



## Reporting on Equator Principles Implementation For the year 2010

### Introduction

The Equator Principles (EPs) have become the financial sector's leading voluntary standards for identifying, assessing, and managing social and environmental risks related to Project Finance (PF) transactions<sup>1</sup>. They are based on the IFC<sup>2</sup> Performance Standards (PS) and the World Bank Group Environmental, Health & Safety (EHS) Guidelines, which are comprised of both general and industry specific sets of documents. More information on these standards can be found under the client requirements section of the [IFC Sustainability webpage](#). As of early May 2011, 72 financial institutions from 30 countries have adopted the Equator Principles, accounting for a majority of the PF activity worldwide.

The Equator Principles, launched in 2003 and updated in 2006, are an evolving initiative which has to adapt to address growing expectations from a wide range of stakeholders. The EP Association Steering Committee has initiated in 2010 the EP Strategic Review in which BNP Paribas actively participates. A specific website<sup>3</sup> has been put in place and contains updated information on this process.

In addition, the IFC Performance Standards have been undergoing an extensive review process for the past two years; they were finally approved by IFC Board of Directors in May 2011 and will be publicly released on August 1, 2011, with an effective date of January 1, 2012.

As the EP Financial Institutions (EPFIs) are the largest users of the PS, the Steering Committee (of which BNP Paribas is a member) has provided, on behalf of all EPFIs, comprehensive comments and feedback to the IFC during the various consultation phases. Main proposed changes to the Performance Standards are related to climate change, ecosystem services and biodiversity, human rights, labour and supply chains, land acquisition, resettlement, indigenous people, stakeholder engagement, and access to information.

This document constitutes BNP Paribas reporting of the EP implementation for the year 2010 pursuant to Principle 10 of the EPs, which states that *"Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations"*<sup>4</sup>

---

<sup>1</sup> **Project finance** is "a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets." Source: *Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards ("Basel II")*, November 2005. <http://www.bis.org/publ/bcbs118.pdf>.

<sup>2</sup> The International Finance Corporation is the World Bank's private sector arm.

<sup>3</sup> <http://www.ep-strategic-review.com/>

<sup>4</sup> [http://www.equator-principles.com/documents/Equator\\_Principles.pdf](http://www.equator-principles.com/documents/Equator_Principles.pdf)



## General Considerations

A financial institution adopting the EPs, such as BNP Paribas, undertakes not to provide loans to projects where the borrower will not or is unable to comply with the respective social and environmental policies and procedures contemplated under the EPs. The first step is to categorise projects based on the associated potential environmental and social (E&S) impacts.

Project categorisation under the EPs is in line with the recommendations of the IFC and is defined as followed:

- Category A for projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented;
- Category B for projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; and
- Category C for projects with minimal or no social or environmental impacts.

As such, the **initial categorisation is crucial because it triggers the level of due diligence to be undertaken**. This initial categorisation is based on a preliminary assessment of the potential environmental and social risks of a project without considering mitigation measures. It is worth insisting on the fact that **project categorisation (A, B or C) does not constitute a rating of the project's E&S performance** nor a way of pre-selecting or excluding projects based on E&S concerns. In that sense, a project initially categorised as "A" will trigger a high level of due diligence resulting in the implementation of adequate mitigation measures that will eventually lower the level of E&S risks initially assessed. In addition, projects with E&S risks that BNP Paribas would deem unacceptable, or for which there would be no satisfactory mitigation prospects, will not be pursued.

It is also important to note that the evaluation of such risks may evolve between mandate signing (or any form of commitment by BNP Paribas) and the credit committee (for lending mandates), as a result of additional information on E&S risks arising during the due diligence phase. However, once a transaction is approved internally (e.g. green light from the credit committee), the initial categorisation is not modified further.

Based on the identified project risks and the extent of related impacts, the Equator Principles requires the client to carry out mitigation measures, in a comprehensive and structured manner. Building on the findings of an Environmental and Social Impact Assessment, an action plan should be set up to mitigate the identified impacts by taking appropriate corrective actions (Action Plan). An overarching Social and Environmental Management System is also defined and implemented by the project company to address the management of the actions described in the Action Plan, in order for the project to comply with applicable E&S standards throughout the life of the project.

