

REVIEW OF THE EQUATOR PRINCIPLES - DRAFT EP4 RELEASED FOR COMMENT

23 July 2019 | Global

Legal Briefings - By **William Oxby, Partner, Antony Crockett, Senior Consultant and Louise Kruger, Senior Associate**

The Equator Principles (**EPs**) is a risk management framework adopted by financial institutions to determine, assess and manage environmental and social risks of the projects they finance. Established in 2003, the EPs have been adopted by 96 financial institutions in 37 countries. These financial institutions are known as Equator Principles Financial Institutions (**EPFIs**).

The EPs aim to ensure that the projects that EPFIs finance are developed in a manner that is socially responsible and reflect sound environmental management practices. The most recent version of the EPs, known as EP III, came into force in June 2014.

In November 2017, the Equator Principles Association (**EP Association**) announced a review of EP III in response to the changing approach of financial institutions, regulators, proponents and civil society to environmental and social risks. On 24 June 2019, the EP Association released a draft version four of the Equator Principles (**Draft EP4**).

The proposed key amendments are as follows:

1. **Scope:** a broader range of financial products being subject to the EPs;
2. **Designated Countries:** new requirements for projects in certain high-income OECD countries (referred to in the EPs as Designated Countries);
3. **Climate Change:** new requirements with respect to the assessment of climate change

risk and reporting; and

4. **Human Rights:** new requirements with respect to social impact, human rights and stakeholder consultation.

You can view the Draft EP4 [here](#).

SCOPE

EP III applies to four financial products: Project Finance Advisory Services, Project Finance, Project-Related Corporate Loans, and Bridge Loans.

The Draft EP4 broadens the scope of products subject to the EPs in three key respects.

1. It introduces a fifth category of financial products, namely Project-Related Refinancing and Project-Related Acquisition Financing. These products will be subject to the EPs where:

- the underlying project was financed in accordance with the EPs;
- there has been no material change in the scale or scope of the project; and
- the project is not yet completed. A project is completed at the date at which the project has been finished, functions, and performs according to certain pre-defined measures. After this date, the project's cash flows become the primary method of repayment.

2. It reduces the total aggregate loan amount for applicable Project-Related Corporate Loans from \$100 million to \$50 million.

3. It includes loans to sovereign borrowers as Project-Related Corporate Loans in all Category A and, as appropriate, Category B projects.

- Category A projects continue to be defined as projects with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented.
- Category B projects continue to be defined as projects with potential limited adverse environmental and social risks and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.

DESIGNATED COUNTRIES

Under EP III, the environmental and social assessment for a project in a Designated Country evaluates the project's compliance with the Designated Country's laws, regulations, and permits pertaining to environmental and social issues. EP III expressly provides that the laws of a Designated Country meet the requirements of the environmental and social assessment under Principle 2, the development and maintenance of an environmental and social management system under Principle 4, the demonstration of stakeholder engagement under Principle 5, and the establishment of a grievance mechanism under Principle 6.

The Draft EP4 will continue to require that the environmental and social assessment for a project in a Designated Country evaluates the project's compliance with the relevant laws, regulations and permits of that Country. However, it will now require EPFIs to evaluate whether the environmental and social risks of the relevant project warrant the application of one or more of the IFC Performance Standards, in addition to the Designated Country's laws and regulations.

The Draft EP4 also removes the language from EP III that provides a Designated Country's laws meet the requirements of Principle 2, Principle 4, Principle 5 and Principle 6. In practice, this will mean that, for a project in a Designated Country, the project's compliance with the Designated Country's laws, regulations and permits may not necessarily be sufficient to address the relevant environmental and social risks and impacts of the project.

CLIMATE CHANGE

The Draft EP4 proposes additional language in the preamble that recognises that EPFIs have a role to play with respect to achieving the goals of the 2015 Paris Agreement. The Draft EP4 contains corresponding changes to reflect this recognition.

