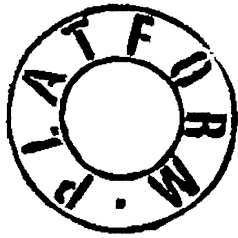


Equator Principles II

**NGO comments on the proposed revision of the
Equator Principles**

April 26 2006

Comments on the proposed revision of the Equator Principles from:



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About this paper

On April 19 2006, representatives from 18 Equator Principles Financial Institutions (EPFIs) met in London with a delegation of civil society organizations including representatives from 12 NGOs to discuss the draft text of what has been dubbed 'Equator Principles II'; the new version of the Equator Principles. The meeting was part of a short but intensive effort of the EPFIs to seek comments from a variety of stakeholders on the proposed changes.

This paper presents some of the concerns and constructive comments offered by 25 civil society organisations on the proposed changes of the Equator Principles. It is a slightly adapted version of what was presented to the EPFIs for their consideration prior to the meeting in London.

Our understanding is that the EPFIs will release a final version of what will be sent for endorsement by EPFIs in mid-May. We have reason to believe that several adaptations will be made to the draft text. Our organisations intend to give a final assessment of the new EPs once they are final.

April 26 2006

*Johan Frijns
Coordinator BankTrack*

Introduction

BankTrack member organizations and other endorsing NGOs welcome the opportunity to present our view on the proposed changes in the Equator Principles, as presented by the Equator Principle Financial Institutions (EPFIs) in the 'EP Final Draft – March 2006'.¹

Changing the current Equator Principles (throughout this paper referred to as EPI) is inevitable given that the International Finance Corporation (IFC) has replaced its 'Safeguard Policies' – the basis for the Equator Principles – with new 'Performance Standards'. However one views the final outcome of IFC's Performance Standards, and many of our organizations have serious concerns,² the revision does provide the EPFIs with a unique opportunity to address both the shortcomings in the EPI and the IFC's Performance Standards, as well as reflect some of the promising developments that have recently taken place in the private financial sector. In short, this is a moment for an approach and commitment to bring the social and environmental responsibilities of EPFIs up to the level of evolving international good practice.

After analyzing the proposed revision, it is our sense that the EPFIs have failed to grasp this opportunity. While the draft EPII does offer some improvements, the overall approach is based on establishing the lowest common denominator and allowing some of the least committed institutions to hold the standards back.

Furthermore, the rushed engagement and review process does not allow the time necessary to address the fundamental problems and shortcomings of EPI. We share the concern of the EPFIs for a timely and efficient revision and adoption process, but we also strongly believe that excessive haste will result in a final product that does not address weaknesses and lack of clarity in the revised principles, which will be much more costly in the longer term.

Vision Required

Given that this is a unique opportunity to address some of the significant problems and shortcomings with the current Equator Principles, we urge the EPFIs to take the time necessary to ensure that the new policy framework is clear and leads to improved implementation and compliance.³

Even more important, we call upon the EPFIs to be more ambitious and use this opportunity to make significant advancements. We hope that the comments provided in this paper will assist the EPFIs in moving forward and recapture the spirit of ambition that led to the EPs in the first place.

A word of caution is in order here. While robust policies are important, our organisations measure the effectiveness of the EPs by how they are applied to projects and day-to-day operations, including whether the lives of project affected communities are improved as a result.

¹ See www.equator-principles.com

² See <http://www.grrr-now.org/>

³ Moreover, this process is moving forward before the IFC has released the final version of the Guidance Notes for each Performance Standard. Given the vagueness of the Performance Standards, some aspects of the Guidance Notes may need to be referenced explicitly by the EPFIs

Three years after the launch of the EPs we find ourselves in the uncomfortable situation of debating the EPIIs in good faith, at a time when several EPFIs continue to be involved in projects that directly erode the integrity of the Principles.

We especially consider two projects now under consideration as highly problematic, namely the Sakhalin II oil and gas project in the Russian Far East and the Botnia/ENCE pulp and paper mill projects in Uruguay. BankTrack member groups and others have documented extensively that both projects are in gross violation of the Equator Principles.⁴ Yet, some of the very same banks that took the lead in EPI are now are seeking a lead role in financing these operations.⁵ It is these financial decisions that will ultimately determine whether or not the Principles are seen as credible and effective. Thank you for your attention.

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- Andreas Missbach, Private Finance Program, Berne Declaration, Switzerland
- Antonio Tricarico, CRBM, Italy
- Bruce Jenkins, Bank Information Center, US
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- Sebastien godinot, Les Amis de la Terre, France
- Techa Beaumont, Mineral Policy Institute, Australia
- Victorio Mattarozzi and Cássio Trunkl, Amigos da Terra - Brazilian Amazon, Brazil
- Yuki Tanabe, Japan Center for a Sustainable Environment and Society (JACSES)

⁴ See www.banktrack.org, www.cedha.org.ar, www.pacificenvironment.org, www.carbonweb.org

⁵ Banks considering getting involved in Sakhalin II include ABN AMRO, RBS, with Credit Suisse serving as financial advisor. The Uruguay paper mills are being considered for financing by BBVA. While a test case for the integrity of the EPs, these are by no means the only problematic projects under consideration by EP banks. Other examples are the Tangguh gas project in Papua Province, Indonesia and the Rosia Montana gold mine in Romania.

