CLUSTER REVIEW

Mining operations in Mongolia

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EBRD EVALUATION DEPARTMENT

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for Reconstruction and Development

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This report was led by Saeed Ibrahim and Karin Becker with Sofia Keenan providing analytical support. The inputs provided by Management and in particular its Natural Resources team are acknowledged with thanks.

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Executive summary

This is an EvD cluster evaluation of the mining portfolio in Mongolia since EBRD operations began in 2006 and involved a review of the themes emerging from 14 private sector projects, worth €734m of net cumulative investment (€704m debt, €30m equity) and associated donor funded EBRD technical assistance, most of which was non-transactional. The mining sector in Mongolia is critical to the economy, representing around 27% of GDP, 19% of state budget, and 88% of exports, mainly to China. Top mineral exports are coal, followed by copper and gold.

The first period of EBRD investment, from 2006 to 2012, was characterised by a mining boom with the EBRD becoming closely involved, less risk adverse and more prepared to support small and domestic players. Seven of the fourteen projects in the portfolio were approved in this period, most of which were with domestic mining companies, and around half of which related to coal mining. The Bank's strategy changed after 2013 to drop further investment in coal mining, with all subsequently approved mining projects being in gold or copper mining.

From 2012 to 2016, global commodity prices fell. Around half the existing portfolio ended up in Corporate Recovery in part due to the global commodity price slump, business conduct issues and lack of sponsor support. Three of the domestic mining companies became repeat clients, however all these amongst others ended up in Corporate Recovery. From 2013 onwards, and reflecting a more cautious approach, all newly approved projects were with listed clients, mostly Canadian.

The Oyu Tolgoi copper/gold project, approved in 2015, alone constitutes nearly 50% of the entire EBRD Mongolia mining portfolio. Oyu Tolgoi, 34% state owned, was projected to account for one third of Mongolia's GDP and budget revenues and over half of national exports by 2020, although development is now delayed.

Country strategies from 2006 to 2017 indicated transition in the mining sector was expected to derive from improvements to governance (policy dialogue, implementation of the Extractive Industries Transparency Initiative (EITI), capacity building, revenue management); increased competitiveness (investments in private sector mining companies, corporatisation of state owned mining companies, SME and supply chain development), greater integration (through supporting infrastructure), and in 2017 inclusivity by promoting participation for women. Mining projects were unable to make much progress across these areas, apart from towards implementation of EITI standards, where project benchmarks made explicit commitments. Some progress towards reform was made at government level through non-transactional TCs managed by the Legal Transition Team on implementation of EITI and drafting of a new mining law, but substantial gaps remain in policy dialogue for capacity building, revenue management and on issues emerging from EBRD's experience with corporate recovery workouts in Mongolia.

A slowing pipeline, with no new mining projects approved in 2018, has moderated EBRD ability to address country objectives for mining and presents an opportunity to focus on policy work for future investment, and to seek projects which may provide transition potential through supporting new technologies, exploration or emerging minerals markets (for example on critical raw materials).

Key findings:

- Half the projects in the Mongolia mining portfolio ended in up in Corporate Recovery, high compared with the average of 5.9% across the Bank natural resources portfolio: reasons were related to the global commodity price cycle reaching unexpected lows, business conduct issues and lack of sponsor support.

- Corporate Recovery has been effective at working down substantial amounts owed to the Bank with a number of examples of concrete successes. Nevertheless enforceability of any contractual rights within the local legal system for foreign and local investors has been and continues to be a major issue. In addition low levels of integrity of local sponsors and management teams contributed to financial underperformance and hampered recovery efforts.
- The new transition qualities provide a new lens for a retrospective look at EBRD work, as the Bank's overall mandate remains the same, but they also offer a chance to better articulate objectives going forward. In the mining projects under review, transition objectives, benchmarks and inputs were frequently lacking ambition, clarity and consistency, and not addressing key country strategy priorities. There was overlap between operational, environmental and transition objectives and lack of explanation of expected outputs, outcomes and impacts and how they would be monitored.
- In terms of country strategy objectives, there was no progress on supporting privatisation of state owned mining companies, no explicit support for infrastructure and only 2 projects attempting to support supply chains.
- Coal mining is leading resource in Mongolia (both thermal and coking) with knock on effects for air quality and pollution but has been a contentious area for the EBRD resulting in no coal mining projects of any type being approved since 2013.
- IFI collaboration was made official in 2007 with a formal MoU between IFIs and the GoM on reforming the mining sector, with a working group establishing TORs to implement the various reforms. According to Management, under that MoU, EBRD conducted work in some specific areas including establishing the EITI, a national geoscience database and a new draft mining law. EvD notes, however, that overall progress on the key objectives set out in the MoU has been limited, as they continue to be raised by investors. In 2019 EBRD contributed to an IMF paper which details ongoing issues for reform in the country, including those which have long impacted on the mining sector.
- Frequent changes in governments and relevant authorities represent a real challenge for EBRD policy dialogue in Mongolia. Policy dialogue is called for in the country strategies on legislation, licensing & taxation issues, implementing EITI and capacity building of regulatory authorities. Policy dialogue was often included as an attribute in projects, but this did not follow through to any specific objectives, activities, or monitoring of outputs and outcomes at the project level.
- In this context, the Legal Transition team pursued work selectively using non transactional TCs to implement the Extractive Industries Transparency Initiative in Mongolia, geological database and a revised draft mining law to help improve the investment climate and address issues in the existing legislative and regulatory framework for mining.

Recommendations

1. *Oyu Tolgoi:* The EBRD should ensure that both a team self-assessment (OPA) and EvD OPA Validation of the Oyu Tolgoi investment are conducted prior to approving any follow on financings or extensions. This will provide an opportunity to ensure the transition objectives are on track, issues addressed or potential for new areas are pursued, and that risks of further participation are fully explored.
2. *Project design:* Future projects for the mining sector should explicitly set out realistic but suitably ambitious transition objectives and benchmarks under new transition qualities, specifically linked to country strategy targets and agreed with clients in advance, embedding adequate resourcing

and monitoring frameworks. Intended technical assistance and policy dialogue work directly related to projects should be clearly articulated only if included as transition objectives. Linked work towards enhancing supply chains or developing infrastructure, including cross departmental efforts should be clearly set out through a programme of investment to maximise influence and gains. Specifically the Bank should consider tracking related industry classifications for all projects linked to supply chains or local development to enable an efficient mapping of the broader impacts beyond the direct financings to mining companies.

3. *Policy dialogue:* In the mining sector, the EBRD has in the past conducted policy dialogue in discrete areas of expertise under the 2007 MoU with other IFIs and GoM (e.g. EITI, geological database, a draft mining law and some other legal reform work). The EBRD recently contributed to a 2019 IMF country report which clearly sets out the ongoing issues which need to be addressed for reform, including those that directly impact on the mining sector. [1] Now the EBRD should request a renewal of the MoU and work together with other IFIs to come up with an action plan for dialogue with authorities to support reform and address key issues impacting on the investment climate for the mining sector and transition. This should clearly set out allocated roles and responsibilities, specific objectives, benchmarks, timeframes, monitoring, reporting and resourcing mechanisms. Issues covered may include a government strategy for mining and revenue management, protection of investor legal rights, local business integrity standards, enforceability of mining licenses and financing agreements for foreign investors, corporatisation of state owned mining companies, infrastructure needs and environmental standards and associated supply chain work.

[1] Mongolia Selected Issues IMF Country Report no. 19/298

1. Introduction

Cluster evaluations focus on sets of interventions that share common features such as objectives, applicable strategy or target country/sector to learn about what happened across the cluster and to ascertain common themes, findings and lessons. A review of a cluster of Mongolia operations was part of EvD's recent multi-year Work Programme, with the intention of gaining a project-connected lens through which to view country presence and effectiveness more broadly. By far the largest EBRD investments in the country have been in the natural resources sector, and in mining in particular (section 1.2). An Approach Paper for this evaluation was discussed and agreed with Management in January 2019. EvD's analysis focussed on three main issues: i) how well the Mongolian mining operations reflected the strategic agendas of the EBRD and the country; ii) the results achieved by the Bank in these operations; and, iii) how effectively they were implemented.

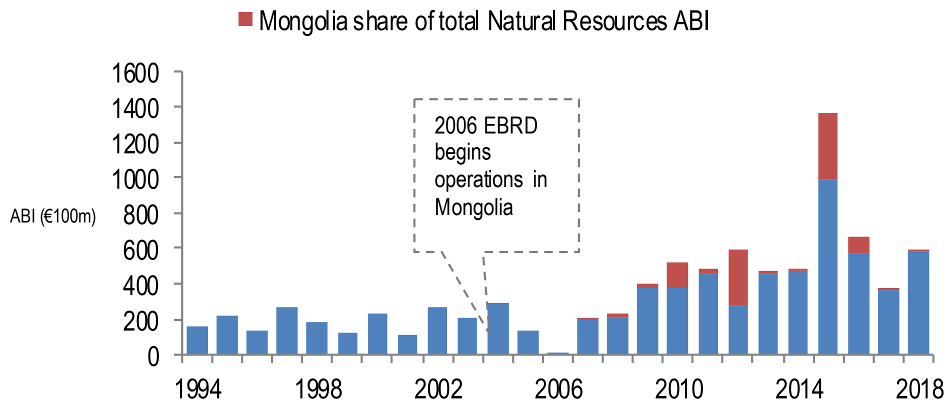
The report is structured as follows: section 2 includes an overview of background, context and scope of the evaluation; sections 3, 4 and 5 include analysis, findings and conclusions for each evaluation question; and section 6 includes the main findings, conclusions and recommendations. An evaluation matrix, containing the criteria and indicators, served as the analytical framework guiding the data collection - which included interviews with key stakeholders (see Annex 1), and detailed document and portfolio analysis. The methods used to approach this evaluation cluster are described in Annex 3.

This study faced limitations in terms of data gathering: quality and coverage of transition impact monitoring and evaluations conducted on projects was uneven; and staff turnover since 2007 has limited institutional memory of the projects and the sector.

1.1 The EBRD's mining portfolio in Mongolia

Since starting operations in Mongolia and opening a resident office in Ulaanbaatar in 2006, the EBRD's investment has been concentrated in the natural resources sector. Prior to this, the EBRD's natural resource team had been experiencing a year of low overall investment. Thereafter, until 2017, Mongolia became a significant contributor to the overall ABI of the natural resources team, averaging about 13% (see below).

Figure 1: EBRD natural resources ABI over time and Mongolia's share



At the point of this evaluation, 54% of EBRD investment in Mongolia (or €778m) has been in the natural resources sector. This is followed by the financial institutions sector, with 19% of €277m total net cumulative investment (less than half of EBRD investment in the natural resources sector). Natural resource total project size has tended to be larger than in other sectors, with the total value of all projects amounting to around €5.5 billion.

Table 1: Mongolia operations by sector team, investment and total project volume

Sector team	Investment (€m)*	% Investment	Total project value (€m)
Natural Resources	773	54%	5,434
Financial institutions	277	19%	421
Manufacturing & Services	160	11%	306
Agribusiness	108	8%	217
Power and Energy	86	6%	310
Equity Funds	8	1%	26
ICT	7	0%	7
Transport	6	0%	6
MEI	0	0%	1
Grand Total	1,425	100%	6,728

Source: BPN213 - Net Cumulative Bank Investment Listing as at Jan 2018. *Investment = Net cumulative Bank Investment

The EBRD's work in the natural resources sector in Mongolia, according to the EBRD's 1999 Natural Resources Policy, covers projects in three main areas: i) metal and mineral mining; ii) oil including the whole cycle from production to transportation, oil refining, oil product distribution and petrochemical plants; and, iii) natural gas including production, transportation, power generation and petrochemicals.

A breakdown of EBRD natural resources projects in Mongolia along these lines (using Standard Industry Classifications) reveals that the vast majority have been related to mining (94% of investments and 73% of operations), justifying the focus of this evaluation. Specifically, of the 20 natural resources operations in Mongolia, 14 have been in metal and coal mining – with the remaining 6 related to petrol stations, primarily with one client.

Table 2: Natural resources projects in Mongolia by sub sector

NR sub-sector (EvD)	Standard Industry Name*	# of Ops	% of Ops	Investment €m	% Investment	% investment within sub sector
Mining	Coal Mining	4	20%	143	18%	19%
	Metal Ore Mining*	8	40%	573	74%	78%
	Support Activities for Coal Mining	1	5%	13	2%	2%
	Support Activities for Metal Mining	1	5%	5	1%	1%
	Sub-total	**14**	**70%**	**734**	**94%**	**100%**
Oil	Gasoline Stations	5	25%	34	4%	77%
	Oil and Gas Extraction	1	5%	10	1%	23%
	Sub-total	**6**	**30%**	**43**	**6%**	**100%**
Total		20	100%	778	100%	

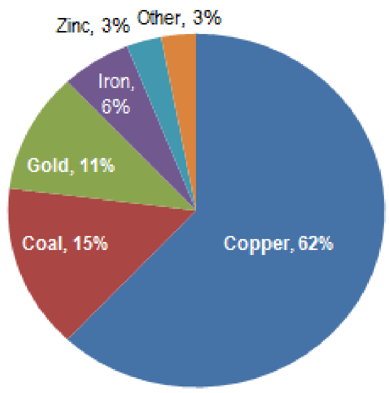
- Excludes 2 regional projects, which predominantly operated in another country in Central Asia.

The 14 operations defined as the population for this evaluation are all managed by the Natural Resources team, within the Industry, Commerce and Agribusiness sector group. They exclude oil and gas operations, and two regional projects with minimal involvement in Mongolia.

1.2 Context of mining in Mongolia

The EBRD's investment emphasis on mining is consistent with its importance to the wider Mongolian economy. Of all EBRD countries of operations mining is the most dominant in Mongolia as a percentage of GDP (27%), state budget (19%) and exports (88%). However it contributes less to the country's workforce (around 4%).[3]

Figure 2: 2015 Export values by commodity in Mongolia[2]



According to the EBRD's latest 2017 Extractive Mining Industries Strategy, Mongolia has "world-class copper and coal deposits [and] excellent exploration potential for metals".[4] There are major mines in copper (Oyu Tolgoi and Erdenet), coal, iron ore, gold and fluorspar. These endowments are reflected in the export revenue split of the country by commodity, which is dominated by copper.

The country's key export commodities of copper, coal and iron are primarily (93%) exported to China. Mongolia has also been exposed to major fluctuations in commodity prices with knock-on effects on existing mining operations and reduced investment. Commodity prices boomed from 2010 to 2012, fell between 2013 and 2015, and then started to recover more recently. This is an important contextual factor referenced throughout this evaluation due to its impact on investment performance.