For projects located in High Income<sup>1</sup> OECD countries, the IFC Performance Standards and EHS Guidelines do not apply as the *"regulatory, permitting and public comment process requirements"* in these countries *"generally meet or exceed the requirements of the IFC Performance Standards and EHS Guidelines"*. Local and national laws are therefore considered as an adequate substitute for the IFC Performance Standards, EHS Guidelines and some of the Principles. More information can be found on the [Equator Principles official website](#).

One of the major strength of the Equator Principles is the contractual obligation for the client under the financing documents to regularly demonstrate its compliance with the proposed Action Plan and the relevant laws, regulations and permits, through the inclusion of covenants and other conditions in the project's contractual structure<sup>2</sup>. For the most sensitive projects, an independent consultant is mandated by the lenders to review and monitor the project's E&S documentation and performance, during the planning, design, construction and operation phases all over the life of the loan.

<sup>1</sup> <http://data.worldbank.org/about/country-classifications/country-and-lending-groups>

<sup>2</sup> A guidance note has been prepared by the EP Association on this subject, and is publicly available: <http://www.equator-principles.com/bestpractices.shtml>



## **Implementation of the Equator Principles**

BNP Paribas considers that the E&S due diligence is an integral part of the regular due diligence conducted for PF transactions which also covers financial, technical and legal aspects. As such, the PF teams which are located within CIB<sup>1</sup> remain essentially in charge of applying the EP process as they are the ones who know best the transactions and the clients.

The role of the CIB Corporate Social Responsibility (CIB CSR) team is to review and monitor the application of the EPs, based on the CIB EP procedure that has been proposed by CIB CSR and validated by the senior management. The CIB CSR team is independent from PF teams and acts as a second pair of eyes to review the proposed categorisation and has the ability to challenge or review the EP implementation on any project. Its level of involvement in the overall EP implementation process for a specific project depends on the level and nature of associated risks.

In order to ensure a consistent categorisation, all PF teams must use the Sustainable Assessment Tool (SAT), a categorisation tool licensed from the consulting company Sustainable Finance Limited, a subsidiary of PwC. Such tool has been customised for BNP Paribas. PF teams are requested to identify and assess the potential risks and associated impacts of a project as well as the client performance / track-record using information available to them. The SAT will then suggest a classification of the transaction among the three categories A, B and C defined in the EPs<sup>2</sup>. The document generated by the SAT is added to the credit proposal. The SAT has been updated in 2010 to accommodate for internal structural changes and to facilitate its utilisation. In case of a disagreement on a project's categorisation proposed by the PF team, CIB CSR has the right to escalate the category to a more sensitive level (e.g. from B to A), leading to increased due diligence and scrutiny.

This procedure enables the early detection of sensitive projects so that they can be brought to the attention of senior management prior to any firm commitment, and allows the PF team to engage with the client as early as possible to put mitigation measures in place.

According to the CIB EP procedure, Category A projects are systematically subject to a TAC (Transaction Approval Committee) due to their high sensitivity. The TAC is an existing internal process which usually takes place well in advance of the credit committee and focuses on some particular and exceptional risks associated to a transaction which have to be validated by CIB senior management. For PF transactions, it is chaired by a senior executive of the Structured Finance division, involves relevant PF officers as well as representatives of Global Risk Management, CIB CSR, Compliance, Communication, and Legal as necessary, and focuses on the E&S risks of the project.

The entire EP process and tools available are detailed in length in the 2009 EP Reporting, which is available on BNP Paribas' website<sup>3</sup>. It is to be mentioned that following the acquisition of Fortis Bank, BNP Paribas restructured its PF business and a combined EP reporting is now conducted. Although the respective internal EP procedures of BNP Paribas and BNP Paribas Fortis were still distinct in 2010, they have been fully harmonized during the first half of 2011.

Although the process is globally efficient, CIB CSR has identified minor irregularities in the implementation of the EP procedure for the year in review. For a few projects, the internal procedure has not been appropriately followed resulting in the CIB CSR team not being in a position to give its final approval on EP categorisation before projects were presented to credit committee. To identify such irregularities, CIB CSR team has conducted a cross checking exercise between the transactions it reviewed in 2010 and the ones that closed or were submitted in the same year, according to league tables' providers and internal information. However, the few projects for which the procedure was not strictly followed presented low or moderate E&S risk profiles and reasons leading to such situation have been identified. Measures will be taken in 2011 to correct these punctual gaps and ensure a consistent implementation of the EP internal procedure.

