The Equator Principles Revision Process – Better, Stronger Standards?

Presentation to:

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North American Task Force
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Agenda Overview

• Intro – Where are we?
• Quick Overview of Citigroup’s ESRM Policy
• Overview of Equator Principles Revision Process
• Key Proposed Changes to Equator Principles
• Future challenges
The New Global Business Environment

Increasing resource scarcity

Growing stakeholder awareness

Strengthening legislative, regulatory and enforcement frameworks worldwide

Increased transmission of global reputational risk to the financier
“... Citigroup has no meaningful social or environmental criteria by which it evaluates companies or projects. Unless an investment is illegal or risky financially, from Citigroup's perspective, it's fair game.”

Rainforest Action Network
We know environmental and social risk can translate to financial risk…

Work stops at $350m cement plant
According to an eye-witness account, the protest was spurred by plans by the major contractor of the cement factory, to slash salaries from an initially agreed upon amount.

Work has been suspended indefinitely.

Ecuadorian Soldiers Clash with Oil Protesters

Argentina asks Uruguay to Halt Pulp Project

Stones Kill 4 Indonesian Officials in U.S. Mine Protest
March 16, 2006
The Influence of Key Stakeholders

- **Community**
- **Shareholders**
- **Employees**
- **Company**
- **Export market Regulators**
- **Insurers**
- **Clients**
- **Media**
- **Government**
- **NGOS**

**External Influences:**
- Disinvestment
- Market loss
- Increased cost
- Loss of cover
- Loss of operating license
- Contract loss, boycott
- Strike, sabotage
- Shutdown, delay
- Campaigns
- Negative publicity

**Internal Influences:**
- Increased cost
- Disinvestment
- Contract loss, boycott
- Strike, sabotage
- Shutdown, delay
- Campaigns
- Negative publicity
Environmental and Social Risk Management (ESRM) at Citigroup

**Transactor:** screens transactions and complies with approval, analysis, documentation and process requirements

**ESRM Unit:** The ESRM Director and VP serve as a technical resource and counsel for the ESRM Specialists. The Director is also available to others in the CIB for consultation and advice on policy interpretations and on transactions that may have environmental or social risk concerns

**ESRM Specialists:** Certain senior credit officers are appointed ESRM Specialists by CIB’s Chief Risk Officer. The ESRM Specialists have review and approval responsibilities for transactions with sensitive environmental and social risks

**Portfolio Banker:** Continues ESRM monitoring over life of loan, in consultation with ESRM Director, as needed
Citigroup ESRM Policy

- Citigroup has a comprehensive Environmental and Social Risk Management Policy (developed in 2003 following adoption of EPs)
- Covered Transactions range from project financings (Equator Principles transactions) to corporate and government loans, letters of credit, bonds, and equity deals (covered by the ESRM Policy)
- Core of the Policy is “known use of proceeds”
- We Categorize all of these Transactions according to the IFC screening criteria (A, B, C)
- All Category A transactions receive elevated/heightened review and approval by a Senior Credit Officer in the Firm, in consultation with ESRM Director
ESRM Covered Transactions

- Facility amount > $50 MM and known use of proceeds
- Capital costs > $10 MM and known use of proceeds
- Equator Principles apply
- Expansion or upgrade is planned and capital costs > $10 MM
- Equator Principles apply
- Capital costs > $10 MM and known use of proceeds
- Aggregate amount > $50 MM and supports specific investment/project
- Financing amount > $50 MM and known use of proceeds
- Citigroup investment > $5 MM
- Underwriting or arranging > $50 MM in aggregate
ESRM specific Sector Policies –

• Our ESRM Policy also includes two “sector policies”

• Anti-illegal Logging Initiative/Sustainable Forestry
  – New risk assessment criteria and steps for Forest Products Obligors
  – Forestry projects in “high risk” geographies (or those covered by the Equator Principles) will require independent certification (e.g., CERFLOR in Brazil, SFI, FSC)

• Nuclear-related Transactions
  – Based on USExim Nuclear policy (and EBRD standards for Eastern Europe)
EQUATOR PRINCIPLES 2 – Revisions Process

During 2005, EPFIs engaged with IFC, clients and NGOs regarding IFC’s revisions to the Safeguard Policies (now called Performance Standards), which underpin the Equator Principles.

