The Equator Principles;drawing the line for socially responsible banks?
An interim review from an NGO perspective

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Berne Declaration is a Swiss public-interest organisation with 18000 individual members. Through research, public education and advocacy work, it has promoted more equitable, sustainable and democratic North-South relations since 1968. Among other efforts Berne Declarations works on topics like trade, patents, biopiracy, labour standards, multilateral financial institutions and private finance.

Abstract
In June 2003 leading investment banks 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. In this paper the Equator Principles are discussed confronting them with a broader NGO-Vision on sustainable finance (the Collevecchio Declaration). It is shown that there are ways of implementing the Principles in a way that they really make a difference.

Keywords
Project finance, equator principles, safeguard measures, collevecchio declaration

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Introduction: The role of banks in project finance

In the nineties there was not only a dramatic change in the composition of North-South financial flows – private commercial flow outstripped governmental and multilateral development finance – but also a change in the way, large infrastructure projects in the global south where financed. Private Financial Institutions entered into areas as large dams, oil pipelines and large infrastructure project, which previously where financed by the World Bank and other multilateral development banks. The projcect finance departments of the large US investment banks and the European Banks that copied there busines model (like Credit Suisse First Boston, West LB and others) developed new ways of financing those investments.
For NGOs one of the most serious aspect of this change, where those cases where the private banks stepped in after World Bank decided not to finance a project because of environmental and social concerns. The OCP- Pipeline in Ecuador, the three gorges dam in China (which was financed through bonds of a chinese government agency) and the Ilisu dam in Turkey (where UBS had a mandate as arranger until they stepped back and the project was shelfed) where examples of the private banks replacing multilateral financial institutions.
The most common situation in financing large infrastructure today is a presence of all three key actors: Multilateral Development Banks (esp. IFC, the private sector arm of the World Bank), Export Credit Agencys and private banks.
The financial sector in general has fallen relatively far behind other corporate sectors in understanding its role and responsibilities in advancing sutstainability. In June 2003 ten leading banks from seven countries announced the adoption of the «Equator Principles»[2], a voluntary set of guidelines developed by the banks for managing social and environmental issues related to the financing of infrastructure

[1] The Swiss development NGO Berne Declaration is one of the founding member of the BankTrack network (see below).
[2] In a draft version the Priciples where labelled «Greenwhich Principles», the name was changed, when the banks realised that it could easily changed into «Greenwash Principles».

projects. The Principles where a response to society's increasing social and environmental expectations of the financial sector. Notably all the banks that drafted the Equator Principles have been the subject of NGO advocacy reacting on bad projects
In this paper the Equator Principles are discussed confronting them with a broader NGO-Vision on sustainable finance (the Collevecchio Declaration). In the concluding section we make some proposal for implementing the Principles in a way that they really make a difference.

The Equator Principles; the initiative of the banks

By today 21 financial institutions, who together account for over 70 per cent of the global project finance market, have endorsed the Equator Principles[3]. 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.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.

[3] Banks Which Have Adopted the Equator Principles: ABN AMRO Bank, N.V.,Bank of America, Barclays plc, CIBC, Citigroup Inc., Credit Lyonnais, Credit Suisse Group, Dexia Group, Dresdner Bank, HSBC Group, HVB Group, ING Group, KBC, MCC, Mizuho Corporate Bank, Rabobank Group, Royal Bank of Canada, Standard Chartered Bank, The Royal Bank of ScotlandWestLB AG, Westpac Banking Corporation.

The fact alone that the banks recognize that they «as project financiers often encounter environmental and social policy issues» is a major step (Preamble of the Equator Principles, http://www.equator-principles.com/principles.shtml). 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, NGOs see the chance of a break from the «take the money and run» attitude of the past.

Weaknesses and limitations

The Equator Principles are a significant start. But they have serious limitations.

1. Limited scope

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 NGOs 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.

NGOs feel that a logical and necessary precursor to any potential initiative to advance sustainability for the financial sector 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.

2. Reliance on the IFC

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.[4]

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 (see below). 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.

3. Lack of transparency

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. 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. Certainly, information disclosure can help to secure accountability, but it is not enough. The Equator Principles have no formal mechanism for ensuring

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[4] Compliance Advisor Ombudsman, A Review of IFC’s Safeguard Policies, Core Business: Achieving Consistent and Excellent Environmental and Social Outcomes, January 2003.

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.

4. Bad start

Soon after the presentation of the Equator Principles it became evident, that the adoption of the Equator Principles have not stopped banks from going ahead and agreeing to finance highly damaging projects, such as the Baku Ceyhan oil pipeline, which when completed will run from Azerbaijan to Turkey via Georgia and has been the subject of numerous criticisms from the peoples in the region and environmental and human rights NGOs.[5]

Furthermore some of the Equator Banks acted as a lobby group against the findings of the Extractive Industries Review at the World Bank. On april 14th 2004, World Bank president Wolfensohn received a letter, signed by eleven Equator Banks, urging him to reject most of the recommendations in the end report of the Extractive Industries Review - an independent study of oil, mining and gas projects financed by the World Bank.

