

# Sustainable Finance: Bringing the "S" into focus



## *The Equator Principles 4*

### *Abstract*

*The Equator Principles ("EPs") are a voluntary risk management framework adopted by 101 financial institutions across 38 jurisdictions to assist them in determining, assessing and managing environmental and social risk. Although launched more than a decade ago, they had not been in the spotlight in the same way as other voluntary frameworks such as the UN Sustainable Development Goals and the UN Guiding Principles on Business and Human Rights ("UNGPs") until very recently. Beginning 2016, a number of financial institutions – 13 of which were signatories to the EPs – were heavily criticised for their support of the Dakota Access Pipeline project ("DAPL") in which local Indigenous consent was disputed. The criticism drew unprecedented media attention to the EPs as an ESG benchmark in project financing. Momentum had been building for regulatory reform and industry initiatives directed at promoting environmental issues in the financial sector, however there had been less focus on the "S" in ESG. The DAPL protests put human rights and social risk at the centre of the debate.*

*A review of the EPs was already projected given that they were last updated in 2013. Following the DAPL protests however, the continued media scrutiny and associated reputational risks made human rights the keystone of this review period. A targeted review process of the EPs was announced in late 2017 with a focus on social risk. Following the release of the draft of Equator Principles 4 ("[Draft 4](#)") in June 2019, civil society had an opportunity to comment on its efficacy in meeting their concerns about managing the human rights impacts of projects within its mandate. In mid-November, the fourth iteration of the Equator Principles ("[EP4](#)") was formally adopted. This paper sets out the changes in EP4 and assesses how far these go towards addressing the human rights concerns articulated by civil society during the review process. It also identifies emerging developments on human rights and finance to assist financial sector participants in promoting and respecting human rights in their commercial activities.*

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## *I. Introduction - Standing Rock DAPL protests*

The EPs are a voluntary risk management framework adopted by financial institutions to determine, assess and manage environmental and social risk. As a “soft” industry initiative, the EPs do not impose any legally binding obligations or sanctions. However, as the 2016 DAPL protests demonstrated, a failure to ensure that clients are implementing a minimum standard of ESG adherence in a project can cause catastrophic reputational damage. The EPs are therefore a useful and critical litmus test for banks considering providing finance to a project sponsor.

The DAPL protests began as a grassroots movement in opposition to the construction of the Dakota Access Pipeline, an oil pipeline proposed between the Bakken oil fields in North Dakota and southern Illinois. The pipeline is a project of the Texas-based sponsor Energy Transfer Partners. At the time of the protests, seventeen major banks were directly financing the project (contributing an aggregate of US\$2.5 billion) with Citigroup, Mizuho, Bank of Tokyo Mitsubishi UFJ and TD Bank as lead financiers. Thirteen of these banks were signatories to the EPs, including Société Générale, BBVA Spain, Crédit Agricole, Natixis France and Intesa Sanpaolo.

The route of the pipeline crosses under the Missouri river, near the Standing Rock Sioux reservation. The Standing Rock Sioux Tribe is a part of the Great Sioux Nation. They have land rights to the Standing Rock reservation under the Treaty of Fort Laramie which was signed in 1851. The Standing Rock Sioux objected to the pipeline’s trajectory, claiming that it violated sacred ancient burial grounds and constituted a threat to the reservation’s water supplies. In addition, they claimed to have been denied their right to “Free, Prior, Informed Consent” (“FPIC”), as recognised in international law and enshrined in the UN Declaration on the Rights of Indigenous Peoples (“UNDRIP”). This was confirmed by the UN Special Rapporteur on the rights of Indigenous Peoples in late 2016:

The [Standing Rock Sioux] tribe was denied access to information and excluded from consultations at the planning stage of the project and environmental assessments failed to disclose the presence and proximity of the Standing Rock Sioux Reservation.<sup>1</sup>

Protests against these violations began as a social media campaign in April 2016 and quickly grew into mass peaceful encampments at the project site. Delegates from more than 300 federally recognised Native American tribes and many other high profile activists joined the Sioux; at the height of the protests in September 2016, an estimated 3,000 to 4,000 resistance supporters were camped there. In September, despite a pending injunction motion, the project sponsor brought in bulldozers to dig up a section of land which had been identified by the Sioux as sacred territory, in addition to a private security firm tasked with suppressing further protests. This firm reportedly used guard dogs and pepper spray to control protesters. There were also allegations of state violence throughout the protests, including harsh police treatment during arrests, the use of water cannons and riot gear and the intervention of armed soldiers.

In December 2016, following significant national and international scrutiny, the Obama administration denied an easement for construction of the pipeline under the Missouri river, preventing the project from proceeding. However, an executive order in January 2017 by President Trump days after his inauguration allowed construction to continue. The pipeline was completed in April 2017.

### *Impact on the financial sector*

The fallout from the protests was significant, in part due to civil society campaigns promoting divestment as an opposition strategy. The most public boycotts have been by the city councils of Seattle, Washington and Davis, California which voted not to renew their contracts with Wells Fargo, one of the project’s financiers. A report by

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<sup>1</sup> UN Office of the High Commissioner on Human Rights media release, 22 September 2016.