<sup>1</sup> Corporate & Investment Banking (one of the three core businesses of BNP Paribas, with Investment Solutions and Retail Banking)

<sup>2</sup> By decreasing level of identified and potential risks and associated impacts.

<sup>3</sup> <http://bank.bnpparibas.com/en/pid2286/international-efforts.html>



## Project finance transactions reviewed in 2010

You will find below statistics related to the numbers of projects reviewed by the CIB CSR team in 2010. As mentioned above, the project finance activities of BNP Paribas and BNP Paribas Fortis have been integrated for this reporting exercise and the following figures are the consolidated ones.

In 2010, 70 PF transactions were reviewed by the CIB CSR teams of both BNP Paribas and BNP Paribas Fortis. The bulk of these transactions (i.e. 77%) were classified as Category B (with potential moderate or limited environmental and social impact), followed by 19% classified as Category C (with minor or no impacts), and only 4% as Category A (projects with potential significant negative impacts but for which there are adequate mitigation prospects).

It is important to stress that the 70 PF transactions reviewed do not represent the actual number of PF transactions that BNP Paribas has closed in 2010. Indeed, out of the 70 transactions reviewed, only 18 reached financial close in 2010.

The remaining transactions that were reviewed, but not closed, in 2010 are either (i) ongoing (closing likely to happen in 2011 or later), or (ii) transactions that have not been pursued (e.g. mandate lost or transaction abandoned). The former case is not surprising since CIB EP procedure specifically requires that the initial categorisation is carried out early in the credit process as explained in the previous section. This is typical of PF transactions where the due diligence process can take a very significant amount of time and in many cases can last more than the period between the first EP categorisation and the end of the corresponding calendar year.

The table below further details the breakdown (by status as of 31/12/2010) of the 70 projects reviewed in 2010 by the CIB CSR team.

<b>Transactions closed in 2010</b>	<b>19</b>
<b>Transactions ongoing as of end 2010</b>	<b>23</b>
<b>Transactions that did not proceed</b>	<b>27</b>
<b>Transactions not pure project finance</b>	<b>1</b>
<b>Total</b>	<b>70</b>

There are several remarks to be made on the above table:

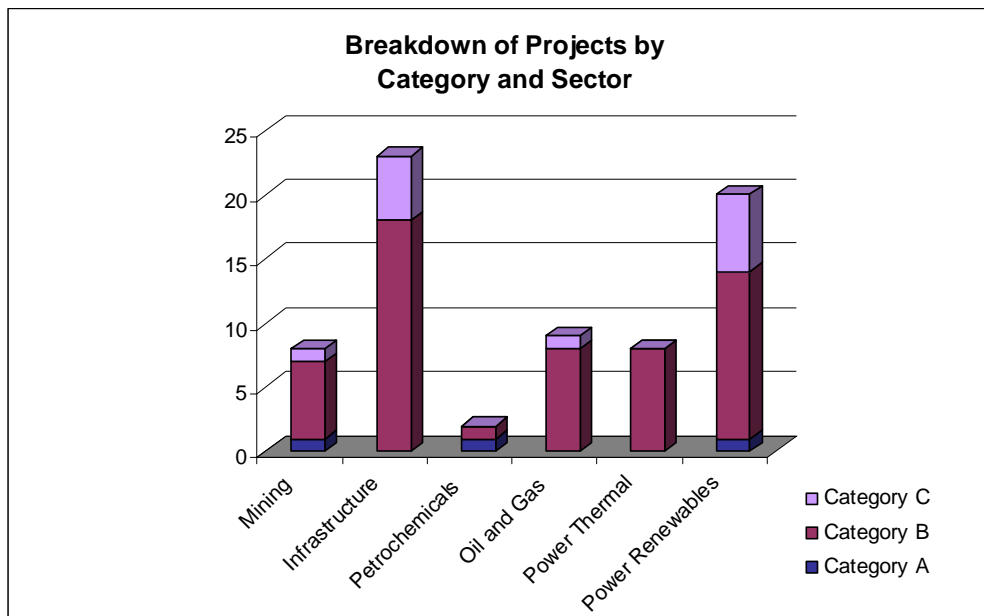
- ◆ The 19 transactions closed cover both lending mandates that have been closed and advisory mandates that have been completed.
- ◆ Ongoing transactions are mandates that are still active and which have not come to a term as of 31/12/2010.
- ◆ CIB CSR has reviewed a number of transactions that eventually did not proceed due to various reasons (including not winning a bid, mandate cancellation, project put on hold etc.). This is normal and due to the fact that CIB CSR is usually contacted early in the project due diligence phase, as required by the internal EP procedure.
- ◆ It is to be noted that although one transaction handled by our PF teams was not financed through a conventional project finance structure, the Equator Principles have been applied as it was related to a specific and clearly identified project.



