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Corporate Social Responsibility in Canadian Banking a Case Study on the Equator Principles

Ian Osellame
The University of Western Ontario

Supervisor
Christopher C Nicholls
The University of Western Ontario

Graduate Program in Law

A thesis submitted in partial fulfillment of the requirements for the degree in Master of Laws

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**CORPORATE SOCIAL RESPONSIBILITY IN CANADIAN
BANKING**

A CASE STUDY ON THE EQUATOR PRINCIPLES

Thesis format: Monograph

by

Ian Osellame

**A thesis submitted to the Faculty of Law in partial fulfillment
of the requirements for the degree of
Master of Laws**

**The School of Graduate and Postdoctoral Studies
The University of Western Ontario
London, Ontario, Canada**

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Abstract

This thesis considers the role of Corporate Social Responsibility (CSR) in the Canadian banking sector. Although the relevance of CSR continues to be debated, this analysis starts from the position that CSR is now a fact of life for modern banks and tests whether Canadian banks are demonstrating CSR behavior through their adoption of the Equator Principles: a series of guidelines on the management of social and environmental issues that banks voluntarily commit to follow in their project financing activities. This thesis concludes that examples of CSR behavior can be observed as Canadian banks continue to define the scope of their involvement with the EPs. However, this conclusion is tempered by the finding that self-interested business motivations are also behind EPs adoption. Any expectations that we might arrive at “socially responsible” banks should therefore be tempered by the reality that CSR has yet to gain universal implementation in Canadian banking.

Keywords

Corporate Social Responsibility; CSR; Equator Principles; Project Finance; Financial Regulation; Canadian Banks; Banking; Financial Services.

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CHAPTER 1 – INTRODUCTION

1.1 Overview of Thesis Topic and Contribution

This thesis considers the emerging role of Corporate Social Responsibility (CSR) in the Canadian banking sector. Although the relevance of CSR continues to be debated in academic circles, the analysis for this thesis starts from the position that CSR is increasingly becoming a fact of life for modern Canadian banks. As a result, this thesis reflects the pragmatic view of commentators who claim that CSR is now a phenomenon that can be observed in varying degrees in the practices and behavior of modern businesses. Writers in this area argue that CSR has largely “won the battle of ideas” in that, practically speaking, few businesses today would argue against the need for CSR and it is likely to remain important to our political, regulatory, academic and corporate agendas.¹

The research proposition for this thesis is that Canadian banks are demonstrating CSR behavior through the steps they are taking to implement and comply with the Equator Principles (EPs). The EPs were chosen for study because they represent a potential real-world example of CSR: a voluntary framework “for determining, assessing and managing environmental and social risk in projects.”² The EPs were developed by

¹ See e.g., Norman Keith, *Corporate Crime and Accountability in Canada – From Prosecutions to Corporate Social Responsibility* (Markham, ON: LexisNexis Canada Inc., 2011) [Keith] at 254 and 275.

² See online at: <http://www.equator-principles.com/index.php/about-ep/about-ep>. As at the date of submission of this thesis, the EPs are undergoing an update process that will be implemented in 2013 and 2014. A draft of the new principles (referred to in this thesis as EP III) was released for stakeholder consultation and public comment on August 13, 2012 and the formal comment period closed on October 12, 2012. The updated principles were formally launched and are effective from June 4, 2013, but there is a transition period in place to allow banks to continue using the current version of the EPs (the EP II) until December 31, 2013. As such, this thesis focuses on the current version of the EP II (which are referred to generally in this thesis as the “EPs”) and the requirements they currently prescribe for member banks. Chapters 4 and 7 will provide a discussion of the EP III update process in order to support further study in this area as the updated principles are implemented in the second half of 2013 and into 2014.

major international private banks, together with the International Finance Corporation (IFC) and the World Bank Group on June 4, 2003. At the time of writing, seven Canadian financial institutions (including all of the “Big-5” Canadian banks) have formally adopted the EPs: Royal Bank of Canada; TD Canada Trust; Bank of Montreal; Bank of Nova Scotia; Canadian Imperial Bank of Commerce; Export Development Canada; and Manulife Financial.³

This thesis seeks to contribute to the growing body of work on CSR in the financial services sector generally and in the banking industry specifically. CSR scholars and legal practitioners now recognize the financial industry as a sector that is particularly relevant to CSR. They argue that the sector is relevant, not because of its own direct social and ecological footprints, but rather because of impacts that arise through allocation of capital to other business sectors, primarily in infrastructure development and natural resource exploitation.⁴ More to the point, scholars in this area argue that the EPs, taken together with other environmental and social initiatives, are evidence of a shift toward greater importance being attributed to CSR considerations in the banking sector.⁵

³ See the list of EPs member banks online at: <http://www.equator-principles.com/index.php/members-reporting/members-and-reporting> (accessed as of June 28, 2013). This list can be sorted by country or geographic region.

⁴ See e.g., Benjamin J. Richardson, “Financing Environmental Change: A New Role for Canadian Environmental Law” (2003) 49 McGill L.J. 145 [*Richardson-Financing Change*] at 147-148. See also e.g., Paul Q. Watchman, Angela Delfino and Juliette Addison of the law firm LeBoeuf, Lamb, Greene & MacRae, “EP 2: The Revised Equator Principles: Why hard-nosed bankers are embracing soft law principles” at 4, electronic copy available online at: <http://www.deweyleboeuf.com/~media/Files/inthenews/EP2TheRevisedEquatorPrinciplesWhyhardnosedbankersareembracingsoftlawprinciples.ashx>.

⁵ See e.g., John M. Conley and Cynthia A. Williams, “Global Banks as Global Sustainability Regulators?” (2011) 33 Law & Policy 542 [*Conley and Williams*] at 543 and 552. The authors argue that it is “possible that experience with the EPs is leading to real change—in some cases, rapid change—in the culture of banking organizations. In fact, it could be the case that the moral and ethical sensibilities of employees and managers are being more deeply engaged by the reflective processes the EPs demand.”

The purpose of this thesis is to provide insight into these claims from the Canadian perspective by documenting EPs adoption by Canadian banks as an illustration of the practical effect of CSR in a particular context. This research will respond to calls for further study into a fundamental question posed in the academic literature: why do banks, as profit maximizing institutions, voluntarily agree to adopt and adhere to the EPs?⁶ This apparent contradiction between corporate goals and corporate practices is explored further with particular focus upon the interesting space the EPs occupy between self-interested business motivations and CSR.⁷

At a higher level of abstraction, this thesis will also examine the role of the EPs as a mode of governance in regulating banking conduct. Along these lines, there is an emerging body of social science literature that considers the EPs in the context of theoretical questions about CSR, voluntary codes of conduct, regulation, and

⁶ See e.g., Richard Macve and Xiaoli Chen, “The “equator principles”: a success for voluntary codes?” (2010) 23 *Accounting, Auditing & Accountability Journal* 890 [Macve and Chen] at 894-896. See also Conley and Williams, *supra* note 5 at 547 (noting that the EPs provoke “many questions,” but pointing out that it is still early days in their study of this area: “[w]hy have so many banks signed onto the EPs, including banks that were not particularly exposed to the kinds of reputational risk that motivated some of the early adopters? What predictions can we make about which banks will be vigorous implementers and which will not? How will regional patterns of adoption affect the efficacy of the EPs as global regulation? What implications are there for theories of corporate governance if industry-wide lending standards have effects within individual corporations? And why do some banks appear to be adopting the spirit of the EPs at a deeper level than others?” However the authors note that scholars are “at the start of a broader investigation of these phenomena and have no definitive answers as yet. ... Ultimately, we hope to be able to address the questions of why the market has worked here to promote at least some degree of responsibility, yet has failed in other banking contexts, and what we can learn from those differences.”).

⁷ See e.g., Olaf Weber, “Environmental Credit Risk Management in Banks and Financial Service Institutions” (2012) 21 *Business Strategy and the Environment* 248 [Weber] at 249. In the context of the interplay between profit motives and adoption of CSR principles in banking, Weber notes that the business of banks is to “accept deposits and channel the capital into lending or investment activities. They are intermediaries with an economic and channeling function.” As a result, Weber argues that banks are “primarily concerned about the financial return of their activities in relation to the risk that has to be taken. They often stress the trade-off between financial return and corporate sustainability rather than seeing a win-win situation.”

developments in corporate governance.⁸ More specifically, scholars use the EPs as a model to examine the voluntary action by banks as a form of corporate regulation. They argue that by “constructing a kind of “bottom up” framework, but leaving the decision on adoption as voluntary,” the EPs are an example of “soft law.”⁹ Similarly, scholars in this area argue that, by voluntarily choosing to adopt the EPs, member banks have become de facto “sustainability regulators,” acting in ways that can be characterized as both responsible and sustainable.¹⁰

This research is needed and timely. There is no question that financial institutions occupy a tenuous space in the hearts and minds of most people and banks in particular are often thought of as profit hungry machines with little or no social conscience.¹¹ The recent financial crisis brought many of these issues to a boiling point, as the sector generated significant public anger in response to the widely publicized and criticized government bailouts in international financial systems. In the aftermath of the crisis, and coupled with widely condemned compensation practices for financial executives, it is

⁸ See e.g., Deborah E. Rupp and Cynthia A. Williams, “The Efficacy of Regulation as a Function of Psychological Fit: Reexamining the Hard Law/Soft Law Continuum” (2011) 12 *Theoretical Inquiries in Law* 580 [*Rupp and Williams*] at 582-584; see also e.g., *Conley and Williams, supra* note 5 at 545 and 553-555.

⁹ See e.g., *Macve and Chen, supra* note 6 at 891.

¹⁰ *Conley and Williams, supra* note 5 at 543. The authors note that “in one limited area of their operations, project finance, where global banks kept risk on their own balance sheets and were actually exposed to many types of risk usually dismissed as “externalities,” many joined an initiative whereby they agreed to act in ways that can be labeled both responsible and sustainable.”

¹¹ See Christopher C. Nicholls, *Financial Institutions - The Regulatory Framework* (Markham, ON: LexisNexis Canada Inc., 2008) [*Nicholls*] at 1-3. Nicholls describes the tenuous nature of society’s relationship with banks, noting that “the bank, after all, is the quintessential financial ‘institution,’ standing at the center of the financial system in Canada and in most other industrialized countries. . . .” Despite the important role played by financial institutions in the economy and society, however, Nicholls points out that “engendering confidence does not necessarily engender affection. . . . Popular resentment of powerful institutions and the well-paid people who run them is neither a new phenomenon nor a surprising one, and the central role played by banks in our credit system has made them very powerful institutions indeed.”

possible that bankers may now be even more generally detested than lawyers, although it remains a tight race.¹²

More recently, the financial sector has become a hot-bed of activity as governments, regulators and academics work to understand the causes of the financial crisis and to ensure the soundness of domestic and international banking systems.¹³ Some legal commentators and scholars have also started to consider the financial crisis in the context of CSR theory. Janda et al argue in their recent legal analysis of CSR, for example, that the “causes of the financial crises, in fact had much to do with the lack of sufficient progress in CSR.”¹⁴ Amongst the contributing factors to the financial crisis they identified were a lack of transparency and accountability; a lack of minimum standards and best practices; a lack of appropriate risk management; and a neglect of the duties that financial institutions owe to society and the financial system. In short, they argued, the financial crisis was caused in part at least by conduct that demonstrated the “opposite of sensible CSR principles.”¹⁵

¹² *Ibid* at 2. Nicholls notes that few professions (with the possible exception of the legal profession) have been “more vilified than banking in popular literature, films and television.” This leads to an obvious question: what might be said of banking lawyers?

¹³ A discussion of the causes of the financial crisis and the steps taken by international regulators in response is beyond the scope of this thesis. However, for more information in this area, see the Basel Committee on Banking Supervision’s response to the financial crisis, available online: <http://www.bis.org/bcbs/fincriscomp.htm>. The work in this area continues with respect to the “International regulatory framework for banks (Basel III),” see online at: <http://www.bis.org/bcbs/basel3.htm>.

¹⁴ Michael Kerr, Richard Janda and Chip Pitts, *Corporate Social Responsibility - A Legal Analysis* (Markham, ON: LexisNexis Canada Inc., 2009) [*Janda et al*] at 590. However, this view is not universally held. Financial economists argue, for example, that the financial crisis was caused by structural problems in domestic and international banking systems that had very little to do with the decision by banks to adopt (or not) CSR. See e.g., Gary Gorton, “Getting Up to Speed on the Financial Crisis: A One-Weekend Reader’s Guide (with A. Metrick)” (2012) 50 *Journal of Economic Literature* 128. Gorton states that the catalyst for the near collapse of the international banking system was a relatively familiar concept: a “banking panic” or “run on the bank.”

¹⁵ *Ibid*

Against this backdrop, this thesis ultimately concludes that examples of CSR behavior can now be observed as Canadian banks continue to define the scope of their involvement with the EPs.¹⁶ However, this conclusion is tempered by the finding that there is little doubt that pragmatic and self-interested business motivations are also behind EPs adoption and implementation by Canadian banks. Any expectations that we might one day arrive at “socially responsible” banks should therefore be tempered by the reality that CSR remains in a state of flux as a business and legal concept and has yet to gain universal implementation in Canadian banking.

Interestingly, as will be discussed in this thesis, these findings are also consistent with broader themes identified in the scholarship in this area: the idea that adopting banks see the EPs as “good for business” in that they use the principles in their own self-interest to manage certain credit and reputational risks inherent in some of their lending activities. Moreover, given these self-interested motivations, some banks have been heavily criticized for lacking transparency and accountability in complying with the EPs’ requirements. Since no overt legal mechanism exists to monitor and enforce EPs compliance, concerns about “free-riding” have now emerged as critics point out that all adopters are likely to gain some reputational benefits irrespective of their actual compliance practices.

As noted in this thesis, these criticisms demonstrate one of the key drawbacks of voluntary CSR initiatives like the EPs: they may lack the necessary compliance and enforcement measures to effectively promote and implement CSR. In particular, the instant research shows that these observations are directly relevant in the Canadian

¹⁶ Conley and Williams used a similar backdrop for their paper on the EPs, noting that this “is an ironic time to be writing about banks as possible global sustainability regulators, ...” See *Conley and Williams, supra* note 5 at 542.

context as it finds that Canadian banks are using the EPs primarily for their important reputational benefits. This thesis therefore concludes that Canadian banks need to do a better job of promoting the transparency of their EPs reporting and compliance practices in order to more fully implement the EPs, and to avoid being labeled with the free-rider problem referred to above. Given the importance of many of these issues and the significant power and influence of banks on the everyday lives of Canadians, this area of analysis should remain as an important item on academic, regulatory, political and social agendas.

1.2 Introduction to CSR

This thesis adopts a broad conception of CSR to mean the idea that “a corporation must act in a responsible manner with regard to the environment, community and broader society in which it operates.”¹⁷ This definition is chosen for its inclusiveness as this thesis acknowledges that CSR means different things to different people and does not enjoy a universally accepted definition.¹⁸ As discussed below, however, the lack of a unified definition of CSR does not mean that it cannot (or should not) be studied as a concept.¹⁹ In this regard, the study of CSR necessarily reflects concerns about the proper conduct of

¹⁷ This is the definition of CSR endorsed by the late Hon. Mr. Justice Charles Doherty Gonthier, formerly of the Supreme Court of Canada, in his forward to the text by Janda et al. See *Janda et al, supra* note 14.

¹⁸ See Chapter 2 of this thesis for a more detailed discussion of some of the legal, economic and business theory related to CSR. The starting point for this analysis acknowledges that the academic relevance of CSR remains hotly debated and controversial and that the concept itself does not have a universally accepted definition.

¹⁹ The early development of CSR as a concept is said to have occurred primarily in business schools. However, CSR scholars claim that there has now been a resurgence of CSR, with its prominence widened to other disciplines, such as politics, economics, law and sociology. See e.g., Stephen Brammer, Gregory Jackson and Dirk Matten “Corporate Social Responsibility and institutional theory: new perspectives on private governance” (2012) 10 Socio-Economic Review 3 [*Brammer et al*] at 7.

business enterprise and there can be little doubt that this area of concern has occupied philosophers, scholars, religious and political leaders and law-makers for centuries.²⁰

More recently, these issues were brought to the forefront in the corporate law context by the famous 1930s Harvard Law Review exchange between Professors Adolf A. Berle Jr. of Columbia Law School and Merrick Dodd Jr. of Harvard. Professor Berle espoused the idea that the primary duty of corporate directors is to use their powers only to further the interests of shareholders.²¹ Professor Dodd, on the other hand, argued that corporations should take into account the interests of other corporate stakeholders as well – those of employees, consumers and the general public.²² Although the Berle-Dodd exchange did not focus directly on CSR (the formal concept was not yet established), these fundamental questions continue to dominate the academic discussion and debate in this area.²³ In this vein, CSR is also understood in this thesis to emphasize an approach to

²⁰ See the discussion on this point by Jennifer A. Zerk, “Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law” (Cambridge University Press, 2006) [Zerk] at 15.

²¹ Adolf A. Berle Jr., “Corporate Powers as Powers in Trust” (1931) 44 Harvard Law Review 1049 [Berle]. Berle’s thesis was that “all powers granted to a corporation or to the management of a corporation, or to any group within a corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.” As Berle explained in later articles in the Columbia Law Review, his principal concern was that directors were not really qualified for the task of serving non-shareholder interests and, as he noted in the original paper, a multi-stakeholder model raises accountability issues. See ““Control” in Corporate Law” (1958) 58 Colum. L. Rev. 1212[Berle-Control], and “Modern Functions of the Corporate System” (1962) 62 Colum. L. Rev. 433.

²² E. Merrick Dodd Jr., “For Whom are Corporate Managers Trustees?” (1932) 45 Harvard Law Review 1145 [Dodd]. Dodd viewed as problematic the idea that business corporations exist for the sole purpose of making profits for their shareholders. He advocated instead for a view of the “business corporation as an economic institution which has a social service as well as a profit-making function ...”

²³ See e.g., Archie B. Carroll and Kareem M. Shabana, “The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice” (2010) International Journal of Management Reviews 85 [Carroll and Shabana] at 86-87. The authors note that the roots of the formal concept of CSR emerged sometime after the Berle-Dodd exchange during the period 1945–1960. In particular, they reference Dean Donald K. David’s comments to the incoming MBA class at the Harvard Business School in 1946 wherein Dean David “exhorted the future business executives to take heed of the responsibilities that had come to rest on the shoulders of business leaders.”

corporate governance that “integrates and balances the self-interests of the corporation with the interests of the public” such that the “role of the corporation goes beyond providing individual benefits to its shareholders; it also includes a responsibility towards a wider community.”²⁴ As discussed in further detail in Chapter 2 of this thesis, the primary importance of earning economic returns from business activities is recognized under this model, with the idea being that corporations can also be asked to “do more.” From a legal perspective, for example, CSR is often understood to mean “doing more than what is required by law, i.e. beyond legal compliance.”²⁵

As will be shown in Chapter 2, however, any claim about the merits of CSR must be considered in light of the fact that CSR remains in a state of flux and is not universally accepted. This is particularly true in economics and corporate law circles where scholars

²⁴ This is the second part of the definition of CSR endorsed by Justice Gonthier in his forward to Janda et al. See *Janda et al*, *supra* note 14.

²⁵ Karin Buhmann “Corporate Social Responsibility: what role for law? Some aspects for law and CSR” (2006) 6 *Corporate Governance* 188 at 189. As discussed in Section 2.2 of this thesis, however, there are difficulties associated with this “balancing” of profits with CSR approach. For example, it assumes that there is some knowable, objective “reasonable” amount of profitability that can be balanced against a corporation’s other social interests. Questions therefore arise regarding the point at which a particular business can be said to have achieved the base measure of profitability which then subjects it to the expectation that it should now “do more.”

For a practical example of the idea that businesses should “do more” in the banking context, see the recent coverage of the statement by Royal Bank of Canada’s CEO Gord Nixon on his bank’s response to the temporary foreign workers controversy, available online at:

<http://www.cbc.ca/news/canada/story/2013/04/11/rbc-gord-nixon-apology-letter.html>.

“The recent debate about an outsourcing arrangement for some technology services has raised important questions.

While we are compliant with the regulations, the debate has been about something else. The question for many people is not about doing only what the rules require - it’s about doing what employees, clients, shareholders and Canadians expect of RBC. And that’s something we take very much to heart.

...

[w]e are reviewing our supplier arrangements and policies with a continued focus on Canadian jobs and prosperity, balancing our desire to be both a successful business and a leading corporate citizen.”

continue to be heavily critical of CSR because it does not correspond with their views of the role of business in society. As will be discussed, CSR is largely irrelevant (and possibly even harmful) under these positions because the only social obligation of business is to contribute to the wealth of society.²⁶

The purpose of this thesis is not, however, to support or reject the classical economic or corporate law views as they relate to CSR. Rather, as noted above, this thesis proceeds on the basis that CSR values²⁷ may now be observed in modern corporate practice, and argues that the EPs offer a workable practical model for study in the banking context because they not only demonstrate CSR but also are good for business.²⁸ As a result, this research argues that the EPs offer a practical example of the “business case” approach to CSR discussed in further detail in Chapter 2.²⁹ As will be discussed,

²⁶ See Section 2.2(a) of this thesis for a discussion of the classical economic and corporate law views.

²⁷ A discussion of the normative underpinnings for CSR is beyond the scope of this thesis. However, the reference to CSR “values” here is to the general idea that businesses have a responsibility “to do what is right, just, and fair, and to avoid or minimize harm to stakeholders (employees, consumers, the environment, and others).” See Archie B. Carroll, “The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders” (1991) 34 *Business Horizons* 39 [*Carroll-Pyramid*] at 42.

²⁸ This pragmatic approach to the analysis in this area is adopted by some business lawyers. See e.g., the 2005 study “Banking on Responsibility” by U.K. law firm Freshfields Bruckhaus Deringer LLP [*Freshfields*] at 42. Freshfields notes that “it is important not to see making profits and protecting society as well as the environment as diametrically opposed. Progress can be made by agreeing on how to balance the need to generate profits against the need to protect the environment and society.” A copy of this study is available online at: http://www.banktrack.org/manage/ems_files/download/banking_on_responsibility/050701_banking_on_responsibility.pdf. Semotiuk adopted a similar approach for her LLM thesis on the role of corporate law in CSR. See Orysia Semotiuk, “The role of law in corporate social responsibility and stakeholder theory” Queen’s University (2004) ProQuest Dissertations and Thesis [*Semotiuk*] at 1-2.

²⁹ As discussed in Chapter 2, however, it is important to point out that the business case approach is not universally accepted and significant debate continues on whether CSR in this form fits into other theories of the firm. The classical economic view, for example, may continue to reject CSR in principle and doubt the value-creating contribution of CSR activities. See Section 2.3 of this thesis for further discussion on this point.

the focus of the business case approach is on the argument that CSR can be integrated with financial management to create sustainable companies in the long-run.³⁰

1.3 Thesis Organization and Methodology

This thesis is divided into 7 Chapters and utilizes multiple lines of doctrinal resources and extrinsic evidence, including bank public disclosures, law firm articles and various domestic and international research reports relevant to the banking industry. The remainder of this Chapter 1 provides a brief description of Canadian Schedule 1 banks as the population under study and then sets out some of the limitations of the methodology used.

