

# Environmental and social management system – risk assessment

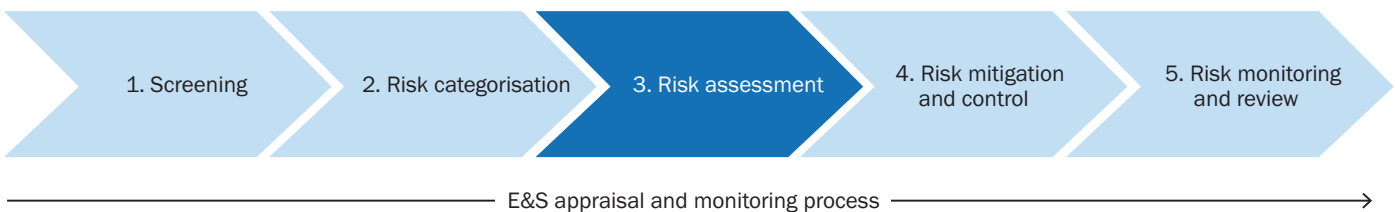


**European Bank**  
for Reconstruction and Development

## Introduction

The risk assessment ensures that sub-projects are structured to mitigate adverse environmental and social impacts and risks, meet national regulatory requirements on environmental and social matters, and require sub-borrowers, where necessary, to implement corrective action plans.

**Figure 1. Risk management stage of sub-projects**



The scope of the environmental and social (E&S) risk assessment should be determined by the E&S risk categorisation that the financial intermediary (FI) assigned to the transaction. Typically, the higher the level of E&S risk associated with a transaction, the more comprehensive the E&S risk assessment should be. This is reflected in the level of depth and thoroughness of the E&S risk assessment, the approach and tools that the FI uses to assess E&S risks, and the external expertise the FI needs to engage.

E&S risk assessment activities include:

### A regulatory compliance check

According to EBRD Performance Requirement 9 (PR9), all sub-projects should comply with applicable national E&S laws and regulations.

This regulatory compliance check can be performed in house by dedicated FI E&S resources familiar with the E&S regulatory requirements of the countries in which the sub-project will take place.

A regulatory compliance check should be conducted as follows:

- **Step 1: Identify the applicable regulatory E&S requirements.** The FI should identify and agree with the sub-borrower the regulatory E&S requirements that apply to the sub-project.
- **Step 2: Review relevant documentation including permits and licences.** The FI should request and review all permits, licences, due diligence reports, environmental impact reports (environmental impact assessments (EIAs)/ environmental and social impact assessments (ESIAs) and so on that apply to the sub-project.
- **Step 3: Review audit reports.** Where applicable, FIs can ask to review annual audits undertaken by national environmental and labour authorities, among others, to determine their compliance with national E&S requirements.

## E&S due diligence

FIs should assess E&S risks by conducting environmental and social due diligence (ESDD), which is an appraisal of the actual or potential E&S risks associated with a sub-project, commensurate with the level and category of the risk identified. In all cases, ESDD should be performed against national E&S standards. If the sub-project has been screened and categorised as Category A, the EBRD also requires ESDD to be performed against PRs1-8 and PR10 (Figure 2).

The FI can undertake the ESDD of medium- and low-risk transactions internally, although more complex, medium-risk transactions may require the support of external consultants. Internal ESDD should always be undertaken by a skilled and experienced expert, typically a dedicated E&S officer or other staff with sufficient knowledge and skill to perform the task.

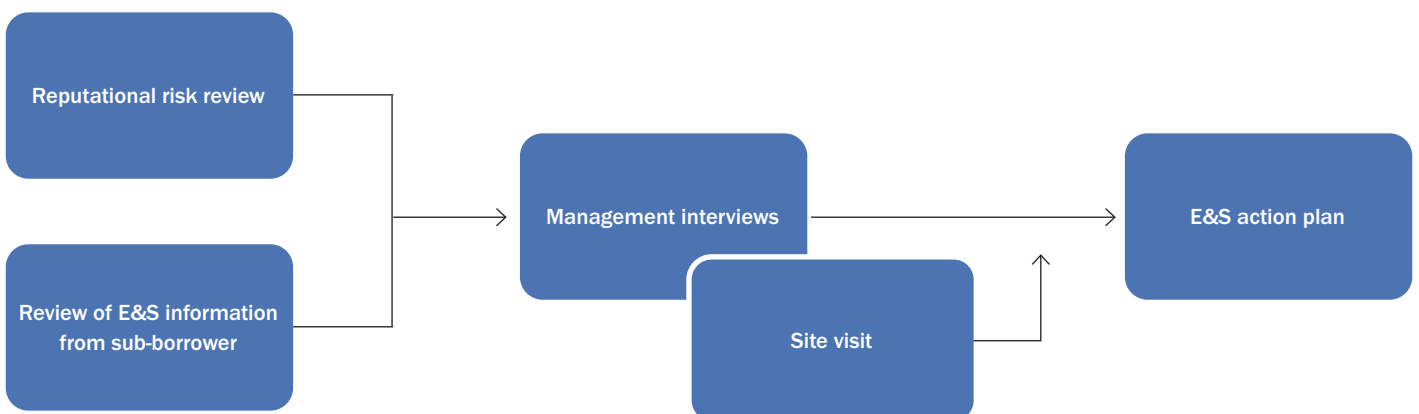
**Figure 2: Indicative ESDD activities commensurate with risk category**