On the total of 70 transactions considered (regardless of their final status), 5 were advisory mandates, and 65 were transactions where BNP Paribas provided, or looked to provide, financing (either as mandated lead arranger or as participant).

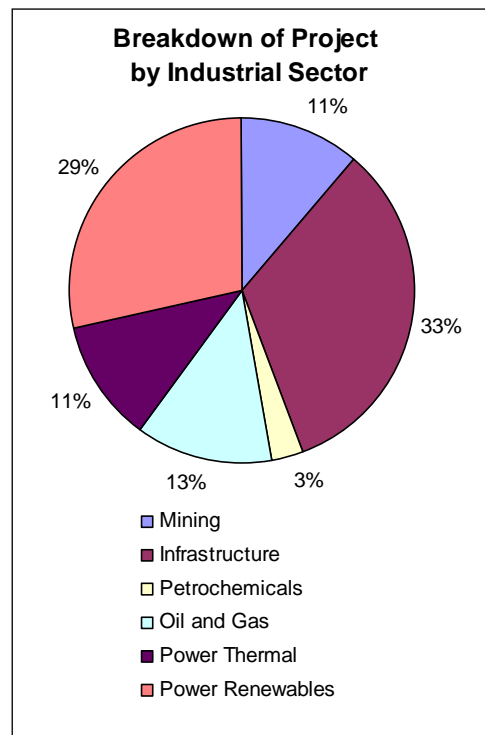
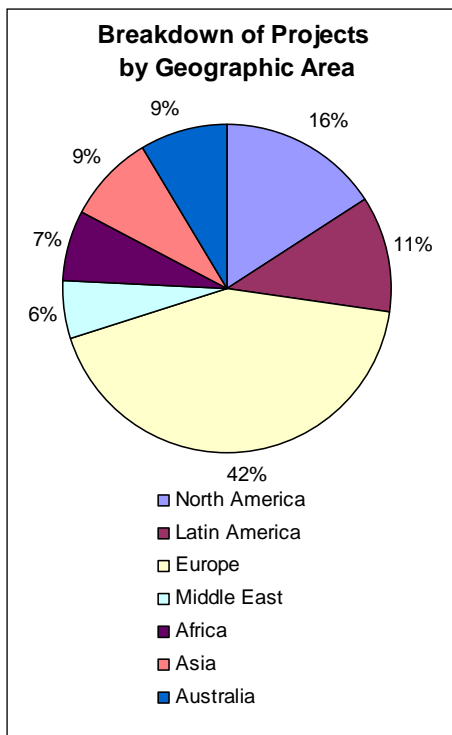
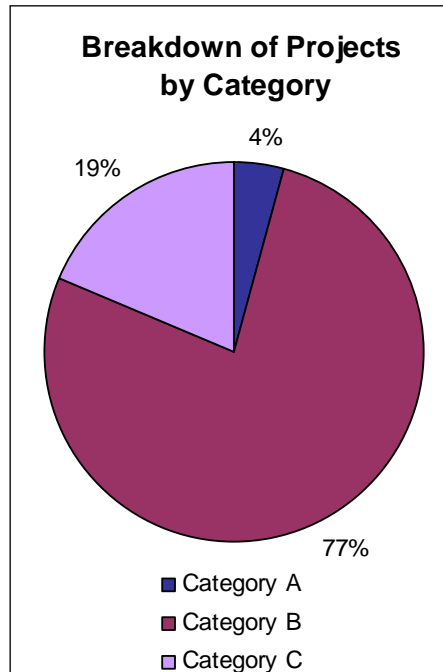
A breakdown of projects by category and sector is provided in the table and graph below:

Projects	Category A	Category B	Category C	Total
Mining	1	6	1	8
Infrastructure	0	18	5	23
Petrochemicals	1	1	0	2
Oil and Gas	0	8	1	9
Power Thermal	0	8	0	8
Power Renewables	1	13	6	20
<b>Total</b>	<b>3</b>	<b>54</b>	<b>13</b>	<b>70</b>





The following pie charts illustrate the breakdown of the 70 PF transactions reviewed by CIB CSR in 2010 by category, sector and geographic area:





**Additional reporting by estimated volume**

There are limitations associated with a reporting based on the number of projects as contemplated under Principle 10 of the EP. Indeed this type of reporting does not take into account the size of the projects being financed and therefore does not give any indication on the influence that an EPFI, as a “promoter of good E&S practice”, would exert on the global PF market, which is comprised of both EPFIs and non-EPFIs.

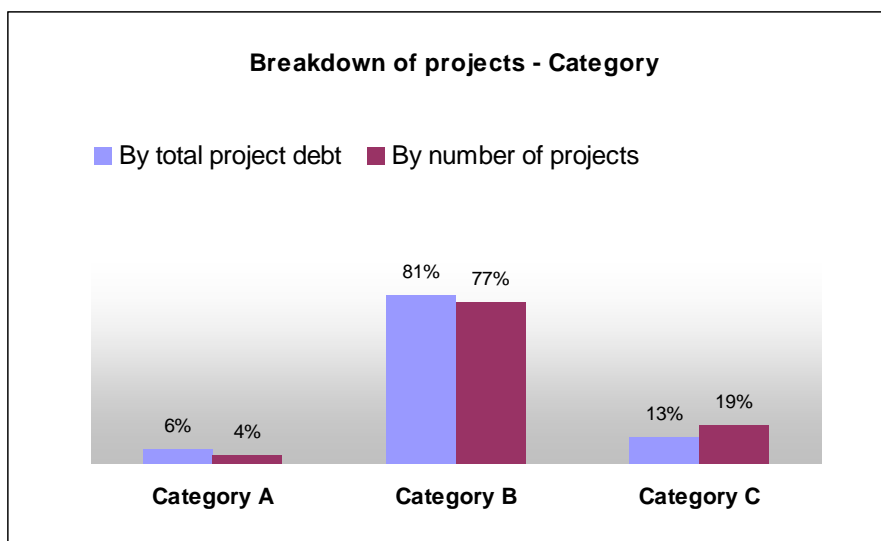
In order to provide an additional perspective on our annual reporting, we felt it would be interesting to report also on the estimated amount of the PF transactions reviewed by CIB CSR.

The estimation comes from the fact that, out of the 70 transactions reviewed in 2010, only 19 were eventually closed in 2010. We had therefore to estimate BNP Paribas’ share for the other projects which were not closed, (either postponed or abandoned), as explained in the previous section. The methodology used is described at the end of this section.

Based on this methodology we came up with an estimated share of BNP Paribas’ participation of ca USD 12.0 bn for the 70 projects CIB CSR team reviewed in 2010. For these projects, the total amount of commercial debt was estimated at USD 41.7 bn. This gives an idea of the volume of transactions that went through CIB CSR review, i.e. the volume of transactions that were subject to EP implementation, regardless of their outcome<sup>1</sup>.

The total debt amount of the 70 projects reviewed by CIB CSR is estimated at USD 41.7 bn. The total debt amount of the 65 projects reviewed by CIB CSR for which BNP Paribas had a lending role<sup>2</sup>, i.e. not taking into account financial advisory mandates, is estimated at USD 35.6 bn. This figure can be compared to the total PF market in 2010 (which has been estimated at USD 208.2 bn by PFI, which does not take advisory mandates into consideration). We however do recognize the difficulty to compare these two figures, given the fact many transactions reviewed by CIB CSR in 2010 have not been closed the same year, and that other transactions closed in 2010 have been reviewed by CIB CSR on the previous year.

By doing the calculation in terms of volume of the transactions reviewed (total project debt), we thus obtained a different spread per EP category, geographic area, and industry sector than the spread obtained based on the number of projects as contemplated in Principle 10. This is illustrated in the charts below where we have also added the traditional reporting.



