



# BSR submission to Equator Principles Association on Equator Principles Draft III

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## About BSR

BSR works with its global network of nearly [300 member companies](#) to build a just and sustainable world. From its offices in Asia, Europe, and North and South America, BSR develops sustainable business strategies and solutions through [consulting](#), [research](#), and [cross-sector collaboration](#). [Learn more about BSR's more than 20 years of leadership in sustainability: www.bsr.org](#).

## OVERVIEW

On 13 August 2012, the Equator Principles Association released the draft Equator Principles III (EP III) for stakeholder consultation and public comment. The proposed amendments to the Equator Principles provide an opportunity for key changes concerning the credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions from Equator Principles Finance Institutions (EPFIs).

As an industry standard for environmental and social risk management and financial institutions, BSR welcomes the proposed areas of development in EP III. Namely, the extension in the scope to Project-Related Corporate Loans and Bridge Loans; changes reflecting the recent 2012 update of the International Finance Corporations (IFC) Performance Standards; new requirements related to managing impacts on climate; emphasis on human rights in due diligence; recognition of the Guiding Principles on Business and Human Rights and its "Protect, Respect, Remedy" framework; and the strengthening of reporting and transparency requirements are to be commended.

The views and comments expressed in this submission are BSRs own. While they are based on our experience with our corporate members and clients around the world, they do not necessarily represent their views.

## Overall Comments

BSR would like to congratulate the Equator Principles Association and its team on the significant progress made since the inception of the Equator Principles in October 2002 and its subsequent amendments in 2006. It is encouraging that the Equator Principles Association continues to value a consistent approach towards environmental and social risk management through demonstrating its inclusive advance towards the integration of recent amendments to 2012 amendments to the IFC Performance Standards.

In our view, the principles adequately address the application of environmental and social performance risk management. We would also encourage:

- The standardization of environmental and social assessments and the importance of integrating the international human rights framework, in particular the Guiding Principles on Business and Human Rights into the assessment, review and implementation of EPIII projects.
- The application of the EPIII to both Category A and B projects and encourage the frequent review, and as appropriate, re-categorization and of these projects to ensure due diligence is carried out in a manner that reflects the dynamic nature of environmental and social risk management.

The specific comments below are organized by principle and any line reference refers to the Draft version that is not otherwise tracked. These comments below reflect our intention to provide constructive input to this important process based on our experience working with business to address human rights and environmental and social risk management challenges.

## Specific Comments

### PREAMBLE

We welcome and support amendments to the Preamble such as the acknowledgment of the potential social and environmental impacts resulting from large project development in addition to the previously acknowledged risks for project financiers arising from these impacts.

We support the introduction of fulfilling the responsibility to respect human rights by undertaking due diligence. However, we encourage the Equator Principles to adopt an acknowledgement of the originating source by which these concepts should be interpreted. As such the responsibility to respect human rights should:

- Acknowledge the international human rights framework, and at a minimum United Nations Guiding Principles on Business and Human Rights (UN Guiding Principles) and the “Protect, Respect and Remedy” Framework (UN Framework).
- Ensure its application and interpretation is based on the international human rights framework and at a minimum the UN Guiding Principles and UN Framework.

The application of human rights standards, obligations and responsibilities globally should remain consistent and recognize international best practice standards, including the Voluntary Principles on Security and Human Rights.

In this vein, we would suggest:

- Amend the word “sound” [line 80] to read “international best practice”. It is envisaged that the Equator Principles support the continued improvement of environmental and social performance and as such an application of the highest standards are encouraged to be applied by EPFIs for the benefit of its client companies.
- The term “local stakeholders” [line 85] could be amended to read “Affected Communities and Other Stakeholders” for the sake of consistency and to ensure clarity on this terminology by way of their existing definitions.

While we welcome the application of the Equator Principles “globally” and to “all sectors”, we recognize the overall distinction that has been made between High-Income OECD countries and Non-OECD Countries or OECD Countries not designated as High Income. Specifically, EP III must bear in mind that OECD High-Income countries have varied national country environmental, social and governance standards and varying enforcement regimes and practices. Some countries have a weak approach to enforcement of local environment and labor laws and varied approaches in implementing social and environmental directives and EU regulations.

We would seek further clarity on when relevant laws, regulations and permits in High-Income OECD Countries would be considered as sufficiently displacing the Equator Principles and IFC Performance Standards; the basis for such a decision that positively affirms that the host country meets or exceeds the Equator Principles (i.e. will an assessment of the application of these laws, regulations

and permits through case law be considered); and whether the EPFIs will be making such an assessment.