Major strengths and opportunities in the Mongolian mining sector include:[5]

- Mongolia's close proximity to Asia provides ready market for minerals;
- The country has rich levels of metal and minerals that can boost long-term mining growth;
- The government's May 2015 agreement with Rio Tinto to launch Oyu Tolgoi-2 suggests a more conciliatory approach to foreign mining investors going forward (see section 3.6);
- Rising revenues on the back of the mining boom will provide the government with additional funds to invest in improving the country's operating environment.

Major weaknesses and threats comprise:

- Political risks: resource nationalism, unilateral action by authorities, populist political system, frequent changes in government and reversal of policies, creating uncertainty;
- Inadequate logistics infrastructure is a sizeable challenge to doing business, particularly the lack of transport connectivity;
- As a frontier and perceived high-risk market, the country is vulnerable to decreased investment flows in a low-price environment;

2 Source: Mineral Resource Authority of Mongolia: Annual Bulletin of Mining and Geology 2016
3 BDS17-215 (Final) Extractive Mining Industries Strategy - Mining country snapshot: Mongolia
4 BDS17-215 (Final) Extractive Mining Industries Strategy, Annex G
5 See BMI Mongolia mining report Q3 2018, EIU Mongolia Country report July 2018, Mongolia Minerals Yearbook 2014 and BDS/MN/17-1 (Final) Strategy for Mongolia

- Heavy reliance on mineral exports to China and also on ports in China and Russia to transport goods via sea, drive up cost of doing business;
- High dependence on exports from Oyu Tolgoi for economic growth in 2020, looming debt payments, and potential renegotiation of the Oyu Tolgoi investment agreement[6]
- Investors expressed concerns of lack of access to public comment or response on legislation that affects international commerce.
- On the legal regime some concerns of foreign investors include: existence of judicial corruption (need for judicial independence); delays and difficulties in enforcement of local court decisions due to a thinly staffed General Executive Agency for Court Decisions and conflict of staff interests; a vague, onerous and time consuming bankruptcy process; foreign investors perceive a bias if they pursue legal action against a Mongolian state owned enterprise.[7]
- Concerns over stalled negotiations with the government on key infrastructure projects and lack of progress on construction of power plants;[8]
- The government has resorted at times to anti-business policies (such as state ownership of strategic mines and windfall taxes), and shown mistrust of foreign investors, decreasing Mongolia's attractiveness to foreign investors;
- Smaller miners are less well-placed to capture investment opportunities in Mongolia due to the capital intensive nature of infrastructure projects (and restricted access to long term finance).

6 US State Department report Investment Climate Statement 2019
7 US State Department report Investment Climate Statement 2017 p 14
8 US State Department report Investment Climate Statement 2017 p 5

2. Relevance: rationale and design

2.1 Country strategies

Summary

- The limited number of projects in each strategic period and their content point to constraints on progress on the themes mentioned in the country strategies: no progress on supporting privatisation of state owned mining companies, no explicit support for infrastructure and only 2 projects supporting supply chains.
- Consistent progress was made over time on implementation of the EITI in Mongolia due to non-transactional TC grants, and term debt and equity investments in private mining companies.
- Two main themes in the 2017 Mongolia Country Strategy, women in mining and future heritage fund development are absent from the Country Strategy results framework and there is a lack of a clear project pipeline or action plan for these.

Since becoming a country of operations in 2006, the EBRD has had four Mongolia country strategies in 2006, 2009, 2013 and 2017. Each included specific coverage of the mining industry, and recurring themes include the provision of debt and equity investment to private mining companies, support for implementation of EITI, corporatisation or privatisation of state-owned mining companies, infrastructure to support mining activities (power, transport see 2009, 2013 & 2017 strategies), and SME development (see table below).

More recent themes in the 2013 and 2017 strategies include: participation of women in the mining sector, development of value and supply chains, supporting the authorities in development of a geological information system (GIS) and a future heritage fund (formerly referred to as a national wealth fund) (see table below).

Table 3: Themes from EBRD Country Strategies for Mongolia 2006-2017

<table>
<tr><th colspan="5">EBRD Mongolia country strategies - Mining sector <u>priorities</u></th></tr>
<tr><th>TI Quality</th><th>2006 – 2008
2 projects, worth €28m</th><th>2009 – 2012
7 projects worth €316m</th><th>2013 – 2016
4 projects worth €392m</th><th>2017 – to date
1 project worth €2m</th></tr>
<tr><td>Green</td><td colspan="4">Application of EBRD Environmental and Social Policy (ESP), Public Information Policy (PIP)</td></tr>
<tr><td rowspan="2">Well-governed</td><td colspan="4">Support for implementation of regulatory framework of EITI</td></tr>
<tr><td colspan="2">Policy dialogue on legislation, licensing & taxation issues (non EITI)
Capacity building of regulatory authority</td><td>Policy dialogue to support institutional capacity building programmes
Assist in strengthening framework and policies for revenue management</td><td>Support development of future heritage fund

TC for GIS</td></tr>
<tr><td rowspan="4">Compet-itive</td><td colspan="3">Debt and equity investments in reputable domestic and foreign mining companies</td><td>Debt & equity in reputable foreign mining companies only</td></tr>
<tr><td colspan="3">Support for corporatisation and privatisation of select state-owned mining companies</td><td></td></tr>
<tr><td></td><td>Support PSP in larger strategic deposits</td><td colspan="2"></td></tr>
<tr><td>Mining sector SME development</td><td colspan="3">Develop mining supply and value chains</td></tr>
<tr><td>Integrated</td><td></td><td colspan="3">Support development of transport and power infrastructure to support mining industry</td></tr>
<tr><td>Inclusive</td><td colspan="3"></td><td>Promote participation of women</td></tr>
</table>

This section explores whether the projects approved during the respective country strategy periods addressed the strategic priorities, and most importantly the adequacy of the coverage of EBRD projects to achieve progress. Most of the projects under review for this evaluation were approved by the Board under the 2006, 2009 and 2013 Strategies for Mongolia.

Mongolia Country Strategy	Operational content
2006-2008 **2 projects, worth €28m**	Analysis of relevance of the two projects at approval showed that few of the themes in the strategy were addressed during the period. Particularly they supported debt and equity to reputable foreign and domestic mining companies, one supported EITI, the other some SME development and both applied the Bank's ESP and PIP.
2009 - 2012 **7 projects worth €316m**	The three main strategic priorities receiving consistent attention from each project approved during this period were application of the EBRD's ESP and PIP; support for implementation of EITI in Mongolia, and; term debt and equity investments in reputable domestic and foreign mining companies. The following findings stood out when assessing the portfolio against the country strategy. – No project addressed support for privatisation of state-owned mining companies. A question can be raised as to why this priority was included in the strategy at all, without a clear roadmap for implementation. – Just one project supported private sector participation in a strategic deposit and only 2 projects mentioned conducting policy dialogue with the Mineral Resource Authority of Mongolia (MRAM) in relation to a geological database of mining licenses. – Three projects mentioned infrastructure (upgrading of road transportation), but the discussion in most cases was limited to what the client intended to do to export its produce rather than an explicit programme of investment financed by the EBRD. There were no EBRD investments addressing power infrastructure related to these mining projects

2013 – 2016 **4 projects worth €392m**	The projects consistently applied the EBRD's policies, EITI framework, and involved investment in reputable mining companies, and there was no support for privatisation of state-owned mining companies leading to the question as to why it was included in the strategy, if not possible. Infrastructure support, like the previous strategic period, involved upgrade of roads by the clients in two cases. Just two projects discussed development of mining supply chains. Oyu Tolgoi assured the continuation of policy dialogue to improve the legal framework and investment climate, although this is too early to assess.[9]The projects consistently applied the EBRD's policies, EITI framework, and involved investment in reputable mining companies, and there was no support for privatisation of state-owned mining companies leading to the question as to why it was included in the strategy, if not possible. Infrastructure support, like the previous strategic period, involved upgrade of roads by the clients in two cases. Just two projects discussed development of mining supply chains. Oyu Tolgoi assured the continuation of policy dialogue to improve the legal framework and investment climate, although this is too early to assess.[10]
2017 **1 project worth €2m**	It is still too early to fully appraise the relevance of EBRD mining projects to the new country strategy, as this report only covered projects approved up until the end of 2018. To improve governance of the mining sector the 2017 Country Strategy proposed a Future Heritage Fund which would be the vehicle for prudent fiscal policies for sustainable and transparent revenue management. It states: "the Bank will support improvement in the capacity of Mongolia's Future Heritage Fund focussing on areas such as procurement practices."[11] No further elaboration on what the Future Heritage Fund entails is provided in the strategy, nor does it link to a previous 2012 EBRD working paper entitled "Managing Mongolia's Resource Boom' exploring options for a national wealth fund.[12] The renewed suggestion for a Future Heritage Fund however is not included in the country strategy results framework section for a well governed mining sector however, suggesting it may not be prioritised for delivery. This points to lack of clarity and specificity of any policy engagement activity in the area to achieve results despite the importance of revenue management to the development of the Mongolian mining sector and the larger economy. No attempt was made to include it as a policy priority objective under the more recent enhanced and structured approach to policy dialogue at the EBRD.

Overall the limited number of projects in each strategic period point to very limited progress on any of the themes mentioned in the country strategies. The main area of progress that was consistent across country strategies was on implementation of the EITI framework in Mongolia and term debt and equity investments in foreign and domestic mining companies. The pipeline to date appears too thin to substantively address any of the main themes in the 2017 Country Strategy for Mongolia.

2.2 Sector strategies

Summary

9 BDS13-023 Oyu Tolgoi p 9
10 BDS13-023 Oyu Tolgoi p 9
11 2017 Country Strategy for Mongolia p 27
12 2012 EBRD Working Paper: Managing Mongolia's Resource Boom

- A Bank wide sector strategy for mining was absent from 2006 to 2012 when the majority of mining projects reviewed under this cluster were approved. This precludes analysis of specific ways the projects helped deliver EBRD mining sector objectives in that period. For approval, mining projects relied instead on an earlier 1999 Natural Resources Policy or cited extracts from the 2006 Energy Policy.
- Coal mining (both thermal and coking) has been a contentious and problematic area for the EBRD to produce a clear statement of strategic intent over time, resulting in mixed messages and an inconsistent approach, with unclear objectives, and no coal mining projects of any type being approved since 2013.

The Bank approved 5 coal related projects between 2007 and 2013 (out of the 14 total projects reviewed). The approach to coal mining has evolved over time, in the 2006 Energy Operations Policy thermal coal mining was supported where in keeping with the Environmental Policy.[13] The 2012 Mining Operations Policy supports projects EHS aspects of thermal coal and steel related mining of coking coal.[14] The 2017 Extractive Mining Industries Strategy supports financing of mining coking coal for steel, but would only support thermal coal projects in relation to improvement of EHS aspects.[15]

The EBRD's strategic framework governing mining operations has varied over time with mining initially captured under broader sector policies that covered the entire natural resource and energy sectors, followed by more dedicated mining sector policy and strategy documents in 2012 and 2017.

The EBRD's first document setting out priorities in the mining sector was the **1999 Natural Resources Operations Policy** which covered the full oil and gas cycle as well as metal and mineral mining.

This was followed by the **2006 Energy Operations Policy** which combined activities in natural resources (thermal coal mining, oil and gas (from production to transportation refining and distribution) and energy sector (power generation, transmission, distribution and supply) into one comprehensive policy, complementing regional and global energy initiatives through support for energy efficiency and renewable energy, corporate governance and transparency.

From 2006 to 2012 the mining sector (other than thermal coal) became an orphan sector with respect to EBRD's strategy and policy framework although this was when the majority of the Mongolian mining projects were approved (9/14). The **2006 Energy Operations Policy** stated that the Bank's metals mining policy would be covered in a separate policy paper, which took until 2012 to be approved. Interviewees suggested the strategic directions for these projects remained the 1999 Natural Resources Operations Policy, but this was contradicted by the fact that at approval these projects cited the 2006 Energy Operations Policy despite its apparent irrelevance.

The **2012 Mining Operations Policy** was introduced to focus specifically on mining as a chief contributor to economic and social development in resource-rich EBRD countries such as Ukraine, Mongolia and Russia. The rationale was that development of the mining sector was critical and required responsible management over time to maximise transition. The policy covered extraction and basic processing of ores and minerals, including iron ore and coking coal (for steel) through all financial instruments including financial intermediaries. However, unlike the Energy Operations Policy 2006, the 2012 Mining Operations Policy did not cover the extraction of hydrocarbons such as oil and gas or use of thermal coal and the impact

13BDS06-093 Energy Operations Policy p36
14 BDS12-2019 Mining Operations Policy p5
15 BDS17-215 Extractive Mining Industries Strategy p5

of coal on climate change or role in the energy mix and energy security in specific countries. The policy did though cover EHS issues related to thermal coal mining.

A 2013 project for a coal wash and briquette plant was approved under both the 2012 Mining Operations Policy and the 2006 Energy Operations Strategy on the basis that it (amongst other things) supported increased efficiency and decreased carbon intensity of the coal value chain in Mongolia, as a result of improved coal washing and briquetting facilities for domestic supply (as per the 2006 Energy Operations Strategy). No coal project has been approved since.

The most recent **2017 Extractive Mining Industries Strategy** covers the same areas and financing instruments - all industries involved in mining and processing of ores and minerals including coking coal for steel and cement. Like the 2012 Policy it does not cover extraction of oil, gas or thermal coal. Only EHS issues related to thermal coal mining would be considered.[16] It identifies existing transition challenges through the lens of the EBRD's new transition qualities – the one project approved under this strategy to date targets the competitive and green qualities.

2.3 Additionality

Summary

– Additionality based on provision of long term debt tenors was demonstrated in around half the debt projects and in the case of Oyu Tolgoi, where IFC offered the same terms, EBRD was still additional due to the unprecedented size of the investment programme in Mongolia.

– Additionality based on equity, considered a novelty in Mongolia, was evident for SMEs in high risk exploration or drilling where financing would not be otherwise available.

– Mobilisation of private finance was verified in two projects; Oyu Tolgoi, where the EBRD syndicated over US$820m to 15 commercial banks; and another.

– Political risk comfort provided by the EBRD was confirmed as important to foreign investors in Mongolia, and in the case of Oyu Tolgoi, an investment programme of unprecedented size in Mongolia, IFC and EBRD together.

2.3.1 Financial additionality: terms

The first Natural Resources Operations Policy in 1999 stated that additionality in the mining sector would come from the Bank's ability to structure long-term finance on a commercial basis with due consideration to political risk and environmental concerns. This was because large development and exploration projects in mining require long-term financing which was limited in many domestic banks in the countries of operations.

