

July 2006

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# The "Equator Principles"

## A financial industry benchmark for determining, assessing and managing social & environmental risk in project financing

[www.equator-principles.com](http://www.equator-principles.com)

### **PREAMBLE**

Project financing, a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure, plays an important role in financing development throughout the world<sup>1</sup>. Project financiers may encounter social and environmental issues that are both complex and challenging, particularly with respect to projects in the emerging markets.

The Equator Principles Financial Institutions (EPFIs) have consequently adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices. By doing so, negative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately. We believe that adoption of and adherence to these Principles offers significant benefits to ourselves, our borrowers and local stakeholders through our borrowers' engagement with locally affected communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development. As such, EPFIs will consider reviewing these Principles from time-to-time based on implementation experience, and in order to reflect ongoing learning and emerging good practice.

These Principles are intended to serve as a common baseline and framework for the implementation by each EPFI of its own internal social and environmental policies, procedures and standards related to its project financing activities. We will not provide loans to projects where the borrower will not or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles.

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<sup>1</sup> **Project finance** is "a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the 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 may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. 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." Source: Basel Committee on Banking Supervision, [International Convergence of Capital Measurement and Capital Standards](http://www.bis.org/publ/bcbs118.pdf) ("Basel II"), November 2005. <http://www.bis.org/publ/bcbs118.pdf>.

# July 2006

## **SCOPE**

The Principles apply to all new project financings globally with total project capital costs of US\$10 million or more, and across all industry sectors. In addition, while the Principles are not intended to be applied retroactively, we will apply them to all project financings covering expansion or upgrade of an existing facility where changes in scale or scope may create significant environmental and/or social impacts, or significantly change the nature or degree of an existing impact.

The Principles also extend to project finance advisory activities. In these cases, EPFIs commit to make the client aware of the content, application and benefits of applying the Principles to the anticipated project, and request that the client communicate to the EPFI its intention to adhere to the requirements of the Principles when subsequently seeking financing.

## **STATEMENT OF PRINCIPLES**

*EPFIs will only provide loans to projects that conform to Principles 1-9 below:*

### *Principle 1: Review and Categorisation*

When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC) (Exhibit I).

### *Principle 2: Social and Environmental Assessment*

For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment ("Assessment") process<sup>2</sup> to address, as appropriate and to the EPFI's satisfaction, the relevant social and environmental impacts and risks of the proposed project (which may include, if relevant, the illustrative list of issues as found in Exhibit II). The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.

### *Principle 3: Applicable Social and Environmental Standards*

For projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the Assessment will refer to the then applicable IFC Performance Standards (Exhibit III) and the then applicable Industry Specific EHS Guidelines ("EHS Guidelines") (Exhibit IV). The Assessment will establish to a participating EPFI's satisfaction the project's overall compliance with, or justified deviation from, the respective Performance Standards and EHS Guidelines.

The regulatory, permitting and public comment process requirements in High-Income OECD Countries, as defined by the World Bank Development Indicators Database, generally meet or exceed the requirements of the IFC Performance Standards (Exhibit III) and EHS Guidelines (Exhibit IV). Consequently, to avoid duplication and streamline EPFI's review of

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<sup>2</sup> **Social and Environmental Assessment** is a process that determines the social and environmental impacts and risks (including labour, health, and safety) of a proposed project in its area of influence. For the purposes of Equator Principles compliance, this will be an adequate, accurate and objective evaluation and presentation of the issues, whether prepared by the borrower, consultants or external experts. Depending on the nature and scale of the project, the assessment document may comprise a full-scale social and environmental impact assessment, a limited or focused environmental or social assessment (e.g. audit), or straight-forward application of environmental siting, pollution standards, design criteria, or construction standards. One or more specialised studies may also need to be undertaken.

## July 2006

these projects, successful completion of an Assessment (or its equivalent) process under and in compliance with local or national law in High-Income OECD Countries is considered to be an acceptable substitute for the IFC Performance Standards, EHS Guidelines and further requirements as detailed in Principles 4, 5 and 6 below. For these projects, however, the EPFI still categorises and reviews the project in accordance with Principles 1 and 2 above.

The Assessment process in both cases should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

### *Principle 4: Action Plan and Management System*

For all Category A and Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the borrower has prepared an Action Plan (AP)<sup>3</sup> which addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable Performance Standards and EHS Guidelines, as defined in the AP.

For projects located in High-Income OECD countries, EPFIs may require development of an Action Plan based on relevant permitting and regulatory requirements, and as defined by host-country law.