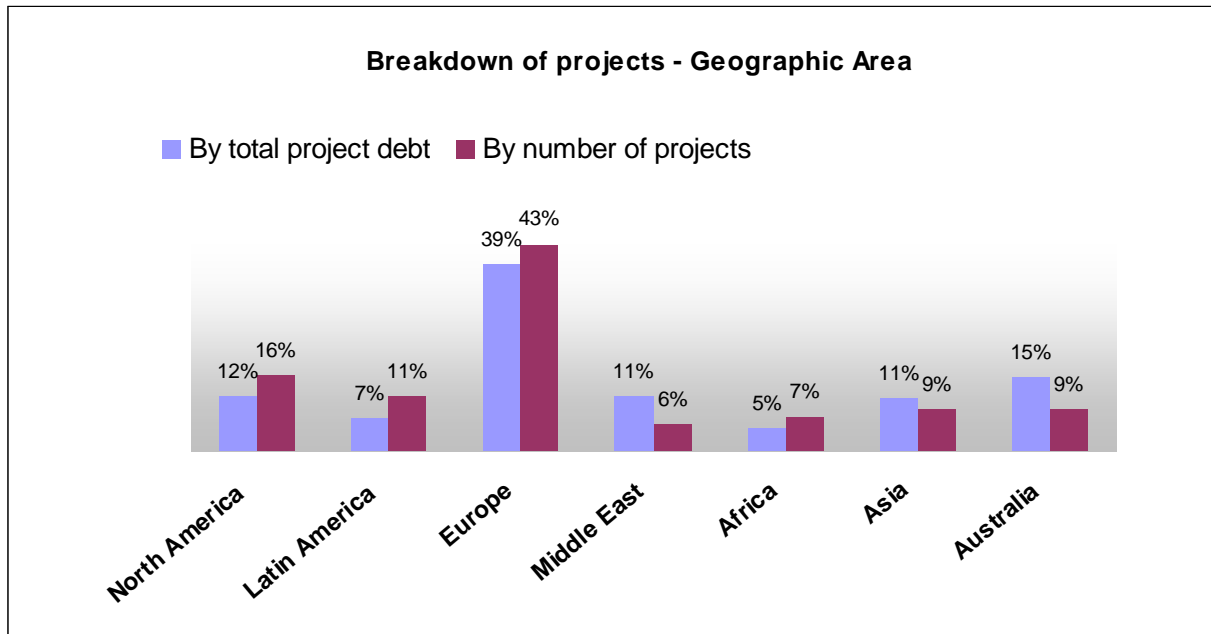
The breakdown by category is broadly consistent using the two methodologies (volume against number of deals) and shows that the projects categorised as B were generally larger, and projects categorised as A somewhat larger, than the ones categorised as C, which is not surprising as the latter are generally renewable

<sup>1</sup> Either “closed”, “ongoing”, or “did not proceed” (see previous section).

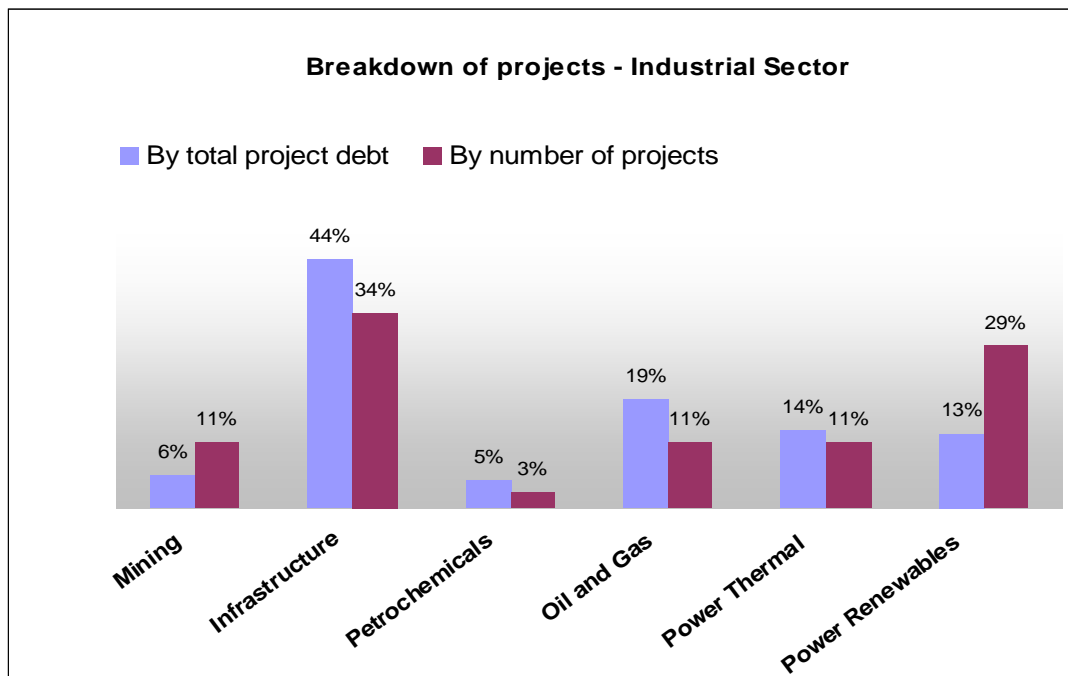
<sup>2</sup> Either as Mandated Lead Arranger (MLA) or as Participant.



