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Alert | Environmental

August 2020

Enhanced Equator Principles – What to Know Before Oct. 1

Environmental, Social, and Corporate Governance (ESG) refers to the three central factors in measuring sustainability and societal impact of an investment in a company or business. An update of one of the main frameworks used in ESG, the Equator Principles (the EPs), is scheduled to take effect on Oct. 1, 2020. This latest iteration, "EP4," includes significant changes from its predecessor, EPIII, with potentially significant implications for financial institutions and their clients seeking to finance projects. The EPs have been broadly applied to large-scale infrastructure projects as well as to projects in the extractive and energy industries. Given the Oct. 1 effective date, companies in those industries should take a close look at EP4 and consider its implications, particularly for projects located in developing economies. Importantly, EP4 also extends certain obligations to "designated countries" such as the United States, potentially requiring assurance of steps *beyond* compliance with those countries' legal requirements.

What are the Equator Principles?

Formally launched in June 2003, the EPs were created based on the environmental and social policy frameworks established by the International Finance Corporation. The EPs are a risk management framework for assessing and managing environmental and social risks associated with project financing. The EPs provide a minimum due diligence standard and monitoring protocol designed to encourage responsible risk assessment and decision-making. The EPs apply globally, to all industry sectors, and are focused on risk management for projects financed by the institutions that have adopted the EPs.

Currently, the EPs have been adopted by 108 financial institutions across 38 countries. Financial institutions that are members of the Equator Principles Association commit to making informed investment decisions and withholding or withdrawing financing on projects or assets that do not conform to "good international industry practice."

In November 2019, the Equator Principles Association released "EP4," the latest iteration of the EPs. On June 19, 2020, the Equator Principles Association issued guidance on the implementation of the EPs during the Coronavirus Disease 2019 (COVID-19) pandemic. EP4 was scheduled to take effect on July 1, 2020, but in light of COVID-19, the Equator Principles Association approved a three-month extension until Oct. 1, 2020.

Who Is Affected?

The EPs apply to all Equator Principles Association member financial institutions and cover a variety of financial services and products across all industry sectors. Since their initial adoption, the EPs have been applied to a broader cross-section of projects, including those arising in the energy and extractive industries, as well as to large-scale projects with significant potential to impact the environment or local communities in developing economies. More transactions and projects are covered under EP4 than previous iterations, including certain loans to local, regional, or national governments and project-related refinancing and project-related acquisition financing that meet certain conditions. Additionally, EP4 is the first time the EPs have included a statement recognizing a broader responsibility for managing adverse environmental and social risks and impacts, even for financial products that fall outside the EPs' current scope.

What Are the Implications of EP4?

- Applicability: More transactions and projects are covered by EP4. Also, certain loans to local, regional, or national governments or agencies are now in-scope. EP4 will also cover expansions and upgrades to certain existing projects.
- Biodiversity: Some high-risk projects will be encouraged to share biodiversity data with the Global Biodiversity Information Facility and relevant national or global data repositories.
- Climate Change: Financial institutions that adopt EP4 will be required to support the objectives of the Paris Agreement. In addition to conducting an analysis of lower-emission alternatives for any project in a location triggering the greenhouse gas (GHG) emissions threshold, any Environmental and Social Impact Assessments (ESIAs) must include a climate change risk assessment identifying physical risks (e.g., direct damage to infrastructure, indirect impacts to supply chains) and transition risks (e.g., policy and legal risks from national policy changes, reputational risk).
- Designated vs. Non-Designated Countries: Projects in designated countries may be subject to greater requirements under EP4 than what is necessary to satisfy the law of the host county. The new EP4 requirements could result in divergence between what is necessary for compliance with applicable environmental laws and what a project must do to comply with EP4 to obtain and retain funding.
- Human Rights and Social Risks: Under EP4, a human rights impact evaluation will be required, even if the level of risk does not warrant a full ESIA.
- Indigenous Peoples: EP4 will require financial institutions to retain an independent consultant to evaluate the consultation process with Indigenous Peoples. All projects affecting Indigenous Peoples are subject to this process – even projects in "designated countries" such as the United States.

Additional Differences Between EPIII and EP4

EP4 differs from EPIII in a few critical ways. As in previous iterations of the EPs, many projects subject to EP4 will conduct due diligence through the creation of an ESIA (similar to ESAs created under the National Environmental Policy Act). However, EP4 is more explicit than EPIII about what should be included in an ESIA, with an increased focus on biodiversity, climate change, human rights, and Indigenous Peoples. The main differences between EPIII and EP4 are outlined below.

	EPIII	**EP4**
Applicability	• Project-related refinancing and acquisition financing not in-scope. • Project-related corporate loans over $100 million.	• Project-related refinancing and acquisition financing in-scope. • Project-related corporate loans over $50 million.
Biodiversity	• No requirements re: biodiversity.	• Projects encouraged to report re: biodiversity.
Climate Change	• No specific recommendations re: climate change. • Lower-emission alternative analysis required for projects above specified GHG threshold. • Report GHG emissions for certain projects.	• Climate change risk assessments required for certain projects. • Requirements to: (i) consider physical and transition risks; (ii) conduct lower-GHG alternatives analysis; and (iii) report GHG emissions for certain projects. • Acknowledgement of financial institutions' role in achieving targets under Paris Agreement.
Designated Countries	• Projects located in "designated countries" are deemed to satisfy Equator Principles 2, 4, 5, and 6 if they meet host-country laws.	• All projects will be reviewed for compliance with the EPs. • Projects located in designated countries will be separately evaluated for specific project-related risks to determine if IFC Performance Standards should be applied.
Human Rights	• General statement re: responsibility to respect human rights.	• Financial institutions will meet UN Guiding Principles on Business and Human Rights. • ESIA must include human rights impacts assessment.
Indigenous Peoples	• Projects must obtain Free, Prior, and Informed Consent (FPIC) of Indigenous Peoples.	• For all projects, in all countries, independent consultation with affected Indigenous Peoples is required, consistent with host-

	• Projects in designated countries must follow host-country laws on Indigenous Peoples.	country laws and IFC Performance Standards, including negotiation of FPIC.

EP4 includes material changes from EPIII, with potentially significant impacts on institutions and their clients seeking to finance projects. Some nongovernmental organizations have been critical of the EPs for their perceived failure to impose adequate mitigation standards, compliance, or policing mechanisms. Still, impacted industries have become increasingly concerned about the potential for legal challenges to arise from shortfalls between a project's commitments under the EPs or other similar ESG protocols, and the project's actual implementation. In some instances, those ESG commitments could be legally binding, making the upcoming EP4 update even more important to review.

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