Equator Principles III
An introduction and practical guide

This book is the culmination of years of work of a team of technical professionals with extensive experience in environmental and social risk management. The book features a single, cited reference source that distils and summarizes hundreds of pages of information and guidance about the IFC Standards into one convenient guidebook.
Introducing the Equator Principles

The Equator Principles (EP) is an agreement amongst signatory Financial Institutions (known as EPFI) to assess and manage environmental and social risks associated with certain project and asset based financings in accordance with procedural requirements, internationally accepted standards and host country and international laws and regulations. EPFI will not provide Project related loans and Project Finance Advisory services within the scope of the EP, to projects where the borrower cannot or will not comply with the EP.

Short history of the EP

The EP was originally developed in 2003 and reviewed and revised in 2006, giving rise to the second iteration, EP II framework. A subsequent review took place in 2011 and 2012 which it is anticipated will result in the release of a further revised version of the EP agreement known as EP III, to be adopted by EPFI in early 2013. A draft of EP III was released in August 2012 suggesting what the final contents may look like.

The release of EP III follows a major revision of the IFC Performance Standards on Environmental & Social Sustainability in 2012 (“IFC Performance Standards”), a set of guidelines that is incorporated by reference into the EP framework. Together, these changes mark an important evolution in best practice in sustainable finance of particular importance for both bankers and those seeking access to capital.

To date, 79 EPFI have committed to the EP. That number is set to grow with emphasis on banks in emerging markets.

What are environmental and social risks?

The IFC Performance Standards pertain to the management of certain types of environmental and social risks, including (1) Labour and Working Conditions (including Occupational Health and Safety); (2) Resource Efficiency and Pollution Prevention; (3) Community Health Safety and Security; (4) Land Acquisition and Involuntary Resettlement; (5) Biodiversity Conservation and Sustainable Management of Living Natural Resources; (6) Indigenous Peoples; (7) Cultural Heritage. Human rights risks are also addressed through the foregoing aspects of the IFC Performance Standards and significant human rights risks may require human rights due diligence in accordance with IFC Performance Standard One – Assessment and Management of Environmental and Social Risks and Impacts. So, when we use the phrase “environmental and social risks”, this is primarily what we mean.

Legal implications

The Performance Standards reflect and embody the concept of “sustainable development” which is central to the mandate of numerous global organizations, including the World Bank and its financing arm the IFC, and is enshrined as the explicit object and purpose of over 50 international legal treaties. Sustainable development is widely acknowledged as a legitimate goal of international law and therefore is of the utmost importance for States as well as bodies like the World Bank. The IFC Performance Standards and the EP were borne out of an effort by the World Bank to ensure its private sector partners took the appropriate steps to meet best practice in sustainable development.

While the EP is an agreement amongst EPFI, many of the obligations of the EP must be carried out wholly or in part by borrowers with EPFI oversight. Borrower expectations may be set out in contractual agreements between the EPFI and borrower,
conferring upon the EPFI certain rights and remedial avenues should the requirements of the EP not be met by the borrower. Where borrowers are unable or will not comply with the EP, no loans are to be extended by the EPFI. Where loans are extended, the role of the EPFI is analogous to that of a regulator, establishing rules and obligations for borrowers and monitoring their implementation, with the possibility of adverse consequences (in the form of contractual remedies) being imposed on the borrower for non-compliance with EP requirements.

The primary legal significance of the EP derives from the incorporation of EP obligations into contractual relations through covenants. It remains an open legal question whether public commitments and contractual agreements to apply the EP give rise to third party beneficiary rights (such as in relation to Affected Communities) through tort or contract law. There is also a growing relevance of the EP and IFC Performance Standards in international trade law, as there may be implications for their application in the context of investment treaty and international trade disputes, in light of increasing recognition of “sustainable development” or “corporate social responsibility” in investment agreements (see for example the Canada-Peru Free Trade Agreement and role of the ESIA of the IFC in Case Concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay), [2010] I.C.J. Rep. 14). Export Credit Agencies (ECA) may be legally obligated to apply environmental and social risk management standards in extending their export credit facilities in accordance with the OECD Common Approaches, which refers to the IFC Performance Standards.

Moreover, the environmental and social review process is an ideal time to consider other legal and sustainability risks affecting a project, such as corruption and bribery risks.
Principle 1: Review and categorisation

Principle 1 of the EP III requires EPFI to conduct a preliminary assessment of the level of environmental and social risks associated with a project that is within the scope of the EP III, and to categorize that risk as either Category A (significant risks), B (limited risks) or C (minimal or no risks).

Scope

EP III has extended the Scope of the EP so that they apply to the following financial products (this is referred to as the “Scope” of the EP III):

(a) Project Finance Advisory services where the total Project capital costs are US$10m or more
(b) Project Finance with total Project capital costs of US$10m or more
(c) Project-Related Corporate Loans where the following all apply:
   (i) the loan relates to a single Project
   (ii) total aggregate loan amount is not less than US$100m
   (iii) EPFI’s individual initial exposure is at least US$50m
   (iv) loan tenor is at least 2 years; and
   (v) Borrower has “Effective Operational Control”, either direct or indirect, of the Project
(d) Bridge Loans with a tenor of less than 2 years that are intended to be re-financed by a Project Finance or a Project-Related Corporate Loan

This scope expands the scope of EP II which did not apply to “Project-Related Corporate Loans” or “Bridge Loans”. The EP III framework will apply to these activities of EPFI on a going forward basis (not retroactively), including expansions or upgrades of existing facilities if such expansions or upgrades may have significant Environmental and Social impact or change the nature or degree of existing impacts assessed under prior versions of the EP.

Meaning of “project”

The definition of a “project” in the Performance Standards is quite broad. A “project” is generally defined as a set of business activities likely to generate environmental and social risks and impacts. The scope of a project includes, but is not limited to, a physically defined set of activities associated with the financing. The requirements of the EP and IFC Performance Standards may have implications for the direct impacts of the Project itself, as well as indirect impacts on the Project’s Area of Influence.

Categorisation

Principle 1 of the EP III requires EPFI to categorise projects based upon their associated environmental and social impacts and risks. A similar process of categorisation is carried out by the IFC.

The process of categorization used in the EP is derived from the categorization approach of the IFC, set out in the IFC “Policy on Environmental and Social Sustainability”. As applied by the IFC, project categorisation is not intended to be a “once and for all” exercise and will typically be reviewed on a regular basis, at least annually or wherever changes to the project occur which could affect the level of Environmental and Social risk of a project.

Categorising projects is a highly discretionary and inexact process. The US Treasury Department requested in 2010 comments on the last IFC Performance Standards review that the IFC provide guidance to ensure consistency in categorization processes. No such guidance has been released as yet, but the EP Secretariat has state this will be forthcoming.
There are three categories of risk for an EP Project:

- **Category A** – for projects with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented.

- **Category B** – for projects with potential limited adverse environmental and social risks and/or impacts that are “few in number, generally site-specific, largely reversible and readily addressed through mitigation measures”; and

- **Category C** - projects are expected to have minimal or no adverse environmental and social risks and/or impacts and therefore a large number of the EP do not apply.

Category A projects will require more diligence and planning than lower risk Category C projects. For example, the Equator Principles require that an Environmental and Social Impact Assessment and Action Plan be developed for all Category A and B projects. As well, Category A projects and certain Category B projects must also have an independent review process. Beyond these examples, the full implications of a project’s categorization should be established in consultation with the project stakeholders, reviewing the environmental and social risks of the project.

As such, there may be risks (legal, reputational or business risks) of improper categorisation. A project categorised at a higher level than appropriate may incur unnecessary costs for the assessment and mitigation of Environmental and Social risks. Alternatively, a project incorrectly categorized as a lower risk than it actually is, could result in improper implementation of risk mitigation strategies and controls, increasing the possibility of environmental or social harm that could result in legal, reputational or business risks for lenders who use the EP as a risk mitigation strategy. Such risks are intended to be mitigated by the regular review of categorization. EPFI should therefore be flexible and open to changing the categorisation of a project if warranted. This should be built into contractual terms.

**Case study: The challenges of categorisation**

As part of the Greater EQUATE project, a $2.5 billion petrochemical project was built in an existing, large industrial park in Kuwait including both the development of new plant and the upgrade of existing facilities. Although the IFC guidelines include ‘large industrial plants’ amongst its examples of Category A projects, on Greater EQUATE, the lenders’ technical adviser recommended a Category B classification. The key factor in this decision appeared to be a clarification received from an IFC Principal Environmental Specialist that Category A projects typically involve greenfield constructions, whereas projects being built in existing, large industrial parks were viewed as having less associated risk, making Category B more appropriate.

Importantly, risk categorization is based on the potential for Project related environmental and social risks prior to the implementation of mitigation efforts. The assessment and categorization process does not take into account how risks can be avoided or minimized with mitigation strategies, but rather the inherent risks of the project itself.
Principle 2: Environmental and social assessment

An Environmental and Social Impact Assessment (ESIA or Assessment) (taking a variety of possible forms from full-scale to limited ESIA or compliance audit) must be developed for all Category A and B projects, providing an evaluation of the environmental and social risks of the project.

What is an assessment?

An Environmental and Social Assessment is a process that determines the potential environmental and social risk and impacts (including labour, health and safety) of a proposed Project in its Area of Influence. The EP III makes clear that, in the first instance, the Assessment process will address compliance with relevant host country laws, regulations and permits that pertain to environmental and social issues. As such, legal compliance issues will always be the primary consideration in conducting an Assessment.

An Environment and Social Impact Assessment involves a comprehensive compliance analysis of environmental and social risks, intended to identify and assess the potential impacts of a proposed project. It will typically be done for a greenfield development and will not always be necessary. An ESIA, in the context of the IFC Performance Standards, would typically include:

- stakeholder identification and gathering of social and environmental baseline data;
- an initial screen of the project for environmental and social risks (in particular the risk of non-compliance with local laws and regulations and/or the IFC Performance Standards requirements);
- examination of alternatives to the proposed development and generating mitigation measures;

Full-scale ESIA are typically required for large scale industrial initiatives, such as mines, oil and gas pipelines etc. and may be legally required in many jurisdictions. For the purposes of the IFC Performance Standards, the form and content of an ESIA must comply with host country environmental assessment laws and regulations and be consistent with applicable Good International Industry Practice (GIIP). The ESIA process should also flag special issues including cumulative or transnational risks, or disproportionate impacts on disadvantaged groups.

