EBRD's Environmental & Social (E&S) Risk Management Procedures for Corporate Loans, SME and Micro Loans

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.

Note:

- **where EBRD has debt exposure only (e.g. credit lines), these procedures *MUST* be applied to all loans financed with the proceeds of the EBRD Loan**
- **where EBRD has an equity stake in an FI, these procedures *MUST* be applied across the FI's entire lending portfolio**

Introduction

The objectives of these E&S risk management procedures are to:

- support FIs to meet EBRD requirements to manage E&S risks in business activities; and
- provide FIs with step-by-step guidance on identifying, assessing and managing E&S risks with respect to this type of lending.

These Procedures should be integrated into the FIs standard procedures for assessing loan applications.

Scope of Application

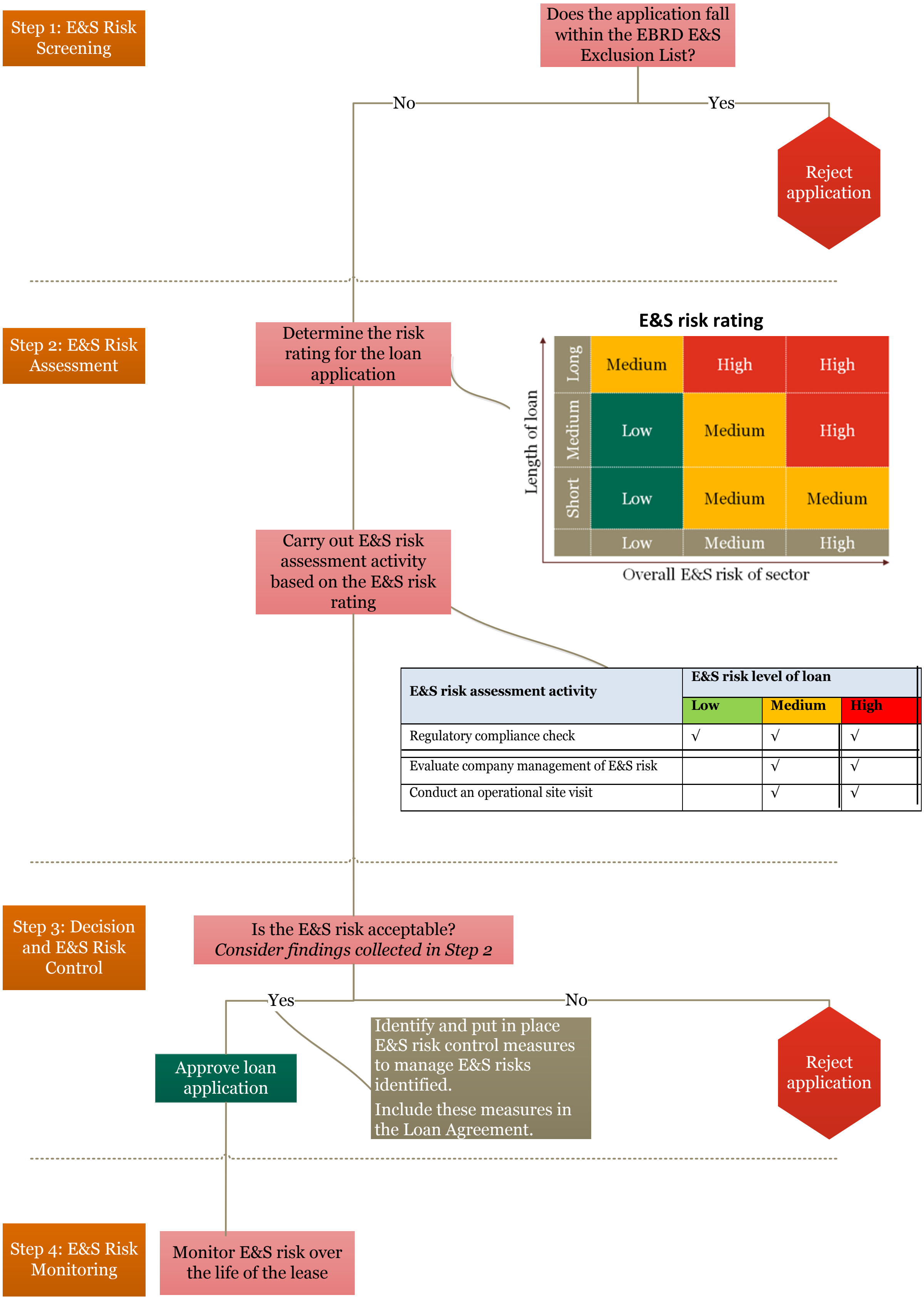
These procedures apply to:

- ***Corporate loans*** applications of more than the equivalent of €100,000
- ***SME loans*** which (i) are less than the equivalent of €2,000 but have a term of more than 18 months, or (ii) are for more than the equivalent of €2,000 but not more than the equivalent of €100,000
- ***Micro loans*** of not more than the equivalent of €2,000, which have a term of not more than 18 months

Summary

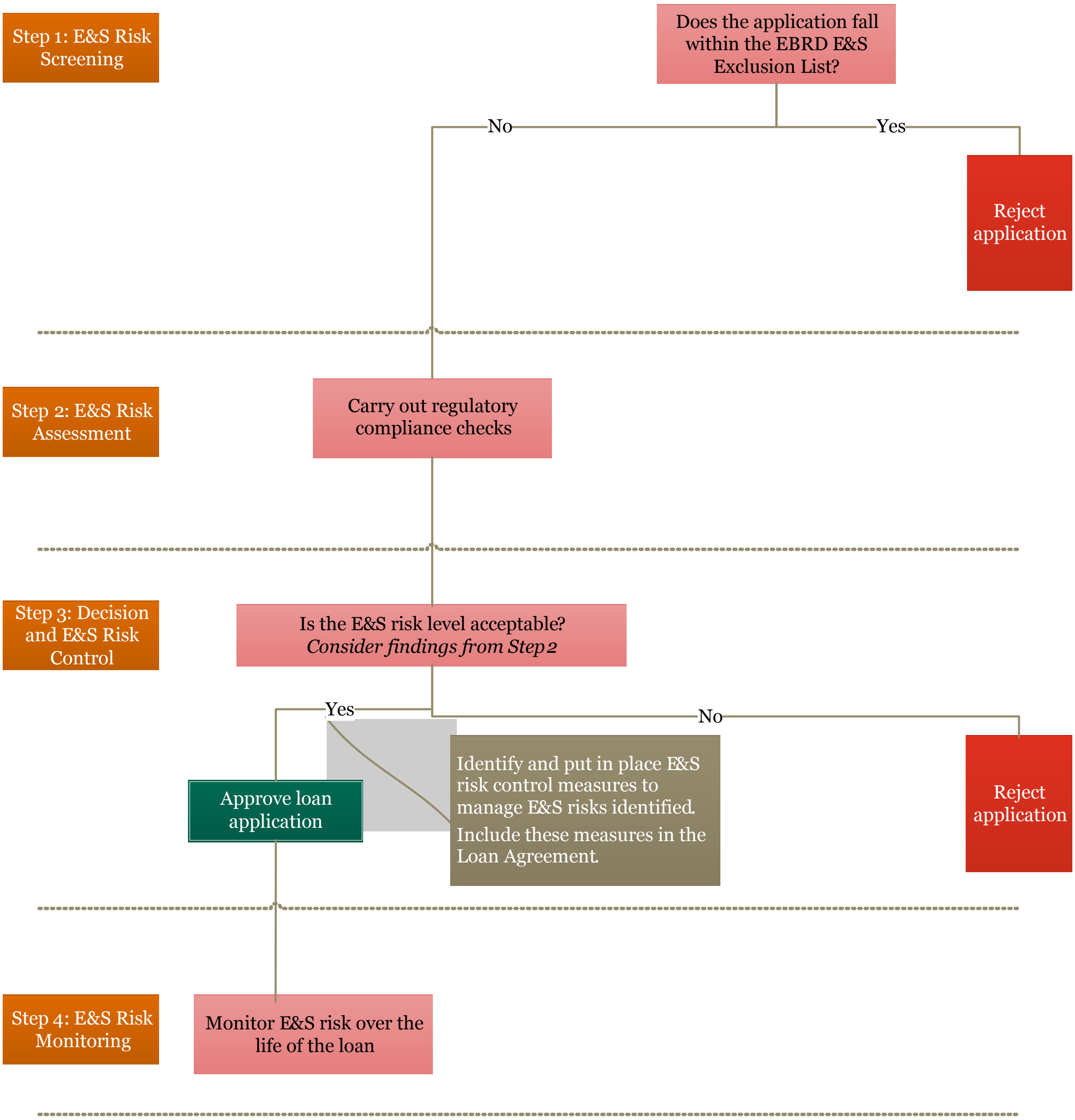
The two diagrams below summarise the E&S risk management procedures for (1) Corporate Loans and SME loans and (2) micro loans, Detailed guidance follows for each step outlined below.