Chapter 2 provides a brief update on developments in CSR theory and the primary research method is doctrinal. The intention is not to cover the extensive body of CSR related scholarship but, rather, to provide a briefing on developments in this area that are most relevant to the instant research. Some of the conceptual challenges advanced against CSR will be briefly discussed; however, the purpose of Chapter 2 is ultimately to show that the lack of a unified understanding of CSR does not mean that it cannot be studied as a legitimate academic concept. In particular, recent scholarship has identified common themes or approaches to CSR, including the “instrumentalist” approach that is most relevant to the instant research. This, in turn, leads into a discussion of the “business case” for CSR and other related theories including the “enlightened self-interest” and “enlightened shareholder” theories. Finally, Chapter 2 reviews recent commentary to make the argument that CSR is often misunderstood as a concept because of changes in

³⁰ *Ibid*

the so-called “voluntary” versus “mandatory” (e.g. imposed by law or regulation) corporate conduct debate. As will be shown, this distinction is no longer as important as once thought as CSR activity is now understood to exist in a wide range of both voluntary and mandatory corporate behavior.

Moving away from the ongoing academic debate surrounding CSR, Chapter 3 makes the case for the practical relevance of CSR in Canada generally and in the Canadian financial services industry specifically. The purpose is to set the stage for the remainder of this thesis by arguing that, the lack of a universally accepted theoretical model notwithstanding, the emergence of CSR is now a phenomenon that can be observed in practice in Canada. The methodology here includes a review of examples of CSR in the Canadian context to show that CSR has gained a strong foothold in practice in this country. Doctrinal sources are also considered to show that general CSR principles can now be connected to developments in the Canadian financial sector. As noted above, the financial sector is viewed as increasingly relevant to CSR and some commentators claim that a shift is occurring toward greater importance being placed on social and environmental values in this industry. However, despite these developments and early “wins” for CSR, Chapter 3 concludes that significant work remains to be done to advance CSR in Canada and, in particular, the Canadian financial sector.

Chapter 4 begins the thesis’s case study by introducing the EPs. As noted above, the EPs were chosen for study because they represent a potential example of CSR in practice: a series of voluntary guidelines that banks have committed to follow in managing the social and environmental risks of their project financing activities. A brief overview of the EPs is provided, along with a description of the requirements they

currently prescribe for member banks generally. Chapter 4 also discusses some of the events that occurred on the international project financing stage leading up to the development of the EPs in 2003. These developments are interesting because they show that reputation risk management was a strong motivating factor behind the development of the EPs in the aftermath of significant public relations scandals for member banks. In particular, the fallout from the private sector financing of the Three Gorges Dam Project in the People's Republic of China is discussed.

Chapter 5 provides a literature review of the EPs related scholarship that has emerged to-date. It considers a fundamental question posed in the academic work in this area: why did banks and other profit maximizing financial institutions voluntarily develop and adopt a code like the EPs? A review of several papers that have addressed this apparent contradiction shows that scholars agree that pragmatic motivations are behind EPs adoption as member banks see them as good for business. The second part of Chapter 5 provides a review of the theoretical CSR framework developed for the EPs. As noted above, it is generally well accepted in this scholarship that the principles amount to a voluntary code, thereby evidencing an example of the form of global regulation known as "soft law." Finally, Chapter 5 canvasses some of the concerns associated with the EPs compliance practices of member banks and the so-called "free-rider" problem that has emerged in this context.

Chapter 6 considers the practical relevance of the EPs in Canadian banking and the methodology shifts to a market based analysis of the EPs related public disclosure of key Canadian banks. The emerging role of the EPs in Canada is assessed, along with a consideration of how far (if at all) the EPs have become embedded in the Canadian

banking industry. This methodology is adopted from a recent study by Macve and Chen of EPs disclosures by banks in the U.K.³¹ The authors note in their paper that the EPs provide an interesting arena in which to analyze how banks are implementing CSR but pointed out that there remains a need for further research to investigate actual bank practices and how this varies over time.³² The instant research will respond to this call for further study from the Canadian perspective by considering the following questions:

1. What are the motivations for adopting and adhering to the EPs in Canada?
2. Are Canadian banks' EPs disclosures adequate and credible?
3. How far have the EPs become embedded in Canadian banking?

In conclusion, Chapter 7 sets out some of the general observations that can be made on the basis of this research and the case study on the adoption of the EPs in Canada. As a first point, Chapter 7 concludes that the results of this study provide support for the proposition that Canadian banks are demonstrating CSR behavior through the steps they are taking to implement and comply with the EPs: each of the Canadian banks studied has made broad public statements concerning the importance of CSR and point to their adoption of the EPs as evidence of their commitment in this regard. As a result, there can be little doubt that a practical shift of business and financial values is occurring leading toward greater importance being attributed to CSR considerations in the Canadian banking sector.

However, this conclusion is ultimately tempered by the finding that Canadian banks are using the EPs primarily for self-interested reasons. As discussed in this thesis,

³¹ *Macve and Chen, supra* note 6.

³² *Ibid* at 894-896.

this is not necessarily inconsistent with CSR to the extent that the business case for CSR contemplates self-interested business motivations as being a primary driver of corporate activity.³³ However, the business case for CSR also requires that consideration be given to environmental and social concerns and this study found no evidence of positive environmental or social outcomes in the EPs reporting of Canadian banks. In fact, this study found that the limited EPs reporting and disclosure by Canadian banks makes it impossible to draw any conclusions in this area. As a result, this thesis concludes that there is clearly room for improvement for Canadian banks, particularly in the areas of EPs disclosure and compliance practices, and further study will be needed to see if Canadian banks are mindful of these concerns as they move forward in their implementation of the principles.

Moreover, Chapter 7 concludes that while the case study conducted here shows that the emergence of CSR behavior can be observed in Canadian banking, it also shows that many of the theoretical problems associated with CSR emerge when it is put into practice in this industry. As result, significant work remains to be done to advance CSR in financial services and even more work will be needed to see if it works in practice in the Canadian banking sector. Beyond Canada, Chapter 7 also identifies that further study is needed into the impact of the EPs on the international banking industry. For example, as geopolitical shifts are taking place, it will become increasingly important to understand the extent to which banks from emerging market economies are adopting the EPs.

Finally, Chapter 7 identifies that there will be significant opportunity for further study in this area when the on-going EPs update process is implemented in 2013 and 2014. A draft of the new principles was released for stakeholder consultation and public

³³ See Section 2.3 of this thesis for a discussion of the business case approach to CSR.

comment on August 13, 2012 and the formal comment period closed on October 12, 2012. The updated principles were formally launched and are effective from June 4, 2013, but there is a transition period in place to allow banks to continue using the current version of the EPs until the end of 2013. Although banks have made a number of commitments to make improvements during the update process, some commentators and NGOs are highly critical of the efforts taken in this regard to date. BankTrack in particular has indicated its frustration on these issues and has demanded firm commitments from the banks; failing which, it argues the updated principles will have failed to achieve any meaningful improvements.³⁴

1.4 Population under Study: Schedule 1 Canadian Banks

All banks operating in Canada are subject to the regulation and supervision of the Office of the Superintendent of Financial Institutions (OSFI).³⁵ According to the Canadian Bankers Association, the banking industry in Canada currently includes “24 domestic banks, 25 foreign bank subsidiaries, 24 full-service foreign bank branches and

³⁴ See online at: http://www.banktrack.org/show/pages/about_banktrack. BankTrack is a global umbrella network of NGOs and individuals tracking the operations of the private financial sector (listed as including commercial banks, investors, insurance companies and pension funds). BankTrack’s submissions to the EPs Association are contained in its paper, “The Outside Job, Turning the Equator Principles towards people and planet” (October 2011) [*Outside Job*], available online at: http://www.banktrack.org/download/the_outside_job/111021_the_outside_job_final.pdf. BankTrack argues that the updating process has had “serious flaws” and that, if continued in their current mode, the EPs “risk to become an inward looking initiative, largely irrelevant to outside stakeholders and thus will contribute little to restoring the trust lost in the sector” (*Outside Job* at 3).

³⁵ See OSFI’s website, online at: http://www.osfi-bsif.gc.ca/osfi/index_e.aspx?ArticleID=3.

five foreign bank lending branches operating in Canada.”³⁶ The CBA provides the following information relating to the breakdown of banks in Canada:

- Schedule I Banks are Canadian banks and are authorized by OSFI under the *Bank Act*³⁷ to accept deposits, which may be eligible for deposit insurance provided by the Canada Deposit Insurance Corporation;
- Schedule II banks are foreign bank subsidiaries authorized to accept deposits, which may be eligible for deposit insurance;
- Schedule III banks are bank branches of foreign institutions that are authorized to do some specific form of banking business in Canada. Certain restrictions are placed on their activities (e.g. they may not be eligible to take deposits); and
- Most Schedule II and Schedule III banks specialize in certain niche financing sectors and have only one or two offices or branches located within Canada.³⁸

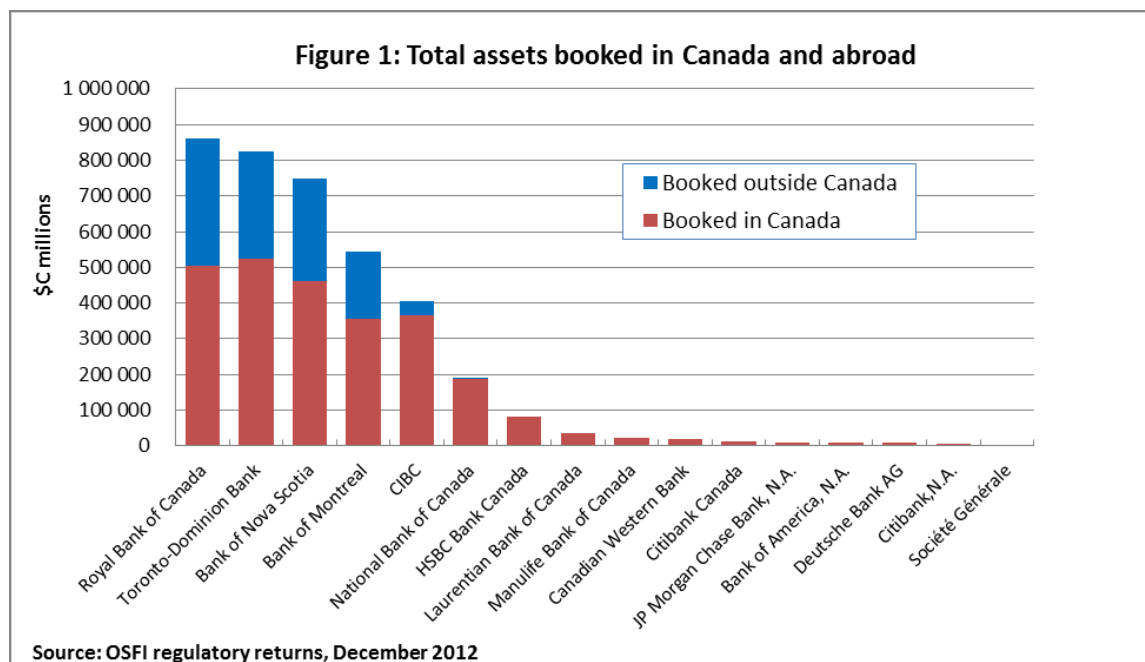
The focus of this thesis is on Schedule 1 banks as representing the largest portion of the Canadian financial banking industry. More specifically, this thesis focuses on Canada’s five largest domestic banks (referred to in this thesis as the “Big-5” Canadian banks): Royal Bank of Canada, Toronto-Dominion Bank, Bank of Nova Scotia, Bank of Montreal and the Canadian Imperial Bank of Commerce. Together, the Big-5 Canadian banks are taken as representative of the Canadian banking industry for the purposes of this thesis as they hold over 80 percent of total banking assets in Canada: OSFI confirms

³⁶ See the website of the Canadian Banker’s Association [*CBA*], online at: <http://www.cba.ca/en/component/content/category/61-banks-operating-in-canada> (accessed as of June 28, 2013).

³⁷ *Bank Act*, SC 1991, c 46 [the *Bank Act*].

³⁸ *CBA*, *supra* note 36.

this relative importance of the Big-5 Canadian banks in the following graph:³⁹



1.5 Research Limitations

The following limitations in the methodology have been identified for this thesis, each of which could form the opportunity for further study in this area. First, this research presupposes that the emergence of CSR in banking is something that can be observed. However, as will be noted in Chapter 2 of this thesis, there is no definitive agreement in the academic literature on what constitutes CSR and whether or not observed corporate conduct falls into a conception of what is socially responsible depends on the context and is open to interpretation. It is therefore difficult to measure in any meaningful sense. As noted above, however, it is relatively early days in the study of the implications of CSR

³⁹ See the Canadian banking industry information contained in the March 26, 2013 letter to the banking industry from Mark Zelmer, Assistant Superintendent Regulation Sector of OSFI, regarding *Domestic Systemic Importance and Capital Targets – DTIs*, at 3. Electronic copy available online at: http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/DSIB_let_e.pdf. The OSFI Advisory relating to Domestic Systemic Importance and Capital Targets – DTIs is also available online at: http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/DSIB_adv_e.pdf.

for the banking industry⁴⁰ and the purpose here is only to use a broadly defined understanding of CSR to document the emergence of a range of activities in Canadian banking that appear to be socially responsible. The goal is to support further theoretical and practical research into a model of CSR that is relevant to the banking sector and further research will be needed to measure whether and how banks are being socially responsible in any quantifiable way.

A second and related limitation is that this research also presupposes that the emergence of social type duties in the banking sector can be attributed to CSR. In this regard, however, since there is no agreed upon definition of CSR, it is difficult to state with certainty that any of the behaviors discussed in this thesis are directly caused by the promulgation of CSR principles. Some of the implications of this are discussed in Chapters 5, 6 and 7 where it is noted that banks are likely incentivized to adopt the EPs by competitive pressures and self-interested motivations rather than strict adherence to CSR. However, as noted above, the overall purpose of this thesis is simply to make an initial connection between CSR and observed practices in the Canadian banking sector; further study will be needed to determine the strength of the connection, or whether there may be other causal factors at play.

This thesis is also limited to a discussion of CSR and does not purport to cover the entire range of corporate conduct models developed in the areas of law and business, as well as other disciplines, such as, politics, economics, sociology and philosophy. This approach is justifiable given that it is consistent with statements by scholars who confirm that CSR remains the “dominant, if not exclusive, term in the academic literature and

⁴⁰ See e.g., *Conley and Williams, supra* note 5.

business practice.”⁴¹ However, further study would be needed to determine if and how the results of this thesis might support other theories in this area. For example, this research might also align with stakeholder theory, which is understood to be closely related to CSR. A full discussion of stakeholder theory is beyond the scope of this thesis but, generally speaking, it holds that corporations should take into account the considerations of other persons that impact or may be impacted by corporate actions.⁴²

Finally, this thesis is obviously limited in terms of its geographic application to Canada. Further, the population under study is again limited to the Big-5 Canadian banks listed under Schedule 1 of the *Bank Act*. Although this is justifiable given the weighting of the Big-5 Canadian banks in Canada’s banking sector (see Section 1.4 above), the research will be limited in that it may not consider emerging issues in other areas of the Canadian and international financial industries. As discussed in Chapter 7, further research will be needed to see whether some of the findings of this thesis can be applied more generally across the larger body of what we consider to be financial institutions in Canada and internationally.

⁴¹ *Carroll and Shabana, supra* note 23 at 86. The authors point out that the “term ‘corporate social responsibility’ is still in popular use, even though competing, complementary and overlapping concepts such as corporate citizenship, business ethics, stakeholder management and sustainability are all vying to become the most accepted and widespread descriptor of the field. At the same time, the concept of corporate social performance (CSP) has become an established umbrella term which embraces both the descriptive and normative aspects of the field, as well as placing an emphasis on all that firms are achieving or accomplishing in the realm of social responsibility policies, practices and results. In the final analysis, however, all these concepts are related, in that they are integrated by key, underlying themes such as value, balance and accountability, and CSR remains a dominant, if not exclusive, term in the academic literature and in business practice.”

⁴² See e.g., Thomas Donaldson and Lee E. Preston, “The stakeholder theory of the modern corporation: Concepts, evidence and implications” (1995) 20 *Academy of Management Review* 65.

CHAPTER 2 – UPDATE ON CSR

2.1 Introduction

This Chapter provides a brief update on recent CSR related scholarship. The body of work that makes up the academic literature on CSR is extensive and a full review is beyond the scope of this thesis. Instead, this Chapter focuses on CSR developments that are relevant to the instant research and, in particular, the recent legal scholarship in this area advanced by Janda et al in *Corporate Social Responsibility - A Legal Analysis*.⁴³

The remainder of this Chapter is divided into 3 parts. Section 2.2 provides a discussion of some of the conceptual challenges that have contributed to the lack of a formal unified definition of CSR. In particular, the criticisms of CSR advanced on the basis of the classical economic view and corporate law are discussed.

Section 2.3 then turns the analysis to a potential middle ground in the CSR debate - the “business case” for CSR - that has been developed at least partly in response to the challenges advanced by scholars espousing the classical economic view. As will be discussed, this thesis argues that the EPs offer a chance to study the business case approach because the principles evidence CSR values and are also good for business.

Finally, Section 2.4 makes the argument that CSR is also often misunderstood as a concept because of changes to the so-called “voluntary” versus “mandatory” (e.g. imposed by law or regulation) corporate conduct debate. As will be shown, this issue is no longer as important as once thought as CSR activity is now believed to exist within a range of both voluntary and mandatory corporate behavior.

⁴³ *Janda et al, supra* note 14. For a review of this text, see Sara Seck “Review of Corporate Social Responsibility: A Legal Analysis by Michael Kerr, Richard Janda and Chip Pitts” (2010) 49 C.B.L.J. 335.

2.2 Update on CSR Theory

(a) Conceptual Challenges

This analysis starts from the position that there is no universally accepted definition of CSR.⁴⁴ In a general sense, it is probably accurate today to say that the concept of CSR clearly “means something” but, as will be shown below, it does “not always mean the same thing to everybody.”⁴⁵ This is confirmed by Janda et al in the legal context as the authors conclude that there is no single “legal definition” of CSR.⁴⁶ However, although CSR is often criticized on this point as being theoretically problematic, Janda et al argue that the absence of a definition is, in fact, purposeful: CSR needs to remain “conceptually flexible in order to foster on-going evolution and development” and any legal understanding must therefore be directed at a moving target.⁴⁷ They point out that what is *socially responsible* in any given context depends on changing social needs and concerns, and these cannot be confined to current standards. As a result, CSR is necessarily a dynamic concept that remains “in a constant state of evolution and, arguably, should never be subject to a fixed, universal definition.”⁴⁸

⁴⁴ See e.g., the discussion on this point by Carroll and Shabana. *Carroll and Shabana, supra* note 23 at 86.

⁴⁵ Dow Votaw’s comments from 1972 still ring true today. See Dow Votaw “Genius Became Rare: A Comment on the Doctrine of Social Responsibility Pt 1” (1972) 15 *California Management Review* 25 at 25. Votaw wrote that the term corporate social responsibility “means something, but not always the same thing to everybody. To some it conveys the idea of legal responsibility or liability; to others, it means socially responsible behavior in the ethical sense; to still others, the meaning transmitted is that of ‘responsible for’ in a causal mode; many simply equate it with a charitable contribution; some take it to mean socially conscious; many of those who embrace it most fervently see it as a mere synonym for legitimacy in the context of belonging or being proper or valid; a few see a sort of fiduciary duty imposing higher standards of behavior on businessmen than on citizens at large.”

⁴⁶ *Janda et al, supra* note 14 at 5-6.

⁴⁷ *Ibid*

⁴⁸ *Ibid*

As noted in the introduction to this thesis, one of the main conceptual difficulties in defining and understanding CSR arises in the literature because of disagreement over the nature of the corporation and its role in society. In this regard, it can be argued that the typical focal point of the CSR debate is the “inquiry into what obligations corporations owe to society” and this can be thought of as a debate about the nature or purpose of the corporation or, stated another way, “any view of CSR conceals complex normative conclusions about the nature of the corporation.”⁴⁹

In this regard, a detailed discussion about the highly complex nature of CSR and its controversial underpinnings is beyond the scope of this thesis. In a very general sense, however, the scholarship identifies two different but related theoretical models for CSR: “rights approaches and power models.”⁵⁰ Rights approaches typically center on arguments that corporations and society engage in a form of “social contract,” also referred to as a “social compact.”⁵¹ CSR scholars point out, for example, that the corporation has “always been a political creation” in that “the state granted the

⁴⁹ See *Semotiuk, supra* note 28 at 10 and 18. See also the reference to the Berle-Dodd exchange in Section 1.2 of this thesis.

⁵⁰ See Adaeze Okoye “Theorizing Corporate Social Responsibility as an Essentially Contested Concept: Is a Definition Necessary?” (2009) 89 *Journal of Business Ethics* 613 [*Okoye*] at 614-615 (describing attempts to analyze the complex theoretical underpinnings for CSR and noting that questions regarding the relationship between corporations and society have generally been analyzed in the “two-fold vein; that of rights approaches and power models.”)

⁵¹ See Section 3.2 of this thesis for a discussion of the social contract approach in relation to Canadian banks specifically. Banks are corporations, but a special kind such that the social contract made with banks is likely different and more comprehensive. There is also a more extensive legislative context imposed on banks giving them the legal right to operate as financial intermediaries in our economic system. See e.g., *Nicholls, supra* note 11. The social contract approach in the general sense is normally associated with Thomas Donaldson; see e.g., Thomas Donaldson “Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory” (1994) 19 *Academy of Management Review* 252.

corporation the benefit of limited liability in order to facilitate the accumulation of capital.”⁵² As a result, Brammer et al argue on this point that

“[t]his extension of limited liability created a fundamental issue of corporate governance. But it is not simply a matter of how managers are to be made accountable to the more diffuse group of shareholders as agency theory tells us, but a more fundamental issue of what responsibilities society places on the corporation itself in exchange for the legal privilege of limited liability.”⁵³

Similarly, as a starting point, for their discussion, Janda et al point out that the social contract or compact conception of CSR holds that in

“exchange for public trust and the social license to operate its business, the corporation makes a series of social business commitments or reciprocal undertakings. According to this understanding, the corporation cannot exist without its social setting and therefore makes undertakings to preserve and enhance the very social setting that has made its existence possible.”⁵⁴

Other prominent Canadian authors have commented positively on this social contract theory as well. For example, Hutchinson refers to a “democratic wager” being made:

“[i]f particular individuals wish to avail themselves of the many benefits of incorporation (the most important of which is limited liability), it seems entirely fair and appropriate that they assume a reciprocal series of public responsibilities and forgo their almost unlimited control over the corporation’s organization and operations... .”⁵⁵

In addition to rights approaches, scholars argue that there are at least four power models in this area, including the power-responsibility model; the bureaucratic

⁵² *Brammer et al, supra* note 19 at 6.

⁵³ *Ibid*

⁵⁴ *Janda et al, supra* note 14 at 17.

