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ENVIRONMENTAL AND FINANCE & BANKING **ALERT**

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The Revised Equator Principles – encouraging a movement to environmental and socially sustainable financing of projects across the globe

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The Revised Equator Principles – encouraging a movement to environmental and socially sustainable financing of projects across the globe

For the first time in the 15-year history of the WEF Global Risks Perception Survey, climate-related issues dominated all of the top-five long-term risks by likelihood in 2020 according to members of the WEF's multi stakeholder community.

Although the impacts of climate change have not been devoid of attention or debate, climate change was yet to be presented as one of the top threats to the global economy. This is no longer the case as from January 2020, when climate change and related environmental issues were ranked by the World Economic Forum (WEF) in its annual Global Risks Report (2020 Risks Report) as the most likely risks our world faces today.

For the first time in the 15-year history of the WEF Global Risks Perception Survey, climate-related issues dominated all of the top-five long-term risks by likelihood in 2020 according to members of the WEF's multi stakeholder community. Specifically, risks 1 to 5 of the Top 10 Risks by likelihood over the next 10 years are, in order of priority: (1) extreme weather; (2) climate action failure; (3) natural disasters; (4) biodiversity loss; and (5) human-made environmental disasters.

Locally, these concerns have become central to several discourses, especially amongst the younger generations. On Youth Day this year, 16 June 2020, the Minister for Environment, Forestry and Fisheries (DEFF Minister) hosted a virtual Youth Environment and Sustainability Dialogue (Youth Dialogue) that focused on how to rebuild South Africa's economy and society after the global COVID-19 pandemic. One of the key concerns raised was the effect of COVID-19 on South Africa's ability to achieve its 2015 Paris Agreement goals, with the key themes, concerns and proposed solutions captured in the 2020 Risks Report reflected in the Youth Dialogue.

The growing recognition of the interdependence of economic stability and climate change has also recently been highlighted in the publication by the South African Reserve Bank of its working paper titled "*Climate change and its implications for central banks in emerging and developing economics*" (Working Paper). Aligned with the 2020 Risks Report, the Working Paper recognises the ability of climate change to affect financial stability and augment economic risks, particularly within emerging markets.

As the risk to global economic growth becomes more tangible, as a result of *inter alia*, the impact of the COVID-19 pandemic and debt burdens that are causing a recession across emerging markets, the climate change responsiveness across various sectors becomes of increasing relevance, with such response being echoed in the latest revision to the Equator Principles.

The Revised Equator Principles

The Equator Principles are intended to provide financing institutions a minimum standard for due diligence, assessing and monitoring to support responsible environmental and social risk management and decision-making, and are applied by Equator Principles Financial Institutions (EPFIs) to infrastructure projects globally and in all industry sectors that are financed by various financial products. The Equator Principles are administered by the Equator Principles Association (EPA) which is the unincorporated association of member EPFIs, including a number of South African financial institutions.

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The Revised Equator Principles – encouraging a movement to environmental and socially sustainable financing of projects across the globe*...continued*

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The last iteration of the Equator Principles (being the third version) has been in place since 2013 and has subsequently been revised in accordance with the EPA's strategic review process. The review process commenced in 2018 and was subjected to extensive engagement with EPFIs and various stakeholders with the EPA describing the process as a *"an intensive two-year process with hundreds of contributors"*. The revision process considered four themes being: social impact and human rights; climate change; designated countries (being: countries deemed to have robust environmental and social governance, legislation and institutional capacity); and scope of applicability of the Equator Principles. It is important to note that South Africa is considered a non-designated country as it does not appear on the list of designated countries. The list of designated countries can be found here.

On 18 November 2019, the EPA launched the fourth version of the Equator Principles, with the intention that EPFIs implement the revised Equator Principles with effect from 1 July 2020. However, due to the impact of the COVID-19 pandemic, the EPA has granted EPFIs an extension until 1 October 2020. A copy of the latest version of the Equator Principles can be found here.

The Equator Principles are incorporated by EPFI's into finance documents through covenants linked to compliance and continuous monitoring until such time as the loan is fully repaid by the borrower. The finance documents will generally include an Equator Principles Action Plan prepared by a reputable technical expert, detailing a plan for the borrower to comply with the Equator Principles on an on-going basis during the tenure of the loan funding; remedial measures to be implemented to remedy any breach of the Equator Principles; and detailing the time schedule for such remedial action.

The Equator Principles Action Plan, as well as an Environmental and Social Management Plan (which summarises the borrower's commitments to address and mitigate risks identified in the Environmental and Social Impact Assessment) are mainly incorporated as condition precedents prior to any funds being made available by lenders in relation to a project. It is also customary for the finance documents to contain adequate undertakings and provisions to ensure ongoing compliance with the Equator Principles.

