Equator Principles Association: Strategic Review

EXECUTIVE SUMMARY

20 December 2018
NOTE TO READER


The Strategic Review Report was prepared under contract with the Equator Principles Association ("EPA"). It was prepared by Environmental Resources Management, the trading name of Environmental Resources Management Limited (ERM), with all reasonable skill, care and diligence within the terms of the Contract with EPA, incorporating our General Terms and Conditions of Business and taking account of the resources devoted to it by agreement with EPA. We disclaim any responsibility to EPA and others in respect of any matters outside the scope of the above.

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Under the terms of the Contract with EPA, ERM undertook interviews with stakeholders and identified common themes and topics raised by those interviewed. ERM prepared recommendations, in response to the main themes and topics identified, related to the proposed targeted update of the Equator Principles by EPA and EPA’s longer-term strategy. ERM has communicated its recommendations to EPA in the Strategic Review Report, for EPA’s consideration as part of its internal process to review the Equator Principles; ERM has not been involved in this internal EPA process.
EXECUTIVE SUMMARY

Environmental Resources Management Ltd (ERM) was appointed by the Equator Principles Association (EPA) to assist with EPA’s strategic review and consultation process, including a proposed targeted update of the Equator Principles (EP). ERM’s engagement contributed to EPA’s ‘Initial Stakeholder Consultation’ phase during Q2/Q3 2018.

ERM’s engagement comprised:

- Interviewing 7 Equator Principles Financial Institutions (EPFIs) and 20 Tier 1 external stakeholders identified by EPA, utilising an agreed interview template;
- Designing an online survey to which EPA invited 90 Tier 2 and 3 external stakeholders to respond (10 responses received);
- Analysing the information from the above, together with 13 EPFIs interviews previously conducted by EPA, 2 responses (one external, one EPFI) to EPA’s website and the results of the 2017 survey of EPFIs conducted by EPA. This analysis focused on identifying themes and related Topics raised in stakeholder feedback and establishing a basic scoring system to differentiate the relevance of each topic to a particular stakeholder. The number of stakeholders commenting on a particular Topic, combined with the relevance score, was used to calculate an overall weighted relevance score for each topic (banded to ‘High’, ‘Medium’, ‘Low’ relevance). This analysis is summarised on a heat map, shown overleaf.
- Preparing recommendations for EPA’s consideration as part of the targeted EP4 revision and the longer-term strategy for EPA.
- Creating a ‘Sustainable Finance Map’ to provide a high-level scan of the fast evolving sustainable finance landscape and the themes associated with this evolution over the last five years, which are pertinent for EPA to consider as part of its strategic review.

The 32 external stakeholders comprised 8 civil society / non-governmental organisations; 5 client and industry groups; 5 E&S consultants and legal practitioners; 4 thought leaders and academia; 3 financial institutions; 3 supranational bodies and regulators; and 4 unknown.

Recommendations fell into three groups:

1. Recommendations associated with EPA’s longer-term strategy;
2. Recommendations that relate directly to targeted changes in EP; and
3. Recommendations to implementing targeted changes in EP.

Nine Themes and a total of 44 Topics (as shown on the heat map overleaf) were identified from the stakeholder feedback, against which recommendations have been made. The distribution of the Topics in terms ‘High’, ‘Medium’, ‘Low’ relevance is summarised below:

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<tr>
<th>Theme</th>
<th>Topic Prioritisation (number of Topics per overall weighted relevance score)</th>
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<tbody>
<tr>
<td>EPA mandate / capacity</td>
<td>High 4  Medium 2  Low -</td>
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<tr>
<td>Climate Change</td>
<td>High 2  Medium 2  Low -</td>
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<td>Human Rights</td>
<td>High 3  Medium 3  Low -</td>
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<tr>
<td>Indigenous Peoples</td>
<td>High 1  Medium 2  Low</td>
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<tr>
<td>Transparency / Engagement / Remedy</td>
<td>High 2  Medium 3  Low</td>
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<tr>
<td>EP Scope</td>
<td>High 2  Medium 3  Low</td>
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<tr>
<td>Application of Standards</td>
<td>High 1  Medium 2  Low</td>
</tr>
<tr>
<td>EP Implementation</td>
<td>High 3  Medium 2  Low</td>
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<tr>
<td>Other E&amp;S Issues</td>
<td>High 5  Medium 2  Low</td>
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</table>