First Peoples Worldwide, a global Indigenous-led foundation (“FPW”), attempted to quantify material losses incurred by financial institutions involved in the project, identifying as much as US\$4.4 billion in direct account closures by individuals and local governments.<sup>2</sup> In addition, six banks withdrew their funding including ABN AMRO, BNP Paribas, DNB and ING by way of share and loan debt sales. Although the terms of these sales were not disclosed, it is likely that these divestments also attracted losses.<sup>3</sup>

### *Equator Principles Association response*

To say that the DAPL protests precipitated the EP4 review would be an overstatement. An update was already expected and was appropriate for several reasons, given that the last version had been issued in June 2013. Attitudes to ESG risks in finance had progressed considerably, for all sector participants including regulators, investors and the Equator Banks themselves: this was widely discussed at the Annual Meeting of the Equator Principles Association (“EPA”) in 2017.<sup>4</sup> In addition, several relevant multilateral instruments had been launched since the last iteration including the 2015 Paris Agreement and the UN Sustainable Development Goals. However, the DAPL protests shifted the focus of the Draft 4 review towards social risk and human rights, including the rights of Indigenous Peoples.<sup>5</sup>

A letter from 10 EP signatory banks to the Chair of the EPA in May 2017 confirms this. Citing a real possibility of reputational damage to the EPs as a “golden standard” as a result of a “recent project” which did not involve the FPIC of an indigenous community, the letter calls on the EPA to create a working group directed at improving the EPs. The letter’s recommendations reiterate the concerns of civil society, including removing the distinction between Designated and Non-Designated countries and an amendment of the EPs framework to “facilitate the resolution of issues resulting from a potential breach... that may lead to a significant damage to the environment and/or communities”.<sup>6</sup>

## *II. The Equator Principles – A closer look*

The EPs were formally launched in 2003 in Washington DC. Early signatory banks included industry giants such as Barclays, Citigroup, HSBC and Mizuho however the EPs are now adopted by 101 financial institutions in 38 countries (the “[Equator Banks](#)”).<sup>7</sup> The scope of the guidelines was initially based on environmental and social policy benchmarks established by the International Finance Corporation (“IFC”) and the EPs have gone through several review processes since implementation.

The EPs apply to specific financial products globally and across all industries, including project finance advisory services, project finance, project-related corporate loans, bridge loans and project-related refinance and acquisition financing.<sup>8</sup> EP4 has expanded the scope of Equator Principles 3 (“EP3”) to include these last two financial products: acquisition financings were explicitly excluded from EP3’s mandate.

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<sup>2</sup> [Social Cost and Material Loss: The Dakota Access Pipeline](#), November 2018, pages 38-39.

<sup>3</sup> *Ibid*, pages 39-40.

<sup>4</sup> [EP Association Annual Meeting 2017 Outcomes](#), 2 November 2017.

<sup>5</sup> *Ibid*.

<sup>6</sup> [Open letter to the Chair of the Equator Principles Association](#), 22 May 2017.

<sup>7</sup> Latest membership as at 24 November 2019.

<sup>8</sup> The following products are captured by the EPs: 1. Project Finance Advisory Services with a total project cost of US\$10 million or more; 2. Project Finance with a total project cost of US\$10 million or more; 3. Project-Related Corporate Loans where a. the majority of the loan is related to a single Project over which the client has Effective Operational Control (either direct or indirect); and b. the total aggregate loan amount is at least US\$50 million and the EPFI’s individual commitment (before syndication or sell down) is at least US\$50 million; and c. the loan tenor is at least two years; 4. Bridge Loans with a tenor of less than two years that are intended to be refinanced by Project Finance or a Project-Related Corporate Loan; and 5. Project-Related Refinance and Project-Related Acquisition Finance where the underlying project was financed in accordance with the EPs framework, there has been no material change in Project’s scale or scope, and Project Completion has not yet occurred at the time of signing the facility or loan agreement. Project-Related Corporate Loans are defined as any corporate loan to a business entity

“Project” is defined broadly and captures any development in any sector at an identified location, including operation expansions or upgrades which result in a material change in output or function. Examples listed by the EPs include power plants, mines, oil and gas projects and large scale real estate developments.<sup>9</sup>

An adopting bank (“EPFI”) is required to assess and monitor how their “Client” – i.e. the sponsor entity implementing a project for which they are providing a relevant financial product – is managing the environmental and social risk inherent in that project. Any relevant project must be assessed against the “common baseline” of good environmental and social governance set out by the EPs:

|                               |   |
|-------------------------------|---|
| <b>Review and Assessment</b>  | Principles <b>1, 2, 3, 4</b> and <b>7</b> |
| <b>Stakeholder Engagement</b> | Principle <b>5</b>                        |
| <b>Grievance Mechanism</b>    | Principle <b>6</b>                        |
| <b>Covenants</b>              | Principle <b>8</b>                        |
| <b>Reporting</b>              | Principles <b>9</b> and <b>10</b>         |

To ensure compliance, financial institutions should:

- develop and maintain internal environmental and social policies, procedures and standards aligned with the mandate of the EPs;
- conduct appropriate environmental and social due diligence on a relevant project;
- negotiate and document appropriate environmental and social covenants with their client; and
- publish applicable project data in their annual sustainability reports.

In practice, what is required by an EPFI is that their **internal due diligence includes the following review process**:

1. An environmental and social assessment review is undertaken at the financing proposal stage (“Assessment”), the scope and extent of which is dictated by the nature and scale of the proposed project.
2. If any issues are raised in the Assessment, an Environmental and Social Management Plan (“ESMP”) is prepared by the client to address them and incorporate any actions required to comply with the applicable standards. Where the standards are not met to the EPFI’s satisfaction, the EPFI and client agree an Equator Principles Action Plan.
3. For all Category A and Category B projects,<sup>10</sup> EPFIs must also require that clients develop and maintain an Environmental and Social Management System (“ESMS”).
4. For all Category A and, as appropriate, Category B Projects, an independent environmental and social consultant will carry out a review of the Assessment documentation including any ESMP, ESMS and stakeholder engagement documents.

