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BLOG

Updated Equator Principles Include Additional ESG Due Diligence Requirements

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On October 1, 2020, the fourth version of the Equator Principles (EP4) came into effect. The Equator Principles are global, cross-industry risk management guidelines applicable to project finance advisory services, project-related corporate loans, and bridge loans. Financial institutions adopt the guidelines voluntarily to aid in the determination, assessment, and management of environmental and social risks associated with large-scale development projects. The Equator Principles have been adopted by 111 financial institutions in 37 countries.

There are several key areas of change in EP4. First, EP4 provides additional due diligence measures and protections of human rights. Specifically, EP4 adopts the United Nation’s Guiding Principles on Business and Human Rights as the operative due diligence risk management framework, which requires financial institutions to evaluate the impact on human rights and include this impact in every Environmental and Social Impact Assessment.

Relatedly, EP4 enhances guidelines for engagement with indigenous communities by requiring free, prior and informed consent where this would be required by the International Finance Corporation’s Performance Standard 7. The financial institution’s independent consultant is also required to review the requisite consultation with indigenous communities.

With respect to climate change, EP4 expressly recognize the role of financial institutions in meeting the objectives of the Paris Agreement. For some projects, EP4 requires a Climate Change Risk Assessment, with the exact requirements depending on the nature of the underlying project. This requirement applies to projects that will have significant emissions of greenhouse gases (greater than 100,000 tons of CO_2 equivalent annually) and include “Category A” projects, defined as projects that have the potential for significant adverse environmental and social risks, and “Category B” projects, defined as projects that have the potential to cause limited adverse environmental and social risk.

Finally, while EP3 applied to Project-Related Corporate Loans over $100 million, EP4 lowers the applicable financial threshold to $50 million. As such, in addition to the heightened requirements noted above, EP4 will also apply to a larger number of projects.

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