

Environmental and social management system – risk mitigation and control



European Bank
for Reconstruction and Development

Introduction

The risk mitigation and control process forms part of the risk management component of the environmental and social management system (ESMS), as depicted in Figure 1.

Figure 1. Risk mitigation and control stage in sub-projects



Measures to mitigate E&S risks and impacts

There are different types of mitigating measures that financial intermediaries (FIs) can use to address the identified environmental and social (E&S) gaps of a sub-project and/or sub-borrower in line with applicable E&S standards. These include:

- **E&S policy:** If the sub-borrower's E&S policy is not aligned with the E&S standards of the FI, then the policy needs to be updated to bring it in line (for example, a sub-borrower could be required to develop a clear policy on overtime management for its staff if the nature of the business requires employees to work long hours).
- **Legal mitigation measures:** These are meant to address issues of legal non-compliance.
- **Procedural mitigation measures:** Gaps in the sub-borrower's E&S risk management could be procedural, in that a procedure to implement a policy commitment has not been developed, or has been developed but insufficiently implemented (for example, a formalised road-safety management procedure should be developed for a sub-borrower that operates a large fleet of trucks).
- **Organisational mitigation measures:** Such mitigation measures are required if the sub-borrower's E&S capacity or competence is lacking, that is, the sub-borrower's staff with E&S responsibilities are insufficiently skilled or are missing specific expertise (for example, E&S staff need to be trained and skilled to address gender-based violence and harassment [GBVH] if such risk has been identified during the assessment phase and/or relevant grievances have been received from affected stakeholders).
- **Technical mitigation measures:** These address technical risks identified in sub-projects (for example, malfunctioning equipment or machinery or could result in E&S risks).

To be acceptable to a sub-borrower, recommended actions (mitigating measures) need to be:

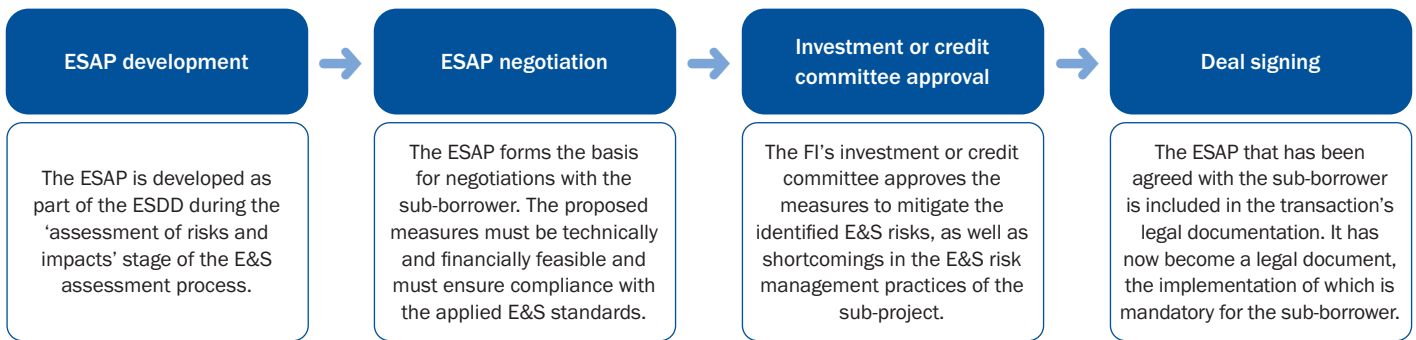
- **Financially feasible:** Recommended actions have financial implications that need to be budgeted into the project's financial plan. For example, if a sub-project requires involuntary resettlement, the sub-borrower should earmark a budget for land acquisition and livelihood restoration in compliance with national expropriation laws and EBRD requirements.
- **Technically feasible:** The implementation of a proposed mitigating measure must be feasible from a technical perspective (for example, the proposed technology to mitigate the risk might be available at an acceptable cost, but the infrastructure of the sub-project location cannot accommodate it).
- **Implementable timeline:** Some measures can take longer to implement than others depending on the nature of the sub-project, so a carefully planned timeline should be developed.