Additionality of debt tenors

16 BDS17-215 Extractive Mining Industries Strategy p5

Table 4: Average tenors for debt financing in Mongolia mining portfolio

Year of approval	Project	Weighted Average Tenor (years)
2007	MAK I	6
2009	Leighton Mongolia	5
2010	MMC Debt	6
2010	Centerra I	4
2011	MAK II	7
2012	Altain Khuder - Debt	3
2013	DIF - Sharyn Gol	5
2015	Oyu Tolgoi	15
2016	Centerra II	5

For debt projects in the mining portfolio in Mongolia, operation teams frequently stated in approval documents that investments would be additional as they provided longer tenors than those available in the market. The three sub-operation projects emphasised that long term finance for SMEs to be particularly scarce.

When looking at the tenors of debt operations in the portfolio, EvD finds they range from 3 years to 15 years (Oyu Tolgoi) (see table). The median tenor was 5 years and the average was 6.5 (due to Oyu Tolgoi which was particularly long term due to the extraordinary size of the mine and the investment). There was no pattern of an increase of tenor over time and tenor was decided on the specific needs of each client.

Half the debt projects had information about their existing debt financing tenors showing them to be lower than that provided by the EBRD. Only other IFIs provided longer tenors similar in length to that offered by the EBRD. In the case of Oyu Tolgoi, IFC matched the long tenor provided by EBRD, but this did not preclude an argument for additionality due to it being an investment programme of unprecedented size requiring joint EBRD-IFC led participation and syndication.

Self-assessments of two projects confirm that the provision of longer term financing by the EBRD was additional to that which was available on the local market.

Cancellations and prepayments

Around half the projects in the Mongolia mining portfolio were exposed to cancellations of originally approved finance, totalling almost €150m, or 35% of the €430m ABI. The main argument for additionality through longer tenors never materialised for a third of approved finance.

Early prepayments of 40-50% of financing occurred in a further 2 projects, and associated monitoring for those projects ceased, weakening the evidence of additionality materialising.

Additionality of equity financing

Additionality arguments for equity projects in the portfolio were based on their novelty in Mongolia. The 2017 Country Strategy for Mongolia stated that the equity market in Mongolia is more a trading venue for a few shares and does not tend to play a significant role in financing the broader economy.[17]

SMEs engaged in exploration or early stage production are higher risk investment propositions and have difficulty attracting private sector financing. Equity financing is even higher risk, making it a rare option for these companies. Equity financing provided by the EBRD to these types of companies is therefore highly additional, but can be more speculative with in part equally uncertain exit routes and test sound banking requirements.

EvD was unable to verify additionality in a project with a domestic miner as the client had equity investments from a major private Bank, another IFI and a loan from a local bank. The client appeared to have good access to debt and long term equity.

17 2017 Country Strategy for Mongolia p15

2.3.2 Financial additionality: mobilisation

Just two of the projects in the portfolio claimed to mobilise private finance that would not be otherwise available (Oyu Tolgoi and another).

The EBRD went on to syndicate over US$820m of its investment in Oyu Tolgoi to 15 commercial banks, showing success in this area.[18] Financing in another project was provided on condition an international private equity fund first provided financing of US$2.5m out of a total US$5m, but EvD found no evidence that this was mobilised investment. The fund was considered a project sponsor investing in their own project, so it is possible that this explains why it wasn't documented in EBRD systems.

EvD found one other project involved mobilisation of private finance, which expected to syndicate US$100m of the loan, but this was not stated at approval. The self-assessment mentions that the subsequent B lenders involved relied on the EBRD's presence and experience in Mongolia when deciding to invest, although EvD was unable to verify this.

A majority of projects had some external co-financing from bilateral financial institutions and IFIs. However this does not count towards commercial mobilisation as it is related to the public sector.

The EBRD's equity and debt investments in one domestic company was mentioned in its prospectus and is likely to have provided comfort to investors, helping the company to secure funding from commercial banks and issue bonds.

2.3.3 Non-financial additionality: attributes and conditions

Limited evidence was found in the Mongolia mining projects to verify additionality from EBRD attributes (specific Bank characteristics reduce transaction risk, support project feasibility and offer direct value to clients above what other financiers can).

One reason for the lack of supportive evidence for non-financial additionality is that whilst financial ratio conditions are almost always covenanted, other conditions are often not. Moreover where they have been covenanted it is difficult to ascertain the extent to which these conditions have been enforced or waived, especially when a considerable proportion, of the projects have been impaired, pre-paid or largely cancelled. EvD understands that in distressed situations breached financial or other covenants are frequently and deliberately not waived by the bank as part of a chosen recovery strategy.

Additionality conditions in mining usually concern environmental and social standards, and aspects of corporate governance and business practices such as transparency. Standards are supposed to exceed what would normally be asked by alternative financiers. There have been a number of evaluations which have verified the additionality from attributes ex post, for example in one, "EBRD's technical assistance and conditionality supported improved mine management systems, and higher environmental health and safety standards." Similarly EvD agreed in the EvD evaluation of another project "that having the company reach higher environmental, health and safety standards for the project (as cited in the Board documents), would not have been required had the Bank not been involved."

Political risk comfort

An often cited argument for additionality in EBRD Board documents is that the EBRD would provide political risk comfort, especially for foreign investors, which was born out in monitoring and evaluation. Monitoring documents for Oyu Tolgoi show that political risk continues to be the main risk assumed by the EBRD

18 EBRD arranges US$1.2b syndicated loan in Mongolia, www.ebrd.com

together with other IFI, in particular the risk of resource nationalism and unilateral action by authorities that may be detrimental to the project. "The presence of EBRD, IFC, MIGA and Export Credit Agencies from US, Canada and Australia, as well as 15 international commercial banks add significant comfort on political risk."[19] Interviewees reported that when issues occur between the Mongolian government and Rio Tinto concerning the investment Agreement and project, it is EBRD and IFC as lead investors that participate in key discussions to reach an amicable solution to protect investor concerns.

For one project with a foreign sponsor: "political risk remains the main concern, with little ability to mitigate. Ongoing turbulence is expected within what is a noisy and populist political system, seeing natural resource interests as a tool that can be played to good effect."[20] One interviewee told EvD:

> "The lack of political stability is a particular problem for the larger projects, as this leads to a lack of political continuity in policy – especially with respect to mining policies. There are a lot of reversals of policies [from one government to the next] and this can cause uncertainty. There is also a certain level of mistrust of the big foreign players. For smaller projects this is less of a problem." (Interviewee)

Summary of non-financial additionality

Overall non-financial additionality from attributes and conditions has been challenging to prove. Strongest cases for non-financial additionality come from political risk comfort and from environmental and social and corporate governance standards. Weaknesses in verifying non-financial additionality lie in lack of readily available monitoring data from effective implementation of specific covenants.

2.4 Project design

Summary

- Transition objectives, benchmarks and inputs were frequently lacking ambition, clarity and adequacy, and did not address some of the key country strategy priorities.
- There was overlap between operational, environmental and transition objectives and lack of explanation of expected outputs, outcomes and impacts and how they would be monitored
- Policy dialogue was included as an attribute in many project approval documents, but this was not followed through with any specific programme of planned objectives, activities, or monitoring of outputs and outcomes.

2.4.1 Planning transition objectives

EvD reviewed the design of the projects in the Mongolia mining portfolio from the perspective of transition impact objectives. Selected inputs and benchmarks lacked ambition, clarity and adequacy. For example, completion of a feasibility study was a transition benchmark in 4 projects but was used in each project to address a different transition objective including: setting of standards, transfer of skills, private sector development and demonstration effect. This made it difficult to assess the extent to which impact objectives were contributed at the cluster level, which would have been helped by a greater degree of clarity and consistency in the operationalisation of these objectives through monitoring benchmarks.

Key country strategy objectives were not translated into project design:

19 Credit analysis 2016
20 Credit Review Summary 2016

- *Policy dialogue on legislation, licensing & taxation issues (non EITI) and capacity building of regulatory authority* - Of the 13 projects approved between 2006 and 2016 only 3 mentioned some form of policy dialogue other than EITI (two regarding the Mineral Resource Authority of Mongolia, and Oyu Tolgoi to improve the legal framework and investment climate)
- *Support for corporatisation and privatisation of select state-owned mining companies* – no project addressed this
- *Support development of transport and power infrastructure to support mining industry* – no project attempted to address power infrastructure, and transport was only mentioned in the context of what clients were already investing in rather than a new programme of EBRD investment.
- *Developing mining supply and value chains* – only 2 projects attempted to address this.

The Mongolian mining projects for the most part targeted the "setting standards for corporate governance and business conduct" (11 projects) and "expanding private sector participation" (7 projects), followed by transfer and dispersion of skills (6 projects). One project has so far been formally approved under the new transition concept, targeting both the 'competitive' and 'green' qualities.

Several evaluations and assessments noted overlap between operational, environmental and transition objectives, resulting in double or triple counting. There was a common lack of specification of expected outputs, outcomes and impacts or monitoring frameworks.

Findings on results management from previous evaluations of Mongolian mining projects

- There was overlap between operational objectives, transition impact objectives, and environmental and social impact objectives, resulting in double and triple counting. EvD argues that greater attention needs to be applied by OPSCOM in distinguishing between the three sets of objectives.
- Several of the TIMS benchmarks were also listed as physical objectives, financial objectives, or environmental objectives, leading to double and triple counting. Management should clearly specify the project intended results in the Board document and, if possible, provide a breakdown of the expected output, outcomes and impacts of the project. This will also help identify what the bank has done to monitor and track progress in the different areas.
- Monitoring frameworks should clearly explain how information will be collected to provide evidence of achievement of transition objectives. In this project, achievement of environmental conduct and transparency standards required clearer evidence. Further, it was difficult to appraise whether training sessions provided actually contributed to skills transfer without evidence of what skills and knowledge had been learned and then applied by trainee participants.
- Expected results of the project were reflected in the Board document but did not differentiate between outputs, outcomes and impacts and hence the assessment of effectiveness was difficult. Results were not articulated concisely and rather spread in different sections.

In 2016, the EBRD moved towards a more comprehensive compendium of indicators for transition impact planning, which should address some of these design issues for future projects. Assessing results for this cluster evaluation required a disaggregation of objectives targeted at individual project level and a more consistent grouping and consideration, broadly in line with the recurring country strategy themes, of promoting a well governed, more competitive, inclusive and sustainable mining sector, for which the main findings are discussed in the next chapter.

In a number of projects, non-transactional TCs were used to carry much of the transition impact argument of individual projects. It is difficult for EvD to estimate the strength of the transition impact case (and assess performance) in the absence of these TC. Prior to Board approval of one repeat project, Directors advisors asked: “Could the team together with the CSE provide an assessment of the transition potential without the non-transactional TCs?” to which the team replied:

> “Transition impact is achieved through a package of investment and policy dialogue activities and would be difficult to assess independently. The TC elements are thus important in delivering systemic benefits both at the company and country levels particularly in Early Transition Countries where the Bank is pursuing a sectoral reform process. The transition impact from the project arises from a number of elements including specific investments and broader behavioural...”

2.4.2 Policy dialogue as part of the investment programme

In terms of how investments were used to promote the policy agenda for topics such as EITI and the regulatory environment, EvD observed that policy dialogue was frequently mentioned as an EBRD attribute in Board approval documents but this was not verifiable since no specific programme was set out with objectives, benchmarks and timeframes. Only two project documents alluded to some areas of focus:

- One 2010 project Board Document stated more generally the project would provide a platform to re-engage in policy dialogue with authorities on ‘some of the key remaining challenges in the sector including EITI and improved regulatory and licencing regimes’ without setting out any specifics.
- The Board document for Oyu Tolgoi mentioned only that: ‘The Bank and other IFIs involved in OT have been engaged in ongoing policy dialogue with the Mongolian authorities, stressing the importance of the project for the investment climate in the country and advocating resolution of any outstanding issues within the existing legal framework rather than through unilateral action’ (see section on The Client and the Project).

Without specific planning, monitoring and reporting it is impossible to gauge the Bank’s overall progress in this area. Scattered information is available where technical assistance was provided through donor reporting systems. Where technical assistance did take place for work with the authorities, it was through the Legal Transition Team for EITI, a geological database, training for commercial law judges, assisting the Bank of Mongolia to prepare amendments to the Financial Leasing Law (impacting on leasing in mining services) or through ESD for training on biodiversity. This work contributes to improving the general investment environment rather than being introduced as part of a specific investment project.

3. Results: Did the use of proceeds lead to transition impact?

The impetus of this paper is to gain perspective concerning EBRD's contribution to transition impact over time across multiple interventions. This chapter discusses results across each of the transition qualities relevant to the mining sector: well-governed, competitive, green and inclusive (the quality of integrated is relevant but was not specifically targeted by the projects). Whilst the Bank adopted these definitions formally in 2016, the themes have been core to the transition mandate of the Bank since it began operations, and are reflected in the transition impact objectives of the projects reviewed. Key findings were as follows:

Outputs	×	There was a low level of achievement of expected operational outputs from the proceeds overall across the portfolio. The most prevalent issues were delays, cost escalation, and lack of definition of or follow up on use of proceeds leading to reputational concerns.
Well governed	✓	Implementation of EITI was the greatest achievement for a well-governed mining sector with limited progress across other areas.
	–	A 2012 working paper *Managing Mongolia's Resource Boom* was produced by OCE but there is no evidence on whether recommendations were promoted to authorities.
Competitive	×	The EBRD has not been able to participate in any privatisation or commercialisation of state owned mining assets due to the challenging political environment, lack of commitment to reform, legacy corruption or lack of transparency, financial issues and environmental legacies.
	✓	The EBRD has supported competition by investing only in private sector mining companies or contractors; the EBRD's biggest investment in Oyu Tolgoi copper mine involves a joint venture with the government of Mongolia (34%) and Rio Tinto (66%).
	✓	An array of new technologies, products and processes were implemented through EBRD mining projects
	×	The Bank has achieved little in terms of supporting mining supply chains including forward and backward linkages. There is room for more support and recording in this area.
Green	×	Ongoing policy dialogue with Mongolia's Ministry of Environment and Green Development on environmental standards has had limited success.
	×	The EBRD is unable to directly help reduce impact of coal burning on air pollution as it has not engaged in coal projects since 2013. The first smokeless coal plant in Mongolia was thanks to an EBRD project in 2007.
	✓	A world class water recycling scheme was introduced at Oyu Tolgoi resulting in 85% of water being recycled.
	–	Project complaints regarding EBRD projects in the Mongolian mining sector have been unsuccessful but project boundaries for controls in this sector are difficult to draw.

Inclusive	–	The EBRD has pinned high hopes on the largest mining investment project, Oyu Tolgoi, to deliver results on increasing skills transfer and local workforce employment.
	×	No progress on opening up further opportunities for women to work in mining in Mongolia (currently 16% of mining workforce is women).