Any breach of the Equator Principles Action Plan which remains unremedied or is incapable of being remedied will trigger an event of default under the finance documents. It has become market practice globally for project finance transaction that lenders insist that sponsors of a project prepare an Equator Principle Action Plan prior to such lenders approving the funding.

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The Revised Equator Principles – encouraging a movement to environmental and socially sustainable financing of projects across the globe*...continued*

Although the Equator Principles do not apply retrospectively, EPFI's were previously required to apply the Equator Principles in instances where the expansion or upgrade of an existing Project would cause significant environmental and social risks.

The notable revisions to the Equator Principles can be summarised as follows:

Revisions applicable to project finance considerations

- The Equator Principles were previously applied to four financial products, namely: Project Finance Advisory Services (where total project capital costs are US$ 10 million or more); Project Finance (with total project capital costs of US$ 10 million or more); Project-Related Corporate Loans (the requirements of which have also now been revised where all of the following three criteria are met: (i) the majority of the loan is related to a project over which the client has effective operational control (either direct or indirect); (ii) the total aggregate loan amount and the EPFI's individual commitment (before syndication or sell down) are each at least US$ 50 million; and (iii) the loan tenor is at least two years); and Bridge Loans (with a tenor of less than two years that are intended to be refinanced by Project Finance or a Project-Related Corporate Loan that is anticipated to meet the relevant criteria applicable to the respect financial product). A fifth financial product has now been included to which the Equator Principles will apply, namely Project-Related Refinance and Project-Related Acquisition Finance, where all of the following three criteria must be met:
    - The underlying Project was financed in accordance with the Equator Principles framework;
    - There has been no material change in the scale or scope of the Project; and
    - Project Completion has not yet occurred at the time of the signing of the facility or loan agreement.
- EPFI's may at their own discretion utilise the Equator Principles framework for financial products that fall outside of the scope of the Equator Principles. This is significant, as a potential borrower would need to confirm whether they are willing to and can comply with the Equator Principles in order to obtain funding.
- Although the Equator Principles do not apply retrospectively, EPFI's were previously required to apply the Equator Principles in instances where the expansion or upgrade of an existing Project would cause significant environmental and social risks. EPFI's are now, it appears, required to apply the Equator Principles in all instances of financing of expansions or upgrades of an existing Project and not just instances where there are significant environmental and social risks.

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The Revised Equator Principles – encouraging a movement to environmental and socially sustainable financing of projects across the globe...*continued*

The EPA is in the process of developing a guideline document to be made available to EPFIs and all stakeholders regarding the implementation of the revised Equator Principles.

Revisions applicable to environmental considerations

- When a Project is proposed for financing, the EPFI must now, as part of its internal environmental and social review and due diligence, include consideration of the human rights, climate change and biodiversity impacts when categorising the Project.
- A Project must also include assessments of potential adverse human rights impacts and climate change risks as part of the Environmental and Social Impact Assessment prescribed by Principle 2 of the Equator Principles as well as the commitment of EPFI in supporting the objectives of the 2015 Paris Agreement. In a South African environmental context, it is recommended that projects that will be project financed and which will require environmental authorisation incorporate the specialist assessments prescribed by the Equator Principles as part of the environmental impact assessment process. Climate Change Risk Assessments, for instance, are recommended to be aligned with Climate Physical Risk and Climate Transition Risk categories of the Task Force on Climate-related Financial Disclosures, over and above any South African environmental legislative requirements.
- Where the free, prior and informed consent of impacted indigenous/traditional communities is required, the EPFI will require a qualified independent consultant to evaluate the consultation process with indigenous/traditional communities, and the outcomes of that process, against the requirements of host country laws and IFC Performance Standard 7. Public participation as prescribed by South African environmental legislation may need to be bolstered accordingly.
- In terms of reporting obligations, the EPFI will encourage the borrower to share commercially non-sensitive Project-specific biodiversity data with the Global Biodiversity Information Facility and relevant national and global data repositories to enable such data to be accessed and re-used in future decisions and research applications.

The EPA is in the process of developing a guideline document to be made available to EPFIs and all stakeholders regarding the implementation of the revised Equator Principles. It is almost certain that financial institutions will, with effect from 1 October 2020, start introducing compliance with the revised Equator Principles in their term sheets and mandate letters. EPFIs are therefore encouraged to familiarise themselves with the new revised Equator Principles.

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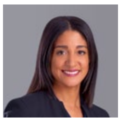

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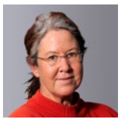

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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