Comments on the EPII Final Draft

Our comments are divided into “General Comments” and “Specific Comments on the Proposed Revisions to the Equator Principles.”

1. General comments

1.1 Implementation and compliance

In the three years since the Equator Principles were adopted, their shortcomings and weaknesses have become apparent and noted by many private sector analysts and NGOs alike.⁶

One of the most significant problems is that the Equator Principles lack mechanisms to ensure that endorsing banks properly integrate the EP requirements into their operational systems, creating an incentive to adopt the Principles without any oversight or consistency in how these policies and systems are being implemented from bank to bank. Many banks and other observers have expressed their concern that the current approach allows some banks to ‘free ride.’

The revision process should lead to improved compliance with, and consistent application of, the policies. The revised Equator Principles should provide a definitive means for affirming that all endorsing banks meet *and implement* the same minimum standards described in the Equator Principles Framework. The process should also address internal governance issues and improve coordination around the Equator Principles amongst endorsing institutions.

1.2 Moving beyond project finance?

The most obvious improvement in the EPII draft is the expansion of the scope of the Principles to include the expansion or upgrades of an existing project with significant social and environmental effects and project finance advisory services. The latter may be considered a codification of a logical practice that banks in an advisory role advise clients on how to obtain finance from EPFIs by applying the EPs.

That said, the application of the Principles to these limited financial operations significantly impedes one of the stated goals of the Principles: “*to promote responsible environmental stewardship and socially responsible development.*” It is the scale of the impact, not the nature of the transaction that should determine the appropriate response and approach of the financial institution. EPFIs may facilitate project investments through other financial services, including corporate loans, debt and security underwriting. The key question should be what kind of environmental and social impact will result from certain financial transactions and what EPFIs should

⁶ In addition to NGOs like BankTrack, observers from the private sector, such as FreshFields, KPMG, F&C Asset Management, have highlighted weaknesses and problems with the Equator Principles framework.

do to counter any negative effects. Several EPFIs already apply their policies beyond project financing.⁷

By restricting the application of the Equator Principles to project finance, the proposed Equator Principles revision is failing to avoid and reduce environmental and social risk created by a significant part of the EPFI's business activities. One common response from EPFIs has been that the EPs are specifically developed for project finance. If that is the case, then we recommend that the EPFIs develop *joint* initiatives similar to the EPs to bring their other activities in line with the ambition of the EPs, and expand the scope of the EPs to address the majority of their business.

1.3 Addressing weaknesses and backtracking in standards

The Equator Principles are intended to serve as 'a common baseline and framework' for the financial sector. Given that they are pegged to IFC's Performance Standards, this baseline does not always reflect international law and international best practice, as evidenced in the recent WWF/ BankTrack report, *Shaping the Future of Sustainable Finance*.⁸ This is particularly true for issues such as human rights, climate change, biodiversity and forest protection, as well as standards and practices for the extractives, dams, fisheries and agricultural sectors.

As evidenced in the 2006 WWF/Banktrack report *Shaping the Future of Sustainable Finance*, several EPFIs have already adopted stronger environmental and social policies than the minimum reflected in the Equator Principles framework, which apply also to other transactions beside project financing. For example, Rabobank has adopted the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights. HSBC has adopted the World Commission on Dams recommendations to protect communities and the environment in dam and water related projects. Banks, such as JP Morgan Chase, Bank of America and Citigroup have developed policies on climate change, which include reporting on greenhouse gas emissions; the policies at JP Morgan Chase and Bank of America also address emission reductions. Others are in the process of developing their own policies to address climate change. Other initiatives of note which banks should engage with include the Framework for Responsible Mining⁹.

Meanwhile, an international consensus is evolving on the need for agreements on best practice in environmentally and socially risky investments such as large dams and the extractives industries. The World Commission on Dams and the World Bank Extractive Industries Review are examples of such multi-stakeholder processes whose recommendations are gaining increasing acceptance world-wide.¹⁰ It is in the

⁷ HSBC applies its basic policy to "project advisory roles, corporate lending where the end use of proceeds is for a project, and to other forms of financial assistance such as bonding and guarantees directly linked to projects". Similarly, Citigroup applies a policy derived from the Principles to corporate loans and debt securities underwriting where the specific use of proceeds is known. JPMorgan Chase applies its basic environmental and social policy to all loans, debt and equity underwriting, financial advisories and project-linked derivative transactions where the use of proceeds is designated for potentially damaging projects. Banco do Brasil and Banco Itaú, both from Brazil, developed environmental and social criteria to be applied in their credit decision making process.

⁸ See www.banktrack.org

⁹ See http://www.frameworkforresponsiblemining.org/pubs/Framework_20051018.pdf

¹⁰ The *Shaping the Future of Sustainable Finance* report has a useful bibliography of international legal agreements and accepted sectoral best practice references.

interest of the EPFIs and their borrowers to alert clients to the importance of rapidly evolving international best practice, since clients are increasingly expected to follow these practices.

