



**A PATH TO RESPONSIBLE INVESTMENT:
THE EQUATOR PRINCIPLES
AND BEYOND**

ITD-UNCTAD REGIONAL WORKSHOP: PHASE 2 OF IIA REFORM

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TWO SIDES OF RESPONSIBLE INVESTMENT

- **DO NO HARM:** Risk management to prevent, minimize, mitigate or compensate for negative environmental and social impacts; stakeholder identification and engagement
- **“DO GOOD:** Debt or equity investment in projects that promote sustainable investment
 - ✓ For remediation of past pollution
 - ✓ For conservation and protection of biodiversity and natural resources
 - ✓ For mitigating or adapting to climate change
 - ✓ For promotion of economic, social and cultural rights and economic inclusion
- **“KNOW AND SHOW”**

EQUATOR PRINCIPLES IN A NUTSHELL



- A framework for international banks to manage environmental and social impacts in project finance = **risk management (due diligence and mitigation of risks)**
- Based on the IFC Performance Standards
- 92 EPFIs in 37 countries cover approximately 70% of project finance in emerging markets
- Version 3.0 (2013) expanded applicability: 1) Project Finance Advisory Services 2) Project Finance 3) Project-Related Corporate Loans and 4) Bridge Loans
- Specific reference to the UNGPs/human rights, climate change
- Common Secretariat, knowledge sharing, but individual reporting and accountability
- EP III will bind the entire syndicated banks if there is one EPFI / breach of EP III will result in cross-default across all the participating banks

Chile dam row shows IFC's problems with projects

Environmental groups in the US and Chile have accused the International Finance Corporation (IFC), the private-sector lending arm of the World Bank, of disregarding its own environmental and social guidelines during construction of a controversial dam in southern Chile.

Activists allege the IFC ignored an independent review of the Panguí hydroelectric project, releasing a version with a third of the original report deleted.



ALEXANDER COCKBURN

Wolfensohn, Indian Killer

Every age contributes its own dollop of cast to the business of wiping out Indians. Today the banal business of ethnocide is spray-painted with uplifting language about "sustainable development," with more menacing words like "re-settlement" inconspicuously lurking.

Back in 1992 the huge Chilean utility Endesa embarked on the first of a series of hydroelectric dams on the Bío-Bío River some 300 miles south of Santiago. Endesa duly applied to the International Finance Corporation for funding.



the Indians computed to be anywhere from \$6 million to \$18 million worth of timber already handed off. In other words, the Indians were involuntarily subsidizing the dam that was finishing them off.

Dowling's report was sent to Endesa, which promptly threatened to sue the I.F.C., whose natural instinct was to keep Dowling's report from all inconvenient eyes, starting with those of the Pehuenche. The I.F.C. made the report available only to non-Indian members of the Peltum Foundation board. By now the Chilean government and private Chilean

**IFC**International
Finance CorporationWorld Bank Group



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EP I



- “Even the Banks Can Do It – New Accountability in Global Finance” by Michael Conroy, Author of “Branded!”
- Ten large international banks launched the initiative in 2003
- IFC played a facilitation role; the Principles were initially based on the IFC safeguard policies
- Exclusive focus on project finance (allows identification of use of proceeds, maximum leverage)
- Quickly grew in the first and subsequent years