Legal and regulatory compliance

Compliance with host country and international laws and regulations (including laws implementing international legal obligations of host countries) pertaining to environmental and social matters is a fundamental requirement of the EP (and IFC Performance Standards). Proper implementation of the EP III will therefore necessitate a regulatory compliance review that must take into consideration legal requirements and assess legal compliance.

The role of the IFC Performance Standards is to set a baseline of performance in the management of environmental and social issues. In this respect, the Performance Standards must be seen to overlap and inter-relate with legal standards addressing the same topic areas. Legal compliance is a fundamental requirement of both EP III and the IFC Performance. Under the IFC Performance Standards, where host country regulations and the requirements of the IFC Performance Standards differ, the more stringent should be applied, or a detailed justification for using the less stringent level will be required and should be documented. The Performance Standards may also fill gaps or voids in legal governance, especially in weak governance areas. In this way, legal compliance is always integral to the implementation of the Performance Standards, and constitutes a necessary (if not always sufficient) condition for sustainability in EP III.

There are some circumstances where only applicable laws and regulations will apply to an EP III project and not the IFC Performance Standards. That scenario is discussed further under our section on Principle 3. In such circumstances, the importance of a legal compliance review as part of EP III implementation is heightened.
**Human rights due diligence**

In a significant development, the new IFC Performance Standards (and consequently certain EP III projects) now require that in “limited high risk circumstances” it may be appropriate for the Client to complement its environmental and social risks and impacts identification process with specific human rights due diligence. This requirement derives from the work of the United Nations Special Representative of the Secretary-General on Business and Human Rights, John Ruggie, who developed the “Protect, Respect and Remedy” Framework and associated Guiding Principles which were adopted by the United Nations Committee on Human Rights.

As the IFC Performance Standards Guidance notes, this may necessitate consideration of human rights issues when negotiating host country agreements, stabilization clauses or concessions. Such agreements should not be drafted in a way that could interfere with the human rights of parties potentially affected by the project or interfere with the State’s legitimate efforts to meet its human rights obligations. When negotiating stabilization clauses companies should not seek to impose economic or other penalties on the state party in the event that the state introduces laws that are of general application and reflect international good practice in areas such as health, safety, labour, the environment, security, non-discrimination, and other areas that concern business and human rights.

**GHG alternatives analysis**

Another important change in the EP III is the requirement that all projects (A, B or C) with more than 100,000 tonnes of CO2 emissions annually require an alternatives analysis to identify potential ways of avoiding CO2 emissions in the design of the project. This may coincide with any alternatives analysis required by a regulating permitting process. Once completed, the borrower must provide evidence of “technically and financially feasible and cost-effective options” to reduce GHG during the design, construction and operation of the project.
Principle 3: Applicable environmental and social standards

For Projects taking place in what are referred to as “Designated” countries the applicable standard will be host country laws, regulations and permitting requirements that pertain to Environmental and Social matters is the requirement for the EP. For projects taking place in other Non-Designated countries, the EP requires compliance with the “then applicable” IFC Performance Standards and the World Bank Environmental, Health and Safety Guidelines (EHS Guidelines). These standards must be met “to the EPFI’s satisfaction”, with any deviation justified. In addition to the IFC Performance Standards and EHS Guidelines, compliance with host-country laws, including laws implementing host-country obligations under international law is also required.

The list of “Designated” countries is selected by the Equator Principles Secretariat and is generally composed of countries that are known as “high income OECD Countries” (as defined by the World Bank Development Indicators Database), which are presumed to have a more highly developed legal and regulatory system to manage environmental and social matters.

Is IFC performance standards and legal compliance required or only compliance with law?

Implementation of EP III will require an EPFI to satisfy itself that a Project within the Scope of the EP is in compliance with (or justifiably deviates from) the applicable environmental and social standard required in Principle 3. The applicable standard will either be:

1. Applicable environmental and social laws, or;

In EP II, all projects were to be evaluated on both applicable laws and the IFC Performance Standards and EHS Guidelines, unless the Project took place in a “High-Income OECD” country, in which case host country laws would apply to the exclusion of the IFC Performance Standards. This threshold remains in the latest draft of the EP III but the use of the “High Income OECD” threshold was subject to change in EP III with the concept of “Designated” countries. The applicable environmental and social standards (as stated above) remain the same.

IFC performance standards

The substantive content of the EP III (meaning what actually must be done in implementing EP III) will continue to derive from the requirements of law and in some cases additionally the requirements of the IFC Performance Standards and EHS Guidelines, as it did in EP II. As such, it is critical to understand what the IFC Performance Standards require in applying EP III.

The IFC Performance Standards were established by the IFC in 2006 as a system of private regulation to fill governance gaps created by weak environmental and social regulations in emerging markets. The IFC Performance Standards were revised as of January 1, 2012. The revised framework was automatically applicable to the EP from that date forward, in accordance with EP Principle 3, as it became the
“then applicable” IFC Performance Standards. There are eight IFC Performance Standards which will be described in turn below.

**Performance standard one: Assessment and management of environmental and social risks and impacts**

Performance Standard 1 can be viewed as the “umbrella” of the Performance Standards, setting out the procedural framework and methodology for administering and effectuating the issue areas covered by the other IFC Performance Standards. Generally speaking, an ESMS under Performance Standard 1 must incorporate: (a) policies; (b) a process for identification of risks and impacts; (c) management programs; (d) organizational capacity and competency; (e) emergency preparedness and response procedures; (f) stakeholder engagement plans; and (g) monitoring and review processes.

The remaining IFC Performance Standards establish topical objectives and requirements to avoid, minimize, or offset risks and impacts of a project in relation to specific issue areas affecting sustainability. Read together, the IFC Performances Standards and the EP III framework establish the tenets of a governance system for the management of environmental and social risks associated with a commercial activity.

**Performance standard two: Labour and working conditions**

Performance Standard 2 sets standards for the management of human resources, including workers’ organizations, occupational health and safety, non-discrimination, child and forced labour practices, migrant labour, and the establishment of grievance mechanisms.

In the revised 2012 IFC Performance Standards, the expectations of Performance Standard 2 apply to both direct workers on the Project and also to indirect workers, including requirements in relation to primary supply chain employees and contracted workers and fair treatment of migrant workers. Employers are required to make “commercially reasonable efforts” to ascertain that the third parties who engage such workers are reputable and legitimate enterprises and have an appropriate ESMS that will allow them to meet the requirements of Performance Standard 2.

The OHS section of Performance Standard 2 establishes an overarching obligation on the Client to provide a safe and healthy work environment subject to “inherent risks” in particular sectors and hazards in work areas. This includes management of physical, chemical, biological, and radiological hazards and threats to women in the workplace. These requirements extend to the primary supply chain.

Requirements are also set out for fostering workers organizations in jurisdictions where there is substantial interference in workers’ freedom of association. Where these types of restrictions manifest, Performance Standard 2 requires Clients to take steps to engage with workers to address issues relating to their working conditions and terms of employment, to the extent permissible by law. Clients must not impede workers from developing “alternative mechanisms” to express their grievances and protect their rights regarding working conditions and terms of employment. Alternative mechanisms include recognizing worker committees and allowing workers to choose their own representatives for dialogue and negotiation over terms and conditions of employment in a manner that does not contravene national law. Such mechanisms must be free from interference, influence or control by employers.
CAO case study: Complaint regarding labor rights

On October 17, 2008 the CAO received a complaint from TURK-IS, the Confederation of Turkish Trade Unions. Filed on behalf of Turk Metal, the Metal Workers Union of Turkey and workers of Assan Aluminum (the “Union”). The complaint raised concerns about restrictions on workers’ rights of freedom of association and collective bargaining. The complaint was deemed eligible for assessment on October 27, 2008. At the time of the complaint, the IFC was under initial stages of appraisal of a potential $150 million investment program to modernize, upgrade and expand Assan Aluminum’s existing capacity. Assan was a formerly State-owned company acquired by a private family-owned company. Assan’s operations were located in Dilovasi-Gebze in Marmara region of Turkey. Upon receiving the complaint, the CAO notified the IFC and gave the IFC the opportunity to do its own diligence as part of the IFC’s environmental and social review. In addition, a third party labour assessment was done in respect of Assan’s operations. The IFC conducted a review of the project in relation to PS 2, including management/worker relationship, workers’ rights to join a workers’ organization and the effectiveness of the workers’ grievance mechanisms.

Workers and workers’ representatives were interviewed individually and in groups. It was the position of management for Assan that workers were free to join workers’ organizations. It was emphasized that employers were not required by law to negotiate collective bargaining agreements with unions in Turkey. While anti-union activity had been alleged, no evidence was found from the labour audit that had been conducted.

Based on the information collected from these processes, the IFC prepared an Environmental and Social Review Summary of the project. The IFC agreed with Assan to develop an environmental and Social Action Plan. As part of this plan, and as a condition of disbursement of IFC funds, Assan committed to:

- implementing human resources policies including commitments to respect freedom of association. The revised policies were published in all plants;
- training for all employees to raise awareness of rights and responsibilities of company and employees in relation to freedom of association;
- being an equal opportunity employer and not make employment decisions on basis of personal characteristics not related to job requirements;
- make visible in the workplace standardized statements of core labour standards in a manner understandable to workers; and
- ensuring that workers’ representatives were elected by employees in all plants with training on worker rights and duties.

As this case study illustrates, PS 2 may be applied to ensure Clients adopt and promulgate policies that promote freedom of association and workers’ rights as defined in the standard. This may necessitate processes of education and training, and the election of workers’ representatives. Such obligations may go beyond the requirements of local laws. These requirements inevitably create opportunities for external parties such as trade unions to exert control over the corporate entity, through the requirements of the Performance Standards.