1 Names / organisation of these respondents to the survey were not captured and subsequently could not be identified.
<table>
<thead>
<tr>
<th>Stakeholder Group</th>
<th>Stakeholder Cluster</th>
<th>Stakeholder Tier</th>
<th>Stakeholder Number</th>
<th>Theme / Topic Heatmap</th>
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<td>Overall Relevance</td>
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**Theme / Topic Heatmap**

- **2.1** ERM Vision / Mission
  - 2.1.1 EPA external outreach
  - 2.1.2 EPA external capacity building
  - 2.1.3 EPA governance / strategy
  - 2.1.4 EPA mandate
  - 2.1.5 EPA capacity / budget
  - 2.1.6 EPA external communication

- **2.2** Climate Change
  - 2.2.1 Alignment with TCFD recommendations and other climate-related guidance
  - 2.2.2 Paris Agreement alignment
  - 2.2.3 Strengthen approach to manage climate change risk
  - 2.2.4 Guidance on GRI assessment methodology

- **2.3** Sustainability
  - 2.3.1 Define human rights
  - 2.3.2 HRI Risk Assessment Methodology
  - 2.3.3 Reference UN Guiding Principles
  - 2.3.4 HRI Risk Assessment Implementation
  - 2.3.5 Reference other HR guidance
  - 2.3.6 Integrating HRI into ESG assessment

- **2.4** ESG Reporting
  - 2.4.1 Environmental, Social, and Governance (ESG) Reporting
  - 2.4.2 ESG risk identification
  - 2.4.3 ESG risk assessment
  - 2.4.4 Integration of ESG in financial reporting

- **3** Thematic Heatmap
  - 3.1 Environment
    - 3.1.1 Environmentally sensitive areas
    - 3.1.2 Environmental footprint
    - 3.1.3 Environmental targets
  - 3.2 Social
    - 3.2.1 Human rights
    - 3.2.2 Labor
    - 3.2.3 Community engagement
  - 3.3 Governance
    - 3.3.1 Governance structure
    - 3.3.2 Governance processes
    - 3.3.3 Governance effectiveness

**Overall Relevance**

- E: Essential
- R: Required
- L: Less important
- N: Not applicable
1. Longer Term Strategic Recommendations

The recommendations relating to the longer-term strategy of EPA and EP are worthy of consideration ahead of those relating to the targeted EP4 update; as decisions on this strategy will in many ways determine what is implemented as part of the targeted EP4 update.

The sustainable finance landscape provides some useful context for consideration by EPA in developing a longer-term strategy as follows:

- **Opportunity and threat** – The sustainable finance market is evolving rapidly and becoming more defined. This creates opportunity for EPA to articulate its mandate within this broader landscape and to continue to evolve to serve its members’ needs.

- **Other finance industry bodies** – Other significant finance industry bodies are creating E&S focused work streams as part of their broader mandate to support their members across the financial markets (e.g. LMA, AFME, ICMA), creating potential opportunities for strategic alignment and threat from occupying current/future EPA ‘territory’.

- **Regulator expectations** – Regulatory developments / plans, for example in China and Europe, point to a more regulated sustainable finance market, with potential for enhanced transparency and governance requirements from those involved. EPA has the potential to contribute to this evolution and needs to stay in step with these growing regulatory expectations; the Financial Stability Board’s Taskforce on Climate-related Financial Disclosures (TCFD) recommendations being an example of this.