⁵⁵ Allan C. Hutchinson, *The Companies We Keep - Corporate Governance for a Democratic Society* (Toronto, ON: Irwin Law Inc., 2005) [*Hutchinson*] at 9.

responsibility model; the mutual interest model and the power-legitimacy model.⁵⁶

Generally speaking, power issues become relevant here to the extent that “[p]ower over the lives of others tends to create on the part of those most worthy to exercise it a sense of responsibility.”⁵⁷ For example, under the power-legitimacy model, concerns about a corporation’s power legitimacy arise in the context of “examining questions of the legitimacy of corporate power within modern society; both in the sense of power being exercised legitimately and in the sense, of having legitimacy for the exercise of such power.”⁵⁸

However, economists and corporate law scholars typically reject the rights and power model approaches to argue that CSR is largely irrelevant (and possibly even harmful) to the extent that it is inconsistent with their own views on the role of business in society.⁵⁹ The classical economic view holds, for example, that corporations contribute to the wealth and well-being of society by earning a profit and, as a result, the pursuit of economic goals becomes the only corporate social responsibility of business. This was perhaps most famously stated by Milton Friedman in his 1970 article in the *New York Times* wherein he argued that “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it

⁵⁶ See *Okoye, supra* note 50 at 614-615.

⁵⁷ *Dodd, supra* note 22 at 115.

⁵⁸ See *Okoye, supra* note 50 at 614-615.

⁵⁹ See e.g., the reference to Professor Berle’s views in Section 1.2 of this thesis.

stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”⁶⁰

From this economic perspective, it can be argued that the common good of society will be furthered by “the self-interested actions of individual economic agents in a market economy, including in particular the actions of business enterprises guided by the profit motive”⁶¹ As a result, under this view, economists see “profitability as a *prima facie* indicator of changes in general welfare: this is their starting point.”⁶² CSR could in fact be dangerous to the extent that the actions of companies are taken beyond profit motives, thereby worsening economic performance and making society and people in general worse off.⁶³

Traditional corporate law theory gives a similar but less clear cut conclusion. It holds that corporate directors have a duty to act in accordance with the best interests of

⁶⁰ See Milton Friedman, “The social responsibility of business is to increase its profits” *New York Times Magazine*, September 13, 1970.

⁶¹ David Henderson, *Misguided Virtue, False Notions of Corporate Social Responsibility*, IEA Hobart Paper No. 142 (The Institute of Economic Affairs, London, 2001) [*Henderson*] at 20. However, CSR scholars question whether profitability should be used as the only guide for business given differences between short-term and long-term assessments of profit. As noted below in Section 2.3 of this thesis, one of the true complexities of CSR is that disregarding social and environmental issues may very well be profitable in the short term. In the long-term, however, CSR may improve a company’s overall value and even its profitability. Another complexity arises here surrounding whether *profit maximization* should be used as a guide, particularly since profit is an accounting construction that is open to interpretation; see e.g., *Carroll-Pyramid*, *supra* note 27 at 39-41. Carroll recognized that what he referred to as business’s “economic responsibility” was paramount and that “[a]ll other business responsibilities are predicated upon the economic responsibility of the firm, because without it others become moot considerations.” However, Carroll questioned the classical economic insistence on profit maximization, arguing that the profit principle was originally set in terms of “acceptable profits” until Friedman and others adopting the classical economic view turned it into the principle of “profit maximization.”

⁶² *Ibid* at 21.

⁶³ *Ibid* at 28. See also the discussion at 107-128 (arguing that the adoption of CSR by corporations would on balance do much harm).

the shareholders of the corporation.⁶⁴ To the extent that shareholders wish the corporation to “make as much money as possible,” it can be argued that corporate law facilitates wealth creation when corporations pursue economic returns for their shareholders within the rules imposed by law.⁶⁵ Former Chancellor William T. Allen put it this way:

“[s]tated broadly, but I think accurately, the elemental purpose of corporate law is the facilitation of cooperative activity that produces wealth. A net increase in total wealth, other things remaining unchanged, is an absolute good. With increased wealth, all other things remaining the same, there is a great ability to relieve human suffering and enhance life.”⁶⁶

As a result, scholars in this area argue that conclusions about CSR are the same under both classical economics and traditional corporate law:

“Since both give pre-eminence to shareholders, they are cool towards the idea, now widely accepted, that power or status should be conferred, whether by law or corporate decisions, on other ‘stakeholders’ in a business. Both believe that companies will best discharge the responsibilities which specifically belong to them by taking profitability as

⁶⁴ In Canada, corporate law statutes mandate that the directors’ (and officers’) duty is to the corporation, not directly to the shareholders. The unresolved issue that remains, however, is how directors and officers are to operationalize this duty. The traditional view was that directors and officers were to act in the best interests of the “company” (meaning the company of shareholders, collectively). However, recent developments have hinted that that reading might be too narrow and that other corporate interests should be considered. See e.g., the recent Supreme Court of Canada decisions in *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. and *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461. For a discussion of these cases, see Ed Waitzer and Johnny Jaswal, “Peoples, BCE, and the Good Corporate ‘Citizen’” (2009) 47 Osgoode Hall Law Journal 444. The authors note at 441 that “one of the great unresolved debates in corporate law” remains “whether the interests of the corporation are limited to those of its shareholders, or whether they extend to the stakeholder constituencies that contribute to, or are impacted by, the corporate enterprise.”

⁶⁵ See the reference to Professor Berle’s views in Section 1.2 of this thesis. Berle argued that the traditional corporate law view was that the corporation “was formed and existed to make money for its stockholders” and that stockholders “presumably wished the corporation to make as much money as possible.” However, this position is no longer as clear cut as Berle acknowledged that “[m]id-twentieth century conditions obviously have modified that straight-forward and simple idea. The changes are so many that they need merely be suggested. The ‘control’ undoubtedly is still interested, as a rule, in maximizing profit. But it may be a secondary interest.” See *Berle-Control*, *supra* note 21 at 1214.

⁶⁶ Chancellor T. Allen, “Ambiguity in Corporation Law” (1997) 22 Del. J. Corp. L. 895 at 895-896. Allen was Chancellor of the Court of Chancery of the State of Delaware.

a guide, subject always to acting within the law, and that they should not go out of their way to define and promote wider self-chosen objectives.”⁶⁷

(b) CSR as a Concept

Due in part at least to the theoretical differences described above, we are left with CSR today as what can only be described as an ill-defined and often misunderstood concept.⁶⁸ In fact, CSR continues to be criticized on this point as being unrealistic and lacking in academic legitimacy.⁶⁹ However, these criticisms often represent an oversimplified understanding of CSR and ignore the fact that scholars from several disciplines have devoted significant effort toward the development of CSR into a workable theoretical concept.⁷⁰

Further, significant scholarly work in this area continues as efforts today focus on key features of CSR that can be readily identified and understood.⁷¹ Scholars point out, for example, that the field of CSR has “grown significantly and today contains a great proliferation of theories, approaches and terminologies.”⁷² More specifically, in their recent attempt to “map” this proliferation of CSR in the academic literature, Garriga and Mele point out that “the most relevant CSR theories and related approaches are focused on one of the following aspects of social reality: economics, politics, social integration

⁶⁷ See Henderson, *supra* note 61 at 20-21.

⁶⁸ Okoye, *supra* note 50 at 614-615.

⁶⁹ Semotiuk, *supra* note 28 at 19. Semotiuk notes that CSR is perceived as a rather naïve position by its critics: “a well-intentioned (yet unrealistic) plea to corporations by left-of-center political types hoping to do “good” in the world.”

⁷⁰ See e.g., the description of the renewal of academic interest in CSR by Brammer et al, *supra* note 19 at 7.

⁷¹ *Ibid*

⁷² Elisabet Garriga and Dome`nec Mele, “Corporate Social Responsibility Theories: Mapping the Territory” (2004) 53 *Journal of Business Ethics* 51 at 51.

and ethics.”⁷³ Based on this work, Garriga and Mele conclude that most current CSR theories are focused on the following four key aspects:

1. instrumental in the sense of creating long-term value for companies,
2. political in the sense of using business power responsibly,
3. integrative in the sense of integrating business and social demands, and
4. contributive in the sense of creating value for society by doing what is ethically correct.⁷⁴

This thesis aligns with the “instrumentalist” approach in that it argues that the EPs represent a potential example of the merger of CSR values with the economic reality of firms. In this regard, Archie B. Carroll is credited with having developed a multi-layer conception or “pyramid” model of CSR that consists of four interrelated aspects: a corporation’s economic, legal, ethical and philanthropic responsibilities.⁷⁵ Importantly, Carroll recognized that the economic responsibility to “provide goods and services” to society was paramount because all “other business responsibilities are predicated upon the economic responsibility of the firm, because without it the others become moot considerations.”⁷⁶ Based on this, Carroll articulated a pyramid of CSR that contains the four components he identified:

⁷³ *Ibid* at 52.

⁷⁴ *Ibid* at 65-66.

⁷⁵ *Carroll-Pyramid, supra* note 27 at 39-48. It should be pointed out that some CSR scholars now argue that the “instrumental” approach to CSR is outdated as they advocate instead for approaches that focus on “political” or “institutional” concerns. See e.g., *Brammer et al, supra* note 19. Despite this, the instrumental approach remains prominent in the balance of the scholarship in this area and, as will be discussed in Chapter 5, is used as the primary approach to support the academic work surrounding the EPs.

⁷⁶ *Ibid* at 41.

“[b]eginning with the basic building block notion that economic performance undergirds all else. At the same time, business is expected to obey the law because the law is society's codification of acceptable and unacceptable behavior. Next is business's responsibility to be ethical. At its most fundamental level, this is the obligation to do what is right, just, and fair, and to avoid or minimize harm to stakeholders (employees, consumers, the environment, and others). Finally, business is expected to be a good corporate citizen. This is captured in the philanthropic responsibility, wherein business is expected to contribute financial and human resources to the community and to improve the quality of life.”⁷⁷

Stated in more pragmatic terms, Carroll argued that “the CSR firm should strive to make a profit, obey the law, be ethical, and be a good corporate citizen.”⁷⁸ However, Carroll recognized that this model was imperfect and subject to criticism on the basis that there are inherent “tensions” between a corporation's responsibilities. Carroll conceded that the most critical tensions would be between the economic and legal, economic and ethical, and economic and philanthropic responsibilities, and that the economic traditionalist might see this as a conflict between a firm's “concern for profits” versus its “concern for society.” Carroll suggested, however, that this objection amounted to an oversimplification because a CSR perspective “would recognize these tensions as organizational realities, but focus on the total pyramid as a unified whole and how the firm might engage in decisions, actions, and programs that simultaneously fulfill all its component parts.”⁷⁹

⁷⁷ *Ibid* at 42.

⁷⁸ *Ibid* at 43.

⁷⁹ *Ibid* at 42-43.

2.3 The Business Case for CSR

Today, the economic rationale for CSR is often discussed in terms of the “business case” for CSR.⁸⁰ Janda et al point out, for example, that a common theme is one of “integration of economic considerations, as the traditional focus of business, with environmental and social imperatives.”⁸¹ In short, this school of thought holds that “companies need to be ‘socially responsible’ to fulfill their obligations to shareholders.”⁸² Stated more broadly, the business case for CSR “refers to the arguments or rationales supporting or documenting why the business community should accept and advance the CSR ‘cause’” and the primary question becomes “[w]hat do the business community and organizations get out of CSR; that is, how do they benefit tangibly from engaging in CSR policies, activities and practices?”⁸³

However, it is important to point out that the business case approach is not universally accepted and significant debate continues on whether CSR in this form fits into economic theory.⁸⁴ Moreover, on the issue of firm profitability, it is important to note that, despite significant and on-going academic work, the practical connection between CSR and short-term financial performance has not been fully established. As a result, commentators conclude that continued work in this area is needed as academics remain skeptical and some find that “the theoretical arguments as well as the empirical evidence so far are rather poor. Financial performance is only weakly linked to corporate

⁸⁰ *Carroll and Shabana, supra* note 23 at 91-92.

⁸¹ *Janda et al, supra* note 14 at 9.

⁸² *Zerk, supra* note 20 at 16-17.

⁸³ *Carroll and Shabana, supra* note 23 at 86.

⁸⁴ See Section 2.2(a) of this thesis.

socially responsible behavior; many papers even find a negative relationship between the two.⁸⁵

On the other hand, CSR scholars point out that the focus of the business case for CSR is on long-term rather than short-term performance. Carroll and Shabana argue, for example, that this version of CSR may not be inconsistent with the classical economic view to the extent that:

“[t]he notion of an economic responsibility in terms of financial profit to stockholders is accepted and required by both views. One may even argue that maximizing shareholder wealth in the long run is an underlying principle of both views. The real difference may be that the classical economic view fails to appreciate the long-term negative effects of the application of the maximization principle in the short term. In contrast, the opposite view applies the maximization principle for long-term benefits, which entails that such principle may be suppressed in certain short-term considerations.”⁸⁶

It can be argued generally in this context that one of the “main drivers” of the business case for CSR arises because companies may already be aware that there are long-term gains to be made by adhering to CSR.⁸⁷ For example, Carroll and Shabana have now identified that the business case is understood to include four different sub-groupings based on the “value creation focus” of the approach:

1. cost and risk reduction;
2. gaining competitive advantage;
3. developing reputation and legitimacy; and

⁸⁵ Bert Scholtens, “Finance as a Driver of Corporate Social Responsibility” (2006) 68 *Journal of Business Ethics* 19 [*Scholtens*] at 19.

⁸⁶ *Carroll and Shabana, supra* note 23 at 91. It is in this way that the goals of corporate law and the business case for CSR may align: the idea that shareholder interests are best served by companies that maximize shareholder value in the long-term, and that long-term value creation implicitly requires some form of commitment to sustainability.

⁸⁷ *Zerk, supra* note 20 at 33.

4. seeking win–win outcomes through synergistic value creation.⁸⁸

Based on these developments, scholars note that the business case for CSR should be more palatable to classical economists and corporate law scholars because of the way that it fuses “economic and moral considerations” in a “utilitarian rather than an idealistic or altruistic discourse.”⁸⁹ For example, Macve and Chen argue in this context that the business case does not *per se* conflict with a primary objective of serving shareholders, as required under traditional corporate law models.⁹⁰ Similarly, Okoye points out that the business case is “not inconsistent” with the theories of the firm to the extent that “certain social activities may contribute to the long-term shareholder value of the corporation.”⁹¹

In any event, CSR scholars argue that the business case approach ultimately helps to frame the debate as it emerged in response to Milton Friedman and the classical economist view that businesses must focus only on maximizing profits. On this point Carroll and Shabana state that “[i]f it could be demonstrated that businesses actually benefited financially from CSR, then possibly Friedman’s arguments would somewhat be neutralized.”⁹² Moreover, it can be argued from a practical perspective that, the inconclusive results regarding short-term profitability notwithstanding, the business case version of CSR holds “firm ground in the commonsense of the field” as “consultancies,

⁸⁸ *Carroll and Shabana, supra* note 23 at 92.

⁸⁹ Ronen Shamir, “Capitalism, Governance, and Authority: The Case of Corporate Social Responsibility” (2010) 6 *Annu. Rev. Law Soc. Sci.* 531 [*Shamir*] at 544 . However, corporate law scholars may argue in this regard that commitment to long-term value is already contemplated under existing corporate governance models and requires no special theory of CSR. See e.g., the reference to Professor Berle’s views in Section 1.2 of this thesis.

⁹⁰ *Macve and Chen, supra* note 6 at 893.

⁹¹ See *Okoye, supra* note 50 at 615.

⁹² See *Carroll and Shabana, supra* note 23 at 91-92 (discussing that one incentive for the development of the business case approach was a response to Milton Friedman’s continuing arguments against CSR).

auditing firms, SRIs, and CSR indices routinely invoke the business case in general and its value as a risk-management device in particular in order to ground CSR in the universe of an expert legitimated rational order.”⁹³

Support for the long-term approach to the business case for CSR can also be found in the ethical context as a form of “enlightened self-interest theory.” This theory holds that persons who act to further the interests of others ultimately serve their own interest.⁹⁴ In this way, enlightened self-interest is used as an important argument in favor CSR: “the belief that it is in business’s long-term self-interest – enlightened self-interest – to be socially responsible. If business is to have a healthy climate in which to function in the future, it must take actions now that will ensure its long-term viability.”⁹⁵ Janda et al argue, for example, that CSR may serve the self-interests of corporations in ways that may not necessarily be reflected in short-term profit: cost savings and increased efficiency (through, for example, energy savings and reduction of employee absenteeism); improved risk management; improved employee recruitment and retention; and building corporate brand and attracting customers.⁹⁶

Another closely related concept is “enlightened shareholder theory.” This approach to CSR encourages “cooperative inclusive relationships” between the shareholders and those affected (e.g. stakeholders) only when there is an economic case for it.⁹⁷ Macve and Chen argue, for example, that

⁹³ *Shamir, supra* note 89 at 544.

⁹⁴ *Janda et al, supra* note 14 at 41-46.

⁹⁵ *Carroll and Shabana, supra* note 23 at 88-89.

⁹⁶ *Janda et al, supra* note 14 at 41-46.

⁹⁷ *Macve and Chen, supra* note 6 at 893.

“[i]n between the traditional “shareholder value maximization” theory which argues for the shareholders’ interests exclusively, and “stakeholder” theories, which call for a fair consideration of all parties for their own sakes, enlightened shareholder theory has been promoted both as the most theoretically defensible and as the most practical corporate goal in the modern business world, where it is generally labeled as “the business case” for CSR.”⁹⁸

They point out that a real world example of this theory may now be found in the recent addition of section 172 to the U.K. *Companies Act 2006*,⁹⁹ which, they argue, “imposes a duty on directors to ‘have regard’ to other stakeholder interests – in particular of the employees, the community and the environment – and to any long-term consequences of their decisions,” but only within “their pursuit of the primary objective “to promote the success of the company for the benefit of its members [i.e. shareholders] as a whole.”¹⁰⁰

2.4 Debunking the Voluntary vs. Mandatory Debate

The lack of a unified definition of CSR may also be attributed to the fact that the line between voluntary and mandatory corporate conduct is no longer as clear as once thought. It is true that CSR was initially understood in terms of voluntary corporate action, and that the emphasis on voluntary approaches was the primary focus of CSR at the turn of the millennium.¹⁰¹ However, Janda et al point out that CSR is now understood in wider terms to include both voluntary and mandatory corporate behavior and interactions with a variety of internal and external stakeholders and constituencies

⁹⁸ *Ibid* at 892-893.

⁹⁹ *Companies Act 2006* (c. 46).

¹⁰⁰ *Macve and Chen, supra* note 6 at 893.

¹⁰¹ *Janda et al, supra* note 14 at 30.

(employees, customers, regulators and society).¹⁰² As a result, CSR commentators are increasingly recognizing that the debate between voluntary and mandatory conduct is misguided: voluntary and mandatory approaches may now overlap to form a variety of approaches to CSR.¹⁰³

Despite this, it is still useful to understand why the voluntary versus mandatory debate was important and why it no longer applies. Commentators note that part of the confusion in this area is caused by the fact that different definitions of CSR are typically presented with different political, social and corporate agendas in mind.¹⁰⁴ For example, they note that businesses themselves may seek to avoid mandatory regulation by emphasizing the importance of voluntary initiatives, arguing that only voluntary corporate conduct amounts to CSR.¹⁰⁵ More generally, commentators have identified a number of conceptual benefits associated with voluntary initiatives from a regulatory perspective: they place responsibility at the corporate level where the available information and ability to impact outcomes may be maximized; they may be more flexible and easy to implement than mandatory regulation; they can be less costly than regulation; and, in theory at least, voluntary initiatives may lead to higher levels of corporate compliance with the requirements.¹⁰⁶

Despite this, commentators point out that there are also a number of drawbacks associated with voluntary approaches. For example, voluntary initiatives are typically

¹⁰² *Ibid* at 93.

¹⁰³ *Ibid*

¹⁰⁴ *Zerk, supra* note 20 at 30.

¹⁰⁵ *Ibid*

¹⁰⁶ *Janda et al, supra* note 14 at 96.

non-binding in nature and may not be enough to achieve responsible corporate conduct in practice.¹⁰⁷ In this regard, an often-cited 2003 study by the Organization for Economic Cooperation and Development (OECD) found that voluntary initiatives typically do not result in improvements beyond the outcomes expected without them.¹⁰⁸ Commentators also note that business may support voluntary initiatives precisely because they can be used to argue against the adoption of formal laws. This is a drawback to the extent that it may ultimately serve to prevent regulatory action that is needed to address social or environmental concerns.¹⁰⁹

The mandatory versus voluntary debate can also be framed in terms of “command and control regulation” versus “self-regulation.” Command and control regulation refers to the imposition of regulatory requirements, backed up by sanctions and other enforcement mechanisms.¹¹⁰ Self-regulation refers to regulatory schemes organized and adopted by individual companies, or their trade associations or professional bodies. As is

¹⁰⁷ See e.g., Richardson’s detailed discussion on the pros and cons of voluntary initiatives in the context of his article on the EPs: Benjamin J. Richardson, “The Equator Principles: The Voluntary Approach to Environmentally Sustainable Finance” (2005) *European Environmental Law Review* 280 [*Richardson-EPs*] at 284-285. For further in depth discussion of developments in the area of voluntary initiatives, see also e.g., Kernaghan Webb, “Voluntary Codes – Private Governance, the Public Interest and Innovation” (2004) Carleton Research Unit on Innovation, Science and Environment [*Webb*], electronic copy available online at: www.carleton.ca/spa/Research/cruise.html.

¹⁰⁸ A copy of the OECD study is available on the OECD website at: <http://www.oecd.org/>. For a discussion of the implications of this study, see e.g., *Keith*, *supra* note 1 at 263.

¹⁰⁹ *Richardson-EPs*, *supra* note 107 at 285. This should not be confused with Stigler’s “capture theory.” Stigler wrote that governments regulate at the behest of producers who “capture” the regulatory agency and use regulation to prevent competition. See George J. Stigler “The Theory of Economic Regulation” (1971) 2 *The Bell Journal of Economics and Management Science* 3.

¹¹⁰ *Zerk*, *supra* note 20 at 36.

the case with the EPs, this typically involves a requirement for members to adhere to some form of voluntary code or framework of rules.¹¹¹

Like the mandatory versus voluntary debate, however, the line between command and control and self-regulation is not always clear and, in any event, there are several drawbacks associated with mandatory regulatory initiatives. For example, one of the main problems is that, in certain contexts, this style of regulation may be ineffective to the extent that it is less tailored to industry needs and less responsive to quickly evolving situations.¹¹² Further, this imprecision and lack of flexibility may, in some cases, inspire “a race to the bottom” making legal compliance little more than a “box-ticking” exercise.¹¹³

More broadly, commentators note that insistence on regulatory initiatives may also reflect an overly simplistic view of the law and how it guides corporate behavior.¹¹⁴ They note that it is uncontroversial to say that few regulatory regimes are bullet-proof such that significant grey areas exist regarding how any specific law should be interpreted and followed.¹¹⁵ As a result, they argue that companies may be able to determine their own substantive compliance with technical regulatory standards.¹¹⁶ Moreover, commentators note that some corporations might even see non-compliance

¹¹¹ *Ibid* at 37.

¹¹² *Keith*, *supra* note 1 at 265. See also *Richardson-EPs*, *supra* note 107 at 284.

¹¹³ *Zerk*, *supra* note 20 at 37.

¹¹⁴ *Ibid* at 40.

