

## Enhancing the Alignment of the Equator Principles with the UN Guiding Principles on Business and Human Rights: A Public Summary of Shift’s Advice to the Equator Principles Association

### A. Introduction

In June 2018, Shift was asked by the Social Risk Working Group of the Equator Principles Association (EPA) to provide advice on a number of critical questions to inform its work, including on the alignment of the current version of the Equator Principles (EPs) with the United Nations Guiding Principles on Business and Human Rights (UNGPs). We were pleased to provide this advice to the Working Group, recognizing the important role the EPs play in setting expectations and driving better practices in environmental and social due diligence in the financial sector, specifically in the area of project finance.

Our analysis was desk-based, drawing on our expertise in putting the expectations of the UNGPs, and specifically human rights due diligence (HRDD), into practice, as well as over five years of experience working with diverse public and private sector financial institutions on practical implementation of the UNGPs. This experience informs our understanding of common implementation challenges as well as leading practices.

We prepared a detailed analysis of how the expectations in the EPs meet or fall short of the expectations of HRDD under the UNGPs, and identified 10 specific recommendations that we believe would significantly strengthen alignment. This public output provides a brief summary of our extended analysis and observations; it contains our 10 recommendations in full. We hope that this can help inform the EPA’s ongoing work on these issues, as well as providing interested stakeholders with insight into the advice we have given.

### B. Framing observations

The preamble to the EPs states that undertaking “due diligence in accordance with the Equator Principles” enables an Equator Principles Financial Institution (EPFI) to meet its responsibility to respect human rights as set out in the UNGPs. We do not believe that this is currently the case, due to limitations in the scope of financial transactions to which the EPs apply as well as certain limitations in the due diligence required when the EPs do apply.

Robust implementation of the EPs can potentially address a number of human rights risks and impacts – meaning the most severe social risks and impacts a company may be connected to – in line with a company’s responsibility to respect human rights under the UNGPs. However, our analysis highlighted several gaps between the EPs and the expectations of HRDD that frame our recommendations. These gaps include:

- **The more limited scope of coverage of the EPs**, including the limited financial products and services covered by the framework, the financial thresholds that must be met before the EPs apply, and the distinction between designated and non-designated countries;
- **Due diligence gaps between the IFC Performance Standards and the expectations of the UNGPs**, in both policy and practice. This matters because the EPs draw substantially on the Performance Standards for their content. These gaps include:

- Assessing **contextual risks** as part of HRDD;
  - Responsibility of clients for impacts caused or contributed to via third party **business relationships** connected to a project;
  - Clarity in **prioritizing the most severe risks to people** for immediate action;
  - The expectation that financial institutions and clients should use **leverage** to seek to address risks they may be connected to through third parties, including building leverage where they lack it;
  - Using **international human rights standards** as the benchmark for assessing and effectively addressing impacts.
- **Common gaps between good international industry practice and the UNGPs**, including:
    - The expectation that due diligence should be **ongoing and dynamic**;
    - The extent to which financial institutions are able in practice to assess the quality of clients' **stakeholder engagement processes and grievance mechanisms** as well as their capacity to implement them;
    - Ensuring that **relevant human rights expertise** is integrated into the conduct of social impact assessments.
  - **Gaps in expectations regarding transparency and disclosure**, specifically the very limited disclosure expectations under the EPs compared to the expectation in the UNGPs of proactive communication by companies about their management of human rights risks and impacts, including formal reporting where those risks are severe.

Our recommendations are intended to help to address a number of these gaps between the current expectations of the EPs and HRDD, and bring the EPs into greater alignment with the UNGPs. We recognize that the decision about whether these gaps can be fully addressed through the EPs is both a technical and a political one. Our aim in our advice was to highlight what would need to be addressed at the technical level, rather than to advise on the political aspects of this decision. However, should these gaps remain unaddressed, then we believe it is incumbent on the EPA to be explicit that implementation of due diligence in line with the EPs does not, on its own, meet the full expectations of the UNGPs.

## C. Recommendations

1. The EPs should explicitly acknowledge the breadth of a typical EPFI's transactions (and other activities) that are not covered by the EPs and recognize the expectation in the UNGPs that EPFIs should conduct appropriate HRDD across the entirety of their operations (and specifically their client portfolio).
2. The EPs should eliminate the existing financial thresholds so that the expectations of the EPs would apply to all project finance-related services and transactions currently covered by the standards, regardless of capital costs involved. In its place, the EPs could direct members to apply a more appropriate set of screening criteria in order to prioritize certain transactions for enhanced due diligence, where such prioritization is necessary, which would more accurately assess the risk of severe human rights impacts. This approach would bring the EPs into much greater alignment with the UNGPs.
3. The EPs should eliminate the designated/non-designated country distinction and require application of the IFC PS in all cases. Of course, analysis of relevant national laws and regulations,

enforcement and practice should be part of the due diligence process in assessing the likelihood of certain impacts occurring and should clearly factor into the development of an appropriate mitigation plan.

To the extent that the EPs will continue to rely upon the designated/non-designated country distinction, EPFIs should, at a minimum, be required to conduct an analysis of host country laws/regulations, enforcement and practice relevant to the protection of the most salient human rights risks connected to a project, compared with international standards. Where laws/regulations, enforcement or practice do not meet or surpass international standards, EPFIs should seek to ensure that relevant international standards are met in relation to those rights.

4. The EPs should clearly reflect the expectation that EPFIs should consider all the human rights risks and impacts connected to the aspects of a client's operations being financed by the EPFI, including impacts arising from the clients' business relationships throughout the value chain for the specific project the EPFI is supporting, to align with the scope of responsibility in the UNGPs.
5. At the same time, the EPs should provide clear guidance to EPFIs on an approach to prioritizing the most severe risks to people, where prioritization is necessary, across this expanded scope of responsibility, in alignment with the UNGPs.
6. Likewise, the EPs should articulate a clear expectation that EPFIs should use their leverage (and take steps to increase that leverage as necessary) to seek to address the most severe risks to and impacts on people, particularly for impacts caused by third parties and those occurring in extended value chains.
7. The EPs should also place greater emphasis on the expectation that EPFIs assess the quality and effectiveness of clients' stakeholder engagement and grievance mechanism processes in practice at the project level, including from the perspective of affected stakeholders. This may require additional support to members in the form of appropriate diagnostic and engagement tools in order to shift the focus away from the existence of these management systems to their effectiveness in practice.
8. The EPs should clarify the definitions connected to different stakeholder groups to ensure that they cover the full scope of "affected stakeholders" as meant in the UNGPs; for example, "affected stakeholders including local communities, workers involved in the project itself and in its supply chain and potential end-users of the project's goods or services".
9. The EPs should clarify in Principle 7, which provides for independent review of assessment processes and broader compliance with the EPs in higher-risk projects, when appropriate human rights expertise will be needed as part of that review.
10. The EPs should, in addition to the existing information that is required, encourage EPFIs to focus their own and their clients' formal public reporting on finding ways to discuss the areas of the most severe risks to people connected to their financing or operations (as appropriate) and provide insight into how they are seeking to address these issues over time. The EPs should adopt a position of encouraging EPFIs towards greater transparency, as this is clearly an area where the financial sector is well behind others on its alignment with the expectations of HRDD.