

To: Board of Directors  
European Bank for Reconstruction and Development

18 April 2019

**Subject: Policy on corporate loans based on PCM CRR on the EPS Restructuring project**

The PCM has finalised the Compliance Review Report (CRR) of the EPS Restructuring project and has closed the case without further monitoring. We welcome the recommendation that clarification of the policy framework and strategic guidance are urgently required as the EBRD is about to finalise the review of its Environmental and Social Policy (ESP). However we strongly disagree with the CRR conclusions that the EBRD is compliant with the current Environmental and Social Policy provisions on corporate-level financing. We are also concerned, that the current PCM Rules of Procedure do not allow for the PCM to monitor the implementation of the CRR recommendation in cases where no non-compliance is found.

**Therefore we call on the EBRD Board to ensure that lessons learned from the EPS Restructuring project Compliance Review result in clearer and stronger safeguards for impacted communities and the environment in the case of corporate level loans.**

The EBRD's Establishing Agreement mandates the bank to promote sustainable development within ecological limits and the EBRD has signed the European Principles on the Environment that commit the bank to apply the principles and substantive requirements of EU law in its investments, if they are more stringent than regulatory requirements on national level.

**We urge the Board to ensure that new EBRD Environmental and Social Policy reaffirms the bank's sustainability mandate and commitment to EU standards with clear provisions for corporate level investments.**

While the Complainants welcome the PCM recommendation and the CRR findings of harm associated with EPS operations, as well as the findings of inadequate due diligence and monitoring of the EPS Restructuring project, we strongly disagree with the CRR conclusions that the EBRD is compliant with its Environmental and Social Policy.

The 2014 policy clearly spells out that direct investment projects must become compliant with Performance Requirements 1 to 8 and 10 within a reasonable time period (see Annex on Applicable Standards below). The CRR presents sufficient evidence that EPS is nowhere near to meeting the PRs.

**Therefore we call on the Board to request from EBRD Management information on the efforts to bring the EPS Restructuring project in compliance with the EBRD Environmental and Social Policy of 2014, EU standards and national regulatory requirements, and on the successful implementation of the project's Environmental and Social Action Plan (ESAP) before the investment's repayment and project's completion. The Board should request from Management a systemic and transparent monitoring process for the EPS Restructuring project.**

Why should the EBRD Board of Directors act?

We are concerned that **the PCM expert has not followed the Terms of Reference (ToR) with regards to the Scope of the Compliance review**<sup>1</sup> which tasked the expert to review whether the EBRD's assessment, ESAP preparation and monitoring of ESAP implementation were adequate to ensure that the project would become compliant with the PRs within a reasonable time frame, as required by the Environmental and Social Policy (see below).

The Compliance Review provides sufficient evidence that the EBRD did an inadequate job in E&S risk assessment<sup>2</sup> and stakeholder identification<sup>3</sup>, and that there is no evidence from monitoring reports that EPS is anywhere near compliance with the EBRD policy Performance Requirements (PRs)<sup>4</sup>. The conclusion of compliance lacks logic and integrity and is only backed up by the argument that the EBRD made some, even if inadequate, effort to apply GIP and EU standards with regards to E&S issues assessment and management, stakeholder engagement and resource efficiency.

The CRR presents a highly worrying picture of the EBRD environmental and social due diligence (ESDD), risk analysis, ESAP preparation and monitoring of ESAP implementation for the EPS Restructuring project. The CRR finds that the EBRD has done a poor job at assessing and mitigating risks and potential harm, "*which do not adequately mirror the magnitude of some of the environmental and social challenges faced by EPS, especially as they continue to be reflected in the series of PCM complaints against EBRD operations supporting EPS*". This is especially of concern given the bank's long experience with EPS and the limited progress that EPS has made. Yet the EBRD is found to be in compliance with its policy due to the expert's failure to properly examine even those policy provisions which do exist.

