

Client Alert

New Equator Principles – Four Takeaways from Draft EP4

July 17, 2019

Rooted in the reality that energy and industrial projects and infrastructure can have immense environmental and social impacts, the Equator Principles (“EP”) is a risk management framework used by financial institutions to determine, assess and manage environmental and social risks in projects. It is a voluntary undertaking that is currently adopted by 96 financial institutions (“EPFIs”) and administered by the Equator Principles Association (“EPA”). The EP is composed of ten principles that provide a baseline for determining, assessing and managing environmental and social risk in projects, which EPFIs individually adopt as internal policy and enforce through financial documentation.

The EPA released a draft of the fourth version of the EP (“EP4”) for review in June, which can be found [here](#), with a final text of EP4 anticipated in late 2019. The current version, EP3, was adopted in June 2013.

A. An Introduction to EP4

The draft EP4 proposes four key changes:

1. A broadened scope of projects to be subject to the EP;
2. Revised standards for projects that are located in “Designated Countries”¹;
3. Additional human rights requirements; and
4. Requirements related to climate change.

1. US\$50 Million Corporate Loans, Refinancing and Acquisition Financing. As revised, the EP would apply to a large number of transactions. The draft EP4 would expand the scope of EP-application in two ways:

- a. *Project-related corporate loans.* The threshold loan amount is lowered from US\$100 million to US\$50 million; and
- b. *Project-related refinancings and project-related acquisition financings.* Although previously outside the scope of applicability, the EP would now apply when the underlying project was financed according to the EP; has yet to be finished, and has not undergone any material change (in scale or scope).

In addition, the draft EP4 affords EPFIs greater latitude to retroactively apply the EP by removing the requirement that changes in scale or scope create “significant” environmental and social risks and impacts, or significantly change the nature or degree of an existing impact.

2. “Designated Countries” standards. EP3 enables projects located in Designated Countries to satisfy certain EP requirements through compliance with the host country’s environmental and social laws. The draft EP4 eliminates the historic assumption that a host country’s environmental and social laws meet the standards under the EP, and, instead, stipulates that EPFIs will evaluate the “specific risks of the [p]roject”. While the draft EP4 does not enumerate its referenced project-specific risks, it does footnote that EPFIs would engage Independent Environmental and Social Consultants, as applicable. Based on their and their consultants’ evaluation of project-specific risks, the EPFI would determine whether one or more of the IFC

¹ The EP defines “Designated Countries” as countries deemed to have robust environmental and social governance certain different principles, each of which is listed on the EPA’s website, found [here](#).

Performance Standards² could be applied to address the project's risks, in addition to host country laws. Under EP3, compliance with host country laws may have been sufficient.

3. Human Rights. Additional language in the draft EP4 seeks to better align the EP with the U.N. Guiding Principles on Business and Human Rights and otherwise increase EP applicability to human rights from the standards in EP3. Under the draft EP4, EPFIs would assess the potential adverse human rights impact as part of environmental and social impact assessment and documentation. In addition, two options are introduced relating to Free, Prior and Informed Consent (“FPIC”) of indigenous people, each of which incorporates IFC Performance Standards 7³. In each option, all projects must also comply with the rights and protections for indigenous people contained in relevant national law, including those laws implementing host country obligations under international law.

4. Climate Change. The draft EP4 requires EPFIs to assess climate change as part of their environmental and social impact assessment and also consider the project's compatibility with the host country's national climate commitments. The draft EP4 specifically recognizes the EPFIs and their role with respect to the 2015 Paris Agreement, as well as the recommendations set forth by the Task Force on Climate-related Financial Disclosures published on June 15, 2017.

B. EP4: Next Steps

In anticipation of the final text late this year, the EPA is currently seeking feedback and comments on EP4 from external stakeholders through its online portal, which can be found [here](#), now through mid-August. BSR, a global nonprofit organization, will be organizing the consultation process, which will be comprised of face-to-face meetings, as well as webinars. A final version of EP4 is anticipated later this year.

As was the case when the EP3 launched in 2013, we expect there to be a transition period during which EP4's revisions are implemented. Milbank will continue to deliver information as EP4 evolves, including a more fulsome analysis upon release of the final draft.

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Environmental Practice Group

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² The IFC Performance Standards define clients' responsibilities for managing their environmental and social risks. More information is available on the “Performance Standards” tab of the IFC website, found [here](#).

³ IFC Performance Standard 7 sets forth requirements designed to ensure that business activities minimize negative impacts, foster respect for human rights, dignity and culture of indigenous populations, and promote development benefits in culturally appropriate ways.