There is clearly a risk that this could be used for ulterior motives, in order to extract concessions from a company or to engage in a public campaign for unrelated goals. It may be, in some cases that the Client may perceive trade union allegations to be an effort to achieve through the Performance Standards what cannot be achieved through domestic laws. That being the case, Performance Standards 2 requires the Client to take certain measures, through policies, practices and training, which may well exceed local laws, in order to demonstrate respect for freedom of association. It will not be an answer to an allegation of non-conformance with PS 2 that compliance with domestic law has been achieved in all circumstances.
Performance standard three: resource efficiency and pollution prevention

Performance Standard 3 requires the management of emissions such as greenhouse gases, pollution of land, air, or water. Performance Standard 3 also places some focus on greenhouse gases (GHGs) and water consumption.

Under EP III, the Client is required to implement technically and financially feasible and cost effective measures for improving efficiency in the consumption of energy, water and other resources and material inputs. The measures must integrate principles of cleaner production into product design and production processes with the objective of conserving raw materials, energy and water. The terms “cleaner production” and “resource efficiency” refer to the concept of integrating pollution reduction into the design of a product and associated production processes, or adopting an alternative production process. Well designed and implemented cleaner production projects, of which energy and water efficiency measures are a subset, can be highly cost-effective and often have a higher internal rate of return than the larger project to which they are applied.

Application of cleaner production and resource efficiency applies to the “core business activities” of the Project. These are the activities that “are essential to the operation of the Client’s business and without which the Client’s business would not be viable”. While cleaner production could result in cost and environmental benefits in non-core business activities it is not required by Performance Standard 3. The cost effectiveness test must be applied when implementing cleaner production measures.

In regards to GHG emissions, Performance Standard 3 generally requires the Client to take technically and financially feasible and cost effective measures to reduce GHGs during design and operation of the project. Moreover, where projects are expected or currently produce more than 25,000 tonnes of CO2 equivalent annually, the indirect and direct emissions should be quantified in accordance with internationally recognized methodologies and good practice.

In respect of water consumption, a Project which will potentially use, or is currently using significant quantities of water must adopt measures that avoid or reduce water usage so that the project’s water consumption does not have a significant adverse impact on third parties and Affected Communities.

Pollution prevention principles are normally regulated by applying and complying with standards and limits applicable to the project set out (primarily) in national legislation. Although there is a legacy of significant environmental standard setting in developed countries and in a number of developing countries, national legislation may present a developer (and financing parties) with significant gaps. The EHS Guidelines will for most, if not all financed projects address shortfalls in nationally legislated standards. Performance Standard 3 requires that where there is duplication of a standard or guideline, the more stringent of the two applies.

The relevant principles of international law which drive the implementation and management of Performance Standard 3 include the international legal duties of states to ensure sustainable use of resources, the precautionary principle and the principle of integration and interrelationship. In addition to those principles, the public trust doctrine (and the notion of stewardship), the preventative principle linked to pollution prevention and the polluter pays (waste minimization) principles are also applicable to Performance Standard 3. Performance Standard 3 requires Clients to determine whether they are responsible for mitigation measures where there is historical pollution such as land or groundwater contamination. If the Client is responsible, then these liabilities will be resolved in accordance with national law, or where this is silent with GIIP.
Principle 3: Applicable environmental and social standards

CAO case study: Air pollution and monitoring

Pre-development, a Client is required by the IFC Performance Standards to use established methods to determine whether the project would meet air quality standards. During operations, emissions must comply with standards set out in international legislation or with the WHO Air Quality Guidelines or other internationally recognized sources.

In 2004 the World Bank CAO received three complaints in relation to the Lukoil Overseas Project (Lukoil is a member of an international consortium, the Karachaganak Petroleum Operation (KPO)) situated in Western Kazakhstan. The complaints, submitted by the residents of Berezokova (located 5 kilometres from the production facilities) related to air emissions and monitoring of the emissions, and the effect of these emissions on the health and well-being of the residents.

The residents maintained that the levels of hydrocarbon emissions to the air produced during operations exceeded permissible international standards. In 2006 KPO commissioned an air quality study of the Karachaganak field. The study was a preliminary evaluation of air quality. The complainants refuted the validity of the health and air quality studies conducted by KPO and the Kazakhstan government. Data reliability was one of the main issues between the parties. It was agreed that a collaborative air quality monitoring program would be implemented with involvement of all appropriate parties. The technical professionals would be independent and agreed on by all parties. It was recorded during the initial CAO assessment that a baseline health study had been conducted by KPO. According to KPO, the study concluded that there was no link between ambient pollution and the health status of the residents of Berezkova. The study was not made available to the general public.

Based on the initial assessment, CAO concluded that it would not be possible to determine if the health effects of the residents were due to the project’s operations, or the poorly maintained municipal infrastructure but recommended that KPO disclose the relevant information in relation to environmental monitoring to the residents and appoint external independent reviewers to review environmental health aspects of the project. The assessment did not confirm whether or not the project was complying with the relevant air emission standards.

In 2007 the CAO concluded that the parties were not willing to engage in a facilitated solution, and the case was transferred to CAO compliance for an appraisal. The appraisal concluded that the concerns relating to emissions to air raised by the complainant fulfilled the criteria for a CAO compliance audit of IFC. The findings of the audit and conclusions are recorded as follows:

- It was concluded that neither the stack emissions monitoring program nor the data reported from the monitoring verified compliance with the IFC requirements. The monitoring reports did not include VOCs or hydrogen sulphide gas (H2S) as required by the relevant guidelines.

- It was also found that the monitoring frequency (two to four times per year) was inadequate to ensure that the emission concentrates were within the required limits as set out in the guidelines. In terms of Performance Standard 3 and the relevant guidelines, frequent sampling is required until consistent performance has been established.

- The audit report also recorded that in some of the monitoring reports values were either recorded as zero (for CO and SO2) or extremely low for concentrations of nitrogen oxides (NOx). It was noted that “such values are not plausible and indicate a lack of adequacy and accuracy of monitoring, or malfunctioning equipment”.

- Ambient Air Quality Monitoring Program: It was concluded that neither the ambient air quality monitoring program nor the data reported from the monitoring verified compliance with IFC requirements. There was no evidence that the sampling sites which were used had been identified as sites where the maximum ambient ground level concentrations could be expected, or where there would be sensitive receptors. It was also noted that the monitoring program and mitigation actions did not address the problem of offensive odours of H2S.
The report also noted that the instances of non-compliance identified highlighted the fact that the monitoring program only addressed national legislative requirements, and not the provisions in the IFC standard, or relevant guidelines. In its official response to the CAO audit, the IFC failed to substantiate actions that assured the CAO that the IFC would move back into compliance. Therefore the CAO kept the audit open and continued to monitor how the IFC assured itself that the project complied with the IFC requirements.

On January 8, 2009 Lukoil ended its contractual obligations to the IFC by repaying its outstanding balance to the IFC. This ended the IFC’s obligations to assure itself of project performance. However, the CAO audit team continued to engage the Project developers to verify and address compliance issues identified in 2008. In January 2009, the Project developers committed to an action plan to address all outstanding issues relating to reporting of stack emissions, completeness of air quality monitoring programs and the adequacy of selection of ambient air quality monitoring sites. In April 2009, the compliance audit was closed notwithstanding the fact that the issues remained unaddressed.

This case highlights a number of important requirements in respect of Performance Standard 3 and to some extent Performance Standard 1.

— Stakeholder engagement is important in relation to Performance Standard 3 because of the possible health effects caused by pollution emanating from the project activities and facilities to the surrounding environment. Proper communication must be maintained over the life of the project, and constructive relationships must be maintained with stakeholders. Projects with actual or potential risks or adverse impacts may require a comprehensive consultation process involved in active and informed consultation and participation of Affected Communities.

— Information about the project must be accessible and understandable and must be the basis of the consultation process.

— Emissions which may result in pollution must be identified at the ESIA stage using international sources and models. All relevant sources of emissions must be identified and monitored as required by the EHS Guidelines, the industry-specific guidelines and international guidelines. Dispersion models such as AERMOD and CALPUFF should be used to determine the effects of a project on ambient air quality. Point source emissions which need to be monitored will depend on the project and may include particulate matter, VOCs and other metals associated with different industrial activities. These must be determined at the ESIA stage.

— Monitoring programs must accurately reflect compliance with laws and regulations and the progress in the implementation of management programs. The type, extent and frequency of monitoring will depend on the potential impacts and risks of the project identified during the ESIA. Appropriate processes must be in place to ensure reliability of data.

These monitoring requirements are even more rigorous in EP III, with specific monitoring of GHG emissions required in the new framework.

Performance standard four: Community health, safety, and security

Performance Standard 4 requires Clients to address community health safety and security risks in the design of Projects, manage hazardous materials risks, conduct emergency planning and preparedness, as well as conduct risk management on security services associated with the Project.

The stated objectives of Performance Standard 4 are (1) to anticipate and avoid adverse impacts on both the health and safety of the Affected Communities during the project life from both routine and non-routine circumstances; and (2) to ensure that the safeguarding of personnel and property is carried out in accordance with relevant human rights principles.
Principle 3: Applicable environmental and social standards

The community health and safety element sets out requirements with respect to:

- infrastructure and equipment design and safety;
- hazardous materials management and safety;
- ecosystem services;
- community exposure to disease; and
- emergency preparedness and response.

In terms of security, Performance Standard 4 requires that where security personnel are provided by government or local authorities, companies conduct and document a risk assessment and implement risk elimination or mitigation measures as far as possible. Companies should seek to ensure that security personnel act in a manner consistent with requirements for privately engaged or contracted security staff. Wherever possible, companies should aim to encourage relevant authorities to disclose information about security arrangements for a project to Affected Communities, subject to any overriding security concerns.

CAO case study: Mitigation planning for major but unlikely accidents
How far must mitigation plans, programs, and practices go? Must they consider every possible outcome, no matter how remote or implausible?

The CAO considered these questions in the CAO's Appraisal for Audit of the IFC dated May 20, 2011 with respect to the Tullow Oil/ Kosmos Energy/ Jubilee FPSO deepwater oil and gas exploration project (C-I-R4-Y11- F137) in Ghana (the Tullow Project).

In that case, the CAO considered whether the IFC properly reviewed and addressed issues related to accidents that may occur with respect to the Tullow Project. The Tullow Project's Spill Contingency Plan described the potential consequences of a series of scenarios including major accidents (oil spills) with an estimated probability of once in 10,000 years.

The Spill Contingency Plan gave consideration to response times, and mapped ecologically sensitive areas to ensure special protection during a major spill event.