The EIR found that the World Bank's policies in the oil, mining and gas sectors are currently seriously deficient. Few, if any, projects succeed in meeting the Bank's stated poverty alleviation objectives and most exacerbate the so-called «resource curse» - the tendency of states reliant on oil revenues to become more corrupt, more impoverished and less democratic. The review recommends that the Bank should not fund future projects in the sector unless a number of preconditions - including good governance and the free, prior informed consent of affected communities - have been met.

The letter, leaked earlier to BankTrack, urges the World Bank not to phase out its support for coal extraction immediately and oil extraction by 2008, as recommended by the EIR report. EP banks also speak out against adopting the principle of 'prior informed consent', giving potentially affected communities a decisive say in project design. Interestingly, not all Equator banks signed on to the letter, which was meant to be a unified message of support from the EP banks to Amongst the banks who did sign were Citigroup, Credit Suisse and ABN AMRO.

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[5] For a detailed NGO-analysis how this project violats the Equator Principles see http://www.baku.org.uk/publications/Equator_Principles.pdf

NGOs were shocked and angered that signatories to the Equator Principles, which are themselves based on the social and environmental principles of the World Bank; seek to undermine the recommendations of the EIR.[6]

The Collevecchio Declaration: A civil society roadmap to sustainability for the financial sector[7]

While environmentalists and activists concerned about corporate globalization commonly speak of the World Bank, International Monetary Fund, World Trade Organization and multinational corporations, relatively little attention and critique has been leveled at the financial sector – big banks and investors in the City, on Wall Street.

But in 2002, a group of NGOs that work on finance and sustainability met in Collevecchio, Italy to draft a statement outlining civil society's perspectives of the role and responsibilities Financial Institutions (FIs) have in fostering sustainability.[8] In January 2003, the Collevecchio Declaration on Financial Institutions and Sustainability (the "Declaration") was released in Davos, Switzerland concurrent with the World Economic Forum. At the time of its release, the Declaration was endorsed by over 100 civil society groups.
Although it is not meant to be endorsed by financial institutions themselves, it is a call to action that focuses on what individual they should do to change their own core business and to create new financial rules, systems and practices that enable the financial sector to better advance sustainability. The following section is paraphrased from the Collevecchio Declaration and its implementation document (http://www.banktrack.org/index.php?id=53).

Principle 1: Commitment to Sustainability

> *FIs must expand their missions from ones that prioritize profit maximization to a vision of social and environmental sustainability. A commitment to sustainability*

[6] IFC's safeguard policies are currently under revision. NGOs fear negative lobbying of the equator banks in this process as well.
[7] I thank Michelle Chan-Fishel of Friends of the Earth US for help with this Chapter.
[8] Since then the group has strengthened its cooperation. Since the beginning of 2004 the network is active under the name of BankTrack, www.banktrack.org.

would require FIs to fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting, advising), to put sustainability objectives on an equal footing to shareholder maximization and client satisfaction, and to actively strive to finance transactions that promote sustainability.

Banks and other financial institutions usually measure their sustainability in terms of internal operations, such as paper and energy use. Civil society groups believe that FIs should measure the environmental and social impacts of their portfolios. They should commit to continuously improving the environmental, social and economic impact of their transactions by creating objectives, strategies, timetables and performance indicators that increase the sustainability profiles of their portfolios.
In addition, the NGOs called on FIs to actively seek to shift their businesses to proactively sustainable practices which improve environmental and social conditions, and use their influence to ensure that companies and projects in which they invest or support act in line with best practice.

Principle 2: Commitment to 'Do No Harm'

FIs should commit to do no harm by preventing and minimizing the environmentally and/or socially detrimental impacts of their portfolios and their operations. FIs should create policies, procedures and standards based on the Precautionary Principle to minimize environmental and social harm, improve social and environmental conditions where they and their clients operate, and avoid involvement in transactions that undermine sustainability.

The Equator Principles for project finance fail to recognize the precautionary principle. The Collevecchio Declaration explicitly calls for transactions-based procedures that screen and categorize potential deals on the basis of environmental and social sensitivity. Its implementation document further urges FIs to perform appropriate levels of due diligence, stakeholder consultation, and assessment. However, the Equator Principles and many other bank standards do not embrace the idea of categorical prohibitions – the concept that some transactions or their characteristics are be so environmentally and socially harmful that the FI should

categorically decline involvement in them. Similarly, very few FIs have developed sector-based or area-based (i.e. based on ecologically important regions, indigenous territories, etc.) standards that meet international best practice.[9]

Principle 3: Commitment to Responsibility.

