support programs, such as a new factoring law, Basel III reporting support, a grid enforcement study and judicial training for Palestinian judges. These programs provided support to key Palestinian institutions, such as the Palestine Monetary Authority, the Palestinian Capital Markets Authority and the Palestinian Energy and Natural Resource Authority. Moreover, the Bank concluded a first *dedicated* Women in Business ('WiB') credit line extended by an IFI to a Palestinian commercial bank, supported by the *first of its kind* WiB EBRD Advisory Programme benefitting Palestinian women entrepreneurs with advisory, mentorship and coaching opportunities.
 - The Bank, through OCCO, has taken a leading role in the WB&G in improving the AML/CFT/Sanctions Compliance governance by Palestinian banks through organising, in close cooperation with the regulator, the Palestine Monetary Authority, three sector-wide seminars which attracted over 100 Palestinian compliance professionals across 13 banks and 6 micro-finance institutions.
 - Despite the small investment volumes under Theme 1, the Bank managed to implement two relevant projects in support of private sector competitiveness and innovation: i) An investment in a Jordanian quality medical laboratory company's expansion into the West Bank supporting regional integration and, ii) the *first of its kind in WB&G* youth employment impact bond. These two transactions, whilst small, are meaningful and will have substantial impact. For example, the impact bond so far has succeeded in providing trainings to 700 Palestinian youth to develop their on-the-job skills.
- The EvD report states in its key messages that whilst the Bank's mandate covers both the West Bank and Gaza, to date all EBRD investments were made in the West Bank. It calls on Management to 'assess the demand in the area and opportunities for private sector support and clarify EBRD's position and intention with respect to its involvement in Gaza'. In this context, Management would like to highlight that it takes a robust approach to assessing compliance risks in all its projects in the WB&G, as set out in the EBRD Engagement in the West Bank and Gaza document of May 2017. All operations in the WB&G are subject to Enhanced Integrity Due Diligence in order to assess money laundering, terrorist financing, sanctions exposure and broader integrity and reputational risks. The EBRD's screening and analysis of projects in WB&G covers thus beneficial owners, clients, subsidiaries, affiliated entities, board members, management, other beneficiaries and consultants. In line with this, when it started its operations in the WB&G, Management took a cautious approach to familiarize itself with the territory though, factually, almost all finance projects identified were in the West Bank. To date, the Bank could not identify potential bankable private sector finance projects in Gaza, not helped by the fact that due to the serious COVID crisis in Gaza and the hostilities between Israel and Hamas in 2021, access to Gaza has not been realistic for a long period.

It is clear that the nature of the challenges confronting potential finance operations in Gaza in particular requires a heightened and careful approach in assessing integrity risks. Such integrity risks, particularly those associated with money laundering, terrorist financing and sanctions exposure are higher in Gaza when compared with the West Bank, in light of Hamas's control of Gaza and its designation as a terrorist organisation by the EU, U.S., Canada, the U.K., Israel and others. EBRD Management and OCCO are fully aware that the governance, security, legal, institutional and law enforcement challenges confronting Gaza are distinct from those of other regions in which the Bank operates and will consider potential finance projects in Gaza carefully. Moreover, the Bank will face challenges to identify bankable private sector projects of a sizeable nature in Gaza coupled with the fact that also local banks have only limited risk appetite to expand their SME portfolio in the territory.

Management, however, remains committed to work towards identifying potential projects in Gaza, including supporting our partner financial institutions. In this context, Management highlights the Bank's successful outreach of the Advice for Small Businesses Program (ASB) in Gaza, jointly with the Gaza Chamber of Commerce in the autumn of 2020, that resulted in three advisory mandates with Gaza based SMEs currently being implemented. Management also notes the constructive approach by the Israeli Authorities to develop an operational protocol for Bank staff to visit Gaza in due course.

