

The Equator Principles

The Equator Principles (EPs) are risk management framework adopted by financial institutions to identify, assess and manage environmental and social risks in project financing.¹ To address the environmental and social risks, the EPs were developed in 2003 by the International Finance Corporation (IFC), which were intended to serve as an international de facto benchmark for sustainable project financing. Financial institutions are required to adopt the EPs when financing large-scale development or construction projects involving oil and gas development, mining, power plants and dams. The term "Equator" is used since the EPs are to be adopted globally by financial institutions in the northern and southern hemispheres and the equator is equidistant from the two hemispheres. Financial institutions that implement the EPs are known as Equator Principles Financial Institutions (EPFIs).

The EPs are applied to five financial products, namely (i) Project Finance Advisory Services, (ii) Project Finance, (iii) Project-Related Corporate Loans, (iv) Bridge Loans and (v) Project-Related Refinance and Project-Related Acquisition Finance.²

The Principles³

The EPs are periodically updated to meet the current development on climate change, biodiversity, human rights and indigenous people. The EP4 is the latest EPs, which expands the scope of the EPs to Project-Related Refinance and Acquisition Finance and emphasizes on climate change and human rights i.e. indigenous peoples' rights in developed countries. The ten principles of the EP4 are summarized below:

Principle 1: Review and Categorisation – EPFIs have to review and categorise the proposed project into three categories i.e. high risks, addressable risks and no risk.

Principle 2: Environmental and Social Assessment – The borrower has to assess and declare the environmental and social risks of the proposed project.

Principle 3: Applicable Environmental and Social Standards - The borrower has to address the country's laws, regulations and permits in their assessment document.

Principle 4: Environmental and Social Management System and Equator Principles Action Plan – For high risks and addressable risks projects, the borrower has to develop an Environmental and Social Management Plan (ESMP) and an Environmental and Social Management System (ESMS) to evaluate and address the risks.

Principle 5: Stakeholder Engagement - The borrower has to show an ongoing stakeholder engagement process to mitigate the risks.

Principle 6: Grievance Mechanism - The ESMS should provide grievance mechanism to resolve arising concerns as the project progresses.

Principle 7: Independent Review - An independent environmental and social consultant will review the compliance of the assessment document with the EPs.

Principle 8: Covenants - When the borrower's proposal fails to comply with the covenants of the EPs, the EPFI needs to propose remedial actions within a grace period. If the borrower still fails to comply, the EPFI reserves the right to take action.

Principle 9: Independent Monitoring and Reporting - The borrower has to maintain an independent environmental and social consultant to generate reports.

Principle 10: Reporting and Transparency – The borrower has to generate project-specific sustainability reports and the EPFI has to publicly report completed transactions (without violating confidentiality agreements).

Members⁴

As of today, the EPs have been adopted by 137 financial institutions in 38 countries including big financial players such as JPMorgan Chase & Co., Barclays plc and HSBC Holdings plc. Even financial institutions from South East Asia such as Singapore and Thailand have become signatories to the EPs. None of the Malaysian financial institutions, however, is a member of the EPs. As members of the EPs, the EPFIs have to consider the potential impacts of the proposed financing on the environment and the affected communities; hence the EPFIs are obligated to not provide financing to any project where the borrower will not be able to comply with their environmental and social policies.

Sustainable Finance in Malaysia

Bank Negara Malaysia (BNM), being the regulatory body that regulates the financial institutions in Malaysia, has not ratified the EPs. Nonetheless, there have been numerous sustainable efforts initiated by BNM. First, BNM has formed the Joint Committee on Climate Change (JC3) in 2019.⁵ The JC3 aims to pursue collaborative actions for building climate resilience within the Malaysia financial sector. Second, BNM has prepared the Climate Change and

Principle-based Taxonomy (CCPT) in 2021.⁶ The CCPT serves as a guiding principle for financial institutions to assess new financing and investments. The JC3 is also currently developing an ESG Disclosure Guide tailored to Small and Medium Enterprises to improve access to information on business resilience to ESG-related risks. It is noteworthy that the BNM's sustainable initiatives are only applicable within Malaysia.

Future sustainable initiatives are also provided in the Budget 2023⁷. For instance, a Sustainable Development Financing Scheme worth RM1.5 billion will be provided through Bank Pembangunan Malaysia Berhad (BPMB) to achieve the United Nations 17 sustainable development goals. With the global shift towards sustainable development following the 2021 United Nations Climate Change Conference (COP26), we could see that Malaysia has moved to join the bandwagon.

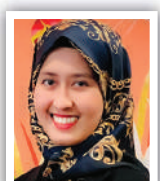
Conclusion

The implementation of the EPs is an inclusive and collaborative effort between financial institutions and borrowers to improve the banking standard and to ensure that projects are less harmful to climate, local ecosystems and communities. It is apparent that the EPs are less established in developing nations such as South East Asia and Africa – this includes Malaysia. Although Malaysia has started to introduce sustainable related initiatives, Malaysian financial institutions should consider implementing the EPs to assist them in managing business risks. This is also important to the extent that Malaysian financial institutions can adopt world-class principles, eventually become significant players in the ASEAN green business market.

¹ The World Bank, <https://ppp.worldbank.org/public-private-partnership/library/equator-principles-eps>.
² Equator Principles, <https://equator-principles.com/about-the-equator-principles/>.
³ EP4, July 2020, https://equator-principles.com/app/uploads/The-Equator-Principles_EP4_July2020.pdf.
⁴ Equator Principles, <https://equator-principles.com/members-reporting/>.
⁵ Bank Negara Malaysia, <https://www.bnm.gov.my/inaugural-meeting-of-joint-committee-on-climate-change>.
⁶ Bank Negara Malaysia, <https://www.bnm.gov.my/documents/20124/938039/Climate+Change+and+Principle-based+Taxonomy.pdf>.
⁷ Budget Official Website, <https://budget.mof.gov.my/en/budget2023/speech/>.



**Ahmad Syahir
Yahya**
Partner



Rohamina Jamil
Senior Associate 2