

Written Submission on Asian Development Bank's (ADB) September 2023 Draft Environmental and Social Framework (ESF)

Submission from the Institute for Energy Economics and Financial
Analysis (IEEFA)

Received on May 6, 2024

Disclaimer: The views expressed in this document are the views of the author/s and and/or their organizations and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this document and accepts no responsibility for any consequence of their use.



Comments on the Asian Development Bank's Draft Environmental and Social Framework

May 5, 2024

Thank you for the opportunity to comment on the Asian Development Bank's (ADB) completed draft Environmental and Social Framework (ESF). The Institute for Energy Economics and Financial Analysis (IEEFA) has been pleased to have been part of the consultations since the first rounds of discussions on the scope of the review in 2021.

IEEFA applauds the Safeguards team for greatly advancing the provisions of the 2009 Safeguards Policy Statement (SPS) to account for an up-to-date understanding of potential project impacts in ADB's operations and the ADB's role in helping mitigating or eliminating them. Of particular importance is the explicit inclusion, for the first time, of climate change in the evaluation of projects.

We provide the following affirmations, comments, and questions in the spirit of our ongoing support to the process of the ADB safeguards review team, and to the betterment of the overall framework design and intended outcomes.

Should you wish to reach out to us with any questions or need additional information, please coordinate with **Grant Hauber, Strategic Energy Finance Advisor, Asia** at ghauber@ieefa.org.

IEEFA is a United States based non-profit, non-government organization think tank.

IEEFA's website is www.ieefa.org

IEEFA is pleased to have its comments disclosed publicly on the ADB website.

General Comments

Definition of the term “Proportionate”

Throughout the document, the phrase “proportionate to the nature of the project” is used. While it is acknowledged that this is meant to provide for flexibility and reasonableness, it can also be open to misapplication, whether over- or under-protecting the subject to which it is referenced.

There should be threshold materiality criteria defined as to what is proportionate. This may not be a direct proportionality based on total project cost, as it should be acknowledged that some compliance measures could take up larger percentages of smaller projects yet remain critically important to the sustainability and outcomes of that activity.

Technical and Financial Feasibility Definition and Updates

IEEFA highlights that sustainable energy transition investment can follow the ESF’s principles of taking a “precautionary approach” as defined in the Draft ESF, and that non-fossil sustainable energy investments are both “technically feasible” and “financially feasible” also as defined in the Draft ESF.

It is important that the criteria of “feasibility” are constantly updated to take into account the latest standards, capabilities, and measures of what is truly feasible given the state of technology development and associated costs. This cannot be based on someone’s opinion or political policy statement, but rather on empirical evidence of technological capabilities, implemented costs, proven performance, demonstrated outputs, etc. Technical and financial feasibility feature repeatedly throughout the draft ESF, thus it is critical to have those criteria well-defined and relevant.

Some questions arise:

- How does ADB propose to track the definition of feasibility, both technically and financially?
- How will that feasibility be determined and decided upon?
- How would that be informed to prospective borrowers/clients?
- How often would that information be updated?

The bases for those determinations should be published in guidelines. Given the pace of the evolution of technology and costs, IEEFA would recommend that updated technical and financial criteria are established at least annually.

Clarification of the scope and purpose of the document “Environmental and Social Requirements for Financing Modalities and Products” versus the draft “Environmental and Social Framework”

It is not clear from the documentation what is the purpose of the separate document, “Environmental and Social Requirements for Financing Modalities and Products.” Is it meant to *summarize* the cases and principles of the main “Environmental and Social Framework?” Does it provide extra explanation of what is in the main ESF statement? It should be made explicit which document governs, which, from our reading, appears should be the master Environmental and Social Framework.

Right now, as it reads, paragraph 2 of “Environmental and Social Requirements for Financing Modalities and Products” seems to imply that there is a bit of both – that the ESF is applied in general but that there are some further specifics in this document. The “Environmental and Social Requirements for Financing Modalities and Products” provisions read more generally than those in the ESF or may potentially be repetitive. While summarizing the financing modalities and the principles governing them are helpful for stakeholder reference, we would recommend that it is made clear that there is only one place where the rules are set and defined.

Using the ESF to Assure a Sustainable Energy Transition and Climate Smart Development

While IEEFA focuses on energy economics including resources, energy, environmental and financial efficiencies that demark the sustainability transition, we also recognize that such issues exist in a broader context of just human development and protections under the umbrella of climate change.