The CAO found that the accident potentials and consequences were in line with standard guidelines and industry practices. It went on to conclude that mitigation planning requirements cannot be expected to go beyond international good business practice.

In light of this, we can conclude that a Client should ensure that mitigation measures for accidents align with international good business practice. In some industries, such as deepwater drilling, this may require full planning for one-in-10,000 year events.

Performance standard five: Land acquisition and involuntary resettlement
Performance Standard Five establishes standards to be applied where there is expropriation of land and/or resettlement of communities affected by a Project. The applicability of Performance Standard 5 should be considered whenever Clients intend to acquire or use land in a way that may cause physical and/or economic displacement to a community or group of persons.

Physical displacement describes the permanent or temporary relocation of individuals and/or communities from the homes and/or lands which they occupy. Physical displacement results in a loss of shelter and access to valuable assets such as land, water and forests. Physically displaced persons can be divided into three categories: (1) persons who have formal legal rights to the land or assets they occupy or use (including customary and traditional rights); (2) persons who do not have formal legal rights to land or assets, but have a claim to land that is recognized or recognizable under national law (including adverse possession and customary or traditional tenure arrangements); and (3) persons who have no recognizable legal right or claim to the land or assets they occupy or use (otherwise referred to as “squatters”).
CAO case study: Broad applicability of performance standard 5

On July 18, 2007 a letter of complaint regarding the Wilmar Group’s (Wilmar) oil palm plantations on the islands of Sumatra and Sulawesi, Indonesia was submitted to the CAO. The letter indicated that land was being obtained without the consent of sellers and without providing compensation arrangements, carrying out consultations, establishing a grievance mechanism and developing a RAP. Instead, Wilmar was relying on the Government’s powers of land acquisition.

In November 2007, the CAO prepared a Preliminary Stakeholder Assessment which described the results of their site visit. The CAO reported that villagers did not yet trust a dialogue, as previous dialogues had not resulted in any agreements being implemented. In its Final Ombudsman Assessment Report, dated March 2009, the CAO confirmed that the disputes had been resolved and that settlement agreements relating to compensation and land had been formalized.

The IFC had invested in three Wilmar projects, (IFC Nos. 20348, 24644 and 25532), however, it is important to note that despite the fact that none of the IFC investments in Wilmar Group companies were for the exploitation of oil palm plantations, or were in companies that directly managed oil palm

Economic displacement occurs wherever land acquisition or restrictions on access lead to the permanent or temporary loss of income sources or means of livelihood.

Legal compliance regarding land rights is the basic requirement of Performance Standard 5. However the laws and policies of host governments which govern resettlement are often poorly defined or imperfectly implemented. Where legislation falls short of achieving the objectives specified in the IFC policies, the Client is expected to address the legislative gaps in order to comply with both local law and IFC policies.

Whenever Performance Standard 5 is applicable, the Client is expected to consult with and, where practical, accommodate all communities and persons adversely affected. Stakeholder engagement is also generally required under EP III in Principle 5.

The key deliverable for Performance Standard 5 is called a “Resettlement Action Plan” (RAP). The RAP serves as a tangible recognition of the Client’s obligations (arising from Performance Standard 5) to persons and/or communities physically displaced as a consequence of a project. The RAP should identify development opportunities, identify compensation and livelihood restoration requirements and resettlement plans. All relevant local and national laws and customs should be noted and summarized in the RAP. Relevant local customs and traditions should also be included. The legal framework of the host country will provide a foundation for determining compensation rates, eligibility for compensation, and mechanisms to resolve grievances.

The IFC’s involuntary resettlement policy applies to any displacement that is causally connected to a project even if the displacement occurs without the Client’s knowledge or as a result of activities distinct from the project. For example, the establishment of buffer zones or biodiversity offsets (such as restrictions on access to fishing areas around ports, docks or shipping lanes, creation of safety zones around mines, quarries or blasting zones or green spaces around industrial plants) may not be directly related to land-related transactions pertaining to a particular project but may still cause physical or economic displacement of communities and persons which is indistinguishable from adverse impacts caused by land-related transactions and should therefore be subject to Performance Standard 5.

Key risks for businesses stemming from displacement may include legal risk, financial risk and operational risk. Performance Standard 5 would not apply to resettlements which occur as a result of voluntary land transactions in which individuals or communities affected by the project or proposed project are willing to sell their property to the Client unless the selling individuals or communities are obligated to sell and the Client can invoke expropriation or other compulsory measures under the auspices of the host State.
Principle 3: Applicable environmental and social standards

Performance standard six: Biodiversity conservation and sustainable management of living natural resources

Performance Standard 6 establishes requirements to manage and mitigate impacts on habitats and ecosystems. In particular, Performance Standard 6 seeks to:

(a) protect and conserve biodiversity;
(b) maintain the physical, provisioning, regulating, indirect, and cultural benefits that people and businesses obtain from the ecosystem (known as ecosystem services); and
(c) ensure the sustainable production of living natural resources.

The required actions described in Performance Standard 6 apply only to a Project:

- Located in modified habitat with significant biodiversity value, natural habitat, critical habitat, or a Legally Protected Area or an Internationally Recognized Area, which determination is based on specific definitions and tests (described herein) that consider the nature and content (i.e., biodiversity) of the habitat in question;
- That may potentially impact, or is dependent on, ecosystem services over which the Client has direct management control or significant influence; or
- That involves the production of living natural resources.

Where Performance Standard 6 applies, a Client must develop an ESMS which manages the implementation of the actions (be they prohibitions, obligations or suggestions) set forth in Performance Standard 6. As well, a Client must consider issues related to alien species, engage and monitor primary supply chains related to the project and seek to avoid impacts on biodiversity and ecosystem services, when possible.

There were several changes to Performance Standard 6 that will affect EP III. This included the replacement of the concept of “renewable natural resources” with the dual concepts of “ecosystem services” and “sustainable management of living natural resources”, which places greater importance on ecosystems and removed some specific details on forest and marine ecosystems. Where Performance Standard 6 is applicable, a Client must complete an Ecosystem Services Review and must categorize the applicable ecosystem services to determine which ecosystem services are priority ecosystem services. Based on the review and categorization, a Client may be required to conduct further stakeholder consultation, develop a mitigation hierarchy, and implement mitigation measures.

Another change affecting EP III was the redefinition of “critical habitat” and addition of the requirement for a Biodiversity Action Plan in relation to critical habitats affected by a Project. There is now a requirement that a business engaged in the primary production of living natural resources to implement sustainable management practices according to one or more relevant and credible standards as demonstrated...
A project that involves the primary production of living resources is required to implement sustainable management practices and, where such practices are codified, implement sustainable management practices to such relevant and credible standards including independent verification or certification.

Client purchasing primary production of living natural resources must also consider supply chains and take actions related to (a) verification, (b) risks identification, (c) working relationships with suppliers, and (d) purchasing policies.

**CAO case study: Looking at supply chain to identify biodiversity issues**

The CAO considered the relevance of supply chains in its Audit Report dated June 19, 2009 of the IFC’s investments in Wilmar Trading (IFC No. 20348), Delta–Wilmar CIS (IFC No. 24644), Wilmar WCap (IFC No. 25532), and Delta–Wilmar CIS Expansion (IFC No. 26271) (C-I-R6-Y08-F096) (the Wilmar Projects). The Wilmar Projects audit considered complaints that the IFC gave no attention to Performance Standard 6 concerning biodiversity when assessing the Wilmar Projects. The complaint (made by the Forest Peoples Programme on July 18, 2007) specifically complained that the project proponent cleared rainforests, cleared peatlands, and destroyed the habitat of orangutans without giving adequate attention to threatened habitats, species and ecosystems and without giving adequate special attention to the conversion of natural habitats and the degradation of critical habitats.

In considering these complaints, the CAO Audit Report found that the risk and impact identification process for the Wilmar Projects mistakenly did not consider the appropriate primary supply chains, so the project area and project scope were too narrow to result in the application of Performance Standard 6. The CAO found that the IFC: (a) excluded supply chains from its analysis; (b) did not consider ecologically sensitive resources relevant to the sector; (c) inconsistently focused on the proponent’s ownership of the primary inputs (crude palm oil); and (d) failed to correctly assess the supply chains related to the project.

The risks and impacts identification process established under Performance Standard 1 sets out the elements that must be included in such a process (including the risks and impacts associated with primary supply chains), which process determines whether Performance Standard 6 applies. The shortfall of the IFC in implementing these requirements highlights the importance of giving full consideration to Performance Standard 1 and GIIP in determining whether Performance Standard 6 applies to a project.

**Performance standard seven: indigenous peoples**

Performance Standard 7 requires, most basically, consultation with affected Indigenous Communities, including, in some circumstances, to the point of Free Prior and Informed Consent (“FPIC”) as part of the stakeholder engagement process.

Performance Standard 7, like all of the Performance Standards, sets a performance baseline for private actors in relation to Indigenous Peoples that may interrelate and overlap with domestic and international legal obligations. Performance Standard 7 is based on recognition of the following characteristics of Indigenous Peoples:

- Indigenous Peoples have a distinct identity from other groups forming the society in which they live;
- Indigenous Peoples are often among the most marginalized and vulnerable groups within society;
- In many cases, economic, social and judicial factors limit the capacity of Indigenous Peoples to defend their rights and interests in lands; and
- Indigenous People are particularly vulnerable when their lands and resources are exploited.
Performance Standard 7’s primary objectives are basically threefold:

— To meet to international legal or customary expectations, such as those set out in the United Nations Declaration on the Rights of Indigenous Peoples. These expectations include the requirement to fully respect the rights, dignity and culture of Indigenous Peoples. It also requires preservation of the culture, knowledge and practices of aboriginal populations;

— To address adverse effects induced by economic projects that can be anticipated and avoided where possible. When adverse effects cannot be avoided, the Client should reduce such risks through mitigation measures and/or compensate the Affected Community without neglecting the possibility that the Indigenous Peoples may receive benefits and sustainable development opportunities as a result of these projects;

— To require consultation and consent, with Indigenous Peoples and foster, throughout all phases of their projects, sustainable relationships with aboriginal populations. Consultation may include the requirement of Informed Consultation and Participation (ICP) or Free, Prior and Informed Consent (FPIC) of Indigenous Peoples.

