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The Equator Principles – EP4

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Background

Recent global trends related to corporate governance include increased emphasis on the social and environmental responsibilities of business. As a result, the environmental and social affairs of a corporation are now a topic of great interest to all stakeholders of the corporation, including its lenders and shareholders.

Due to growing interest in the environmental and social impacts of business, the Equator Principles were formulated in June 2003 to establish a framework for managing these risks and impacts when financing projects. The Equator Principles have been periodically updated, with the most recent version—EP4—taking effect as of October 1, 2020. Under EP4, Canadian borrowers could potentially be subject to more stringent requirements with respect to environmental and social risk management compared to what is typically required under Canadian law.

The Equator Principles – What Are They?

The Equator Principles are a risk management framework for identifying, assessing, and managing environmental and social risks in development projects. Its primary purpose is to provide a minimum standard for due diligence and monitoring, and to support responsible risk decision-making.

Financial institutions (EPFIs) voluntarily adopt the Equator Principles and commit to implementing them through their internal policies, procedures, and standards. By agreeing, adhering institutions agree they will not finance projects that do not comply with the regime’s requirements.

EPFIs are responsible for categorizing projects based off their potential environmental and social risks and impacts. Different requirements will apply depending on a project’s category. For instance, certain projects will require borrowers to develop and maintain an environmental and social management system to identify, assess and manage risks related to the project on an ongoing basis. EPFIs may also require borrowers to create an action plan to minimize or offset any potential risks of a project, or to demonstrate ongoing engagement with local communities affected by the project.

EP4

EP4 includes significant changes from its predecessor, including new requirements related to assessing human rights and climate change impacts of a project, and enhanced requirements for projects affecting Indigenous Peoples. For instance, Free, Prior, and Informed Consent from Indigenous Peoples may be required in certain projects, which goes beyond the current Canadian legal requirement of the duty to consult.

One of the significant changes in EP4 is the possible requirement for EPFIs to assess projects located in “Designated Countries”—countries deemed to have robust environmental and social governance and legislation systems in place, which includes, among others, Canada, the US, the UK, and Australia. Prior to EP4, Designated Countries were deemed in automatic compliance with certain principles and were not subject to any evaluation separate from that of the relevant host country laws. With the development of EP4, that is no longer the case. EPFIs will evaluate specific risks of certain projects in Designated Countries to determine whether one or more of the IFC Performance Standards — an international benchmark for identifying and managing environmental and social risks — should be used as guidance to address those risks in addition to the host countries laws.

What Should You Do As a Company?

Because of the new requirements in EP4, the Equator Principles will play a larger role in domestic project finance transactions for both Canadian projects and for Canadian borrowers and sponsors than previously. Borrowers should become familiar with EP4, and the standards and requirements that may apply to them when seeking financing. Borrowers should review the policies, procedures, and standards of EPFIs that may act as lenders for their projects.

As EP4 brings considerable new changes to project finance within Canada, there are several steps that borrowers can take to prepare themselves for upcoming projects that may be subject to the Equator Principles, such as:

- Borrowers should start the conversation with EPFIs early and ask important questions to ensure that expectations are clear at the outset;
- Borrowers should review and, if necessary, update their environmental and social governance regimes;
- Borrowers should review and ensure that they are aligned with the UN Guiding Principles on Business and Human Rights;
- Borrowers should become familiar with the requirements under EP4 and review EPFI policies; and
- Borrowers should proactively manage environmental and social risks and impacts in light of the

revised standards under EP4.

Finally, companies lacking internal expertise in these matters should consider seeking guidance from external experts. As always, the Cassels Banking & Specialty Finance Group is available to provide advice and assistance to businesses navigating these tricky financing issues.