projects and therefore of a smaller size. Category A projects clearly represent a small fraction of the projects reviewed by CIB CSR in 2010, both in terms of number of projects and total amount of debt.



The breakdown by geographic area using the estimated total debt amount for PF transactions reviewed shows that the size of projects reviewed in the Middle East and Asia Pacific were comparatively larger than in Europe and the Americas.



The breakdown by industrial sector using the estimated total debt amount for PF transactions reviewed shows that the size of projects reviewed in the oil & gas and petrochemical sectors are significantly larger than projects in the renewable energy sector. Mining projects reviewed in 2010 were of relatively small size.





*Methodology for the reporting on estimated volumes (total debt and BNP Paribas' participation)*

We used the following methodology to estimate the debt amount associated with each project we reviewed. Clearly this is not an issue for the PF transactions reviewed in 2010 and closed in the same year. However it was more difficult for the others which represent the majority and where the debt amount has not been finalised. The proposed methodology also considers a different approach between transactions in which BNP Paribas acts as lender from the transactions where it acts as financial adviser. For advisory transactions, we used the total debt for the amount allocated to BNP Paribas as we were the sole financial adviser.

For the PF transaction in which BNP Paribas acted as a lender, we took a two steps approach:

1. Estimate of the debt amount: the figures are obtained from the Project Finance International (PFI) deals database when available, completed as necessary by information given by the PF teams. Infrastructure Journal (IJ) database was also used for information purposes. We have not taken into account facilities provided by other type of lenders such as bilateral or multilateral institutions (e.g. IFC, EBRD, EIB, etc), or sovereign wealth funds (e.g. PIF, SIDF, etc) where BNP Paribas did not participate. Loans directly granted by ECAs (e.g. JBIC, KEXIM, etc) are not taken into account in the total debt amounts when CIB CSR is aware of their existence and amounts. However, such information was not systematically available for the relevant projects.
2. Estimate of BNP Paribas share: for projects that BNP Paribas has closed in 2010, such figures are essentially compiled from the 2010 PFI League Tables. For the other projects that did not close in 2010, the estimated BNP Paribas share is based on information obtained from the PF teams, except for one project where relevant information could be found in the PFI database. In the case where projects have not been pursued (e.g. mandate lost or transaction abandoned), the information provided by PF teams is based on the latest data available at the time they stopped working on the project.



## **Additional contribution to the Equator Principles development**

BNP Paribas, in its capacity of Member of the Steering Committee, is actively participating to the future development of the Equator Principles, in the context of the EP Strategic Review. In addition, it maintains its participation in key working groups, as detailed below.

➤ **Steering Committee** In its capacity of Member of the Steering Committee (SC), BNP Paribas has been involved in monthly calls and meetings, especially to move forward in the EP process. Indeed, as mentioned previously, the EPs are currently undergoing a strategic review, and BNP Paribas has been partnering with the other Steering Committee members to manage this crucial process.

This Review was launched in October 2010 by the SC to adapt both to the growth of the Equator Principles Association and to the growing expectations of a wide range of stakeholders. The Strategic Review assesses the current EP framework and identifies its strengths and weaknesses through a multi stakeholders' engagement, including clients and industries, civil society and financial industry peers. This will lead to the prioritisation of recommendations and actions to be taken in order to improve the EPs as a tool for managing social and environmental risks in an evolving environment.

