Response by European Bank for Reconstruction and Development to Bankwatch's comments on the bank's Sustainable Energy Initiative 3

Sent on March 28, 2012

Dear Mr Trzaskowski

Thank you for Bankwatch's note titled 'Comments for the consultation on the EBRD Sustainable Energy Initiative 3' which the EBRD received in London on 28 November 2011. I appreciate the contribution you and your colleagues have made to the EBRD's Sustainable Energy Initiative (SEI) consultation process. This consultation process is a crucial part of the Bank's efforts to make the SEI as effective as possible. I also appreciate your acknowledgement of the Bank's efforts relating to sustainable energy investments in the last few years. In this regard, the Bank shares your concern about climate change and the urgent need for action. Indeed, this is why the EBRD has placed sustainable energy and climate change investments at the heart of its portfolio since 2006.

Allow me to address the main issues you raise in your note.

Criteria used to select SEI projects

You mention that the criteria used for selecting SEI projects need to be strengthened, with CO_2 saved being set as the primary metric. As you are aware, the Bank has a transition mandate. The transition impact will remain the key metric against which we evaluate projects. Having said that, CO_2 saved is an important metric for SEI and CO_2 savings is still being proposed as an SEI Phase 3 target.

Client selection

I agree with your comment that the EBRD should not invest with socially irresponsible clients. The EBRD has rigorous financial, social and environmental due diligence in place to prevent this.

Transport issues

You raise a number of issues relating to the inclusion of transport investments in SEI. In particular, you question the inclusion of motorways, shopping centres and airports in the SEI portfolio because of induced transport impacts and issues relating to carbon-intensive transport modes. The EBRD does take account of associated induced transport for the transport catchment as a whole when analysing road-transport investments. Furthermore, such investments are only included in the SEI portfolio when the total traffic forecasts deliver net positive CO2 savings compared to the baseline scenario (for example, some bypasses around city centre relieve congestion, or some new infrastructure allow much shorter routes). SEI investments in airports focus on improving the energy efficiency of the building shell. Therefore, only the benefits associated with building energy efficiency improvements are counted as part of the SEI portfolio.

Please note that in addition to the SEI due diligence process, issues of transport impact are also the focus of both EBRD environmental impact assessments and local authority planning permission process.

The EBRD also takes a careful approach to evaluating investments in carbon-based transport modes. The Bank's approach to all transport projects is based on comparing the energy savings of the investment scenario to a baseline scenario in the catchment area. To that extent, we have developed several models which take into account the traffic forecasts (including induced traffic). Accordingly, we don't allocate the total business volume to SEI, but only the economic return of the energy savings, when these can be justified.

Production capacity issues

You also raise the issue of the potential for SEI investments to lead to *increased production capacity* and, therefore, increased CO_2 emissions. This is a critical concern for the EBRD, and the Bank assesses this issue carefully. To capture capacity change issues, the EBRD tries, wherever possible, to develop project baselines that reflect the broader system capacity issues (such as import substitution etc).

Power sector investments

Many of your comments focus on the appropriateness of including carbon-based power-generation investments in the SEI. We acknowledge that there is growing urgency to decarbonise economic activity. The Bank responds to this issue by promoting the development of low carbon technologies (such as renewable energy and state of the art high-efficiency generation units), pursuing both supply and demand side energy efficiency to reduce the need for new capacity investment and increase overall resource efficiency in electricity production by introducing high technical standards. In addition, the Bank engages in policy dialogue that actively promotes the creation of carbon markets in the region.

More specifically, the Bank is only financing carbon-based electricity generation projects (new units or rehabilitation) where there is no other alternative lower carbon option and where the project significantly improves energy resource efficiency and reduces overall carbon emissions. As a result, during SEI Phase 2 (2009-2011) power generation refurbishment projects were largely focused on gas-based CCGT facilities, but also include upgrades and investments into BAT at coal fired power stations. Here, on average, efficiency improvements of 30% and 15% were achieved for new and modernised units respectively.