ADB has developed an array of bank-wide policies to support sustainable development and address climate change. The new operating model under Strategy 2030 aligns bank operations with Paris Agreement goals. The Climate Change Action Plan 2023-2030 (CCAP) and calls for making climate-smart development a centerpiece consideration of bank operations in developing member countries (DMCs). These are materially positive changes to bank operations, but they require reinforcement to see them from concept into implementation. The scope and nature of this ESF draft take large steps forward to take guidance and transform it into requirements.

The CCAP acknowledges the need to incorporate holistic development in all infrastructure given that most of Asia’s infrastructure needs for this century have yet to be built. Given the energy and resource intensity of infrastructure and the services it provides and, in turn, its climate change impacts, it is imperative that the principles of sustainability, efficiency, and resource use minimization are compulsory considerations in all of ADB’s operations. This can be better achieved by strengthening such compliance requirements in this ESF.

Need to Harmonize ADB Energy Policy with the Principles of the ESF

The ESF is of critical importance to for assuring ADB, its borrowers/clients and its DMCs achieve sustainable benefit from ADB operations. The draft ESF goes much further than the 2009 SPS to achieve this. To assure that ADB is truly sustainability aligned with the demands climate change is placing on its DMCs and their populations, consistent review of ADB policies is warranted.

This ESF policy must be robust and unwaveringly adhered to in ADB-funded projects and supports as ADB's DMCs make their own transitions. Within each DMC there are many policies and perceptions that compete with climate change and sustainability matters. These may serve to delay the transition, even in cases where the benefits would be positive and immediate, potentially due to vested interests in fossil fuels, misperceptions of what can be achieved, legacy fiscal impediments, distortionary pricing/subsidy/tax policies, etc. Thus, the ESF must help buttress ADB's position on climate change matters such that the institution is in a solid position to push back on policy-deviating funding requests and support sustainable project pathways.

In the context of this ESF, the ADB's overall "New Operating Model" and alignment with the Paris Agreement, IEEFA would encourage the ADB to revisit the principles and assumptions underlying its Energy Policy 2021 (EP21). Energy technology, the financial economics that underpin that technology, application, and use cases have and continue to evolve rapidly. While, importantly, ADB's policies clearly exit the bank from support of coal production, handling and use, as well as from upstream oil and gas exploration, the bank continues to consider the role of fossil fuels in matters of primary energy supply, energy security, and energy economics.

However, rapidly evolving, favorable trends in renewable energy and energy storage systems costs and performance, energy efficiency, and electrification, combined with the demonstrated ability of operating electricity networks to support large quantities of renewable energy are already challenging the assumptions ADB has used in the EP21. ADB, in applying its energy policy, would benefit all climate initiatives by taking renewed, objective assessments of the science of energy technologies that qualify under EP21, their resource intensity, the risks associated with their implementation, their costs versus benefits and their environmental and sustainability impacts – including the timeline to achieving net zero climate outcomes using different technologies.

ADB's financial support cannot be hinged on niche technological, philosophical, or political preferences or opinions of its DMCs or private borrowers; rather, it should focus on hard science, hard facts, and sustainability economics. Indeed, as we highlighted earlier, it is precisely the rapid progress in energy technology and costs that drive the request to have regular reviews of the technical and financial feasibility criteria in the ESF.

Specific Comments

ESF main text

Section IV – A&B. Associated Facilities and Existing Facilities

IEEFA supports the scope and definition of “associated facilities” and “existing facilities” in the ESF as being important to assure that the function and intention of systems taken as a whole conform with the ESF.

Paragraph 65 and ESMF Annex A-4 – Financing modalities with unidentified sub-projects

While IEEFA acknowledges that the purpose of pooled, sector lending is to create efficiency, the unidentified nature of end use of funds poses a material risk particularly in the energy or resource sectors. By the nature of the ADB financial instrument, the review of end use of monies necessarily comes after the facility has already been approved by the ADB Board. Thus, it is imperative that the ADB insist on application of the ESS's under the ESMF the borrower uses accompanied by retained ADB veto power to prohibit use of funds in non-conforming circumstances. Disclosures of these subprojects are also important to assure all stakeholders know how funds are being used. This would be similar to the rules proposed for funding under Paragraph 69.