3.1 Achievement of operational outputs

The top most common use of proceeds or 'outputs' of investments in Mongolian mining projects were: capital expenditure for purchase of equipment; construction of plants; and, infrastructure and development works. Other designated uses of proceeds were for balance sheet restructuring, working capital and exploration.

There was a low level of achievement on outputs overall across the portfolio. The most commonly cited reasons for non-delivery of outputs were delays and cost escalation. Explanations for these vary in each case and include situations such as overstretched project management, poor preliminary exploration outcomes and delays in financial closing.

Past evaluations made observations about the ambiguity in the definition of use of proceeds in mining projects. There was little evidence of funds being used for intended purposes in several cases, suggesting a lack of verification taking place and an emerging risk of funds being diverted for unknown purposes to unknown entities or individuals, leading to potential financial and reputational risks to the EBRD. In another project, where use of funds was for general operational development and acquisitions, this lack of precision drew questions about whether the funds were actually needed unless for political risk mitigation.

3.2 Well governed

The EBRD's only area of substantive achievement in the area of good governance has been towards helping Mongolia implement the Extractive industries Transparency Initiative, a global standard for improving transparency and accountability in the oil, gas and mining sectors and launched at the World Summit for Sustainable Development in 2002 and endorsed by the G7. The Bank followed a bottom up (at corporate level) and top down (at the national level though policy dialogue) approach to implementing EITI in the country. TC support for roll-out of EITI at the country level has been vindicated by various EITI achievements at the country level, most notably in February 2018, Mongolia became the second country to meet all the requirements of EITI standard among over 50 resources rich countries.

Other areas concerning good governance set out in the country strategies for Mongolia included improved frameworks and legislation, for mine licensing, taxation, regulatory authority, revenue management (through for example a future heritage fund) and government policies. To date EBRD's support for better governance at the national level has focused on two main strands: (i) improving the transparency and wider accessibility of mineral data and (ii) supporting drafting of new mineral law. Both these are yet to bear fruit in terms of impacts.

The well-governed transition quality covers two aspects: national level and corporate level governance. This section begins with a discussion of the results relevant to the national level, followed by those for corporate governance.

3.2.1 Implementing EITI - Achieved

EITI was launched at the World Summit for Sustainable Development in 2002 and was then endorsed by the G7, the IFIs (including EBRD), civil society groups and major western oil, gas and mineral companies. Mongolia was admitted as candidate in 2007, and by late 2010 became one of the first countries to be compliant.

About the Extractive Industries Transparency Initiative (EITI)

'The Extractive Industries Transparency Initiative (EITI) is the global standard to promote the open and accountable management of oil, gas and mineral resources.

Guided by the belief that a country's natural resources belong to its citizens, the EITI has established a global standard to promote the open and accountable management of oil, gas and mineral resources. The EITI Standard requires the disclosure of information along the extractive industry value chain from the point of extraction, to how revenues make their way through the government, and how they benefit the public. By doing so, the EITI seeks to strengthen public and corporate governance, promote understanding of natural resource management, and provide the data to inform reforms for greater transparency and accountability in the extractives sector. In each of the 52 implementing countries, the EITI is supported by a coalition of government, companies, and civil society.'

Source: https://eiti.org/homepage

The EBRD's support for EITI has been carried out both through policy dialogue at the level of national authorities and in 10 projects at the project level through adherence to EITI reporting standards. Implementation of EITI has been a reoccurring objective in all EBRD country strategies for Mongolia and used as an argument for transition in multiple Board project approval documents.

Amongst IFIs, EBRD has been the primary mover towards assisting Mongolia implement EITI. Since 2011, the EBRD Legal Transition team secured around €2.4m of grant funding (€2m SSF, €0.4m ETC Fund) to support government implementation of EITI. It has administered up to €900,000 in two phases over a 6 year period (2001-2016). A €1.5m from SSF in 2017 for improving disclosure of beneficial ownership is underway.

By the end of a first phase in 2015 major results included: a draft EITI law submitted to parliament; capacity building of the EITI Mongolia secretariat; an e-reporting system piloted to replace paper reporting; a new communications strategy implemented by the secretariat; and, local staff used where possible. Results from implementation of phase II from 2015 to 2018 include: implementation of the e-reporting system and reconciliation of government receipts and company revenues from mining.

In 2018, Mongolia became the second of over 50 resource rich countries worldwide to meet all EITI standards. Revenue reporting is now fairly transparent with good progress on EITI.

3.2.2 Digitised geological database – Suspended, revived and now on-track

A national digitised geological database was first promoted in Mongolia by World Bank and EBRD in 2010 (TC funding from ETC Fund), to improve transparency and access to mining resource information, leading to increased investment, exploration and reduced corruption in relation to licensing, following success of the model in Papua New Guinea. The Mongolian National Security Council ordered the initiative to be suspended shortly thereafter citing national security concerns. It was only resumed after the government reconsidered its support under the new Minerals Policy in Mongolia, and a second EBRD TC funded by SSF resulted in several milestones being achieved by April 2019. Despite some gains in preparing the database, lack of investment in mineral exploration has continued to be an issue in Mongolia.

Diminished pipeline and the importance of exploration projects

Investments in exploration in Mongolia have decelerated significantly, and many interviewees also pointed to recent weaknesses in the natural resources pipeline due to downturn in commodity markets (in 2018 only one US$ 7.75m debt project was signed under the RSF with local partner bank). However, as favourable commodity cycle movements start to help to improve investors' sentiments, and change the economics of potential projects, the Bank should remain alive to stepping in and seizing appropriate opportunities as they arise.

The strategic review did not foresee any growth in ABI in Mongolia and the mining sector and expects EBRD's major engagements to centre around implementation of phase two of the Oyu Tolgoi copper mine as a key driver of economic growth that will trigger investments, related services and boost supply chains. A number of staff members interviewed noted that the EBRD must continue supporting exploration plays where resources are available. This is because systematic underinvestment in mineral exploration has negatively impacted the pipeline of new sizable mining projects in the country. Many felt that helping exploration companies discover the next Oyu Tolgoi is where the EBRD should be. Challenges with exploration can be linked to the yet to be completed digitised geological database discussed above.

3.2.3 Draft new mining law - Underway

In 2016 the Government of Mongolia requested assistance with a 4 year strategic programme to enhance the legal framework for the mining sector, to draft a new mining law, amend related laws and regulations and support implementation. It also included support for advocacy needed to achieve parliamentary approval of the new laws and regulations. Some of the concerns with the existing legislative framework included duplication, conflicts and loop holes, discretion of individual ministers to form secondary legislation and regulations on mining issues and the absence of a mine closure framework. Overhaul of the framework would enhance the investment climate and reduce investor risk.[21] The EBRD launched a 2017 TC (SSF €350k) to help prepare a new draft law and regulations, and to support implementation. The second draft was delivered to the Ministry in 2018, and feedback to date has suggested the government will make some revisions and additions to the existing law, adopting some of the suggestions of the draft prepared by the TC.

3.2.4 Policy dialogue – Limited progress

From the first Country Strategy for Mongolia, the EBRD has prioritised engaging in policy dialogue with authorities to improve the business environment and support reform efforts for the mining industry.

However, frequent changes in governments and also at the working level in relevant authorities are important contextual factors impeding the ability of the EBRD to conduct policy dialogue at the sector level. In interviews, staff indicated finding the right counterpart is challenging. Interactions are made difficult by the government intervening in investment agreements and the mining sector is prone to attack during the election cycle.

EvD finds that where policy dialogue objectives have been defined, monitored and reported in relation to the cluster of mining operations, it has been in reference implementation of EITI and advice on the mining law and revenue management (discussed earlier in this section). These areas were seen as more resilient

21 See EBRD TCRS section 'Rationale' Mongolia Mining Sector Legislative and Regulatory Support Programme 8018

to governmental changes. This work was led by the Bank's Legal Transition team and appears largely independent of the investment work. EvD finds little evidence of other policy dialogue conducted in support of EBRD's operations in mining and other sectors and instead abundant generic references to policy dialogue undertaken or intended to be.

One exception, mentioned in the Relevance section 3.1 Country Strategies, the EBRD's Office of the Chief Economist conducted an initial 2012 working paper on *Managing Mongolia's Resource Boom* which surveyed what Mongolia could do to build on reform steps and avoid a "resource trap".[22] This was preceded by an EBRD inter-departmental mission to Ulaanbaatar meeting key government counterparts and discusses issues and options. There is no evidence that that analytical work has been used as a platform for any further policy dialogue in this area. The 2017 Country Strategy for Mongolia reintroduces the concept of dialogue towards a future heritage fund to manage mining revenue. Although the 2017 Country Strategy has only been in place for two years at the time of writing, there is no evidence of plans or progress in this area through the EBRD's reporting systems for the enhanced approach to policy dialogue.

3.2.5 Corporate governance of mining companies – Limited progress

Corporate governance is part of the new transition quality of well-governed. Corporate governance of mining companies in Mongolia was highlighted as an issue in the EBRD Assessment for Corporate Governance 2016 and mentioned in country strategies, in terms of legislation, transparency and company practices. This is also closely related with implementing the EITI discussed above. Board functioning, code of conduct, integrity and corporate social responsibility were areas to be addressed through corporate governance action plans but only one of the EBRD operations sought transition through a specific corporate governance action plan. The singular poject designed to prepare for a future IPO was delayed and abandoned, with minimal progress. Other projects cited ESAPs, waste management plans and water monitoring and updated HR policies as indicators of improved corporate governance.

3.3 Competitive

The EBRD has aimed to increase the competitiveness of the mining sector in Mongolia through increased private sector participation, development of supply chains and adoption of new technologies, products and processes.

3.3.1 Private sector participation - Limited progress

All EBRD mining projects in Mongolia have been with private companies and many aim to increase production. Where private sector participation has been targeted through production related targets, there has been little evidence of achievement so far. One project introduced contract mining to Mongolia, providing new services. The EBRD's biggest investment in Oyu Tolgoi copper mine involves a joint venture with the government of Mongolia (34%) and Rio Tinto (66%).

The Bank has not been able to assist in the commercialisation of state owned mining assets and strengthening the frameworks for privatisation. Despite many meetings with SOEs and potential joint ventures to improve their transparency, data on mineral resources, and introducing international standards, they lacked commitment to reform. Behind this the challenging political environment, legacy corruption or lack of transparency, financial issues and environmental legacies made progress difficult.

22 Plekhanov A & Zettlemeyer J 2012 Managing Mongolia's resource boom

Many EBRD projects sought to prevent state interference however this was only successful in relation to one mine, through an EBRD equity investment.

3.3.2 Supply chain linkages- Limited progress against targets

Development of mining supply and value chains has been an explicit priority in Mongolia since the 2013 Country Strategy for Mongolia, but SME development in mining was a priority in the 2006-2008 Country Strategy. The Bank has long since recognised the opportunities offered from mining and the revenues that flow from it to support the development of local and regional economies so that they can continue to prosper even after completion of the EBRD mining project. As far back as the 1999 sector policy, Bank aimed to maximise domestic added value by focusing on projects with maximum *forward and backward linkages*; promoting upstream service and material supply projects that facilitate local sourcing.[23] Around half the projects in the Mongolian mining portfolio included a commitment to strengthen the capacity of SMEs (in particular the contractors and suppliers in the sector), by raising their standards of operation and expanding their activities in the sector. This would be achieved through the Advice for Small Business programme, using donor funding with part contribution from clients.

Results show the Bank has achieved limited progress in its specific targets in this area despite its ambitions:

- SME development targets were not achieved in 4 projects, with clients unable to continue due to financial difficulties created by commodity price declines.
- Donor funding is often not available for initiatives in the extractives sector. The only donor funded programme in Mongolia since 2011 excludes extractive industries.
- A significant plan to develop the mining supply chain via a 5 year local business development plan for Oyu Tolgoi did not proceed due to the client deciding to partner with other development partners. Interviews pointed to concerns from OT on procurement as reasons for abandoning the SBS led programme but also that "cheaper money may have been offered by other donors". Project monitoring revealed that OT has signed a MoU with IFC and GIZ in May 2018 on its SME capacity building program.

Local SMEs participating in the mining supply chain have benefitted from EBRD independently of natural resource projects. For example one company provides logistics solutions for Oyu Tolgoi and received two EBRD loans in 2017. Interviews and anecdotal evidence suggest the agenda has been active, especially through EBRD intermediated investments through financial institutions. However it has not been possible to independently establish how much Bank operational work in sectors other than natural resources concerns mining in Mongolia.

Interviewees indicated support to Mongolian business indirectly involved in mining is an area the Bank could do more in.

A starting point would be for the EBRD to be able to identify which projects outside of the Natural Resources team are indirectly connected to mining in Mongolia. This would include for example FI SME credit lines targeting the mining value chain. As part of its data management, the EBRD should consider having an 'associated industries' category or 'second relevant industry classification' so these type of projects can be identified and quantified. This forms one of the recommendations of this study (see Recommendations and Conclusions).

23 Section 2.2 of 1999 Natural Resources Operations Policy

3.3.3 Adoption of new technologies, products and processes – Some progress

Adoption of new technologies, products and processes featured strongly across the projects as a way to improve competitiveness. Some progress was made in this area with 5/7 projects achieving targets although past evaluations raised concerns regarding use of proceeds in this area.

- Introduction of: advanced mine management information systems (*Achieved* – in two projects); advanced project management system for TS (*Achieved* in one project)
- Commissioning of the first “coal handling & preparation plant” (*Achieved* in one project)
- Development of a GIS planning tool (*Achieved* - Oyu Tolgoi)
- Introduction of advanced reverse circulation drilling technology (*Partly Achieved* in one project)
- Advanced mining software for exploration, database management, tactical mine planning and fleet management (*Not achieved* in one project)
- Introduction of the first refractory gold ore treatment plant using bio-oxidation technology (*Not Achieved* in one project)
- Introduction of block cave mining (*Delayed* - Oyu Tolgoi) The potential for demonstration from the Oyu Tolgoi project is material given that Rio Tinto is a world class project manager with strong expertise in panel block caving and the Oyu Tolgoi concentrator is Mongolia’s largest and most advanced piece of machinery.

Integrated

EvD did not find transition targets in related to the integrated transition quality. Nevertheless, the Bank indicated it would support development of transport and power infrastructure in Mongolia to support the mining industry since the 2009 Country Strategy for Mongolia. Mining projects in Mongolia are particularly susceptible to infrastructure constraints: transport issues impacted heavily on two clients. The 2017 Country Strategy for Mongolia notes lack of transport infrastructure as a continued constraint to mining sector growth in Mongolia.[24] Reliance on mineral exports to China is heavy. One interviewee stated:

> “We found that no matter how good the sponsor was – there were always difficulties with the sheer isolation from other markets, vast distances and remoteness of the deposits and the reliance on China for offtake. To be that reliant on one market made an added level of complexity compared to for example natural resources projects in Russia – where you also had a large internal market.”

