

Andreas Missbach, Berne Declaration, Switzerland: The Equator Principles; opportunities and shortcomings.

It makes perfect sense that we have a panel on the Equator Principles here at the Public Eye on Davos because in the secret prehistory of the Equator Principles the Public Eye marks an important step. Last year we launched at the Public Eye the Collevocchio Declaration with the endorsement of over 100 civil society groups. The declaration is a tangible symbol of NGOs' increasing scrutiny of the financial sector, a sector which has fallen relatively far behind other corporate sectors in understanding its role and responsibilities in advancing sustainability. We are now beginning to see banks develop initiatives such as the Equator Principles as a response to society's increasing social and environmental expectations of the financial sector, and notably all the banks that drafted the Equator Principles have been the subject of NGO advocacy. With the BankTrack-Network, NGOs will be keeping the pressure on.

In my presentation I will first introduce the Equator Principles. Then I'll briefly lay out its importance and some of its shortcomings. I will conclude my speech with some ideas of how the Equator Principles could be strengthened.

As a reaction to NGO-pressure in June 2003 ten leading banks from seven countries announced the adoption of the Equator Principles, a voluntary set of guidelines developed by the banks for managing social and environmental issues related to the financing of infrastructure projects. By today 19 financial institutions, who together account for over 70 per cent of the global project finance market, have endorsed the principles. The banks have committed themselves to applying the principles globally

and to project financing in all industry sectors, including mining, oil and gas, and forestry.

What are these Principles?

The Equator Principles are based on the policies and guidelines of the World Bank and the International Finance Corporation (IFC), the private sector arm of the World Bank. Within the World Bank Group, the IFC is responsible for investment in companies and company-sponsored projects. The banks that have signed on will apply the Equator Principles to all loans for projects with a capital cost of USD 50 million or more. The Equator Principles will use a screening process for projects which is based on the IFC's environmental and social screening processes. Projects will be categorized by the banks as A, B or C for high, medium or low environmental or social risk. For high and medium risk projects, the borrower will have to complete an Environmental Assessment addressing the environmental and social issues identified in the categorization process of the banks.

After appropriate consultation with affected local populations, Category A projects, and Category B projects where appropriate, will prepare Environmental Management Plans which address mitigation and monitoring of environmental and social risks.

The fact alone that the banks recognize that they – I quote from the preamble of the Equator Principles - «as project financiers often encounter environmental and social policy issues» is a major step. Until very recently, banks simply didn't want to accept that they have a broader responsibility than just financial ties with the projects they finance. Because the Equator Principle banks have promised that they will take some

responsibility for the environmental and social impact of the projects they finance, we expect a break from the «take the money and run» attitude of the past.

This is a significant start. But, let me now mention some of the limitations and critical points of the Equator Principles.

First: When judging this initiative it is very important to see that it is limited to project finance in a very strictly defined sense. This means that the Principles apply to only a very small fraction of the banks total activities. Many other transactions also have environmental and social impacts but they do not fall under the Equator Principles.

For example, the bulk of bank support for forestry projects does not come from project finance and therefore much of the destruction occurring to the world's forests will in no way be abated by the Principles as they stand. The Principles only apply to direct lending in project finance transactions, and there is no indication in the Principles to suggest a broader future commitment to develop policies governing other financial vehicles. The February 2003 version of the Equator Principles covered a broader range of financing, but by May 2003 the Equator Principles became limited only to «direct lending». This was a step backwards, and we are disappointed that the Principles were weakened by not being applied to project finance deals where a bank may be a financial advisor, underwriter, arranger or lead manager, that is, when the bank is also involved in important ways.

We feel that a logical and necessary precursor to any potential initiative to advance sustainability was left out. Namely, the banking sector should have undertaken to conduct an assessment of the facts and figures regarding the environmental and social impacts of all kinds of financial transactions that they are involved in.

Second: Another danger lies in the fact that the Equator Principles are based exclusively on the safeguard policies of the International Finance Corporation (IFC). The IFC sector standards in some cases do not represent best practice and even with 30 environmental staff the IFC has a poor track record of implementing its own safeguard policies. A review by the Compliance Advisor and Ombudsman of the IFC concluded recently that environmental assessment quality control at IFC needs to be tightened. It noted that the social component of the Assessment needs to be strengthened to provide a comprehensive approach to social issues missing in the present safeguard policies.