ESS1: Assessment and Management of Environmental and Social Risks and Impacts

Paragraphs 25 and 26

IEEFA supports the requirement for external experts to be hired to help assess impacts of proposed projects. In particular, the concept of independence of this assessment and advice is vital. We believe the principle of independence of even greater importance in the case of high and substantial risk activities.

It is important for borrowers/clients and the ADB to have available to it clear, unbiased, objective information on the risks and actions covered by this ESF. This allows for informed project design, reconsidering scope or elements, or, in extreme cases, project cancellation altogether if adequate safeguards cannot be guaranteed.

Paragraph 28 – institutional capabilities

It is essential to consider a borrower/client's ability to evaluate risks, propose mitigations/solutions and implement safeguards. In addition to this, it is equally important to assess a host country government's/regulator's safeguard rules, its institutional capacity and demonstrated willingness to and track record performance on enforcing those rules without hesitation.

Climate change importance. The principles of capacity assessment, implementation abilities and performance review are of particular importance in the application of the newly proposed climate change related safeguards. Currently, climate change risks, impacts, and mitigation and adaptation measures are not uniformly understood amongst stakeholders in the context of ADB projects as are those of more traditional environmental pollutants.

ADB, in applying this ESF, should consider extending guidance and supports around application of climate change ESF parameters, perhaps even insisting on providing such support, even for borrowers/clients with high capacity and experience in other areas of ESF, given the varying understanding and potential wide applications of climate safeguards. A working partnership between ADB and borrower/client in these areas would be more constructive, time, resource and cost saving while likely achieving better aligned outcomes. It would also advance ADB's own goals of Paris Agreement alignment and overall better sustainability outcomes with more efficient effort and resource allocations.

ADB might consider allocating TA resources or similar for aiding counterparts in making use of the new ESF during its first years.

Paragraph 30 – compensatory measures

IEEFA concurs that it is important to have this provision as a last resort backup if elimination, avoidance, or minimization provisions are insufficient. There can be no free pass for project impacts.

Paragraph 35 – proportionate frameworks/tools/management systems

It seems to be implied here that the frameworks, rules, and tools are those created newly for a proposed project being considered. It may be helpful here to clarify that if a borrower/client already has a fully functioning set of safeguard measures that were established and used under prior ADB-support projects, that those measures should continue to be used as designed as long as they comply with the requirements of the updated ESF. There is no reason to back off, back down, or simplify them if they are already designed, resourced and functioning, especially if those are robust. (such as is implied in Paragraph 41)

Financial Intermediaries (FI) provisions in ESS1

We note that we are commenting on the FI provisions presented here in ESS1, but these comments also apply to the FI sections in the supplemental Environmental and Social Requirements for Financing Modalities and Products.

Paragraph 66

It is important that ADB insist upon FIs making use of ADB's ESSs for high-risk transactions. A question arises as to how these groups might develop or improve their capability to assess, design solutions for, and apply these standards. These are clearly important capabilities for institutions across ADB's DMCs – as well as those from outside who support the DMCs – to have developed.

Annex A-4 ESMF

Paragraph 2 outlines principles very generally. It seems a bit vague by comparison to the more explicit definitions provided in for ESIA, ESMP, ESA in the prior sections. It would seem that there should be clear instructions to borrowers/clients that once they apply their ESMF to prospective projects that, if the results indicate that they are high or substantial risk, that there should be the subsequent measures of having those recipient projects prepare the necessary more detailed evaluations/studies required of projects. It should be made clear in this annex that rigorous standards for the end use of monies from a funding facility falling under the applicability of this annex still has to comply.

ESS 3 – Resource Conservation and Pollution Prevention

General comment

IEEFA supports the principles ADB has introduced here on resource use minimization/optimization and promotion of a circular approach to development. It is a much-needed advancement over the 2009 SPS.

Paragraph 8 – efficient consumption of energy

This paragraph importantly emphasizes the need to assure “efficiency consumption of energy,” a concept IEEFA supports. We would emphasize that this principle should be applied systematically, on both a scientific and financial economic basis, when comparing and evaluating proposed energy technology solutions. Energy inputs, losses and waste generation, net outputs, emissions-intensity (covering all pollutants, including GHGs), resource use, output benefits are all important aspects of assessment. It would be helpful if parameters defining what is “efficient consumption of energy” are provided in guidance and updated periodically to reflect global efficiency progress.