Development and negotiation of an environmental and social action plan

An environmental and social action plan (ESAP) or corrective action plan is a key deliverable of any environmental and social due diligence (ESDD) process. It includes mitigation measures to address any adverse E&S impacts and risks of sub-projects. The sub-borrower will be accountable for the implementation of the ESAP, which is usually part of the legal agreement between it and the FI.

As illustrated in Figure 2, the proposed ESAP needs to be negotiated, agreed and approved by the FI, as well as by the sub-borrower. ESAP items have financial and practical implications for the sub-borrower, so negotiations must take place and mutual agreement must be reached on the measures to be implemented to ensure compliance with national laws and applicable E&S standards.

Figure 2. Stages of E&S risk management



Technical guidance on ESAP structure and content

A good ESAP should be specific, measurable, achievable, realistic and time-bound (SMART). A template is provided in the table below. A well-drafted ESAP should:

- Include a summary of the key gaps/issues identified. Generally, companies/clients find it helpful to understand why an action is going to be implemented and the gaps/issues each action aims to address.
- Include concise (but suitably detailed), accurate and clear descriptions of the actions to be implemented. High-level actions should be avoided (for example, "manage waste"). In some cases, one risk can require several actions to ensure appropriate risk management and/or capitalisation on opportunities (for example, appropriate occupational health and safety management may require: (i) the preparation of written management plans, procedures and risk registry; (ii) the implementation of risk mitigation measures, including changes of process where needed, (iii) the development and delivery of an ongoing training programme; and (iv) the purchase of protective equipment).
- Contain actions designed to address specific E&S gaps/opportunities and not simply an overarching action for the client to put in place an E&S management system.
- Set realistic and clear timelines for the completion of the actions required, with the emphasis on achieving compliance with the applicable regulations and the FI's standards as soon as possible.
- Prioritise the actions in order to emphasise those aimed at addressing the most relevant gaps and high-risk areas.
- Include clear indicators of completion for each of the actions (for example, installation of a wastewater treatment system or the completion of an anti-corruption policy).
- Clear allocation of responsibility for each of the actions/tasks.
- In some cases, a cost estimate may be included.
- Where appropriate, include a reference to the relevant standards (for example, a specific EBRD PR).

Table 1. Template/example of an ESAP

| E&S Standard | Action required (examples) | Priority low, medium, high | Responsibility | Completion deadline | Deliverable/ completion indicator |
|--|--|----------------------------|--|--|---|
| Applicable E&S standard on health and safety | Implement an occupational health and safety (OHS) plan to guide all activities on the project site during site preparation, construction and operation. This includes, at a minimum: - job and task-specific hazard analysis and controls for all activities - use and provision of personal protection equipment (PPE) - appropriate safety training for all personnel - review and approval of contractors' OHS plans - oversight of contractor OHS performance - recording incident statistics. | High | Head of environmental health and safety (EHS) unit | Prior to construction; maintain throughout construction and operations | OHS plan; OHS statistics and training records |

To ensure that the negotiated and agreed actions to mitigate E&S risks are implemented by the sub-borrower, the ESAP should be included in the transaction's legal documentation. This binds the sub-borrower to implementing the agreed measures, including all the financial and practical implications. These requirements include incorporating appropriate E&S definitions, provisions, warranties and covenants in legal documentation, such as the loan agreement entered into between the FI and the sub-borrower.

E&S clauses to be included in loan agreements

E&S clauses are designed to set expectations and requirements for the sub-borrowers to ensure that they implement and comply with E&S requirements. The clauses should, at a minimum, prescribe processes on the following topics:

Positive covenants

Positive covenants in E&S clauses are commitments and actions that the sub-borrower is required to undertake to promote E&S good practices during the term of the agreement. Positive covenants are proactive in nature and focus on requiring the adoption of sustainable practices rather than merely preventing negative impacts. Examples of positive covenants in E&S clauses include:

- The sub-borrower shall designate appropriate resources and key E&S personnel to effectively manage E&S aspects.
- The sub-borrower shall undertake its activities in compliance with the local regulations of [country of operation] and international E&S standards.
- Immediately and no later than 72 hours after its occurrence, the sub-borrower shall notify the FI of any major environmental and/or social incident as a result of the sub-borrower's operations, for example, occupational accidents that result in fatalities or lost time injuries; environmental incidents, such as a fire or release of pollution; community incidents, such as a strike or unrest related to the company; or reputational risks related to an adverse media campaign.
- The sub-borrower grants the right to the FI or the FI-appointed representative to carry out E&S inspections to assess the effective implementation of the E&S requirements of the agreement.
- The sub-borrower's employees/staff shall operate and maintain their activities in compliance with the E&S requirements of the contract.