NGOs fear that the Equator Principles will be even weaker on social issues. The January 2003 version of the Equator Principles included reference to «human rights», but it was substituted with the term «socially responsible» in subsequent versions. This term has a very unclear meaning whereas human rights are clearly agreed upon by the UN.

Regarding the track record of the IFC in implementing its own safeguard policies, Equator banks should not rely on the IFC decision in judging a project, as they have done in the case of the Baku-Tibilissi-Ceyhan pipeline. If banks blindly follow the IFC they run into reputational and financial risks because the IFC's decisions are not objective but are politically biased. As a part of the World Bank Group, the IFC is under pressure from the World Bank's largest shareholder, the United States. As we have seen in the past, the interests of the US Government can heavily distort the application of the environmental and social safeguard policies.

Thirdly: There are areas where the Equator Principles should have been more closely modelled on the policies of the IFC, especially in information disclosure and stakeholder consultation. But even with the Equator Principles as they stand, banks could develop them further. BankTrack has made a proposal of what a good faith implementation would look like. I will give you some concrete points taken from this analysis, you can find the complete document on the web and it is also in the media package.

Information disclosure and external reporting are essential to the implementation of the Equator Principles. When dealing with the World Bank, information disclosure has been one of the most important topics NGOs have raised and they have been successful in making the World Bank more transparent. Equator banks should make an assumption in favour of disclosure and publicly disclose information on transactions when requested. They should require borrowers to release Environmental Assessments before project appraisal and engage with affected communities and public interest organisations regarding projects of concern.

Certainly, information disclosure can help to secure accountability, but it is not enough.

The Equator Principles have no formal mechanism for ensuring accountability. Equator Banks have suggested that they will police themselves. This is a wholly inadequate system of accountability. Banks must be accountable not only to themselves, but also to the public and those communities that are affected by their transactions.

Instead of voluntary compliance mechanisms, we urge Equator Banks to create a joint 'independent accountability mechanism' for ensuring the implementation and

continuous improvement of the Equator Principles. The experience of the various existing accountability mechanisms of the World Bank Group, the Asian Development Bank and several Export Credit Agencies can provide important guidance for the development of such a mechanism. Among other tasks, the independent accountability mechanism should help create processes between Equator Banks and directly affected communities on projects that have received community petitions. The mechanism could also identify «lessons learned» and make recommendations on systemic issues that have contributed to the problems of the affected communities.

One of the most powerful ways banks can ensure that borrowers meet environmental and social standards is through the effective use of loan covenants. Loan covenants are the contract between the bank and the borrower, they usually cover the financial side of the loan, such as the interest rate and duration, but they can include other things as well.

Environmental and social loan covenants should include project specific covenants. These must not be formulated simply in general terms. The World Bank experience shows that covenants must be very detailed and specify very clearly and concisely the steps required to obtain compliance. Whenever possible, an implementation program for specific covenants should be attached to the legal agreement. Such programs specify the steps to be taken in executing the project, those responsible for the action, and the timing or phasing of steps.

Equator banks have the duty, under Principle 8 of the Equator Principles to which they have agreed, to help borrowers to find solutions to come back into compliance with the terms of the environmental and social loan covenants. They must develop adequate mechanisms and in-house capabilities to be able to do so. In cases of

massive breach of the Environmental Management Plan or host country laws and regulations, or in cases of any substantive claim by affected or local people of socially unacceptable misbehaviour, loans should be cancelled.

Finally the Equator banks should change the incentives in their project finance departments. Today project finance is – as investment banking in general – essentially bonus driven. That means that the salary of staff is almost negligible compared with the bonuses they receive when they successfully conclude a deal. The bonus system promotes greed. Greed is what lies at the heart of all the corporate scandals of these days. Bonuses act as an inbuilt antidote to a serious check of projects on environmental and social grounds. If a project was rejected because of a bad environmental or social performance this means there will be no bonuses for the staff involved. You can image how committed bank staff would have to be to reject projects if the bonus system remains unchanged.

Let me conclude. NGOs have tentatively welcomed the Equator Principles. Whether or not the Equator Principles represent a major step forward or a negligible one will be demonstrated through the level of commitment banks display towards the transparency and implementation of the Principles. Ultimately, financial institutions will be judged by the real world impacts of the projects they support, not the loftiness of the principles they articulate.