

Momentum is building in favour of sustainability standards but there is still a long way to go. *Jane Monahan* looks at the state of progress in the implementation of the Equator Principles.

What has sustainability to do with private banks? Their labour policies are good and they do not produce the carbon emissions that are the main culprits of climate change.



Rachel Kyte

Yet, in the late 1990s, an oil pipeline project in Ecuador, Oleoducto Crudo Pesado, failed to meet the environmental safeguards and guidelines of the International Finance Corporation (IFC), the World Bank's private sector arm.

Then, when the US Export Import Bank and the World Bank both refused to finance China's controversial Three Gorges Dam, private banks, unhampered by public scrutiny, stepped in and filled the gap.

As a result, non-governmental organisations (NGOs) started to target private financial institutions as the ultimate source of environmentally unfriendly projects. The media scrutiny that followed the corporate governance scandals of Enron and WorldCom meant that the major banks were already keen to protect their reputations when investing in projects like dams, oil and gas pipelines, and mining in emerging economies, and willing to respond to the NGOs' concerns. An example of this is the Equator Principles (EPs), launched in June 2003 by the IFC, ABN AMRO, Citigroup, Barclays and West LB.

The Principles are neither the first nor the only sustainability standards in the financial services sector. But Michelle Chan Fishel of Friends of the Earth (FoE) tells *The Banker* that she considers them to be the best. "They are much more specific. And they oblige banks to do due diligence and environmental assessments when investing in large projects," she says.

The Principles also include safeguards in areas ranging from environmental assessments and natural habitats to the rights of indigenous peoples and child labour. And if borrowers fail to comply with loan conditions, lenders can call in the loan. "They have more meat on them," says Ms Chan Fishel.

The IFC's safeguards are currently being extended and the changes will be included in the Principles later in 2005.

### **De facto standard**

In the first year of the EPs, a total of 27 banks signed up, representing more than 75% (more than \$55bn) of global project financing funds. "The Principles have become the de facto standard for foreign direct investment in emerging markets," says Rachel Kyte, director of the IFC's environment and social development department. "The momentum exceeded expectations."

Despite the success, banks and NGOs disagree over how the Principles should be implemented and over how big a policy change they imply. For BankTrack, an international network of NGOs that monitors banks' investments, adopting the Principles ought to lead to banks financing projects that are positive for the environment, such as renewable energy. And banks should be expected to reject projects such as oil and gas pipelines and coal mining, which all contribute to global climate change.

But for the EP banks, adopting the Principles is mainly about managing social, environmental and reputational risk, and avoiding potentially costly litigation that could damage their bottom line, when financing projects of all kinds, including those in traditional areas like fossil fuels.

### **Reporting standards**

Another area of contention concerns the implementation of the EPs and how this should be measured, as well as what should be reported. Without a standardised method of reporting or any independent auditing/compliance mechanism in the Principles, "banks are not obliged to any disclosure or record-taking on implementation. As a result, it's not possible to see how one signatory bank compares with another regarding sustainability, or how one bank's sustainability performance compares from one year to the next. Evaluation is up in the air," says Ms Chan Fishel.

However, Chris Beale, managing director of global corporate investment at Citigroup, tells *The Banker* that there is some uniformity in the way that banks implement and report on the Principles. That is because most large projects are financed by banking syndicates. "These banks have to agree what category of environmental assessment to apply to a project, how severe the impacts will be and whether the assessment should be more or less detailed," says Mr Beale.

## **The first test**

Bankers and NGOs agree that the first major test of the Principles concerns the construction of a 1000-mile long pipeline by a BP-led consortium. The pipeline snakes its way from Baku in Azerbaijan to the Turkish Mediterranean, via Georgia. When fully operational at the end of this year, the Baku-Tbilisi-Ceyhan (BTC) pipeline will transport up to one million barrels of oil each day from the Caspian to world markets.

Two-thirds of the project's cost – \$2.6bn – is financed by public and private institutions, including the IFC, the UK's Export Credits Guarantee Department (ECGD) and nine EP banks: ABN AMRO, Citigroup, Mizhuo, Dexia, HVB, ING, KBC, Royal Bank of Scotland and West LB.

But, in a report on the Principles in their first year, BankTrack singled out the BTC pipeline as an example of how EP banks are continuing to finance unsustainable projects. The report said that EP banks backed the project in spite of accusations by NGOs that it violated dozens of the Principles, not to mention World Bank human rights, legal, ethical and environmental standards.

For instance, NGOs allege that the BP-led consortium did not provide sufficient consultation or compensation for Azeri, Georgian and Kurdish locals along the pipeline route. However, Mrs Kyte says that a substantial amount of consultation was carried out.

The pipeline has also been hit by construction issues. Felicia Swanson, an IFC investment officer on the BTC project, tells *The Banker* that the BP-led consortium did not inform the IFC and other lenders about these before they approved its loans. This led to hearings last November by a special committee in the UK parliament on the circumstances of the ECGD's BTC funding.

However, Mrs Swanson says that the "IFC and some other lenders" are "now satisfied" with "corrective actions" on the pipeline taken by BP.

In another setback, Banca Intesa, Italy's biggest bank, recently sold a third of its \$60m quota in the consortium. The bank says that it is also negotiating the sale of the rest of its stake.

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## **The equator principles banks**

The banks that have adopted the Equator Principles include Citigroup, which has been active in project finance for 25 years. In contrast, Italian bank MCC and Brazil's Banco Itaú, which are also signatories, both conduct a negligible amount of project finance; it is unclear what signing up to the Principles means for them.

The capabilities of the signatory banks also vary widely. For instance, Citigroup says that 800 of its staff have received training in the Principles, and that an estimated 400 bankers have also completed Equator Principle training programmes at the IFC.

The signatories to the Equator Principles are:

- ABN AMRO
- Banco Bradesco
- Banco Itaú
- Banco Itaú BBV
- Bank of America
- Barclays
- BBVA
- Calyon
- CIBC
- Citigroup
- Credit Suisse First Boston
- Dexia Group
- Dresdner Bank
- EKF
- HSBC Group
- HVB Group
- ING Group
- KBC
- MCC
- Mizhuo Corporate Bank
- Rabobank Group
- Royal Bank of Canada
- Standard Chartered Bank
- The Royal Bank of Scotland
- Unibanco
- West LB
- Westpac Banking Corporation