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(either privately, publicly, or state-owned or controlled) related to a single project where the known use of proceeds is related to either (a) the lender looking primarily to the revenues generated by the project as the source of repayment and where there is security in the form of a corporate or parent company guarantee or (b) documents for the loan (such as terms sheet, information memorandum, credit agreement or other client representations) indicate that the majority of the loan’s proceeds will be directed to the project. They previously excluded sovereign loans but EP4 has changed its position on this and these types of loans are now captured. *Equator Principles 4*, pages 5, 31 (Glossary).

<sup>9</sup> *Equator Principles 4*, page 30 (Glossary).

<sup>10</sup> **Category A Projects** are those with potential significant adverse environmental and social risks or impacts that are diverse, irreversible or unprecedented. **Category B Projects** are those with potential limited adverse environmental and social risks or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures. *Equator Principles 4*, page 8.

### III. Lead up to EP4

The Draft 4 review process began in late 2017. Following two rounds of stakeholder consultation carried out by consultants ERM in late 2018 and BSR from June to August 2019, [Draft 4](#) was released on 24 June 2019. Final submissions were received on 23 August 2019. After considering feedback and external consultant recommendations provided during both periods of stakeholder consultation, the EPA issued [EP4](#) on 18 November 2019, alongside a [feedback response document](#).

#### *Draft 4: what was proposed?*

During the review period, changes to the EPs framework were proposed in four key areas.<sup>11</sup>

##### 1. Scope

Most significantly, Draft 4 proposed to expand the scope of the EPs to capture two additional financial products, in certain circumstances:<sup>12</sup> Project-Related Refinancings and Project-Related Acquisition Financings.

Other threshold changes included:

- the total aggregate loan amount for applicable Project-Related Corporate Loans to be reduced from US\$100 million to US\$50 million; and
- Project-Related Corporate Loans to include loans to sovereign borrowers for Category A, and as appropriate, Category B projects.<sup>13</sup>

These changes were adopted in the final text of EP4 with little contention.

##### 2. Designated and Non-Designated Countries

The EPs historically applied different standards for Designated and Non-Designated Countries. Designated Countries were defined in EP3 as countries “deemed to have robust environmental and social governance, legislation systems and institutional capacity designed to protect their people and the natural environment”.<sup>14</sup> The EPA maintains a [list](#) on their website which aligns with high-income OECD countries. Clients operating projects in Designated Countries are entitled to use the environmental and social laws of that host country as a proxy for governance. In practice, this means that where a project is located in a high-income OECD country, an EPFI’s Assessment need only consider compliance with the relevant environmental and social laws, regulations and permits of that host country. Where a project is located in a Non-Designated Country, an EPFI was required under EP3 to apply the [IFC Performance Standards on Environmental and Social Sustainability](#) (“IFC Performance Standards”) and the [World Bank Group Environmental, Health and Safety Guidelines](#).<sup>15</sup>

Although this bifurcation of applicability was widely criticised,<sup>16</sup> Draft 4 retained the list of Designated Countries but proposed modifying the due diligence obligations of an EPFI in the following ways to reflect that a Designated Country’s host laws may not always be sufficient:

<sup>11</sup> See an official EPA summary of the four key areas of revision [here](#).

<sup>12</sup> 1. The underlying project was financed in accordance with the EPs framework; 2. there is no material change in the project’s scale or scope; and 3. project completion has not yet occurred at the time of signing the facility or loan agreement.

<sup>13</sup> The definition of Category A and Category B Projects remains the same: see fn 9.

<sup>14</sup> [Equator Principles 3](#), June 2013, page 15 (Glossary).

<sup>15</sup> *Ibid*, page 6.

<sup>16</sup> See commentary below on this issue.

- As part of the Assessment process, an EPFI would be required to evaluate the specific risks of that project to determine whether one or more of the IFC Performance Standards should be applied in addition to the host country laws.
- For all Category A and Category B Projects globally, an EPFI's due diligence process would include review and confirmation of how the project and/or transaction meets each of the EPs (regardless of whether host country laws are satisfied).<sup>17</sup>

This position was substantively adopted in the final text of EP4: the continuing debate around this distinction is discussed below.

### 3. *Human rights*

EP3 was largely silent on human rights. In limited high-risk circumstances, it was appropriate for an EPFI to “complement” its Assessment with specific additional human rights due diligence but otherwise its obligations with respect to human rights were subsumed within the umbrella of “social risk”. Given the rapidly growing emphasis on the “S” in ESG in the sector, the EPA unsurprisingly adopted a stronger position in relation to human rights due diligence in Draft 4.