## **SCOPE**

We welcome and support the expanded scope of the EPIII to include bridge loans and project-related corporate loans. This expansion captures the many stages of project finance and highlights the various types of project financing structures and finance portfolios that exist in the market today. We acknowledge that though this expanded scope does not necessarily capture smaller projects, we encourage the EP Association to continue broadening this scope in the future to efficiently capture smaller size projects while not burdening project developers with excess costs.

Specifically, we encourage the EP Association to:

- Build into any Guidance Notes the provision for training and capacity-building in the finance sector, particularly for smaller financial institutions, on these matters pertaining to the implementation of social and environmental risk management standards.
- Define to what extent each party to a joint venture project is considered to have control, pursuant to the term 'Effective Operational Control' [120] which requires further explanation. We suggest a threshold exist to provide clarity in determining this level of control. In addition, joint venture partners may dually be exposed to similar risks that are material and as such may be dually responsible for meeting the requirements of EPIII whether party to the same loan or not.
- Provide guidance on the extent to which project-related corporate loans, particularly with respect to a 'single project' [116] will capture the due diligence requirements on social and environmental risks pertaining project related infrastructure.

## **PRINCIPLE 1: REVIEW AND CATEGORIZATION**

We acknowledge that the initial project categorization is based on the preliminary Assessment of the potential environmental and social risks in line with the categorization scheme of the IFC without the considering of mitigation measures.

We encourage:

- That Principle 1 stipulates, due to the fluid nature of project development, that projects be re-categorized in the event that the scale or scope of a project materially increases or decreases its environmental and social impact over the life of the project.
- The inclusion of further detailed guidance in the Annex pertaining to the methodology for the country risk evaluation scheme and categorization. Given the importance of categorizing 'A', 'B' and 'C' projects, and especially 'A' versus 'B' projects, further detail in the Annex may provide financial institutions and external stakeholders with further understanding of the rigor to be applied in adherence of this principle.

## **PRINCIPLE 2: ENVIRONMENTAL AND SOCIAL ASSESSMENT**

We acknowledge the comprehensive list of issues provided for in Exhibit II and the use of this list as a minimum standard of guidance for the purposes of carrying out environmental and social assessments.

In this regard, we encourage:

- A consistent approach and standardization of environmental and social assessments through the development of EPIII Guidance Notes that align with both the requirements of social and environmental legislation, IFC Performance Standards and international best practice social assessment standards through a risk management and human rights lens.
- In accordance with IFC Performance Standard 1, amending “the assessment will be an adequate, accurate and objective in its presentation of risks, whether prepared by the borrower, consultants or external experts” [182] to read, “the assessment will be *comprehensive*, accurate and objective in its presentation of risks, whether prepared by the borrower, consultants or external experts.”
- An environmental and social assessment to be either reviewed or newly established in the event the scale or scope of the project significantly changes the nature or degree of any existing impacts. This can be done in accordance with Principle 9: Independent Monitoring and Reporting.

Consistency in approach towards the Assessment is particularly important for those ‘independent consultants’ whom shall conduct an Independent Review to ensure whether these Assessments comply with EPIII, per Principle 7. In addition, the adoption of a consistent industry standard approach regarding environmental and social assessments provides a level playing field and demonstrates the desire to reduce project risks by addressing social and environmental issues in a manner that may exceed local legal compliance mechanisms. The adoption of such international best practice standards may assist to reduce political risks by ensuring that all countries are subject to the same set of environmental and social standards.

### **PRINCIPLE 3: APPLICABLE ENVIRONMENTAL AND SOCIAL STANDARDS**

We support the general notion that projects conducted in High-Income OECD countries may, in some cases, carry less exposure regarding environmental and social risks, however the methodology used to determine which standards apply require further elaboration within a set of EPIII Guidance Notes.

Under international law not all High Income OECD countries have ratified key environmental and social protection treaties and protocols or do not properly enforce them. The exclusion of High Income OECD countries from certain principles in the EPIII underestimates the importance of public international law in coastal and trans-boundary areas or where host countries fail to embed responsibility for their implementation in independent tribunals or an impartial judiciary.

Therefore, we encourage that:

- The EPIII should address projects with a trans-boundary nature, including those involving a High Income OECD country, and therefore one set of environmental and social standards should apply and such standards must be provided through EPIII Guidance Notes in line with international best practice and international law.
- Further explanation on how such decisions are made to determine whether such national laws meet or exceed the requirements of the EPs and which entity makes this decision. This process will be especially relevant where matters such as Free, Prior and Informed Consent, human rights and the implementation of adequate grievance mechanisms are considered to meet or exceed the requirements of the EPs.

