

EBRD's Environmental & Social (E&S) Risk Management Procedures for Active 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 Active 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 the FI's standard process for assessing equity investments.

Scope of Application

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

What is an active investment?

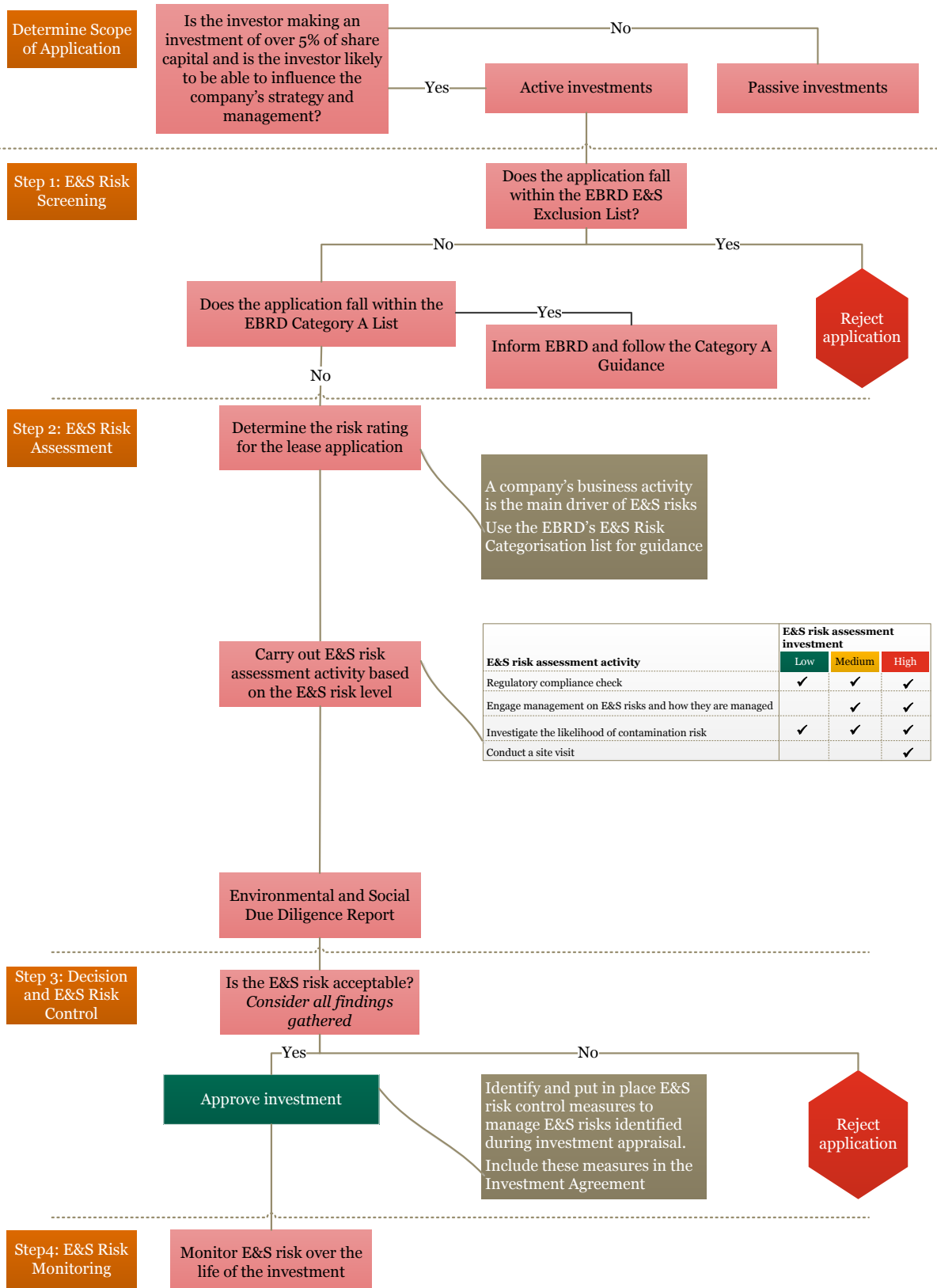
- The investor makes significant investments of over 5% of share capital.
- The investor is likely to be able to influence the investee company's strategy and management.