- **Investor expectations** - The expectations of investors, both asset owners and managers, on environmental, social and governance (ESG) continues to develop and increasingly part of mainstream investment practices (e.g. Legal and General’s climate action engagement). This includes infrastructure funds enhancing their ESG due diligence processes.

- **New engagement models** – Different actors in the sustainable finance landscape are finding new and innovative ways of working together, for example the Dutch Banking Agreement on human rights was agreed between banks, government and civil society. EPA may wish to consider whether EPA’s

/ EP’s construct as primarily a risk management framework for EPFIs retains relevance or whether it needs to evolve.

- **Beyond green bonds** – The growth of green bonds attracts significant attention within the sustainable finance market, but still represents a fraction of the US$100 trillion global bond market. Beyond green bonds there is a significant part of the market (e.g. lending, ‘vanilla bonds’, trade finance) where there are increasing opportunities to define enhanced E&S frameworks to meet stakeholders’ expectations, presenting opportunity for EPA.

Recommendations related to ‘High’ relevance Topics under the ‘EPA Mandate / Capacity’ Theme for consideration as part of developing a longer-term strategy for EPA include:

- **Strategy** - Develop, consult on and agree a documented strategy for EPA, with a three to five year horizon. It is recommended that EPA considers issuing a public version of this strategy at the same time as EP4, to provide context to the changes and, more importantly, information on how EPA (and EP) plans to evolve and contribute to the enhanced management of E&S issues / impacts.

- **Mandate** - A clear mandate for EPA is a cornerstone for establishing a clear and coherent strategy and, it is suggested, will assist EPA in articulating its purpose and position within the sustainable finance market to external stakeholders. It is recommended that as part of this mandate, EPA in the first instance seeks to provide support to EPFIs on E&S risk management, and beyond this seeks opportunities to develop new principles / commitments either within EP or under the umbrella of EPA.

- **Outreach programme** – A formalised outreach programme, as part of the wider strategy, will provide a more structured and frequent basis for EPA to monitor and manage stakeholder expectations and to evolve its mandate. It could also contribute to EPA being seen in a more positive and ‘collaborative’ context by some stakeholders.

- **EPA internal capacity building** – Development of a knowledge sharing and training platform for EPFIs will contribute to enhancing implementation of EP. This platform could encompass additional guidance documents, tools, training modules / resource and databases.
2. EP4 Recommendations

Recommendations related to relate directly to targeted changes in EP, and to implementing these, made against ‘High’ relevance Topics are discussed below by Theme.

- **EP Implementation** – Amend EP10 to require EPFIs to report on planned / executed internal (or external) audit of their implementation of EP, including closing-out any material audit findings, on a suggested five year frequency for existing EPFIs and within two years of joining for a new EPFI. Develop guidance associated with this to assist audit functions with planning and undertaking audits. An additional/alternate option for new joiners is review of a submitted ‘EP implementation plan’ and implementation of a subsequent ‘adoption plan’ identifying corrective actions, during a probationary period. Associated EPFI adopter guidance and guidance to support the due diligence / probationary review process would be required.


- **Application of Standards** – A number of options are available, with the suggested preferred option being to retain the current basis for the application of standards (based on Designated / Non-Designated Countries), but to establish in EP3 the concept of a formal screening exercise to determine if additional standards above Designated Country standards should be applied. This with the exception of the recommendation related to the application of FPIC below. Other options include completely removing the current basis for application of standards or removing this just for Category A projects. The preferred option would require preparation of additional guidance on undertaking an ‘additional standards assessment’ and process guidance on the application of additional standards in Designated Countries, together with building a database of gaps between Designated Country legislation and IFC PS.

- **EP Scope** – Remove the current exemption for government agencies under Project Related Corporate Loans by amending the text in ‘Exhibit 1: Glossary of Terms’. Amend the definition for ‘Project-Related Corporate Loans’ by changing the final paragraph to remove the exclusion for “… loans to national, regional or local governments, governmental ministries and agencies.”