First, this was reflected by proposed additional wording in Draft 4's preamble recognising **the responsibility of Equator Banks to respect human rights in line with the UNGPs**. Draft 4 also imposed a hard obligation on an EPFI to include consideration of potential adverse human rights impacts in an Assessment.<sup>18</sup> These changes have been adopted in the final text of EP4 and constitute a significant departure from EP3's approach to human rights due diligence as a “complement” to any project review. Although EP4 does not propose any guidance on the scope of human rights assessment required, it qualifies the requirement for human rights due diligence by reference to paragraphs 17-21 of the UNGPs.<sup>19</sup> UNGPs 17-19 set out in more detail what is expected of corporate actors in carrying out human rights due diligence. In particular, UNGP 17 states that human rights due diligence should include “assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed”.<sup>20</sup> For financiers, this means that their broader risk management systems will need to include due diligence that “goes beyond simply identifying and managing material risks to the [financier] itself, to include risks to rights-holders”.<sup>21</sup>

### *Stakeholder consultation*

Draft 4 approached the issue of Indigenous engagement by proposing two options for stakeholder consultation relating to obtaining FPIC:

- **Option 1:** a client must document its efforts to engage in meaningful consultation with Indigenous Peoples affected by a project with the goal of achieving FPIC. Where FPIC has not been achieved, an EPFI must then evaluate if further consultation efforts are required and whether the client has appropriate plans to mitigate and remedy potential adverse impacts.
- **Option 2:** a client must demonstrate that the FPIC of Indigenous Peoples affected by a project has been obtained.<sup>22</sup>

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<sup>17</sup> Draft Equator Principles 4, pages 11-12.

<sup>18</sup> Draft Equator Principles 4, page 10.

<sup>19</sup> Equator Principles 4, page 9. This qualification is a new addition to the final text since Draft 4.

<sup>20</sup> UN Guiding Principles on Business and Human Rights, page 17.

<sup>21</sup> Ibid, page 18 (Principle 17 Commentary).

<sup>22</sup> Draft Equator Principles 4, pages 13-15.

Draft 4 noted that FPIC is not universally defined but provided the following formulation:

Based on good faith negotiation between the client and affected indigenous communities, FPIC builds on and expands the process of Informed Consultation and Participation, ensures the meaningful participation of Indigenous Peoples in decision-making, and focuses on achieving agreement. FPIC does not require unanimity, does not confer veto rights to individuals or sub-groups, and does not require the client to agree to aspects not under their control.<sup>23</sup>

Given that indigenous consultation was a central issue during the review, the EPA received significant feedback from civil society on the proposed approaches. These concerns and the EPA's subsequent response are explored below.

Draft 4 also proposed to expand the obligation to engage with stakeholders and provide appropriate grievance mechanisms to "Workers".<sup>24</sup> Interestingly, the draft definition of "Workers" captured all workers engaged directly or indirectly by the client to work on a project such as part-time workers, contractors, sub-contractors and temporary workers, but supply chain workers were expressly carved out.<sup>25</sup> The definition adopted in EP4 now includes supply chain workers to align it with IFC Performance Standard 2.<sup>26</sup>

#### 4. *Climate change*

Since EP3 was issued in June 2013, several international instruments and industry-wide initiatives have been adopted which aim to mitigate and address the climate crisis. The financial sector has increasingly welcomed such reforms. The EPA sought to increase their climate ambition in the latest iteration of the EPs. Accordingly, the preamble of Draft 4 recognised the role of EPFIs in:

- delivering on the outcomes of the UN Sustainable Development Goals;
- achieving the aims of the 2015 Paris Agreement; and
- reporting climate-related information in line with the recommendations of Financial Stability Board's Task Force on Climate-Related Financial Disclosures ("TCFD Recommendations").

In particular, Draft 4 introduced a climate change risk assessment as part of the Assessment process for certain projects:

- For all Category A Projects and, "as appropriate", Category B Projects: an assessment of the relevant physical risks. Where appropriate, clients delivering these projects<sup>27</sup> will also be required to report their greenhouse gas ("GHG") emission levels publicly on an annual basis during the operational phase.
- For any project, regardless of location, when the combined direct GHG and indirect GHG emissions are expected to exceed 100,000 tonnes of carbon dioxide equivalent annually: consideration of the relevant transition risks and completion of "an alternatives analysis" to evaluate less GHG intensive alternatives.<sup>28</sup>

To capture climate change risk, Draft 4 drew on the definitions proposed by the TCFD Recommendations:<sup>29</sup>

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<sup>23</sup> *ibid* page 15.

<sup>24</sup> *ibid*, pages 15, 33.

<sup>25</sup> *ibid*, page 33 (Glossary).

<sup>26</sup> *Equator Principles 4*, page 33 (Glossary). See also *EPA Response to Feedback During Review of the EPs*, page 32. Consideration of the interplay between the EPs and various modern slavery laws would be worthwhile however this analysis is beyond the scope of our paper.

<sup>27</sup> Where such projects emit 100,000 tonnes of carbon dioxide equivalent annually.

<sup>28</sup> *Draft Equator Principles 4*, page 11.

<sup>29</sup> For a further breakdown of these risks, see *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures*, pages 5-6.



- **“Physical risks”** are those risks resulting from climate change which are either (a) acute event-driven risks such as increased severity of extreme weather events including cyclones, hurricanes or floods or (b) chronic longer-term shifts in climate patterns which may cause rising sea levels or chronic heat waves.<sup>30</sup>
- **“Transition risks”** are those legal and policy risks arising from the adjustment to a lower-carbon economy. These include policy constraints on emissions, carbon tax impositions by a host country, water or land use restrictions or incentives, shifts in demand and supply due to technology and market changes and reputational risks reflecting customer or community perceptions of the organisation's impact on the transition to a low carbon and climate-resilient economy.<sup>31</sup>

These changes were adopted in the final text of EP4. As climate change litigation and activism continues to gain traction, the legal and reputational risks of a project could be significant, particularly in the fossil fuel industries. This means that financial institutions will need to develop robust internal procedures for measuring and determining these risks.