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

Active Equity Investments

Summary

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



Step 1: E&S Risk Screening

1.1 Screen against EBRD's E&S Exclusion List

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

1.2 Screen against EBRD's Category A List

- Screen the investee company's business activity against EBRD's Category A List (refer to refer to Annex II attached 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.

Step 2: E&S Risk Assessment

2.1 Determine the E&S risk rating

- An investee company's business activity is the main driver of E&S risk associated with an investment.
- Refer to EBRD's E&S Risk Categorisation List which provides an index of business activities with corresponding environmental and social risk ratings (high, medium, low).
- Identify the risk rating for social and environmental risk respectively.
- Take the highest risk rating as the overall E&S risk rating.

2.2. Assess E&S risks associated with the potential investment

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

E&S risk assessment activity	E&S risk level of investment		
	Low	Medium	High
Regulatory compliance check	√	√	√
Engage management on E&S risks and how they are managed		√	√
Investigate the likelihood of contamination risk	√	√	√
Conduct a site visit			√

Regulatory compliance check:

- Carry out a regulatory compliance check to confirm that the investee is meeting relevant laws, regulations and standards, including environmental and health and safety regulations, planning permissions, operating licences and permits.

Engaging management on E&S risks

- Engage in discussions with the investee company'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 company has been managing E&S issues. FIs 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.

Investigate the likelihood of contamination risk

- For all investments, regardless of the level of E&S risk, determine whether the investee company owns any sites that are at risk of contamination due to neighbouring industrial activity, past industrial activity on the site or current industrial activity. This can be done by questioning management and/or visiting the company's sites.
- Where there is a risk of contamination, conduct a site visit to the property/properties to assess contamination risk and identify mitigation and/or clean up measures required.

Conduct a site visit

- Conduct a site visit to the company's operations to further evaluate E&S risks identified during management discussions and investigate how the company'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.
- FIs can conduct site visits themselves or commission an E&S expert to do so on their behalf.

- EBRD has provided guidance for FIs on how to conduct a site visit (refer to EBRD's web-site <http://www.ebrd.com/downloads/about/sustainability/14-site-visit.pdf>)
- If the FI has access to previously commissioned E&S due diligence reports on the company'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).

Further Guidance

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

FIs can use these methods to confirm an investee's compliance with E&S laws and regulations.

- Obtain written representation from the company of its full compliance with laws and regulations. Include this in investment agreements and require the investee to inform investors of any regulatory breaches.
- Employ in-house legal expertise to investigate and monitor legal compliance, including with E&S laws and regulations.

Additional checks can include:

- Search online media for the company's past history of fines or legal action taken against it.
- Check for visits by regulatory authorities and any improvement actions imposed upon the company.
- Check for licences and permits in place during site visits.
- Check for any criminal or civil action in recent years (e.g. past three years) for any liabilities (current or potential) that may affect the business in the future.

How can and 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 investee 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 investee company /the investor seek legal recourse?

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

- EBRD's Sub-Sectoral E&S Guidelines can help FI's understand the E&S issues relevant to businesses in different sectors and good practice measures for managing them.
<http://www.ebrd.com/who-we-are/our-values/environmental-and-social-policy/tools-for-financial-intermediaries.html%20>

- EBRD has provided guidance to help FIs prepare for site visits
<http://www.ebrd.com/downloads/about/sustainability/14-site-visit.pdf>

How can an FI check if the investee company owns any properties with contamination risk?

- The FI can investigate this risk by asking the company's management about the sites' current, past or neighbouring activities. The FI manager can also visit the sites .
- There is a risk of contamination if the investee company owns property that is used for, or nearby, industrial activities, or if using previously developed land, particularly if it was once used for industrial purposes.
- The risk of contamination is lower for properties built on greenfield sites or those that have always contained residential dwellings.
- Where there is contamination risk, conduct a site visit to the properties to check for contamination and engage with management to understand how this risk is managed.

Document the findings from the E&S risk assessment

- Document the results of the E&S risk assessment in the Investment Committee papers.
- The length and scope of the E&S risk section should be determined by the level of E&S risk.

