

ENVIRONMENTAL AND SOCIAL MANAGEMENT SYSTEM: AUDIT FINDINGS AND DETAILS OF ARRANGEMENT

A. Introduction

1. The Asian Development Bank (ADB) proposes a senior unsecured loan of up to \$100 million (at a 5-year tenor) to Joint Stock Company Bank of Georgia (BOG) as a coronavirus disease (COVID-19) indirect response loan to support micro, small, and medium-sized enterprises (MSMEs)—especially MSMEs owned by women (WMSMEs). ADB is also mobilizing a parallel loan of up to \$100 million to be provided by the Japan International Cooperation Agency (JICA). The proposed loan will support the maintenance and growth of BOG's lending to MSMEs, providing critically needed financial assistance to this segment by reinjecting liquidity into the economy in the form of credit. BOG will particularly support WMSMEs by creating a special COVID-19 program for WMSMEs with financial features such as the extension of loan payment moratoriums for existing WMSME clients and a waiver of fees for new WMSME clients, and nonfinancial features such as the creation of an e-commerce platform and online training modules to increase the digital resilience of WMSMEs.

2. BOG has been an issuing bank in ADB's Trade Finance Program since 2010, with current net line limits of \$10 million. In 2010, ADB disbursed a 5-year \$50 million loan for SME lending that has been fully repaid, and in 2014, the extended annual review report rated the project's environmental, social, health, and safety performance as *satisfactory* (the overall project was rated as *successful*).¹

3. MSMEs in BOG's portfolio operate in the following segments: agriculture and forestry, construction, financial institutions, mining and mineral processing, retail or services, transport, and communications. BOG's MSME portfolio in those segments includes transactions classified low (category C), medium (category B), or high risk (category A). BOG has confirmed that it has a sufficient volume of loans per year to deploy ADB's proceeds for investment in general MSMEs classified as category C or low risk for a tenor of 5 years. Low-risk MSME transactions (about 20.3% of BOG's gross loan portfolio) will be the focus of the ADB and JICA use of proceeds. However, BOG has indicated that it would like flexibility in the use of ADB's proceeds for potential medium-risk transactions. Based on this, the project is classified *category FI* for environment, and *category FI treated as C* for involuntary resettlement and indigenous peoples under ADB's Safeguard Policy Statement (2009). Investment activities that are classified category A (high risk following BOG's environmental and social management system [ESMS]) for the environment, and category A or B (high or medium risk following BOG's ESMS) for involuntary resettlement and indigenous peoples, will be excluded from ADB funding.

B. Review of Existing Environmental and Social Management System

4. **Policies.** BOG has an environmental policy and strategy (2019) that sets the goals and key performance indicators to track the performance of its implementation. The policy and strategy cover the management of environmental risks associated with BOG's activities; waste minimization and reduction; efficient use of natural resources; awareness of the bank's employees on environmental issues; environmental performance of suppliers; minimization of negative impacts on biodiversity and ecosystems and, where possible, have direct and indirect positive impacts; and environmental legislation requirements and stakeholders' expectations.

¹ ADB. 2014. *Extended Annual Review Report*. Manila.

5. **Systems and procedures.** BOG adopted and implemented an ESMS in 2017 that meets the requirements of the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD). BOG screens all investments against a list of activities that are excluded or limited from financing, which is in line with the exclusion lists of ADB, IFC, European development finance institutions, and EBRD. The exclusion list, among others, prohibits onlending of international financial institution funds to subborrowers causing involuntary resettlement impacts or relocation of indigenous peoples from traditional or customary lands, and production or activities that impinge on the lands owned, or claimed under adjudication, by indigenous peoples, without the full documented consent of such peoples. Social and environmental risk management procedures are integrated into BOG's credit risk management process and are routinely applied to all commercial transactions, including MSMEs. The ESMS is updated periodically and approved by the Board of Directors to ensure that it still fits its purpose and reflects experiences and changes in applicable legislation. The ESMS is under revision by a third party to meet shareholders' requirements.