The IFC policy revision process has subsequently informed the EPFI network in its own revision of the Equator Principles which started in earnest in early 2006.
EQUATOR PRINCIPLES 2 – Revisions Process

• Citigroup and ABNAmro have led re-drafting process, with significant support and input from “EPFI Working Group”, and all interested EPFIs

• March/April/May ‘06: external outreach, and comments received, from NGOs, clients and industry groups

• Meetings with clients, NGOs, and Official Agencies/ECAs
  • Good and constructive comments received from these key stakeholders

• Citigroup and ABNAmro, together with “EPFI Working Group”, currently reviewing feedback and re-drafting

• July 1, 2006: target effective date for new Equator Principles
EQUATOR PRINCIPLES 2 – Proposed Key Changes

PREAMBLE:
• Shorter, crisper preamble
• Explicit limitation of EPs to project finance (definition of “project finance” based on BASEL II)
• Inclusion of “negative impact avoidance” language

NEW SCOPE SECTION:
• Equator still applies to all new project financings GLOBALLY in all industries
• Lowering of project capital costs threshold from USD50m to USD10m
• Extension of EPs to project finance advisories
• Explicit inclusion of EPs to upgrades and expansions of existing projects
EQUATOR PRINCIPLES 2 – Proposed Key Changes

Principles – Grouping into concrete principles

• Principle 1: Review and Categorization
• Principle 2: Social and Environmental Assessment (Process)
• Principle 3: Applicable Social and Environmental Standards
  • High-income OECD countries vs. Emerging Markets
• Principle 4: Action Plan and Management System
• Principle 5: Consultation and Disclosure
• Principle 7: Grievance Mechanism
• Principle 8: Independent Review
• Principle 9: Covenants
• Principle 10: EPFI Implementation Reporting
EQUATOR PRINCIPLES 2 – Proposed Key Changes

**Principles**

- Social and Environmental Assessment instrument and Action Plan for all Category A and Category B projects (change from existing procedure)
- Action Plan to be covenanted for both As and Bs
- More robust consultation language (including “free, prior and informed consultation”)
  - EPFIs did not adopt “broad community support” language (IFC institutional commitment)
- New covenant requirement for compliance w/ applicable host country social and environmental laws/regulations
- Independent review still required for As and, as appropriate, for Bs
EQUATOR PRINCIPLES 2 – Proposed Key Changes

• EPFIs will only formally adopt/endorse the new Performance Standards and EHS Guidelines

• EPFIs will not formally adopt the IFC Guidance Notes on each Performance Standard, but these will be useful reference points for us and for clients

• EPFIs will not adopt the IFC “Sustainability Policy” commitments
  • Issues such as EITI/revenue transparency may be taken up by each individual EPFI

• New proposed commitment for all EPFIs to report publicly (Principle 10)
  • big step forward for EPFIs and will increase transparency
EQUATOR PRINCIPLES 2 – Applications of EPs in High Income Countries (US, Canada, Western Europe)

• Equator Principles still apply to all projects globally in all industry sectors
• Much clearer standard/procedure for application of EPs to projects in High Income countries:
  • EPFIs will still categorize and conduct a review of relevant social and environmental information
  • EPFIs will not apply IFC Performance Standards or EHS Guidelines to projects in High Income countries
  • EPFIs view compliance with local and national environmental laws, regulations and permitting processes (including public comment processes) as acceptable substitute to
  • May still require an “action plan” to be covenanted (based on local/national laws and regulations) and may still require Independent Review
  • EPFIs should still count these Transactions in their annual external implementation reporting
  • Examples in N. America (US/Canada)?
Future challenges / what next?

• There are now over 40 Equator Principles Financial Institutions
  – Not yet signed up: Soc Gen, BNPParibas, many national and regional banks (e.g., China, India)

• Key goal for 2006 and beyond: recruitment/sign up more Banks, especially key regional and national banks

• EPFI governance?

• Implementation guidance? Emerging good practice?

• Other? Questions?