Furthermore, as noted in a memo from BankTrack and other NGOs to the Equator Banks in October 2005, and as predicted in our Spring 2005 meeting with EPFIs in London, the IFC's revision process has resulted in some major weakenings to previous policies, particularly around protections for displaced persons and minimum consultation requirements for communities. This backtracking means that, if the EPFIs adopt the IFC Performance Standards with no further alterations, some key aspects of the EPII would be weaker than the current version of the Equator Principles, the policies that the IFC previously followed, and related World Bank policies. To avoid a backsliding situation, key aspects of the Safeguard Policies that are stronger than the Performance Standards should be addressed by the EPFIs, and the policy protections restored and incorporated into EPII.

At the February 2005 Zurich meeting between the Equator Banks and representatives of civil society organizations, several Equator Bank representatives stated their commitment to no weakening of the existing Equator Principles, noting that any weakening of policy requirements in the Performance Standards, once finalized, might require delinking from, or strengthening the IFC standards in some cases. The EPII draft already partly addresses and corrects one significant weakening in the Performance Standards – dropping the requirement for independent assessments of Category A projects – by requiring in paragraph 5 that for Category A projects, “the SEA and AP will be subject to independent expert review.” Given that change, clearly it is possible for the Equator Principles to reflect stronger commitments in certain areas than those made by IFC

The Equator Principles should be developed and interpreted as a tool for ratcheting up the standards being applied in the financial sector, and it would be helpful for the EPII and the EPFIs to explicitly adopt a commitment to no weakening of standards already agreed to. We strongly suggest that the EPFIs consider including a commitment to this effect in the Preamble of the EPIIs.

2. Specific comments on the EP final draft

2.1 Improving implementation and compliance

Very little is changed in the EPII draft to address the need for consistent implementation and compliance with the Equator Principles.

Indeed, we have noted with some concern the slight change in formulation in the last paragraph of the Preamble. Whereas the EPI version reads as a commitment to ‘not provide loans directly to projects where the borrower will not or is unable to comply with our environmental and social policies and processes’¹¹ this paragraph now specifies that no loans will be provided if the borrower is unable to comply with ‘our *respective* social and environmental policies and procedures *that implement the Equator Principles*’ (emphasis added). This is a de facto acceptance that endorsing banks may choose to implement the principles as they see fit.

¹¹ Preamble EPI, last paragraph

Over the years, we have also pointed out that the Equator Principles lack of transparency and subsequent lack of accountability mechanisms may be its fatal flaw. We have provided the EPFIs with a set of constructive suggestions for addressing these problems.¹²

The issues of improved compliance, consistent implementation and mitigating impact can be addressed in a number of ways in the draft. We offer the following comments and recommendations.

Ensuring compliance

The efficacy of the Principles rests on how well the standards and operational system are carried out. We welcome the step of the EPFIs to require independent expert review of Social and Environmental Assessments (SEAs) and Action Plans (APs) for Category A projects at least, as well as Category B projects "as appropriate".

We note, however, that this improvement over PS 1 does not fully rectify the weakening of the requirement of the World Bank's Operational Policy (OP) 4.01 which states that for Category A projects "the project sponsor retains independent EA experts not affiliated with the project *to carry out* the EA." Moreover, "For Category A projects that are highly risky or contentious or that involve serious and multidimensional environmental concerns, the project sponsor should normally also engage an advisory panel of independent, international recognized environmental specialists to advise on all aspects of the project relevant to the EA." (OP 4.01, para. 4) Even when the IFC was following OP 4.01, the IFC's Compliance Advisor Ombudsman observed that the IFC itself still needs to improve the quality and oversight of assessments. Objective information, independent of the client, is an essential requirement for an effective assessment system. We strongly recommend that the independent assessment requirement as well as the independent advisory recommendation for highly risky projects, which are required by OP 4.01, be restored also to the Equator Principles in EPII.

Also, given that EPFIs rely on outside expertise for objective information and assessment, we recommend that the EPFIs require the independent expert -- the preparer of the SEA -- to sign an agreement attesting to its validity and factually based information. In order to make informed choices and minimize risks, short of building up environmental and social review departments, it is necessary for the EPFIs to build in measures such as these that guarantee that the information they receive is objective and accurate.

Similarly, we note that paragraph 8 states that "*to ensure ongoing monitoring and reporting to EPFIs over the life of the loan, EPFIs may require appointment of an independent environmental and/or social expert.*" This language should be revised to make clear that EPFIs will require annual independent compliance reviews for all Category A projects.

Ensuring better compliance and therefore performance necessitates a number of additional changes in the draft proposal.

¹² *Good Faith, Good Practice: December 2003, No U-Turn Allowed: January 2004*

First, the Principles should clearly state that the due diligence and review of the Social and Environmental Assessment (SEA) has to be conducted and completed prior to the commencement of any project construction. Without such clarity, it is possible for clients to engage in pre-approval construction activities that result in significant harm and irreversible damage to the environment and communities. Indeed, we have seen many instances when major projects are a significant way through construction before SEAs are completed and approved. Since the purpose of SEAs is to predict and prevent negative impacts before they occur, the post-hoc development and approval of these documents renders the process moot (e.g., Sakhalin II).

