

# Proposed Revisions to Equator Principles Released for Review

June 2019

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The Equator Principles Association (EPA) has released the much-awaited draft text of Equator Principles 4 (EP4). Further consultation of the draft text will be coordinated by the EPA in July and August, and it is anticipated to be finalised in late 2019.

The text contains the fourth round of revisions to the Equator Principles — which are a framework used by signatory financial institutions (known as Equator Principles Financial Institutions, or EPFIs) to assess and manage environmental and social risk in international project finance. As of January 2019, there were 96 EPFIs, including many export credit agencies that have also become EPFIs.

While the Equator Principles are voluntary and not legally binding, they take force of law from the financing agreements into which they are incorporated: in the case of non-compliance with Equator Principles requirements, lenders are guided to prescribe remedial measures and may invoke remedies under the applicable financing agreements.

The key changes proposed by EP4 relate to the scope of transactions to be covered by the Equator Principles, new requirements for projects in high-income Organization for Economic Cooperation and Development (OECD) nations, human rights, and climate change.

## Scope of Covered Projects

The draft EP4 revises the scope of projects that may be subject to the Equator Principles in two key respects:

- it reduces the threshold for project-related corporate loans from US\$100 million to US\$50 million; and
- it proposes to apply the Equator Principles to project-related refinancing and project-related acquisition financing, if the underlying project was Equator Principles financed, is not completed, and there has been no material change in the scale or scope of the project.

## New requirements for projects in Designated (OECD) Countries

The draft EP4 proposes additional review standards for projects in “Designated Countries” which are high-income OECD nations that are historically perceived as having robust environmental and social governance systems and institutions.

Under the current version of the Equator Principles, such projects are reviewed for compliance with “relevant host country laws, regulations, and permits,” based on the assumption that such laws and regulations in Designated Countries already offer a high standard of environmental and social protection. However, this assumption received criticism stemming from recent projects in Designated Countries that may have met the relevant Designated Country’s legal standards but did not necessarily meet the standards of the Equator Principles (the Dakota Access Pipeline project in the United States, which was opposed by many indigenous communities, was cited as an example).

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The EPA attempts to address this criticism in EP4 by specifying in the draft text that an EPFI should evaluate “the specific risks of the [p]roject” in a Designated Country to determine whether one or more of the International Finance Corporation Performance Standards can be used as guidance to address those risks, in addition to host country laws. In practice of course, some EPFIs do this as a matter of choice or discretion, particularly in regard to a project’s impacts on indigenous communities in Designated Countries. However, “hard-wiring” this into the Equator Principles is likely to make this practice more common. For project sponsors, this will mean that merely complying with environmental and social laws in Designated Countries will not necessarily be sufficient to satisfy EPFIs that environmental and social risks are appropriately addressed throughout the project life-cycle.

## Human Rights Due Diligence

Another significant update in draft EP4 is the addition of requirements related to human rights and social risk. It adds language requiring EPFIs to assess potential adverse human rights impacts, including impacts to indigenous peoples, and provides two specific options related to obtaining the “Free, Prior, Informed Consent” (FPIC) of indigenous peoples:

- a project must demonstrate, to the EPFI’s satisfaction, that the FPIC of the indigenous peoples affected by the project has been obtained; or
- if it is unclear whether FPIC has been achieved, the EPFI should evaluate if further consultation efforts are required and whether the project’s mitigation and remedy plans are appropriate.

EP4 also attempts to define FPIC. However, the definition does not meaningfully address the challenges that can arise in determining whether indigenous stakeholders have freely granted, or been given the opportunity to grant, their free and informed consent to the project — especially when there are differences in opinion within the indigenous community about the project’s impacts and whether it should proceed.

## Climate Change

As expected, the draft EP4 includes several updates relating to climate change impacts, including a recognition of the EPFI’s role in the 2015 Paris Climate Change Agreement and responsibilities to report climate-related information. Most of the climate change-related edits attempt to address the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) published in June 2017.

Perhaps most notably, the draft EP4 proposes to require the Environmental and Social Impact Assessment to include a climate change risk assessment for two classes of project:

- for all Category A projects, as well as Category B projects “as appropriate;” and
- for all projects, regardless of location, when the combined direct (Scope 1) and indirect (Scope 2) carbon dioxide equivalent emissions are expected to total more than 100,000 tonnes annually.

The risk assessment would require the analysis of acute and chronic physical risks, alternative technologies, quantification of emissions, and reporting of emissions. The types of transition risks are defined very broadly to encompass legal and policy risks (such as the introduction of a carbon tax by the host nation), shifts in demand and supply due to technology and market changes, and reputation risks reflecting customer or community perceptions of the organisation’s impact on the transition to a low carbon and climate-resilient economy. The reputational risk aspect of the assessment could present particular challenges in circumstances where there is strong (or loud) community and media opposition and comment on new project proposals — especially in the fossil fuel industries.

## Comment and engagement

Draft EP4 is expected to be used as the basis for a formal round of public consultation on EP4, which is expected to run until mid-August. Based on this, a final revision of EP4 could be released by the end of 2019. Lenders, advisors, project developers and others involved in financings should review the draft EP4 and provide feedback on whether it provides an appropriate roadmap for its covered finance transactions.

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