You also raise issues relating to investments in high-voltage transmission lines connected to unsustainable energy sources (in particular, you mention the Rivne Kyiv HV line, South Ukraine Transmission line and the Black Sea energy transmission system projects). In this context, it is important to note that electricity transmission systems are not dedicated exclusively to specific power plants. In general, as in these cases, they improve system stability, reliability and efficiency by reducing technical losses and also reduce required power supply from high carbon intensity plants.

Also, as we mentioned in the Bank's letter to Bankwatch in April 2011, the main criterion for investing in transmission lines is that at least a part of the capex is dedicated to EE improvement by reducing technical losses or optimising system management to reduce power supply from high carbon intensity plants. This part of the capex will then be counted as SEI. This is confirmed by a baseline calculation comparing resource efficiency and carbon emissions before and after the project implementation.

Investments in public and residential building energy efficiency

You comment that the SEI has made too few investments in the public and residential building energy efficiency sectors. Moreover, you comment that the Bank needs to devote attention to meters and ESCOs.

The Bank acknowledges that achieving energy efficiency improvements in public and residential buildings is challenging. However, the Bank also recognises the importance of this sector for delivering CO_2 mitigation at scale. As a result, the Bank is putting significant effort into removing barriers to investment in these sectors by addressing policy framework issues (e.g. in Russia, Ukraine, Kyrgyzstan and Moldova). It is encouraging that our efforts are now starting to bear fruit (e.g. we are working with several ESCOs in Russia and Ukraine) but the issues are far from being resolved. If BW has any specific ideas on what else the Bank could be doing I would welcome your suggestions.

Energy efficiency in coal mining

Your comments raise the issue of the Bank investing in coal mining. You correctly point out that the EBRD includes mining projects in the SEI, when they improve specific energy consumption by at least 10%. However, you note that improving the efficiency of coal mining can lead to increased coal extraction.

Coal will continue to be an important energy source in the EBRD countries of operations for the foreseeable future. This will not change if the EBRD simply abstains from investing in coal mines. Therefore, we will continue to:

a) consider these investments as they arise

b) conduct rigorous due diligence to ensure impacts are minimised.

Renewable energy investments

You expressed concern that the EBRD’s renewable energy portfolio is too focused on investments in EU countries, new hydro and wind. First, let me point out that during SEI Phase 2, the Bank significantly increased the proportion of renewable energy investments. In fact, in 2011, renewable energy investments made up around 36% of total SEI investment volume.

The EBRD is attempting to diversify its portfolio beyond the EU. However, in many cases the policy frameworks are not conducive to renewable energy investments. Hence, we are putting effort into policy dialogue – with some success (e.g. Kazakhstan).

The EBRD works to improve policy frameworks so that all renewable energy sources can compete on a level playing field. At the same time, we continue to invest in bankable projects. Given the current challenging policy and market environment, wind is often the most commercially viable renewable energy investment. The Bank is working to improve the situation for other renewable energy sources.

The EBRD does invest in new hydro projects. However, we have stringent due diligence processes (financial, social and environmental) to minimise any impact. In the context of the need for urgent climate change action, we disagree that hydro should be removed from the SEI portfolio.

Sustainable Energy Finance Facilities (SEFF)

Thank you for your positive comment regarding the EBRD's SEFFs. The EBRD regards SEFFs as a core delivery mechanism for sustainable energy finance to smaller projects (SMEs, small renewable energy projects and residential).

However, you raise the issue of transparency regarding where the EBRD credit line finance is actually being invested by local partner banks. As you are aware, the Bank has strict eligibility criteria (publicly notified on websites) for partner banks' loans. We monitor these sub-loans closely through quarterly reports from local banks. We are not intending to disclose this information.

Reporting and evaluation

You also raise several reporting issues relating to Project Summary Documents (PSDs), carbon neutrality and CO2 emission reductions achieved. It should be noted that the Bank's ability to report SEI results has improved during SEI2. This improvement was a response to the Bank's Evaluation Department (EvD) review of SEI Phase 1. In particular, in response to this review, the Bank is expanding its assessment of the technical and financial performance of projects and improving the data collection and reporting system. At the same time, the Bank seeks to strike the right balance between the development of new activity with increased attention to monitoring.