Second, the Principles should clearly state that in syndications or arrangements with other non-Equator Banks, an Equator Bank will seek to assume the lead on environmental and social related issues, and that EPFIs will ensure that the environmental and social due diligence process fully complies with the Equator Principles. The Environmental and Social Lead responsibility should not be delegated to non-Equator Banks.

Third, the Principles should clarify that any agreements between the borrower and the affected community will be incorporated into the Action Plan, and compliance with the Action Plan will be covenanted in the loan agreement to help ensure that the borrower meets its commitments to the community. On this note we also suggest that the parties to such agreements explicitly be recognized as including affected communities, and that mechanisms are provided for local people to enforce the terms of the agreements vis-à-vis the project sponsor and financial institutions or to seek effective recourse for violations.

Finally, paragraph 3 describing the aspects of the SEA should explicitly include language from IFC Performance Standard 1, which emphasizes avoidance of adverse impacts over minimizing and mitigating impacts.¹³

Recommendation:

In summary, we recommend the following changes be incorporated into the Equator Principles revision:

1. Fully restore the independent assessment requirement as well as the independent advisory recommendation for highly risky projects;
2. Clarify that the EPFIs requires that a SEA be prepared and due diligence completed prior to the beginning of project construction;
3. State commitment of EPFIs to maintain role as lead bank on environmental and social related issues.
4. Make clear that any agreements between the client and affected community will be incorporated into the Action Plan, covenanted and actionable.
5. Clarify that the SEA process emphasizes avoidance of adverse impacts over mitigation.

Transparency and disclosure

Paragraph 10 of the draft EPII states that: *"Each EPFI adopting the Equator Principles commits to periodically report publicly about its implementation processes and experiences, taking into account appropriate confidentiality considerations."* In

¹³ For more details on SEAs see http://www.wwf.org.uk/filelibrary/pdf/seas_0105.pdf

footnote 6, it states that at a minimum this would include the number of transactions screened and the categorization accorded to each transaction.

We appreciate that the Equator Banks view this initial step in addressing public disclosure and transparency as a breakthrough with respect to the confidentiality many have practiced in the past. It must be observed however that only revealing the number of transactions screened and categorization accorded to each transaction would still provide minimal information of use in insuring a level playing field in implementation. The EPFIs should stay in step with the industry standards being developed for transparency issues, in particular by following the emerging Financial Services Sector Supplement developing by the Global Reporting Initiative. They should also adhere to the CIS¹⁴ reporting transparency guidelines in which the SRI sector echo the requirements of civil society and in particular the views of Banktrack.

As we have recommended in the past,¹⁵ transparency and disclosure should cover the following:

- **Performance data:** information on the scope of EP application regarding recent transactions
- **Process data:** information on banks' processes and systems in place to implement the EPs
- **Project-level data:** information on steps taken to avoid and minimize project impacts; information on projects that have affected communities, including tracking of impacts and mitigation and compensation measures over time
- **Impact:** description of how the EPs have advanced sustainability

Recommendation:

More specifically, we recommend that the Equator Principles be revised to:

1. require *EPFIs* to report annually on the categorization for each project screened, the number of projects rejected on environmental and social concerns, an explanation of any deviations from standards, information about loans suspended or called in due to non-compliance with environmental and social requirements, a breakdown of core business activities by sector and region, and an assessment of implementation of environmental and social policies and management systems.
2. clarify what and when the *client* is required to publicly disclose concisely in one paragraph. This should include:
 - (a) the full Social Environmental Assessment (SEA) and any non confidential project related information, including information on the purpose, nature and scale of project and any risks to and potential impacts on communities;
 - (b) Timely disclosure of supplementary documents that are part of the SEA or SEA process but developed in parallel to or supplemental to the SEA (e.g, oil spill response plans; emergency response plans; resettlement plans; environmental and social consultants' reports that the banks generate or require clients to generate).
 - (c) both draft and final Action Plans;

¹⁴ See

<http://www.cfs.co.uk/servlet/Satellite?cid=1124867052292&pagename=CFSSustain/Page/tplCFSPageStandard&c=Page#CISethical>

¹⁵ For example, see *No U-Turn Allowed: January 2004*; and a memo prepared at the request of Equator Banks, *Transparency and the Equator Principles: Proposals for EP Bank Disclosure*, November 2004.

- (d) compliance monitoring and auditing reports developed under paragraph 7(c); and
- (e) draft and final decommissioning plans developed under paragraph 7(d).