E&S risk assessment activity	E&S risk level of project/loan/customer			
	Low	Medium	High	Cat A
Regulatory compliance check	✓	✓	✓	✓
Assess how E&S risks are managed; conduct ESDD		✓	✓	✓
Conduct a site visit			✓	✓
Compliance with EBRD PR1-8 and PR10				✓

Depending on the complexity and risk level of the project, the ESDD may include some or all of the following:

- **Step 1: A reputational risk review (RRR).** An RRR consists of a review of publicly available information on the E&S performance of the potential sub-borrower, especially information indicating inadequate E&S performance, incidents, complaints from stakeholders, regulatory non-compliance (such as fines) or occasions where the sub-borrower has been the subject of adverse campaigns by stakeholders such as non-governmental organisations (NGOs).
- **Step 2: A review of the potential sub-borrower's E&S information.** Depending on the nature and scale of the sub-project, the FI should request relevant E&S risk management information from the potential sub-borrower, including E&S risk management policies, procedures, guidelines and tools, as well as information on stakeholder engagement and grievance management. The requested information should also include, for example, data on the workforce, information on incidents and grievances, data on emissions, waste, and so on. This information can be requested using a document request list (DRL) or a questionnaire aligned with the E&S standards applied.
- **Step 3: Management interviews.** These are an effective way of verifying and clarifying the E&S information reviewed. They often provide additional information to the documentation, for example, on recent trends and developments at the sub-borrower, challenges the company is facing in implementing effective E&S measures (for instance, because of budget constraints), plans to improve their E&S performance (such as additional hires), stakeholder engagement and so on.
- **Step 4: Site visit.** A site visit is recommended for high- and medium-risk projects where visual observation of the potential sub-borrower's premises and sites is of added value for understanding the company's E&S risk exposure and management. The purpose of a site visit is to triangulate information; that is, confirm on site the information gleaned from reports and interviews. Low-risk transactions do not require a site visit. A site visit as part of internal ESDD should only be considered if the FI has a qualified E&S officer experienced in conducting site visits. A trained eye is required to know what to look for and to obtain the right information, while appropriate skills are required to interview people from various backgrounds.
- **Step 5: Environmental and social action plan (ESAP) –** An ESAP is a tool for listing the gaps identified by the ESDD and proposing actions to close them. Depending on the level of risk of the sub-project, this can be developed by the FI's E&S officer internally or by an external consultant as part of the outsourced ESDD. An ESAP is a critical tool for ensuring that the sub-borrower adheres to the E&S requirements of the FI. Further guidance on the contents, characteristics and negotiation process of an ESAP are provided in the Mitigation guidance note in this series.

Figure 3: Components of an ESDD





**Case study 1:**  
**E&S risk assessment of a medium-risk transaction**

A commercial bank (FI) is considering a loan to a logistics company to modernise the industrial refrigeration units in its main warehouse for food and drink products. The investment will improve energy efficiency and use refrigerant gases that have a lower greenhouse gas (GHG) impact than those currently used by the old system.

The FI's E&S officer categorised the transaction as medium risk and undertook ESDD internally by way of a reputational risk review (no controversial issues were identified) and a review of information provided by the sub-borrower (copies of current operating licences and permits plus the manufacturer's technical specifications for the new refrigeration units), followed by management interviews and a site visit. The site visit did not uncover any problems with the proposed refrigeration project, but the FI's E&S officer noticed that health and safety signage in the warehouse was largely absent and the accident logbook revealed that accidents and incidents involving forklift trucks were relatively common. The officer discussed this with the sub-borrower and agreed a simple ESAP, in which the company would commission an independent health and safety inspection within the next six months and would implement the associated recommendations.



**Case study 2:**  
**E&S risk assessment of a high-risk transaction**

A commercial bank (FI) is considering financing a major expansion of a cashew nut plantation. The planned expansion covers 2,000 hectares and will include a cashew nut processing plant. The plantation is located in a water-stressed region with limited rainfall. The bank's E&S officer categorised the transaction as high risk, based on a high-level screening of E&S risks. The screening revealed, among other things, the potential need for resettling neighbouring farmers and extracting large amounts of water in an already dry area. The E&S officer decides to engage an external consultant to conduct the ESDD.

The document review and management interviews conducted by the external consultant revealed that the company was lacking a land acquisition and compensation strategy, as well as community liaison officers to engage with the surrounding communities. They identified a further issue in the capacity of the sub-project to manage effluent streams from the processing plant to be built as part of the expansion.

During the site visit, the external consultant interviewed the plantation's environmental manager, who had been with the plantation for five years. When she asked about his experience with cashew nut processing, he indicated that he had not worked in a processing plant before. He expected to receive training on the environmental management of the plant, but could not provide details on content or timing of the training.

When the consultant visited the area where the expansion was planned, she noticed that much of the land was used by small farmers. When she spoke with the farmers, she learned that they had formed a close community and that their families had been living in the area for multiple generations. The farmers said they had heard rumours about the planned expansion, but were unable to get further information from the cashew nut plantation. They also said they had no intention of selling their land.

After the site visit, the consultant submitted the ESDD report and the ESAP (including the recommended corrective actions) to the FI's E&S officer. The report confirmed the high risk categorisation of the transaction and justified the use of an external consultant.

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