#### *IV. Do the changes address civil society's criticisms?*

Between the release of Draft 4 in June 2019 and the issue of EP4 in mid-November 2019, a number of NGOs commented on the effectiveness of the changes in transforming the EPs into “strong scaffolding” which can be relied upon by both communities and financiers to ensure that client sponsors adhere to their ESG responsibilities.<sup>32</sup> The dialogue between the Equator Banks and civil society was unprecedented and centred on a number of key issues. These concerns were noted by the EPA in the response paper accompanying the final text of EP4. However, several significant points have been left unaddressed, particularly those relating to stakeholder engagement.

##### *1. Indigenous consultation: “Free, Prior, Informed Consent”*

Strengthening Indigenous rights under the EPs, particularly in relation to Principle 5 “Stakeholder Engagement”, was arguably the central issue of this review period. Several NGOs voiced concerns with the EPA's approach to Indigenous consultation set out above. In a significant move, FPW issued its own [redline](#) of Draft 4 and an accompanying explanatory memorandum.

The major objection to Draft 4 was proposed Option 1 for stakeholder engagement, which only required EPFIs to ensure that clients demonstrate “good faith efforts to engage in meaningful consultation” to obtain the FPIC of affected Indigenous communities.<sup>33</sup> NGOs argued that FPIC is a right, not a process and therefore, good faith efforts alone are unacceptable. It was also suggested that “for FPIC... to function effectively, there must be an option to withhold consent”.<sup>34</sup> To sharpen the lens of EP4 in relation to this point, FPW proposed that the Preamble and Principle 5 of Draft 4 explicitly refer to the UNDRIP which formally establishes FPIC as a right.<sup>35</sup>

<sup>30</sup> [Draft Equator Principles 4](#), page 25 (Glossary).

<sup>31</sup> *Ibid*, pages 25-26 (Glossary).

<sup>32</sup> [First Peoples Worldwide Outcome Document on EP4](#), page 12.

<sup>33</sup> [Draft Equator Principles 4](#), pages 13-14.

<sup>34</sup> See, for example, on the nature of consent in Australian native title law: Southalan, J., & Fardin, G. (2018). [Free, prior and informed consent: how and from whom? An Australian analogue](#), *Journal of Energy & Natural Resources Law*, page 24.

<sup>35</sup> [First Peoples Worldwide Draft EP4 Redline](#), pages 4, 15. Following the second round of consultation, BSR recommended that EP4 not reflect this comment EP4 on the basis that the emphasis of the UNDRIP is on state responsibilities, not private sector actors. [Equator Principles 4: Stakeholder Consultation Summary and Recommendations](#), page 18.

The final text of Principle 5 requires stakeholder consultation to be benchmarked against [IFC Performance Standard 7](#) (“IFC PS 7) which emphasises “[i]nformed consultation and participation... throughout the project process [as] a core requirement” which “may include FPIC under certain circumstances”.<sup>36</sup> Under EP4, where good faith negotiations that meet IFC PS 7’s requirements have been documented but it is unclear if FPIC has been achieved, an EPFI must determine with advice from an external consultant whether this qualifies as a “justified deviation” from the requirements of IFC PS 7 and whether “additional corrective actions” are required by the sponsor.<sup>37</sup> EP4 does not incorporate explicit reference to the UNDRIP, other than in the definition of Indigenous Peoples.<sup>38</sup>

This position is likely to generate considerable debate among interested stakeholders. The consultation mechanism set out in Principle 5 of EP4 arguably more closely resembles a modification of Option 1 which was strongly objected to. One of FPW’s key criticisms during the review period was that the revisions already relied too heavily on IFC PS 7 which it considers outdated in relation to best practice on Indigenous consultation. On this point, FPW suggested that the IFC Performance Standards place insufficient emphasis on early stakeholder engagement to properly understand the social risks of a project at the project design phase, well before financing and construction proceeds.<sup>39</sup> Since the release of EP4, FPW has criticised the EPA’s decision to benchmark the IFC Performance Standard instead of developing their own as signalling “deference to institutional laggards rather than a desire to create a gold standard”.<sup>40</sup>

Another major criticism of Draft 4’s approach to Indigenous consultation was the definition of FPIC proposed by the EPA which states that FPIC is not universally defined. This assertion was disputed by Indigenous rights groups including FPW who argue that there is international consensus on FPIC in a number of instruments including the UNDRIP.<sup>41</sup> Furthermore, the formulation proposed by the EPA stated that FPIC does not “confer veto rights on individuals or sub-groups”.<sup>42</sup> Although this is aligned with the broad definition set out in various human rights instruments, this reflects a wider ongoing debate over the demarcation between “veto” and “consent”. The EPA adopted the text of Draft 4 in relation to this point without amendment.

Finally, FPW’s redline had called for a significant change to the scope of an EPFI’s responsibility in relation to host government engagement. Under Draft 4, it was proposed that if a host government is responsible for stakeholder engagement, an EPFI is entitled to expect client collaboration with the government agency to achieve Principle 5’s objectives. FPW argued for stronger language requiring an EPFI to determine via their due diligence whether a host government is “properly engaging” with affected Indigenous Peoples and, if not, to ensure that their client obtains FPIC themselves.<sup>43</sup> FPW described this as a “double layer of accountability” to insure against a host country “misrepresenting their solicitation of FPIC”.<sup>44</sup> They cited the history of land concessions granted by host states in breach of the rights of Indigenous Peoples as the basis for this concern. For example, they referred to an approval granted by the state of Hawaii in respect of a recent observatory project with the potential of future financial losses due to a growing opposition movement.<sup>45</sup> This concern was not addressed in the final text.<sup>46</sup>

<sup>36</sup> [IFC Performance Standard 7 summary](#). See also the full text of [IFC Performance Standard 7: Indigenous Peoples](#).