Grievance mechanisms

In paragraph 6, it is proposed that the *“borrower will establish appropriate procedures in order to receive and address concerns or grievances about the project’s social and environmental performance raised by individuals or groups from among project affected communities.”*

We welcome the inclusion of this important language in the draft EPIIs. It could be further improved by describing key characteristics and references to specific good practice examples that clarify and illustrate effective project-level grievance mechanisms, namely that the process be **fair, transparent, impartial, accessible, and responsive** in reviewing project compliance and in reacting to and adequately addressing the concerns of the affected community.¹⁶

Furthermore, we caution against an over-reliance on client-generated information and against depending solely on client-based grievance mechanisms. We further note that this provision on grievance mechanisms must include guarantees that the mechanism functions in such a way that there is no fear of reprisal for using it.

In addition to requiring project level grievance mechanisms, the EPFIs must also establish a system for ensuring that Equator Principles are being implemented on the ground, that important environmental and social conditions of investments are being met, and that the activities they finance are not causing significant adverse impacts. As BankTrack has urged in the past,¹⁷ the EPFIs need a process for hearing concerns from affected communities unfiltered through their clients and a mechanism to ensure accountability and consistent adherence to the Equator Principles on the part of all endorsing financial institutions. The problem is not simply that of borrowers abiding by the terms of the covenant, but also of the EPFIs themselves fully implementing and complying with the Equator Principles.¹⁸

Because of the nature of the Equator Principles, the EPFIs should agree to take a coordinated approach to accountability in order to ensure greater adherence to these commitments. They could do so by establishing a shared accountability mechanism, independent of any one bank. Such a mechanism would be less costly, promote clear, coherent and consistent application of the Equator Principles and be perceived as more independent and objective than mechanisms beholden to any one bank.

Unfortunately this crucial issue for the credibility of the EPs is not addressed in the proposed revision.

Recommendation:

To improve accountability and results, we recommend that:

¹⁶ We would encourage the EPFIs to look at other grievance mechanisms such as OPIC’s Compliance Officer or the IFC’s Compliance Adviser/Ombudsman for operative language.

¹⁷ See *No-U Turn Allowed: January 2004*; *Principles, Profits or Just PR?: June 2004* and *Unproven Principles: A BankTrack Statement June 2005*.

¹⁸ See for example BankTrack ‘Standards at Stake’, p.11.

1. The project-level grievance mechanism language be further strengthened and clarified as discussed above, and consistent with good practice;
2. The EPFIs agree to establish a shared accountability mechanism.

Governance around the Equator Principles

Establishing an accountability mechanism is one solution to addressing lax implementation amongst Equator Institutions; another solution is to improve the cooperation amongst EPFIs and establish a mechanism of sorts able to ensure proper compliance not only with the letter but also with the spirit of the EPs.

Other voluntary industry initiatives have some characteristics that should be explored and developed by the EPFIs, namely:

- a well resourced secretariat that effectively manages internal and external relations
- minimum requirements for endorsement and continued participation
- ongoing resources to aid endorsers in implementation
- internal accountability mechanisms which often include reporting obligations, corrective actions and ultimately a process for sanctioning or removing free riders.

Recommendation

To further address the 'free rider' problem, we therefore recommend:

1. Endorsing institutions be given a strict and limited timeframe to meet the requirements of the Equator Principles;
2. Demonstrate successful implementation by issuing an annual report detailing their implementation systems and environmental and social policies. Failure to abide by this requirement should result in membership and endorsement of the Equator Principles being revoked;
3. EPFIs commit to a periodic consultative review of the Principles to ensure that the Principles keep in step with best practices.

2.2 Moving beyond project finance

We welcome lowering the project threshold to \$10 million and the application of the revised Principles to all project expansions and upgrades in the future. We also note the addition of advisory services will be subject to the Equator Principles.

However, as stated earlier, the test for when and how the Equator Principles apply to financial operations should be based on potential impact, not the type of financial transaction involved. The current approach to apply the Equator Principles to project finance only, and now advisory services, creates a double standard approach. In the end, this double standard does not allow the financial institution to fully identify and minimize risks for clients, shareholders, or affected people and ecosystems.

We have already observed that many of the EPFIs are already applying its environmental and social requirements to other financial operations. Thus, the reluctance to do this collectively is therefore a political decision, not a decision based on what is feasible.

Recommendation:

We urge the EPFIs to reconsider the limitation of EPIIs to project finance and advisory roles alone and commit to extend the Principles to other financial operations and address the full impact of your business operations by:

1. Agreeing that the decision on whether and when to apply the Equator Principles will be based on the anticipated or expected social and environmental impacts of a financial operation, not the type of the financial operation itself.
2. For those non-project finance activities to which the EPIIs, because of their nature, cannot be applied, commit to develop *joint* initiatives similar to and resulting in the same outcome as the EPs.

2.3 Addressing weaknesses and backtracking in standards

It is evident that for now, the EPFIs plan to continue their link to the environmental and social standards of the IFC and its newly adopted Performance Standards.

This raises several questions. First, as noted above, IFC's Performance Standards are a step backward in some important aspects and, if these shortcomings are not repaired, would represent a backsliding for the EPFIs. Second, some critical requirements for the IFC system are not found in the Performance Standards, but rather are found in the IFC's Sustainability Policy and implementing procedures. Furthermore, IFC's Performance Standards remain behind evolving international best practice and the standards of international law in some aspects. These deficiencies should be corrected, as described below.