¹¹⁵ *Ibid*

¹¹⁶ *Ibid*

with a regulation as efficient on a pure cost/benefit analysis.¹¹⁷ Ultimately, however, they point out that the existence of a legal loophole should not be the only determining factor: a responsible corporation would seek to comply with the spirit of the law rather than trying to find ways around it.¹¹⁸

As a result, like the mandatory versus voluntary debate, commentators now recognize that the command and control versus self-regulation debate is misguided for several reasons. They advocate for a broader understanding of regulation which recognizes that rules may not have to be legally binding and enforceable to be effective.¹¹⁹ Also, commentators argue that, although many CSR-related issues are already heavily regulated, for example, in areas of work place health and safety, environment and consumer protection, voluntary initiatives in these areas may ultimately have an impact by shaping the background against which companies operate.¹²⁰

Finally, commentators note that some governments and regulators are increasingly recognizing that effective regulation involves an understanding of all of the factors that influence corporate behavior and how these can be used to achieve regulatory goals.¹²¹ As evidence of this, they point to alternative regulatory techniques already in use such as incentives and awards, accreditation systems, market-based initiatives and compensation schemes, disclosure obligations and other privately or publicly sponsored

¹¹⁷ *Janda et al, supra* note 14 at 102.

¹¹⁸ *Zerk, supra* note 20 at 40.

¹¹⁹ *Ibid* at 41.

¹²⁰ *Ibid* at 34-36.

¹²¹ *Webb, supra* note 107 at 4-5.

initiatives.¹²² As a result of these developments, commentators argue that the crucial question today is not “whether CSR should be voluntary or mandatory, but, in light of a particular problem, what is the best response?”¹²³

¹²² *Ibid*

¹²³ *Zerk, supra* note 20 at 34-36.

CHAPTER 3 CSR IN THE CANADIAN CONTEXT

This Chapter turns away from the on-going academic debate canvassed in Chapter 2 to argue that CSR has largely won the battle of ideas in Canada. The purpose is to set the stage for the remainder of this thesis by arguing that, the lack of a universally accepted theoretical model for CSR notwithstanding, practical examples of CSR can now be observed in this country. More specifically, the second part of this Chapter argues that the emergence of CSR principles can be observed in the regulation and market practices of the Canadian financial services industry and several developments in this area are discussed.

3.1 Social Context in Canada

There can be little doubt that the concept of CSR has gained wide acceptance in practice in Canada. For example, the Canadian Government confirms the relevance of CSR on instrumentalist grounds as follows:

“Industry Canada promotes CSR principles and practices to Canadian businesses because it makes companies more innovative, productive, and competitive. CSR helps make Canadian business more competitive by supporting operational efficiency gains; improved risk management; favourable relations with the investment community and improved access to capital; enhanced employee relations; stronger relationships with communities and an enhanced licence to operate; and improved reputation and branding.”¹²⁴

Similarly, Canada’s department of Foreign Affairs and International Trade confirms the ethical obligations on Canadian companies operating abroad as follows:

¹²⁴ See the Industry Canada website, online at: <http://www.ic.gc.ca/eic/site/csr-rse.nsf/eng/home>. Industry Canada also states that “[t]he integration of Corporate Social Responsibility (CSR) practices and principles into business operations can help companies realize innovation and competitiveness benefits” and provides a “CSR Toolkit” for Canadian companies to use. The toolkit is also available online at: http://www.ic.gc.ca/eic/site/csr-rse.nsf/eng/h_rs00597.html.

“Canada is a strong supporter of CSR. The Government of Canada expects and encourages all Canadian companies working internationally to respect all applicable laws and international standards, to operate transparently and in consultation with host governments and local communities, and to conduct their activities in a socially and environmentally responsible manner. We work with the Canadian business community, civil society groups, foreign governments and communities, as well as other stakeholders to foster and promote CSR.”¹²⁵

Janda et al note that CSR principles may also be underpinned by private law in Canada as they inform standards of care in civil liability and to the extent that they are incorporated into the contractual commitments of companies.¹²⁶ Moreover, they point out in this context that the common law and courts are now emerging as important parts of CSR as companies that cause negative social and environmental impacts may be liable under tort law.¹²⁷ More broadly, other Canadian writers in this area claim that CSR has largely “won the battle of ideas” in that, practically speaking, few corporations today would argue publicly against the need for CSR efforts.¹²⁸

It is interesting to note, however, that commentators have identified different social and political contexts for CSR in Canada than might exist elsewhere. In the U.S., for example, commentators point out that the notion of CSR gained popular awareness in the 1960s and 1970s with the emerging civil rights movements.¹²⁹ They argue that

¹²⁵ See the Foreign Affairs and International Trade Canada website, online at: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/ds/csr.aspx>.

¹²⁶ Janda et al, *supra* note 14 at 30.

¹²⁷ *Ibid* at 99.

¹²⁸ See Keith, *supra* note 1 at 254 and 275. As a practical example, see also e.g., MacLean’s magazine listing of the “Top 50 socially responsible corporations,” available online at: <http://www2.macleans.ca/2011/06/09/better-business>. MacLean’s states that “[t]hese companies are making corporate social responsibility a key part of the business plan.”

¹²⁹ See e.g., the overview of the historical development of CSR in the U.S. by Carroll and Shabana. Carroll and Shabana, *supra* note 23 at 86-88.

increasing awareness of social issues was combined with a belief that corporations should also be asked to make their own contributions to society.¹³⁰ In the context of voluntary CSR initiatives for example, it is understood that voluntary corporate codes of conduct “first emerged in the United States in the 1970s in response to bad publicity caused by U.S. companies engaging in bribery when operating abroad, but later came to include industry wide codes of conduct covering environmental practices and labor standards as well.”¹³¹

In the U.K., commentators note that the trend away from command and control type regulation began in the 1970s with the introduction of economic liberalism and adherence to the idea that small government would drive economic success.¹³² Under this view, they point out that there was a belief that unnecessary government intervention in the markets had damaged productivity and competitiveness and it followed that any regulation in this area should be minimal. In this context, they argue that CSR emerged at least in part as a way for U.K. companies to regulate themselves using voluntary initiatives.¹³³

In Canada, Foster and Meinhard have identified that CSR emerged somewhat later in the 1980s, and largely as an ideological response to Canada’s own shifting

¹³⁰ *Ibid*

¹³¹ Christopher Wright and Alexis Rwabizambuga, “Institutional Pressures, Corporate Reputation, and Voluntary Codes of Conduct: An Examination of the Equator Principles” (2006) 111 *Business and Society Review* 89 [*Wright and Rwabizambuga*] at 92.

¹³² *Zerk, supra* note 20 at 30-34.

¹³³ *Ibid*

political philosophies.¹³⁴ They note that during the 1980s and 1990s, Canada was evolving into a neo-conservative philosophy of statehood and that this, coupled with forces of globalization, accelerated a “shift in priorities from domestic welfare considerations to global economic strategies.”¹³⁵ They argue that, in response to this shift in political philosophy, there was a corresponding (and newly expressed) concern that “in addition to government support of universal social programs, corporations should act as responsible social citizens ...”¹³⁶

Interestingly, this shift in ideology occurred at around the same time as significant increases in CSR activity were observed in Canada in the 1990s through the turn of the millennium.¹³⁷ On this point, Keith notes, for example, that CSR reporting rates for companies listed on the Toronto Stock Exchange rose from 35 percent in 2001 to 60 percent in 2003 and then to 80 percent by 2007.¹³⁸ Further, Keith argues that growing public concern over the role of corporations during this period led to the establishment of

¹³⁴ Mary Foster and Agnes Meinhard, “Corporate social responsibility in the Canadian context: The new role of corporations in community involvement and social issues” (2002) Ryerson Working Paper Series [*Foster and Meinhard*] at 3. Available online at: [http://www.ryerson.ca/content/dam/cvss/files/new-WORKING-PAPERS/WP16%202002\(1\)%20Corporate%20Social%20Responsibility.pdf](http://www.ryerson.ca/content/dam/cvss/files/new-WORKING-PAPERS/WP16%202002(1)%20Corporate%20Social%20Responsibility.pdf).

¹³⁵ *Ibid* at 3-4.

¹³⁶ *Ibid*. An interesting debate surrounds this issue. Under the classical economic view (see Section 2.2(a) of this thesis), it can be argued that Canadian corporations have already contributed at least their “fair share” to Canadian society by contributing to a generation of wealth that supports one of the highest standards of living in the world. On the other hand, however, the modern corporate structure has recently been the subject of significant criticism from Canadian scholars. See, for example, Hutchinson, *supra* note 55 at 10-11. Hutchinson argues that, while the corporate form may initially have made great contributions to economic wealth and wellbeing, “whatever the roots and original ambitions of the corporate structure, modern corporations have begun to undermine the very ideals and interest they claim to serve and advance.” Hutchinson therefore argues that “the legal nature and operation of the large Canadian corporation is not conducive to the health and development of a thriving democratic culture. Indeed, it might well be that the existence, governance, and activities of corporations in their present form are one of the most significant and negative influences on the further progress of Canadian democracy at the beginning of the twenty-first century.”

¹³⁷ *Ibid* at 3.

¹³⁸ Keith, *supra* note 1 at 254.

the Canadian Democracy and Corporate Accountability Commission to promote national CSR.¹³⁹

However, despite these early developments and wins for CSR, it is important to point out that the business case for CSR has not been fully established in Canada. On the issue of the relationship between CSR and financial performance, for example, Foster and Meinhard reviewed a number of early Canadian studies in this area which showed that the relationship between firm social performance and financial performance produced inconclusive results.¹⁴⁰ They also reviewed more recent research during the 1990s that produced similarly conflicting results: some studies found evidence of a positive relationship while others found that no connection exists.¹⁴¹

In their own study, though, Foster and Meinhard considered the relationship between public relations prominence of CSR activities and financial performance of Ontario-based companies. They found that companies that gave more prominence to CSR activities on their website and in their annual reports were also more likely to have high scores on corporate citizenship, which included financial performance in their study.¹⁴² They noted that this result was consistent with some elements of the previous research that showed a positive relationship between social disclosure and financial performance,

¹³⁹ *Ibid*

¹⁴⁰ *Foster and Meinhard, supra* note 134 at 5.

¹⁴¹ *Ibid* at 5. In this regard, these findings in Canada are consistent with the broader findings on the relationship between CSR adoption and short-term firm profitability. See Section 2.3 of this thesis.

¹⁴² *Ibid* at 12.

implying that a “virtuous circle” may exist in Canada with CSR as both a predictor and a consequence of financial performance.¹⁴³

(a) Bill C-300

A notable step forward for CSR in the Canadian legal context occurred in 2009 with the introduction of a private member’s bill by John McKay, then a Liberal M.P. from Scarborough East: the *Corporate Accountability of Mining, Oil and Gas Corporations in Developing Countries Act*¹⁴⁴ (Bill C-300). Bill C-300 was intended to promote social and environmental awareness relating to extractive companies who were receiving Canadian government support to operate in developing countries.¹⁴⁵ Despite its eventual defeat, Keith argues that Bill C-300 remains an important development in the Canadian CSR movement because it raised awareness in these areas and ultimately led to the development of certain CSR initiatives by the Conservative government of Stephen Harper.¹⁴⁶ As most notable amongst these developments, Keith points to the recent activity and work by the Department of Foreign Affairs and International Trade in defining and implementing CSR.¹⁴⁷

¹⁴³ *Ibid* at 13.

¹⁴⁴ Bill C-300, *An Act Respecting Corporate Accountability for Mining, Oil and Gas Corporations in Developing Countries*, 2nd Sess, 40th Parl (2009). For a discussion of the context in which Bill C-300 arose, see Sara Seck “Canadian Mining Internationally and the UN Guiding Principles for Business and Human Rights” (2011) 49 *Canadian Yearbook of International Law* 51 [Seck] at 62-75.

¹⁴⁵ See *Keith*, *supra* note 1 at 266 to 273. Keith notes that the basic premise for Bill C-300 was that “Canadian taxpayers have the right to encourage mining companies that are receiving funding from their government, to behave in a socially responsible way.”

¹⁴⁶ *Ibid* at 273.

¹⁴⁷ *Ibid* at 273-274.

More specifically, Seck points out that Bill C-300 was significant because it would have given the Department of Foreign Affairs and International Trade the power to develop corporate accountability standards and a complaint reporting process for the Canadian extractive industry.¹⁴⁸ Further, Seck describes that Bill C-300 contemplated that the corporate accountability standards were in turn expected to incorporate, among others, the social and environmental standards of the IFC. This is significant according to Seck in that it was consistent with other initiatives indicating that the IFC's standards were to be used as a reference point for Canadian mining companies.¹⁴⁹ A more controversial issue, however, was whether Bill C-300, by adopting the IFC's standards, would also have imposed international human rights standards on Canadian companies.¹⁵⁰

Ultimately, Seck points out that Bill C-300 received significant support with some commentators arguing on instrumentalist grounds that that it would give Canadian companies in this area a competitive advantage over others by providing a forum to address complaints and by requiring companies to respect human rights, thus reducing

¹⁴⁸ *Seck, supra* note 144 at 67-70.

¹⁴⁹ *Ibid.* This is interesting in the context of the instant thesis in that the EPs are also based on the IFC standards; see Sections 4.1 and 4.2 of this thesis for further discussion on this point. Interestingly, Seck notes that supporters of Bill C-300 suggested that “most companies were already adhering to the standards in Bill C-300, which were in effect preexisting de facto international standards due to financing requirements implemented by export credit agencies and banks following the Equator Principles.”

¹⁵⁰ *Ibid* at 70. See also Sections 4.1 and 4.2 of this thesis. It is noted here that the IFC standards are themselves both an environmental and social standard and the human rights dimension of the social standard is evolving in light of recent developments in this area. An example of this is the work by Harvard professor John G. Ruggie, appointed as Special Representative of the UN Secretary-General (SRSG) on the issue of human rights and transnational corporations and other business enterprises, and Ruggie's *Report of the Special Representative of the Secretary-General on the Issues of Human Rights and Transnational Corporations and Other Business Enterprises: Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework*, UNHRC, 18th Sess, UN Doc A/HRC/18/31(.11) [2011 *Guiding Principles*].

the chance of operations being disrupted by local communities experiencing unrest.”¹⁵¹ Despite this support, however, many critics contended that Bill C-300 was flawed from the outset from a policy perspective, arguing that the penalties contemplated were not in line with procedural processes, and that Canadian mining companies could be unfairly targeted by a complaints process that could easily be abused by competitors.¹⁵² As a result, Bill C-300, having been attacked by its critics and having received little political support, was narrowly defeated by the Conservatives and died in the House of Commons on October 27, 2010.¹⁵³

3.2 CSR in Canadian Financial Services

This Section argues that CSR can now be situated in the context of the Canadian financial services sector. Much of this analysis is based on the work of Benjamin Richardson, a Canadian legal scholar in this area, who confirms that the “potential of private financial organizations to be a force for environmentally and socially sound development is no longer regarded as quackery, but as a serious issue gaining some policy-makers’ attention.”¹⁵⁴ Interestingly, the developments in this area can also be used on analogous grounds to situate the social contract approach to CSR in the Canadian financial sector.¹⁵⁵ In the context of banking specifically, for example, Nicholls points out

¹⁵¹ *Seck, supra* note 144 at 68-69 (discussing the report prepared by professor Janda for the civil society coalition Canadian Network on Corporate Accountability). See also Section 5.1(a) of this thesis for a discussion surrounding similar issues in the context of the “business motivations” for EPs adoption.

¹⁵² *Keith, supra* note 1 at 272-273. See also *Seck, supra* note 144 at 71-74.

¹⁵³ *Ibid* at 274.

¹⁵⁴ *Richardson-Financing Change, supra* note 4 at 53.

¹⁵⁵ See the discussion on the theoretical approaches to CSR discussed in Section 2.2(a) of this thesis.

that, as Canadian financial institutions continue to grow in size and power, consideration is being given to market conduct regulation to prevent unfair business practices and to “community reinvestment” or “public utility” regulatory approaches.¹⁵⁶ Nicholls points out that this is evidence of the public’s perception that banks are generally not subject to effective market discipline and need to be more closely regulated.¹⁵⁷

Moreover, from a social concern perspective, Canadian courts have also already recognized that banks are the focal point of the commercial operations of our society as reported decisions acknowledge that banks generally enjoy good profit margins and operate in a regulated environment where there are relatively few eligible participants. In return for these privileges, these decisions have held that it may be fair to impose additional social duties on banks; for example, to take certain steps to protect consumers and the public from fraud and other illegal activities in the banking system.¹⁵⁸ In addition, Canadian banks with equity of more than one billion dollars are required, under section 459.3 of the *Bank Act*, to “. . . annually publish a statement describing the contribution of the bank and its prescribed affiliates to the Canadian economy and society.”¹⁵⁹ As such,

¹⁵⁶ See e.g., *Nicholls, supra* note 11 at 42.

¹⁵⁷ *Ibid*

¹⁵⁸ See e.g., the reasons of Justice Cameron of the Ontario Superior Court in *Semac Industries Ltd v. 1131426 Ontario Ltd.* (2001) 16 B.L.R. (3d) 88 (Ont S.C.) at para 67. Interestingly, however, it is noted here that Canadian financial institutions are already subject to significant additional duties not imposed on other private enterprises. For example, private corporations are not subject to OSFI regulation and supervision, are not required to pay deposit insurance premiums, are not subject to limits on their equity ownership or other similar restrictions on their businesses. For a discussion of the regulatory context imposed on Canadian banks, see e.g., *Nicholls, supra* note 11 at 1-3.

¹⁵⁹ *Bank Act, supra* note 38.

most large Canadian banks build on the contents of this annual public accountability requirement to create an annual CSR report that they publish on their websites.¹⁶⁰

As a starting point, however, it is important to point out that the traditional (and more natural) focus of financial regulation and oversight in Canada is typically on prudential standards: solvency and liquidity requirements and avoiding risks to banks and the broader economy.¹⁶¹ The primary regulatory goals in this area are to protect depositors' and investors' funds and to avoid broader systemic risks that arise from the linkages that necessarily exist among financial institutions so that no solvency situation arises that could put the entire system at risk.¹⁶²

Richardson notes that environmental and social issues traditionally did not fit into this framework as those who traded in money were often seen as irrelevant to CSR and the “province of social responsibility was not normally associated with banks, pension funds, or other financiers.”¹⁶³ As a result, Richardson argues there remained an “enormous abyss” between financial regulation and CSR in Canada as there was virtually no reference to CSR considerations in domestic financial laws.¹⁶⁴ Rather, Richardson argues with specific reference to environmental regulation, that Canadian government strategy has been to treat these areas of policy as distinct, to be regulated separately:

¹⁶⁰ See Section 6.1 of this thesis for further discussion on this point.

¹⁶¹ *Nicholls, supra* note 11 at 42. See also the reasons of Justice Beetz writing for a majority of the Supreme Court of Canada in *Canadian Pioneer Management Ltd. et al. v. Labour Relations Board of Saskatchewan et al.*, [1980] 1 SCR 433. Beetz J. considered the essential nature of “banking” by reviewing, among other things, the nature of the economic and legal functions performed by banks in society, and concluded that the function of banking was primarily one of financial intermediation in which the public had an interest with respect to solvency and allocation of financial resources.

¹⁶² See M.H. Ogilvie, *Bank and Customer Law in Canada* (Toronto, ON: Irwin Law Inc., 2007) [*Ogilvie*] at 81-82.

¹⁶³ *Richardson-Financing Change, supra* note 4 at 147.

¹⁶⁴ *Ibid* at 157.

“[e]nvironmental regulation in Canada, as in most other nations, hardly addresses the financial services sector—the banks and investors that finance development. To most environmental lawyers, this might seem a strange comment, as the province of environmental law is not normally associated with banks, pension funds, or other financiers. If anything, those who trade in money are seen as rather environmentally innocuous or irrelevant, away from the main action, Although Canada has made great strides in improving its environmental laws since the 1970s, this lack of interaction between environmental and financial policy is arguably Canadian environmental law’s greatest handicap.”¹⁶⁵

There is, however, evidence that things are beginning to change. Richardson points out that the trend is shifting as scholars and some policy makers are increasingly recognizing the importance of the financial sector to CSR: based on their “ability to provide financial leverage, financial organizations are in effect “gate keepers” to the economy . . . principally because they have amassed vast empires of financial assets.”¹⁶⁶ Richardson therefore argues that the biggest CSR impact of private financial institutions is not their own social or ecological footprints, but, rather, their “strategic role in allocating capital to other businesses.”¹⁶⁷ Further, Richardson argues that this area is growing in importance to the study of CSR as the “institutionalization” of financial markets has put financial assets in Canada “increasingly into the control of banks, pension funds, and other financial institutions, rather than into the hands of individual retail investors.”¹⁶⁸

In addition to these developments, it is also well established that secondary reasons for government regulation of financial services in Canada may include more

¹⁶⁵ *Ibid* at 147.

¹⁶⁶ *Ibid* at 148.

¹⁶⁷ *Ibid*

¹⁶⁸ *Ibid*

socially orientated goals: “consumer protection” and “minimizing fraud through money laundering and terrorism.”¹⁶⁹ Ogilvie argues, for example, that the financial system requires honesty and trust to operate smoothly so regulation is needed to keep fraud and consumer exploitation to a minimum.¹⁷⁰ Interestingly, a similar justification is used by OSFI, traditionally viewed as prudential regulator only, for its intervention into Canada’s anti-money laundering and terrorist financing regime.¹⁷¹

Beyond this, CSR scholars have also identified the increasing importance that social and environmental pressures have on marketing financial products and services. For example, Richardson notes that greater awareness in this area has led to a proliferation of social and environmental financial products, including “green mortgages, ethical mutual funds and pollution damage liability insurance.”¹⁷² There is also evidence of an emerging niche for ethical financing in Canada’s financial markets: Richardson cites a national survey conducted in 2002 by the Social Investment Organization which identified assets of environmentally and socially responsible investments as of June 2002 at CDN \$ 51.4 billion.¹⁷³ In addition, Richardson argues that there are some features of financial products and institutions themselves that should support a commitment to sustainable and long-term goals. For example, he argues that “because of their extended

¹⁶⁹ *Ogilvie, supra* note 162 at 81-82.

¹⁷⁰ *Ibid*

¹⁷¹ See OSFI guidance document B-8 “Deterring and Detecting Money Laundering and Terrorist Financing,” which is found in OSFI’s “Sound Business and Financial Practices” category; available online at: http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/sound/guidelines/b8_e.pdf.

¹⁷² *Richardson-Financing Change, supra* note 4 at 154.

¹⁷³ *Ibid* at 157.

product liabilities, life insurance companies and pension funds should be biased toward longer-term sustainable investments.”¹⁷⁴

Finally, as discussed in the remainder of this thesis, Richardson points out that banks should have an interest in the long-term viability of a borrower’s business in the context of ensuring loan repayment, which can often be contracted over lengthy periods.¹⁷⁵ Similarly, Janda et al argue that social and environmental performance could become important factors to consider in the loan underwriting process for banks.¹⁷⁶ On this point, Weber recently studied the efforts of several Canadian banks to integrate environmental risks into their corporate loan requirements and found that they were “best in class” in conducting environmental due diligence when compared to their global peers.¹⁷⁷ Along these lines, the instant thesis tests whether the EPs are also a good example of this development as they are intended to provide a credit risk management framework for managing environmental and social risks in project finance transactions.¹⁷⁸

¹⁷⁴ *Ibid* at 151.

