NGO Issue Paper

Financial intermediaries: Do economic, environmental and social benefits lie behind the big numbers?

CEE bankwatch network

CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

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Background

In order to prevent the collapse of the banking sector in central and eastern Europe following the outbreak of economic crisis conditions in autumn 2008, the European Bank for Reconstruction and Development (EBRD) has provided a large number of loans to private banks in the region. Most of the projects have aimed to provide crisis support via these financial intermediaries (FIs) for small- and medium-sized enterprises with some aimed specifically at energy efficiency and small-scale renewable projects.

Mirroring lending trends at other public development institutions such as the European Investment Bank (EIB) and the International Finance Corporation, the EBRD's FI lending is now reckoned to account for roughly 40 percent of the bank's total lending volumes. Yet even though this form of lending is taking on ever greater importance at the EBRD, next to no concrete details about what it is achieving and who is benefitting from it exist for the public.

Thus, regretably, this issue paper is unable to address any tangible benefits or failures of the EBRD's FI lending in practice.

Are FI loans getting through to SMEs?

It is increasingly clear, however, that greater accountability and transparency of such loans is urgently needed to ensure that they are used for socially and environmentally sustainable projects that bring real benefits for people and the environment. The threat of rising unemployment in central and eastern Europe as a result of the economic crisis has been noted by the EBRD - whether or not the bank's FI lending to support small businesses and, in turn, to secure jobs is having a positive effect remains absolutely unclear.

Businesses in the region are undoubtedly suffering in the downturn. According to Creditreform, the number of companies in central and eastern Europe that became insolvent last year grew by 40 percent to 47,000; in the same period in western Europe, according to Creditreform, the number of insolvencies was up 22 percent to 185,000. The worst situations in central and eastern Europe were recorded in Latvia and Lithuania, with the Czech Republic third worst.[1]

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[1] 'Number of Czech companies in insolvency up 57% in 2009', 23 February 2010, ČTK - Czech Press Agency

The EBRD and other international financial institutions (IFIs) may well argue that things would have been much worse without their ramped up crisis credit lines, but without any information about who has benefited from FI lending and how, such claims hold little water.

Tougher standards and a lot more transparency needed

In its submission to the EBRD's Capital Resources Review 4, Bankwatch has called for a tightening up of the EBRD's rules on FIs, to ensure that:

- FI financing is not used for socially harmful lending practices.
- FI financing complies with the environmental and social standards used by the EBRD for directly financed projects, not merely conforming with national legislation which may be weaker
- the names of the final beneficiaries of FI financing are disclosed
- qualitative, independent evaluations are disclosed routinely to increase accountability and to properly assess the extent to which the EBRD is achieving its stated goals with such loans.

Currently, and as we expressed in the consultation process for the EBRD's Environmental and Social Policy that pre-dated the bank's increased emphasis on FI lending, far too much disgression is being permitted to the FIs. The relevant performance requirement in the policy for FIs states:

> “The very nature of intermediated financing means that the EBRD will delegate to the FI responsibility for transaction appraisal and monitoring as well as overall portfolio management. Environmental and social risk management are part of the responsibilities delegated to the FI. Nevertheless, by virtue of its relationship with the FI, the EBRD continues to have an interest in assessing and monitoring whether the environmental and social risks associated with the FI’s business activities are adequately addressed by the FI.”

The risks attached to this 'delegated' approach adopted were clear, then, in 2008. They have surely increased now, since:

- the EBRD is increasing its lending volume via the FI approach
- crisis-induced pressure on the banks has dramatically increased, with questions arising not only about their abilities to provide adequate environmental and social oversight but also about their willingness to lend to SMEs on the favourable terms that EBRD lending ought to facilitate
- in terms of transparency, the CEE region continues to be blighted by high levels of corruption in the business sphere.

European Parliament on the case

Significantly, European political vigilance and oversight – by elected representatives – appears to be increasing when it comes to this form of lending.

A vote on the EIB's annual report for 2008 was passed in a plenary session of the European Parliament on May 6, 2010. Having been through the European Parliament's Budgetary control committee, as well as receiving opinions from the Economic and Regional committees, it contains robust language on how the EIB conducts its own lending via FIs:

> *"Recalls the recommendations made in its resolution of 25 March 2009 on the 2007 Annual Reports of the EIB and the European Bank for Reconstruction and Development(12), in paragraph 8 of which it urged the EIB 'better to monitor and to make transparent the nature and final destination of its global loans in support of SMEs'; calls on the EIB to further enhance transparency in its lending through financial intermediaries and to establish clear financing conditions for financial intermediaries and lending effectiveness criteria...*
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> *"Urges the EIB better to monitor and to make more transparent the nature and final destination of its global loans in support of SMEs; suggests setting up a scoreboard on the multiplication effects of EIB lending operations".*[2]

What is to be done?

The EIB may be a different institution from the EBRD, yet it shares very similar gaps in transparency when it comes to its approach to lending via FIs – both banks are also channelling more and more public money via the FIs.

It's about time for a much fuller, qualitative debate about this form of lending as carried out by the EBRD and other IFIs – the big lending numbers that do exist have long since stopped meaning anything.

For more information

Pippa Gallop
Research coordinator / Interim EBRD coordinator
CEE Bankwatch Network
Tel: +385 997559787
Email: pippa.gallop@bankwatch.org

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[2] The text of the European Parliament resolution on the EIB's Annual Report for 2008: http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2010-0062&language=EN