

Environmental and social management system – risk monitoring and review



European Bank
for Reconstruction and Development

Introduction

The environmental and social (E&S) monitoring process forms part of the risk management component of the environmental and social management system (ESMS), as depicted in Figure 1.

Figure 1. Risk monitoring and review stage of sub-projects



This guidance note explains E&S monitoring requirements for sub-projects and provides recommendations on how to demonstrate compliance with the EBRD's Performance Requirement 9 (PR9) in this regard. It is to be used in conjunction with other supporting EBRD guidance notes designed to help financial intermediaries (FIs) manage specific E&S risks during the investment cycle. In particular, financial intermediaries (FIs) should ensure that their E&S monitoring of sub-projects financed by the EBRD provides the information the FI will need to report to the EBRD (see PR9 guidance note and the one on reporting to the EBRD). This E&S monitoring will normally rely at least in part on self-reporting by the sub-borrower, so also needs to be reflected in the loan agreement between the FI and the sub-borrower (see the Mitigation guidance note in this series: E&S clauses for use in loan agreements).

Monitoring of E&S risks

E&S monitoring focuses on the sub-project's performance against national laws and regulatory requirements, the applicable E&S standards and, if relevant, progress on implementing any corrective actions agreed and documented in an environmental and social action plan (ESAP). It should also provide early warning of any change or deterioration in the sub-project's E&S risk profile (for example, in the event of project delays due to local community opposition). Consequently, E&S monitoring focuses on the adequacy of the E&S risk management measures that the sub-project has in place and includes indicators that could reveal poor E&S performance, for example, the number and severity of external grievances, accidents, increase in harmful emissions, labour unrest events and other issues. It should also include the identification of new E&S risks or changes in the severity of known E&S risks that may occur as a result of the sub-project's evolving operations.

Minimum information needed

To meet its reporting commitments to the EBRD, the FI's monitoring of sub-projects financed with EBRD support should include, at a minimum:

- a review of the sub-project's E&S category with adjustments if appropriate (justification for upgrading or downgrading the category should be recorded)
- confirmation that the sub-project continues to be in compliance with national E&S standards and the EBRD exclusion list (for low- and medium-E&S-risk sub-projects, it is normally sufficient to obtain a representation from the sub-borrower to this effect)
- details of any material E&S issues associated with sub-borrowers during the reporting period, in particular:
 - accidents, litigation or complaints linked to E&S matters
 - incidents of non-compliance with applicable E&S standards, such as fines, penalties or excess fees
 - incidents of significant non-compliance with E&S covenants by sub-borrowers or conditions imposed by the FI via the loan agreement
- for sub-projects that have been screened as high E&S risk or Category A and where an ESAP has been agreed, more in-depth information will normally be needed to demonstrate that E&S performance is satisfactory
- other information or impact key performance indicators (KPIs) agreed between the EBRD and the FI under specific frameworks such as the Green Economy Financing Facility or Women in Business programme.

E&S monitoring methods

The FI's approach to monitoring should be commensurate with the E&S risk associated with the investment. The comprehensiveness and frequency of such monitoring should increase as the level of E&S risk increases. In general terms, the E&S monitoring methods used by the FI may include:

- **Self-reporting by the sub-borrower** (usually on an annual basis), in line with the requirements of the loan agreement. This may be relatively simple for low- and medium-risk sub-projects (for example, written affirmation that E&S compliance representations made by the sub-borrower at loan approval stage continue to be valid), but more granular templates should be used for higher-E&S-risk sub-projects, especially sub-projects with ESAPs and/or Category A.
- **Public source reviews** (such as Google searches), media monitoring or use of proprietary information services (such as WorldCheck and RepRisk) to identify any E&S-related controversies, incidents or other material information that may need to be followed up.
- **Online/telephone review meetings** conducted by the FI to monitor the level of compliance and any changes that could affect E&S risk management practices in future (for example, budget, E&S capacity, potential expansions of operations or new operations, new products and services, and so on).
- **Site visits and management interviews conducted by the FI:** For more complex medium-risk sub-projects, those that lean towards the high-risk category or have an ESAP that is relatively straightforward in scope, the FI may choose to conduct an E&S monitoring visit to the sub-project to verify compliance with applicable E&S standards and to identify potential new E&S risks or changes in severity of known E&S risks. The FI should have sufficient internal expertise to carry out an E&S monitoring site visit and, if not, needs to hire an external consultant. Similar to visits conducted during the E&S appraisal stage (such as for E&S due diligence), the visit can also help strengthen the relationship between the FI and the sub-borrower, for example, if the FI representatives share some good E&S practices with the sub-project.
- **Site visits and other E&S monitoring support conducted by external consultants** may be appropriate for sub-projects with more complex ESAPs and/or those that have been screened as high E&S risk, and will normally be a strict requirement for any Category A sub-projects.
- If a monitoring **site visit** is conducted by the FI (or an E&S consultant on behalf of the FI), it should focus on the following:
 - E&S risks that are relevant to the sector, in line with sector-specific guidance notes and those that were identified during the E&S risk assessment of the sub-project
 - the closure of gaps identified through the ESAP
 - any changes in the company or site that could result in new E&S risks or a change in severity of existing E&S risks
 - a review of grievance registers, incident registers or any fines or prosecutions to understand the root causes of issues
 - engagement with key stakeholders, as relevant, including employees, sub-contractors, nearby communities, regulatory agencies and so on to understand any underlying issues or concerns
 - provision of a short closure meeting with the sub-borrower on good practices observed and outstanding gaps to the applicable E&S standards.

Figure 2 provides summary guidance on the combination of E&S monitoring methods recommended/expected by the EBRD.

Figure 2. Combination of E&S monitoring methods recommended/expected by the EBRD

Low risk	Medium risk	High risk and Category A
<p>Frequency: Annual</p> <p>Audit team: Internal</p> <p>Approach:</p> <ul style="list-style-type: none"> - E&S monitoring (such as through E&S monitoring tool) - Annual E&S compliance (online) meeting with sub-project (optional) 	<p>Frequency: Annual or biannual for more complex medium risk transactions</p> <p>Audit team: Internal or External</p> <p>Approach:</p> <ul style="list-style-type: none"> - E&S monitoring (for example, through E&S monitoring tool) - Periodic E&S compliance (online) meeting with sub-project - Monitoring site visit (optional) 	<p>Frequency: Annual, biannual or quarterly</p> <p>Audit team: External</p> <p>Approach:</p> <ul style="list-style-type: none"> - E&S monitoring (for example, through E&S monitoring tool) - Periodic E&S compliance (online) meetings with sub-project - Monitoring site visit - Engaging external specialists for E&S compliance monitoring

In all cases, E&S monitoring (together with any supporting documents, such as reports and site visit notes, as well as the FI's conclusions and decisions on any required follow-up action) should be recorded systematically in the credit file and/or management information systems.

How to respond to unplanned E&S events

Where unplanned events take place (such as workplace incidents or accidents) or unforeseen circumstances arise that could affect the sub-borrower's ability or willingness to implement the ESAP or other legally binding corrective actions (such as budget or time constraints), or the sub-borrower fails to effectively mitigate and manage most E&S risks, the FI should consider the following options:

- **Engage with the sub-borrower** – engagement should focus on analysing the root causes of the event and discussing a way forward, including measures to prevent recurrence. If necessary, the FI could require an update of the ESAP to include a corrective action.
- **Engage an external consultant** – experts to undertake a root cause analysis and propose mitigation measures, as well as an analysis of the sub-borrower's capacity to resolve the matter. The proposed mitigation measures should be included in the updated ESAP.
- **Activate legal clauses** – as a last resort, and if all engagements with the sub-borrower have not resulted in consistent E&S compliance, the FI could consider activating the legal clauses of the investment documentation.

Portfolio monitoring

FIs are encouraged to develop and implement a portfolio-level E&S monitoring tool that enables them to review and analyse key E&S information of sub-projects across their portfolios based on a central information repository. Portfolio-level E&S monitoring provides two important advantages:

- **Increased oversight of E&S risks** – portfolio-level E&S monitoring provides an overview of E&S compliance across the portfolio. This provides information on where in the portfolio the FI is exposed to E&S risk, trends across the portfolio, and where the FI should focus its monitoring and engagement efforts to enable the more efficient and effective management of those risks.
- **Basis for internal and external reporting** – FIs have internal (for example, to senior management) and external (for example, to lenders, investors and/or the broader public) E&S reporting obligations. A portfolio-level overview of E&S compliance provides a basis for meeting those reporting requirements efficiently and effectively.

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