¹⁷⁵ *Ibid*

¹⁷⁶ *Janda et al, supra* note 14 at 49. The authors refer to the *UNEP Statement by Financial Institutions on the Environment & Sustainable Development*, available online at <http://unepfi.net>:

“We recognize that identifying and quantifying environmental risks should be part of the normal process of risk assessment and management, both in domestic and international operations. With regard to our customers, we regard compliance with applicable environmental regulations and the use of sound environmental practices as important factors in demonstrating effective corporate management.”

¹⁷⁷ *Weber, supra* note 7 at 261 (noting, however, that further research is needed on the costs and benefits of integrating environmental risk assessment into the general credit risk assessment of banks, and in developing “credit services and products that actively foster borrowers that positively contribute to the environment.”)

¹⁷⁸ See Section 5.1(a)(i) of this thesis.

3.3 Conclusion

This Chapter argues that the emergence of CSR can be observed in Canada and, more specifically, the Canadian financial services industry. In particular, scholars have identified that, with the growing economic importance and influence of financial institutions, we should expect to see growing demands that these organizations act more responsibly. However, expectations in this area should be tempered by the reality that CSR remains in a state of flux and has yet to gain universal acceptance in this industry sector. In Canada, in particular, significant work remains to be done to advance CSR related theory in financial services. Moreover, additional work will be needed in this context to establish the business case for CSR and, in particular, the long-term benefits that it may offer for firms in the financial sector.

Using this background, the remainder of this thesis tests whether the practical emergence of CSR can be observed in the context of the decision by Canadian banks to adopt and adhere to the EPs. Ultimately, this case study will show that it is not clear whether these developments demonstrate a clear commitment by banks to CSR, or whether they are just reflections of prudent self-interested lending practices. Ultimately, the business case for CSR suggests that it is likely to be some combination of the two.

CHAPTER 4 – INTRODUCTION TO THE EQUATOR PRINCIPLES

4.1 Introduction

This Chapter provides an overview of the EPs. As noted in the introduction to this thesis, major global banks, together with the IFC and the World Bank Group developed the EPs on June 4, 2003, to “provide a credit risk management framework for determining, assessing and managing environmental and social risk in international project finance transactions.”¹⁷⁹ The EPs are based on the IFC’s social and environmental policy framework, including the Environmental and Social Safeguard Policies, Pollution Prevention and Abatement Guidelines.¹⁸⁰ These IFC policies have evolved into what are currently known and referred to in this thesis as the “IFC’s Performance Standards.” In order to reflect developments in the IFC’s Performance Standards, the EPs requirements were revised and updated on July 6, 2006 and became the EP II.

At the time of writing, the EPs are undergoing another strategic review process to reflect recent updates to the IFC’s Performance Standards.¹⁸¹ The EPs Association

¹⁷⁹ See the EPs homepage, available online at: <http://www.equator-principles.com/>. This website notes that the EPs were initially developed and adopted by ten large global financial institutions: ABN AMRO Bank, N.V., Barclays plc, Citi (formerly Citigroup), Credit Lyonnais, Credit Suisse First Boston, HVB Group, Rabobank Group, The Royal Bank of Scotland, WestLB AG, and Westpac Banking Corporation. There were over forty further member banks added during the first three year implementation period. In July 2010, the Equator Principles Association (EPs Association) was created to “ensure the long-term viability and ease of management of the member EPFIs and Associates.”

¹⁸⁰ See the IFC website online at: http://www1.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Risk+Management/Sustainability+Framework/Sustainability+Framework+-+2006/Performance+Standards+and+Guidance+Notes/

¹⁸¹ The IFC’s Performance Standards were reviewed and updated in 2012. See online at: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework/Sustainability+Framework+-+2012/Performance+Standards+and+Guidance+Notes+2012/. As noted in Section 3.1(a) of this thesis, the human rights dimension of the social standard is something that has evolved significantly in light of recent developments in this area and, in particular, the work being done to bring the IFC’s Performance Standards in line with the *2011 Guiding Principles*; see *Seck, supra* note 144 at 67-70. See also *Freshfields, supra* note 28 at 98 (discussing in the context of the EPs that commercial projects may involve a “substantial

released a draft of the revised and updated EPs (now referred to as EP III) for comment and the formal Consultation and Public Comment period for the EP III closed on October 12, 2012.¹⁸² The EPs Association launched the EP III effective as of June 4, 2013, but the effective date is subject to a transition period that will allow member banks to continue using the current version of the EP II until December 31, 2013.¹⁸³ As such, this thesis focuses on EP II (referred to in this thesis as the EPs) and a brief overview of the EPs is provided in this Chapter, along with a description of the requirements they currently prescribe for member banks generally.¹⁸⁴ The concluding Chapter of this thesis provides a discussion of the EP III update process in order to support further study in this area as the updated principles are implemented in the second half of 2013 and into 2014.¹⁸⁵

As discussed below, the EPs represent a series of guidelines on the management of social and environmental risks that banks voluntarily commit to follow in their project

number” of human rights (and corruption) issues, and that member banks need to bear in mind the employment related human rights and labor laws of developed countries that may not exist in a project’s host nation).

¹⁸² See “The Equator Principles III Update,” available online at: <http://www.equator-principles.com/index.php/ep3>.

¹⁸³ *Ibid*

¹⁸⁴ The EPs’ requirements are contained in “The Equator Principles, A financial industry benchmark for determining, assessing and managing social and environmental risk in project financing” June 2006 [*EPs*]. A copy of the EPs is attached as **Appendix I** to this thesis and is also available online at: <http://www.equator-principles.com/index.php/ep3>. The EP II update adopted the Basel II definition of project finance, and incorporated a number of changes such as a lowering of the dollar threshold for implementation from U.S. \$ 50 million to U.S. \$ 10 million; the inclusion of project finance advisory services; and the inclusion of stronger and better social standards as outlined in the IFC Performance Standards (including enhanced consultation and covenanting requirements, labor standards and project-level grievance mechanisms).

¹⁸⁵ See Section 7.2 of this thesis.

financing activities.¹⁸⁶ As a result, this Chapter proceeds on the basis that the EPs provide a real-world arena in which to study CSR in its broader forms: the idea adopted earlier in this thesis that “a corporation must act in a responsible manner with regard to the environment, community and broader society in which it operates.”¹⁸⁷ The last Section of this Chapter addresses some of the interesting international events that occurred on the international project financing stage that led up to the development of the EPs.

4.2 Overview of the EPs

The EPs can be understood from a corporate governance perspective as an example of industry self-regulation at the global level.¹⁸⁸ As a voluntary code of conduct, the principles apply only when a bank chooses to sign on to them and agrees to follow certain requirements with respect to its project financing activities.¹⁸⁹ Specifically, member banks commit under the EPs that they will not provide loans to projects where total capital costs will exceed U.S. \$ 10 million and where the borrower will not or cannot comply with the bank’s own social and environmental policies.¹⁹⁰

¹⁸⁶ This is the stated purpose of the EPs. See online: <http://www.equator-principles.com/index.php/about-the-equator-principles>.

¹⁸⁷ See Section 1.2 of this thesis.

¹⁸⁸ See Franck Amalric, “The Equator Principles: A Step Towards Sustainability?” (January 2005) Working Paper No. 01/05, Centre for Corporate Responsibility and Sustainability at the University of Zurich [*Amalric*] at 1, electronic copy available online at: <http://www.nachhaltigkeit.info/media/1317385761phpOHcawW.pdf>.

¹⁸⁹ See e.g., *Macve and Chen*, *supra* note 6 at 891-892 (discussing the EPs’ requirements generally as an example of how such codes can provide a bridge between voluntary action and uniform regulation).

¹⁹⁰ See *EPs*, *supra* note 184. For a discussion of how the EPs’ requirements apply in practice see e.g., Richard F. Lawrence and William L. Thomas, “The Equator Principles and Project Finance: Sustainability in Practice?” (2005) *Natural Resources & Environment* 20 [*Lawrence and Thomas*].

Under Principle 1, each adopting bank is required to undertake a characterization exercise in respect of new projects being considered for financing:

- Category A represents projects with potentially significant adverse social or environmental impacts that are diverse, irreversible or unprecedented;
- Category B represents projects with potentially 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 represents projects with minimal or no social or environmental impacts.¹⁹¹

Under Principle 2, for Category A and B projects, each bank commits to satisfy itself that the key environmental and social issues identified during the categorization process are properly addressed in a social and environmental assessment (Assessment) that must be provided by the project's sponsor or borrower.¹⁹² In addition, under Principles 4 and 5, a project's sponsor will be required to prepare and implement an Action Plan (AP), establish a social and environmental management system, consult with various stakeholders, and report on the implementation of the AP.¹⁹³

Under Principle 6, the borrower is required to establish a grievance mechanism as part of the management system in order to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the

¹⁹¹ *Ibid*

¹⁹² *Ibid*. Note that the discussion points under Principle 2 state that the Assessment and reporting requirements contained in Principles 2 through 6 vary depending on whether the project is located in an OECD country, non-OECD country or OECD country not designated as High-Income, as these concepts are defined by the World Bank Group. Generally speaking, the regulatory, permitting and public comment process requirements in High-Income OECD Countries meet or exceed the EPs requirements so successful completion of an Assessment (or its equivalent) process under and in compliance with local or national law in High-Income OECD Countries is considered to be an acceptable substitute.

¹⁹³ *Ibid*. See also the discussion of the requirements of Principles 4 and 5 by Amalric, *supra* note 188 at 2-3.

project.¹⁹⁴ Under Principle 8, the EPs' requirements must also be inserted into loan covenants in the financing documents compelling the borrower to comply with the AP during construction and operation of the project, and to provide regular reports on compliance with the AP.¹⁹⁵

Finally, Principle 10 requires banks to satisfy ongoing reporting requirements.¹⁹⁶ Generally, the EPs Association states that this reporting should at a minimum include the number of transactions screened by the member bank, including the categorization accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.¹⁹⁷

4.3 Development of the EPs

The trends leading up to the development and adoption of the EPs in 2003 are covered extensively in the literature. Writers in this area have identified that the principles arose in the context of pressure from institutional investors and NGOs as private banks began to do more project financing after the withdrawal of the World Bank Group and other multilateral development banks (MDBs) from the market in the 1990s.¹⁹⁸ They point out that, as private banks began to do more financing in emerging

¹⁹⁴ *Ibid*

¹⁹⁵ *Ibid*

¹⁹⁶ *Ibid*. These are discussed in further detail in Section 6.1 of this thesis, dealing with the adequacy of Canadian banks' EPs reporting and disclosure.

¹⁹⁷ See the EPs website, online at: <http://www.equator-principles.com/index.php/about-ep/faqs/42-about/frequently-asked-questions/45>

¹⁹⁸ See e.g., *Richardson-EPs*, *supra* note 107 at 285. Richardson refers to investors like the Calvert Group of funds in the U.S. and Insight Investment in the U.K., as well as NGOs like the Worldwide Fund for Nature and Friends of the Earth. Richardson also notes that a coalition of environmental NGOs in 2003 drafted their own code of environmental conduct for financial institutions, known as the Collevocchio

economies to fill the void left by the MDBs, many of them inevitably became embroiled in their own projects with negative social and environmental impacts.¹⁹⁹ As a result, commentators argue the EPs emerged in the aftermath of these developments as a way for banks to control and mitigate the negative impacts of the projects they were financing.²⁰⁰

The narrative in this area generally begins with a description of the withdrawal of MDBs from international project financing in the 1990s over social and environmental concerns.²⁰¹ Commentators point out that project financing typically occurs in industries with increased risk of negative social and environmental impacts: extractive industries, and energy and transportation infrastructure.²⁰² Moreover, they note that infrastructure projects are often very large and can have substantial social and ecological footprints in sensitive areas.²⁰³ Based on these observations, commentators argue that the withdrawal of MDBs from project finance was precipitated by the fact that they were being increasingly targeted by negative publicity and pressure over their involvement in these types of projects.²⁰⁴

Declaration. A copy of this declaration is available on BankTrack's website at: http://www.banktrack.org/download/collevecchio_declaration/030401_collevecchio_declaration_with_signatories.pdf. See also *Freshfields, supra* note 28 at 36. Freshfields notes that NGOs generally see the EPs as falling short of the Collevecchio Declaration obligations.

¹⁹⁹ For a discussion on these issues, see e.g., Andrew Hardenbrook, "The Equator Principles: The Private Financial Sector's Attempt at Environmental Responsibility" (2007) 40 *Vanderbilt Journal of Transnational Law* 197 [*Hardenbrook*] at 203-206 (discussing that the withdrawal of the World Bank Group and other MDBs essentially left the door open for private banks to play a greater role in international infrastructure development than they had previously).

²⁰⁰ *Ibid*

²⁰¹ See e.g., *Conley and Williams, supra* note 5 at 543-545.

²⁰² *Wright and Rwabizambuga, supra* note 131 at 97.

²⁰³ *Ibid*

²⁰⁴ See discussion of the Three Gorges Dam Project below. See also *Conley and Williams, supra* note 5 at 543-545, and *Amalric, supra* note 188 at 10. Amalric notes that under pressure from NGOs and other

This withdrawal of MDBs from international project financing occurred in the face of increasing demand for financing for new and developing infrastructure projects.

This was particularly true, according to Wright, in developing countries where the financing demands for such projects often far exceeded the resources available locally.²⁰⁵

On this point, the International Project Finance Association notes, for example, that

“[i]n the face of an ever increasing world population, greater expectations, demands from society and budgetary constraints, governments are facing an increasing amount of pressure to deliver new and improved infrastructure projects in transport (roads, railways, bridges); education (schools and universities); healthcare (hospitals, clinics and treatment centers); waste management (collection, disposal, waste to energy plants); water (collection, treatment, distribution), government accommodation and defense.”²⁰⁶

In short, the money for these projects had to come from somewhere, and the stage was set for private banks to enter the international project financing market.²⁰⁷ However, commentators point out that, unlike the World Bank Group and MDBs, the mission of private banks is not typically focused on social and sustainability issues.²⁰⁸ Hardenbrook in particular identifies this fact, along with the lack of significant regulation and

stakeholders, the World Bank Group and other MDBs were forced to pull out of such large projects as the Narmada Valley series of dams in India.

²⁰⁵ Christopher Wright, “Global Banks, the Environment, and Human Rights: The Impact of the Equator Principles on Lending Policies and Practices” (2012) 12 *Global Environmental Politics* 56 [Wright] at 57-58.

²⁰⁶ See the International Project Finance Association website, online at: <http://www.ipfa.org/about/projectfinance/benefits.asp>.

²⁰⁷ See e.g., the discussion by Conley and Williams, *supra* note 5 at 543-544. See also e.g., Karen Cook “Dam shame: activists target global financiers of Chinese eco disaster” (2000) *The Village Voice* [Cook]; electronic copy available online at: www.villagevoice.com/2000-03-28/news/dam-shame/2. Cook argues that banks that had once viewed emerging markets as too risky now saw good potential for profit and provides as support for this proposition the fact that, during the 1990s, public development assistance to developing countries remained steady at approximately U.S. \$ 60 billion a year, while investment from private capital sources increased from U.S. \$ 30 billion in 1990 to U.S. \$ 212 billion in 1996.

²⁰⁸ Hardenbrook, *supra* note 199 at 205.

enforcement in developing nations, as contributing to a scenario in which project sponsors and their banks were in many cases free to set their own standards for development projects.²⁰⁹ Moreover, since establishing and enforcing social and environmental standards increases the costs of a project, little incentive existed to impose strict standards in this area. The result of this combination, according to Hardenbrook, was that privately financed projects often resulted in significant negative social and environmental impacts.²¹⁰ Similarly, Lawrence and Thomas argue on this point that, absent the involvement of an MDB, it was highly unlikely that private social and environmental standards would be imposed on any given project.²¹¹ Given this background, it is not surprising that, as they began to do more financing in emerging economies to fill the void left by the MDBs, many private banks became embroiled in their own projects with negative publicity over significant social and environmental impacts.²¹²

In fact, although no one incident or project is said to have triggered the development and adoption of the EPs, the literature identifies the public backlash from the private sector financing of the highly controversial Three Gorges Dam Project (TGDP) in the Peoples Republic of China as having played a significant role.²¹³ The China Three Gorges Corporation (CTGPC) identifies December 14, 1994, as the official

²⁰⁹ *Ibid* at 204-205.

²¹⁰ *Ibid*

²¹¹ *Lawrence and Thomas, supra* note 190 at 22.

²¹² See the discussion on this point by Wright (referring specifically to several projects where commercial banks provided loans even after one or more MDB had withdrawn funding due to concerns over social and environmental harms); *Wright, supra* note 205 at 58.

²¹³ See e.g., *Macve and Chen, supra* note 6 at 892.

kick off date for TGDP on the Yangtze River. It now claims to be one of the largest hydropower-complex projects in the world with twenty-six turbine-generator units, each with installed capacity of 700MW, sending electricity to Central China, East China, Guangdong, and Chongqing, with a maximum transmission range of over 1000 kilometers.²¹⁴

Aside from being one of the largest hydro-electric installations in the world, TGDP was by all accounts also an incredibly expensive undertaking. Although there are no universally accepted publicly available figures, original estimates put the cost of the project at U.S. \$ 9 billion and this estimate more than doubled by 2000, and is expected to have been close to U.S. \$ 57 billion by completion.²¹⁵ Cook notes that, with the withdrawal of World Bank Group over social and environmental concerns, the Chinese government looked to external funding from large international private banks.²¹⁶ As a result, Cook describes a financing structure in which bonds were issued for the State Development Bank of China, which in turn loaned money to TGDP, and several major private banks acted as the arrangers on the initial Chinese bond offerings.²¹⁷

Almost from the outset of TGDP, commentators predicted social and ecological catastrophe for the surrounding areas and the project and its financiers received

²¹⁴ The CTGPC states that it owns TGDP and is responsible for the financing, construction and operation of the project. See the TGDP website online at: http://www.ctg.com.cn/en/introduction/introduction_a.php.

²¹⁵ See Sui-Lee Wee “Thousands being moved from China's Three Gorges – again” (Reuters, August 22, 2012), electronic copy available online at: <http://www.reuters.com/article/2012/08/22/us-china-threegorges-idUSBRE87L0ZW20120822> (discussing that China relocated 1.3 million people during the 17 years it took to complete TGDP).

²¹⁶ Cook, *supra* note 207.

²¹⁷ *Ibid.* Cook’s article names specifically as private financiers, among others, Lehman Brothers, Credit Suisse First Boston, Morgan Stanley, and J.P. Morgan; Smith Barney and Bank of America.

significant (and well documented) negative attention from NGOs.²¹⁸ As a result, some commentators now look back to TGDP as representing a “watershed moment” in the international NGO movement as pressure began to be directed primarily at private banks.²¹⁹ They note that, until the time of TGDP, NGOs were focused on public development finance and, in particular, lending from the World Bank Group and other MDBs.²²⁰ However, after TGDP, environmentalists and NGOs began to adopt their approach to advocacy by attacking private project financiers directly.²²¹ Wright refers to this phenomenon as the “boomerang effect:” NGOs effectively drew on their existing advocacy networks previously used to launch successful campaigns against the World Bank Group and other MDBs.²²² Wright argues that “[a]pplying this strategy to the world of private finance, local community groups and international NGOs sought to halt projects by confronting commercial banks at the project level in countries hosting their

²¹⁸ See e.g., the discussion on this point by Mara Hvistendahl, “China’s Three Gorges Dam: An Environmental Catastrophe? Even the Chinese government suspects the massive dam may cause significant environmental damage” (Scientific American, March 25, 2008), electronic copy available online at http://www.scientificamerican.com/article.cfm?id=chinas-three-gorges-dam-disaster&WT.mc_id=SA_emailfriend. See also Brian Handwerk “China’s Three Gorges Dam, by the Numbers” (National Geographic News, June 9, 2006), electronic copy available online at: <http://news.nationalgeographic.com/news/2006/06/060609-gorges-dam.html>.

²¹⁹ Cook, *supra* note 207. For examples of this see Danielle Knight “ENVIRONMENT-FINANCE: Activists Warn Investors about Banks of the Yangtze” (INTER PRESS SERVICE News Agency, May 31, 2001), available online at: <http://www.ipsnews.net/2001/05/environment-finance-activists-warn-investors-about-banks-of-the-yangtze/>; and see “Environmental advertisement campaign targets Three Gorges dam bonds” (Waterpower Magazine, February 10, 1999), available online at: <http://www.waterpowermagazine.com/news/newsenvironmental-advertisement-campaign-targets-three-gorges-dam-bonds>

²²⁰ Richardson-EPs, *supra* note 107 at 283.

²²¹ See the discussion on this point by A. L. Nguyen, “Investigating Compliance/Non-Compliance with the Equator Principles To Comply or Not to Comply... That is the Question” (2008) Graduate School of International Relations and Pacific Studies, University of California, San Diego [Nguyen] at 10.

²²² Wright, *supra* note 205 at 58.

investments and at the corporate headquarters and consumer bank branches in their home countries.”²²³

4.4 Conclusion

The scholarship in this area confirms that the EPs emerged in the aftermath of negative publicity campaigns against private banks brought about by their financing of large international projects like TGDG.²²⁴ In the context of these developments, commentators argue that, even in cases where the project sponsor or direct borrower is a profitable company, private banks may still face increased risks from associated negative social and environmental impacts that might slow down or shut down a project.²²⁵ As a result, it is now understood that “[i]n these cases, financial institutions are forced to consider whether the environmental and social risks of the project, including potential damages to their corporate reputation, will outweigh any short and long-term financial benefits that the project may generate.”²²⁶ As discussed in Chapter 5, it is in this context that the EPs emerged at least in part as a logical and business orientated response to these concerns: a way for private banks to control the negative social and environmental outcomes of the projects they are associated with.

²²³ *Ibid*

²²⁴ *Ibid*. As another example, Wright refers to the Sakhalin II oil and gas project in the Russian Far East that he notes came under the scrutiny of NGOs involved in pressuring governments, investors and lenders in North America, Europe, Japan, and Russia.

²²⁵ *Conley and Williams, supra* note 5 at 544.

²²⁶ *Wright and Rwabizambuga, supra* note 131 at 97.

CHAPTER 5 – THEORETICAL APPROACHES TO THE EPS

This Chapter provides a review of the EPs related scholarship that has emerged since the principles were launched in 2003. Section 5.1 considers a fundamental question posed by scholars: why would banks and other profit maximizing financial institutions voluntarily develop and adopt a code like the EPs? A review of several papers that address this apparent contradiction is provided to show that pragmatic business motivations are behind EPs adoption: it is generally accepted in this scholarship that banks look to the principles to reduce certain credit and reputational risks. As a result, Section 5.1 concludes that the EPs represent an example of the business case for CSR.²²⁷

Turning away from the issue of why banks adopt the EPs, Section 5.2 provides a review of the theoretical CSR framework for the EPs developed in the literature. It is generally well accepted in this scholarship that the principles amount to a voluntary code, thereby evidencing an example of the new form of regulation known as “soft law.”²²⁸

Finally, Section 5.3 canvasses some of the concerns that have emerged regarding EPs’ compliance and the so-called “free-rider” problem. As noted, one of the main drawbacks of voluntary CSR initiatives like the EPs remains that they often lack the necessary procedural and enforcement measures to implement compliance and effectively promote CSR values. As a result, in the case of the EPs specifically, critics now argue that banks may get the reputational benefit of EPs adoption irrespective of their implementation and compliance practices.