Addressing weakenings

There are two major weakenings of IFC's Performance Standards that require repair. Without correction, the Equator Principles will be weakened in two significant ways: by making requirements for community consultation less clear and reducing protections for displaced people without officially recognized claim to land.

Community Consultation Issues

Specifying how and when the affected community will be engaged by the client and directly consulted is essential. Performance Standard 1 is a dilution of clear, specific requirements that were present in OP 4.01.¹⁹ Furthermore, some of the other language addressing community consultation in the draft EPII does not provide a clearer picture of what is expected of the client, but rather obscures it. Given this, the draft should be revised in several ways.

First, the Principles should include a clear, minimum set of procedural requirements for public consultation, as is currently required by the Safeguard Policies and the existing EPs. Paragraphs 19–22 in the new Performance Standard 1 concerning community engagement, disclosure and consultation are vague and hard to interpret when compared with the clearer, more specific requirements of OP 4.01.

¹⁹ IFC OP4.01 : Operational policy on Environmental Assessment (old). PS1: social and environmental assessment and management systems (new).

Thus, the revised policy should require that for all Category A projects, the project sponsor consult with the affected community at least twice during the SEA process: (a) shortly after environmental screening and before the terms of reference for the SEA are finalized (i.e. during scoping), and (b) once a draft SEA report is prepared. See OP 4.01 para. 12.

The EPII should clearly state that the draft and final Action Plans, and all monitoring or implementation reports, will be released to the affected community. Currently, there is no mention that the client will be required to release the Action Plan, as is required by Performance Standard 1.

In addition, because the Action Plan should reflect the outcome of consultation with the community, effective and "prior informed" consultation requires release of a draft Action Plan as part of the community consultation process so the community is meaningfully informed about mitigation and prevention measures proposed by the sponsor. We note that the final comments of the IFC CAO also make this recommendation.²⁰

In addition, the language around information disclosure by clients to affected communities is unnecessarily vague. Paragraph 5 of the EPII draft currently states that the "*SEA documentation or non-technical summary thereof, will be made available to the public by the borrower for a reasonable minimum period.*" This language should be strengthened by stating that the full SEA and any non-confidential project information, including information on the purpose, nature and scale of project and any risks to and potential impacts on communities, will be disclosed to the public and affected communities by the borrower as required by IFC's Performance Standard 1. Incorporating such language will ensure consistent application of the Principles with what is required in the Performance Standards.

Furthermore, a reasonable minimum period should be more clearly defined as at least a minimum of 60 days prior to a project decision. We note that the CAO makes a similar observation in its comments regarding "timing of disclosure and links between consultation and disclosure."²¹

Oddly, the draft restricts the requirement for free, prior informed consultation for Category A projects only. We expect that "free", "prior" and "informed" are the minimum criteria for all consultation processes, regardless of how a project is categorized. The language in the Principles should be changed accordingly.

Finally, footnote 5 on consultation should also state that in the event that there are major changes to the project proposal, the borrower will engage in free, prior informed consultation with affected communities on those proposed changes and seek to ensure their approval of and support for such changes.

In summary, there are several changes required in the draft to ensure that the revised Equator Principles are consistent with the Performance Standards and provide greater clarity for clients and affected communities.

Recommendation:

²⁰ See CAO's comment on the January 25, 2006 draft of IFC's Sustainability Policy and Performance Standards, <http://www.cao-ombudsman.org>

²¹ *Idem*

These changes include:

1. Incorporating the minimum consultation requirements laid out in OP 4.01;
2. Clarify that the client is expected to publicly release the draft and final Action Plan and monitoring reports, the full SEA and any other non-confidential project related information;
3. Revise the language around free, prior informed consultation to explain that these are expected minimum criteria for all consultation processes. Furthermore, in the event of a proposed major change to a project, the client will be required to seek the approval and input of the affected community through a process of free, prior, informed consultation.

Displacement Issues

Many of the EPFIs in the London meeting recognized that involuntary resettlement as perhaps the highest risk variable in a project. This is true not only for the project financiers and sponsors, but also for those people who face the risk of severe human rights violations in the context of involuntary physical or economic displacement from their lands and livelihoods.

In developing countries, many people derive their livelihoods from land-based sources, but do not necessarily have nationally recognized claims to that land. In Performance Standard 5, people without formal title to land or a nationally recognized claim to title would only receive compensation for lost assets, and would be denied compensation or resettlement assistance that would include replacement land or fair compensation for the lost land.

The current World Bank policy and the IFC's previous safeguard policy on involuntary resettlement (Operational Policy 4.12 and Operational Directive 4.30, respectively), both allow for the provision of land-based compensation, explicitly including people who did not have clear title to the land that they were losing. The IFC, in Performance Standard 5, has reversed that important policy protection, and in direct contrast it will explicitly deny the right to compensation for loss of land for all people who do not have a nationally recognized claim to land. If the Equator Banks follow the IFC's proposed change in formula, they will be subject to increased reputational and project risks, as this weakened standard could lead to severe impoverishment for many individuals and communities and increased conflict on the ground.