24 BDS/MN/17-1 (Final) 2017 Country Strategy for Mongolia p29-30

3.4 Green

An integral quality of transition identified in the 2016 transition concept is 'Green', which focuses on incorporating environmental considerations as drivers of growth, competitiveness and sustainability. This has been part of the Bank's Mandate since the Agreement Establishing the EBRD (Article 2). Project compliance with the ESP has been achieved, and despite some steps taken towards capacity building for standards in Mongolia, progress is limited.

3.4.1 Investment project adherence to the Bank's Environmental and Social Policy - Achieved

Mining projects carry significant potential environmental and social risks due to their extractive nature. To help mitigate this, EBRD mining projects are subject to the EBRD's Environmental and Social Policy, through which each project is classified A (for potential significant social and environmental impacts) or B when impacts are site specific, readily identified and addressed through mitigation measures. Category C projects have minimal or no adverse impacts. Approximately half of the mining portfolio in Mongolia was classified Category A, highlighting its high exposure to environmental and social risks and issues.

EBRD environmental and social performance standards are applied only within project boundaries defined during environmental due diligence and use of proceeds. Work conducted by clients outside of this scope is not subject to screening by the EBRD. This may result in environmental and social risks that the EBRD has no control over but is closely associated with through investing with the client, leading to reputation risks. In one project, a road was built which was not subject to EU standards by a client and had potential implications for dust, dislocation of herders and ecology. This suggests the EBRD might consider broadening its scope with regards to imposing standards on clients.

Project complaints brought by Mongolian herders and Civil Society Organisations regarding two projects on the basis of impact on herders' health, livelihoods and cultural heritage were dismissed, with the expert concluding the Bank was in compliance in both cases. A further complaint could not be taken further as the relationship with the client had completely broken down with the project in Corporate Recovery.

In Category A projects, performance was generally strong in completed projects, with thorough due diligence, international standard impact assessments and constructive public disclosure throughout implementation. One project did not meet expectations due to financial impairment and non-implementation. In the other half of the portfolio classified B or C, funding was generally provided for balance sheet restructuring, working capital or procurement for existing mines, and risks were low or satisfactorily mitigated.

3.4.2 Capacity building on environmental controls – Some progress

In addition to individual investment projects in mining, the Bank's ESP (2014 & 2019) strives to establish wider standards in countries of operations: "Through its technical cooperation and policy dialogue, the EBRD will seek opportunities to build capacity to consider and manage environmental and social issues in its countries of operations" (p3, 2014). To this end, the EBRD's ESD has engaged consistently over time in capacity building with the Mongolian government using TC funds for conferences, trainings, action plans and workshops with the Mongolian Ministry of Environment and Green Development on environmental issues including biodiversity, regional planning, water resources management, hazardous waste management and information sharing between government and the private sector (see Annex 4 for details).

Progress at the overall macro level however, appears to be limited as evident in the 2017 Extractive Industries Sector Strategy which characterises Mongolia as still having weak capacity to implement environmental controls; significant issues with water management and dust and limited transparency on environmental controls.

3.4.3 *Coal and sustainability initiatives – Limited progress*

Half the mining portfolio in Mongolia claimed contribution to the Bank's sustainability initiatives, mostly through cleaner energy production in relation to coal (smokeless or washed coal or metallurgical coal for steel production).

Future prospects to contributing in this area are reduced with the EBRD no longer approving coal mining projects. Some staff members raised concerns about the ability of other mining projects to be compliant with the EBRD's green economy approach (Green Economy Transition or GET) because mining capital expenditure on crushers, mills and so forth do not offer value in this regard.

Case Study: Attempting to addressing air pollution in Ulaanbaatar – An EBRD project with a domestic mining company

Ulaanbaatar has overtaken Mexico City to become the most polluted capital in the world for air quality, despite the population in Mexico City being 20 times larger. It is also the coldest capital city on earth, and located at the bottom of a valley, trapping air, and the city lacks heating infrastructure, with the increasing population from mass rural-urban migration burning raw coal to stay warm. This is leading to serious public health problems, particularly in infants.

In March 2019 the government banned burning of raw coal, and is providing semi-coke on the market, a coal by product instead (briquettes). Affordability is a problem for many though. ADB has invested in urban infrastructure development projects including heating in some neighbourhoods to combat the problem, although the adequacy of the scale for the size of the problem is unclear.[25]

In 2007, soon after it started operations in Mongolia, as part of this project, the EBRD used TC funds for a feasibility study for the smokeless coal plant. The plant was built, had low levels of pollution, and coal was sold to local consumers for heating and cooking.

This was the first briquette plant in Mongolia producing smokeless coal. Thanks in large part to the Bank's TC and the company's supply of washed coal to Ulaanbaatar city hospitals, schools and light industry, it is estimated that the minimum amount of daily sulphur dioxide concentration was reduced by 3.4 times and its maximum amount was reduced by 1.6 times compared to those in the zones where raw coal use is not restricted.

The challenge for the EBRD going forward is how to help Mongolia develop affordable clean energy infrastructure, and whether or not coal should or needs to play a role in that.

Specific sustainability targets were rarely set out in project documentation in the mining sector portfolio (3 projects), and only implemented in one case, Oyu Tolgoi, through the introduction of a water monitoring programme, leading to world leading water recycling rates of 85%.

[25] See Mongolia's capital banned coal to fix its pollution problem. Will it work? NPR 30 July 2019

3.5 Inclusive

Mining projects in Mongolia have included some objectives related to development of the local workforce through skills transfer. The Strategy for the Promotion of Gender Equality was only approved in 2016, and only one project has attempted to address issues around the low participation of women in the mining sector workforce in Mongolia, without success.

3.5.1 Skills transfer – Limited progress against targets so far

Mining sector projects in Mongolia are often located in remote areas where local labour force and SME contractors may not have the right skills to match the opportunities. Large mines are often located near traditional herding communities. The majority of skills transfer from EBRD's mining projects has been concentrated in the Oyu Tolgoi project, attempting to encourage training and recruitment of local staff and local SMEs, with mixed success in terms of performance against targets so far, though more time would be required to fully assess results.

Case studies: Training and employment for local staff

investment project with a domestic mining company

As part of this project, a major mining contractor would be brought in to manage copper processing facilities and train local staff to take over management and operations. In practice, the contractor successfully trained local staff but trainees did not take over operations and management. – *Partly Achieved*

Oyu Tolgoi

Oyu Tolgoi is anticipated to make the largest contribution to local workforce development through supporting high quality training in local education facilities as part of a US$126m university education and vocational training programme, impacting on 3,300 graduates. It would: construct 2 new universities; upgrade 5 educational centres and colleges; and, establish 2 new mining vocational centres.

The Oyu Tolgoi Investment Agreement commits to specific quotas over time, to employ local staff:

> 'OT may incur fines if Mongolians do not comprise at least 90% of its employees. In addition, the company should utilise best efforts to ensure that during the construction and expansion periods the Mongolian workforce used by its contractors represents no less than 60% of total and at least 75% for mining related activities. In terms of qualified employment, OT must use best efforts to ensure than within 5 and 10 years of commencement of production, respectively, at least 50% and 70% of the engineers it employs are Mongolians'

These benchmarks are monitored by the EBRD, but raise questions about attribution to EBRD involvement and how they will be monitored. – *On Track*

3.5.2 Gender and equal opportunities – No progress

The 2017 Extractive Industries Strategy observed that women constitute just 16% of employment in mining in Mongolia. The 2016 Strategy for the Promotion of Gender Equality notes that Mongolia had just one significant gap across all major areas – labour practices. Prior to this the 2006 Country Strategy for Mongolia stated that women represented approximately one half of the workforce.

Only one mining project in Mongolia attempted to address equal opportunity for women in mining. This project was piloted in the client's operations in Kyrgyz republic and was to be replicated in Mongolia. There was no evidence this materialised.

There are no projects in the pipeline that promise to address this issue of opportunities for women in mining in Mongolia so progress is unlikely without a concerted strategic effort.

3.6 Oyu Tolgoi

Oyu Tolgoi is by far the largest project in the EBRD's mining portfolio and can be set apart from smaller operations in this cluster for its unique characteristics and contributions to transition and demonstration effects. The site was discovered in the south Gobi desert in 2001 and contains one of the world's largest gold and copper resources. Open pit mine construction began in 2010 with first copper production in 2013, exporting mostly to China. Plans for underground mine development where most of the value lies began in 2015.

The EBRD and IFC together pursued participation in Oyu Tolgoi from the outset in 2010 when ESD specialists began appraisal of the site. In 2015, as part of a US$4b financing package, the EBRD Board approved a loan to Oyu Tolgoi LLC (US$1.2b of which US$850m was syndicated), which would be the biggest in the history of the Bank. IFC made an equivalent commitment through an A/B loan; parallel loans were provided from Export Development Canada (up to US$ 750m), US Exim (up to US$ 300m), and Australian EFIC (up to US$ 100m); and MIGA World Bank provided political risk cover for a US$1b commercial bank tranche. The entity is 66% privately operated by Rio Tinto (through Turquoise Hill) and 34% owned by the Government of Mongolia. The operation was expected to enable development of the deposit so that it could account for one third of Mongolia's GDP and budget revenues and over half of national exports by 2020. The project would have a systemic impact on the economy by supporting the largest foreign direct investment to date, and increase private sector participation in mining, and transfer skills from a leading foreign mining operator. It was supposed to contribute to SME development in the local economy, introduce international EHS standards including biodiversity offsets, water resource management, and provision of electricity and drinking water to the local town, and adopt transparency of EITI.

At approval, Directors Advisers directly questioned financial additionality and what other options Rio Tinto had since Rio Tinto is a large international sponsor with considerable financial flexibility and sufficient access to capital to enable financing for the project on its own balance sheet. Management put forward the following arguments in response:

- Whilst Rio could find financing on the market to provide to Oyu Tolgoi, large shareholder loans would carry higher financing costs and not be prudent. Continued bridging by Rio of the Mongolia government's share under the existing carry arrangements would lead to a growing balance due by the Mongolian shareholder that will need to be offset against future dividends, pushing further into the future the timing of dividends flow to the GoM
- Funding on Rio's own balance sheet would fail to provide the comfort of IFI presence
- EBRD and IFC intended to play a key role in mobilising a broad range of international commercial lenders and Export Credit Agencies, most of which had limited or no exposure to Mongolia historically.

- In terms of specific features, the Bank's A loan has a very long tenor of 15 years, extending 3 years beyond that of B lenders with additional margin of 37.5bps. As lead lenders the EBRD and IFC loans were identical to reduce potential for conflicts.

Prior to Board approval, in the run up to Mongolia's 2013 Presidential elections, renegotiation of the 2009 Mongolian government Investment Agreement underpinning Oyu Tolgoi development was prominent within Mongolian politics and civil society. Joint IFI presence in the funding structure was accepted as an important risk sharing and mitigation factor for such a large scale investment programme. Both EBRD and IFC had long standing and on-going dialogue with the Mongolian authorities (as well as having Mongolia as respective shareholder), with the EBRD in particular having made considerable investments in Mongolian mining sector - and therefore the combined role of the two IFIs was considered an important bulwark against resource nationalism and unilateral action to alter the investment agreement – which was highlighted as a transition risk in the Board document.

During the course of this cluster study, EvD found:

- ✓ US$820m of the US$1b B loan was eventually syndicated to 15 commercial banks who took comfort from EBRD's participation when taking exposure to risks of investing in Mongolia.
- × The EBRD plan to develop the mining supply chain via a 5 year local business development plan did not proceed due to Oyu Tolgoi LLC deciding to partner with other development partners over concerns about the EBRD procurement processes. One local SME development initiative related to mining logistics has occurred independently of Oyu Tolgoi. Terra Express provides logistics solutions for Oyu Tolgoi and received two EBRD loans via DFF in 2017
- – Introduction of latest technology block cave mining at Oyu Tolgoi has been delayed due to difficult and changing ground conditions requiring a rethink of the design and development schedule.
- ✓ Major achievements to date: a world class water recycling scheme which was introduced at Oyu Tolgoi resulting in 85% of water being recycled; and, a GIS planning tool has been developed.

Two factors have the potential to seriously derail funding and timetables for the mine's development:

- In 2015, the Mongolian government and Rio agreed development of the underground mine although parliamentary approval was not sought. The 2015 Investment Agreement has been repeatedly challenged by Mongolia's legislators, and subject to anti-corruption investigations implicating 3 former ministers. Changes to the agreement could undermine investor confidence.
- Rio Tinto reported that the underground mine would be delayed by 16-30 months due to technical issues with construction. This could add anywhere between US$1.2-1.9 billion to the total project cost. These extra funding requirements are beyond current available liquidity of Rio's subsidiary (Turquoise Hill) operating there.

Against this backdrop, the EBRD may receive further funding requests. Before further commitments in such a large scale project, EvD recommends that both a team self-assessment (OPA) and EvD OPA Validation are undertaken prior to any further Board approvals of follow on funding. Assessment of performance against objectives matters much more in a project the size of Oyu Tolgoi and warrants greater inspection. This evaluation was not able to undertake this, as the vast majority of benchmarks were not yet due and linked to project implementation.

4. Effectiveness of implementation

4.1 Commercial and financial success

Mining companies are exposed to volatile world commodity markets and this has a strong impact over time on their financial success or failure. EBRD clients are appraised for their financial success or failure at completion (usually a year and a half after disbursement) during project self-assessment. This project assessment, if repeated a few months or years later, may look very different though. For this cluster review, EvD looked at how clients performed at the time of project completion when self-assessments and/or project evaluations took place. The Evaluation department measures financial performance against projects at appraisal, using information provided by Banking teams in approval and monitoring documents, equity valuation sheets, and self-assessments and past evaluations.

At the time of EBRD project completion, around half the clients within the mining portfolio in Mongolia underperformed on a financial level. Over performing projects were approved in the earlier period between 2007 and 2010 (except Oyu Tolgoi) and incorporated commercial performance as transition benchmarks. Repeat projects with clients that over performed initially often did not perform well in the second project, due to shifts in commodity prices, particularly during the global commodity shock of late 2014.

Financial performance of mining companies was heavily influenced by world commodity prices. Of the 6 projects which experienced financial difficulties, 3 entered Corporate Recovery between late 2014 and mid 2015, at the time of a rare global commodity shock when prices fell 38% across all commodity price indices. The large price drops were caused by multiple macroeconomic and financial factors colliding. EvD identified falling commodity prices as the key impetus behind 5 out of the 6 operations entering Corporate Recovery, with other knock on issues such as escalating debts, failed IPOs, delays to new plants, poor management and deteriorating relationships with the client making matters worse.

