

9 August 2019

Dear Equator Principles Association and BSR,

**Hermes EOS Response to the Review of the Equator Principles (Towards EP4)**

Hermes welcomes the opportunity to provide comments to this consultation. Hermes Investment Management is an asset manager with a difference. With £34.1 billion<sup>1</sup> in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world. Our stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £451 billion<sup>2</sup> on behalf of international institutional investors.

The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients. Our response to this consultation is explicitly supported by PNO Media (the Netherlands), VicSuper (Australia) and Ministry of Finance State of Saxony-Anhalt (Germany).

We believe this is a timely and necessary intervention to reset the Principles as a global good practice standard that both manages risks to the EP financial institutions (EPFIs) and supports societal environmental and social goals. Our comments are provided based on these two objectives.

We support an updated and strengthened set of principles which is fit for purpose and continues to raise the standard in good environmental and social management. There have been significant events since the last EP update in 2013, not least the Paris Agreement, Sustainable Development Goals and concerns and failings in major oil pipeline projects. We believe the current draft text does not reflect the importance of, and learnings from, these events and leaves signatory financial institutions, and their investors, open to unnecessary risks in future. EP4 should be strengthened to reflect current international good practice and remain relevant in the face of the events of the next 5+ years.

We encourage the EPFIs to adopt a risk-based approach to the application of the principles, regardless of project location or transaction size. As such we support removal of the distinction between designated and non-designated countries, to remove the risk of any legalistic 'compliance with the law' approach. As an international good practice risk management framework the principles should adopt and refer to international good practice standards, in particular the UN Guiding Principles on Human Rights and the UN Declaration on the Rights of Indigenous Peoples which are underrepresented and absent, respectively, in the current text. Similarly, the principles should embed the goals of the Paris Agreement, requiring EPFIs and clients to consider the alignment of projects over their full lifetime with those goals.

Below we set out our response to the consultation and hope our comments and suggestions are of assistance. We also attended the London in-person consultation to be involved in the discussion, shape our response and share our perspective.

If you would like to discuss our views in further detail, please do not to hesitate to contact us at ([andy.jones@hermes-investment.com](mailto:andy.jones@hermes-investment.com)).

Yours sincerely,

Andy Jones and Roland Bosch, Hermes EOS

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<sup>1</sup> As at 31 March 2019

<sup>2</sup> As at 31 March 2019

**Note:** new wording suggestions are shown in italic text.

### **General/overall**

We welcome the new references to international agreements and initiatives, in particular the Paris Agreement, Nationally Determined Contributions and the Sustainable Development Goals.

### **Social impact and human rights**

1. Given that i) principle 2 and the definition of ESMP require offsetting, and ii) human rights and other social impacts cannot be offset, we recommend changing the preamble wording to:

“If these impacts are unavoidable they should be minimised, mitigated and, *where possible*, offset.”

2. A risk-based approach should be applied to human rights regardless of transaction size (see also our comments on implementation reporting under Other Comments).

3. Option 1 under principle 5 is in our view not a viable option, as not obtaining consent would be a violation of the right to Free Prior and Informed Consent (FPIC). The EPFIs, like all banks, have a responsibility to respect human rights, globally. We recommend that under option 2 explicit reference is made to the UN Guiding Principles and UN Declaration on the Rights of Indigenous Peoples as key applicable international standards.

4. Principle 5 and the Exhibit I definition of FPIC should make it clear that consent should be obtained before the construction phase, and again should include reference to the UN Declaration of the Rights of Indigenous Peoples.

### **Climate change**

1. Given the global and economic importance of the Paris Agreement the wording in the preamble on the responsibility of EPFIs with respect to it should be strengthened. We suggest:

“we will respect the goals of the 2015 Paris Agreement, and our responsibility to contribute to their achievement, and recognise that EPFIs have a role to play to improve the availability....”

2. The requirements of the climate change assessment (principle 2) to look at emissions, and the requirement for clients to publicly report annual emissions, should include an estimation of Scope 3, in particular for upstream processes and downstream product use. The client reporting requirement should also include a projection of emissions over the life of the project.

3. The climate change assessment (principle 2 and annex A) should:

i. Consider the whole project/asset life. Suggested wording:

“Consideration of relevant physical risks *over the life of the project/asset*” and “What are the current and anticipated climate risks (transition and/or physical) of the Project’s operations *over the life of the project*?”

ii. Integrate adaptations, and where possible carbon sequestration, into the design of the project.

4. The wording in Annex A on the climate change risk assessment should be amended to:

“this assessment should also consider the Project’s compatibility with *international and* host country national climate commitments.”

5. A definition of national climate commitments/nationally determined contributions should be added into Exhibit I.

### **Designated countries and applicable standards**

1. Our preference is for the designated/non-designated distinction to be removed, as set out in the Investor Statement to the Equator Principles Association we supported in 2017. We recommend the onus is placed on EPFIs to understand the laws/regulations, enforcement and

practice<sup>2</sup> in the project host country, the gaps relative to international standards and the resulting risks.

2. If the distinction is to be retained we recommend it is used only as a guide and that the onus is still placed on the EPFIs to undertake a risk and gap analysis approach as above. It is critical that this is clarified under Principle 3.

### **Scope of applicability of the EPs**

Please see 'Other Comments' section below regarding implementation reporting.