<sup>37</sup> [Equator Principles 4](#), page 12-13.

<sup>38</sup> [Equator Principles 4](#), page 29 (Glossary). FPW addressed this point, along with other strong objections, in their initial response following the release of EP4. [First Peoples’ Response to EP4: Critically Weak Equator Principles Put Global Development Ahead of Human Rights and Environment](#), 19 November 2019.

<sup>39</sup> [First Peoples Worldwide Outcome Document on Draft Text of the Equator Principles 4](#), pages 13-14.

<sup>40</sup> [First Peoples’ Response to EP4: Critically Weak Equator Principles Put Global Development Ahead of Human Rights and Environment](#), 19 November 2019.

<sup>41</sup> [First Peoples Worldwide Memorandum re: Proposed Redline Revisions to EP4](#), page 7.

<sup>42</sup> [Draft Equator Principles 4](#), pages 14-15.

<sup>43</sup> [First Peoples Worldwide Draft EP4 Redline](#), page 15.

<sup>44</sup> [First Peoples Worldwide Memorandum re: Proposed Redline Revisions to EP4](#), page 5.

<sup>45</sup> [First Peoples Worldwide Outcome Document on Draft Text of the Equator Principles 4](#), pages 3, 12. See also “[A New Hawaiian Renaissance](#)”: how a telescope protest became a movement, 17 August 2019.

<sup>46</sup> Although note that EP4 does elevate government collaboration from an EPFI expectation to a client requirement. [Equator Principles 4](#), page 12.

Noting the above, the approach adopted in EP4 to Indigenous consultation is likely to attract further criticism and may lead some civil society stakeholders to question the effectiveness of the EPs in ensuring that the interests of Indigenous Peoples are adequately represented and advanced.<sup>47</sup>

## 2. *Accountability mechanism: access to remedy*

In August, following publication of Draft IV, a group of NGOs issued a [joint submission](#) calling for an accountability mechanism to ensure that effective remedy avenues are available to project-affected groups and individuals. Many NGOs had encouraged the EPA to implement a multi-stakeholder mechanism in this iteration of the EPs. This was also a recommendation made by the 10 Equator Banks in their letter to the Chair in 2017.<sup>48</sup> The grievance mechanism obligation in the EPs has historically been client-driven and situated at the project level. For this reason, it has been criticised for lacking independence and providing EPFIs too little control over the process. The NGO's submission suggested that an initiative-level mechanism would also uniquely allow the EPA to identify systemic policy gaps and gain insights about ESG compliance.<sup>49</sup>

The joint submission called for a formal process to be launched at the time that EP4 is adopted, to be concluded within 2 years. They suggested a panel of independent experts at the level of individual EPFIs or the EPs initiative itself.<sup>50</sup> The final text of EP4 does not establish any further avenues to remedy although it does broaden the grievance mechanism obligations of clients in Principle 6 to include "Affected Communities and Workers, as appropriate".<sup>51</sup> In addition, the EPA has established an Operations Working Group to consider how to integrate feedback on the need for an "EPA platform through which... EPFIs can receive and respond to grievances" into EPA governance.<sup>52</sup>

"Access to remedy" is a significant issue outside of the EPs and one that is rapidly gaining traction. The submission and its proposals are aligned with a broader movement for robust remedy mechanisms which meet the requirements of Pillar III of the UNGPs. UNGP 30 requires "industry, multi-stakeholder and other collaborative initiatives that are based on respect for human rights-related standards [that] ensure that effective grievance mechanisms are available".<sup>53</sup> The OHCHR's [Accountability and Remedy Project](#) is currently in its third phase and aimed at providing recommendations to improve the state- and non-state- based remedies available for human rights abuses linked to business activities. In parallel, the [Business and Human Rights Arbitration Working Group](#) is in continuing discussions on the creation of an international arbitration mechanism for business and human rights disputes. Financial institutions should continue to track these initiatives as momentum grows.

## 3. *Designated Countries List*

Another major ongoing criticism of the EPs is the distinction made between Designated and Non-Designated Countries. During the EP4 review process, many civil actors including FPW and the Investor Alliance for Human Rights called for the distinction to be removed. It was argued that as a "global framework", the same benchmarks should apply regardless of where a project is based.<sup>54</sup> The assumption that high-income OECD host countries

<sup>47</sup> For example, FPW has already issued a response which describes EP4's "weak and noncommittal language [as render[ing] it instantly obsolete". [First Peoples' Response to EP4: Critically Weak Equator Principles Put Global Development Ahead of Human Rights and Environment](#), 19 November 2019.

<sup>48</sup> The letter broadly called for a mechanism which would "facilitate... resolution of issues... that may lead to significant damage to the environment or communities". [Open letter to the Chair of the Equator Principles Association](#), 22 May 2017.

<sup>49</sup> [Joint submission to the Equator Principles Association: Towards an accountability mechanism for the Equator Principles](#), page 2.

<sup>50</sup> *Ibid*, page 3.

<sup>51</sup> [Draft Equator Principles 4](#), page 13.

<sup>52</sup> [EPA Response to Feedback During Review of the EPs](#), pages 10, 33.

<sup>53</sup> [UN Guiding Principles on Business and Human Rights](#), page 32.