Flow Chart for SME Loans and Corporate Loans



E&S risk assessment activity	**E&S risk level of loan**		
	Low	**Medium**	**High**
Regulatory compliance check	√	√	√
Evaluate company management of E&S risk		√	√
Conduct an operational site visit		√	√

Flow Chart Micro Loans



Step 1: E&S Risk Screening

1.1 Screen against EBRD's E&S Exclusion List

- Screen the potential beneficiary's business activity against EBRD's E&S Exclusion List (attached as Annex 1 to this document).
- If the potential beneficiary is involved in any activity listed here, reject the application.

*1.2 **For Corporate Loans only,** Screen against EBRD's Category A List*

- Screen the potential beneficiary's business activity against EBRD's Category A List (attached as Annex 2 to this document).
- FIs are required to provide a written report to EBRD on E&S risk assessment and obtain EBRD's written consent prior to approving any Category A investments.

Further Guidance

What are EBRD's E&S Exclusion List and Category A 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.
- The Category A List describes activities that are likely to have significant E&S impacts and which require a more formalised process of assessment than other projects. Such projects will be required to meet EBRD's Performance Requirements 1 to 8 and 10. FIs will likely require third party support to assess Category A investments. http://www.ebrd.com/pages/about/principles/sustainability/requirements.shtml

Step 2: E&S Risk Assessment

2.1 E&S Risk Assessment for Micro Loans

Typically micro loans are considered to have a low E&S risk. However, for all micro lending transactions, it is essential that FIs confirm the beneficiary's compliance with relevant E&S laws and regulations.

Further Guidance

- Carry out a regulatory compliance check to confirm that the beneficiary is meeting relevant laws, regulations and standards, including environmental and health and safety regulations, planning permissions, operating licences and permits.
- For micro lending, the FI can use any one or more of these methods to confirm a beneficiary's compliance with E&S laws and regulations.
- Obtain written representation from the beneficiary of its full compliance with laws and regulations, e.g. in the loan agreement. Require the beneficiary to inform the FI of any regulatory breaches.

- Search online media for the beneficiary's past history of fines or legal action taken against it.
- Check publicly available databases (e.g. through regulators) for any criminal or civil action in recent years (e.g. past three years) and for any liabilities (current or potential) that may affect the beneficiary's business in the future.
- In low E&S risk transactions, it is sufficient to confirm compliance through warrantees and covenants.

No further E&S risk assessment activities are required for micro loans.

2.2 E&S Risk Assessment for SME Loans and Corporate Loans

2.2.1 Determine the E&S risk rating

- It is important to determine the E&S risk rating, as different activities are required for the different risk ratings
- To determine E&S risks, the FI should consider two factors: (1) the level of E&S risk associated with the beneficiary's business sector; and (2) the length of the loan.
- The E&S risk level of the beneficiary's business sector is taken from EBRD's E&S Risk Categorisation List.