Other factors severely impacting client financial performance were delays in executing operational plans. Delays in commissioning new plants (coal wash plant, processing plant), led to reduced sales and increased penalty costs. In another case with a domestic mining company, weak project management and lack of access to funding led to delays which had an adverse impact on financial performance.

Financial underperformance in exploration projects related to the deep seated risks in this activity. Clients are initially not in a position to generate revenue and are highly dependent on successful drilling. When exploration programmes do not produce positive outcomes, financing can run out. This was an issue in projects where the EBRD took equity stakes in relation to drilling for copper and gold.

EvD found all three mining projects approved under larger frameworks underperformed financially, although reasons varied from delays, market falls and failed exploration. Smaller projects can consume large amounts of staff time but produce few gains.

4.2 Returns on EBRD investments

It is often argued that in the mining sector it is important to take a portfolio approach when it comes to assessing profitability due to the high risks of investing in a volatile sector. There is an expectation that some projects will not perform, whilst others will make larger gains to cover losses. This section reviews the extent to which the Mongolian mining operations demonstrate efficient deployment of finance and support to generate net profit.

4.2.1 Debt returns

Out of the 9 projects using debt as the main instrument, profitability was lower than expected in all but 1 mainly due to impairments, undrawn commitments, and cancellations:

- Only Oyu Tolgoi, due to its longer tenor of 15 years, and its magnitude, had the potential to significantly contribute to EBRD income for a long period of time.
- 50% of the projects with debt financing ended up in Corporate Recovery due to clients being unable to service debt obligations.
- A large portion of the debt portfolio remained undrawn or cancelled, suggesting over commitment at project approval.

4.2.2 Equity returns

Lower than expected returns occurred in most equity financing operations, except with one domestic mining company. Overall it generated substantial profit (total realized IRR was 43.81% in US$ and 2.06x return on original investment) but also represented one of the Bank's largest paper losses in 2013. The other three equity opportunities in Mongolia involved SMEs related to exploration.

The ups and downs of equity exits in a volatile market – EBRD equity in a domestic mining company

In 2009 the EBRD invested in a 5% stake. During the boom in commodity prices in 2010, at the time of the IPO, EBRD sold a 24% portion of its 5% equity stake for a large profit but it held on the remainder of 3.8% despite the EBRD Risk department recommending immediate disposal of one-third at the prevailing price. When EvD evaluated the project in 2011 it noted that noted that following the IPO and based on funds raised, the value of the company was estimated at over US$3 billion, thus the EBRD's remaining 3.8 per cent is estimated to have been worth over 6x the original investment size at the time of the IPO. EBRD management proposed instead a phased exit from 2013 to 2015 at what it assumed would be higher prices.

In contradiction to this belief, the market declined sharply in 2013. The EBRD had to conduct a discreet exit via a dribble out programme which resulted in total net proceeds of the remainder being less than half of the original investment size.

4.3 Bank handling

Mining projects with complicated structures featuring multiple sponsors and syndicated loans combined with fluctuating commodity prices, led to large challenges for Bank staff handling the projects. Corporate Recovery became involved in approximately half the mining portfolio reviewed in this cluster. From EvD's document analysis and interviews with staff, it finds key issues facing staff were managing relationships, appraising risks and developing appropriate structures to mitigate risks, monitoring and reporting and addressing problems including impairments.

4.3.1 Corporate recovery work outs - strong performance

The EBRD's Corporate Recovery Unit becomes involved in investments which have gone wrong for whatever reason to recover the maximum value and avoid further value erosion. Corporate Recovery has been involved in around 50% of projects in the Mongolia mining portfolio, very high compared with the average of 5% across the Bank's entire portfolio.[26]

EvD found that overall; Corporate Recovery has been effective at working down substantial amounts owed to the Bank. Documentation in Corporate Recovery projects is understandably restricted, nevertheless, there were a number of examples of concrete successes – for example, where Corporate Recovery used a novel approach to recover substantial amounts of money (overall circa EUR 100 million) owed to EBRD at the same time as assisting client restructuring of significant amounts of other debt and also delivering some transition impact by demonstrating best practice restructurings in a local market (see box below). Though each case is distinctive with some instances of no recovery, generally the Bank's biggest exposures that have fallen into Corporate Recovery have all seen either substantial recoveries, exits with partial recoveries or important legal victories pending enforcements.

Numerous interviewees working on mining projects indicated there is a lack of enforceability of financing and collateral agreements within the local legal system. Amongst others, there is no guarantee that foreign investors can have legal title to mining licenses, which becomes an issue where security in form of the pledge on the mining licence needs to be enforced. This is a major competitive disadvantage for foreign investors in the sector, or was one interviewee asked "If EBRD as an international institution with Mongolia as a shareholder cannot enforce its legal claims in Mongolia then who can?" It is worth noting that such an environment creates governance and compliance issues with borrowers and sponsors as little to no repercussions are to be feared. Integrity (in terms of business conduct) is therefore of critical importance in an adverse market environment. Almost unanimously, it was felt EBRD could be doing more on tackling these issues, using its leverage as one of the largest private sector investors in the country, to flush out the issues of enforceability of legal rights with the GoM, if required by imparting that otherwise the EBRD was likely to reduce new business as a result.

The strength of the Corporate Recovery work was seen as a major signal to both the GoM and the market generally, as successful recovery in distress helps avoid a "soft touch" reputation and discourages approaches from the less prudent or scrupulous players, thus reducing future defaults and losses.

Corporate Recovery success from a novel approach in Mongolia

Since summer 2013 Corporate Recovery worked down an amount owed in a debt project. Client had been negatively affected by significant drop in commodity prices and demand from China. Initially, Corporate Recovery spent time (re-)building working relationship with the company's management. In December 2014, the company successfully raised money through emergency rights offering, but this only funded the company for one year as coal market deteriorated further in 2015 and the total debt rose and was completely unsustainable. The company even had to temporarily stop production when operating margin became negative.

With a payment cross-default looming at the end of 2015 and shareholders not willing to inject further equity, Corporate Recovery was facing prospect of a protracted large multi-layer, multi-party, multi-asset huge debt restructuring involving five different jurisdictions. By then, the EBRD's exposure to the borrower had already been amortized down to around half the original amount owned.

In 2016, the borrower obtained one-year promissory notes issued in local currency issued by the Mongolian Ministry of Finance (settling an obligation the GoM had to the borrower). The borrower

26 The rise in the share of NPLs has also affected the EBRD: since the financial crisis of 2008/9 the NPL share has risen and remained stubbornly high. Even though our NPLs are relatively low by comparison with other institutions, they are at a historic high and have an impact on EBRD's financial results. (At the end of 2016 they were at around 5.5 per cent).

attempted to monetise the notes with local banks but was only marginally successful. Corporate Recovery took the opportunity to settle all outstanding amounts under the loan by accepting the promissory notes at full face value of the outstanding loan. This was complex and time critical (e.g. issues like potential legal challenges of the settlement transaction) but Corporate Recovery signed the agreements and settled the loan four months later. After, the holding company filed for voluntary liquidation with the aim to orchestrate a restructuring of all its debt The other creditors did not challenge EBRD's settlement.

Corporate Recovery worked with Treasury on hedging the long Mongolian currency position for the EBRD. A year later, the promissory notes were redeemed in full by the Mongolian Ministry of Finance. MD Risk Management noted "this final stage was innovative, required us to take more risk and was ultimately uncertain until the very end," Then Director CR called this "an excellent result … We have maximised recoveries under this project and taken off our books one of the largest Top 20 impaired exposures. The positive profit and loss contribution - of plus around €34 million - is very significant."

Source: Internal documents and EBRD intranet

4.3.2 *Relationship management – mixed performance*

The Bank has leveraged strong relationships with clients to secure projects in Mongolia's mining sector. Three quarters of the portfolio involves work with repeat clients. Four key relationships stand out in this regard. Two projects with one client led to an operation with mining contractor to introduce contract mining to Mongolia.

Working with repeat clients can allow the EBRD to nurture their value over time, and improve business and corporate governance practices, however 3 of the 4 repeat client projects ended in Corporate Recovery. And while Corporate Recovery was able to restore and maintain good relationship with one domestic mining company, two other projects continue to suffer from weak, or no relationship at all. In one project, communication breakdown over project directions (a contractor was terminated without informing the Bank, leading to delays and cost overruns). In another project, the majority shareholder was uncooperative leading to difficulties in implementing the project. Further issues with client relationships are evident from the Corporate Recovery process (disputes, evasiveness in settling) – this is no different than any other CR clients or countries when things go wrong.

One project with a domestic mining company proved the exception. Benefits of a strong client relationship as identified in EvD's Validation report included more rapid due diligence and closer monitoring. Also, this was the only project to attempt to address equal opportunity.

4.3.3 *Risks and mitigation –mixed performance*

The Bank's risk appraisal system reflects the risky nature of Mongolian mining operation. The probability of default ratings is applied to sovereign and non-sovereign counterparties, to represent the likelihood of default, measured on a 1-8 scale (8 being more risky), with those rated lower than 4.3 being considered investment grade. None of the 14 projects were rated investment grade overall and all but one of the projects were in as rated between 4.7 - 6.3, signifying that these investments had large uncertainties or major exposure to adverse conditions. Credit Risk commented on the high risks prior to project approval, and recommended improvements be made to risk mitigation measures.

Top risks in Mongolian mining operations identified in approval documents include: operational and construction risk, commodity price risk, client management and financial risk, environmental health and safety risks and legal and license risks. Political risk was much less cited in Board documents. The negative impact of commodity price drops on project financial performance is demonstrated above (see Commercial and Financial Success), and occurred despite sensitivity analysis conducted within certain ranges at approval. Commodity price drops combined with other factors such as delays in commissioning a new plant or issues with an existing plant result in performance failures.

Licensing risks were identified as significant in over half of projects in the portfolio, although this did not stop the projects from proceeding. According to staff interviewed by EvD, the process by which mining licenses in Mongolia are allocated lacks transparency.

Integrity risks are significant in the mining sector, and all clients are subject to an integrity check before projects proceed. This was found to be inadequate in the case of one project, despite independently verified client due diligence, where the client had a reputation for ignoring creditors rights and even bullying lenders. This controversy with a major private international bank did not lead to the project being cancelled. The client then defaulted on the EBRD loan whilst continuing a programme of spending. This highlights the importance of using information provided through integrity checks (formal and informal local channels) in making decisions to proceed with EBRD projects.

In another case, an indirect minority shareholder was identified as carrying significant integrity risks through improper dealing and significant environmental damage in the US. The EBRD proceeded, as his influence was diluted as the project went ahead due to the presence of other shareholders (Oyu Tolgoi). In another project information regarding a politically exposed person with a minority shareholding was discovered, as the shareholding was too small to be considered a conflict of interest.

4.3.4 Effectiveness of Bank structuring

The high number of Mongolian mining projects entering Corporate Recovery to some extent demonstrates that Bank structuring of the projects was not able to mitigate identified risks. Alternatively, it could be argued (as some interviews did) that this shows Bank preparedness to take on bigger risks than private banks due to its mandate of being additional in the market, which can lead, in some cases, to unsuccessful transactions. Examples of more specific structuring issues highlighted to the evaluation in individual projects:

- Sponsor put options negotiated to protect an EBRD equity investment can be inadequate in unsuccessful exploration projects as the Sponsor has no incentive to voluntarily fulfil its liability. Further, in situations where it is possible to obtain security to cover the contingent put liability, such security should be an asset that maintains its realizable value.
- Clients reliant on funding investment programmes through future cash flows from volatile commodity prices can be high risk as they are exposed to commodity market downturns. Financing for EBRD projects should be based on well-defined sources of equity and debt funding.
- Large project finance loans for complex greenfield mine development should be accompanied where possible by a creditworthy completion guarantee from the sponsor's parent company.

4.3.5 Project Monitoring- mixed performance

- Credit monitoring has been consistent and complete.

- Transition monitoring has been more uneven with 4 projects lacking transition monitoring (one in Corporate Recovery). Gaps in transition monitoring are due to projects being approved under larger frameworks with different monitoring standards.
- Environmental and social performance monitoring and compliance monitoring has been extensive, leading to the Bank being responsive in addressing emerging problems.

Monitoring of equity investments is often more challenging than a regular debt transaction of the Bank, so the fact that about one third of the Mongolian mining projects (5 out of 14) is important to bear in mind.. However one weakness in the monitoring of these projects was highlighted in a previous evaluation, where EBRD was also a lender and issues around Chinese walls emerged.

4.3.6 Staffing of projects

One staff member was responsible for several projects in the portfolio. This left the Bank exposed to key person risk if that person were to leave, and meant that handover procedures were critical. In one project the operation leader went on extended and unauthorised absence, and another team member resigned within 6 months of signing. It took 12 months to establish replacements. There is a pattern of Bank staff departing or taking extended absence during periods when projects faced difficulties.

4.3.7 Nominee board directors and observers – weak performance

EvD found information about EBRD representation on client company boards for 4 projects, 2 as a board member and 2 as an observer, although this had little impact overall on the results of the portfolio. The EBRD often has board membership if it holds equity in a company, and uses that position to improve corporate governance and provide advice. Two examples illustrate mixed performance in this area:

- In one project the EBRD board representative was taken up by the EBRD Country Director for Mongolia. This would provide long term investment in a Mongolian private sector company and help improve corporate governance. Monitoring reports show the EBRD representative attended all Board meetings and assisted with preparing the company for a successful IPO. This success led to other mining companies approaching EBRD for finance.
- In another case of a project that failed to perform, an EBRD board director was nominated and attended several meetings but resigned when the Bank initiated legal proceedings against the client. Targeted corporate governance standards were not achieved.

For another two equity investments the Bank had board and observer positions but did not exercise its right. In one case, the team argued that this was due to the high calibre of the company's board and highly specialised nature of the investment, and when the project subsequently became distressed and went to special assets status, transition monitoring considered this no longer relevant.

4.3.8 IFI Cooperation - mixed performance

As far back as 1999, the Bank fostered a strategic relationship with the IFC in this sector, with "several large projects jointly financed and the sector teams of the two organisations having learned to work closely together." Mongolia country strategies have also sought for EBRD to closely coordinate investment activities and policy dialogue efforts and technical assistance initiatives with the IMF, World Bank and ADB and with private sector focussed donors in the country.

In 2007, soon after the country became an EBRD country of operations, the government of Mongolia and a group of IFIs (World Bank Group, Asian Development Bank, and EBRD) signed a joint Memorandum of Understanding (MoU). The overarching focus was "sustainable long-term development of the mining sector in Mongolia, including strategic mining deposits" and the government wanted the IFIs to play a unique "neutral and honest broker" role between government and potential strategic investors into the strategic deposits.