- The EPIII should delete the term “generally considered” [203] and “may extend” [204]. We understand that the laws of High-Income OECD countries are presumably well developed; however, we would encourage the EPIII to provide Guidance Notes and levels of disclosure regarding the basis for such decisions where assessments are made in compliance with host country laws, regulations and permits on matters such as social assessments, management systems and plans, stakeholder engagement, disclosure and grievance mechanisms.
- All financial institutions through the EPs leverage states through the application of international best practice environmental and social standards into the laws of their country. We further encourage financial institutions to reflect these sentiments through their commitment to and implementation of best practice standards through the both UN Guiding Principles and UN Framework in addition to the international human rights framework as an acknowledged in the IFC Performance Standards.

#### **PRINCIPLE 4: ENVIRONMENTAL AND SOCIAL MANAGEMENT SYSTEM AND ACTION PLAN**

We commend the Equator Principles Association for requiring borrowers on Category A and Category B Projects to develop or maintain an Environmental and Social Management System (ESMS) [215-216]. However, given the vital importance of robust environmental and social management systems and plans in responsibly managing impacts, we encourage:

- Further guidance on the purpose and contents of Action Plans (“AP”) [221].
- Amending ‘the AP is intended to outline gaps and commitments to meet EPFI requirements in line with the applicable standards.’ [221-222] to read ‘the AP *must* outline gaps and commitments to meet EPFI requirements in line with applicable standards.’

#### **PRINCIPLE 5: STAKEHOLDER ENGAGEMENT**

We welcome the acknowledgement of indigenous people as an often vulnerable segment of Project-Affected Communities. We also acknowledge the difficulties regarding the application of Free, Prior and Informed Consent (FPIC) for all countries, including those where national laws both do and do not acknowledge the existence of FPIC. Nevertheless, we encourage the acknowledgement of this terminology within the EPIII and support a balanced approach towards its application.

As such, we encourage:

- The amendment of “Informed Consultation and Participation” [244-245] to read “Free, Prior and Informed Consent”. To this, end we would further amend, “...and comply with applicable national law...” [245] to read “...”in compliance with applicable national laws...”.
- A set of Guidance Notes to be developed to interpret, apply and assess the application and process of FPIC.
- The use and application of FPIC projects affecting indigenous people to apply equally to non-OECD countries, OECD countries not designated as High-Income and High Income OECD countries.
- Where alignment with the IFC Performance Standard 7 is otherwise maintained, the EPIII to provide further guidance on the interpretation and application of FPIC with respect to ‘special circumstances’ [247] outlined in IFC Performance Standard 7 in collaboration with the IFC.

- The EPIII to align with the IFC Performance Standards regarding the assessment and implementation of FPIC; and where appropriate, map and categorize those countries that are otherwise considered to meet the requirements of FPIC.

We acknowledge the reference to the importance of complying with national laws and those laws implementing host country obligations under international law and emphasize the need for the EPIII to dually acknowledge international law standards so as to encourage the adoption and implementation of international law within national regimes widely. In addition, we are of the view that even where countries have otherwise implemented international laws into national legislation, there can remain gaps in adhering to these laws within implementation processes.

In addition, we encourage:

- The deletion of “as appropriate” [234] regarding Category B projects
- Both Category A and B projects to demonstrate effective stakeholder engagement as an ongoing process in a structured and culturally appropriate manner with Affected Communities and Other Stakeholders.
- Guidance Notes that explicitly define the way in which Category B projects are categorized and provide a further definition for “potentially significantly adverse impacts” [237].
- The definition of Project-Affected Communities to be defined within the glossary of the EPIII.

## **PRINCIPLE 6: GRIEVANCE MECHANISM**

We encourage:

- The deletion of the term “as appropriate” [257] regarding Category B projects and encourage both category A and B projects to establish grievance mechanisms so as to reflect the overall adoption and recognition of both the UN Guiding Principles and UN Framework, thereby reflecting their universal nature.
- EPIII to draft Guidance Notes addressing the way in which grievance mechanisms should be created so as to be “scaled to the risks and impacts of the Project” [261] and strike a balance between levels of transparency and confidentiality.
- The adoption of a grievance mechanism within each EPFI, in addition to project specific grievance mechanisms. We suggest an audit requirement form part of the Guidance Notes to ensure that grievances are dealt with in a timely, adequate, legitimate and responsible manner.