With respect to your specific comments:

- You comment that the PSDs are not updated. The Bank acknowledges this issue and will attempt to improve the timeliness and accuracy of PSD content over the SEI Phase 3 period.
- Your comments also call on the Bank to "report on CO2 emissions achieved, not only those expected". In line with the 2011 EvD report, the Bank is reviewing its ex-post evaluation monitoring approach for SEI3.
- Your comments suggest that the EBRD should report the Bank's total carbon footprint. As you point out, the Bank's 2011 EvD report mentioned that the Bank does not report its total carbon footprint. The issue of absolute greenhouse gas reductions is addressed by the annual portfolio assessment. The EvD report also mentioned that the Bank should examine whether to set a carbon neutrality objective as a corporate objective. The Bank is proposing to consider this issue during the first year of SEI3 implementation.

Climate change adaptation

You raise several issues relating to adaptation. Specifically, you commented that adaptation should not be included within the Sustainable Energy Initiative, that adaptation for developing countries should be paid for by grants and that climate finance should be channelled through the United Nations Framework Convention on Climate Change (UNFCCC).

The Bank considers that an increased emphasis on climate change adaptation is necessary. This reflects the fact that a significant rise in temperature is by now likely – independent of further mitigation action. Second, adaptation issues are expected to be more severe in the Southern and Eastern Mediterranean region than in the CEE region.

EBRD is aware of the international debate about the modalities of adaptation finance (e.g. loans vs grants), and of concerns that low-income countries should not be indebted due to adaptation. However, we feel that this argument is much more nuanced than indicated in the Bankwatch paper.

First, the role of the private sector in adaptation has to be considered. Many stakeholders, including some leading NGOs, have observed that the private sector has a crucial role to play in achieving climate resilience (e.g. see Oxfam's recent initiative: http://www.oxfamamerica.org/articles/business-partnership-to-promote-resilience-and-environmental-preparedness-forms). The potential role of a private sector-oriented IFI such as EBRD in encouraging private sector action on adaptation must be considered. The international debate around the use of loans in adaptation finance has focused on public debt - i.e. governments should not have to take on public debt because of adaptation. However, the proposition of providing targeted loans for adaptation to the private sector is very different, as the debts incurred would be private, not public, and furthemore subject to rigorous credit analysis by both the lender and the borrower.

The Bankwatch paper correctly states that there are concerns about adaptation finance being provided as loans to low-income countries. However, most of the countries in the EBRD region do not fall into this category. For example, there are a number of middle-income countries that face severe adaptation challenges (e.g. Egypt, Kazakhstan, Turkey). International negotiations on climate finance offer little indication that these large, middle-income countries stand much chance of receiving significant amounts of the finite grant assistance expected to be made available. Therefore, the Bank maintains that the option of loan finance for adaptation should be kept open for these countries (especially for the private sector).

Your comments also state that climate finance should be channelled through the UNFCCC. Unfortunately, the lack of progress in COP negotiations means that we are a long way from having the comprehensive UNFCCC-led climate finance mechanism envisaged at Copenhagen in place. This means that if we wait for the UNFCCC/GCF, we could be waiting for a very long time, at a time when all parties are calling for urgent action on adaptation. In the Bank’s view, IFIs and mechanisms such as the CIF have an important role to play in ensuring that adaptation finance reaches countries that need it even while the UNFCCC negotiations are held up. Furthermore, EBRD is a GEF implementing agency, and the GEF is the financial instrument of the Convention. The EBRD is also in the process of being accredited as one of the implementing agencies for the UNFCCC Adaptation Fund, so the Bank does not accept the argument that channelling climate finance through EBRD means diverting it from the UNFCCC. On the contrary, I hope that the Bank’s capacity to deliver projects and leverage finance will enhance the impact of UNFCCC-managed funds.

Thank you again for taking the time to provide comments on the future direction of the SEI.