In applying this standard, the Client should avoid, where possible, adverse impacts on affected communities of Indigenous Peoples caused by bank assisted activities. Where alternatives have been explored and such impacts are unavoidable, the Client should minimize, restore and/or compensate for these impacts. The Client should undertake an engagement process with the affected indigenous communities. This may minimally include developing the project with the informed consultation and participation (ICP) of the affected communities. The Client may also, in certain circumstances, be required to build upon the requirement for ICP and, through a good faith negotiation process, obtain the FPIC of the affected indigenous communities when necessary. In addition, Performance Standard 7 requires that the Client and the affected indigenous communities identify mitigation strategies and compensation measures where appropriate.

As part of the implementation of Performance Standard 7, the Client must prepare an “Indigenous Peoples Plan” (IPP) describing the actions that will be taken to reduce the impacts of the project and/or compensate for any such impacts in a culturally appropriate manner. An IPP should contain:

— Baseline information on the indigenous communities in question;

— Analysis of project impacts, risks and opportunities;

— Result of consultations and future engagement with Indigenous Peoples;

— Measures to avoid, minimize and mitigate negative impacts and enhance positive impacts;

— Means to ensure continuance of indigenous livelihood activities (e.g., grazing, hunting, gathering and fishing);

— Measures to promote conservation and sustainable management of natural resources, where appropriate;

— Measures to enable Indigenous Peoples to take advantage of opportunities brought about by the project;

— Plans for a grievance mechanism;

— Costs, budget, timetable and organizational responsibilities; and

— Monitoring, evaluation and reporting mechanisms.

Where Indigenous People live among non-Indigenous Peoples, a broader community development plan with separate components for Indigenous Peoples might also be appropriate and necessary.

Performance standard eight: cultural heritage

Performance Standard 8 requires the identification, management, and protection of cultural heritage that may be affected by project activities. These requirements are based on internationally recognized standards and treaties including the Convention Concerning the Protection of the World Cultural and Natural Heritage (the World Heritage Convention) and the Convention on Biological Diversity (the Biodiversity Convention).
For purposes of Performance Standard 8, “cultural heritage” encompasses:

— Tangible forms of cultural heritage, such as tangible moveable or immovable objects, property, sites, structures, groups of structures, having archaeological (prehistoric), paleontological, historical, cultural, artistic, religious, aesthetic, or other cultural value. Tangible forms of cultural heritage are typically unique and non-renewable;

— Unique natural features or tangible objects that embody cultural values, such as sacred groves, rocks, lakes, and waterfalls; and

— Certain instances of intangible forms of culture — cultural knowledge, innovations, and practices of local communities embodying traditional lifestyles — that are proposed to be used for commercial purposes. Traditional medicinal knowledge, sacred techniques for processing plants, fibres, or metals, and locally sourced industrial design, are all considered intangible cultural heritage for the purposes of Performance Standard 8.

The main objectives of Performance Standard 8 are to protect cultural heritage from the adverse impacts of project activities and support its preservation by avoiding, reducing, restoring and, where appropriate, compensating for adverse impacts to cultural heritage. It also promotes the equal sharing of benefits from the commercial use of such cultural heritage. Performance Standard 8 goes beyond a simple “avoidance of harm” approach, requiring Clients to have a positive contribution. This approach is in line with the Biodiversity Convention’s objective of benefit-sharing.

A secondary objective of Performance Standard 8 is to promote the awareness of and appreciation for cultural heritage. The Standard is designed to help Clients achieve these outcomes through means that are appropriate to the nature and scale of the project and commensurate with the degree of environmental and social risk and/or impact.

An integral component of Performance Standard 8 is early and frequent consultation with Affected Communities and other stakeholders. By collaborating with these parties from an early stage, a Client stands a far better chance of identifying cultural heritage within the project area and designing around such heritage, thereby avoiding delays and ill-will toward the project.

EHS guidelines

The World Bank EHS Guidelines are expressly incorporated by reference into EP III. There are general EHS Guidelines addressing Environmental practice, Occupational Health and Safety practice, Community Health and Safety and Construction and Decommissioning. There are also over 60 industry-sector guidelines, in relation to:

- Agribusiness/Food Production
- Chemicals
- Forestry
- General Manufacturing
- Infrastructure
- Mining
- Oil & gas
- Power

In the context of the IFC Performance Standards, the EHS Guidelines represent an example of what is referred to as “Good International Industry Practice” (GIIP).

Performance Standard 3, for example requires that methods used to identify the risks and impacts and the methods to implement mitigation measures where necessary must be consistent with Good International Industry Practice (GIIP), with reference to the World Bank Environmental Health and Safety Guidelines (EHS Guidelines) and any other internationally recognized sources. This may also include “Any other internationally recognized sources” normally refers to those advocated by the United States Environmental Protection Agency (USEPA), the European Union (EU), and World Health Organization (WHO), although flexibility from financing parties for new projects is normally offered where there is a need for fairly specific guidance.

When host country regulations differ from the levels and measures presented in the EHS Guidelines, projects are expected to achieve whichever is more stringent. If less stringent levels or measures are appropriate in view of project circumstances a full and detailed justification must be provided. The justification should demonstrate that the choice for any alternate performance level is adequately protective of human health and the environment.
Principle 4: Environmental and social management system and action plan

Principle 4 of the EP III requires the development by the borrower of an Environmental and Social Management System (ESMS), which is composed of policies, procedures, organizational, training and stakeholder engagement requirements.

In addition, the Borrower must develop an Environmental and Social Management Plan (ESMP) to address issues raised in the ESIA and incorporate actions to comply with the applicable standards.

Where the ESMP is not adequate, an additional document called an Action Plan (AP) will be developed to address gaps to the EPFI’s satisfaction in line with applicable standards.

Environmental and social management system

Generally speaking, an ESMS can be considered a methodological process to manage ongoing environmental and social risks and impacts of a project to ensure sound and sustainable environmental and social performance. An ESMS under Performance Standard 1 must incorporate: (a) policies; (b) a process for identification of risks and impacts; (c) management programs; (d) organizational capacity and competency; (e) emergency preparedness and response procedures; (f) stakeholder engagement plans; and (g) monitoring and review processes.

Action plan

The purpose of the AP is to define desired outcomes and actions to address environmental and social issues raised in the risks and impacts assessment, the implementation of which can be tracked over time. It should be a “living” document that adjusts to address corrective actions needed to ensure compliance of the Project with legal or IFC Performance Standards requirements, as the case may be. ESAP plans should evolve over time. Supplemental ESAPs may be necessary as new risks are identified and as the project progresses. Supplemental ESAPs may also be required where independent audits by financiers identify additional measures and actions necessary to ensure compliance with the Performance Standards or other obligations.

The ESAP is critical in making the “sustainability case” for the Project and the EPFI’s decision to invest. ESAPs are important to lenders as evidence of the measures that a Client will undertake to manage environmental and social impacts. ESAPs will typically be the document of record upon which lending decisions and legal covenants are based.

In light of the potentially broad distribution, it is permissible for an ESAP to exclude certain confidential internal information, including information which is proprietary or confidential for business reasons such as cost data, information that would affect project site security and safety and detailed procedures, business processes or instructions for workers. True confidentiality can only come where “privilege” is attached to a document, which most often requires the involvement of external legal counsel. Without privilege, such documents could be producible in the course of litigation, even if they were intended to be kept confidential. Legal professional privilege can allow communications and documents to be legally privileged and therefore kept confidential in the event of future litigation. It can also allow for more open deliberation about the environmental and social risks of the project, without fear that such deliberations would become
Mitigation hierarchy

A primary focus of the ESMS and AP is mitigation of identified risks, along with the implementation of performance improvement measures. To this end, Clients are expected to design a mitigation approach that follows a structure — referred to as a “hierarchy” — of avoidance, minimization and compensation or offset.

The elements of the mitigation hierarchy are:

1. **Avoidance:** a process whereby the Client identifies and implements technically and financially feasible changes to the project’s design, location or other approach that would avoid completely identified adverse risks and impacts. This is the ideal form of mitigation.

2. **Minimization:** To be employed where avoidance is not possible. Minimization approaches may include abatement of impacts, rectification, repair or restoration. These approaches imply that the risks have materialized into adverse effects, but that those effects are being remediated by the Client.

3. **Compensation/Offset:** where avoidance or minimization measures are not available, it may be appropriate to adopt measures to compensate for harm done or to offset the adverse effect with a comparable positive benefit. This is the least desirable mitigation strategy and is to be done where residual impacts cannot be avoided. That being so, offset is a very important consideration, which underpins many of the mitigation obligations under the IFC Performance Standards, including such concepts as “Commercially Reasonable Efforts” and “Best Available Technology Not Entailing Excessive Costs”. These concepts all involve consideration of some sort of trade-off considering proportionality and economics.

The adoption of any particular mitigation strategies should be documented, including justification for any trade-offs between the various mitigation strategies.
Principle 5: Stakeholder engagement

For all Category A and ("as appropriate") Category B projects, the borrower must "demonstrate" effective and ongoing "Stakeholder Engagement" with Affected Communities and other stakeholders, taking into account disadvantaged and vulnerable groups. Legal requirements for consultation must be met as part of the implementation of this aspect of EP III.

Category A and certain Category B projects and projects affecting "Indigenous Peoples" require the implementation of a process of "Informed Consultation and Participation" (ICP) in a "culturally appropriate manner". "Free, Prior and Informed Consent" (FPIC) of Indigenous Peoples may be required in accordance with Performance Standard 7 of the IFC Performance Standards.

ESIA and ESMP will be made public to facilitate stakeholder engagement.

Role of stakeholder engagement

In establishing the ESMS, the Client must prepare a Stakeholder Engagement Plan to identify and plan engagement with stakeholders and Affected Communities. As part of this Plan, the Client should identify stakeholders, which are defined as persons, groups or communities external to the core operations of a project that may be affected by it or have an interest in it.

High-risk projects may require engagement with indirectly affected stakeholders who may have the ability to influence or alter the relationship of the Client with Affected Communities as well as identify risks, impacts, and opportunities for the Client’s consideration.

Engagement efforts should be oriented towards dialogue regarding the risks of the project and the needs and concerns of the local community. The level of engagement will vary with the nature, risks, impacts and Affected Communities of a project. Where potential risks and impacts to Affected Communities are identified they should be communicated in a timely way. All communications should be in the preferred language and method of the Affected Communities.