Negative covenants

Negative covenants in E&S clauses are restrictions or prohibitions that the sub-borrower must adhere to in order to prevent or minimise negative E&S impacts. Unlike positive covenants, which focus on encouraging responsible practices, negative covenants are designed to avoid harmful actions or practices that could lead to adverse E&S consequences. Examples of negative covenants in E&S clauses include:

- The sub-borrower will refrain from carrying out any operations in contravention of the laws, rules or regulations of [country of operation] and local requirements or activities that are listed in [EBRD exclusion lists], which are annexed to the agreement [specify annex reference].
- The sub-borrower cannot exceed [specific pollution or emission limits] and shall ensure that its operations do not cause significant harm to the environment or public health.

- The sub-borrower is prohibited from engaging in labour-related abuses, such as forced labour, child labour or discriminatory practices, including the financing of any sub-projects that may be associated with any of the listed practices.

Conditions precedent

Conditions precedent in E&S clauses refer to specific requirements or obligations that must be fulfilled by the sub-borrower before the agreement can become effective or before the proceeds of the loan or investment can be disbursed to the sub-borrower. For example:

- The sub-borrower is required to undergo a comprehensive E&S due diligence (ESDD) assessment.
- The sub-borrower is required to submit an ESAP outlining how it intends to address any E&S issues identified during the ESDD.
- The sub-borrower is required to conduct consultations with [relevant stakeholders], such as affected communities, environmental groups and labour representatives.
- The sub-borrower is required to obtain all necessary environmental and social permits and approvals from relevant authorities.

Reporting requirements

The FI should include in the legal agreements clauses that require the sub-borrower to provide relevant and accurate E&S information to the FI as part of its ongoing reporting requirements. For example, the sub-borrower may be required to provide the following to the FI:

- reports on its E&S performance, including data, metrics and progress towards meeting predefined E&S targets or commitments
- evidence of its compliance with E&S actions of the ESAP and other legal requirements
- E&S audit reports conducted by external independent consultants
- information on any significant E&S incidents or risks that may affect the project or investment
- information on its engagement with local communities, including feedback received and actions taken to address grievances.

Consequences of a breach of E&S clauses

The consequence of a breach of any E&S clause should vary depending on its severity and nature, the specific terms outlined in the agreement and the legal and regulatory framework governing the agreement.

FIs are encouraged to include remedies in their legal agreements with sub-borrowers that may be applied in E&S breach situations. Examples of breach clauses include:

- If the FI has reasonably determined that the sub-borrower is in breach of any of the E&S requirements as stipulated in the legal agreement, the FI shall inform the sub-borrower of its concerns. The FI has the right to appoint consultants to investigate the possible breach.

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- The sub-borrower must cooperate in good faith with the FI in determining whether a breach has occurred. The sub-borrower must respond promptly and in reasonable detail to any request for information from the FI and provide documentary support for the response if requested.
 - If a breach has occurred, the FI and the sub-borrower shall engage in discussions to identify possible remedies for the E&S breach.
 - The sub-borrower must undertake to implement any corrective measures necessary or appropriate to remedy such breach, stipulated and formally documented in a defined corrective action plan within the associated timeframe specified by the FI.
 - The sub-borrower shall keep the FI regularly informed of the ongoing implementation of those measures by providing progress updates on the corrective actions.
 - If the sub-borrower fails to implement such corrective measures within such timeframes, the FI has the right to take certain actions, which may include demanding immediate repayment of the loan or investment, terminating the agreement or pursuing other remedies available under the agreement.

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