This will lead to massive resentment of the investment project causing displacement, and could perpetuate a grave and in some cases life-threatening injustice against communities that are affected by global project finance. Accordingly, we recommend that the EPFIs break rank with the IFC on this issue, and explicitly allow for land-based compensation systems that truly seek to improve and restore the standard of living and livelihoods of all people affected by the project (including those who are poor and marginalized).

There is no justifiable reason for excluding those who are legally landless from the full range of compensation that is necessary for them to reestablish themselves and rebuild their economic and cultural base. The concern about people who would invade a site in order to unjustly pursue benefits can be addressed through existing tools such as establishing a reasonable cut-off date and undertaking a careful baseline socio-economic survey to learn more about the residents of the affected area.

Recommendation:

1. That EPII be consistent with and restore Safeguard Policy provisions allowing for land-for-land compensation for all people who are losing homes, land and/or land-based livelihoods as a result of the project, including those without official claim to their land, to minimize project risks and avoid weakening current requirements.

Strengthening policies and standards to meet evolving best practice

The proposed revision references the Performance Standards but not IFC's Sustainability Policy that precedes the standards. EPFIs consider these policies more suitable for IFC with its poverty alleviation mandate and less for their own operations. While we understand this point of view, we do feel there are some important requirements and clarifications in IFC's Sustainability Policy that should also be incorporated into the EPIIs. We are particularly concerned that failing to follow the policy provisions could be used as an attempted loophole by EPFIs to avoid having to address the question of Broad Community Support. We also note the conceptual linkages to "social license to operate" and "demonstrable public support" for a project.

Broad Community Support

Paragraphs 15 and 20 of the IFC Sustainability Policy link the requirement of "free prior informed consultation" with obtaining "broad community support." This link is missing in the EPII draft (see paragraph 5). We consider it meaningless to require free prior informed consultation of affected communities without clarifying that the process must lead to the support and approval of that affected community for it to proceed.

This requirement and linkage is also important for minimizing project risks since without the support of a community, the project can be endangered and project costs could mount. We assume that one of the objectives of the revision process is to institute policies that will help eliminate project-associated risks. Making the connection between free, prior informed consultation to the support and approval of the community is therefore essential.

Recommendation:

We recommend that the EPFIs:

1. Change the text to clarify that free, prior informed consultation processes must lead to broad community support and the approval of the affected communities.

Higher Standards Required for Indigenous Peoples

Furthermore, with respect to Paragraph 5 of the EPII draft, it should be noted that PS 7 on Indigenous Peoples goes beyond the notion of broad community support, by requiring that clients enter into and successfully conclude good faith negotiations with indigenous peoples if a project is to be located on, or commercially exploit resources within, indigenous peoples' traditional or customary lands, and adverse impacts can be expected on their livelihoods, or cultural, ceremonial or spiritual use. This good faith and successfully concluded negotiation requirement also extends to

projects potentially involving physical and economic displacement, and those that seek to commercially exploit indigenous peoples' traditional knowledge.

International standards require respect for indigenous peoples' right to free, prior and informed consent, which is not necessarily fulfilled with the adoption of a good faith negotiation standard as reflected in PS 7. Given the enforceability of international standards through regional human rights courts in some parts of the World, financing projects in indigenous peoples' traditional territories without their free prior and informed consent is not only a violation of their rights, but also represents substantial commercial risk.

2. Recognize in the text of EPII that there are higher standards at play when projects impact indigenous peoples' lands or livelihoods, and that EPFIs should strive to ensure respect for indigenous peoples' rights of free prior informed consent, as well as the minimum standards reflected in PS 7.
3. Engage in dialogue with indigenous peoples themselves about how they will adopt and implement the Equator Principles; one suggested avenue for initiating this dialogue is through the United Nations Permanent Forum on Indigenous Issues.

Revenue transparency and release of Foreign Investment Contracts

IFC's Sustainability Policy requires (paragraph 22) public transparency of revenue payments from extractive industry projects to host governments as well as the public release of relevant terms of Host Government Agreements (HGAs) and Foreign Investment Contracts. These provisions should be adopted by the EPFIs at least for extractive industry projects, by requiring revenue transparency and the release of HGAs of its borrowers.

We note that calls for revenue transparency in extractive industries and greater transparency in general for large-scale projects is an issue rapidly growing in importance for governments and the private sector alike. The U.K. Government has been leading an Extractive Industries Transparency Initiative for several years, and the issue has been addressed by G8 Leaders.²² The IMF and IFC now also support increased disclosure of revenues and contracts.²³

Moreover, a revenue transparency requirement is clearly in the interests of extractive industries borrowers. Disclosing payment is a valuable risk mitigation strategy, as it can alleviate the political and social risks that arise when host communities do not benefit from a project because government officials have squandered or stolen the public proceeds.

In those circumstances, communities often look to the company to provide essential services, and significant tensions may arise where the company does not meet those expectations. Companies may be able to better manage public expectations by being forthcoming about how much they have paid the government in royalties.

