

# **Project Finance: helping the investor**

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## Who is EIRIS?

- leading provider of CSR information for socially responsible investors
- non-profit organisation, founded in 1983
- independent - owned by charitable foundation
- cover c2,900 companies + major indices e.g FTSE All World Developed
- integrate a variety of sources

## Research areas covered

- Environment e.g. policy, man sys, biodiversity
- Social e.g. employees, human rights, community
- Governance e.g. board structure, code of ethics
- Other ethical concerns e.g. military, tobacco
- International conventions & norms
- SEE risks & opportunities - Project Finance part of a series of sector risk briefings and sector criteria development. (Others include obesity, access to medicines in 'developing world')

# EIRIS client base

- **Retail funds** e.g. M&G, F&C, ABN Amro
- **Pension funds** e.g. ATP (Denmark), Strathclyde (Scotland)
- **Charities** e.g. WWF, Oxfam
- **Indices** e.g. FTSE4Good
- **Clients can use criteria flexibly** e.g.
  - screening
  - best in class
  - engagement with companies
  - risk identification / management
  - alone or in combinations

# Background

Banks adopting the Equator Principles (2003) commit to:

- *“undertake to review carefully all proposals for which our customers request project financing. We will not provide loans directly to projects where the borrower will not or is unable to comply with our environmental and social policies and processes”*
- recently revised
- EIRIS methodology captures Equator Principles + extra aspects (e.g. IFC standards), especially around management systems

# SEE risks and opportunities

Direct risks - might have direct bearing on project returns

- environmental e.g. possible pipeline leakage due to insufficient anti-corrosion coating (BTC pipeline)
- social e.g.
  - community structures and social safety nets are weakened
  - reduction in cultural identity
  - poorly managed resettlements
- legal e.g. land ownership or resources access disputes
- political e.g. Sakhalin oil project - changes in Russian government policy

Indirect risks - reflects on on companies more generally

- reputation - can harm brand value, employee morale, ability to recruit / retain staff, attract media scrutiny

## EIRIS' research approach

- **Exposure factors** – which companies are affected by issue of project finance?
- **Managing the risk** – how can a company mitigate this risk or maximise the opportunity?
- **Assessment of management response** – does the company have this issue under control?

# Exposure factors

- a) 'high risk' if either a mandated arranger or provider within project finance deal  
[N.B. Legal advisors or sponsors such as contractors or users of project facilities are included]
- b) location
- c) sector

## Exposure factors - location

Region	Exposure
Asia	High
Australia and Japan	Low
Europe	Low
Latin America	High
Middle East & Africa	High
North America	Low

## Exposure factors - sector

Type of project	Exposure
Oil & gas	High
Power	High
Transport	Medium
PPP	Low*

## Exposure - classification rules

- A company will be classified as '**high exposure**' if it is identified to be in at least two high exposure categories.
- A company in the '**medium exposure**' category will be exposed to a maximum of one high risk factor.
- '**Low exposure**' companies will only be exposed to low exposure factors or to a maximum of one medium exposure factor

# Managing the risk

- **22 key indicators** examined in five broad areas:
  - Strategy and responsibility (8 indicators)
  - Risk assessment (2)
  - Compliance and monitoring (3)
  - Reporting and dialogue (7)
  - Performance and innovation (2)

# Managing the risk

- **Strategy and responsibility**
  - policy including SEE criteria
  - commitment to Equator Principles (EP) within policy
  - commitment only to enter loan syndication with EP banks, or if EPs are fully applied to the project
  - various environmental / social management plans (or ESIA)

# Managing the risk

- **Risk assessment**
  - Client diagnostic tool
  - Environmental audits and site visits
  - Social audits and site visits

# Managing the risk

- **Compliance and monitoring**

- Training of relevant staff
- Guidance notes outlining possible risks
- SEE conditions attached to loan agreement
- Compliance monitoring of any SEE conditions attached to the loan agreement

# Managing the risk

- **Reporting and dialogue**

- Engagement on proactive basis with stakeholders
- Detailed public response to any NGO allegations
- Public reporting on project finance
- Quantitative reporting e.g. KPIs
- Qualitative reporting
- Reporting on projects that were denied credit
- Disclosure of person/committee responsible for approving project finance deals

