Managing E&S risks through the Equator Principles: Intesa Sanpaolo’s view

IAIA – Florence, April 2015
The Intesa Sanpaolo Group: who we are

A PRESENTATION OF THE GROUP - ITALIAN LEADER WITH A EUROPEAN SCALE

- **ITALY**: 4,473 Branches
- **OTHER EUROPEAN COUNTRIES**: 1,217 Branches, 5 Representative Offices
- **AMERICA**: 2 Branches, 2 Representative Offices
- **ASIA**: 5 Branches, 6 Representative Offices
- **AFRICA**: 170 Branches, 3 Representative Offices
- **OCEANIA**: 1 Representative Office
### Managing Environmental and Social risks: why should banks worry?

<table>
<thead>
<tr>
<th><strong>Reputational risk:</strong></th>
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<tbody>
<tr>
<td>Damage to the reputation deriving from being associated with the client that is exposed to environmental or social risk</td>
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<th><strong>Financial risk:</strong></th>
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<tr>
<td>Uncertainty of the return if the client has to bear high costs due to e.g. environmental damages</td>
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<td>Loss of asset and collateral value due to contaminations or environmental penalties</td>
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<th><strong>Legal risk:</strong></th>
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<td>Direct responsibility of the bank if it controls the client or directly owns the assets</td>
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<tr>
<td>If the bank is deemed jointly liable for environmental damages caused by the client</td>
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#### CREDIT RISK

- block of activities or heavy administrative sanctions due to failure to abide by antipollution laws
- change in cash flow trend of the borrower that jeopardizes its solvency
When a client proposes a project for financing, the bank must assess all the risks potentially deriving from it, amongst which environmental and social risks.

The main requirement of the Equator Principles is the assignment of a risk level category to the projects. The three levels are A, B and C, where A is the highest. This categorization is based on:

- the magnitude of potential risks and social and environmental impacts of the project
- The International Finance Corporation (IFC)'s social and environmental criteria
- nature, size and level of achievement of the project

Last updated release: June 2013
What are the Equator Principles?

- The Equator Principles (EP) are a financial industry benchmark for determining, assessing and managing environmental and social risk in large infrastructure and industrial Projects. They apply globally and to all industry sectors.

- They are primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making.

- Implementing the EP implies respecting also the IFC Performance Standards on Environmental and Social Sustainability (Performance Standards – PS), on which the EP are based, and the World Bank Group Environmental, Health and Safety Guidelines (EHS Guidelines).
The IFC Performance Standards and their impact areas - 1

1. Assessment and Management of Environmental and Social Risks and Impacts
   - The Social and Environmental Management System entails a *methodological approach* to managing environmental and social risks and impacts in a *structured way* on an *ongoing basis* and through a business management process of “plan, do, check, and act”.

2. Labour and Working Conditions
   - The pursuit of economic growth through employment creation and income generation should be accompanied by *protection of the fundamental rights of workers*. Failure to establish and foster a sound worker-management relationship can undermine worker commitment and retention, and can jeopardize a project.

3. Resources efficiency and Pollution Prevention
   - Increased economic activity and urbanization often generate increased levels of *pollution to air, water, and land, and consume finite resources* in a manner that may threaten people and the environment.

4. Community Health, Safety, and Security
   - Project activities, equipment, and infrastructure can increase *community exposure to risks and impacts*. 
Project-related land acquisition and restrictions on land use can have **adverse impacts on communities and persons** that use this land. Involuntary resettlement refers both to **physical displacement** (relocation or loss of shelter) and to **economic displacement** (loss of assets or access to assets that leads to loss of income sources or other means of livelihood).

Protecting and conserving **biodiversity**, maintaining **ecosystem services**, and sustainably managing **living natural resources** are fundamental to sustainable development.

**Indigenous Peoples**, as social groups with identities that are distinct from mainstream groups in national societies, are often among the **most marginalized and vulnerable segments** of the population. In many cases, their economic, social, and legal status **limits their capacity to defend their rights**.

Cultural heritage is **crucial for current and future generations**. The client will consider potential project impacts to cultural heritage and will apply this PS throughout the project development.
The Equator Principles

Principle 1  Review and Categorization
Principle 2  Environmental and Social Assessment
Principle 3  Applicable Environmental and Social Standards
Principle 4  Environmental and Social Management System and EP Action Plan
Principle 5  Stakeholder Engagement
Principle 6  Grievance Mechanism
Principle 7  Independent Review
Principle 8  Covenants
Principle 9  Independent Monitoring and Reporting
Principle 10  Reporting and Transparency
Transactions within the scope of the Equator Principles

The Equator Principles apply **globally** and to **all industry sectors**, in the following cases:

1. **Project Finance** and **Project Finance Advisory Services** when the total capital expenses of the project are equal to or greater than **10 million US $**

2. **Project–Related Corporate Loans*** (corporate loans intended for one or more projects), including Export Finance in the form of Buyer Credit, when the following conditions occur at the same time:
   - the majority of the loan (more than 50%) is related to a single project over which the client has effective operational control (either direct or indirect)
   - the overall amount of the loan is equal to or greater than **100 million US $**
   - the bank’s loan is equal to or greater than **50 million US $**
   - the loan tenor is at least 2 years

3. **Bridge loans** with a tenor of less than 2 years which are expected to be re-financed with financial instruments for which the above criteria are valid.