<sup>54</sup> [Investor Submission to the Equator Principles Association: Ensuring Alignment of Draft EP4 with the UNGPs](#), page 2; [First Peoples Worldwide Memorandum re: Proposed Redline Revisions to EP4](#), page 2.

require lesser standards due to their strong domestic environmental and social protections has been criticised as a “flawed premise”.<sup>55</sup> The misperception has been said to be particularly borne out in the context of projects which affect Indigenous communities such as the Dakota Access Pipeline. For example, high-income OECD countries Australia and New Zealand were some of the last states to endorse UNDRIP.<sup>56</sup> During the review, FPW argued that a global framework would ensure the rights of Indigenous Peoples are consistently and adequately protected. Some financiers may already apply the EPs indiscriminately according to internal policy. A hard obligation, however, would ensure that the EP standards are applied as a minimum to every applicable project before ensuring compliance with local laws as well.

The approach has not changed substantively with the latest iteration of the EPs. In its response to this feedback, the EPA noted the debate around Designated Countries but concluded that a wholesale deletion of the distinction was not “appropriate at this stage” and that concerns were better addressed through the development of guidance documentation.<sup>57</sup> EP4 now requires clients in Designated Countries to apply IFC Performance Standards, however this is discretionary and only applicable in certain circumstances. The EPA has suggested that it will be developing guidance on the due diligence expected of EPFIs operating in Designated Countries.<sup>58</sup> In addition, benchmarking to IFC PS 7 has been introduced in relation to stakeholder consultation. This revision arguably goes some way to addressing the concerns around the “flawed premise” that high-income OECD countries necessarily have robust Indigenous rights protections, since evaluation of the consultation process against IFC PS 7 will now be a requirement for all projects, regardless of location. However, as discussed above, reference to the IFC standard may be considered problematic by some interest groups.

#### 4. Other criticisms to note

During the review process, a number of other criticisms were levelled at Draft 4 by civil society in relation to:

- **Climate Change:** although the EPA’s proposals relating to environmental risk are not the focus of this paper, the UN recently warned of **the interconnection between climate change and human rights**.<sup>59</sup> Discussions around the EPA’s approach to climate therefore deserve some consideration. During the review period, civil society warned that Draft 4 is not forward-thinking enough and would be improved by:
  - Considering broader issues than project and transition risks, such as direct restrictions on projects which relate to the burning of fossil fuels.
  - Requiring that clients and take action based on the findings of any alternatives analysis.<sup>60</sup>
  - Requiring decision-making and not just reporting.
  - Making explicit commitments to align with the Paris Agreement targets, in particular limiting global warming to 1.5 degrees Celsius.<sup>61</sup>

<sup>55</sup> [First Peoples Worldwide Memorandum re: Proposed Redline Revisions to EP4](#), page 1.

<sup>56</sup> [First Peoples Worldwide Outcome Document on Draft Text of the Equator Principles 4](#), page 10.

<sup>57</sup> [EPA Response to Feedback During Review of the EPs](#), pages 1-2.

<sup>58</sup> *Ibid*, page 12.

<sup>59</sup> [Climate crisis is greatest ever threat to human rights, UN warns](#), 9 September 2019.

<sup>60</sup> EP4 adopts the recommendation by BSR following the second round of consultation that EPFIs encourage clients to publish a summary of any alternatives analysis completed as part of the climate change risk assessment. [Equator Principles 4](#), page 20. See also [Equator Principles 4: Stakeholder Consultation Summary and Recommendations](#), page 24.

<sup>61</sup> For more, see [Investor Submission to the Equator Principles Association: Ensuring Alignment of Draft EP4 with the UNGPs](#), page 3; [First Peoples Worldwide Outcome Document on Draft Text of the Equator Principles 4](#), page 15. BSR recommended against *direct* alignment with the Paris Agreement targets to avoid inconsistency across NDC and corporate commitments. [Equator Principles 4: Stakeholder Consultation Summary and Recommendations](#), page 23. EP4 retains Draft 4’s requirement that climate change risk assessment includes consideration of a project’s compatibility with the host country’s climate commitments (as appropriate) however it removes Draft 4’s express reference to NDCs in Exhibit II (an illustrative list of issues to be considered in an assessment). [Equator Principles 4](#), pages 20, 33 (Glossary).

The EPA has largely retained the proposed text of Draft 4 without reflecting these points. Nonetheless, EP4's express alignment with the TCFD recommendations for climate change risk assessment reflects a significant expansion to the EPA's climate ambition since EP3.

- **Better reporting mechanisms:** in late 2018, BankTrack highlighted seven reporting problems which limit the transparency and accountability of the EPs, including the lack of a searchable EPA database of ongoing and past projects which are subject to the EPs and the fact that EPFIs are only required to report certain project names and are limited by confidentiality laws.<sup>62</sup> Although these concerns are not addressed by the final text of EP4, the EPA has suggested that improved transparency and reporting will be a priority area going forward.<sup>63</sup>
- **Scope:** the scope of EP4 was not amended to include project bonds. This was identified during the stakeholder consultation process as a major loophole which allows EPFIs to provide project financing without EP-governed ESG assessment (noting these are also captured under broader initiatives such as the Principles of Responsible Investment). The EPA has advised they will be considering the feasibility of expanding the scope of the EPs (including to non-Project financial products) from 2020.<sup>64</sup> In addition, suggestions to remove the delineation of Category A and Category B Projects and to include all projects regardless of capital costs were noted by the EPA but are not reflected in EP4.<sup>65</sup>

#### V. EP4: next steps and implementation

The effective date for EP4 on all mandated transactions is **1 July 2020**, however an EPFI may apply the updated EPs on a voluntary basis before this effective date.