²²⁷ See Section 2.3 of this thesis.

²²⁸ See e.g., *Conley and Williams*, *supra* note 5 at 544.

5.1 EPs Adoption

The scholarship in this area confirms that the EPs have gained wide acceptance in the global banking community. Macve and Chen cite to an EPs press release that states that 71 percent of total project finance debts in emerging market economies were subjected to EPs in 2007 (U.S. \$ 52.9 billion out of a total of U.S. \$ 74.6 billion).²²⁹ Similarly, Conley and Williams note that an estimated 85 percent of international project financing in emerging markets was expected to be subject to the EPs as of 2011.²³⁰ More generally, other commentators argue that the EPs' impact on the financial sector has been far greater than predicted.²³¹ Wright and Rwabizambuga describe the EPs' effective market penetration among the world's largest project finance providers, noting that all but three of the top ten global arrangers of project finance loans have signed on to the EPs.²³² Similarly, Amalric notes that the EPs have become one of the more visible and concrete global initiatives promoting social concerns and sustainable development.²³³

Given this wide-spread adoption rate, a significant body of legal, economic and business literature has emerged to consider banks' motivations for joining the EPs. The dominant theme in this scholarship is that adopters of the EPs see the principles as good for business, even if, for any one bank, they increase short-term costs and limit growth opportunities:

²²⁹ *Macve and Chen, supra* note 6 at 899.

²³⁰ *Conley and Williams, supra* note 5 at 545.

²³¹ See e.g., *Richardson-EPs, supra* note 107 at 286. Richardson cites from the 2005 study on banking responsibility by Freshfields. See *Freshfields, supra* note 28.

²³² *Wright and Rwabizambuga, supra* note 131 at 100.

²³³ *Amalric, supra* note 188 at 1.

“[i]n one way or another, the creators of the EPs see them as good for business, even if, for any one bank in the near term, they increase the costs of evaluating potential loans and monitoring on-going compliance, and may even limit opportunities. That banks articulate instrumental motives should not surprise us, since we (and the law) expect business managers to make decisions that they perceive to be in the interests of their firm and its shareholders.”²³⁴

On this point, Amalric argues that, as with other instances of industry self-regulation, the EPs raise crucial questions about motivation: “[i]f the banks’ overarching aim is to maximize firm value, what is their interest in participating in a self-regulatory initiative?”²³⁵ Several papers have considered this question. In his own research, Amalric notes that the costs of EPs adoption to member banks are easily identified: (i) the costs of identifying the potential social and environmental risks of a project in order to categorize it according to the EPs’ requirements; (ii) the costs of checking the adequacy of the reports and information provided by borrowers; (iii) the costs of monitoring compliance; (iv) the costs of enforcing compliance; and (v) the overall opportunity cost of turning down project deals that do not comply with EPs’ requirements.²³⁶

As a result, Amalric notes that banks engage in a cost-benefit analysis: the expected benefits in adopting the EPs should outweigh the expected costs of compliance.²³⁷ Similarly, Scholtens and Dam considered incentives for EPs adoption using microeconomic analysis and concluded that individual banks are likely to engage in

²³⁴ *Conley and Williams, supra* note 5 at 550.

²³⁵ *Amalric, supra* note 188 at 1-2. Amalric conducts an analysis of the economic drivers of EPs adoption based on the assumption that banks are interested primarily in enhancing firm value.

²³⁶ *Ibid* at 3.

²³⁷ *Ibid* at 1.

the EPs only if the perceived benefits exceed the associated costs.²³⁸ Hardenbrook concludes on this point in more general terms that:

“[b]y incorporating environmental provisions in loan agreements, the EPFIs increase a project’s transaction cost. This increase directly impacts the profits of the company constructing the project and thereby affects its ability to repay the loan. At first blush, it appears that adopting the Equator Principles would be detrimental to a private institution’s goal of increasing shareholder profit. Since the Equator Principles appear to be detrimental to a bank’s interest, it is important to identify the incentives that encourage banks to adopt the Equator Principles.”²³⁹

(a) Incentives for EPs Adoption

As will be discussed in further detail below, the literature identifies two principal benefits for banks associated with EPs adoption. Both of these are held to be instrumental motivations, in that they allow EPs member banks to advance their own interests:²⁴⁰

- (i) the management of the credit risk inherent in global project financing; and
- (ii) the mitigation of the reputational risk of being associated with projects that result in negative social and environmental impacts.

(i) Managing risks in project finance

Several authors have looked at the emergence of the EPs as a way for adopting banks to reduce their exposure to lending or credit risks inherent in project financing.²⁴¹

In this regard, the EPs Association itself confirms that for “a number of years, banks working in the Project Finance sector had been seeking ways to assess and manage the

²³⁸ Bert Scholtens and Lammertjan Dam, “Banking on the Equator. Are Banks that Adopted the Equator Principles Different from Non-Adopters?” (2007) 35 *World Development* 1307 [*Scholtens and Dam*] at 1309.

²³⁹ *Hardenbrook, supra* note 199 at 211.

²⁴⁰ *Conley and Williams, supra* note 5 at 552. See also *Rupp and Williams, supra* note 8 at 597-598.

²⁴¹ See e.g., *Amalric, supra* note 188 at 1 and 9-13. Amalric notes that 10 banks representing approximately 30 percent of the international project finance market initially adopted the EPs and fifteen more banks signed on within the next year, bringing the representation in project finance to approximately 75 percent of the total market.

environmental and social risks associated with such investment activities.”²⁴² The inherent lending risks are easily identified within the technical definition of project financing adopted by the EPs:

“Project finance (PF) 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 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. In contrast, if repayment of the exposure depends primarily on a well-established, diversified, credit-worthy, contractually obligated end user for repayment, it is considered a secured exposure to that end-user.”²⁴³

There is no question that this form of financing is inherently risky to lenders, especially when compared to more conventional forms of collateralized lending. This is because, in project finance, the “lender looks primarily to the revenues generated by a

²⁴² See the EPs website online at: <http://www.equator-principles.com/index.php/about-ep/faqs/38-about/about/17>. See also online article by McCarthy Tétrault LLP, “Overview of the Equator Principles for Project Finance Transactions” [*McCarthys*], available at: http://www.mccarthy.ca/article_detail.aspx?id=4215. *McCarthys* partners point out that a key benefit of the EPs for lenders is to enable them to better assess, mitigate and monitor the social and environmental credit risks associated with financing development projects.

²⁴³ This is adopted from the Basel II definition of project financing. See “Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework (2004), Part 2: The First Pillar — Minimum Capital Requirements” at 49, available online at: <http://www.bis.org/publ/bcbs107.htm>.

single project, both as the source of repayment and as security for the exposure.”²⁴⁴ The project essentially “stands alone as a credit matter,” meaning that, if the project fails, the lender will have little or no recourse against the borrower’s assets for repayment of the loan: the lender will only be able to realize on the value of the project, including the project’s assets and revenue stream.²⁴⁵ As a result, with the “collateral in these arrangements being lower than in normal credit transactions, credit risks are automatically higher, and there is a direct link between the social and environmental risks of the project and the credit risks borne by the lenders.”²⁴⁶

Based on this legal structure, Conley and Williams argue that many types of social and environmental risks that are considered externalities in conventional lending (e.g., a human rights issues, displacement of local population or an environmental disaster) may become directly significant to project finance transactions because they could put a lender at risk if they cause a project to be delayed or shut down.²⁴⁷ Indirect risks may also be present here because, as Scholtens points out, in a case where a bank is forced to realize on a project’s assets, there is the risk that the bank could become liable for contamination or threats to the surrounding population.²⁴⁸ Further, as noted below in Section 5.1(a)(ii) of this thesis, these issues may become especially relevant in the context of reputational concerns as major international projects typically attract

²⁴⁴ See the EPs website, online at: <http://www.equator-principles.com/index.php/about-ep/faqs/42-about/frequently-asked-questions/18>

²⁴⁵ *Lawrence and Thomas, supra* note 190 at 21.

²⁴⁶ *Amalric, supra* note 188 at 9.

²⁴⁷ *Conley and Williams, supra* note 5 at 543.

²⁴⁸ *Scholtens, supra* note 85 at 26.

significant attention from NGOs when they are expected to result in negative social and environmental outcomes.

Based on these considerations, commentators argue that a bank's return on investment for any given project may in fact depend on the proper management of the specific social and environmental issues that are inserted into the project's risk profile.²⁴⁹ As a result, it is now well accepted in the scholarship that the initial EPs banks were looking for ways to "level the playing field" by establishing a minimum standard to which all major global project financing lenders would adhere.²⁵⁰ Hardenbrook argues, for example, that

"[b]anks have a large incentive to manage the risks of their investments carefully to ensure repayment of the loan. A project that creates environmental degradation exposes the borrower to liability. Depending on the country, the borrower could incur substantial fines for violating local environmental laws and court fees for defending against these lawsuits."²⁵¹

(ii) Reputation risk management

Scholars have also considered the emergence of the EPs as a tool used by banks to "level the playing field" among different banks facing different reputation risks in the project financing industry.²⁵² In this regard, although the EPs are theoretically a voluntary code, it should be pointed out that the decision to develop and adopt the principles was likely forced at least in part by increased reputational risks in changing market conditions

²⁴⁹ See e.g., *Conley and Williams*, *supra* note 5 at 544.

²⁵⁰ *Ibid.* See also the EPs backgrounder, available online at: <http://www.equator-principles.com/index.php/about-ep/faqs/42-about/frequently-asked-questions/43>.

²⁵¹ *Hardenbrook*, *supra* note 199 at 211.

²⁵² See e.g., *Amalric*, *supra* note 188 at 6.

(see the discussion of TGDP in Section 4.3 of this thesis).²⁵³ Amalric defines a bank's reputation risk in this context as:

“the probability of being a target of a public campaign multiplied by the cost for the bank of such a campaign ... Banks with a well established brand name and located in countries with strong non-governmental organizations, are by and large more likely to be the target of public campaigns than small specialized banks located in countries with weak NGOs; and banks involved in commercial retail banking and thus vulnerable to consumer boycotts will likely incur higher losses than specialized boutiques from NGO-led public campaigns. Hence we can reasonably assume that banks differ in terms of reputation risk.”²⁵⁴

Richardson notes on this point that voluntary codes like the EPs often can only be considered “voluntary” to the extent that their adoption is not formally obliged by authorities: they are “seldom if ever “voluntary” initiatives in the sense that they are “made autonomously and freely,” and most are “adopted because the relevant actors have been pressured to act.”²⁵⁵ Richardson notes that pressure in this area can come from any number of sources: threat of mandatory regulation, negative publicity, competitive pressures, demands from the local community and corporate stakeholders, and industry associations and organizations.²⁵⁶

As support for this position in the context of the EPs, O’Sullivan and O’Dwyer argue that the initial banks were likely pursuing an “appeasement strategy:” the development of the EPs to mitigate the reputational risk caused by NGO campaigns and

²⁵³ See e.g., *Wright and Rwabizambuga*, *supra* note 131 at 94 and 99 (discussing generally the use of voluntary codes of conduct to manage corporate reputation, and citing the EPs as an example of this phenomenon).

²⁵⁴ *Amalric*, *supra* note 188 at 5.

²⁵⁵ *Richardson-EPs*, *supra* note 107 at 284.

²⁵⁶ *Ibid*

to gain legitimacy for their financing activities.²⁵⁷ Similarly, Conley and Williams point out that the EPs likely represented a way to increase the adopting banks' legitimacy in the context of large-scale infrastructure financing and permitted them to “counter critics of large development projects by asserting their ability to manage the risks created by those projects and simultaneously to resist further strengthening of the standards or the imposition of “hard law.””²⁵⁸ Conley and Williams also describe the EPs in this context as a sort of “prisoner’s dilemma:”

“each bank faces reputational risk if it finances a project that leads to a social or environmental disaster, and each would presumably be better off avoiding such risk. But each bank also fears commercial disadvantage from acting alone to limit its lending. An agreement to level the playing field avoids this difficult choice by eliminating the commercial disadvantage for any one bank.”²⁵⁹

Similarly, on this point, Amalric argues that the EPs amount to a “strategy devised by high reputation risk banks to restore a level playing field with their less exposed competitors. The purpose of the initiative is to impose the voluntary standards developed by the more exposed banks on all members of the industry.”²⁶⁰

Commentators have also commented positively on the relationship between EPs adoption and the significant reputational pressures faced by primarily retail banks. In their study, Conley and Williams note that the importance of reputational risk is evidenced by the fact that, of the banks that were most active in developing the EPs, most

²⁵⁷ Niamh O’Sullivan and Brendan O’Dwyer, “Stakeholder perspectives on a financial sector legitimization process. The case of NGOs and the Equator Principles” (2009) 22 *Accounting, Auditing & Accountability* 553 at 564-565.

²⁵⁸ *Conley and Williams, supra* note 5 at 552.

²⁵⁹ *Ibid* at 550.

²⁶⁰ *Amalric, supra* note 188 at 6.

had large retail businesses making them more sensitive to their reputations.²⁶¹ Similarly, Scholtens and Dam demonstrate that CSR behavior is especially displayed by banks that are in the “spotlight,” and that the CSR policies of EPs member banks are typically rated higher than non-member banks.²⁶² Importantly, however, they argue that this may not be mere “window dressing” by banks because they observed no significant impact on the adopters’ stock market value when they announced adoption (implying that adoption may be for reasons other than immediate increase in firm value).²⁶³ Rather, Scholtens and Dam suggest that “adoption is undertaken by banks that pay a lot of attention to CSR,” and that adopting the EPs enables them to “signal this position to the public ... and, as such, positively impacts the risk profile of the adopter.”²⁶⁴

Wright and Rwabizambuga’s study of the proliferation of the EPs globally provides additional insight in this area.²⁶⁵ The authors begin by arguing that the decision to adopt a code of conduct that establishes a firm’s commitment to CSR is typically embedded in the firm’s broader reputational risk management strategies.²⁶⁶ This is true according to the authors in at least four ways: first, a firm’s overall reputation and brand may benefit from the adoption of CSR; second, a firm may be able to differentiate itself on this basis; third, a firm may view this as appropriate in the context of its overall risk

²⁶¹ *Conley and Williams, supra* note 5 at 550.

²⁶² *Scholtens and Dam, supra* note 238 at 1322.

²⁶³ *Ibid*

²⁶⁴ *Ibid*

²⁶⁵ *Wright and Rwabizambuga, supra* note 131.

²⁶⁶ *Ibid* at 95-96.

management strategy;²⁶⁷ and fourth, a firm may view this as a way of reducing the risk of being targeted by regulators and NGOs.²⁶⁸

Based on this, Wright and Rwabizambuga's study considers the regional adoption rates for the EPs among banks, and concludes that adoption rates vary significantly by region, and are concentrated in Western Europe and North America.²⁶⁹ The authors point to the strong regulatory and reputational pressures faced by Western European and North American financial institutions as one possible explanation for this regional adoption pattern. Moreover, they argue that the strong institutional environments in which western banks operate along with significant reputational pressures may in fact compel them to adopt voluntary codes like the EPs. As a result, Wright and Rwabizambuga's study may be used to identify the following key characteristics of EPs banks generally:²⁷⁰

- (i) they are based in countries in which the importance of environmental and social issues is recognized (the authors note that this may explain the large share of western banks among early EPs adopters);
- (ii) they tend to specialize in services and functions with the most visibility (e.g., banks engaged in retail banking services);
- (iii) they are concentrated in institutional environments shaped by advocacy campaigns and strong regulatory systems; and

²⁶⁷ *Ibid.* The authors argue that this notion emerges out of a "contested policy discourse, perpetuated by the actions of many firms, as well as international financial institutions, that a business case exists for sustainable development that rests on the interdependence of financial and social and ecological objectives."

²⁶⁸ *Ibid.* The authors refer to this fourth motivation as "a form of preventative action, motivated by the anticipation that irresponsible practices in a given industry may attract the attention of domestic regulators or civil society groups."

²⁶⁹ *Ibid.* at 92 and 101-110. Although no formal dates are provided, the study appears to have been conducted during the period 2003 to 2005.

²⁷⁰ *Ibid.* at 106-110.

- (iv) they typically operate transnationally and are more likely to have high profile roles in large international project finance deals, increasing the risk to their corporate reputations.

(b) EPs and the Business Case for CSR

The incentives for EPs adoption discussed in Section 5.1(a) above are all held to be instrumental in that they allow adopting banks to further their own interests. As a result, scholars have also started to consider EPs adoption as an example of the business case for CSR.²⁷¹ Macve and Chen argue, for example, that the EPs may be used to consider how banks are determining the scope of their CSR in the context of enlightened shareholder theory, concluding that EPs adoption can add value to banks.²⁷² They note that the EPs are:

“[c]onsistent with the enlightened shareholder theory explanation of how banks respond to CSR and sustainability concerns, ... Not only has the dominant political and business consensus maintained enlightened shareholder theory as the legal basis in the UK of corporate objectives and directors’ duties, it is consistent with the observed variety in level of take up of EP in the different economic, social and political environments in different countries.”²⁷³

The authors test the business case or “value add” by considering the enhanced mitigation of credit and reputational risks enjoyed by member banks. They conclude that enlightened shareholder theory is “consistent with the observed variety in level of take up of EP in the different economic, social and political environments” and that the EPs also “assist banks in building a shared social construction, in responding to stakeholder

²⁷¹ See Section 2.3 of this thesis for a discussion of the business case approach to CSR.

²⁷² *Macve and Chen, supra* note 6 at 894.

²⁷³ *Ibid* at 911.

pressures and concerns, of what are the current and likely future boundaries of enlightened shareholder theory-driven performance.”²⁷⁴

Similarly, Wright and Rwabizambuga, argue that adopting a voluntary code like the EPs can add value to a firm. They refer specifically to improved corporate reputation and branding; increased competitiveness; increased access to capital markets and financing; and decreased scrutiny in public consultation hearings and approval processes. They argue that each of these factors can reduce a firm’s project cost and associated expenses. More generally, they argue that a firm’s adoption of a voluntary code may also allow it to more effectively respond to the variety of demands imposed on it by multiple stakeholder groups.²⁷⁵

5.2 The CSR Context for the EPs

Beyond the pragmatic literature in respect of why banks have signed on to the EPs, there is also an emerging body of social science literature addressing theoretical questions about the EPs as they relate to voluntary codes of corporate conduct, regulation, globalization and global governance.²⁷⁶ Commentators note generally that this new context has given rise to various forms of “new governance” or “private governance” theories that have emerged as models to govern corporate behavior.²⁷⁷ As

²⁷⁴ *Ibid*

²⁷⁵ *Wright and Rwabizambuga, supra* note 131 at 94. See also *Scholtens and Dam, supra* note 238 at 1322 (concluding that EPs adoption comes at some costs, but it also improves the adopters’ reputation and, as such, positively impacts the risk profile of the adopter).

²⁷⁶ See e.g., the discussion by *Conley and Williams, supra* note 5 at 545 and 553-555 (arguing that the EPs have “the potential to import rule-of-law and developed-country business norms into the world’s emerging economies, at least with respect to large development projects”).

²⁷⁷ *Ibid*

noted in Chapter 2 of this thesis, traditional regulation seeks to control corporate conduct through mandatory requirements backed up by enforcement mechanisms and penalties for non-compliance. On the other hand, voluntary codes like the EPs may represent a more “reflexive” approach to guiding corporate behavior – by engaging with businesses to consider what form corporate behavior should take, by incentivizing businesses to act in certain ways and by reinforcing the need for open and transparent disclosure of corporate activities.²⁷⁸

In this context, the EPs have been used by a number of authors to examine the development of voluntary codes. Macve and Chen argue, for example, that the EPs are an example of “soft-law” because of the way in which they prescribe a certain framework of requirements that applies only once a bank voluntarily agrees to sign on to the principles.²⁷⁹ Similarly, Hardenbrook notes that traditionally, private entities like banks were viewed as primarily reactionary to mandatory regulation, but that this “reactionary stance is evolving, and private institutions are beginning to take an increasingly proactive role by self-regulating.”²⁸⁰ Under this new conception, Hardenbrook argues the EPs represent a “proactive stance in the area of environmental regulation and are a major change in the private sector’s traditional role.”²⁸¹ Ultimately, Hardenbrook concludes that the EPs therefore fall into a category of reflexive legislation known as “private second-

²⁷⁸ See e.g., *Richardson-EPs*, *supra* note 107 at 284. See also the discussion of voluntary initiatives in Section 2.4 of this thesis.

²⁷⁹ *Macve and Chen*, *supra* note 6 at 891.

²⁸⁰ *Hardenbrook*, *supra* note 199 at 203.

²⁸¹ *Ibid*

order regulatory agreements,” meaning that they are agreements between private parties, rather than governmental organizations.²⁸²

In terms of the more specific taxonomy defined by corporate code of conduct literature, Wright and Rwabizambuga argue that the EPs are both a “third-party” and “commitment” code of conduct, in that they emerged with support from the World Bank Group and IFC (as the third parties) and include requirements for adopters to follow (the commitment).²⁸³ Similarly, on this point, Richardson notes that

“[c]odes of conduct, negotiated agreements, and unilateral declarations of commitment are some of the various means by which the private sector can take actions to support broader public policy goals on social and environmental causes. . . . Third parties are actors at arm’s length from both the individual businesses who implement the codes and from public authorities. They may be environmental NGOs, industry associations, international technical standardization bodies, or an intergovernmental entity such as the International Finance Corporation in the case of the Equator Principles.”²⁸⁴

Interestingly, Rupp and Williams have recently gone beyond this traditional positioning in the CSR literature, using the EPs example to support their model of a psychological approach to regulation: they argue that a model of soft law that focuses on a broader range of motivations and moral reasoning might be more effective than current approaches in this area that rely primarily on instrumental motivations.²⁸⁵ The authors acknowledge the importance of self-interested reasons for firms to participate in soft law initiatives and note that they “do not mean to suggest that self-interest is not a primary

²⁸² *Ibid* at 204.

²⁸³ *Wright and Rwabizambuga, supra* note 131 at 99.

²⁸⁴ *Richardson-EPs, supra* note 107 at 281-283.

²⁸⁵ *Rupp and Williams, supra* note 8 at 585-586.

factor in many firm decisions.”²⁸⁶ They do, however, suggest that self-interest is not the only factor and that a model that engages in a broader range of interests has the potential to “more effectively encourage behaviors that optimize society’s regulatory goals than do approaches that rely only on appeal to the instrumental considerations or self-interest of the regulated entity.”²⁸⁷

5.3 EPs Compliance and the “Free-Rider” Problem

As discussed in Chapter 2 of this thesis, one of the main drawbacks of CSR and voluntary initiatives like the EPs remains that they often lack the necessary compliance and enforcement measures to effectively promote and implement CSR values. Moreover, there is always the risk that corporations may pursue voluntary initiatives in the CSR area for strategic reasons only.²⁸⁸ Interestingly, this issue has become particularly significant in the context of the EPs as critics focus on the inherent non-binding nature of the principles to argue that they may not be enough to achieve responsible corporate conduct

²⁸⁶ *Ibid* at 596.