Disclosure of information

Proactive disclosure of information regarding project risks and public reporting on the implementation of the Action Plan is also required in the implementation of the IFC Performance Standards and EP III.

In meeting the information disclosure expectations of the Performance Standards, Clients will, at least, provide Affected Communities with access to information on: (a) the purpose, nature and scale of project; (b) the duration of project; (c) project risks and mitigation measures; (d) the proposed stakeholder engagement process; and (e) applicable grievance mechanisms for the Affected Communities.

No less than annually, the Client must report to Affected Communities regarding progress of Action Plans and mitigation measures and material changes to identified risks and impacts. All disclosed information should be disseminated in appropriate languages and formats, accessible and understandable and disclosed as per the Client’s consultation process.

The interest in transparency must be balanced with protecting confidential information, including the protection of personal data and information. Publicly released data should generally not be associated with particular individuals.
**Informed consultation and participation**

For Projects with potentially significant adverse impacts on Affected Communities (Category A and certain Category B) the borrowers will conduct an ICP process. An ICP is a more in-depth and iterative exchange of views and information designed to incorporate the views of Affected Communities into the design and implementation of a project. An ICP process must be open and equal, free of intimidation, coercion or outside pressure or monetary inducements so as to incorporate Affected Communities’ views on potential impacts to them. Critics of the project must be allowed to openly express their views and not be coerced or intimidated into accepting the project.

A primary goal of the process is to allow the Client to incorporate into their decision-making processes the views of the Affected Communities on matters that affect them directly, such as the proposed mitigation measures, the sharing of development benefits and implementation measures.

ICP includes:

- An engagement process;
- A framework document that is commensurate with the scale of impact and vulnerability of Affected Communities;
- Free and voluntary consultation without external manipulation, interference or coercion, and intimidation;
- Access to information at each stage of project implementation prior to any decision that will affect stakeholders;
- The engagement process should take into account the social structures, leadership and decision-making processes of the indigenous communities affected;
- Sensitivity to the capacity of indigenous institutions to deal with the project.
- Consensus building, allowing sufficient time for the engagement process.
- Implementation of a grievance mechanism in consultation with the affected Indigenous Peoples.

Consultation must be an ongoing iterative process and actions taken in response to consultation should be documented by the Client.

**Free prior and informed consent**

If a project adversely impacts Indigenous Peoples, Clients must engage them in an ICP process and, where the IFC Performance Standards apply, may need to obtain their Free, Prior, and Informed Consent (FPIC) as per the requirements of Performance Standard 7 and applicable laws. The FPIC requirement of Performance Standard 7 is undoubtedly one of the most important additions to the 2012 iteration of the Performance Standards framework.

Performance Standard 7 does not provide a singular definition of FPIC. Rather, it provides the following explanation:

*FPIC builds on and expands the process of ICP described in Performance Standard 1 and will be established through good faith negotiation between the Client and the Affected Communities of Indigenous Peoples.*

Good faith negotiation supposes that the parties have the will to engage in a consultative process, be available for meetings, provide necessary information for informed negotiation, explore the principal questions at issue, use procedures mutually acceptable for the negotiation, have an open mind to change from their initial positions, modify their offers when feasible and give sufficient time to permit sound decision-making.

In this context, FPIC should be understood as a process that permits communities of Indigenous Peoples to define a collective position in response to a project while recognizing the fact that different and diverging viewpoints may exist within those communities.

Guidance Note Seven of the IFC Performance Standards explains that it is not necessary to obtain the unanimous support of the members of indigenous communities affected by the project. However, Performance Standard 7 is silent on important questions regarding the scope of support and decision making processes for assessing consent.
Performance Standard 7 stipulates that FPIC applies:

— When the project is likely to have an impact on the land and natural resources subject to traditional ownership or under customary use;

— When the project involves the relocation of Indigenous Peoples from land and natural resources that are subject to traditional ownership or under customary use;

— When the project is likely to have significant impact on the cultural heritage essential to the identity of the Indigenous Peoples; and

— When the project involves the use of the cultural heritage of the Indigenous Peoples, including their knowledge and customs, for commercial purposes.

The Secretariat of the United Nations Permanent Forum on Indigenous Issues proposes the following understanding of each of the elements of FPIC:

— Free: Consent should be given freely, without coercion, intimidation or manipulation.

— Prior: Consent should be sought sufficiently in advance of final authorization and implementation of activities.

— Informed: Consent should be founded upon an understanding of the full range of issues entailed by the activity or decision in question.

Consent is without doubt the most controversial aspect of the FPIC process. For indigenous organizations, consent is generally understood as the right to approve or reject proposed actions or projects that may affect them or their lands, territories and resources. Consent by this definition is a decision made by Indigenous Peoples that is reached through their customary decision-making process. To some, this sounds like a veto right over the furthering of a project.

Both Performance Standard 7 and international legal instruments like the Declaration are silent on whether the right of consent entails a right of veto. A veto right typically entails more than a right of consent and involves a capacity to exercise power to impede a course of action chosen by another from occurring. In light of this lack of clarity over the meaning of “consent”, no strong conclusions can be drawn as to whether Indigenous Peoples’ consent is an absolute precondition for approval of actions that may affect them (in the nature of a veto) or simply a good faith aspiration that requires a procedural process aimed at the establishment of agreement between stakeholders and Indigenous Peoples, or something between the two. It would certainly be contrary to the spirit of FPIC for communities to have the power through FPIC requirements to frustrate reasonable good faith attempts or to take unreasonable positions to thwart decisions or actions in cases where, despite meaningful consultation, agreement is not reached. This suggests that a right of veto is not consistent with the concept of FPIC, although the ultimate definition of FPIC continues to evolve.

Rather than attempting to understand “consent” only in relation to the question of veto rights, it is more useful to interpret Performance Standard 7 with emphasis on how to gain and maintain the consent of the indigenous communities affected by a project to ensure, from a practical perspective, that the Client has a social license to operate throughout the span of the project. When viewed this way, FPIC and the processes and outcomes it entails can be seen as a cost-saving measure and a safeguard (both for the Client and indigenous communities) against the project’s environmental and social risks. FPIC, as part of Performance Standard 7 offers a practically useful approach to managing such risks and promoting the long term viability and sustainability of project activities affecting Indigenous Peoples.

Like all stakeholder engagement, FPIC as understood by Performance Standard 7, should not be viewed as a “one-size-fits-all” and “once-and-for-all” formality. It is an ongoing process of engagement and meaningful consultation with Indigenous Peoples with the explicit objective of disclosing relevant information, identifying impacts, accommodating Indigenous Peoples’ rights and interests and obtaining their consent. Since Performance Standard 7 does not establish a link between the right of consent and the right of veto, there may be circumstances where the Client could be in a position to demonstrate that they have followed and respected all the requirements contained in Performance Standard 7, even if formal agreement has not been reached with affected Indigenous Peoples. That being the case, where agreement cannot be achieved, careful deliberation with appropriate professional advice should be sought to determine the continued viability and sustainability of the project.
Principle 6: Grievance mechanisms

For all Category A and B projects the borrower must create a “grievance mechanism” as part of the ESMS. A grievance mechanism must be designed to receive and facilitate resolution of concerns about the project’s environmental and social performance.

Community focused project level grievance mechanisms

Generally speaking, the Performance Standards require that any project that is likely to generate adverse environmental and social impacts on Affected Communities have in place a project level grievance mechanism. Such a mechanism should be made readily accessible to the Affected Communities and allow for the receiving, addressing, recording and documenting of complaints and communications from external stakeholders. In the case of large projects with potentially complex issues, PS 1 requires that a robust grievance mechanism should be established and maintained from the beginning of the assessment process onwards.

A grievance mechanism is a locally based, formalized way for a company to accept, assess and resolve community complaints related to company activities. It provides a way to reduce project risk by offering communities an effective avenue for expressing concern and promotes a mutually constructive relationship.

A grievance mechanism draws upon conflict resolution resources inside the Client’s organization, as well as traditional, customary and private systems of alternative dispute resolution in Affected Communities, such as mediation, conciliation and arbitration. In developing grievance mechanisms, Clients must understand cultural customs and traditions that may influence or impede their ability to express their grievances, including differences in the roles and responsibilities of subgroups (especially women) and cultural sensitivities and taboos. Cultural characteristics may affect the appropriateness of direct versus indirect negotiation, attitudes toward competition, authority, social rank or the appropriateness of local customary grievance resolution processes.

The qualitative aspects of a grievance mechanism necessary for its effectiveness include that:

— Communities raising an issue receive acknowledgement of the concern;
— The company makes efforts to modify its conduct where appropriate;
— The company’s response is honest and forthright; and
— Some remedial action is taken where appropriate.

In applying these principles, it is imperative that grievances are not handled in an arbitrary or ad hoc manner. Grievances should also not be dealt with in a rigid manner that simply reinforces or exacerbates power imbalances. A well functioning grievance mechanism provides predictable, transparent and credible processes resulting in outcomes that are seen as fair, effective and lasting, builds trust, and enables systematic identification of emerging issues and trends, facilitating corrective action and pre-emptive engagement.

Worker grievance mechanisms

A grievance mechanism is also expressly required by Performance Standard 2 for workers and workers’ organizations to raise workplace concerns. In a workplace context, a grievance mechanism must address complaints and communications from internal stakeholders, namely workers. The establishment of such a mechanism ensures matters of worker concern are brought to management’s attention and addressed expeditiously. The mechanism should be made available to direct workers as well as contracted workers.

Such a mechanism must be developed with an awareness of judicial and administrative mechanisms
Principle 6: Grievance mechanisms

available in the country for resolution of workplace disputes and should not impede access to these judicial mechanisms. Employers are required first and foremost by PS 2 to comply with all legal requirements regarding grievance mechanisms and the resolution of workplace disputes.

Where grievance mechanisms are already provided through a collective bargaining agreement that meets the requirements of PS 2, such mechanisms can be used to satisfy the requirements of PS 2. If workers are not covered by a CBA, Clients must create other grievance mechanisms for unrepresented workers or discuss with any unions the feasibility of extending grievance procedures under the CBA to non-union personnel.

