

DRAFT CHANGES TO EQUATOR PRINCIPLES PUBLISHED

Following a targeted review of the Equator Principles (**EPs**), the Equator Principles Association has published a draft of the fourth iteration of the EPs (**EPIV**). Subject to further consultation, EPIV will broaden the scope of the EPs to cover a wider range of loans, including project refinancing and acquisition financing, as well as tightening standards in high-income OECD countries and addressing human rights and climate change issues in more detail.

BACKGROUND TO EPIV

The EPs are used by financial institutions to assess and manage the environmental and social impacts of development projects. Based on the International Finance Corporation (**IFC**) Performance Standards and World Bank Environmental Health and Safety Guidelines, they have to date been voluntarily adopted by 96 financial institutions (**EPFIs**) in 37 countries globally. They are a key mechanism for ensuring development is undertaken in a sustainable manner that is aligned with international climate change targets.

The EPs were last amended in April 2013 (**EPIII**). At its annual meeting in Brazil in 2017, the Equator Principles Association (**EPA**) responded to the call from stakeholders including governments and civil society to undertake further reform of the EPs; they announced a 'targeted update process' that will lead to a new set of EPs by the end of 2019.

KEY CHANGES IN DRAFT EPIV

The Association has published a [draft](#) of EPIV (**Draft EPIV**) indicating proposed amendments to the current EPs for consultation, along with a [summary document](#), on its website. The changes in Draft EPIV focus on the following areas:

- The scope of applicability of the EPs;
- Designated Countries and Applicable Standards;
- Human rights and social risk; and
- Climate change.

Key proposed amendments are discussed in more detail below.

Key issues

- A draft revised version of the EPs (EPIV), has been published by the Equator Principles Association.
- The key changes are to expand the scope of the EPs so that they cover refinancing and acquisition finance and a wider range of project-related corporate loans, address standards in high-income OECD countries and increase obligations relating to human rights and climate change.
- A final form of EPIV is expected to be published by the end of 2019, with implementation (including a transitional period) thereafter.

Expansion in Scope

Draft EPIV amends the scope of application of the EPs in respect of project-related corporate loans of over two years; the aggregate of the loan and the EPFI's individual commitment must now each be at least US \$50 million to be caught by the EPs, a reduction from the US \$100 million threshold in EPIII.

It also widens the definition of 'Project' to include non-contiguous developments over one or more geographic areas, including expansions and upgrades to existing developments.

In addition, the EPs will now cover project-related refinancing and acquisition financing, provided:

- 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
- Project completion has not yet occurred at the time of the signing of the facility or loan agreement.

Widening the scope of the EPs to cover refinancing and acquisition financing will ensure that expansions and upgrades to projects where new EPFI signatories are involved will now fall under the environmental and human rights best practice of the EPs.

Enhanced requirements for projects in OECD countries

At present, the EPs distinguish between projects in Non-Designated and Designated countries, placing more onerous EP duties on Projects being developed in the former. In Designated countries – high-income OECD nations such as the USA, UK, Japan and Germany – the assumption is that domestic laws and regulations already offer a high standard of environmental and social protection.

However, following events surrounding the development of the Dakota Access Oil Pipeline in the USA, which was financed by a consortium of international EPFIs, it has become clear that projects in Designated Countries may meet relevant local legal standards but still fall below the international standards of the EPs. A letter to the Association from major EPFIs including Société Générale, BBVA and ABN AMRO addressing the issue also highlighted flaws in the process for obtaining the consent of indigenous communities.

Draft EPIV seeks to address these concerns by placing an obligation on EPFIs financing projects in Designated Countries to evaluate the "specific risks of the Project" to determine whether one or more of the IFC Performance Standards can be used as guidance to address those risks, *in addition to* host country laws. For project sponsors, this amendment will mean that merely complying with local environmental and social laws in Designated Countries may not be enough to satisfy EPFIs that risks are being adequately addressed.

Community Engagement

Draft EPIV also seeks to enhance requirements in respect of human rights and social risk, in light of the commitment set out in the preamble to the EPs that EPFIs will fulfil their responsibility to respect Human Rights in line with the UN Guiding Principles on Business and Human Rights (**UNGPs**). Principle 5 of the EPs – Stakeholder Engagement – has been updated to present two options related to obtaining the free, prior and informed consent (**FPIC**) of indigenous communities for projects:

1. Option 1: EPFIs should consult meaningfully with indigenous peoples to obtain FPIC; in cases where it is unclear whether consent has been achieved, the EPFI should evaluate if further consultation efforts are required and whether the developer's mitigation and remedial action plans are appropriate.
2. Option 2: for projects with impacts on indigenous peoples, developers "must demonstrate, to the EPFI's satisfaction, that the FPIC of the indigenous peoples affected by the Project is obtained".