IEEFA supports ADB in its application of a social cost of carbon as part of such evaluations as an important means to compare the impact of carbon intensity from various considered solutions. See also comment on paragraph 12 below.

Paragraph 9 – projects using existing facilities

It is essential to conduct a thorough E&S Audit on existing facilities, both in the context of current operations to gather existing operating characteristics and performance, as well as any proposed new configuration and its associated characteristics and performance.

The principle of efficient/minimized use of energy combined with stringent environmental pollution outcomes, including GHGs, is of paramount importance. It would be important in such an analysis to have comparisons to alternatives, such as no-build or alternative technologies available. For energy sector projects this underpins the principles defined in Paragraph 12.

Paragraph 12 – contribute to environmental sustainability through efficient use of energy

IEEFA supports the application of the principles and the use of the alternative analysis described in this paragraph.

However, there is ambiguity in this section related to definitions of “waste energy” and “low-carbon.” These definitions are important to determine if something is indeed wasteful or low carbon and how a proposed project solution complies or does not comply with this ESF.

IEEFA highlights that ADB’s Energy Policy 2021 does not specifically assign a definition to what “low-carbon” means, even though the term is used throughout the paper. Not qualifying what is low-carbon is a risk to both the ADB and to borrowers/clients regarding compliance. But more importantly, a loose interpretation of what is “low-carbon” could put ADB’s overall environmental protections and goals at risk.

Paragraph 18 – release of pollutants

The hierarchy of principles described in this paragraph must be implemented rigorously. Proposed technology solutions that lead to release of pollutants should be required to be evaluated in comparison to lower release alternatives, applying the principles of technical and financial feasibility as IEEFA has proposed to be maintained and updated under our general comments on the topic.

ESS 9 – Climate Change

General

Firstly, IEEFA applauds the ADB for including this most critical aspect of environmental and social safeguards in the draft ESF. It is amongst the most important topics of our times, and it therefore must be considered seriously and consistently in all work going forward.

At the same time, our understanding of climate change continues to evolve, painting an ever more critical picture of the need for action and protection, mitigation, and adaptation. Given the world's rate of learning, this is one part of the ESF that is going to need close monitoring and regular updating to assure it is delivering the protections needed. Getting an aspect of climate change wrong or overlooking a critical factor cannot be left unaddressed in policy. Particularly since this is a new provision in ADB's policy portfolio, it is likely that it may need to be updated, improved, or strengthened at some point in the near future. ADB management should anticipate these changes could come sooner rather than later, and put in place the ESF climate change-related monitoring, evaluation, and updating processes to assure steps are in place to act promptly upon receipt of critical information.

Paragraph 2 – host country commitments

The provision here states “in accordance with the host country's commitments.” How might ADB handle situations where a country:

- Has stated commitments that do not place them on a Paris Agreement pathway.
- Has reduced or reneged on their initial commitments.
- Have made no commitments.

...particularly if that omission is in contradiction to ADB's policies and/or this ESF?

How does the ESF handle situations, say, where negative changes to a DMC's or borrower's/client's commitment have occurred during the validity period of a sector loan, MFF, policy-based loan, or other such multi-sub-project lending modality?

It would seem that ADB might want to engage in discussions that would encourage the borrower/client to take a compliant pathway, maintaining or tightening their commitment, rather than loosening. Otherwise, there needs to be a clear option to suspend, cancel, or otherwise invalidate the facility.

Section II Objective “a” and Paragraph 8

IEEFA underscores the importance of the concept in this paragraph of minimizing GHG emissions – both absolute and related – by evaluating alternatives.

It is not always going to be the case where a borrower/client selects an appropriate technology or an optimized application of a technology; evaluation of a range of alternatives is important. These standards should require that to be done. The assessment should be done objectively,

based on best and latest available information, sound technology maturity, and empirical evidence across all possible solutions.

There should be a thorough assessment of direct and potentially induced GHG emissions, over appropriate time periods (e.g. 20-year versus 100-year GHG forcing potential), on a lifecycle basis, using appropriate social values of carbon. We further emphasize the application of the prosed efficient use of energy principle included in ESS3.