IFC 2006 Performance Standards



PS1: Social and Environmental Assessment and Management Systems



PS2: Labor and Working Conditions



PS3: Pollution Prevention and Abatement



PS4: Community Health, Safety and Security



PS5: Land Acquisition and Involuntary Resettlement



PS6: Biodiversity Conservation and Sustainable Natural Resources Management



PS7: Indigenous Peoples



PS8: Cultural Heritage

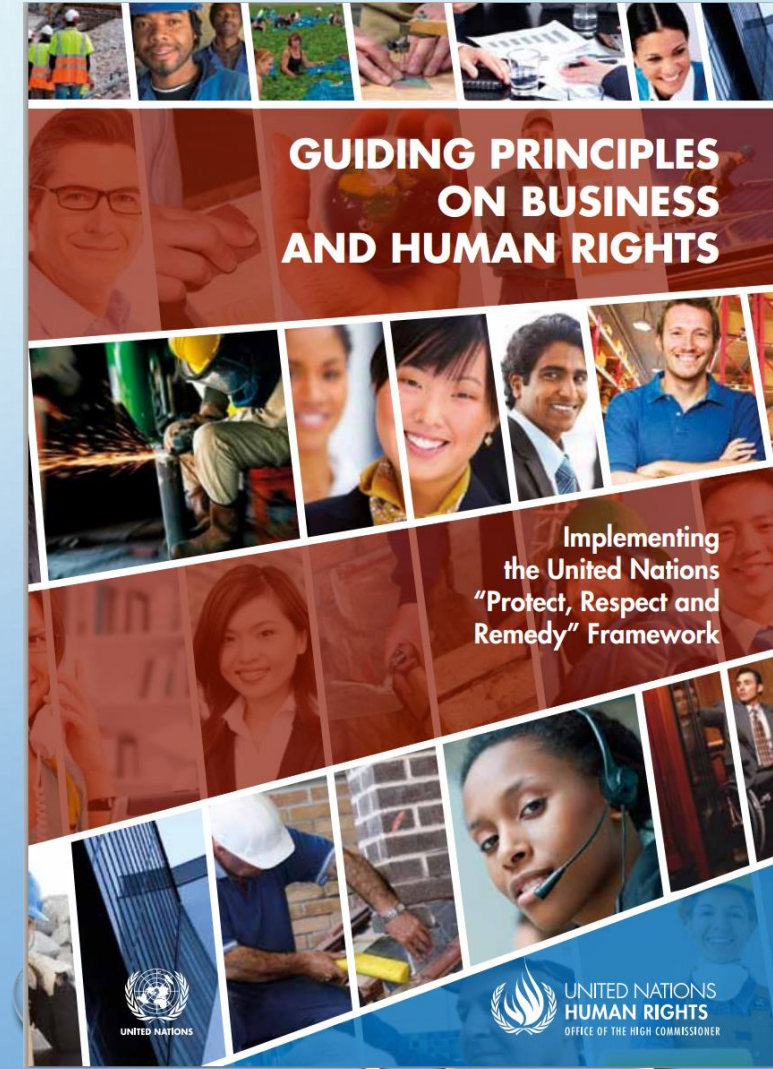
EP II



- **EP II (2007) aligned with IFC's initially controversial 2006 Performance Standards**
- **Similar move by OECD Export Credit Agencies and European Development Finance Institutions**
- **Several IFC client and other companies declare adherence with the Performance Standards / EP II**

BETWEEN EP II AND EP III

- UN initiative to examine the role of transnational corporations and other businesses and human rights → UN Human Rights Council unanimously endorse the **UN Guiding Principles on Business and Human Rights (2011)**
 - “State duty to protect; corporate responsibility to respect; and remedy of human rights violations”
- Major international standards / benchmarks quickly align with the GPs:
 - ISO26000 (2010)
 - IFC Performance Standards (approved 2011, effective 2012)
 - OECD Guidelines for Multinational Enterprises (2011)
 - Global Compact
 - Industry standards (ICMM; IPIECA, etc)



EP III



- **Now in its third generation (2013)**
- **Aligned with 2012 IFC Performance Standards**
- **Expanded applicability to project finance advisory services and project finance (>\$10M); project-related corporate loans (>\$100M total or individual commitment of \$50M); bridge loans to be refinanced as project finance**
- **Specific reference to climate change, human rights**

EQUATOR – WHAT THE BANKS ARE SAYING

- **Promote internal efficiency and effectiveness:**
 - **Improve internal decision making process for banks**
 - **For clients, consistent requirements improve predictability, saving time and money**
 - **Expedite allocation of responsibilities and consensus-reaching among banks in large loan syndications**
- **Level the playing field**
 - **Reduce “loan-shopping” by sponsors based on environmental and social criteria**
 - **Over time, raising tide lift all boats**
 - **One EPFI in a syndicate effectively requires the entire syndicate to be EP compliant**
- **Provide basis for stakeholder engagement**
- **See opportunities to grow their business**

EQUATOR – WHAT THE CRITICS ARE SAYING

- **EP Association commissioned 2011 Strategic Review - identified four challenges:**
 - **Scope and going beyond project finance**
 - **Outreach and expanding membership**
 - **Improving consistency of implementation across members**
 - **Promoting transparency**
- **Disclosure of information continues to be limited**
 - **Annual reporting by individual EPFI only on EFPI website**
- **No accountability / grievance mechanism at the Principles level**
- **Static and closed governance structure**
- **A few notable international player in project finance missing – e.g., only one Indian bank**
- **Principles of have no teeth**
- **How is success defined? Success for whom? How is success measured?**

IS THE PLAYING FIELD LEVEL?