²⁸⁷ *Ibid* at 585-587. The authors make several observations and claims in support of their theory: “First, in many instances, hard law that is either prescriptive (so called “command and control” regulation) or reflexive (required disclosure) is quite effective in changing firms’ behavior, but only up to a point. Beyond that point, resistance or resentment of “overly coercive” regulation can occur and a “culture of regulatory resistance” can develop. Second, many firms in many industries go “beyond compliance,” undertaking more protective (and more expensive) actions than those required by law. Third, soft law forms of governance are proliferating, such as self-regulatory industry standards, public/private hybrid governance, or third-party norms development, and many firms in many industries are orienting their behavior towards those governance initiatives, notwithstanding that they require actions beyond what the law requires, and notwithstanding the lack of any potential government enforcement. And fourth, once firms participate in soft law governance, we can observe changes in some of their cultures as people within the firm exhibit seemingly deeper engagement with the goals of the governance mechanism. While ultimately there may be other important features of observed compliance to explain, at least these four are not fully explained by reference to economic theories of deterrence based purely on the self-interest of the regulated entities.”

²⁸⁸ See the discussion in Section 2.4 of this thesis.

in practice.²⁸⁹ Moreover, many member banks have been criticized for lacking transparency and accountability in their compliance with the EPs. In fact, commentators note that many of the same NGOs that initially supported the development of the EPs have now turned into some of the member banks' harshest critics.²⁹⁰

These concerns are covered extensively in the EPs related scholarship. Richardson points out, for example, that skepticism continues to surround the EPs because of the lack of transparency, disclosure and accountability in the way they are adopted and implemented. More specifically, Richardson notes that the EPs do not provide a forum for interested persons to assess EPs compliance by member banks.²⁹¹ Along these lines, Hardenbrook points out that particularly problematic is the fact that the EPs do not prescribe procedural requirements in this area.²⁹² As a result of this, it can be argued that the EPs provide no way for interested groups to challenge member banks' decision making and disclosures, and that there is no mechanism to challenge a project categorization that is deficient.²⁹³

As noted above, the EPs leave it to member banks to categorize new potential projects as either Category A, B or C, depending on their expected negative social and environmental impacts.²⁹⁴ However, on this point, Richardson states that, although

²⁸⁹ See the detailed review of the criticisms in this area by Hardenbrook. *Hardenbrook, supra* note 199 at 207-210.

²⁹⁰ *Ibid*

²⁹¹ *Richardson-EPs, supra* note 107 at 287. See also the commentary by Lawrence and Thomas, *supra* note 190.

²⁹² *Hardenbrook, supra* note 199 at 209.

²⁹³ See e.g., *Richardson-EPs, supra* note 107 at 287-288.

²⁹⁴ See Section 4.2 of this thesis.

environmental legislation would typically allow interested persons to review and challenge this kind of “threshold decision,” the EPs provide no methodology for certifying that a project meets the EPs’ criteria and there is no process in place to certify compliance with the categorization process.²⁹⁵

An interrelated area of concern is the issue of enforceability. Each bank that adopts the EPs voluntarily commits to developing internal policies and processes to implement the EPs’ requirements. However, beyond this voluntary commitment, the requirement for member banks to implement the EPs is not clear.²⁹⁶ Hardenbrook points out that the EPs specifically disavow liability for member banks so it is up to each member bank to perform its own due diligence on a project and enforce compliance with the EPs where necessary.²⁹⁷ Hardenbrook notes that the result of this is that the EPs do not provide for any recourse against a bank that adopts the EPs in name only and fails to implement any of the requirements.²⁹⁸ Similarly, Lawrence and Thomas argue that member banks have agreed to a set of principles that

“purport to guide their lending decisions, but those principles are only guidelines for internal procedures that no outside person has a right to enforce. Accordingly, signatories can legitimately argue, with respect to any lending decision, that their internal policies and procedures do not require them to comply with the Equator Principles, the PPAH, or the safeguard policies in a particular case or under particular circumstances.”²⁹⁹

²⁹⁵ *Richardson-EPs*, *supra* note 107 at 287.

²⁹⁶ See *Conley and Williams*, *supra* note 5 at 544-545 (discussing the fact that, unlike some other voluntary sustainability initiatives, there are no methods for certifying compliance and the EPs therefore rely on self-enforcement by the participating banks).

²⁹⁷ *Hardenbrook*, *supra* note 199 at 209.

²⁹⁸ *Ibid* at 210.

²⁹⁹ *Lawrence and Thomas*, *supra* note 190 at 23.

These issues have now given rise to the so-called “free-rider” problem.³⁰⁰ The free-rider problem arises in the context of the EPs because, as discussed above, no formal procedural or enforcement mechanisms exist to monitor the practices of individual member banks. This means that all banks are likely to gain some reputational benefits by adopting the EPs even if they do not implement all (or any) of the EPs’ requirements.³⁰¹ The free-rider concept is not necessarily specific to the EPs as Amalric notes that a “general problem of industry self-regulation is to ensure that all actors in the industry abide by the voluntary regulation,” and this may be a relevant (although not exclusive) problem to the case of the EPs because of the lack of any structure to oversee implementation.³⁰² However, it is also important to point out that other commentators have expressed concern that the problem may be particularly pronounced in the case of the EPs because some banks may adopt the principles precisely because of the free-rider benefits without any intention of actually complying with principles.³⁰³

Finally, Conley and Williams argue that one of the most observable manifestations of the free-rider problem arises because of the lack of established full disclosure requirements: the EPs’ require only cumulative disclosure reports and nothing about individual projects.³⁰⁴ As will be discussed in Chapter 6 of this thesis in the context of Canadian banks’ EPs disclosure practices, this makes it virtually impossible to

³⁰⁰ *Hardenbrook*, *supra* note 199 at 210.

³⁰¹ See e.g., *Wright and Rwabizambuga*, *supra* note 131 at 91.

³⁰² *Amalric*, *supra* note 188 at 3-4.

³⁰³ Nguyen, *supra* note 221 at 21. See also *Wright and Rwabizambuga*, *supra* note 131 at 91 (discussing the free-rider problem in terms of adverse selection: banks may join the EPs to claim the benefits of enhanced reputation with no intention of implementing the EPs’ requirements)

³⁰⁴ *Conley and Williams*, *supra* note 5 at 564.

determine if an individual bank is complying with the EPs' standards on a project by project basis. As a result, commentators argue that, without more information in this area, it can be difficult to measure whether free-riding actually does occur for any given bank or on any given project.³⁰⁵ Ultimately, as will be discussed later in Chapters 6 and 7 of this thesis, this is also problematic in the context of trying to assess the overall effectiveness of the EPs: it makes it virtually impossible to measure whether the principles have achieved positive social and environmental outcomes in practice.³⁰⁶

5.4 Conclusion

As discussed above, this thesis proceeds on the basis that the EPs offer the chance to study CSR and, more specifically, the business case for CSR, because of the way they propose to merge CSR values with the business goals of member banks. It is well established in the EPs scholarship that member banks see the principles as good for business in that they serve to reduce certain credit and reputational risks inherent in project financing. Some scholars go so far as to argue that further development of CSR may in fact depend on these types of initiatives and, in the case of the banking sector specifically, the willingness of banks to continue to adopt and adhere to the EPs.³⁰⁷

However, scholars in this area also point out that the value of the EPs as a workable CSR model will depend on how they are implemented and that the quality of implementation in turn depends on accountability, transparency and enforceability.³⁰⁸ In

³⁰⁵ *Scholtens and Dam, supra* note 238 at 1322.

³⁰⁶ See e.g., the discussion on this point by *Conley and Williams, supra* note 5 at 564.

³⁰⁷ See *Richardson-EPs, supra* note 107 at 281.

³⁰⁸ *Ibid* at 287.

this regard, some commentators point to the problems discussed in Section 5.3 above to argue that a specific standard of review should now be established to deter the free-rider problem and to provide a way for determining whether a specific project has met the EPs' requirements.³⁰⁹ Although mandatory requirements are unlikely in the short-term, it is submitted here that something clearly needs to be done to address the concerns surrounding EPs compliance and disclosure by member banks. Commentators in this area have already acknowledged that free-riding could pose a substantial threat to the survival of the EPs because it clearly weakens the legitimacy of the principles.³¹⁰ They note that this would be particularly true if the practice becomes a trend in the banking community.³¹¹ Ultimately, as discussed in the following Chapters of this thesis, this result could serve to provide NGOs with justification for their argument that EPs compliance should be a legal requirement and that member banks should be subject to independent monitoring and enforcement.³¹²

³⁰⁹ See e.g., the discussion of this development by *Hardenbrook*, *supra* note 199 at 210.

³¹⁰ *Wright*, *supra* note 205 at 71.

³¹¹ *Hardenbrook*, *supra* note 199 at 210.

³¹² *Ibid*

Chapter 6 - The Role of the EPs in Canadian Banking

This Chapter tests the relevance of the EPs in Canada by reviewing the EPs related public disclosure of key Canadian banks. It considers the incentives for EPs adoption in Canada and also considers whether Canadian banks are adequately reporting their EPs compliance practices. The goal is to determine how far (if at all) the EPs have become embedded in Canadian banking. As noted in the introduction to this thesis, at the time of writing, seven major Canadian financial institutions have signed on to the EPs, including Royal Bank of Canada (RBC); Toronto-Dominion Bank (TD); Bank of Nova Scotia (BNS); Bank of Montreal (BMO); Canadian Imperial Bank of Commerce (CIBC); Export Development Canada; and Manulife Financial.³¹³ The primary focus of this study is on the EPs disclosures of Canada's five largest banks (referred to in this thesis as the "Big-5" Canadian banks), RBC, TD, BMO, BNS and CIBC, during the period 2008 - 2012. The Big-5 Canadian banks are recognized as leaders among Canadian banks, so although this study only looks in detail at them, the findings should be attributable to the Canadian banking sector more generally.³¹⁴

The methodology for this research was adopted from a similar study conducted by Macve and Chen of EPs disclosures by Barclays and HSBC in the U.K.³¹⁵ The authors noted in their paper that the EPs provide an interesting institutional arena for analyzing

³¹³ For a complete list of EPs member banks, see online at: <http://www.equator-principles.com/index.php/members-reporting/members-and-reporting>.

³¹⁴ Macve and Chen adopted a similar strategy with respect to Barclays and HSBC in the U.K. market. See *Macve and Chen, supra* note 6 at 896. See Section 1.4 of this thesis for a discussion of the Big-5 Canadian banks as representative of the population under study.

³¹⁵ *Ibid.* The instant research adopts Macve and Chen's approach with respect to the public disclosures of the Big-5 Canadian banks but it does not include interviews of members of the Canadian banking industry. As set out below, the results from Canadian banks' disclosures as the primary resource are sufficient to demonstrate consistency with Macve and Chen's analysis without recourse to interviews.

how banks are implementing CSR but noted that there remains a need for further research to investigate actual practice and how this varies over time.³¹⁶ The instant research will respond to this call for further study from the Canadian perspective by considering the following questions:

1. What are the motivations for adopting and adhering to the EPs in Canada?
2. Are Canadian banks' EPs disclosures adequate and credible?
3. How far have the EPs become embedded in Canadian banking?

6.1 EPs Disclosure by Canadian Banks

Under Principle 10 of the EPs, each member bank is required to report annually about its EPs implementation processes and experience:

Principle 10: EPFI Reporting

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.³¹⁷

The footnote to Principle 10 states that the reporting should include (as a minimum) the number of transactions screened by each bank and the categorization accorded to each transaction. It appears optional under Principle 10 for the banks to also provide a breakdown by business sector or geographic region and other “information regarding implementation.”³¹⁸ A reporting best practices guide is available to banks, but

³¹⁶ *Ibid*

³¹⁷ See Principle 10 of the EPs, *EPs supra* note 184.

³¹⁸ *Ibid*

it is not a required reporting frame-work and offers only guidance to assist banks in the development of their own reporting methodologies.³¹⁹

As noted in Chapter 3 of this thesis, Canadian banks with equity of more than one billion Canadian dollars are required by section 459.3 of the *Bank Act* to “. . . annually publish a statement describing the contribution of the bank and its prescribed affiliates to the Canadian economy and society.”³²⁰ As such, large Canadian banks, each of the Big-5 Canadian banks included, typically build on the contents of this annual reporting requirement to create their overall CSR reporting (for ease of reference, the reports in this area are generally referred to below as the “CSR Reports” for each bank studied). Each bank also sets out their EPs disclosure as required under Principle 10 within the “environmental” or “responsible lending” sections of their CSR Reports or on other CSR related sections of their websites.³²¹

The results of the EPs reporting for each of RBC, TD, BMO, BNS and CIBC during the period 2008 - 2012 are set out in the following Table 1:

Royal Bank of Canada					
Project type	2012	2011	2010	2009	2008
Equator Principles Category A	0	0	1	0	0
Equator Principles Category B	9	13	4	5	3
Equator Principles Category C	1	2	2	1	2
Total Projects	10	15	7	6	5

³¹⁹ The guide is available on the EPs’ website, online at: http://www.equator-principles.com/resources/ep_implementation_reporting_guidance_note.pdf.

³²⁰ *Bank Act*, *supra* note 38.

³²¹ This is similar to the practice adopted by HSBC as identified by Macve and Chen. See *Macve and Chen*, *supra* note 6 at 904. However, the authors note that Barclay’s also produces a separate report on “Environmental and social risk assessment in lending” (ESRAL) that appears specifically designed to provide the annual reporting required by Principle 10.

Source: RBC's 2012, 2011 and 2008 CSR Reports, available online at: http://www.rbc.com/community-sustainability/reporting-performance.html

TD Bank and Trust					
Project type	2012	2011	2010	2009	2008
Equator Principles Category A	0	0	0	0	0
Equator Principles Category B	0	0	2	1	7
Equator Principles Category C	12	8	3	0	4
Total Projects	12	8	5	1	11
Source: TD's 2012 and 2011 CSR Reports, available online at: http://www.td.com/corporate-responsibility/report-centre/index.jsp .					

Bank of Montreal					
Project type	2012	2011	2010	2009	2008
Equator Principles Category A	Not published	0	0	0	0
Equator Principles Category B	Not published	2	5	0	1
Equator Principles Category C	Not published	0	0	1	1
Total Projects	N/a	2	5	1	2
Source: BMO Website – Responsible Lending Website, available online at: http://www.bmo.com/home/about/banking/corporate-responsibility/customers/responsible-lending --					

Bank of Nova Scotia					
Project type	2012	2011	2010	2009	2008
Equator Principles Category A	3	0	1	0	1
Equator Principles Category B	7	4	7	1	6
Equator Principles Category C	5	10	8	3	3
Total Projects	15	14	16	4	10
Source: BNS's 2008 – 2012 CSR Reports, available online at: http://www.scotiabank.com/ca/en/0,,2590,00.html					

Canadian Imperial Bank of Commerce					
Project type	2012	2011	2010	2009	2008
Equator Principles Category A	0	0	1	0	0
Equator Principles Category B	12	1	3	0	0
Equator Principles Category C	5	7	3	0	0
Total Projects	17	8	7	0	0
	Source: CIBC's 2008 – 2012 CSR Reports, available online at: https://www.cibc.com/ca/cibc-and-you/public-account.html				

6.2 Analysis

(a) What are the motivations for adopting the EPs in Canada?

As discussed in Section 5.1 of this thesis, the literature points to NGO pressure, credit risk mitigation and reputational risk management as the leading factors in the creation and adoption of the EPs.³²² As might be expected, given that Canada is a western country with relatively vibrant public policy and corporate regulatory systems, Wright and Rwabizambuga's analysis of global EPs adoption patterns matches up well in the Canadian market: each of the Big-5 Canadian banks has formally adopted the EPs so it is uncontroversial to say that the principles are now well accepted in Canadian banking.³²³

Interestingly, however, despite the wide-spread adoption of the EPs in Canada, Canadian banks do not at present have extensive project financing activities that are subject to the EPs' requirements. The results of this study (contained in the tables above) show that Canadian banks engaged in only a small number of project finance transactions that were subject to the EPs during the period 2008 - 2012: RBC, TD, BMO, BNS and

³²² See e.g., *Conley and Williams, supra* note 5 at 567.

³²³ A notable exception is the sixth largest bank in Canada, National Bank of Canada (NBC), which has not adopted the EPs. This thesis found no indication as to why NBC has chosen not to sign up to the EPs.

CIBC had on average only 36 EPs project finance deals per year between them during the five year period studied. By way of comparison, Macve and Chen identified that Barclays alone had 54 EPs project finance deals in 2007.³²⁴ This result suggests that Canadian banks are primarily interested in the reputational benefits of EPs adoption, since the incentive to manage credit risk in project financing is not, practically speaking, present. As noted above, a bank can adopt the EPs by simply issuing a press release stating its intention to follow the rules and there is no official organizational body that certifies or monitors EPs adoption or implementation – meaning that any bank can choose to adopt the EPs and benefit from the associated reputational benefits.³²⁵

TD provides an example of this issue. In terms of TD's motivations for adopting the EPs, the Bank states in its 2011 CSR Report that it adopted the EPs in 2007 as part of its "wider credit risk management process."³²⁶ Taken on its face, this statement indicates that TD was motivated primarily by the credit risk management advantages offered by the principles. However, upon further review, it is more likely that TD uses the EPs for their reputational benefits in these areas: TD is primarily a retail bank, with 80% of its total financing based on personal and residential lending in North America.³²⁷ Moreover,

³²⁴ See Table 1 of Macve and Chen's paper. *Macve and Chen, supra* note 6 at 901. Although a similar table was not provided for HSBC's reporting, the authors note that HSBC is also recognized as among the leading global arrangers of project financings.

³²⁵ See e.g., the discussion on this point by Nguyen, *supra* note 221 at 5-6.

³²⁶ See TD's 2011 CSR Report, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³²⁷ See TD's CSR homepage, available online at: <http://www.td.com/corporate-responsibility/Report2011.jsp?pageid=/environment/index.jsp>. See also TD's 2012 CSR Report at 53, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>. It is also interesting to note that the EPs themselves contemplate different processes depending on whether a project is located in a high-income OECD country or not. See e.g., the discussion contained in *supra* note 192. This implies that the EPs impose no additional requirements on TD or any Canadian banks when projects are located in North America (because local laws will be considered acceptable substitutes to the EPs).

TD itself confirms that only 5 percent of the bank's total financing activities involve clients operating in environmentally and socially sensitive industries.³²⁸

Under the EPs incentive theories canvassed in Chapter 5 of this thesis, an argument can therefore be made that TD falls into the category of a retail bank with significant exposure to NGO activism and reputational issues. This finding is also consistent with TD's other broad statements and CSR commitments concerning its lending practices. It is observed that each of these statements is related to recent high profile environmental and social issues, suggesting that TD is particularly sensitive to public awareness and attention in these areas. For example, TD states that it "does not lend money for transactions that would involve activities within World Heritage sites, would result in the degradation of protected critical natural habitats as designated according to World Conservation Union classification or would involve the purchase of timber from illegal logging operations."³²⁹ Moreover, TD states that it does not lend money for "transactions that are directly related to the trade in or manufacturing of material for nuclear, chemical or biological weapons or for land mines or cluster bombs."³³⁰

This research found similar results across the remaining Big-5 Canadian banks as each of the banks studied also includes broad self-serving statements about the EPs in their CSR Reports and on-line. For example, BMO sets out its EPs disclosure in the

³²⁸ See TD's 2011 CSR Report at 63, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³²⁹ *Ibid*

³³⁰ *Ibid*

broader “Responsible Lending” section of the BMO website, which includes the following broad statements:

“[A]s lenders, we use sound risk management practices to identify, evaluate and mitigate to the extent practical the environmental impacts on credit facilities provided. It is BMO’s intent to avoid dealing with borrowers who have poor environmental risk management track records. . . . Environmental risk is one of many factors considered during the credit assessment process that results in the decision to accept or reject a loan application. All eligible borrowers for commercial and corporate loans are subject to our environmental risk assessment process.”³³¹

However, of the Big-5 Canadian banks studied, BMO had the lowest number of EPs related project finance deals, with only 10 such transactions disclosed during the 2008 - 2012 period. Further, BMO confirms that, to date, all of its projects financed under the EPs have been in North America.³³² Similarly, despite a relatively small number of EPs deals, RBC notes that it was the first Canadian bank to adopt the EPs in 2003, and that this step enhanced the bank’s “existing environmental risk management policies and commitment to sustainable development.”³³³ RBC also mentions that it “will provide loans only to those projects that can demonstrate to our satisfaction that key social and environmental issues have been addressed in accordance with our policies and processes.”³³⁴ CIBC cites “[p]rogress towards the adoption of the Equator Principles” as an area in which CIBC has made a “number of advances toward achieving its goal of

³³¹ See BMO’s CSR website, online: <http://www.bmo.com/home/about/banking/corporate-responsibility/customers/responsible-lending>

³³² *Ibid*

³³³ See RBC press release dated July 21, 2003, available online at: <http://www.equator-principles.com/index.php/all-adoption/adoption-news-by-year/65-2003-2003/163-rbc-financial-group-adopts-equator-principles>.

³³⁴ RBC’s 2003 CSR Report at 8, available online at: <http://www.rbc.com/community-sustainability/reporting-performance.html>.

promoting sustainability and protecting the environment.”³³⁵ BNS identifies its adoption of the EPs as one of its “key achievements” in the area of CSR and cites the principles as an example of the way the bank “evaluates environmental factors as part of our lending and investment decisions.”³³⁶

These results show that Canadian banks are using the EPs as examples of their public commitments to CSR and sustainability despite the fact that they have reported only a small number of cases in which they have used the principles in practice. Moreover, as discussed below in Section 6.2(b) of this thesis, Canadian banks fail to provide any meaningful disclosure surrounding their implementation of the EPs or the extent to which they are applying the principles within their businesses. Taken together, these findings reinforce the finding that Canadian banks are currently using the EPs primarily for the important reputational benefits they offer.

(b) Are Canadian banks’ EPs disclosures adequate and credible?

The results of this study show that the EPs reporting and disclosure by Canadian banks is limited. Although each bank claims to attach great importance to the EPs (see Section 6.2(a) of this thesis), their disclosure fails to go much beyond the bare minimum required by Principle 10. Notably absent from Canadian banks’ EPs reporting, for example, are relevant details concerning project information and the results (if any) of the banks’ EPs analysis and implementation. This makes it impossible to determine whether

³³⁵ See CIBC’s 2003 CSR Report at 82, available online at: <https://www.cibc.com/ca/cibc-and-you/public-account.html>. 2003 was the year CIBC adopted the EPs.

³³⁶ See BNS’s 2009 CSR Report at 18 and BNS’s 2006 CSR Report at 25, available online at: <http://www.scotiabank.com/ca/en/0,,2590.00.html>.

EPs adoption in Canada is having an impact on social and environmental outcomes and, more generally, provides additional evidence to support the conclusion that Canadian banks are primarily interested in the reputational benefits of EPs adoption.

It should be noted, however, that some of the Canadian banks studied do take the additional and optional step of providing general geographic and market sector breakdowns of their EPs projects (a step that is only optionally required under Principle 10 of the EPs). For example, RBC segments its EPs reporting by geographic region, distinguishing between OECD and non-OECD countries. RBC also provides general industry sector categories as follows: Energy (non-renewable); Energy (renewable) and Infrastructure.³³⁷ TD segments its EPs reporting by country and specific market sectors (e.g. “Oil and gas extraction” and “Real estate”).³³⁸ However, TD also notes that all of its EPs projects were located in North America during the period 2008 - 2012.³³⁹ Similarly, BMO confirms that all its EPs projects to date have been in North America, but it does not provide market sector specific information.³⁴⁰ CIBC segments its reporting between “Within Canada and the U.S.” and “Outside Canada and the U.S.”³⁴¹ However, unlike TD and BMO, CIBC reports that it does have projects taking place outside of Canada and the

³³⁷ See RBC’s 2012 CSR Report at 90, available online at: <http://www.rbc.com/community-sustainability/reporting-performance.html>.