IEEFA reiterates its concern about the lack of an effective definition of what is “low-carbon” to avoid chances of abuse of technology choices or permissive emissions that essentially violate the spirit of this ESF and ADB’s CCAP.

We also reiterate the need to keep updated and current the criteria government what is “technically and financially feasible.” Evidence-based technology performance improvements and cost reductions are occurring at a rapid pace and will impact such feasibility assessments.

Paragraph 11 – significant increases in GHG emissions

The provisions of this paragraph appear to be either incomplete or utterly inadequate. A material increase in GHG emissions is essentially a project failure. This is something that should put the loan or project under immediate review with the potential for calling an event of default. While it is recognized that events of default are part of loan covenants, there should be some form of indication within the ESF that a non-compliance is a serious breach.

There should be a call for an immediate halt in project operations until a cause and potential solution can be identified. There needs to be, at minimum, provisions for rectifying the situation, in an acceptable manner within the least amount of time. The analog to such a situation would be a leak of hazardous wastes into a project adjacent community, something that would not be allowed to persist and would be addressed immediately. Rather than simply update the amount of hazardous wastes released from a project, the preference would be to halt the project, stop the leak, rectify and remediate.

This ESF itself defines GHGs as a pollutant, and, as such, should be treated with similar caution. While the overarching principle here is to protect the environment, the situation this paragraph describes is essentially a failure of an ADB-supported project, one for which the institution’s reputation will be on the line. Thus, introducing some sort of consequences is not only environmentally and socially appropriate but also good institutional governance and risk management.

Paragraph 12 – material impact

How is materiality of climate change impact going to be defined? Will ADB be issuing guidance in this regard? This paragraph covers a wide range of environmental and social impacts. Again, as we have mentioned previously, the definition of “proportionate” is important.

Paragraph 13 – implementation of technically and financially feasible solutions

IEEFA emphasizes again the need to have up-to-date definitions and evaluation parameters of what is proportionate – and technically and financially feasible. This is particularly important with this addition of climate change/GHG parameters to the ADB's ESF given that many DMC borrowers/clients may not be familiar with integrating climate change assessments and mitigation matters into their decisions or operations. ADB's deliberate guidance and support will be of utmost importance from the earliest days of implementing this policy. Such guidance should continue until it is well-established part of project design and assessment. This is of importance right now while many of the ADB's DMCs are only beginning to act on their large-scale decarbonization commitments.

Environmental and Social Requirements for Financing Modalities and Products

J. Financial Intermediaries

Paragraph 50 – capital markets

If ADB is participating in a capital market transaction at its origination/placement, we assume that is taking place because such participation with that issuing entity is catalytic to some overall ADB development goal. Otherwise, ADB's money would not be additional to the financing.

If this assumption is correct, then ADB must be engaged in consultations with the issuer around some development principles or goals in advance of going to market. If the issuer wants to see ADB's participation, it would be reasonable to think that the issuers would be willing to adopt those development principles in its operations and, importantly, its use of the capital raised from such an issue. It is difficult to see how ADB would not know about how a targeted investee entity would be selecting, implementing, and managing projects that might result from ADB's participation. Additionally, if it is a public market transaction, it is also difficult to see how the use of proceeds would avoid disclosure ex-post issue, particularly if those capital deployments meet the definition of materiality in that regulatory regime.

Paragraph 53, 55 – ESMS reviews

Given that ESS 9 on climate change has been introduced, it may be the case that ADB will need to review numerous existing ESMSs and ESMFs. Advanced planning may be prudent on how to proactively and productively engage with borrowers/clients on integrating ESS 9 into to their existing ESMSs and ESMFs.

Paragraph 56-57 – disclosures

What is the reasoning for disclosing a “summary” as stated in Paragraph 56, while not disclosing the full documentation? The public should have full access to any impact information. A summary could be provided but only as an accompaniment to the full package of information.

Paragraph 67 – change in risk

If, as a result of an FI's actions and/or operations, the risk associated with ADB's participation goes up and potentially moves into a different (higher) risk category, what are the consequences for the borrowers/clients? What happens to the funding facility that created this? There would ostensibly be consequences – a disbursement suspension or a potential event of default – particularly if the change in risk is based on the actions/inactions, choices/omissions of the borrowers. How does that work in concert with the ESF?