- The EvD report observes that the EBRD's operational engagement in the WB&G has been effective to 'varying degrees' noting that the Bank, whilst successful under Theme 2 ('Access to Finance') has not yet been able to provide a similar level of support under Theme 1 ('Competitiveness and Innovation') and Theme 3 ('Sustainable Energy'). Whilst correct, Management would like to add to this observation the following:
 - Theme 1: The Bank's track record is not dissimilar to that of peer institutions that mainly invested in the financial sector. The corporate sector is particularly challenging for international financiers due the relative few bankable propositions combined with a liquid, risk prone, Palestinian banking sector. In this context, Management endorses EvD's recommendation to seek grant or guarantee support (e.g. EFSD+) to mitigate risks allowing a more competitive pricing proposition, including through blended finance. Management will also discuss internally longer tenors relative to the 6 years offered by local banks that could make EBRD additional. Management notes that Palestinian corporates, assuming a competitive EBRD finance offering, remain very interested to work with the EBRD as they see the value the EBRD can bring relative to commercial banks, in terms of reputation, governance, international market access and TC support.
 - Theme 3: The Bank's efforts to finance private sector renewable initiatives has been hampered by, inter alia, the absence of a bankable legal and regulatory environment. The situation in the WB&G is similar to that that existed in neighbouring countries, such as Jordan and Egypt, where it took years of intensive policy engagement, including by the EBRD, to develop bankable finance structures. In the case of the WB&G, additional challenges will need to be addressed before larger scale renewable programs can be rolled out, like the payment risks related to the 'take or pay' obligations under a single buyer model. The Bank is working closely with the IFC which has been advising the Palestinian Energy and Natural Resource Authority ("PENRA") for over 2 years on the development of a bankable structure, including a power purchase agreement with the overall objective to launch 10-12 MW 'Feed in Tariff' auctions under a single buyer model. The World Bank, in parallel, is working on developing a structure to mitigate the risk of the single buyer of electricity, the Palestinian Energy Transmission Company ("PETL"). Management hopes that in the upcoming strategy period, many of these issues will be addressed paving the way for the financing of renewable projects. Finally, whilst the Bank to date has not been able to finance renewable projects as outlined, it nevertheless did contribute to sector reforms. The Bank is supporting PETL to develop the required technical and regulatory basis allowing the expansion of renewable programs (i.e. a grid enforcement study and a, currently well advanced, TC to develop a legal and regulatory framework to incorporate future battery storage projects into the grid).
- Management notes that the EvD report observes that the EIB has taken 'full advantage of the visibility of the EU-Palestine Investment Platform' as 'it signed seven agreements amounting to USD425 million at the second meeting of the Platform'. The Platform launched only recently and, whilst welcomed by the EBRD, it has mainly served as a high-level communication platform between the Prime Ministry and members of Team Europe. The Bank has participated in all of the three meetings since its launch and in two related working groups (e.g. SME financing and Energy). The Platform has also allowed the highlighting of investments into the WB&G made by Team Europe, as

the EIB example illustrates. The EBRD has not been able to sign a project during one of the Platform meetings due to timing issues though the Bank will continue to look for opportunities to do so. Management has discussed with the EU Delegation in Jerusalem ways to make the Platform more effective, with shorter interventions and more time for discussions.

- Management fully endorses the EvD recommendation that the EBRD should foster a close relationship with other international partners, in particular with the EU Delegation in Jerusalem. With regard to the latter, EBRD teams have worked over a year on an ambitious fiche to seek EU donor support for EBRD's FI business in the WB&G. The Bank hopes that in the near future the EU will approve a EUR 12.5 million grant under an EBRD 'SustainableGrowth4All' proposal. Under the grant, the EBRD will be able to step up support to Palestinian financial institutions (including a 'first loss guarantee' for Women in Business Credit lines and GEFF incentive payments) and continue the Bank's successful ASB in the WB&G. The WB&G team also already has initiated discussions to identify finance opportunities with corporate clients that can benefit from EU's EFDS+ guarantees.
- In line with EvD's recommendations, Management stands ready to work together with international partners on investments and policy matters. In spite of not having a local presence, the Bank has been able to develop excellent working relations at senior and operating level with international partners, with regular interactions and consultations (including with the EU Delegation, World Bank, IFC, FMO, Proparco, EIB and others). Close coordination in the WB&G crowded donor environment is key to guarantee the effective use of public money. The Bank has yet to identify potential joint investment programs with other international partners due to the relative small size of finance projects in the WB&G where a joint approach would not be a (cost) effective solution. Management welcomes the EvD suggestion, on a case-by-case basis, to convey jointly with partners key policy or reform messages to the Palestinian Authorities, for instance the urgent need to develop a bankable power purchase agreement.