The EPA has advised that they will be developing further guidance and training for Equator Banks on implementation of the new human rights and climate change due diligence requirements, in addition to the expanded stakeholder consultation obligations.<sup>66</sup>

They have also committed to delivering on the following priority areas for 2020:

- strengthened accountability;
- improved transparency and reporting;
- expanding the scope of the EPs to non-Project financial products (if feasible); and
- grievance handling/access to remedy.<sup>67</sup>

#### VI. What next for human rights and finance?

The DAPL protests drew attention to the responsibility borne by financiers of projects with potential adverse social impacts. In particular, it has allowed for an unprecedented public dialogue between civil society and the major players of the banking sector about their role in respecting and promoting human rights. The strengthened commitment of EP4 in relation to human rights and climate change due diligence is welcome and reflects a broader

<sup>62</sup> [The seven biggest problems with current reporting under the Equator Principles](#), 17 October 2018. The Investor Alliance for Human Rights has also called on the EPA to require EPFIs to use the most robust corporate human rights reporting frameworks such as the UNGP Reporting Framework. [Investor Submission to the Equator Principles Association: Ensuring Alignment of Draft EP4 with the UNGPs](#), page 3.

<sup>63</sup> [EPA Response to Feedback During Review of the EPs](#), pages 2, 14.

<sup>64</sup> *Ibid*, pages 2, 6, 15.

<sup>65</sup> [Investor Submission to the Equator Principles Association: Ensuring Alignment of Draft EP4 with the UNGPs](#), page 2. The EPA determined to maintain financial thresholds for "practicality of application". [EPA Response to Feedback During Review of the EPs](#), page 11.

<sup>66</sup> [EPA Response to Feedback During Review of the EPs](#), pages 8-9.

<sup>67</sup> *Ibid*, page 2.

shift in the financial sector. However, not all of civil society's concerns were reflected in the final text of EP4. NGOs warned during the EP4 review process that a failure to address certain issues would set EP4 up for "operational irrelevance" as a risk management tool.<sup>68</sup> Whether the changes adopted in EP4 will be viewed as sufficient in addressing the gaps articulated by civil society will soon be seen. However EP4 is received, it is clear that more robust internal frameworks are required to assist financiers in "future-proofing" their portfolios against social risk and the consequent financial loss arising from reputational harm and legal liability.

It is unlikely that the EPs will undergo another review process for some time. However, civil society's criticisms on the EPs will continue to reverberate and fuel the debate around the human rights obligations of financial institutions. Their concerns are likely to be picked up in EU and international regulatory reform. Financial institutions should actively monitor these developments – particularly any access to remedy initiatives – to ensure that they have appropriate internal policies and processes in place to address and mitigate against future risks. Active engagement will allow financial institutions to remain on the front foot in the face of certain and imminent increased regulatory burdens and take the lead in fostering further engagement and debate on what is best practice on human rights and finance.

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<sup>68</sup> [First Peoples Worldwide Outcome Document on Draft Text of the Equator Principles 4](#), page 6.

### *About Finance & Human Rights (FaHR)*

Finance & Human Rights (FaHR) is a non-profit organisation created in 2019. It serves as a knowledge hub that brings together strong expertise on business & human rights with extensive experience in the financial sector. With our offered services within Research, Networking and Professional Development, we provide a collaborative platform that promotes future-oriented financial development consistent with human rights. Click here to visit our [website](#).

**This paper was written for FaHR by Astrea Milne with contributions by Cecilia Barral Diego.**

**Astrea Milne** is a banking and finance lawyer with expertise in business & human rights, ESG and the financial sector.

**Cecilia Barral Diego** is the vice-chair of FaHR and consultant and human rights law expert (LL.M) at Löning – Human Rights & Responsible Business. She is specialised in international human rights law and business & human rights.

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*Acronyms and Abbreviations*

|                      |   |
|----------------------|---|
| <b>Civil society</b> | Society considered as a community of citizens linked by common interests and collective activity              |
| <b>DAPL</b>          | Dakota Access Pipeline project  |
| <b>Draft 4</b>       | The June 2019 draft of the fourth iteration of the Equator Principles   |
| <b>EP3</b>           | Equator Principles 3, the previous iteration of the Equator Principles  |
| <b>EP4</b>           | The final text of Equator Principles 4  |
| <b>EPA</b>           | Equator Principles Association  |
| <b>EPFI</b>          | Equator Principle Financial Institution: a defined term under the Equator Principles meaning a signatory bank |
| <b>EPs</b>           | Equator Principles  |
| <b>Equator Banks</b> | The 101 financial institutions which are currently signatories to the Equator Principles                      |
| <b>ESG</b>           | Environmental, social, governance considerations  |
| <b>FPIC</b>          | Free, Prior and Informed Consent  |
| <b>FPW</b>           | First Peoples Worldwide   |
| <b>GHG</b>           | Greenhouse gases  |
| <b>IFC</b>           | International Finance Corporation   |
| <b>OHCHR</b>         | Office of the United Nations High Commissioner for Human Rights   |
| <b>TCFD</b>          | Task Force on Climate-Related Financial Disclosures   |
| <b>UNDRIP</b>        | United Nations Declaration on the Rights of Indigenous Peoples  |
| <b>UNGPs</b>         | United Nations Guiding Principles on Business and Human Rights  |