The CRR does not present any rationale or justification for how long a client's failure to achieve compliance can be acceptable before this translates into non-compliance? As the EPS Restructuring loan is being repaid<sup>5</sup>, will the ESAP be implemented before the project is completed?

The PCM expert concludes that there is no direct connection between harm and the EBRD's investment, but **the CRR falls short of a full review of whether the EBRD has implemented the Environmental and Social Policy in the EPS Restructuring project.**

<sup>1</sup> PCM Eligibility Assessment Report, EPS Restructuring Project, September 2018

<sup>2</sup> CRR "40 [...] there is no risk analysis of social and environmental factors. From document review and interviews, it is possible to conclude that although EBRD recognizes that environmental and social performance constitutes a continuing challenge for EPS, the assessment carried out was not robust enough to point to the inherent risk of weak EPS environmental and social systems, especially as reflected in past practices of the company and previous complaints to EBRD."

<sup>3</sup> CRR "35. [...] no Project-related issues including those from previous engagements with external stakeholders with regard to EPS were considered in the risk and impact assessment, and the risk criteria did not include any reference to environmental issues. Bank Monitoring Reports reviewed do not provide an update of this risk analysis included in the Board document."

<sup>4</sup> CRR "36. [...] Monitoring] Reports thus contain very little information concerning the progress in implementation of the ESAP various activities."

<sup>5</sup> EPS Restructuring Project Summary Document: <https://www.ebrd.com/work-with-us/projects/psd/eps-restructuring.html>

Looking at the relationship between harm and the EBRD's actions or omissions is a significant narrowing of the mandate of the PCM to conduct compliance reviews and has no basis in the Environmental and Social Policy or PCM Purpose and Rules of Procedure (RoPs). According to the PCM's RoPs, the Compliance Review function "*seeks to determine whether or not the EBRD has complied with a Relevant EBRD Policy in respect of an approved Project*".<sup>6</sup> Assessment and prevention of harm are not the sole purpose or focus of the bank's policy, as the EBRD has made commitments to mainstreaming environmental and social sustainability considerations into all its activities, to promote EU standards and compliance with applicable regulatory requirements and good international practice.

**The CRR presents no evidence that the EBRD commitments to EU and international standards were met in the EPS Restructuring project.** On the contrary, the expert notes that, first, the bank's due diligence and the project ESAP made reference to EU Best Available Techniques Reference and emission reductions from thermal power plants, and second, that ESAP actions were not achieved by the agreed deadlines in 2016 and 2017. The CRR presents no examples of the bank's "*efforts in that direction*"<sup>7</sup>, and yet it does not regard the EBRD's failure to ensure ESAP implementation to date as a non-compliance.

Last but not least, **the CRR makes no attempt to analyse the question of compliance of EPS operations with national regulatory requirements** as required by PR1 paragraph 14 of the EBRD ESP. In this regard the CRR also fails to answer a question posed in the ToR for the Scope of the CR about the Client's compliance record with applicable environmental and social regulatory requirements.

The CRR mentions that, according to the bank's Management's response, "*it remains important to support Client's continuous improvements in environmental and social sustainability performance in line with relevant laws*"<sup>8</sup>, however, no examples are given of either the bank's support or of the client's improvements with regards to its capacity or performance in managing environmental and social issues in line with national regulatory requirements.

Under these circumstances, the Complainants strongly disagree with the PCM expert's findings of the CRR that the EBRD is compliant with its environmental and social standards in the case of the EPS Restructuring project.