The IFIs and the government planned to create a joint working group to draft the detailed terms of reference for the specific IFI assistance, with the government envisioning contributing 10% to the costs of the technical and advisory assistance. EvD found no evidence of this work progressing. It found IFI collaboration to be mostly informal and lacking coherence, defined responsibilities and a specific programme of work and policy dialogue in the area of mining.

Key features that emerged from interviews with staff of the current collaboration are as follows:

– There seemed to be a lack of follow up on results of the 2007 MoU. EvD found there was limited progress across the key objectives. Reform issues are ongoing, and have been highlighted in subsequent issue papers by the IMF and EBRD.[27] This points to weaknesses in the collaboration efforts and a need for reflection and revision of the approach. According to one staff member: "... the MoU is still viewed by both the IFIs and the authorities as the key document providing the framework for policy dialogue and technical assistance in the natural resource sector. "

– Staff indicated the division of labour amongst IFIs is based on the unique strengths of each IFI. The IMF leads policy dialogue on mineral resource revenue management and the World Bank leads on transparency and production sharing contracts. The EBRD and IFC are more active in supporting private sector development through supporting clearer licensing regulations, the creation of an EITI-driven level playing field, and supporting the introduction of best EHS and corporate governance standards in the sector.

– IFI and donor coordination is carried out through an annual workshop organised by the World Bank and informally more regularly. All the major IFIs local offices are in the same building which facilitates continuous dialogue.

– The EBRD's strongest relationship is with IFC, particularly in relation to the debt finance package for Oyu Tolgoi. This was the largest ever limited recourse financing in the mining sector. The cooperation of IFIs to syndicate their allocations led to greater participation of commercial banks. IFC and EBRD could stand together against resource nationalism and any unilateral action to alter the Investment Agreement.

4.3.9 Absorption of lessons from experience

Lessons were identified in all but 2 of the project approval documents reporting around 54 separate lessons. 75% of the lessons used in approval documents related to due diligence (most frequently around reliability of data and cost control) and environmental issues (mostly concerning accident prevention), with implementation issues also accounting for another 20% of lessons identified.

In interviews and analysis, EvD found a great deal of lesson learning and application occurring under the radar. Two areas stand out where project design reflected where lessons were adopted:

[27] Mongolia Selected Issues IMF Country Report no. 19/298 and Investor Conference at the EBRD, December 2019

1) **Appointment of an in-house mining engineer:** Over the initial years of the Mongolian mining operations, independent mining engineers were contracted by the EBRD to work on aspects of the due diligence, planning and monitoring of many projects. Use of these independent mining engineers was highlighted in the majority of projects reviewed. They were used to overcome shortcomings in resource data in mining projects through independent and detailed reserves analysis and review of technical documentation.

Past project evaluations and the *EvD Special Study: Extractive Industries Sector Strategy Review Volume I* recommended the recruitment of a mining engineer to the banking team, noting that "this should help during the planning of technical aspects of projects, providing a quicker mechanism for assessment of technical components and to identify some of the project risks."

The EBRD did in fact recruit an in-house Bank Mining Engineer around 2012 who conducts technical due diligence, is able to provide comfort on technical aspects to Credit and reviews technical information provided by clients during monitoring.

2) **A more cautious approach regarding commodity price risks**: How the Bank appraised and mitigated commodity price risks are covered in detail in chapter 3 of this report. However, from interviews it appears that operations teams have internalised learnings from previous experience and tailored how they work accordingly. There are various sources for commodity price projections globally, and the upshots of financial models for individual projects are sensitive to specific projections (and assumptions) used. Risk management may in the past have reviewed two projects in the same country and subsector, which contained different (or insufficiently conservative) commodity price projections. The number of NPLs experienced globally but also within the Bank due to the fall in global commodity prices after 2012 warranted modification.

Banking and Risk Management moved to jointly prepare and produce centralised projections and commodity fact sheets on a quarterly basis (which are based on a composite from standard industry sources such as Brokers' reports), which are then used by operation leaders in their financial models for relevant projects. These projections are designed to take a conservative approach, forecasting 20% below the average/lowest industry forecasts.

5. Key findings and recommendations

EBRD began investing in the mining sector of Mongolia at the beginning of a commodity boom, and numerous projects with domestic players were approved in the initial years in an attempt to build the local market with additional investment and support for better corporate governance. This evolved from 2012 as prices fell and projects with weak sponsor support started to fail, going into Corporate Recovery. The additionality argument for projects with foreign players approved was based more on facilitating foreign investment by providing political risk comfort through EBRD presence. In the case of Oyu Tolgoi, the largest EBRD loan in the Bank's history, this was jointly led with IFC due to the immense size of investment and syndication needs.

The country strategies of Mongolia consistently called for policy dialogue to help strengthen legal frameworks, capacity building of regulatory authorities and develop revenue management policies. They promised corporatisation and privatisation of state owned mining companies, development of supply chains and transport and power infrastructure to support mining. They also called for implementation of EITI. A review of the transition objectives and rate of achievement shows that very little progress was made across all areas apart from implementing compliance with EITI. Project transition objectives set at approval often lacked ambition and clarity to meet country strategy objectives in the sector.

In the case of policy dialogue, technical assistance delivered through the Legal Transition team led to successful implementation of EITI at government level and a new draft mining law. Little progress was made on helping the government to develop a clear policy on revenue management. A key issue highlighted was lack of enforceability of legal claims in the local system for foreign investors, and prevailing lack of trust in institutions to protect foreign investors. In parallel to the operations, the Bank and ESD in particular have undertaken substantial work to help improve capacity in the country to manage and implement environmental impact controls. Whilst the EBRD has decided not to engage in coal projects, lack of affordable energy and burning of abundant raw coal has led to a pollution crisis impacting on public health.

Key findings:

- Half the projects in the Mongolia mining portfolio ended in up in Corporate Recovery, high compared with the average of 5.9% across the Bank natural resources portfolio: reasons were related to the global commodity price slump, business conduct issues and lack of sponsor support.
- Corporate Recovery has been effective at working down substantial amounts owed to the Bank with a number of examples of concrete successes. Nevertheless enforceability of rights within the local legal system for foreign investors has been and remains an issue.
- The new transition qualities provide a new lens for a retrospective look at EBRD work, as the Bank's overall mandate remains the same, but they also offer a chance to better articulate objectives going forward. In the mining projects under review, transition objectives, benchmarks and inputs were frequently lacking ambition, clarity and consistency, and not addressing key country strategy priorities. There was overlap between operational, environmental and transition objectives and lack of explanation of expected outputs, outcomes and impacts and how they would be monitored.
- In terms of country strategy objectives, there was no progress on supporting privatisation of state owned mining companies, no explicit support for infrastructure and only 2 projects attempting to support supply chains

- Coal mining is leading resource in Mongolia (both thermal and coking) with knock on effects for air quality and pollution but has been a contentious area for the EBRD resulting in no coal mining projects of any type being approved since 2013.
- IFI collaboration was made official in 2007 with a formal MoU between IFIs and the GoM on reforming the mining sector, with a working group establishing TORs to implement the various reforms. According to Management, under that MoU, EBRD conducted work in some specific areas including establishing the EITI, a national geoscience database and a new draft mining law. EvD notes, however, that overall progress on the key objectives set out in the MoU has been limited, as they continue to be raised by investors. In 2019 EBRD contributed to an IMF paper which details ongoing issues for reform in the country, including those which have long impacted on the mining sector.[28]
- Frequent changes in governments and relevant authorities represent a real challenge for EBRD policy dialogue in Mongolia. Policy dialogue is called for in the country strategies on legislation, licensing & taxation issues, implementing EITI and capacity building of regulatory authorities. Policy dialogue was often included as an attribute in projects, but this did not follow through to any specific objectives, activities, or monitoring of outputs and outcomes at the project level.
- In this context, the Legal Transition team pursued work selectively using non transactional TCs to implement the Extractive Industries Transparency Initiative in Mongolia, geological database and a revised draft mining law to help improve the investment climate and address issues in the existing legislative and regulatory framework for mining.

Recommendations

1. *Oyu Tolgoi:* The EBRD should ensure that both a team self-assessment (OPA) and EvD OPA Validation of the Oyu Tolgoi investment are conducted prior to approving any follow on financings or extensions. This will provide an opportunity to ensure the transition objectives are on track, issues addressed or potential for new areas are pursued, and that risks of further participation are fully explored.
2. *Project design:* Future projects for the mining sector should explicitly set out realistic but suitably ambitious transition objectives and benchmarks under new transition qualities, specifically linked to country strategy targets and agreed with clients in advance, embedding adequate resourcing and monitoring frameworks. Intended technical assistance and policy dialogue work directly related to projects should be clearly articulated only if included as transition objectives. Linked work towards enhancing supply chains or developing infrastructure, including cross departmental efforts should be clearly set out through a programme of investment to maximise influence and gains. Specifically the Bank should consider tracking related industry classifications for all projects linked to supply chains or local development to enable an efficient mapping of the broader impacts beyond the direct financings to mining companies.
3. *Policy dialogue:* In the mining sector, the EBRD has in the past conducted policy dialogue in discrete areas of expertise under the 2007 MoU with other IFIs and GoM (e.g. EITI, geological database, a draft mining law and some other legal reform work). The EBRD recently contributed to a 2019 IMF country report which clearly sets out the ongoing issues which need to be addressed for reform, including those that directly impact on the mining sector. [29] Now the EBRD

[28] Mongolia Selected Issues IMF Country Report no. 19/298 and Investor Conference at the EBRD, December 2019
[29] Mongolia Selected Issues IMF Country Report no. 19/298

should request a renewal of the MoU and work together with other IFIs to come up with a an action plan for dialogue with authorities to support reform and address key issues impacting on the investment climate for the mining sector and transition. This should clearly set out allocated roles and responsibilities, specific objectives, benchmarks, timeframes, monitoring, reporting and resourcing mechanisms. Issues covered may include a government strategy for mining and revenue management, protection of investor legal rights, local business integrity standards, enforceability of mining licenses and financing agreements for foreign investors, corporatisation of state owned mining companies, infrastructure needs and environmental standards and associated supply chain work.

Annex 1: Sources

1.1. EBRD staff interviewed

EBRD Staff & Board		
Board	Adviser –Netherlands/China/Mongolia/Nth Mac/Armenia	Vahid Amini
Resident Office Ulaanbaatar	Associate Director, Head of Mongolia	Irina Kravchenko
	Associate Banker	Khangai Tserenraash
	Associate Banker	Amra Erdenebaatar
TI and Global Economics	Director	Alexander Plekhanov
EPG	Associate Director, Lead Sector Economist	Inna Yabbarova
Natural Resources	Director, Head of Natural Resources	Eric Rasmussen
	Associate Director, Mining Engineer	Mark Hodsgon
	Principal Banker	Ulmas Musaliev
	Associate Portfolio Manager	Filip Prodanovich
Legal transition	Associate Director, Senior Counsel	Paul Moffatt
Credit Risk	Associate Director, Senior Risk Officer	Sean Edwards
Corporate Recovery Unit	Associate Director, Senior Risk Officer	Steffen Pohl
	Principal Risk Officer	Marta Matlengiewicz
BD	Director, Head of Business Development	Philip ter Woort
ESD	Associate Director, Head ESD Operations	David Williamson
	Associate Director, Lead Appraisal Adviser, ESD	Jeff Jeter
SBI	Associate Director, Reg Head SME F&D, Central Asia	Nodira Mansurova,
	Principal Manager, ASB, SME F&D, Mongolia (Advisory)	Baigalmaa Sanjjav
Project Complaints Mechanism	Principal	Olga Vasiliev
	Acting Associate Director	Sarah Hanes
	Officer Adviser Associate	Taylor Fulton
Banking Portfolio	Associate director, Senior Banker, Corporate Debt	Valeriu Razlog
	Director PEU, Sustainable Infrastructure Debt Banking Portfolio	Kevin Bortz
Staff at other IFIs interviewed		
IFC	Principal Investment Officer	Rufat Alimardanov
World Bank	Country Manager for Mongolia	Andrei Mikhnev

1.2. EBRD country and sector strategies

Country Strategies for Mongolia Including workshops and minutes	2006, 2009, 2013, 2017
Sector policies and strategies Including workshops and minutes	1999 Natural Resources Operations Policy
	2006 Energy Operations Policy
	2012 Mining Operations Policy
	2017 Extractive Mining Industries Strategy

1.3. EBRD evaluations

Operation Performance Assessments	MAK II; Altan Rio
Operation Performance Assessment Validations OPAVs	2012 MAK I; 2013 Leighton, 2016 Altain Khuder, 2017 Centerra II,
Operation Evaluations	2011 Mongolia Mining Corporation 2012 Mongolia Financial Sector Framework
Special Studies	2010 Extractive Industries Sector Strategy Review

1.4. External documents

2014	Australia Mongolia Extractives Program (AMEP) Investment Design Document
2015	IEG - Mongolia Country Program Evaluation, FY05–13
2015	IEG World Bank Group Engagement in Resource-Rich Developing Countries: The Cases of the Plurinational State of Bolivia, Kazakhstan, Mongolia, and Zambia
2015	Social And Gendered Impacts related to Mining, Mongolia
2016	Mongolia Mineral Resources Authority - Annual Bulletin of Mining and Geology Mongolia
2017	USGS - 2014 Minerals Yearbook Mongolia
2017	Paradigm Capital – Research note Gold Sector
2018	BMI Research Mongolia Mining Report Q3 2018
2018	EIU Country Report – Mongolia
2019	US State Department report Investment Climate Statements