- MIGA (World Bank Group) and the World Bank's public-private partnership projects use the Performance Standards (2013); the new World Bank Environmental and Social Sustainability Framework – better aligned with the Performance Standards than the safeguard policies?
- 38 OECD Export Credit Agencies align with the Performance Standards through the OECD Common Approaches (2012)
- 16 European development financial institutions (EDFIs) benchmark projects against the Performance Standards (2009)
- Multinational enterprises and investment funds refer to the Equator Principles or Performance Standards
- China creates its Green Credit Policy (2007); adopts a banking guideline modeled after IFC's due diligence process and Equator Principles (2012)
- Peruvian Superintendent of Banks write Equator-like E&S due diligence into banking regulation (2015); other similar efforts around the world
- Challenge of implementation, transparency of the banking sector

OTHER SIMILAR BANKING INITIATIVES

- UN Environmental Programme Finance Initiative
 - Founded in 1992, after the Rio Summit
- IFC's Sustainable Banking Network
 - Bangladesh, Brazil, Colombia, China, and Nigeria now have sustainable banking guidelines (for E&S risk management and green finance)
- OECD MNE Guidelines – applicable to finance; also Financial and Enterprise Affairs Directorate work pending
- The Thun Group of Banks (2011)
 - Declared adherence to the UNGPs

SIMILAR INITIATIVES BY THE INVESTMENT COMMUNITY

- UN Principles for Responsible Investment (UNPRI) (2005)
 - 6 basic principles; 1 260 signatories
 - Sustainable Stock Exchange Initiative
 - An initiative co-convened by UNPRI, UNCAD, UNEPFI, and the UN Global Compact
 - Multiple national and thematic initiatives
 - Different types of responsible investments
 - Socially responsible investing (SRIs) – negative screening
 - Impact investments – express goals of effecting E or S change / impacts
 - ESG investing –integration of ESG factors in investment analysis to the extent material
- Note that the approach by the investment community is heavily focused on reliance on investee company sustainability reports; proprietary analysis; screening; engagement; and shareholder activism

BROADER REFORM FOR RESPONSIBLE INVESTMENT TOWARD SUSTAINABLE DEVELOPMENT

- EU Sustainable Finance Initiative
- G20 and green/sustainable finance
- UNEP Inquiry into the Design of a Sustainable Financial System
- FSB's Task Force on Climate-Related Financial Disclosures
- New institutions, new financial instruments
 - National or municipal green banks; impact investment; green bonds, etc.
- More hardwiring into laws and regulations
- More attention to social / human rights aspects of green finance

CHINA'S EXPERIMENT TO GREEN ITS ECONOMY

- Pattern of rapid economic growth characterized by:
 - High consumption of energy and natural resources
 - Environmental pollution & biodiversity loss
 - Growing social tension and inequality
- Recognition that administrative measures need to be coupled with market-based policies
- Turning to the power of the market: *environmental economic policies*
 - Environmental tax
 - Ecological compensation mechanism
 - Green trade policy
 - Green government procurement
 - Green insurance
 - Green securities
 - Green credit



CHINA'S GREEN CREDIT POLICY

- **Context: Banks provide 80-90% of funding to Chinese enterprises**
- **Dual purpose:**
 - **Direct credits away from highly polluting and high energy-consuming enterprises and projects**
 - **Direct credits toward energy conservation and emission reduction at preferential terms**
- **Launched in July 2007 by three agencies:**
 - **Ministry of Environmental Protection (MEP)**
 - **China Banking Regulatory Commission (CBRC)**
 - **People's Bank of China (PBOC)**
- **In 2012, CBRC announced due diligence guidelines**
 - **For banking business inside and outside china**
 - **Modelled after IFC's due diligence procedure**
- **Weak on promotion of environmental financing**
 - **Too many legal and historical constraints**
- **Will innovation come from the banks?**



CHINA GREEN CREDIT GUIDELINES: SPECIFIC PROVISION ON BANKS FINANCING OVERSEAS PROJECTS

21. BANKS SHALL STRENGTHEN E&S RISK MANAGEMENT FOR PROPOSED OVERSEAS PROJECTS, ENSURE PROJECT SPONSORS ARE COMPLIANT WITH LOCAL ENVIRONMENTAL, LAND, HEALTH AND SAFETY LAWS AND REGULATIONS IN THE PROJECT COUNTRY OR REGION. **BANKS SHALL PUBLICLY COMMIT TO ADOPT RELEVANT INTERNATIONAL BEST PRACTICES OR STANDARDS FOR THE PROPOSED OVERSEAS PROJECT, ENSURE THE PROPOSED PROJECT IS CONSISTENT WITH INTERNATIONAL BEST PRACTICES IN ESSENCE.**

BEWARE: GREEN PROJECTS MAY NOT NOT ALWAYS GREEN OR SOCIALLY SUSTAINABLE

- **Unintended harm to biodiversity and natural resources**
 - E.g., wind power; hydro
- **Land acquisition / restriction to access to land**
 - Indigenous peoples' claims to forest, trees and carbon
 - Impacts on small-scale or subsistence farmers
- **Resettlement**
 - Distinct rural and urban issues
- **Inadequate engagement with community leading to mistrust, unrest, disputes**





THANK YOU!

QUESTIONS?

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