

July 6, 2010

Comments from the United Kingdom

Extension of Approval by mail of CTF funding for project entitled, *Ukraine: Renewables Direct Lending Facility*

Dear Patricia,

Please convey our thanks to the EBRD team for their answers to the questions we had raised about the above project.

There are still a number of questions or reassurances that we need before we can give our support to the project. These are the following:

1. We would like to see the EBRD's modelling of CTF risk exposure. (While it may not be possible to do this entirely accurately due to the lack of information related to specific projects, this could use assumptions based on other project experience in Ukraine and on the EBRD's knowledge of the financial sector in Ukraine). In addition, we would be keen to see projections of when the private sector (i.e. commercial lenders) are likely to start actively participating in the market, which would enable the CTF financing to be phased out. Again, we realise that full modelling of this may not be feasible, but an expanded explanatory narrative would be appreciated.

2. We are concerned with the proposition that when commercial banks come on board with projects that the EBRD's risk or exposure would be reduced first. The EBRD says, "If and when we are able to bring in commercial banks as well this will first be applied to reducing the EBRD's exposure to within normal limits so the CTF contribution will still be required." We understand that the EBRD may lend more than they would usually, and would be keen to reduce this. However, the aim of the CTF is to help reduce the barriers for private sector investment in new markets. When commercial banks start to invest in these markets, there will no longer be a need for CTF financing and so we are strongly of the opinion that when commercial banks step in, CTF finance, as well as EBRD finance, should be pulled back. We believe this is in line with the underlying transformational purpose of the CTF. We could therefore support an equal reduction of CTF and EBRD finance, but not a reduction of EBRD's finance before a reduction in CTF finance.

3. We would like greater clarity on how the EBRD will manage and mitigate the conflict of interest it has as both a beneficiary of the deployment of CTF funds (in the sense that CTF funds enable a funding plan and the EBRD's risk is reduced) and as the "judge" as to when and by how much CTF funds are deployed. How will this be determined? Will the sub-committee review any project where subordination occurs, before funds are committed? If not, what other steps are being proposed to manage conflicts?

4. EBRD's response sets out very clearly the need for CTF finance. However, in line with the private sector lending principles, a stronger case still needs to be made for subordination. Specifically, we strongly believe that, in line with the approach proposed in the recent IFC Thailand project, some or all of EBRD's financing should be provided on a *pari passu* basis to CTF financing, to ensure, to the extent possible, that as much CTF finance as possible is preserved for leveraging private finance. Based on a stronger justification of the need for subordinated finance, we will need to agree either: (a) a cap on the percentage of CTF funds that may be required as subordinated finance; or (b) an approvals process for projects that sees CTF TFC approval of any project that seeks to use subordinated finance.

5. Regarding the development of biomass energy. Note is taken of the current inefficiencies in the Ukrainian agricultural and forestry sectors. Are there any studies or opinion in Ukraine on what effect such a large scale use of bio mass would have on soil structure and soil fertility? To what extent is agricultural productivity in Ukraine is dependent upon large scale use of fossil fuel based fertilisers? What are the risks and vulnerabilities in the agricultural sector related to dependence on fossil fuels? Perhaps this dependence could best be mitigated through large scale use of organic fertilisation. We think it would be valuable to get an expert opinion from someone with a strong knowledge of the Ukrainian agricultural and forestry sectors on this matter, if one has not already been sought.

6. With regard to the rehabilitation of hydro-electric facilities, it seems clear that this will be a cost effective way of bring additional clean power on-stream. It is also clear that it makes sense in terms of developing skills that are already present in Ukraine. However, it is the transformational potential this would have that is unclear. We would like greater clarity on how and why this is transformational.

7. Regarding the absence of a satisfactory regulatory environment and the risks that this poses, we would like to see a more comprehensive assessment of these risks and how they will be mitigated and managed.

8. We understand that the Strategic Environmental Review will help shape the development impact indicators. However, we still require that the potential developmental impact and poverty reduction aspect be spelt out and clearly articulated. At present, the project proposal does not contain enough information on development impacts. We cannot agree a project that uses UK funds for which the design phase has not included assessing what impact it will deliver, including in terms of development impacts. It is important that we are able to show that our contribution is having an impact on poverty and is producing value for money. This includes developing baselines, targets and indicators, and verifying data sources.

We regret that responding to these queries may result in a further delay.

Kind regards

Simon