### *Principle 5: Consultation and Disclosure*

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner.<sup>4</sup> For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns.<sup>5</sup>

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<sup>3</sup> The **Action Plan** may range from a brief description of routine mitigation measures to a series of documents (e.g., resettlement action plan, indigenous peoples plan, emergency preparedness and response plan, decommissioning plan, etc). The level of detail and complexity of the Action Plan and the priority of the identified measures and actions will be commensurate with the project's potential impacts and risks. Consistent with Performance Standard 1, the internal **Social and Environmental Management System** will incorporate the following elements: (i) Social and Environmental Assessment; (ii) management program; (iii) organisational capacity; (iv) training; (v) community engagement; (vi) monitoring; and (vii) reporting.

<sup>4</sup> **Affected communities** are communities of the local population within the project's area of influence who are likely to be adversely affected by the project. Where such consultation needs to be undertaken in a structured manner, EPFIs may require the preparation of a Public Consultation and Disclosure Plan (PCDP).

<sup>5</sup> **Consultation** should be "free" (free of external manipulation, interference or coercion, and intimidation), "prior" (timely disclosure of information) and "informed" (relevant, understandable and accessible information), and apply to the entire project process and not to the early stages of the project alone. The borrower will tailor its consultation process to the language preferences of the affected communities, their decision-making processes, and the needs of disadvantaged or vulnerable groups. Consultation with Indigenous Peoples must conform to specific and detailed requirements as found in Performance Standard 7. Furthermore, the special rights of Indigenous Peoples as recognised by host-country legislation will need to be addressed.

## July 2006

In order to accomplish this, the Assessment documentation and AP, or non-technical summaries thereof, will be made available to the public by the borrower for a reasonable minimum period in the relevant local language and in a culturally appropriate manner. The borrower will take account of and document the process and results of the consultation, including any actions agreed resulting from the consultation. For projects with adverse social or environmental impacts, disclosure should occur early in the Assessment process and in any event before the project construction commences, and on an ongoing basis.

### *Principle 6: Grievance Mechanism*

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure that the mechanism addresses concerns promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.

### *Principle 7: Independent Review*

For all Category A projects and, as appropriate, for Category B projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

### *Principle 8: Covenants*

An important strength of the Principles is the incorporation of covenants linked to compliance. For Category A and B projects, the borrower will covenant in financing documentation:

- a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;
- b) to comply with the AP (where applicable) during the construction and operation of the project in all material respects;
- c) to provide periodic reports in a format agreed with 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 experts, that i) document compliance with the AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and
- d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate.

## July 2006

### *Principle 9: Independent Monitoring and Reporting*

To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, for all Category A projects, and as appropriate, for Category B projects, require appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.

### *Principle 10: EPFI Reporting*

Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.<sup>6</sup>

### **DISCLAIMER**

The adopting EPFIs view these Principles as a financial industry benchmark for developing individual, internal social and environmental policies, procedures and practices. As with all internal policies, these Principles do not create any rights in, or liability to, any person, public or private. Institutions are adopting and implementing these Principles voluntarily and independently, without reliance on or recourse to IFC or the World Bank.

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<sup>6</sup> Such reporting should at a minimum include the number of transactions screened by each EPFI, including the categorisation accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.

## July 2006

### Exhibit I: Categorisation of projects

As part of their review of a project's expected social and environmental impacts, EPFIs use a system of social and environmental categorisation, based on IFC's environmental and social screening criteria, to reflect the magnitude of impacts understood as a result of assessment. These categories are:

- **Category A** – Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented;
- **Category B** – Projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; and
- **Category C** – Projects with minimal or no social or environmental impacts.

## July 2006

### **Exhibit II:**

#### **Illustrative list of potential social and environmental issues to be addressed in the Social and Environmental Assessment documentation**

In the context of the business of the project, the Assessment documentation will address, where applicable, the following issues:

- a) assessment of the baseline social and environmental conditions
- b) consideration of feasible environmentally and socially preferable alternatives
- c) requirements under host country laws and regulations, applicable international treaties and agreements
- d) protection of human rights and community health, safety and security (including risks, impacts and management of project's use of security personnel)
- e) protection of cultural property and heritage
- f) protection and conservation of biodiversity, including endangered species and sensitive ecosystems in modified, natural and critical habitats, and identification of legally protected areas
- g) sustainable management and use of renewable natural resources (including sustainable resource management through appropriate independent certification systems)
- h) use and management of dangerous substances
- i) major hazards assessment and management
- j) labour issues (including the four core labour standards), and occupational health and safety
- k) fire prevention and life safety
- l) socio-economic impacts
- m) land acquisition and involuntary resettlement
- n) impacts on affected communities, and disadvantaged or vulnerable groups
- o) impacts on indigenous peoples, and their unique cultural systems and values
- p) cumulative impacts of existing projects, the proposed project, and anticipated future projects
- q) consultation and participation of affected parties in the design, review and implementation of the project
- r) efficient production, delivery and use of energy
- s) pollution prevention and waste minimisation, pollution controls (liquid effluents and air emissions) and solid and chemical waste management

*Note:* The above list is for illustrative purposes only. The Social and Environmental Assessment process of each project may or may not identify all issues noted above, or be relevant to every project.