  Adjust the EP ‘Scope’ section lowering the PRCL thresholds to US$50 million total aggregate and US$25 million per EPFI commitment; track/assess the impact of this change to assess any future amendments.

- **Climate Change** – Amend the EP ‘Preamble’ to reference EPFIs commitment to recognising the importance of contributing to the aims of the Paris Agreement. Include i) preferred option - a specific update to EP2 with a requirement to apply the relevant parts of the TCFD recommendations, in particular as they relate to scenario analysis, potentially with a new Annex or amended Annex A with some further definition; or ii) a more generic reference in EP2 to climate-related transition and physical risk assessment with reference to relevant guidance including TCFD.

- **Human Rights** – Update the EP ‘Preamble’ to recognise EPFIs commitment to respect human rights within the construct of the UN Guiding Principles on Business and Human Rights.

  Amend EP2 to include requirements to i) undertake human rights screening on all projects to inform the need to ii) undertake human rights due diligence. Consistent with this, remove the current limitation for human rights due diligence in “limited high risk circumstances”. Develop guidance / tools to assist with human rights screening and due diligence.

  Enhance the understanding / definition of human rights through amending EP and adding an Exhibit to list potential human rights issues for consideration within the context of development of projects (this consistent with approach to defining ‘Assessment’ in EP2 and Exhibit II). Aligned with this, develop guidance on the definition of human rights relevant to project development; the linkage between human rights topics and where they are, or are not, covered by the IFC PS; and linkage to UN GPs and OECD Guidelines.
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Equator Principles Association
Reference: 0459416

- Indigenous Peoples – Amend EP5 to remove the distinction between applying FPIC in Designated versus Non-Designated Countries and develop guidance for conducting indigenous peoples due diligence and setting out a protocol for FPIC implementation.

- Transparency / Engagement / Remedy – Amend project name reporting to include PRCLs (amend Annex B), EP8 to require clients to approve project name reporting as part of financing agreement covenants, and EP10 to encourage EPFI reporting of project names ahead of the annual EPA reporting cycle. Revise EP6 ‘Grievance Mechanism’ to include emphasis on the review of the design of grievance mechanisms, as part of the Independent Review (EP7), and ongoing implementation, as part of Independent Monitoring and Reporting (EP9).

Other recommendations related to the above short-term priorities but which are for longer-term consideration include:

- Climate change – Assist EPFIs with guidance and training, through the knowledge sharing / training platform, on corporate / portfolio-level response to the TCFD recommendations, and identifying references for understanding the implementation of the Paris Agreement within the context of assessing project resilience to climate-related transition and physical risks (per TCFD).

- Human rights – Provide enhanced human rights related guidance / training, through the knowledge sharing / training platform, including a gap analysis between UN Guiding Principles (GP) Principles and EP / IFC Performance Standards. Consider working with the Dutch Banking Agreement on Human Rights to assist in the development of human rights screening and due diligence methodology / tools. Formally contribute, potentially aligned to the Thun Group, to further defining EPFI’s, and sponsors’, respective roles with respect to the UN GP pursuant to EP being fully and transparently aligned to UN GPs and the UN “Protect, Respect and Remedy” Framework in the future.

- Transparency – Related to the outcome of the last point immediately above, assess the establishment of an EPA platform through which the relevant group of EPFIs can receive and respond to grievances and / or requiring EPFIs to have their own accountability mechanism.

- EP Implementation – In addition to the knowledge sharing / training platform discussed above, consider introducing a formal EPFI report validation process, for example similar to UNPRI, with defined sanctions for material non-compliance with enhanced reporting requirements. Consider creating different EPFI categories which determine the role(s) that an EPFI can take on a transaction, for example lead arranger/advisor, ‘environment bank’.
ERM has over 160 offices across the following countries and territories worldwide:

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