To ensure its functionality, workers must be informed of the mechanism at the time of hire and informed of how to access the mechanism. This mechanism should be designed in a way that is appropriate for them, easy to understand and adapted to the communications challenge they may face (e.g., language, literacy levels, level of access to technology).

A clear policy and procedure for expressing workplace concerns should be established by all companies and communicated to all workers in a clear and understandable manner, with training on how the grievance mechanism will operate. Workers’ representatives should be part of the process of implementation.

Grievance mechanisms as part of the World Bank approach to sustainable development

The IFC and Multilateral Investment Guarantee Agency (MIGA), the private sector components of the World Bank, have policy commitments that relate to grievance mechanisms including their Policy and Performance Standards on Social and Environmental Sustainability and Guidance Notes. Both institutions are held accountable to the Compliance Advisor/Ombudsman (CAO), which is the independent recourse mechanism available to project-affected people. If a grievance cannot be resolved, the complainant may refer to an external party such as the court system, traditional systems of justice or the CAO. Similar principles are applied in the context of EP III, which is derived from the World Bank approach.
Principle 7: Independent reviews

EP III requires that, for Category A and (as appropriate) Category B projects, an “Independent Environmental and Social Consultant” not directly associated with the borrower will carry out an independent review of the Assessment, ESMP, ESMS and consultation process documents, to assist the EPFI’s due diligence and assess EP compliance and propose a suitable AP capable of bringing the project into compliance with the EP or to indicate if compliance is not possible.

For Project-Related Corporate Loans, an independent review is required for projects with high risk impacts, or at the discretion of the EPFI for other Category A or B Project-Related Corporate Loans. High risk impacts may arise from:

- Adverse impacts on indigenous people,
- Critical habitat impacts,
- Significant cultural heritage impacts
- Large scale resettlement.

In exercising this discretion, the EPFI may consider the due diligence performed by an “Official Agency” such as an Export Credit agency or multilateral development bank.

Internal EPFI project reviews

EPFI have diverse approaches to the management of Environmental and Social Risks and implementation of the EP.

Some EPFI have a highly decentralized approach, where implementation of the EP is managed by lending officers, with support from centralized risk management teams for higher risk projects.

At other EPFI, environmental and social risk management is more centralized. Centralized risk management teams may specialize only in environmental and social risk issues, or be staffed by generalist credit risk management personnel. Some EPFI utilize advisory centres who provide technical support to front line business managers or lending officers who are ultimately responsible for EP compliance. In-house legal counsel may have dotted line oversight of this process, but are typically not heavily involved in this process.

Online: “The Equator Principles and SMBC”, http://www.smbc.co.jp/aboutus/responsibility/environment/equator_e.html
Since management approaches may vary between EPFI, complications may arise where lending takes place through a syndicate, particularly if certain lenders are not EPFIs.

The independent review process attempts to overcome such challenges for high risk Projects. Independent reviews are designed to give “sober second thought” to the documents prepared as part of the implementation of the EP III.

**Independent environmental and social consultants**

The “independent” reviewer should be independent from any ulterior (such as financial) motives that may undermine their independence or create the appearance of bias. The wording of Principle 7 is clear that an “independent reviewer” is distinct from an “internal review by the EPFI”. As such an independent review is not consistent with a review conducted by an internal department of the EPFI, even though they are arguably not “directly associated with the borrower”. Independent Environmental and Social Consultants should be external and independent from both the borrower and EPFI. “Independent Environmental and Social Consultant” is also defined distinctly from “Equator Principles Reviewers” which is an internal EPFI role, implying that the former is not the equivalent of an internal reviewer.
Principle 8: Covenants

Principle 8 requires the inclusion of covenants regarding the implementation of the EP III into legal documentation structuring the deal. This requirement gives the requirements of the EP III a legally binding nature between the contracting parties (subject to questions of enforceability and remedy depending on the status of the loan).

The project finance context

The EP has focused on projects tied to a scenario of “project finance” or debt financing. The EP Secretariat refers to the Basel II definition of project financing which is:

“A method of funding in which the lender looks primarily to the revenue generated by a single project, both as a source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment and telecommunications infrastructure…”.

Project finance presents financial institutions with a number of challenges. It involves long-term financing often including major infrastructure development. Financial institutions involved in project finance rely on the cash flows of the project itself rather that of the project sponsors, making effective management of the project critical to the investment.

Major infrastructure projects of this sort can often have significant environmental and social impacts. They may also provide a focal point for local or international opposition from non-governmental organizations (NGOs), local communities, investors, governments and other stakeholders.

Many of these projects take place in emerging markets, where regulatory frameworks around environmental and social safeguards are still developing. As a result, unless environmental and social issues are managed to accepted international standards, they can derail, delay or cause other operational challenges for the project — and affect cash flows — creating direct financial, legal as well as reputational risk to lenders.

In addition to the foregoing considerations, since project finance is often provided in syndicates, it makes it difficult for any one bank to singularly impose specific due diligence or environmental and social management requirements on the project.

The establishment of the EP was spurred by these challenges. This context informs how the EP are applied, and is why the EP is an issue of the utmost importance to those involved in project financings.

The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project’s cash flow and on the collateral value of the project’s assets. An example would be a loan which finances the construction of a pipeline to transport natural resources, where the revenue generated by use of the pipeline would repay the loan. There is limited or no support from a creditworthy party, such as a guarantor. Security would be taken over aspects of the project, such as mortgages over equipment/components, share security over the companies involved, pledges over bank accounts and assignments of earnings under the contracts for use of the pipeline. Many of these projects last for several years during the construction phase and much longer during operations.

Role of covenants

Covenants are continuing obligations of the borrower to do or not do certain things. If a covenant is breached and not remedied or is sufficiently serious, it can cause an event of default to occur. Some lenders insist on an immediate event of default as a result of a breach of a covenant relating to environmental or social matters.
EP III (like its predecessors) requires observance by EPFI not only when deciding whether to finance a project, but also during the life of the project. With this in mind, it is likely that EPFIs will want to obtain certain documentation from the borrower before providing finance, but there are a number of continuing requirements which the borrower will need to observe throughout the life of the loan.

In order to ensure that the borrower will comply with the EPs, and if not, to give the EPFIs an opportunity to work with the borrower to bring the project back into compliance, the EPFIs will need to include some specific EPs provisions in the loan or project documentation. Each project will vary according to industry sector, area of influence, complexity of social and environmental risks and categorization of the project in accordance with Principle 1. This will affect the nature and type of EPs provisions incorporated into the documentation.

**Important dynamics**

Each EPFI is free to take its own approach to the EPs and how to apply them to its project financings. Each EPFI may have an internal policy on how the EPs are incorporated in documentation. For example, it is often the case that an Official Agency such as an export credit agency will take a stricter approach than a commercial financial institution. It is particularly important to consider these different approaches when an EPFI intends to syndicate the project loan to other banks or financial institutions.

If the appropriate EPs provisions are not included in the documentation in accordance with a potential EPFI’s internal policies, changes may be required to the documentation before an EPFI will become a party and a lender under it.

It is also worth noting that although borrowers are bound by relevant laws on social and environmental matters, in certain circumstances the EP requires borrowers to go over and above observance of those local laws. Borrowers may resist such obligations to observe additional standards, given that they have not agreed to adhere to the EPs and doing so may cost additional time and money. The requirements will be the subject of negotiation between the parties. Each of these factors leads to a differing approach in documentation.

**Required covenants**

The EP requires at least four covenants of borrowers to be included in financing documentation to:

a) Comply with the ESMPs and AP (where applicable) during the construction and operation of the Project in all material respects;

b) Provide periodic reports in a format agreed with the EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party professionals that i) document compliance with the ESMPs and AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country environmental and social laws, regulations and permits; and

c) Decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Ultimately, if the borrower is not in compliance with these covenants the EPFI should work with the borrower on remedial actions to achieve compliance. Where non-compliance persists beyond a grace period, the EPFI may exercise remedial rights set out in contractual documentation.

**Other covenants**

**Conditions Precedent**

Conditions precedent (CPs) are a set of conditions that need to be satisfied before EPFIs become obliged to advance funds under the loan documentation. They can take the form of documents, reports, evidence, confirmations or matters of fact.

Depending on the nature of the financing, CPs may only need to be satisfied at the start of the loan term. However, many project financings are structured such that borrowers draw down amounts over a longer period to meet project costs as they fall due. If this is the case, there may be CPs to each drawing.

In addition, if the project involves two phases, such as a construction phase and an operational phase, the financiers may require that certain CPs are met before the project moves into the operational phase.
This gives the EPFIs an opportunity to check that the EPs are being complied with at each stage and if not, require that the project is brought back into compliance before funding/the next stage of the project occurs.

CPs at the start of the project financing should include:

— Evidence that all governmental or administrative approvals required for the project have been obtained;
— An Assessment has been conducted;
— An Action Plan (including a decommissioning plan) has been developed;
— An independent report from an Environmental consultant on the Assessment and Action Plan has been provided; and
— Confirmation that there is no misrepresentation or breach of covenant (including environmental and social provisions) under the documentation. CPs to all drawings should include:
— A certificate from the borrower certifying that the Action Plan is operational and complies with all necessary environmental and social requirements (including the EPs); and
— A confirmation from the borrower on the status of actions completed under the Action Plan. CPs to completion of construction should include:
— If there will be an operations phase, a new assessment, new Action Plan, reports and evidence of approvals relevant to that stage of the project;
— That the Action Plan has been fully implemented; and
— Confirmation that there is no environmental or social claim against the borrower.

Representations and warranties

Representations and warranties are statements made by the borrower (or other parties) confirming a set of circumstances. The lenders rely on those statements in order to enter into the project financing and/or to continue with the project financing. Representations and warranties can be deemed to be repeated periodically under the financing, for example on interest payment dates and on each drawing or can be restricted to the first drawing or the date the financing documents were entered into. If a representation and warranty proves to be materially misleading, it can result in an event of default under the financing. Representations and warranties are often seen as a useful tool for encouraging disclosure by a borrower of facts or circumstances which could have an adverse effect on the project. This is because if a borrower is asked to repeat the representations and warranties by reference to the facts and circumstances then existing, it will need to assess that each statement remains true and correct. If it is unable to repeat the representations and warranties, it will need to explain the reasons and seek to discuss them with its project financiers.