BNP Paribas participated in the tendering process and the definition of the scope of work for the independent consultant to support the SC in the initial phase of the EP Strategic Review. Following this tender process, the SC has selected leading global environmental consultancy Environmental Resources Management (ERM), in partnership with independent sustainable banking consultant Suellen Lazarus

BNP Paribas also participated actively in the EP Strategic Review meetings that were held in Beijing, China, on December 1<sup>st</sup> and 2<sup>nd</sup> 2010. The purpose of these intensive meetings was to start discussing a strategic vision and plan for the Equator Principles among the SC members present together with other EPFIs who wanted to participate. The consultants presented the results of their surveys and numerous exchanges with industry, civil society, the IFC and other agencies. Numerous issues including the 'beyond project finance' issue, transparency and disclosure were debated. A summary of the findings and recommendations is expected to be made available publicly by mid 2011 on the EP website.

The EP Strategic Review should be ongoing through 2011. Building on the findings and recommendations of the Review and subsequent discussions amongst the EPFIs, an update of the EP is likely to be shaped later in 2011 or first half of 2012. BNP Paribas recognizes this is a daunting task as numerous areas have been identified for improvements / developments and there are very diverging views and priorities among the SC members and the EPFI community at large. One should therefore be careful on the expected outcome of such process.

BNP Paribas expects tangible progress and will works towards that, which could ultimately result in a further the evolution of the EPs, of the EP Association' governance and of the EP transparency. It is also expected that the EPFIs will also engage with their stakeholders during this process.



In addition, BNP Paribas has continued to participate actively in the Performance Standard (PS) review process initiated in September 2009, and has been providing comments to the IFC on an ongoing basis since then. The next version of the Performance Standards will *de facto* become the reference set of standards of the Equator Principles upon their validation by the IFC Board of Directors and their official publication and date of effectiveness.

## ➤ Working Groups

### **Governance**

In 2010, the EPFIs launched the EP Association and introduced its new Governance Rules, following a long consultation process among the EPFI community. This was rendered necessary given the growing numbers of EPFIs.

BNP Paribas has played a significant role in the finalisation and implementation of the Governance Rules, which were formally adopted in June 2010 and became effective on July 1st, 2010.

### **Scope**

This working group is composed of three sub-working groups, i.e. Initial Public Offering (IPO), Corporate Loans and Export Credit sub-working groups.

The objective of the working group on Corporate Loans is to develop best practice in the application of environmental and social risk assessment and management processes to corporate loans with an identified use of proceeds.

### **Outreach (Central & Eastern Europe)**

Following the internal reorganisation, the PF teams based in Brussels cover Turkey and a large part of Eastern Europe. As they plan to develop BNP Paribas presence in this region, participating in this working group is logical, as such working group promotes best E&S practices to financial institutions in this region. The goal is that such regional banks operate on comparable E&S standards as EPFIs. Furthermore, BNP Paribas contributes to extend the reach of the EPs by convincing such regional banks to adopt the EPs.

### **Stakeholder Engagement (NGOs and Civil Society)**

The purpose of this working group is to provide a discussion forum for dialogue and communication with the NGOs for whom the Equator Principles are relevant.

BNP Paribas participated on the 3<sup>rd</sup> and 4<sup>th</sup> of February, 2010 to a meeting hosted by Credit Suisse Group in Horgen, Switzerland. This was the opportunity for EPFIs and the NGO community to exchange thoughts on recent developments and resulted in lively discussions regarding for example accountability and transparency of banks in their implementation of the EPs. An update on the progress made by the various EPFI working groups was also provided to NGOs during that meeting. The decision to launch an EP Strategic Review was taken following the NGO meeting and the related discussions.

### **Climate change**

Engagement with the IFC has been continuous over the last year, and it is expected that the revised Performance Standards will include stronger language related to climate change, greenhouse gases emissions, mitigation and adaptation.

### **Biodiversity**



As part of the IFC Performance Standards Review consultation process, BNP Paribas has in particular been involved in providing comments to the IFC on the Performance Standard 6 (on Biodiversity Conservation and Sustainable Natural Resource Management). BNP Paribas believe that a much more precise language is now used in this Performance Standard, not only in terms of definitions but also when it comes to describe the activities, due diligence to be performed, and the mitigation measures to be carried out.