### **Principle 1 (Review and Categorisation)**

No specific comments

### **Principle 2 (Environmental and Social Assessment)**

1. We recommend extending the client requirement with regard to alternatives analysis, and suggest the following wording:

“Following completion of an alternatives analysis, the client will provide, through appropriate documentation, evidence of technically and financially feasible and cost-effective options, *including assumptions used and, if the best available environmental options was not adopted, why this was the case.*”

2. It is important to be clear that human rights and other social impacts cannot be offset. We recommend amending the wording to:

“The Assessment Documentation should propose measures to minimise, mitigate, and, *where possible*, offset adverse impacts in a manner relevant and appropriate to the nature and scale of the proposed Project.”

3. We also recommend changing the wording to:

“The client is expected to include assessments of potential adverse Human Rights impacts and climate change risks *and impacts, including compatibility with host nation and international environmental and social commitments*, as part of the ESIA or other Assessment, with these included in the Assessment Documentation.”

### **Principle 3 (Applicable Environmental and Social Standards)**

1. As highlighted above in the designated countries section, our preference is for the designated/non-designated distinction to be removed.

2. As the equator principles are a risk management tool, the supporting IFC performance standards should be used where appropriate. As such we recommend the wording is amended to:

“In addition, for Projects located in Designated Countries, the EPFI will evaluate the specific risks of the Project to determine whether one or more of the IFC Performance Standards *should* be used as guidance to address those risks, in addition to host country laws.”

### **Principle 4 (Environmental and Social Management System and Equator Principles Action Plan)**

No specific comments

### **Principle 5 (Stakeholder Engagement)**

1. Please see above section on social impact and human rights with regard to our preference for option 2.

2. The text should make clear that affected communities must be involved early enough to meaningfully participate and input into project design. This seems good risk management. Similarly, we recommend changing the wording to:

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<sup>2</sup> As highlighted in the paper by Shift

“To facilitate Stakeholder Engagement, the client will, commensurate to the Project’s risks and impacts, make the appropriate Assessment Documentation readily available to the Affected Communities, and where relevant Other Stakeholders, in the local language and in a culturally appropriate manner. *The documentation should be provided in good time for Affected Communities to meaningfully participate and input, and reasonable efforts should be made to raise awareness among Affected Communities of the documentation.*”

#### **Principle 6 (Grievance Mechanism)**

We support the idea of the Equator Principles Association coordinating its own channel for receiving grievances and concerns, to be used where EPFI client grievance mechanisms fail or stakeholders feel they cannot use the channel for fear of reprisal.

#### **Principle 7 (Independent Review)**

1. EPFIs should seek to see and understand the number and nature of grievances being reported, and evidence that FPIC has been achieved. We recommend changing the wording to:

“...will carry out an Independent Review of the Assessment process including the ESMPs, the ESMS, and the Stakeholder Engagement process documentation in order to assist the EPFI’s due diligence and determination of Equator Principles compliance. *This should include the number of nature of grievances recorded, and evidence that FPIC was obtained, where relevant.*”

2. We believe the second paragraph (beginning “For Category B projects...”) should be removed. That the entity is a multilateral, bilateral or OECD export credit agency does not guarantee that the due diligence is of good quality, nor that interests are aligned with those of EPFIs.

#### **Principle 8 (Covenants)**

No specific comments

#### **Principle 9 (Independent Monitoring and Reporting)**

No specific comments

#### **Other comments**

##### EPFI reporting

As there is no box in the online system to provide input on Principle 10 (Reporting and Transparency) our comments on EPFI reporting are included here.

1. The quality and expectations on corporate transparency have advanced significantly since 2013 and the principles should reflect this. The current requirements of reporting under the EPs provide little accountability or assurance to stakeholders, including investors. In addition to the project level data, we recommend that EPFIs provide annual implementation reporting that includes:

- Whether/how they have applied elements of the Equator Principles beyond the defined scope, including, where applicable, reference to:
  - Smaller transaction sizes;
  - Other financial products, in particular broader corporate lending; and
  - Designated countries (if the distinction is retained).
- Due diligence processes regarding human rights and, where applicable, indigenous peoples.
- How they have considered national and international climate commitments and the Sustainable Development Goals in their project financing and broader corporate lending during the year, including in:
  - Project/asset/client assessment;
  - Management and action plans; and
  - The discussions and decisions by the credit committees.

2. We note there is no proposal in the draft text with regard to monitoring or enforcement of EPFI implementation of the principles. There is still no requirement for EPFIs to gain assurance on their annual and implementation reporting required by Principle 10 despite the work of

signatory banks on this issue. We would welcome this, or other mechanisms, to provide comfort to stakeholders that all signatory EPFIs are adhering to their commitment to implement the principles.

#### Quantification and reporting

We suggest enhancing the wording to:

“GHG emissions should be calculated in line with the GHG Protocol to allow for aggregation and comparability across Projects, organizations and jurisdictions. Clients may use national reporting methodologies if they are consistent with the GHG Protocol, *or are reported in addition to GHG Protocol data.*”

#### Exhibit II

To make the list of potential issues comprehensive we recommend including the following wording:

7. major hazards assessment and management, *including catastrophic risk*
9. pollution prevention and waste minimisation, pollution controls (liquid effluents, emissions and noise), and waste management, *including tailings storage facilities*
11. water usage, water intensity, water source, *water discharge (e.g. temperature, acidity, salinity)*

[Also, include the additional points:]

- \* *Ongoing, post-project, sustainability of community/local economy*
- \* *Benefit sharing*
- \* *Bribery and corruption*