Annex 2: Evaluation matrix

Evaluation questions	Judgement criteria	Indicators	Sources of Data
1. How well have the Mongolian mining operations reflected the **strategic agendas** of the EBRD and the country?	1.1 The degree of each projects' relevance to the Bank's applicable country strategy priorities, both at approval and at evaluation.	– Specific ways the projects actively helped EBRD to deliver on its country strategy priorities	– Project approval documents, Banking self-assessment and EvD evaluation, interviews – Country strategy documents – External literature
	1.2 The degree of each projects' relevance to the Bank's applicable sector policy/strategy, both at approval and at evaluation.	– Where sector policy was in place - evidence of compliance (Energy Policy 2006 Mining Policy 2012) – Where a sector strategy was in place – evidence of specific ways the projects actively helped EBRD to deliver on its strategy intentions	– Project approval documents, Banking self-assessment and EvD evaluation, interviews – Sector policy or strategy documents – External literature
	1.3 To what extent have the EBRD Mongolian mining projects been additional?	– At approval - project additionality claims in the approval document were plausible – In retrospect - whether the Bank's attributes legal covenants and/or the expected additional commercial financing actually happened.	– Project approval documents, Banking self-assessment and EvD evaluation, interviews – External literature
	1.4 To what extent did the Bank demonstrate absorption of lessons from its own experience and that of others in mining in Mongolia?	– The adequacy of identification and incorporation of the lessons of past experience	– Project approval documents, Banking self-assessment and EvD evaluation, interviews – External literature
2. What **results** has the Bank achieved in the Mongolian mining operations?	2.1 Did the mining projects produce the expected levels of output in terms of quality and quantity? on time and on budget?	– Effective use of proceeds as expected at approval, for example. – The extent to which implementation was on projected timeframes and budgets.	– PMMs, Banking self-assessment and EvD evaluation, interviews – Other monitoring documents erg CRS, – External literature
	2.2 What has the environmental and social performance of the projects been?	– Performance (against benchmarks and milestones) in implementing ESAP, and meeting other requirements (such as regular reporting) specified in the investment agreement. – Community impacts such as public health, safety and security, gender equality, effects on indigenous peoples and cultural heritage, involuntary resettlement, and affordability of basic services (under EBRD 2008 and 2014 E&S policies). – Labour standards and working conditions including occupational health and safety. – PCMs, overall compliance with the Bank's Environmental and Social Policy	– Environmental monitoring documents, ESAPs, Banking self-assessment and EvD evaluation, Interviews, – External literature
	2.3 To what extent were the targeted transition impacts contributed to:	Evidence of contribution to: – Well governed Mongolian mining sector	– Banking self-assessment and EvD evaluation, TIMS, interviews

Evaluation questions	Judgement criteria	Indicators	Sources of Data
		– More competitive Mongolian mining sector – More inclusive and sustainable Mongolian mining sector	– External literature Project approval documents,
3. How **effectively** have Bank mining operations in Mongolia been implemented?	3.1 To what extent did the projects demonstrate commercial and financial success?	– This was specifically benchmarked in 6 projects, but will be reviewed for the evaluation portfolio as a whole	– Credit reviews in particular, PMMs, Banking self-assessment and EvD evaluation, interviews, Bank databases
	3.2 How well has the Bank handled mining operations in Mongolia?	– effective appraisal of investment risk and mitigation measures – quality of credit, transition, and environmental monitoring, and the quality of supervision of TC if any; – the monitoring of the client's compliance with the terms of the investment; – adequacy and timeliness of the Bank's response to emerging problems or opportunities	– Banking self-assessment and EvD evaluation, Monitoring documents, interviews – External literature, Project approval documents
	3.3 How well did the Bank perform with respect to Nominee Directors, IFI cooperation and Policy dialogue	Efficiency with which the Bank conducted/made use of: – Nominee Directors and Board observer positions – IFI cooperation in the sector – Policy dialogue to support results in the sector	– Banking self-assessment and EvD evaluation, Monitoring documents, interviews – External literature, Project approval documents
	3.4 What levels of return did EBRD generate in its equity and debt financings?	– The profitability of each of EBRD's investment(s) in the project and/or company, based on Bank estimates of either net project contribution or IRR:	– Data warehouse, Project approval documents, Banking self-assessment and EvD evaluation, Credit reviews

Annex 3: Methodology

The evaluation framework is based on OECD-DAC criteria (relevance, effectiveness, efficiency and sustainability), which have also been used in the underlying self-assessments, validations and evaluations undertaken on the portfolio. A mix of well-established evaluation approaches was used; combining aspects of evaluation cluster and evaluation synthesis methods. The mining projects in Mongolia were suitable for a cluster approach as they represent a set of EBRD interventions with common features facilitating identification of common themes and lessons. This is opposed to an approach focused on ascertaining the success or failure (accountability) of individual interventions, and consequently information is reported in aggregate.

In addition, considering that the majority of the projects identified had already undergone varying forms of ex post assessment, this study sought to make maximum use of this opportunity – by placing effective use of evaluation synthesis at the core of the approach. Though individual evaluations and operation performance assessments provide useful information about specific interventions, often each was too qualified and context specific to allow for broader reflections. One key advantage of evaluation synthesis is that when the results of many assessments are combined, it is possible to make wider observations – such as EBRD effectiveness in a particular sector and country. Evaluation synthesis also provides a basis for making assessments about EBRD effectiveness in the country.

There was no sampling – the evaluation reviewed all approved and signed operations by EBRD in the mining sector in Mongolia.. While there is no specific methodology for cluster evaluations, it is routine for cluster evaluations to employ a mix of methods relying on both qualitative and quantitative data analysis – which is what was undertaken here.

- *Previous evaluations and operations performance assessments:* Interviews: With key stakeholders, structured in line with the evaluation matrix, were conducted (see Annex 1 for sources). Some interviews may be conducted via phone or videoconferencing as necessary.
- *Project planning document review:* The sources for the review included: DTM data, concept review memorandums, final review memorandums, support units comment's, Board approval dicuments, Directors' Advisors' questions, environmental appraisal, environmental and social action plans, country and sector Strategies, due diligence documents, consultants' reports and client board minutes.
- *Implementation and monitoring review*: the project monitoring module system, credit reviews, annual environmental monitoring reports, procurement documents and transition mointoring reports. Legal agreements (loan agreements, subscription agreements and waivers and amendments to the agreements), project complaint mechanism reports, corporate recovery monitoring/memo documents

Primary data collection from field visit was not undertaken but where field-based counterparts were willing and available for interview – these were conducted via phone or video-conferencing.

Annex 4: EBRD's support to Mongolia's Ministry of Environment and Green Development

EvD was able to ascertain substantial (non-transactional) support to the Ministry of Environment and Green Development provided by ESD over a number of years which has resulted in knowledge transfer and capacity building, including but not limited to:

- *March 2011:* EBRD organised a ***workshop*** on biodiversity of the South Gobi Desert, Mongolia – this being the genesis of the subsequent biodiversity engagements in Mongolia;
- *August 2012-16:* EBRD undertook a capacity building TC for MEGD also looking at biodiversity in Mongolia but with an emphasis on regional planning. The ultimate **tool** from this work is available made publicly available[30]:
- *June 2013:* EBRD co-hosted with the MEGD a "***National Forum*** on Green Development" with approximately 650 participants representing government, business, country delegates and research & training institutions.
- *May 2014:* EBRD implemented ***a training*** on the topic of "Mine, Communities and Water Resource Management in the South Gobi Region of Mongolia" for executives in the mining industry with an emphasis on water issues and the importance of water conservation/management;
- *June 2015:* EBRD organised a "***Biodiversity Offset Workshop***" aimed at facilitating dialogue between GoM, environmental consultants, conservation organisations and the mining industry on the topic of recently introduced biodiversity offset requirements for mining and oil/gas projects in Mongolia. Over 50 participants representing MEGDT, MNMA, EBRD, International Conservation and Development organizations (TBC, The Nature Conservancy, Wildlife Conservation Society, The Asia Foundation, and United National Development Programme (UNDP), Mongolian mining companies, and Mongolian biodiversity offset practitioners.
- *September 2018:* EBRD helped produce a "***prioritised action plan*** for facilitating Mongolia's transition to sustainable hazardous waste management" as part of a larger TC project to improve hazardous waste management in Mongolia, and support for the enhancement of institutional capacity. The development of a prioritised action plan; and v)
- *November 2018:* EBRD organised a "Hazardous Waste Management in Mongolia" ***conference*** as part of the previously mentioned TC project as part of raising awareness of sustainable hazardous waste management. It brought together 112 national and international stakeholders to discuss the recent developments in the hazardous waste management in Mongolia and the way forward in this field.

30 Mongolia mitigation design tool

Annex 5: Management's comments on the report

Executive Summary

- Management welcomes the comprehensive and important review on the Bank's Mining Operations in Mongolia and would like to thank EvD for a very detailed report including insightful observations.
- Management thanks EvD for taking a broad view of EBRD's mining portfolio in Mongolia and the context in which the EBRD has operated in since it became a Country of Operation in 2006. The report acknowledges the centrality of mining to the Mongolian economy, as well as the change in EBRD investments, following the discontinued practice of investing in coal mining.
- Management would like to note that in places findings do not fully reflect the progress achieved on the ground, due to the somewhat narrow focus on reviewing the performance of project specific benchmarks. This includes the finding that projects' impact has been limited in expanding supply chain linkages and skills transfer. *Oyu Tolgoi* represents a FDI worth $22bn of which half has been invested with a world class sponsor. The scale and scope of this has had transformative effects on supply chains and lifted skills by training thousands of people.
- Management notes that the report reflects the volatile nature of global commodity prices, which have led to half of the existing portfolio ending up in Corporate Recovery.
- Management appreciates the findings on non-transactional TCs being the main contributor to transition impact, however, greater linkages have not always been possible due to issues of timing: It remains important to be responsive when decision-makers are engaged, as this can often be subject to change and does not always coincide with the timing of investments. This is particularly the case for public sector reforms. In the absence of linkages to private sector deals EBRD has pursued TCs nonetheless to benefit from receptive authorities with the capacity to deliver implementation which, in the case of EITI and the GIS mapping, has delivered positive outcomes.
- Management agrees with the study recommendations and in particular the value of a mid-term self-evaluation of *Oyu Tolgoi*, validated by EvD. It does not agree to make this a condition for any follow-up engagement given the current process of control mechanisms ensuring feedback from monitoring of past projects is taken into consideration in the subsequent engagements. Management would like to highlight that significant improvements were made in the past two years in assessing and setting ambitious transition objectives and benchmarks at project design, and agrees to improve monitoring and consider tracking related industry classifications for all projects linked to supply chains or local development. Management values the close cooperation with other IFIs and always works in close consultation with them particularly to ensure a coherent and well-coordinated approach to policy engagements. Mining strategy caters for mining sector diagnostics and includes consultation with other IFI involved in the mining sector.

Management's comments to the recommendations are provided below. More detailed comments at the draft were incorporated by EvD in the final version of the study.

Recommendation 1: *Oyu Tolgoi*: The EBRD should ensure that a full mid-term evaluation of the Oyu Tolgoi investment is conducted prior to approving any follow on financings or extensions. This will provide an opportunity to ensure the transition objectives are on track, issues addressed or potential for new areas are pursued, and that risks of further participation are fully explored.

Management partly agrees with this recommendation. Given the scale and strategic importance of the Oyu Tolgoi project, Management agrees that a mid-term evaluation (OPA), validated by EvD would be beneficial. However, Management does not agree that this should be a condition for further engagement with OT should this be necessary before it is completed, on the basis that any extension would be thoroughly assessed by Economics, Policy and Governance team (EPG), taking into account the transition impact performance of the existing project based on ongoing reporting.

Recommendation 2: *Project design:* Future projects for the mining sector should explicitly set out realistic but suitably ambitious transition objectives and benchmarks under new transition qualities, specifically linked to country strategy targets and agreed with clients in advance, embedding adequate resourcing and monitoring frameworks. Intended technical assistance and policy dialogue work directly related to projects should be clearly articulated only if included as transition objectives. Linked work towards enhancing supply chains or developing infrastructure, including cross departmental efforts should be clearly set out through a programme of investment to maximise influence and gains. Specifically the Bank should consider tracking related industry classifications for all projects linked to supply chains or local development to enable an efficient mapping of the broader impacts beyond the direct financings to mining companies.

Management agrees with this recommendation. Management agrees that before the updated transition concept and the new transition impact assessment methodology (since mid-2017) under Transition Objective Measurement System (TOMS), there was no standardisation of the link between objectives and indicators. Management notes that projects signed after July 2017 have been assessed under the new methodology. TOMS assigns objectives to indicators from the standardised list in the Compendium through a back-end static mapping process embedded in the system. Project objectives are linked to the relevant country strategy priorities (not targets as country strategies do not have targets) and that link is identified and assessed explicitly through “strategic alignment” score. Technical Co-operation work will be articulated as part of transition objectives if present at the time of project preparation and directly related to the project.

Management notes the recommendation on including text on TCs only when they are central to the TI objectives of the project. Technical Co-operation work will be articulated as part of transition objectives if present at the time of project preparation and directly related to the project. Under the new TI methodology, projects are assessed based on a Primary and a Secondary TI Qualities in order to ensure a clear and focused communication of the expected transition impact. Where significant TC activities relating to a project are present, they will generally be incorporated as part of the TI objectives. The results indicators of investments and technical cooperation will be combined in a single results matrix which allows tracking the contribution of TCs to transition impact directly. The rare exceptions to this would be projects which contain other sources of TI which are deemed to be even stronger and more central, in which case the TC will likely be mentioned but not described in detail or benchmarked. Management agrees to consider tracking related industry classifications for all projects linked to supply chains or local development.

Recommendation 3: *Policy dialogue*: The EBRD should work together with other IFIs to come up with a comprehensive programme of dialogue with authorities to support reform and address key issues impacting on the investment climate for the mining sector and transition. This should include specific objectives, benchmarks, timeframes, monitoring, reporting and resourcing mechanisms. Issues covered may include a government strategy for mining and revenue management, enforceability of mining licenses and financing agreements for foreign investors, corporatisation of state owned mining companies, infrastructure needs and environmental standards and associated supply chain work.

Management agrees in principle with this recommendation and believes this is already a current practice. Efforts to address stronger cooperation with other IFIs, particularly on designing policy engagement have been ongoing. The launch of joint country diagnostics is a major step toward establishing a shared understanding of issues on the ground. This will result in more coherent and well-coordinated approaches between IFIs. The Mining strategy caters for mining sector diagnostics and includes consultation with other IFIs involved in the mining sector. These are included in the country diagnostics for countries where mining is an important sector. Management has already discussed a joint country diagnostics for Mongolia with ADB over the summer that was not pursued due to difference in diagnostics cycles. Management will continue consulting and collaborating with other IFIs. Management will also await the study on IFI Co-operation which will be conducted by EvD according to the 2019-2020 workplan.

Management notes the recommended issues for specific future policy engagements, which align with areas in which the Bank is already active to promote a well-governed mining sector. For example, in 2009, the Bank launched a EUR1.2 million technical assistance project to digitise the national archive of mining licences. The project was part of a coordinated approach by the ADB, World Bank, IFC and the EBRD. The Bank continues with its technical assistance to support the global Extractive Industries Transparency Initiative (EITI) association with the EITI International Secretariat in Oslo, Norway. The Bank is currently implementing a regional technical cooperation framework focussing on implementing new beneficial ownership disclosure obligations of EITI. In Mongolia, as well as the Kyrgyz Republic, work continued in 2018 on amendment of the subsoil law to accommodate beneficial ownership requirements. Working with the Ministry for Mining and Heavy Industry, the Bank is also helping to enhance the legal framework underpinning the mining sector in Mongolia, in particular, helping to draft a new mining law, amend related laws and regulations, and support implementation of those new laws and regulations when approved.