*PRCL exclude Export finance in the form of Supplier Credit as the client has no effective operational control.
Equator Principles implementation in Intesa Sanpaolo - 1

Adoption is voluntary but adopting Institutions are expected to introduce and implement internal social and environmental risk management policies, procedures and standards to comply with the Equator Principles.

Adoption
The Group adopted the Equator Principles in 2007 – EPII second version

Operating Guide for the implementation of EPII
June 2010 - Operating Guide was issued and integrated into the Bank’s regulations

Training activities in Italy and abroad
• Banca IMI Milan and London
• Hong Kong and New York Hubs
• BIIS Milan and Rome
• Workshops in 4 Banks of the Group

Rules for the implementation of the EP in the Subsidiary Banks
August 2012 - Rules for the implementation of the EP for the Subsidiary Banks abroad were issued and integrated into the Bank’s regulations

Corporate Social Responsibility
Equator Principles implementation in Intesa Sanpaolo - 2

- **Re-adoption**: The Group confirmed adoption of the Equator Principles in 2013-EPIII third version
- **Set-up of a cross-functional Working Group**: Multi-functional Working Group deriving from the broadened scope of the Equator Principles
- **Update and publication of the new Operating Guide**: August 2014 - New Operating Guide was issued and integrated into the Bank’s regulations
- **Training activities**:
  - In-person training in the Parent Company about how to implement the Equator Principles and to use the Operating Guide
  - Webinar (IT and EN) on the same subjects
  - Training sessions abroad
  - Updating the Rules for the Subsidiary Banks abroad
The Operating Guide for the implementation of the Equator Principles reflects the two different roles of the Bank

Lead arranger

Activities that go from the financing request to the Financial Close and reporting activities

Support documentation drawn up by Corporate Social Responsibility

Participant in a syndication

Same activities as in Lead Arranger but on a compliance verification basis

In order to facilitate the detection of a project that goes under Equator Principles screening a reference to the EP scope was included in the main Operating Guides dedicated to lending processes
Key steps of the Operating Guide

Before applying for financing, either the client, a consultant or an external expert will have already conducted the Assessment process on the project.

Classification of the project and identification of the applicable standards – PRINCIPLE 1

Verification of reputational risks and the assigned category. Drawing up of the CSR Memo

Implementation of an Independent review – PRINCIPLE 7

Drawing up of the Memo for the Deliberative body. In case of category A projects the credit competency is at a higher level

Definition of covenants – PRINCIPLE 8

Implementation of monitoring activities - PRINCIPLE 9
Expertise required on specific E&S issues and available resources

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<th>Themes</th>
<th>EP required activities</th>
<th>Available resources (examples)</th>
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<td>- Independent E&amp;S Due Diligence and monitoring activities</td>
<td>- Guidance for consultants on the contents of a report for an independent E&amp;S due diligence review (EP Association)</td>
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<tr>
<td>Climate Change</td>
<td>- Alternative analysis for GHG reduction</td>
<td>- IFC’s Climate Accounting Tools (e.g. CEET calculator)</td>
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<td>- Quantification and reporting of GHG</td>
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<td>Human Rights</td>
<td>- Specific HR Due Diligence in limited high risk circumstances</td>
<td>- Forthcoming IFC’s Guidance Note ‘Addressing HR issues through IFC’s Performance Standards’</td>
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<td></td>
<td>- Review on cultural heritage impact</td>
<td>- UNEP FI HR Guidance Tool</td>
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<td>- Review on resettlement impact</td>
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<td>Stakeholder Engagement</td>
<td>- Informed Consultation and Participation Process</td>
<td>- IFC’s Good Practice Handbook on Stakeholder Engagement</td>
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<td>- Obtaining of indigenous People’s Free Prior and Informed Consent (FPIC)</td>
<td>- Performance Standard 7</td>
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<td>Biodiversity</td>
<td>- Review on Critical habitat impacts</td>
<td>- CSBI (Cross Sector Biodiversity Initiative) tools</td>
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<td>- Biodiversity Assessment</td>
<td>- Guidance for EPFIs on incorporating E&amp;S considerations into loan documentation (EP Association)</td>
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<tr>
<td>Loan covenants</td>
<td>- Incorporation of E&amp;S Covenants into loan documentation</td>
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Lessons learned

**Strengths**
- Raising internal and external awareness towards E&S issues beyond Equator Principles scope
- Gap analysis between PS and Italian legislation (e.g. stakeholder engagement, public consultation,....)
- Influence in case of leadership in a syndication over E&S good practices

**Weaknesses**
- Limits of the Equator Principles’ scope
- Non applicability of Equator Principles to government bodies
- Lower degree of leverage in case of participation in a syndication
Thank you!

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