## July 2006

### Exhibit III: IFC Performance Standards on Social and Environmental Sustainability

As of April 30, 2006, the following list of IFC Performance Standards were applicable:

- Performance Standard 1: Social & Environmental Assessment & Management System
- Performance Standard 2: Labor and Working Conditions
- Performance Standard 3: Pollution Prevention and Abatement
- Performance Standard 4: Community Health, Safety and Security
- Performance Standard 5: Land Acquisition and Involuntary Resettlement
- Performance Standard 6: Biodiversity Conservation and Sustainable Natural Resource Management
- Performance Standard 7: Indigenous Peoples
- Performance Standard 8: Cultural Heritage

*Note:* The IFC has developed a set of **Guidance Notes** to accompany each Performance Standard. While not formally adopting the Guidance Notes, EPFIs or borrowers may use the Guidance Notes as useful points of reference when seeking further guidance on or interpretation of the Performance Standards. The IFC Performance Standards, Guidance Notes and Industry Sector EHS Guidelines can be found at [www.ifc.org/enviro](http://www.ifc.org/enviro)

## July 2006

### Exhibit IV: Industry-Specific Environmental, Health and Safety (EHS) Guidelines

EPFIs will utilise the appropriate environmental, health and safety (EHS) guidelines used by IFC which are now in place, and as may be amended from time-to-time.

IFC is using two complementary sets of EHS Guidelines available at the IFC website ([www.ifc.org/enviro](http://www.ifc.org/enviro)). These sets consist of all the environmental guidelines contained in Part III of the World Bank's Pollution Prevention and Abatement Handbook (PPAH) which went into official use on July 1, 1998 and a series of environmental, health and safety guidelines published on the IFC website between 1991 and 2003. Ultimately new guidelines, incorporating the concepts of cleaner production and environmental management systems, will be written to replace this series of industry sector, PPAH and IFC guidelines.

Where no sector specific guideline exists for a particular project then the PPAH's General Environmental Guidelines and the IFC Occupational Health and Safety Guidelines (2003) are applied, with modifications as necessary to suit the project.\*

The table below lists both the World Bank Guidelines and the IFC Guidelines as of March 1, 2006.

#### Industry Specific EHS Guidelines:

World Bank Guidelines (PPAH)	IFC Guidelines
1. Aluminum Manufacturing	1. Airports
2. Base Metal and Iron Ore Mining	2. Ceramic Tile Manufacturing
3. Breweries	3. Construction Materials Plants
4. Cement Manufacturing	4. Electric Power Transmission and Distribution
5. Chlor-Alkali Plants	5. Fish Processing
6. Coal Mining and Production	6. Food and Beverage Processing
7. Coke Manufacturing	7. Forestry Operations: Logging
8. Copper Smelting	8. Gas Terminal Systems
9. Dairy Industry	9. Geothermal Projects
10. Dye Manufacturing	10. Hazardous Materials Management
11. Electronics Manufacturing	11. Health Care
12. Electroplating Industry	12. Life & Fire Safety
13. Foundries	13. Occupational Health and Safety
14. Fruit and Vegetable Processing	14. Office Buildings
15. General Environmental Guidelines	15. Offshore Oil & Gas
16. Glass Manufacturing	16. Polychlorinated Biphenyls (PCBs)
17. Industrial Estates	17. Pesticide Handling and Application
18. Iron and Steel Manufacturing	18. Plantations
19. Lead and Zinc Smelting	19. Port and Harbor Facilities
20. Meat Processing and Rendering	20. Rail Transit Systems
21. Mini Steel Mills	21. Roads and Highways
22. Mixed Fertilizer Plants	22. Telecommunications
23. Monitoring	23. Tourism and Hospitality Development
24. Nickel Smelting and Refining	24. Waste Management Facilities
25. Nitrogenous Fertilizer Plants	25. Wastewater Reuse
26. Oil and Gas Development (Onshore)	26. Wildland Management
27. Pesticides Formulation	27. Wind Energy Conversion Systems
28. Pesticides Manufacturing	28. Wood Products Industries

## July 2006

29. Petrochemicals Manufacturing	
30. Petroleum Refining	
31. Pharmaceutical Manufacturing	
32. Phosphate Fertilizer Plants	
33. Printing Industry	
34. Pulp and Paper Mills	
35. Sugar Manufacturing	
36. Tanning and Leather Finishing	
37. Textiles Industry	
38. Thermal Power Guidelines for New Plants	
39. Thermal Power Rehabilitation of Existing Plants	
40. Vegetable Oil Processing	
41. Wood Preserving Industry	

\* Exception (the following are World Bank Guidelines not contained in the PPAH and currently in use)

Mining and Milling - Underground  
Mining and Milling - Open Pit