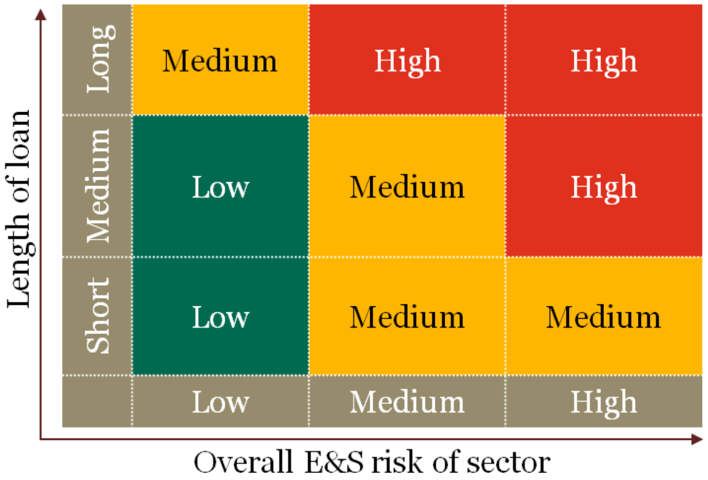
The length of an SME loan is determined as follows:

- Short term loans: <6 months
- Medium term loans: 6 months -2 years
- Long term loan: > 2 years

The length of a corporate loan is determined as follows:

- Short term loans: <1 year
- Medium term loans: 1 -3 years
- Long term loan: > 3 years

Diagram 1: Determining the overall E&S risk rating for SME and corporate loans



Further Guidance (SME and Corporate Loans)

What is the EBRD E&S Risk Categorisation List?

- The E&S Risk Categorisation List is used to understand the typical level of E&S risk associated with a beneficiary in a given business sector. This index of industrial sectors with corresponding levels of environmental, social and overall E&S risk ratings of low, medium or high available to download from the EBRD web-site: http://www.ebrd.com/pages/about/principles/sustainability/intermediaries/implementation_tools.shtml

What if the overall E&S risk rating is different to the separate environmental and social risk ratings?

- When assessing a transaction, FIs should consider both environmental and social risks. In some cases, one type of risk may be more material (e.g. in some manufacturing sectors, social issues are more significant than environmental issues).
- FIs should consider any such differences when carrying out E&S risk assessment activities and prioritising the areas for further investigation with the beneficiary.

2.2.2 *Assess E&S risks associated with the potential SME or corporate loan*

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

E&S risk assessment activity	**E&S risk level of loan**		
	Low	**Medium**	**High**
Regulatory compliance check	Confirm compliance from the beneficiary through warranties and covenants	• Confirm compliance from the beneficiary through warranties • If concerned check compliance, e.g. review permits/licenses, speak to regulator, etc.	*Confirm compliance from the beneficiary through warrantee AND check compliance e.g. review permits/licenses, speak to regulator, etc.
Evaluate beneficiary's management of E&S risk		Engage beneficiary to assess commitment, capacity and track record in managing E&S risk	Engage beneficiary to assess commitment, capacity and track record in managing E&S risk
Conduct an operational site visit			Conduct an operational site visit to check areas of concern

- If the FI is not satisfied with the findings or is concerned about E&S risks, it may choose to carry out additional E&S risk assessment activities beyond the required actions outlined above. Additional E&S risk assessment activities should be considered as appropriate to the concerns and risks identified.

Regulatory compliance check:

- Carry out a regulatory compliance check to confirm that the beneficiary is meeting relevant laws, regulations and standards, such as environmental and health and safety regulations, planning permissions, operating licences and permits.
- In low E&S risk transactions, it is sufficient to confirm compliance through warrantees and covenants.
- For medium and high E&S risk transactions, further evidence is required, as shown in the table above.

Evaluate beneficiary management of E&S risk:

- Engage in discussions with the beneficiary's management team to assess:
    - Commitment to managing E&S issues relevant to the 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 beneficiary has been managing E&S issues. An FI can also investigate past track record through an online search of publicly available information such as media reports, social media and non-governmental organisation websites.

Conduct an operational site visit:

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

Document the results from the E&S risk assessment:

- The FI should document findings and recommendations in the E&S due diligence (ESDD) report to help make an informed decision about the acceptability of the E&S risks associated with a proposed transaction.