# Managing the risk

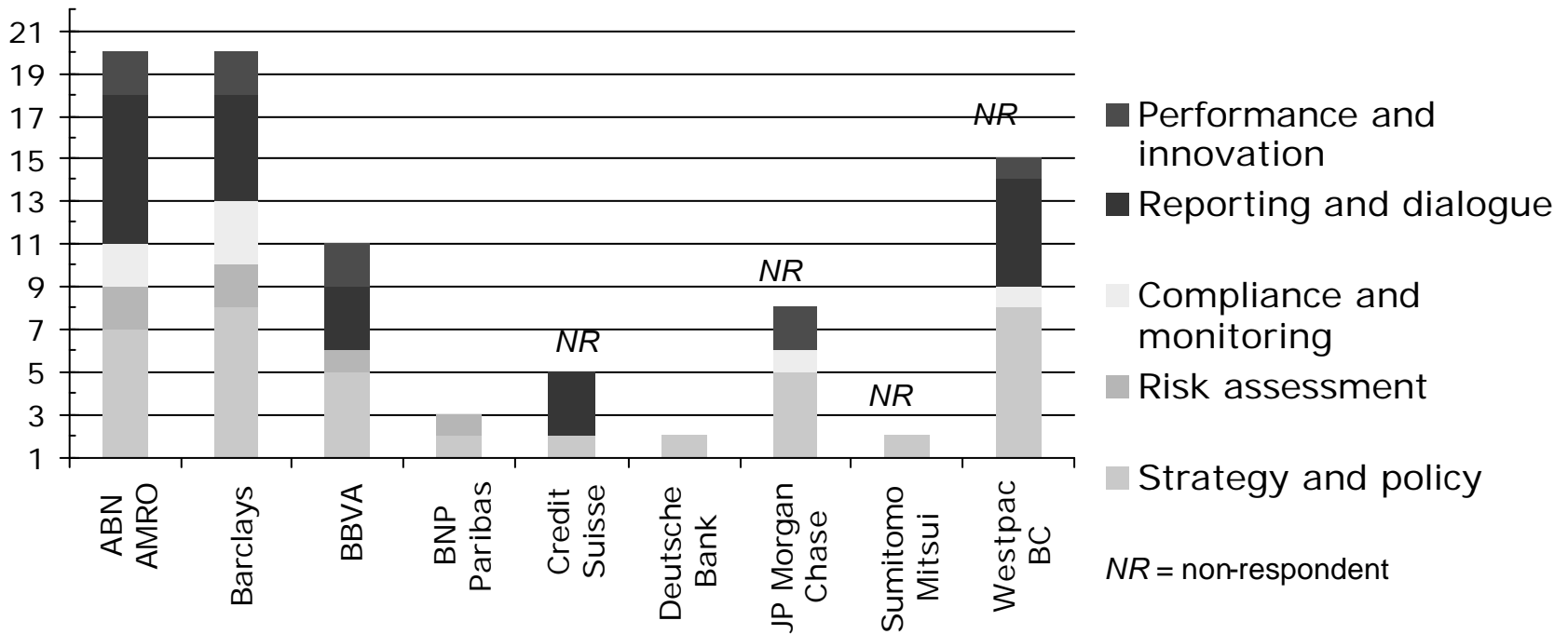
- **Performance and innovation**

- Project finance applied beyond scope of Equator Principles commitment threshold (e.g. applied to projects <USD50m)
- Policy leadership - going beyond EP policy guidelines (e.g. freshwater, logging)

# Key findings

- Study of 9 high and medium exposure companies from wide geographical range
  - \_ ABN AMRO (Netherlands)
  - \_ Barclays (UK)
  - \_ BBVA (Spain)
  - \_ BNP Paribas (France)
  - \_ Credit Suisse (Switzerland)
  - \_ Deutsche Bank (Germany)
  - \_ JP Morgan Chase (USA)
  - \_ Sumitomo Mitsui Banking (Japan)
  - \_ Westpac Banking Corporation (New Zealand)

# Key findings



# Key findings—assessment approach

- **No evidence** - no evidence from publicly available company literature of policy or management system
- **Limited** - some evidence of steps taken to address this issue
- **Intermediate** - evidence of a concerted company response to the risk and 'real' progress
- **Good** - the company's management system is considered adequate and sufficient to mitigate the risk to 'acceptable' levels
- **Advanced** - leading practice that may be gaining a competitive advantage (with stakeholders or society in general)

# Key findings – assessment results

<b>Company</b>	<b>EIRIS assessment</b>
ABN AMRO (20)	Good
Barclays (20)	Good
BBVA (13)	Intermediate
Westpac Banking Corporation (15)	Intermediate
BNP Paribas (2)	Limited evidence
Credit Suisse (5)	Limited evidence
Deutsche Bank (2)	Limited evidence
JP Morgan Chase (8)	Limited evidence
Sumitomo Mitsui Banking (2)	Limited evidence

## Key findings

- The number of EPFIs has risen from 10 to 41
- All 9 companies have global project finance policy
- Some of the companies analysed have taken steps to go beyond the Equator Principles e..g. ABN Amro
- only two company's management response classified as 'good' i.e. sufficient to mitigate risks to an acceptable level
- none assessed as 'advanced'

# Key findings

**Investors need to focus on how companies are implementing these commitments to adequately mitigate company risks.**

- Implementation of these commitments and policies varies greatly
- Only 3 of the 9 companies show evidence of client diagnostic tools or audits to evaluate environmental and social risks
- 5 out of the 9 analysed companies report publicly on project finance but the extent and depth of information varies considerably
- Several companies fail to report in detail on their compliance, monitoring and auditing systems
- Reputational risks could be mitigated by fuller reporting transparently on controversial projects

# Conclusions - possible questions for investors to ask companies

Investors may gain information in private discussions outside of the public realm:

- What **level of financial risk** does the Company attribute to environmental and social factors in project finance and what steps are they taking to minimise this risk?
- What **projects** does the Company identify as **most potentially risky** and how are these risks being mitigated?
- How does the Company identify **project stakeholders** (e.g. community) for each project and address their concerns?
- Which **NGOs** are **significant** to the Company's project finance business and how is the Company engaging with them on this issue?

# Conclusions

## To improve investor confidence:

- Companies should focus on the implementation of their project finance policies
- Greater transparency should be main focus across the sector to ensure a level playing field
- Companies should demonstrate constructive co-operation with civil society groups
- Investors should consider how financial institution can indirectly impact upon sustainable development

**Full report available at:**

**[www.eiris.org](http://www.eiris.org)**

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