Documentation for low E&S risk investments

- State the E&S risk level as 'low'.
- Confirm that the company is not engaged in activities covered by EBRD's E&S Exclusion and Category A Lists.
- Describe the company's E&S regulatory compliance status.

Documentation for medium E&S risk investments

In addition to requirements outlined for low E&S risk investments, document the following:

- Outline the E&S risk assessment activities that were carried out.
- Summarise the key E&S issues facing the investee company.
- Describe the actual or potential E&S risks, liabilities or opportunities and their likely or potential legal, financial and reputational impacts.

Documentation for high E&S risk investments

In addition to requirements outlined for low and medium E&S risk investments, document the following:

- Describe the findings from the site visit, including E&S risks identified, any discussions with site managers and any mitigation measures discussed to manage E&S risks.
- Where a third party E&S consultant was retained to carry out the site visit, provide the full findings report in the annex of the Investment Committee paper.

Step 3: Decision and E&S Risk Control

- Consider the findings of the E&S risk assessment in deciding whether or not to invest.
 - If E&S risks are acceptable and/or the investee agrees to measures to manage any E&S risks, consider approving the investment.
 - Consider declining the investment if E&S risks are significant and/or the investee is unable or unwilling to mitigate the risks.
- If the investment is approved, decide what, if any, controls are needed to manage and minimize E&S risk to the investee company and the FI.

Further Guidance

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

FIs may be able to employ these E&S risk control measures, if appropriate:

- Change the business plan to use options or processes that reduce E&S risks (e.g. improving machinery or facilities).
- Obtain warranties or indemnities from the vendor or insurance cover (e.g. environmental liability insurance) where there is concern about specific E&S risks (e.g. contamination). Agree improvements in an E&S action plan that contains a timeline for implementation, potential costs and roles and responsibilities.
- Limit liability through seeking limited partner status or by securing state indemnification for E&S liabilities during privatization.
- Seek representation on the company's Board and use this influence to improve E&S performance.
- Consider the investee company's ability to comply with pending regulatory changes or trends.
- Make sure any E&S conditions are clearly defined and, where appropriate, incorporated into the investment agreement.

Step 4: E&S Risk Monitoring

- Monitor the investment for E&S risks as they may change during the life of the investment.
- There are two areas to consider when monitoring E&S risks:
 - Events or changes that could present new or increased E&S risks (see further guidance).
 - The investee company's progress in meeting agreed E&S risk control measures.
- Monitoring of E&S risks can take place alongside regular investment reporting and reviews.
- FIs are required to notify EBRD as soon as they are aware of any material environmental or social incidents related to an investee.

Further Guidance

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 business activities (e.g. changes to products sold, raw materials, wastes emitted).
- Regulatory investigations, fines or penalties imposed on the investee.
- 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, or to the level of enforcement.

Who is responsible for monitoring and reporting of E&S risks?

- Responsibility for managing and monitoring E&S risk falls to both the investee company and investor.
- Responsibility for E&S risk management should be clearly defined at the investee company.
- Both FIs and investees are responsible for taking action in the case of material E&S incidents.
- Require investee companies to report regularly to investors on E&S performance, in line with the frequency of financial reporting.
- Require investee companies to notify the FI of any significant E&S issues that arise.

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

A material incident 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 an investee is not meeting agreed E&S risk control measures?

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

Step 5: Exiting the Investment

- Consider E&S issues when developing the exit strategy for an investment, as prospective buyers are likely to be interested in the investee company’s E&S performance and potential liabilities.
- Include appropriate disclaimers related to E&S issues in sale agreements, although this may not always be acceptable to buyers.

- Provide full disclosure (e.g. in the data room or initial public offering prospectus) of the material E&S issues affecting the company and steps taken to improve E&S performance during the ownership period.

Further Guidance

Why consider E&S issues when exiting an investment?

- The company's E&S performance could affect the value of its shares or property.
- For Initial Public Offerings (IPO), stock markets are increasingly requiring E&S disclosures.
- Where the investor has management control, it could be held responsible for E&S liabilities for incidents or contamination that occurred during the management period.

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 (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 II: 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 megawatts⁸ 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.

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

11. Large⁹ dams and other impoundments designed for the holding back or permanent storage of water.
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. Projects¹⁰ 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

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.

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

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.