Further Guidance (SME and Corporate loans)

How can an FI carry out a regulatory compliance check regarding E&S laws and regulations?

For SME loans and corporate loans, EBRD can provide guidance to FIs on confirming regulatory compliance.

How can an FI I 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 beneficiary'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 beneficiary / FI seek legal recourse?

What key tools are available to help an FI understand and assess E&S risks?

- EBRD's Sub-Sectoral E&S Guidelines can help the FI understand the E&S issues relevant to businesses in different sectors and good practice measures for managing them. http://www.ebrd.com/pages/about/what/policies/guidelines.shtml

Step 3: Decision and E&S Risk Control

- Assess any E&S risks identified and decide whether to approve or reject the loan application [from an E&S risk perspective].
    - Reject the application if significant E&S risks have been found and the beneficiary is unable or unwilling to mitigate the risks.
    - Consider approving the application from an E&S risk perspective if E&S risks are acceptable and/or the beneficiary agrees to E&S risk control measures.
- If an FI has identified E&S risks, consider if the risk control measures listed below could help mitigate these.
- Consider the cost of any E&S risk control measures when determining the final loan amount. An FI may choose to support a beneficiary with additional finance to improve E&S performance, provided the transaction is acceptable to the FI from a credit perspective.
- Formalise any E&S risk control measures agreed with the beneficiary, in the loan agreement, as appropriate.

What are appropriate E&S risk control measures FIs can agree with a beneficiary?

- Refer to EBRD E&S Risk Management for FIs (E-manual) on common E&S risk control measures an FI can employ to manage E&S risks, e.g. having first aid kits and fire extinguishers on site or recycling waste. http://www.ebrd.com/pages/about/principles/sustainability/intermediaries/implementation_tools.shtml
- Measures which could be adopted to mitigate or control E&S risks include restructuring the transaction and including E&S conditions in transaction agreements.

Step 4: E&S Risk Monitoring

- Monitor the loan for E&S risks regularly because they may change during the lifetime of the loan.
- Monitoring for E&S risks can take place alongside standard loan 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 beneficiary's progress in implementing agreed E&S risk control measures.

What events or changes should an FI look out for when monitoring loans for E&S risk?

- Key events or changes that can raise, or present new, E&S risks include:
  - Changes in the beneficiary's business activities.
  - Regulatory investigations, fines or penalties imposed on the beneficiary.
  - Public complaints or adverse media reports.
  - Accidents or incidents causing significant damage to the environment or human health and safety.
  - Amendments to relevant E&S laws and regulations.
  - New developments or changes in land / property use, on adjacent land.

What should an FI do if a beneficiary is not implementing agreed E&S risk control measures?

- Engage in discussions with the beneficiary to address areas of non-compliance.
- Where a beneficiary needs additional resources to become compliant with E&S conditions in the loan agreement, the FI may choose to support the beneficiary with further credit to improve E&S performance, provided that the beneficiary is creditworthy.
- Where engagement has failed, consider terminating the loan if necessary.

Step 5: For SME Loans and Corporate Loans - Reporting to EBRD

PR 9 requires 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 an 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 the FI documents 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. FIs should e-mail: ebrdsusindex@ebrd.com for access to the Index.

Annex 1: 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.

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[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 (ODSs): 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.

Annex 2: Category A Projects

This list applies to "greenfield" or major extension or transformation-conversion projects in the categories listed below. The indicative types of projects listed below are examples of projects that could result in potentially significant adverse future environmental and/or social impacts and therefore require an environmental and social impact assessment. The categorisation of each project will depend on the nature and significance of any actual or potential adverse future environmental or social impacts, as determined by the specifics of nature, location, sensitivity and scale of the project.