Management further comments on the EvD's study recommendations are provided below.

Recommendation 1:

Recommendation 1: Strengthen EBRD's profile on the ground by leveraging the presence of the EU Delegation in the WB&G to better inform the Bank's strategy and outreach towards developing the private sector. This, together with a strengthened presence on the ground, in line with other DFIs and major donors, would enhance the Bank's interaction with the private sector, participation in policy dialogue and key regulatory discussions, cooperation with other DFIs and fund-raising prospects.

Management agrees with this recommendation adding some further clarifications. The 2017 Board Engagement Paper for the WB&G stipulated that the Bank's operational activities in the WB&G are directed out of EBRD's Amman Resident Office, given its geographical proximity to, in particular, the West Bank. This arrangement has overall worked satisfactorily, with teams travelling to the West Bank for the day returning to Amman in the evening, allowing 5-6 hours for meetings. On this basis, the Bank was able to organize, pre-COVID, on average 10 visits per month. The pandemic has been a serious challenge to this arrangement due to serious outbreak of the pandemic in the West Bank in 2020 (with recurring peaks in 2021) coupled with travel restrictions imposed on entrants to the West Bank by the Israeli Authorities coupled with EBRD's restrictive travel policies. Since March 2020 and November 2021 Bank staff was unable to travel to the West Bank and, consequently, all meetings and outreach efforts with Palestinian counterparts are conducted virtual. This has been a challenge as, similar to the prevailing business culture in neighbouring countries, Palestinian counterparts prefer to meet in person, allowing for relationship building and trust to develop which is considered key to doing business. In this context, the pandemic has highlighted the disadvantage of not having a local presence in the West Bank out of which the Bank can operate.

In our interactions, the Palestinian Authorities as well as international donors raise, from time to time, the need for a local EBRD presence in the West Bank. As EVD notes, whilst the EBRD has become an integral part of the international donor community in WB&G, the absence of a local representation has contributed to a perception by some about EBRD's lack of commitment to the region.

For these reasons, Management would therefore welcome the establishment of an office or, alternatively, the use of temporary office space in the WB&G. However, due to statutory limitations requiring shareholder alignment, this is not considered. In this context, Article 33 of the Agreement Establishing the Bank states that ‘The Bank may establish agencies or branch offices in the territory of any member of the Bank’ which precludes the opening of an office in a non-Member country, like the WB&G.

However, and crucially, Management believes that, on the assumption that regular border crossings between Jordan and the West Bank will resume, the Bank’s operations in the WB&G can continue to be effectively managed out of the Amman RO in the coming strategy period. In the absence of an office, however, Management endorses EvD’s recommendation to work with the EU, in particular, and other international partners to better inform the Bank’s strategy and outreach towards developing the private sector.