By making revenue transparency a requirement of financing, the EPFIs can alleviate this collective action problem, and allow their clients to reap the risk mitigation

²² www.eitransparency.org

²³ IMF, Guide on Resource Revenue Transparency, June 7, 2005; IFC, Policy on Social & Environmental Sustainability, adopted February 23, 2006

benefits of more informed community expectations about the allocation of responsibility for providing essential services.

Recommendation:

We recommend that the revised Equator Principles include:

1. Requirement for revenue transparency and the release of Foreign Investment Contracts for all extractive industry projects.²⁴

Modified exclusion list

IFC has developed an exclusion list of examples of projects that they will not finance based on certain international laws or politically controversial sectors the institution does not want to support. We recognize that IFC's full list is untenable for many EPFIs given the inclusion of certain politically controversial sectors, such as tobacco, alcohol and gambling industries—but elements of an exclusion list based on international law should be adopted by the EPFIs. Thus, for example, trade in wildlife regulated by CITES, production or trade in products containing PCBs, ozone depleting chemicals and pesticides or herbicides subject to phase-outs or bans, should become a part of a modified exclusion list adopted by EPFIs.

Recommendations

As such, we recommend that the EPFIs:

1. Adopt a modified exclusion list based on restrictions found in international law or best practice as a minimum. Our recommendations for this list are included in Annex 1.

Meeting international best practice

It is important for the EPFIs to establish environmental and social policies based on international law and best practice for sectors in which they finance. In several areas. IFC's Performance Standards do *not* reflect international law or best international practice.

We encourage the EPFIs to address these deficiencies, in particular to strengthen policies to reduce climate emissions, protect biodiversity and certain protected and at risk areas from adverse investments, prevent illegal logging and the protection of human rights.²⁵

3. Conclusion

When the Equator Principles came into being three years ago, they were welcomed by many of our organisations as an important step forward in the efforts of Financial Institutions to address social and environmental risks in their daily operations. BankTrack and others have followed the EPs since their inception and offered constructive suggestions for addressing some of the fundamental problems with EPI.

²⁴ www.publishwhatyoupay.org

²⁵ See 'Shaping the Future of Sustainable Finance' and its accompanying annex. www.banktrack.org

We understand the critical importance of collective agreements amongst EPFIs and the difficulties of bringing diverse financial institutions together.

Yet, the most significant failure in the EPII draft is the decision to ignore its most serious critiques: the lack of consistent and rigorous implementation of the Principles. Without confronting and addressing this problem head on, the reputations of the Equator Institutions, particularly those positioned as leaders of the initiative, are at risk.

Policies aside, the EPFIs should be able to demonstrate how endorsement of the Principles is fundamentally changing day-to-day business operations. To put it bluntly: if the Equator Principles allow for 'determining, assessing and managing' an environmental risk as significant as resulting in the potential disappearance of an entire whale species, as in the case of Sakhalin II, the very relevance of such 'Principles' is at stake.

Clearly some financial institutions have changed their practices and adopted stronger policies. But many other endorsing EPFIs have not been able to show they have taken the Principles on board and applied them to their financial activities. We believe that a level and transparent playing field, as well as clarity in what is required and addressing weaknesses of the Performance Standards, is in the interest of all of the Equator Banks and equally in the interest of prospective clients.

As the EPFIs revise the Principles, they should consider the lessons of the past three years, the critiques of private sector analysts and the NGO community, and the accelerating evolution of international best practice standards in environmentally and socially sensitive sectors. The revision process should take on these issues directly and produce a set of standards and a framework that can be a true benchmark for the financial sector for coming years, rather than a lowest common denominator reflecting past practice that is already obsolete in some areas. Otherwise the EPFIs risk putting forward a proposal that will require even less than what is minimally expected in important segments of the financial sector today.

Annex 1 Recommendation for EPII exclusion list

We suggest that the following activities will be categorically excluded from any financing by the EPFIs, as being fundamentally in contradiction with the objectives of the EPIIs:

1. production or trade in any product or activity deemed illegal under international conventions and agreements;
2. production or trade in weapons and munitions;
3. trade in wildlife or wildlife products regulated under CITES;
4. production or trade in radioactive materials;
5. production or trade in or use of unbonded asbestos fibers;
6. production or trade in products containing PCBs;
7. production or trade in pharmaceuticals and subject to international phase-outs or bans;
8. production or trade in pesticides/herbicides subject to international bans or phase-outs;
9. production or trade in ozone depleting substances subject to international phase-out;
10. drift net fishing using nets in excess of 2.5km in length;
11. production or use of persistent organic pollutants;
12. projects that involve the economic or physical displacement of indigenous peoples without their free, prior, informed consent, which would be a clear violation of established international law;
13. projects that involve the economic or physical displacement of local communities without their free, prior, informed, consent, as reflected through demonstrable public support for the project; this is an emerging principle of equitable and sustainable development;
14. dams that do not fully comply with the WCD framework;
15. projects that involve the conversion or degradation of Critical Natural Habitats (including IUCN I-VI)
16. resource extraction projects in High Conservation Value Forests