> *FIs should bear full responsibility for the environmental and social impacts of their transactions. FIs must also pay their full and fair share of the risks they accept and create. This includes financial risks, as well as social and environmental costs that are borne by communities.*

The FIs that consider the environmental or social impacts of their portfolios or their clients rarely take responsibility for addressing environmental, social or economic harm. The Collevecchio Declaration calls on FIs to pay for their full and fair share of risks that they accept and create. This means FIs should not help engineer country bail-out packages that aggravate the debt burden of developing countries, nor should they lobby against debt relief. The Declaration's implementation document also states that FIs should bear full responsibility for the environmental and social costs that are created by their transactions and borne by communities. This includes using their influence and resources to address the needs of communities whose livelihoods and ways of life are compromised by the adverse environmental or social impacts of their transactions.

Principle 4: Commitment to Accountability

> *FIs must be accountable to their stakeholders, particularly those that are affected by the companies and activities they finance. Accountability means that stakeholders must have an influential voice in financial decisions that affect the quality of their environments and their lives -- both through ensuring that stakeholders rights are protected by law, and through practices and procedures adopted by FIs themselves.*

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[9] After an intensive campaign by RAN (Rainforest Action Network) Citigroup developed internal policies which include sectoral standards and cathecorical exclusions «no-go zones».
http://www.ran.org/ran_campaigns/global_finance/citi_victory_policy.html

For financial institutions, accountability is a vague concept, often associated with disclosure and stakeholder consultation. Although civil society certainly expects FIs to be transparent (Principle 5), NGOs view accountability in terms of power relationships between FIs and other stakeholders. For example, the Declaration's implementation statement calls for stakeholder consulation not just in terms of creating sustainability policies, objectives, procedures, and standards, but also in terms of an FI's transactions. Notably, it is explicitly states that FIs should recognize the right of affected communitites to "say no" to a transaction.

Principle 5: Commitment to Transparency

> *FIs must be transparent to stakeholders, not only through robust, regular and standardized disclosure, but also by being responsive to stakeholder needs for specialized information on FIs' policies, procedures and transactions. Commercial confidentiality should not be used as an excuse deny stakeholders information.*

Banks often think of transparency in terms of publishing annual environmental/social reports. NGOs agree that FIs should publish annual sustainabilty reports according to an internationally recognized reporting format supported by civil society. But NGOs often demand more information on FIs' core business activities by sector and region, so that the public can monitor an FI's environmental and social impact. Civil society groups also expect FIs to take a more genuine attitude towards transparency by making assumptions in favor of disclosure when stakeholder request information, and not hiding behind the excuse of business confidentiality.

Principle 6: Commitment to Sustainable Markets and Governance

> *FIs should ensure that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms which facilitate sustainability and that foster the full cost accounting of social and environmental externalities.*

Financial institutions generally do not consider themselves as having a role in “fixing the rules” of the financial markets to advance sustainability. In an era of deregulation, the role and power of the state is shrinking compared with the private sector. In this sense, the World Summit on Sustainable Development in Johannesburg was a deep failure because governments essentially abdicated their role in setting international policies to promote sustainability, and left sustainability almost solely in the hands of the market and corporate volunteerism.
The Collevecchio Declaration calls on FIs to not only recognise but also to support governments in setting public policy, regulatory or market mechanisms that foster the internalisation of social and environmental externalities, and in safeguarding the environment and human rights. It also calls on Financial Institutions to take an active and construtive role in dealing with issues such as tax havens, currency speculation, and short-term financial time horizons and that discourage companies from making long-term decisions that are inherrently neccessary to promote sustainability.

Conclusion: Implementation matters

Focussing on the weak points of the Equator Principles and the difference between them and the broader vision of the Collevecchio Declaration, the question arises why the NGOs in the BankTrack network welcomed the adoption of the principles. There is a general mistrust among NGOs against voluntary industry initiatives like the Global Compact. NGOs fear Green- and «Bluewash»[10] and most of them prefer legally binding rules for corporations, be it at the national or the UN level.
But confronted with bank sponsored projects that have devastating impacts on the environment and local populations NGOs cannot wait for government regulations. Furthermore the experience in environmental policy shows that government regulation is more likely if the corporate sector has made some initial steps.
The Equator Principles are not as weak as the Global Compact. The IFC Guidelines, which they rely upon are a detailed set of prescriptions, which – if adequately implemented – really make a difference. There is space for a «good faith

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10 Efforts by corporations to be perceived as part of the world humanitarian community through voluntary association with the United Nations, without provisions for accountability.

implementation» of the Equator Principles. BankTrack has made detailed proposals, what equator banks could do, some of which follow below. [11]

First steps in serious implementation

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.
Instead of voluntary compliance mechanisms, BankTrack urges 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

11 For the complete position paper, see: http://www.banktrack.org/fileadmin/user_upload/documents/0_BT_own_publications/No_U_turn_allowed.pdf

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. It isn't hard to imagine how committed bank staff would have to be to reject projects if the bonus system remained unchanged.

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.