6. The draft ESMS (2020) adopts the current international financial institutions' exclusion list being applied. All transactions are (i) screened against the exclusion list to determine the transaction qualification; (ii) categorized according to the environmental and social (E&S) risks: low (equivalent to ADB's category C), medium (equivalent to ADB's category B) or high risk (equivalent to ADB's category A); and (iii) put through a procedure for E&S risk assessment, an E&S due diligence report template and tool kit covering prohibited investment activities, categorization, E&S risk assessment, and legislation and monitoring. Transactions of less than \$50,000 are considered low risk. If the MSME client's exposure is more than \$50,000, the transaction goes through the due diligence process following relevant sector guidelines. Medium-risk clients are expected to comply with applicable environmental, health and safety, and labor regulations and standards, as well as public disclosure requirements. For medium- and high-risk transactions, an environmental and social action plan (ESAP) can be developed, if needed, to identify the risk, mitigation measures, and timeline for implementation; and it is included in the loan agreement. All MSME clients are required to sign E&S covenants that are included in loan agreements regardless of the exposure. BOG's E&S annual report to IFC reports on exposure to IFC exclusion list activities.

7. BOG has an internal audit unit that performs ESMS implementation audits annually. The last audit was performed in March 2020 and did not identify any issues regarding MSMEs or low-risk transactions.

8. **Monitoring and reporting.** Monitoring and reporting procedures are described in the draft ESMS (2020). The environmental and social risk unit (ESRU) monitors clients' ongoing compliance with the applicable E&S covenants, E&S regulations, or ESAPs, as stipulated in the legal loan agreements. The frequency and type of monitoring is determined according to the type of transaction and the level of E&S risk. BOG reviews the E&S performance of all commercial transactions, including MSMEs. BOG undertakes site visits when deemed necessary, usually for medium- and high-risk MSME clients. The ESRU also reports internally on a quarterly basis on the E&S risk assessment process, E&S due diligence reports, and ESAPs; and updates are provided to BOG's senior management.

9. **Capacity and training.** BOG's E&S capacity is considered adequate. BOG has a dedicated E&S team, the ESRU, which is involved in the credit review, categorization, E&S risk assessment, due diligence, and monitoring processes. The ESRU comprises an environmental expert and a social expert, and BOG is planning to hire a health and safety specialist. BOG's current investors require BOG to continue to train the staff responsible for ESMS implementation

and to develop and implement an E&S training plan. In 2019, BOG provided training opportunities for the E&S team and the staff involved in environmental and social risk management processes, and relevant staff attended training organized by other financial institutions. BOG, with the support of an external consultant, is developing an electronic training course for all relevant staff involved in E&S risk management. BOG assesses the effectiveness of the training program through evaluation forms.

10. **Grievance redress mechanism.** BOG has adopted procedures for addressing external queries and concerns that were developed within the framework of its ESMS. The procedures provide a means for the public to submit queries or concerns related to BOG's E&S policies, and require BOG to respond to these inquiries in a timely manner.

11. **Labor.** BOG's ESMS ensures that its own operations comply with IFC's Performance Standard 2 on Labor and Working Conditions. BOG has in place a human rights policy that sets out, among others, its guidelines for equal opportunity and nondiscrimination in the workplace. These guidelines are applied not only to the process of employment but also to supporting BOG employees' training and development. The human rights policy also details BOG's internal grievance redress policy and procedures. Grievances are filed with and managed by authorized staff, and complainants have the right to appeal. In 2019, three grievance cases were investigated and resolved. No grievances were reported in the first quarter of 2020. BOG also has an intranet portal that allows the submission of internal complaints. The human rights policy is being updated to include provisions on freedom of association. BOG also has a retrenchment policy that describes the applicable circumstances and procedural guidelines for retrenchment, in line with the relevant laws of Georgia.

12. Following BOG's ESMS, all its clients are expected to comply with applicable labor regulations and standards. Among the list of activities excluded from financing are production or activities involving forced labor or child labor. Commercial transactions are also evaluated for potential labor risks and impacts.

C. Environmental and Social Management System Recommendations

13. ADB's due diligence and review of BOG's existing ESMS aims to ensure compliance with ADB's Safeguard Policy Statement requirements. As a result of such exercise, the following actions have been discussed and agreed with BOG:

- (i) **Environmental and social management system.** BOG's existing ESMS was adopted in 2017 and is being updated. BOG will finalize within the year 2020 the draft ESMS (dated March 2020), share the final ESMS with ADB, and implement it. BOG will review the ESMS every 2 years and inform ADB of any revisions.
- (ii) **Organizational structure and staffing.** BOG will hire a health and safety specialist within a year from first disbursement, if feasible during the pandemic.
- (iii) **Monitoring and reporting.** BOG prepares and submits E&S performance reports to IFC and EBRD. ADB will revise the report template to ensure that ADB's reporting requirements are addressed, including an update on the use of ADB proceeds. The report will include a representation on the absence of high-risk impacts on the environment, and high- or medium-risk impacts on involuntary resettlement or indigenous peoples.