1. Crude oil refineries (excluding undertakings manufacturing only lubricants from crude oil) and installations for the gasification and liquefaction of 500 tonnes or more of coal or bituminous shale per day.
2. Thermal power stations and other combustion installations with a heat output of 300 megawatts[8] or more and nuclear power stations and other nuclear reactors, including the dismantling or decommissioning of such power stations or reactors (except research installations for the production and conversion of fissionable and fertile materials, whose maximum power does not exceed 1 kilowatt continuous thermal load).
3. Installations designed for the production or enrichment of nuclear fuels, the reprocessing, storage or final disposal of irradiated nuclear fuels, or for the storage, disposal or processing of radioactive waste.
4. Integrated works for the initial smelting of cast-iron and steel; installations for the production of non-ferrous crude metals from ore, concentrates or secondary raw materials by metallurgical, chemical or electrolytic processes.
5. Integrated chemical installations, i.e. those installations for the manufacture on an industrial scale of substances using chemical conversion processes, in which several units are juxtaposed and are functionally linked to one another and which are for the production of: basic organic chemicals; basic inorganic chemicals; phosphorous, nitrogen or potassium-based fertilisers (simple or compound fertilisers); basic plant health products and biocides; basic pharmaceutical products using a chemical or biological process; explosives.
6. Construction of motorways, express roads and lines for long-distance railway traffic; airports with a basic runway length of 2,100 metres or more; new roads of four or more lanes, or realignment and/or widening of existing roads to provide four or more lanes, where such new roads, or realigned and/or widened sections of road would be 10 km or more in a continuous length.
7. Pipelines, terminals and associated facilities for the large-scale transport of gas, oil and chemicals.
8. Large scale sea ports and also inland waterways and ports for inland-waterway traffic; trading ports, piers for loading and unloading connected to land, and outside ports (excluding ferry piers).
9. Waste-processing and disposal installations for the incineration, chemical treatment or landfill of hazardous, toxic or dangerous wastes.
10. Large scale waste disposal installations for the incineration or chemical treatment of non-hazardous wastes.
11. Large[9] dams and other impoundments designed for the holding back or permanent storage of water.

[8] Equivalent to a gross electrical output of 140 MW for steam and single cycle gas turbines power stations.

[9] The International Commission on Large Dams (ICOLD) defines a large dam as a dam with a height of 15 metres or more from the foundation. Dams that are between 5 and 15 metres high and have a reservoir volume of more than 3 million cubic metres are also classified as large dams.

12. Groundwater abstraction activities or artificial groundwater recharge schemes in cases where the annual volume of water to be abstracted or recharged amounts to 10 million cubic metres or more.
13. Industrial plants for the: (a) production of pulp from timber or similar fibrous materials; (b) production of paper and board with a production capacity exceeding 200 air-dried metric tonnes per day.
14. Large-scale peat extraction, quarries and open-cast mining, and processing of metal ores or coal.
15. Extraction of petroleum and natural gas for commercial purposes.
16. Installations for storage of petroleum, petrochemical, or chemical products with a capacity of 200,000 tonnes or more.
17. Large-scale logging or deforestation of large areas.
18. Municipal waste-water treatment plants with a capacity exceeding 150,000 population equivalent.
19. Large-scale municipal solid waste-processing and disposal facilities.
20. Large-scale tourism and retail development.
21. Construction of high voltage overhead electrical power lines.
22. Large scale wind power installations for energy production (wind farms).
23. Large-scale land reclamation and sea dredging operations.
24. Large-scale primary agriculture or forestation involving intensification, land use change or conversion of priority biodiversity features and/or critical habitats.
25. Plants for the tanning of hides and skins where the treatment capacity exceeds 12 tonnes of finished products per day.
26. Installations for the intensive rearing of poultry or pigs with more than: (a) 85 000 places for broilers, 60 000 places for hens; (b) 3 000 places for production pigs (over 30 kg); or (c) 900 places for sows.
27. Projects[10] which are planned to be carried out or are likely to have a perceptible impact on sensitive locations of international, national or regional importance, even if the project category does not appear in this list. Such sensitive locations include, *inter alia*, nature protected areas designated by national or international law, , critical habitat or other ecosystems which support priority biodiversity features, areas of archaeological or cultural significance, and areas of importance for indigenous peoples or other vulnerable groups.
28. Projects which may result in significant adverse social impacts to local communities or other project affected parties.
29. Projects which may involve significant involuntary resettlement or economic displacement.

[10] Including, without limitation, environmentally or socially oriented projects (such as renewables).