Recommendation 2: *Diversify EBRD’s investments toolkit in the WB&G with the view of expanding its activities across all three strategic themes, including through i) the enhancement of the use of blended finance and first-loss guarantees with donor support; ii) the assessment of the performance of the Trade Facilitation Programme; and iii) an update of the diagnostic of the energy sector as a mean to clearly identify constraints and ways for EBRD to address them.*

Management agrees with this recommendation. As mentioned earlier, the perceived risk of investing in the WB&G is relatively high and EBRD’s standard RAROC approach generates a premium to compensate for this risk. Consequently, the Bank’s pricing is often not competitive in particular when targeting Palestinian corporate clients who have access to local banks finance. Therefore, Management aims to seek (first loss) guarantee and/or blended finance structures benefitting from low cost funding with its donors, which can be mobilised for possible FI frameworks (an example is the SustainableGrowth4All proposal which was submitted to the EU in 2021) or for targeted, high transition impact, projects (either corporate loans or project finance). Given the structure of the WB&G Trust Funds, the Bank will also look at options to raise additional donor funding for the Multi-Donor Trust Fund for guarantees, or blending alongside the Net Income Allocation Trust Fund, which constitutes the primary source of funding for projects in WB&G.

Management partly disagrees that the TFP programme had a mixed performance in WB&G. While acknowledging that our clients Cairo Amman Bank (‘CAB’) and The National Bank (‘TNB’) did not utilise their TFP limits to date (total of USD 3.0m), both banks benefited from a variety of face-to-face and online training courses on trade finance and compliance topics delivered by the TFP program. The trainings are structured in a way that the participants, including from CAB and TNB, can apply the knowledge gained at the training in their day-to-day work.

Moreover, TFP has worked well with the other two partner banks, Quds Bank and Bank of Palestine (with total TFP limits of USD 12.0m) as it supports their ability to conduct international trade finance in a challenging environment with a lack of clean limits and the need to place cash collateral to process any trade finance transactions. Also on the policy side, TFP has been of support. For instance, since the Bank of Palestine joined the TFP programme in August 2021, the bank, with support of the TFP, has been actively trying to re-establish relationships with international correspondent banks. Moreover, the Bank of Palestine also already utilized the limits for around seven transactions. Quds Bank has been actively utilizing its TFP limit since September 2019 and sought a limit increase in 2021 to meet its increasing demand for TFP transactions (total limit currently stands at USD 7.0m).

Management believes that the Bank should continue the TFP programme in WB&G, whilst working towards a greater use of the TFP lines with currently inactive TFP banks. Supporting trade is crucial for the local economy, especially in light of the geopolitical situation in the region. TFP is a product that often allows EBRD to continue supporting partner banks in times of need and/or through crises when there may be limited availability of other products. Therefore, it is particularly suitable for an environment facing geopolitical uncertainty/instability. TFP limits coupled with trade finance trainings will strengthen the ability of the banks in the area of trade finance and thereby increasing their potential in attracting limits from foreign correspondent banks.

In the context of the new WB&G strategy period, Management welcomes EVD’s suggestion to commission a diagnostic report on the energy sector. However, Management did not commission a study before given there were adequate resources available covering the energy sector in WB&G (mainly through the World Bank and IFC). Furthermore, through many site visits to the West Bank, the Bank met all key local stakeholders and the Bank has gained a good

understanding of the sector. The lack of an initial diagnostic report is in our view not the reason behind the absence of (EBRD) investments in the energy sector but it is rather the complexities of the sector, as outlined earlier.

Recommendation 3 *Continue to engage in policy dialogue and develop technical assistance to support reforms that help overcome key barriers to economic recovery and key infrastructure development and enhance the synergy between policy reforms and investments.*

Management fully endorses this recommendation, which is in line with the Bank's efforts during the current strategy period. The EBRD has a particular strong comparative advantage vis-a-vis many international partners based on a proven record of accomplishment and a capacity to provide comprehensive TC and policy support. To date, the Bank has already been instrumental in providing a wide range of policy and TC support benefitting the Palestine Monetary Authority (e.g. Basel III reporting requirements and Asset and Liability Management support) and the Palestinian Energy and Natural Resource Authority (e.g. grid enforcement and battery storage regulation), amongst others. The Bank stands ready to explore further potential policy and technical assistance opportunities, also jointly with development partners in support of economic transition and sector reforms, for instance to improve governance and, possibly, increased digitisation of the financial sector.