## **Conclusion**

First, the CRR provides enough examples that demonstrate the failure of the EBRD to ensure that EPS delivers on the intended improvements in environmental and social sustainability at the corporate level in the case of the EPS Restructuring loan. The CR expert's assessment that the EBRD is compliant with its policy therefore contrasts sharply with the fact that the EBRD's

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<sup>6</sup>PCM Introduction and Purpose and RoPs paragraph 47: "*The objective of the Compliance Review will be to establish if (and if so, how and why), any EBRD action, or failure to act, in respect of an approved Project has resulted in non-compliance with a Relevant EBRD Policy*"

<sup>7</sup>CRR conclusion: "*60. In view of the above the CR is of the opinion that the Bank in line with the ESP policy is aware of the need for EPS to comply with EU and international standards and is currently engaging in efforts in that direction. Since, the specific provisions for corporate loans do not refer to this aspect, what constitutes that reasonable time period is not specified. The CR does not maintain, therefore, that the Bank is in noncompliance with the ESP regarding this allegation.*"

<sup>8</sup> CRR paragraph 15

investment has not resulted in specific, measurable and sustainable improvements for people, the environment and climate change mitigation.

Second, the complainants regret that the CRR does not provide any examples or detailed evidence that the EBRD has acted in line with the provisions for corporate loans of its 2014 Environmental and Social Policy and Performance Requirements.

Third, the CR expert has strayed from the PCM's mandate on the purpose and method of conducting a Compliance Review, and has not followed the Terms of Reference set by the PCM for the EPS Restructuring project review. The findings and recommendation of the CR expert are not in line with the PCM RoPs either<sup>9</sup>, resulting in uncertainty and limited PCM role in monitoring the implementation of the recommendation.

The Complainants have asked the PCM to make strong and strategic recommendations to EBRD Management and the Board of Directors that will ensure transparency and accountability on the results of the EPS Restructuring project. However, the PCM has closed the case.

We still believe that the CRR's recommendation should be implemented and the new Environmental and Social Policy of the EBRD should include clearer provisions for corporate level investments. Therefore we ask the Board of Directors to ensure that the new EBRD Environmental and Social policy provides clear and robust requirements with regards to corporate level loans.

If accountability is about learning lessons, we hope the lesson is that the route to compliance is through high quality E&S due diligence, risk assessment and monitoring that translate into tangible and measurable improvements for the life of people and the state of our environment, in line with the EBRD's mandate to promote environmental and social sustainability.

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<sup>9</sup> The PCM Rules of Procedure paragraphs 43-45 provide for closure of the case if full compliance of the EBRD with its policy is found. Therefore the RoPs do not provide for a course of action in case there is a recommendation made in case of compliance – it is unclear if Management is obliged to act on it or if the PCM will have a role to play in monitoring the implementation.

## **Annex 1. ESP 2014 Applicable Standards for Corporate Level Investments by the EBRD**

The 2014 Environmental and Social Policy (ESP 2014) is very clear that “4. All projects financed by the EBRD shall be structured to meet the requirements of the ESP”.

The ESP defines 11 that: “EBRD projects are divided into ‘Direct Investment Projects’ and ‘Financial Intermediary Projects’. In the case of Financial Intermediary Projects, the client is a financial services provider, an investment fund or other similar entity. All other projects are referred to as Direct Investment Projects.” In this regard, the ESP requires also that “36. Direct investment projects must meet PRs 1 to 8 and 10”.

In addition: “38. Where the project involves general corporate finance, working capital or equity financing for a multi-site company, the client will be required to develop measures at the corporate level (as opposed to the project-specific level) to meet the PRs over a reasonable time period,”

and

ESP paragraph 32: “(i) assess the investment based on the risks and impacts inherent to the particular sector and the context of the business activity, and (ii) assess the client’s capacity to implement the project in accordance with the PRs.”

PR1 paragraph 14 states: “In cases where clients with multi-site operations are seeking general corporate finance, working capital or equity financing, the assessment outlined in paragraphs 7 to 12 may not be appropriate. In such cases, the client’s current ESMS and past and current performance will be assessed against the applicable PRs and an ESAP will be developed and implemented at the corporate level (as opposed to site-specific level). The corporate level assessment will:

- assess the client’s ability to manage and address all relevant social and environmental impacts and issues associated with its operations and facilities against the requirements described in the PRs
- assess the client’s compliance record with applicable environmental and social regulatory requirements applicable in the jurisdictions in which the project operates
- identify the client’s main stakeholder groups and current stakeholder engagement activities.”