## **PRINCIPLE 7: INDEPENDENT REVIEW**

We encourage:

- The deletion of the words “as appropriate” [line 272].
- An Independent Review of all documentation, including ESMP and ESMS, required for all project loans that are categorized as either A or B in line with international best practice. The explicit requirement for both Category A and B projects will bring Principle 7 into closer alignment with international standards.
- All adverse impacts, whether reversible or irreversible, be reviewed equally, regardless of whether they occur on a Category A or B project.

- That Guidance Notes be developed to provide a framework on environmental and social risk assessment for the benefit of those Independent Environmental and Social Consultants who carry out an Independent Review of the assessment, ESMP, ESMS and consultation process documentation.

## **PRINCIPLE 9: INDEPENDENT MONITORING AND REPORTING**

We encourage:

- The deletion of the words “as appropriate” [line 324] and value an Independent Review of all documentation required for all Project loans that are categorized as either A or B.
- The inclusion of minimum reporting requirements in Annex B requiring EPFIs to report annually at a minimum. [414].
- The insertion of wording calling for a greater frequency of reporting for Category A projects, as frequent as every quarter, so as to ensure that social management is adequately and frequently addressed in line with the dynamic nature of addressing environmental and social issues on more complex projects.

## **PRINCIPLE 10: REPORTING AND TRANSPARENCY**

We encourage:

- The deletion of the words “as appropriate” [line 341]. We question the exclusion for projects in High-Income OECD countries and the reasoning for their non-disclosure online.
- High-Income OCED countries to apply this requirement of on-line disclosure.
- Financial institutions to harbor assessment documentation for all companies they provide loans to irrespective of the size of their contribution, and particularly in the event the company does not have a company website.
- Dissemination of assessment documentation in multiple forms, than through online company websites particularly in non-OECD countries and OCED countries not designated as High-Income.
- All adverse impacts, whether reversible or irreversible, should be reviewed, reported on and disclosed equally.

In addition, we acknowledge that the disclosure of projects with adverse social or environmental impacts is to occur early in the assessment process [246], prior to construction, in line with previous EPII wording We applaud the EPIII for ensuring that this requirement remains in this version as we share the view that the timing on disclosure is critical in effective social management.

## **CLIMATE CHANGE – PREAMBLE, PRINCIPLE 2, PRINCIPLE 10 & ANNEX A**

We welcome the inclusion and recognition of the climate as a separate subject matter that affords to be recognized as an independent area that is subject to project impact. We encourage:

- The reintroduction of the term “mitigate” that can equally be applied to the climate, ecosystems and communities and remains a separate remedial action in addition to the minimization and compensation or “offset” [line 82] of impacts.

We acknowledge the use of the IFC Performance Standards to address the issue of climate change. However, we encourage:

- The EPIII to move towards providing a standard or set of standards that captures international best practice and current corporate practice relating to climate change.
- The designation of a more standardized threshold for reporting GHGs, understanding that the EPIII must remain neutral to voluntary methodologies such as the Carbon Disclosure Project and GHG Protocol.

We acknowledge the EPIII efforts to have reporting on emissions publically available and applaud this process of transparency as a positive step forward, beyond the IFC Performance Standard requirements.

We welcome the Equator Principles Associations' recognition that climate related impacts should be minimized and reduced, mitigated and/or compensated for, or offset appropriately [81-82]. Climate adaption and resilience issues are important for communities affected by natural resource and infrastructure development, especially in the developing world. In general, BSR believes climate change adaptation/resilience issues could be further addressed in the current draft principles and we encourage:

- The inclusion of detailed guidance, or the reference to external guidance, for EPFIs on assessing climate risk, avoiding and managing potential climate-related impacts, and information on climate resilience strategies early in the project lifecycle.

## Conclusion

BSR would again like to congratulate the Equator Principles Association and its team on the significant progress made since the inception of the Equator Principles in October 2002 and its subsequent amendments in 2006. It is encouraging that the Equator Principles Association continues to value a consistent approach towards environmental and social risk management in line with other evolving international standards such as the 2012 IFC Performance Standards and both the UN Guiding Principles and UN Framework. We also applaud the well-executed Stakeholder Consultation and Public Comment process. BSR appreciates the opportunity to both participate in the consultations and provide public comments.

To the extent possible and appropriate, we would welcome and support the creation of an ongoing forum for discussion, collaboration, and implementation as the focus shifts towards implementation of the Equator Principles III. We believe the real impact of the Equator Principles will be seen through the elevated social and environmental performance of EPFIs and borrowers. Such a forum would allow EPFIs, borrowers and other stakeholders the opportunity to share lessons and best practices pertaining to Equator Principles III implementation.

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