Types of representations and warranties include:

— There is no environmental or social claim outstanding, pending or likely to occur in respect of the project.
— The borrower and the project has at all times and will continue to comply with all applicable environmental and social laws including the requirement to obtain approvals.
— The borrower has provided to the project financiers all relevant reports and information on social and environmental issues.
— The Assessment addresses the matters required by the Equator Principles;
— The borrower consulted in a structured and culturally appropriate manner with persons affected by the project when preparing the Assessment.
Positive and negative covenants

Positive covenants are undertakings to take certain actions and conversely negative covenants are undertakings not to take or to refrain from taking certain actions. Reporting covenants are requirements to report on certain matters and information covenants are requirements to provide certain information.

Positive covenants might include:

— The borrower shall carry out the project in accordance with all recommendations and requirements that arise out of or under the Assessment and the Action Plan.

— The borrower shall comply with all environmental and social requirements.

— The borrower shall ensure that the Action Plan (which includes the decommissioning plan) conforms to, and will achieve compliance with, the IFC Performance Standards on Social and Environmental Sustainability, Industry-Specific Environmental, Health and Safety (EHS) Guidelines, the environmental consents and any laws and regulations relating to the environmental and social matters.

— The borrower shall, at the end of the project, decommission the project in the manner contemplated by the decommissioning plan contained in the Action Plan.

— The borrower shall comply with the Equator Principles. Negative covenants might include:

— The borrower agrees not to amend the Action Plan without consent of the agent and/or the environmental consultant. Reporting covenants might include:

— After becoming aware thereof, the borrower shall promptly provide the project financiers with details of any environmental or social claim against it.

— After becoming aware thereof, the borrower shall promptly notify the project financiers of any event which results in an environmental incident or release of an environmental contaminant.

— After becoming aware thereof, the borrower shall promptly notify the project financiers of any event which results in death or multiple injury.

— After becoming aware thereof, the borrower shall promptly notify the project financiers of any significant community or worker-related protest relating to the project.

— After becoming aware thereof, the borrower shall promptly notify the project financiers of any event which could have a material adverse effect on the project.

Events of default

Events of default are events which entitle the EPFI to:

— stop lending;

— require the facility to be repaid in full with immediate effect; and

— enforce any security they may have. Depending on the sensitivities of the project, it may be required to include specific events of default for environmental and social matters.

Types of events of default include:

— an environmental or social claim is brought against the borrower or in respect of the project;

— the borrower does not comply with environmental and social covenants; or

— any representation and warranty in respect of environmental and social matters is misleading or incorrect.
Future trends

Growing legal implications for banks
By holding themselves out publicly as private regulators of their clients’ environmental and social performance, EPFI have taken on both reputational and legal risks beyond the inherent risks of the project. The business case for doing so is the bank’s interest in mitigating the reputational, legal and financial risks associated with poor environmental and social performance of their clients. The challenge will be to ensure that the risks of acting as a private regulator are also effectively managed by banks taking on that commitment. In light of the inter-relationship and overlap between EP and legal and regulatory requirements. To manage such risks, and avoid duplication of legal due diligence (which is conducted for all financings in any event) and EP III due diligence, an integrated approach to EP III implementation with environmental and social legal due diligence is likely to emerge as a best practice trend. Such an approach would leverage technical expertise of a cross-function legal team, including not only corporate but also environmental, health and safety, labour and indigenous relations professionals as may be needed.

“Equator Principles Bank” role in project finance?
A new trend that may emerge post-EP III is an effort towards increased standardisation of EP implementation strategies, which in turn could lead to increased specialisation and the evolution of an “EP bank” role in project financing. The advantages of such an approach would include: consistency in application of the EP framework; more effective management of legal and reputational risks; economies of scale in the development of EP expertise to the benefit of the industry; and competitive advantage for banks that can leverage their expertise in the EP space to obtain deals.
Principle 9: Independent monitoring and reporting

For all Category A and (as appropriate) Category B Projects, an Independent Environmental and Social Consultant should be appointed by the EPFI or borrower to ensure ongoing monitoring of compliance and reporting to the EPFI over the life of the loan. The same approach is to be applied for Project Related Corporate Loans wherever an Independent Review is required under Principle 7 of EP III. This review is in relation to compliance of the Project with applicable environmental and social laws and/or the requirements of the IFC Performance Standard and the Action Plan. The Client must establish a procedure commensurate to the level of risk and impacts to monitor and measure effectiveness of the management program and compliance with applicable law and regulations. Monitoring processes ought to be conducted by an Independent Environmental and Social Consultant.

Elements of a monitoring program

Monitoring is the primary means for tracking and evaluating progress towards implementation of the management system and programs, and all action items specified in the Action Plans. Consistent with the IFC Performance Standards, measuring and monitoring should examine: (1) the key risks and impacts of the project on employees, communities and the natural environment as identified; (2) compliance with laws and regulations; and (3) progress in implementation of the management programs. Clients should also establish key development measurements for the purposes of benchmarking, including quantitative and qualitative measures of success.

The factors to be considered in establishing an environmental monitoring program typically include engineering estimates, environmental modeling, pollutant source (e.g., emissions to atmosphere, wastewater effluents, solid and hazardous waste) ambient water quality and quantity (surface and groundwater) and air quality. Specific environmental monitoring measures comprise the parameters to be measured, sampling and analytical methods to be used, sampling locations, frequency of measurements, detection limits and the definition of thresholds that signal the need for corrective actions. The IFC Performance Standards contains specific monitoring requirements for Type 1 (direct) and Type 2 (indirect) GHG, where such emissions are in excess of 25,000 tonnes per annum.

Data verification

There should also be measures put in place to ensure the reliability of data, including the calibration of instruments and testing of equipment. External laboratories should be certified to ensure that data is accurate, defensible and reliable. In some cases it may be appropriate to involve external professionals or other third parties to verify information acquired through the monitoring process, in particular, projects with significant impacts (Category A projects).

Role of stakeholders

Stakeholder engagement must be part of the benchmarking process to highlight deficiencies as they arise. Similarly in the environmental sphere, Clients must establish an environmental monitoring program that includes engineering estimates, environmental modeling, identification of pollutant sources, noise, ambient water quality and quantity, air quality and contaminant measurements.

Participatory monitoring (i.e., involvement of Affected Communities) should be considered where appropriate (particularly for projects with potential significant
adverse risks and impacts). In these cases, the Client should evaluate the capacity of those participating in the monitoring and provide periodic training and guidance as appropriate.

**Documentation and reporting**

Monitoring results should be documented, and the necessary corrective and preventative actions identified and implemented. From such documentation, periodic reports should be prepared for senior management as part of the monitoring process. Such reports should inform senior management with the information needed to determine compliance with relevant host country legal requirements and the implementation of the ESMS. Reports should include summaries of findings and recommendations for implementation of the ESAP.

Such reports should be made available broadly throughout the Client’s organization and to workers and Affected Communities as appropriate and consistent with disclosure expectations in the Performance Standards. In particular, the Client must provide reports to Affected Communities that describe progress with the implementation of the ESAP. Where there are material changes to the mitigation measures or the ESAP on issues of concern for the Affected Communities, updates should be communicated to those stakeholders.

**Remedial actions**

A primary objective in monitoring a project’s environmental and social impact is to track deviations between actual outcomes and those predicted during the environmental and social impact assessment process. This may come about through the tracking of key indicators and other performance measures over time.

Where deviation between benchmarks or predictions and actual outcomes occurs, corrective actions should be developed and implemented. Any necessary corrective and preventative actions flowing from the monitoring results should be identified and implemented, with systematic follow up to ensure their effectiveness.
Principle 10: Reporting and transparency

Principle 10 of the EP III sets out specific requirements for public reporting of environmental and social data. EP III will require the public reporting of ESIA and ESMP, including for the purposes of stakeholder engagement. There are also special reporting obligations in relation to greenhouse gas emissions. These obligations are to be fulfilled by the borrower (and will therefore need to be part of the legal covenants as part of the deal). EPFI are also required to report on their implementation of the EP III framework.

**Borrower reporting requirements**

Under EP III, all Category A and (as appropriate) Category B projects located in Designated countries will require the borrower to disclose a summary of the Assessment or ESIA documentation and the ESMP prepared in relation to a project. These documents should be disclosed on the company’s website if one is available.

Disclosure should also be provided to facilitate stakeholder engagement as early in the initial ESIA process as possible, and in any event before construction commences. Reporting to stakeholders should occur on an “ongoing basis”. The meaning of “ongoing basis” in the EP is not defined, although, by analogy, the IFC Performance Standards require public reporting by borrowers on an annual basis, or more frequently if appropriate in light of feedback from stakeholder engagement or grievances. Such reports should describe the project’s successes, positive and negative impacts and lessons learned.

**GHG reporting**

For all Category A and (as appropriate) Category B projects, in all countries, the borrower will be required to report greenhouse gas emission levels during the operational phase for projects emitting over 100,000 tonnes of CO2 equivalent annually. This requirement can be satisfied by regulatory requirements or voluntary reporting mechanisms like the Carbon Disclosure Project.

The details of these reporting requirements are set out in Annex A of the EP III framework.

**EPFI reporting obligations**

EPFIs themselves are required to report annually on EP transactions screened and closed as well as EP implementation processes and experiences, taking into account confidentiality considerations. Detailed requirements are set out in Annex B to the EP III. These requirements include:

- **Aggregated reporting data**: which includes transactions screened, type of transaction within the EP III Scope, category, sector and region of the project and whether an independent review has been carried out, as well as whether the project has reached financial close;

- **Implementation reporting**: which includes a description of the mandates and roles of internal EP reviewers involved in the transaction review process, the level of senior management involvement for Category A and B transactions and the incorporation of EP III in the EPFI’s credit and risk management policies and procedures.

Project specific data must also be reported for Project Finance transactions that have reached financial close (meaning the date when all CP have been fulfilled or waived). This is subject to client consent and applicable laws and regulations as well as any “reduction in the rights or increase in the liability of the EPFI”.

Reporting data of the EPFI should be published online in a single location, or with links to the various aspects if in multiple locations.

**EP secretariat reporting**

EPFI must also submit data to the EP Secretariat for publication on their website, including the project name, sector, region and year in which financial close occurred.
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