- Principle 2 of the Draft EP4 proposes a climate change risk assessment as part of the environmental and social assessment for:
 - Category A and, as appropriate, Category B projects; and
 - any project in which the combined Scope 1 (direct GHG emissions) and Scope 2 (indirect GHG emissions) are expected to exceed 100,000 tonnes of carbon dioxide equivalent (CO₂e)
- Principle 10 of the Draft EP4 proposes to require clients of Category A and, as appropriate, Category B projects with annual CO₂ equivalent emissions exceeding

100,000 tonnes to report their GHG emission levels publicly on an annual basis.

HUMAN RIGHTS

An increased emphasis on social risk (social impact and human rights) was identified as a focus area during stakeholder consultation. The Draft EP4 therefore proposes additional language in the preamble recognising the responsibility of EPFIs to respect human rights, consistent with the United Nations Guiding Principles on Business and Human Rights (**UNGPs**).

Principle 2 of the Draft EP4 now also requires an assessment of potential adverse human rights impacts as part of any environmental and social assessment. This is a significant change from EP III, which only requires a human rights due diligence as a complement to an environmental and social assessment “in limited high risk circumstances”.

The Draft EP4 does not provide guidance on what is expected by way of this assessment, but the scope of due diligence required could be informed by the UNGPs (assessing the actual and potential human rights impacts, integrating and acting upon findings, tracking responses and communicating how impacts are addressed).

The Draft EP4 further strengthens the stakeholder engagement obligation in Principle 5 in respect of any project with potential impacts on indigenous communities. The Draft EP4 proposes two alternative options for stakeholder feedback relating to obtaining the “Free, Prior and Informed Consent” (**FPIC**) of affected communities.

- Option 1: A client must document good faith efforts to engage in meaningful consultation with affected indigenous peoples, with the goal of achieving consent. Where the client has not obtained consent, the client must demonstrate appropriate plans to mitigate and remedy potential adverse impacts.
- Option 2: A client must demonstrate that they have obtained the consent of indigenous peoples affected by a project.

The Draft EP4 extends the requirement to engage with stakeholders and provide appropriate grievance mechanisms to “Workers”. The proposed definition captures all workers engaged directly or indirectly on a project, including contractors and sub-contractors, but expressly excludes supply-chain workers.

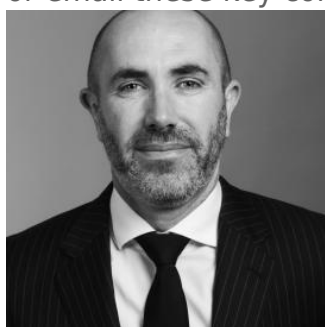
STAKEHOLDER CONSULTATION

The EP Association has invited further external stakeholder consultation on the Draft EP4. The second round of consultation is expected to occur from July to August 2019 and interested parties can submit feedback online [here](#).

If you have any queries about the Draft EP4 or would like assistance in providing feedback to the EP Association, please contact our team below.

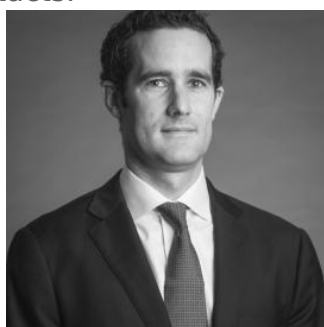
KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



WILLIAM OXBY
PARTNER, BRISBANE

+61 7 3258 6469
William.Oxby@hsf.com



ANTONY CROCKETT
SENIOR
CONSULTANT, HONG
KONG

+852 21014111
Antony.Crockett@hsf.com



LOUISE KRUGER
SENIOR ASSOCIATE,
BRISBANE

+61 7 3258 6380
louise.kruger@hsf.com

LEGAL NOTICE

The contents of this publication, current at the date of publication set out above, are for reference purposes only. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2019

SUBSCRIBE TO STAY UP-TO-DATE WITH LATEST THINKING, BLOGS, EVENTS, AND MORE

Close