Draft EPIV also contains a proposed working definition of FPIC for the first time. This recognises that FPIC focuses on meaningful engagement of indigenous peoples although there is no universally accepted definition. It helpfully notes that achieving "*FPIC does not require unanimity, does not confer veto rights on individuals or sub-groups and does not require the [project developers] to agree to aspects not under their control*".

Climate Change

Draft EPIV, in its Preamble, now highlights the significance of the 2015 Paris Climate Change Agreement for the EPs. This new focus will be of particular relevance for host countries seeking to ensure that project development takes place in a manner that is compliant with their Nationally Determined Contributions (**NDCs**) under the Paris Agreement.

Notably, Principle 2 of the EPs has been amended to require Environmental and Social Impact Assessments (**ESIAs**) to include a Climate Change Risk Assessment as a mandatory requirement for:

- All Category A ('significant' risk) projects; and, as appropriate, Category B ('potential limited' risk) projects; physical climate risks (i.e. arising from changes in acute or long term climate patterns) would be assessed for these projects.
- All projects where combined scope 1 and scope 2 GHG emissions are likely to exceed 100,000 tonnes of TCO₂ equivalent. The assessment for these projects must also cover climate 'transition' risks (i.e. arising from a move to a low carbon economy), annual reporting of GHG emission levels, a GHG efficiency ratio where appropriate, and an analysis of possible, less GHG-intensive, alternatives to the project.

In addition, ESIAs should also consider the project's compatibility with the host country's most recent relevant climate and energy policies including its NDCs. This is of major significance, as it puts compatibility with developing climate commitments at the heart of EPFI risk-profiling for project finance.

Significantly, Draft EPIV explicitly recognises the importance of the recommendations of the Taskforce on Climate-related Financial Disclosures (**TCFD**), both in the Preamble and references to various reporting metrics. The implicit suggestion is that EPFIs use the reporting approach of the TCFD in complying with the EPs.

Principle 10 of the EPs is also expanded to require enhanced reporting requirements on biodiversity issues.

FINAL COMMENTS AND NEXT STEPS

The draft amendments to the EPs have been developed following an initial consultation process with stakeholders from business, government and civil

society in 2018. One key area of concern raised by civil society organisations, in a letter to all EPFIs in October 2018, is that the EPs do not currently seek to address the availability of remedies via a grievance mechanism (despite the UNGPs requiring effective remedies to be made available to affected parties). The organisations proposed a complaints mechanism at the level of the Association (as well as at project level) to enable compliance with the EPs to be assessed and, where necessary, for remedial action to be agreed through mediated dialogue. Unsurprisingly given the voluntary nature of the EPs, Draft EPIV has not taken this suggestion forward.

The Draft EPIV text is now subject to public consultation during July and August 2019. Lenders, advisors, project developers and others involved in financings can review the text and submit feedback on the Equator Principles [website](#).

The Association will take feedback into account before EPFIs vote on a final version – this is expected to take place by the end of 2019. Once agreed, EPIV will be implemented by all EPFIs following an initial transition period.

CONTACTS



Nigel Howorth
Partner, Environment
T +44 207 006 4076
E nigel.howorth@cliffordchance.com



Kirsty Souter
Senior Associate,
Environment
T +44 207 006 4178
E kirsty.souter@cliffordchance.com



Andreas Formosa
Senior Associate,
Environment
T +44 207 006 4421
E andreas.formosa@cliffordchance.com



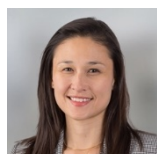
Rae Lindsay
Partner, Business and
Human Rights
T +44 207 006 8622
E rae.lindsay@cliffordchance.com



Roger Leese
Partner, Business and
Human Rights
T +44 207 006 8710
E roger.leese@cliffordchance.com



Jessica Gladstone
Partner, Business and
Human Rights
T +44 207 006 3953
E jessica.gladstone@cliffordchance.com



Anna Kirkpatrick
Senior Associate,
Business and Human
Rights
T +44 207 006 2069
E anna.kirkpatrick@cliffordchance.com



James Pay
Partner, Banking and
Finance
T +44 207 006 2625
E james.pay@cliffordchance.com



Clare Burgess
Partner, Capital Markets
T +44 207 006 1727
E clare.burgess@cliffordchance.com

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www.cliffordchance.com

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London, E14 5JJ

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