³³⁸ See TD’s 2012 CSR Report at 54, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³³⁹ *Ibid.* See also TD’s 2011 CSR Report at 64 and TD’s 2010 CSR Report at 25, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³⁴⁰ See the Responsible Lending section of BMO’s website, available online at: <http://www.bmo.com/home/about/banking/corporate-responsibility/customers/responsible-lending>

³⁴¹ See CIBC’s 2010 CSR Report at 27, available online at: <https://www.cibc.com/ca/cibc-and-you/public-account.html>.

U.S., with 6 such projects disclosed in 2012.³⁴² BNS provides a breakdown of its EPs projects on a percentage basis by country. Interestingly, BNS does appear to have some international project financing activity as it lists Mexico and South America as two of its geographic categories. In 2008, for example, BNS reported that 30 percent of its EPs projects were located in these jurisdictions.³⁴³ BNS has subsequently grouped these two reporting areas into a category defined as “Latin America” and reported that 20 percent of its EPs projects were located in that area in 2012.³⁴⁴ However, BNS does not provide an industry sector breakdown and offers no explanation for this omission.

This is the extent of Canadian banks’ EPs reporting and, as a result, this area should emerge as an obvious area of concern. This result is also consistent with the findings of Macve and Chen who concluded in their study that general and self-serving statements about the EPs do “not seem very helpful for readers who want to know about the impact of EP.”³⁴⁵ Further, these results are consistent with the academic commentary canvassed in Section 5.3 of this thesis that has identified the lack of transparency and accountability in EPs compliance as significant areas of concern.³⁴⁶ For example, Richardson’s conclusion in the Canadian context is on point:

“there is little evidence that Canadian banks pay careful attention to the long-term environmental performance of borrowers. Indeed, Canadian banks have been publicly criticized for not being more open about the

³⁴² See CIBC’s 2012 CSR Report at 29, available online at: <https://www.cibc.com/ca/cibc-and-you/public-account.html>.

³⁴³ See BNS’s 2008 CSR Report at 18, available online at: <http://www.scotiabank.com/ca/en/0,,2590,00.html>.

³⁴⁴ See BNS’s 2012 CSR Report at 9, available online at: <http://www.scotiabank.com/ca/en/0,,2590,00.html>.

³⁴⁵ *Macve and Chen, supra* note 6 at 905.

³⁴⁶ See Section 5.3 of this thesis.

social and environmental aspects and effects of their financing. ... While the Canadian Bankers Association (“CBA”) has made public relations statements about the environment and banking, apart from the usual self-interested statements about protecting banks from environmental liability, the CBA’s contributions have been rather brief and superficial.”³⁴⁷

(c) How far have the EPs become embedded in Canadian banking?

There is anecdotal market evidence to show that the EPs are becoming embedded in Canadian banks’ decision making. Canadian business law firm McCarthy Tétrault LLP notes, for example, that the EPs provide a framework for assessing and managing social and environmental risks in projects across industry sectors in Canada, including energy, mining, oil and gas, and infrastructure projects.³⁴⁸ Similarly, other Canadian observers have commented that the EPs are not only seen as a benchmark in project finance in Canada, but are being used more widely in other areas of banking as well.³⁴⁹ McCarthy’s concludes on this point that that the “standards of the EPs for identifying and managing the credit risks inherent to project financing uniformly across the financial sector are

³⁴⁷ *Richardson-Financing Change*, *supra* note 4 at 160-161.

³⁴⁸ See *McCarthys*, *supra* note 242. See also McCarthy’s press release dated March 20, 2012 “McCarthy Tétrault Tops Canadian Infrastructure Project Finance League Tables”, available at: http://www.mccarthy.ca/news_release_detail.aspx?id=5802. Another major Canadian law firm, Stikeman Elliott LLP, lists several significant Canadian project finance transactions on its project finance specialty practice group website, suggesting that there may be a significant internal market that Canadian banks are participating in. See <http://www.stikeman.com/cps/rde/xchg/se-en/hs.xsl/8063.htm>. For a sampling of other references to project finance deals involving Canadian law firms, see Torys LLP at <http://www.torys.com/OurExpertise/PracticeAreasandIndustryGroups/Pages/ProjectDevelopmentandFinance.aspx>; Davies LLP at <http://www.dwpv.com/en/Expertise/Banking/Project-Finance>; and Bennett Jones LLP at http://www.bennettjones.com/Practices/Project_Finance/?showall=mandates.

³⁴⁹ See e.g., John Fahey and Pascal Meyer, “Weighing Risk in The New Global Financial System: The Equator Principle” (2011) [*Fahey and Meyer*], available online at: <http://renewcanada.net/2011/weighing-risk-in-the-new-global-financial-system-the-equator-principle/>. See also Environment Canada’s Financing Sustainability webpage, available at <http://www.ec.gc.ca/cei-iee/default.asp?lang=En&n=6FE09C10-1&offset=5&toc=show>.

perceived as mitigating risks of default, and so should be directly related to the banks' financial interests in all industry sectors."³⁵⁰

It is important to point out, however, that some of the claims regarding the impact of the EPs are based on the still unproven argument that, because project finance typically involves syndicated loans, the presence of an EPs bank should cause the non-member banks of the syndicate to either raise their review processes to a level closer to compliance with the EPs or otherwise benefit from the greater level of oversight required by the EPs.³⁵¹ Amalric notes on this point, for example, that project finance often requires loan syndications whereby a lead arranger brings together a group of banks to provide financing for a project. If, as in the case of the EPs, "a sufficiently large group of banks adopts a new standard, leading arrangers may find it difficult to get a deal through that does not conform to this standard. The costs of arranging a deal without the participation of banks having adopted it will increase and may supersede the costs of abiding by the standard. If this is the case, leading arrangers will decide to adopt the new standard, and de facto all lenders will also abide by it."³⁵² However, Freshfields cautions against unrealistic expectations in this area given the structure of project financing arrangements. Ultimately, Freshfields argues that the potential leverage of lenders over borrowers' environmental performance may be limited because EPs banks may not get involved in a syndicated project financing deal until late in the game when basic project choices and design decisions have already been made and agreed to.³⁵³

³⁵⁰ *McCarthy's*, *supra* note 242.

³⁵¹ *Ibid*

³⁵² *Amalric*, *supra* note 188 at 7.

³⁵³ *Freshfields*, *supra* note 28 at 11.

Another way to determine the impact of the EPs is to consider the extent to which the principles are becoming embedded in the internal policies and procedures of member banks.³⁵⁴ On this point, there is some preliminary evidence to suggest that Canadian banks involved in project finance (domestically or abroad) may be using the EPs as an informal internal standard to determine if a transaction is well managed from both a credit risk and a reputational viewpoint.³⁵⁵ Consistent with this, BNS notes that it has a “comprehensive set of tools and guidance documents to help ensure banking and credit officers have the necessary information to meet the Equator Principles requirements.”³⁵⁶ BNS also maintains that it reinforces its commitment to the EPs by providing employees with training on how to “[i]ncorporate the principles into their work.”³⁵⁷ Similarly, RBC states that it employs its own “Enterprise-wide ESRM Policy,” under which it considers the impact of environmental and social factors in all of its activities, not just financing. RBC also states that the bank screens all of its debt and equity underwriting activities, and corporate credit facilities, for environmental and social risk, regardless of whether the use of proceeds is known. Under these broader policies, RBC claims that it performed

³⁵⁴ See e.g., *Hardenbrook*, *supra* note 199 at 227.

³⁵⁵ See e.g., *Fahey and Meyer*, *supra* note 349. See also Marjo Johne, “Investing in Green, A Special Report from the Globe and Mail” (2008, Globe and Mail) available online at: <http://v1.theglobeandmail.com/partners/free/investinggreen/managers.html>.

³⁵⁶ See BNS’s 2009 CSR Report at 18, available online at: <http://www.scotiabank.com/ca/en/0,,2590,00.html>.

³⁵⁷ See BNS’s 2006 CSR Report at 1, available online at: <http://www.scotiabank.com/ca/en/0,,2590,00.html>.

detailed environmental credit risk assessments on over 1,100 transactions in Canada and the U.S. in 2011.³⁵⁸

Interestingly, TD appears to be taking EPs implementation a step further in this area, formally stating in its 2011 CSR Report that it has “fully embedded the principles within its credit risk management policy applied to all undertakings including general corporate purpose, project and fixed-asset financing.”³⁵⁹ TD claims that this will “ensure that they are applied to all forms of lending – not just project finance. This progressive and proactive step ensures that all transactions receive a consistent review, and we believe it reflects the direction toward which the Equator Principles should be evolving.”³⁶⁰ TD has now undertaken to update its internal credit risk management policy, procedures and sector-specific due diligence guidance documents in 2013 to reflect these changes.³⁶¹

TD is not alone in this regard as commentators suggest in the international context that other banks are doing this as well as the EPs “have gradually spilled over into the everyday financings of some investment banks.”³⁶² They reference, for example, the

³⁵⁸ See RBC’s Responsible Financing website, online at: <http://www.rbc.com/community-sustainability/environment/responsible-financing.html>. See also RBC’s 2011 CSR Report at 85, available online at: <http://www.rbc.com/community-sustainability/reporting-performance.html>.

³⁵⁹ See TD’s 2011 CSR Report at 64, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³⁶⁰ See TD’s 2012 CSR Report at 53, available online at: <http://www.td.com/corporate-responsibility/report-centre/index.jsp>.

³⁶¹ *Ibid*

³⁶² See e.g., online article by John Wiley & Sons, “When Seeking Long-Term Profit, Consider Long-Term Environmental Risks” 2010 [Wiley], online at: <http://www.triplepundit.com/2012/04/when-seeking-long-term-profit-consider-long-term-environmental-risks/>. See also Wright, *supra* note 205 at 70. Wright refers by way of example to the Arab African Investment Bank’s commission of a consultant to review its project portfolio for compliance and rewrite its internal policies and procedures in accordance with the EPs framework.

website of Morgan Stanley, where that bank states that it has “adopted explicit limitations on financing or investing in projects that would, among other things: significantly degrade a critical habitat; support companies engaged in illegal logging; support extraction or logging projects in World Heritage sites; or violate local and World Bank pollution standards.”³⁶³ Similarly, Macve and Chen note that Barclays has stated that it also applied the “spirit” of the EPs to 268 non-project finance deals in 2006.³⁶⁴

6.3 Conclusion

Macve and Chen concluded in their U.K. study of EPs adoption that the EPs have been among the most successful of the many initiatives relating to corporate social and environmental performance.³⁶⁵ They further concluded that the EPs operate as “soft law” in the regulatory space between individual voluntary action and legally mandated regulation and that this provides an example of the business case for CSR.³⁶⁶ However, the authors also note that any social or environmental benefits of the EPs should be viewed primarily as a “by-product” of banks’ risk management processes rather than their main objective.³⁶⁷ To put it another way, the authors argue that promotion of CSR values is “primarily an advantageous outcome rather than the core objective for banks signing up to EP.”³⁶⁸ Overall, they noted that the EPs disclosures by Barclays and HSBC remain

³⁶³ *Ibid*

³⁶⁴ *Macve and Chen, supra* note 6 at 899.

³⁶⁵ *Ibid* at 910.

³⁶⁶ *Ibid* at 911.

³⁶⁷ *Ibid* at 897.

³⁶⁸ *Ibid* at 900.

too “highly summarized for outsiders to know how EP has impacted on individual decisions.”³⁶⁹ Macve and Chen also note that concerns about free-riding arise in this context because any bank “who joined the “club” could gain some reputational benefits from merely announcing that, regardless of their true compliance.”³⁷⁰

The results of this Chapter show that many of these issues apply in the Canadian context. Canadian banks do not at present have extensive EPs project financing activities so the EPs’ high adoption rate in Canada suggests that Canadian banks are primarily interested in the important reputational benefits offered by the principles.³⁷¹ This, in turn, suggests that Canadian banks view the EPs primarily as a useful public relations tool that helps them to substantiate broad self-serving statements about their CSR initiatives. Moreover, although Canadian banks claim to attach great importance to the EPs, their disclosures fail to go much beyond the bare minimum required by Principle 10. Notably absent from Canadian EPs reporting, are relevant details concerning project information and the results (if any) of the banks’ EPs analysis. These findings therefore reinforce existing criticisms of Canadian banks in this area and demonstrate the lack of transparency surrounding the social and environmental effects of their financings.

Despite this, this research did uncover some positive trends in the EPs practices of Canadian banks and these should merit further study. For example, although it is premature to draw any conclusions in this area, it is submitted here that the commitment by TD and other banks to implement the EPs within their broader businesses may provide

³⁶⁹ *Ibid* at 906.

³⁷⁰ *Ibid* at 895.

³⁷¹ See Section 5.1(a)(ii) of this thesis for a discussion of the reputational benefits associated with EPs adoption.

preliminary support for the social context styles of regulation discussed in Chapter 5. For example, TD may be in the process of engaging in its own “internal reflection” about what form EPs compliance should take and this provides a practical example of the “reflexive” and “soft law” styles of regulation discussed in Section 5.2 of this thesis. Moreover, as Conley and Williams argue, this sort of behavior may act as a catalyst for cultural change within the bank.³⁷² Although likely to be more controversial, these developments may also provide early support for the psychological theory of CSR regulation advocated by Rupp and Williams.³⁷³ Under this theory, for example, the results of this study suggest that TD may be in the early stages of a gradual shift toward “internalization of environmental and social values,” thereby evidencing what Rupp and Williams argue is a commitment to ethical norms that are beyond the minimum requirements of the EPs.³⁷⁴

These results may also be indicative of changes in the broader banking industry. On this point, for example, Rupp and Williams point to the wide-spread adoption of the EPs to argue that this could provide evidence of a change within the banking sector generally, and that this may represent the beginnings of social and environmental regulation of global business by the leading EPs banks.³⁷⁵ They point out that, like TD, there is some evidence that international banks have begun to apply the EPs to social and environmental standards for sustainable banking across product categories, including

³⁷² Conley and Williams, *supra* note 5 at 546.

³⁷³ Rupp and Williams, *supra* note 8.

³⁷⁴ *Ibid* at 598.

³⁷⁵ *Ibid*. See also Wiley, *supra* note 362.

underwriting, commercial lending, and retail banking, and across industries.³⁷⁶

Ultimately, Rupp and Williams refer to this development as the “contagion” effects of the EPs: observed examples of the principles being used as a benchmark for setting up social and environmental standards for other financial practices within the banks (i.e., not limited to just project finance itself).³⁷⁷

³⁷⁶ *Ibid*

³⁷⁷ *Ibid*

Chapter 7 Conclusion

7.1 Conclusions and Further Study

The research proposition for this thesis was that Canadian banks are demonstrating CSR behavior through the steps they are taking to implement and comply with the EPs. The results of this study provide initial support for this proposition: each of the Big-5 Canadian banks issues an annual CSR Report and provides for EPs related disclosure either in their CSR Reports or on other CSR related sections of their websites. Moreover, each of the banks claims to attach great importance to the EPs and rely on the principles as an example of their broader public commitments to CSR. There can be little doubt that these findings provide practical support from the Canadian perspective for the argument that a shift of business and financial values is occurring leading toward greater importance being attributed to CSR considerations in the banking sector.

However, this conclusion is tempered by the general finding in this thesis that banks use the EPs primarily for self-interested reasons. As noted in Chapter 5, the EPs related scholarship identifies that banks adopt the EPs primarily because there are significant business incentives to do so. In short, the EPs are “good for business,” particularly as tools to manage (i) the credit risk inherent in global project financing; and (ii) the reputational risk associated with the large scale infrastructure projects in socially and environmentally sensitive areas. Moreover, as discussed in Chapter 5, these motives for EPs adoption are held to be instrumental, in that they are focused on the means for the participating banks to advance their own interests.

This is not necessarily inconsistent with CSR to the extent that the business case for CSR contemplates self-interested business motivations as being a primary driver of

corporate activity. As a result, this study also confirms the approach of scholars who have studied the EPs in the context of the business case for CSR. As discussed in Chapter 5, scholars have established the business case or “value add” of the EPs through their enhanced mitigation of credit and reputational risks, thereby increasing EPs banks’ competitive advantage vis-à-vis non adopters. However, the business case for CSR also requires integration of business incentives with social and environmental concerns. On this point, it is submitted here that, while the EPs are evidently “good for business,” there is no clear indication that they have resulted in positive social or environmental outcomes.³⁷⁸ Further, as discussed in Chapter 5, the lack of full disclosure and adequate reporting in this area remains a serious area of concern as it is virtually impossible to substantiate any claims about the positive impact of the EPs in practice.³⁷⁹

In the Canadian context specifically, the results of this study show that Canadian banks adopt the EPs primarily for the important reputational benefits the principles offer: Canadian banks do not currently have significant EPs related project financing activities so the incentive to manage credit risk is not, practically speaking, present. As discussed in Chapter 6, this finding leads to obvious questions surrounding the legitimacy of claims about the importance of EPs adoption as part of Canadian banks’ overall “responsible lending” and credit risk management initiatives.³⁸⁰ Moreover, each of the Canadian banks studied makes broad self-serving statements about the value of their commitments to the

³⁷⁸ See e.g., *Conley and Williams, supra* note 5 at 569 (noting that there is no consensus on “whether the EPs are making a substantial tangible difference on the ground, in the local communities they are intended to benefit.”)

³⁷⁹ See e.g., *Macve and Chen, supra* note 6 at 906.

³⁸⁰ See Sections 6.2 and 6.3 of this thesis.

EPs. However, despite these claims, this study shows that the EPs disclosure by Canadian banks generally fails to go much beyond the bare minimum required by Principle 10.

As noted in Chapter 6, these results reinforce the existing criticisms of EPs banks canvassed in Chapter 5: lack of transparency (the EPs do not mandate procedural mechanisms for reviewing and monitoring compliance) and accountability (the EPs do not include mechanisms to enforce compliance with banks' voluntary commitments). This may ultimately serve to provide NGOs with further support for their argument that EPs compliance should be made into a legal requirement.³⁸¹ Several writers have addressed these issues by offering suggested improvements to the EPs reporting framework and significant further study will be required in this area.³⁸² Hardenbrook argues, for example, that one way to determine whether the EPs impact banking decisions would be to examine the policies and procedures that banks have implemented to meet the EPs' standards.³⁸³ As another possibility, Hardenbrook notes it would be helpful to examine whether there have been any changes in loan covenants to reflect the EPs' requirements. Hardenbrook argues that this might be the most important indication of a bank's commitment to the EPs, because it gives direct legal redress if the borrower fails to fully comply.³⁸⁴ However, Hardenbrook concedes that this information would be difficult to obtain on a broad scale because of the confidentiality of loan agreements and

³⁸¹ See Section 6.3 of this thesis.

³⁸² See Sections 5.3 and 5.4 of this thesis.

³⁸³ *Hardenbrook, supra* note 199 at 227.

³⁸⁴ *Ibid* at 228.

the fact that banks typically do not disclose information regarding specific projects that have been turned down for their failure to meet the EPs' standards.³⁸⁵

As noted in Chapter 5, there is also on-going debate in this area surrounding the issue of enforceability: whether the EPs are sufficient as a voluntary code or whether more mandatory requirements are needed.³⁸⁶ Commentators have already noted, for example, that there is the potential for the EPs to evolve into a compulsory requirement, possibly in the form of an international treaty.³⁸⁷ Similarly, other writers have considered this issue in the context of whether EPs banks may be sued for violation of the EPs' standards, or for fraud or false advertising for failing to comply with the principles.³⁸⁸ These developments will support calls from NGOs who argue that mandatory requirements should now be established to deter the free-rider problem and to allow a uniform way of enforcing the EPs.³⁸⁹

However, other commentators note that the principles have been successful to-date primarily because they promote wider adoption rates as a voluntary initiative.³⁹⁰ Similarly, commentators note that, in resisting calls for a mandatory independent system, EPs banks argue that the high level of public scrutiny and media attention in this area ensures that breaches in compliance will be exposed.³⁹¹ However, it is submitted here that

³⁸⁵ *Ibid* at 228-229.

³⁸⁶ Some of the theoretical issues that frame this debate are discussed in Chapter 2 where the debate over "voluntary" versus "mandatory" CSR regulation is described.

³⁸⁷ *Macve and Chen, supra* note 6 at 900.

³⁸⁸ *Hardenbrook, supra* note 199 at 218.

³⁸⁹ See Sections 5.3 and 5.4 of this thesis.

³⁹⁰ See e.g., the discussion on this point by Macve and Chen. *Macve and Chen, supra* note 6 at 900.

³⁹¹ See e.g., *Wright, supra* note 205 at 63.

it remains unclear how “public scrutiny and media attention” are to be effective in ensuring compliance if banks fail to adequately disclose and report on their EPs activities in the first place. On this point, in their recent survey of international EPs reporting, lawyers Christopher Langdon and Claudia O’Brien of the international law firm Latham & Watkins LLP, confirmed that EPs underreporting by member banks is a “legitimate practical concern.”³⁹² They noted that, while all banks in their study reported the number of EPs projects, few described the role the EPs play in decision-making processes making it difficult to assess the EPs’ overall impact.³⁹³

Ultimately, this thesis shows that many of these issues arise in the Canadian context. The findings in Chapter 6 show that there is clearly room for improvement for Canadian banks, particularly in the areas of EPs reporting and disclosure, and further study will be needed to see if Canadian banks are mindful of these concerns as they move forward in their EPs implementation and other CSR programs. It will also be interesting to see if Canadian banks move toward limiting their use of vague self-serving statements about the EPs in order to avoid being labeled with the free-rider and other associated problems discussed in Chapter 5. As noted above, concerns about free-riding arise in the context of the EPs because no formal mechanisms exist to screen or monitor the practices of adopting banks, meaning that all adopters are likely to gain some reputational benefits irrespective of their actual compliance practices. Developments in this area should be

³⁹² Christopher Langdon and Claudia O’Brien of Latham & Watkins LLP, ““Principles Promoting” Project Finance” (2011) at 33 [*Langdon and O’Brien*], electronic copy available online at: <http://www.lw.com/people/ChristopherWLangdon>.

³⁹³ *Ibid.* This was also the case for Barclays and HSBC in the study by Macve and Chen, *supra* note 6 at 903.

monitored closely as some commentators have already concluded that free-riding could pose a substantial threat to the EPs if the practice becomes a trend in the banking sector.

One positive (and somewhat surprising) development identified in Chapter 6 is the decision by TD to adopt the EPs more generally into its broader commercial lending activities. As discussed in Section 6.3 of this thesis, and although further study will be needed to monitor TD's success in implementing this initiative, this result is interesting in that it may provide early practical evidence to support the developing CSR scholarship in this area canvassed in Chapter 5.³⁹⁴ Moreover, this finding provides further evidence in support of the trend identified in this thesis as a shift of business and financial values toward greater importance being attributed to CSR considerations in the financial sector.

Importantly, the TD case also provides evidence of a step forward in the important area of EPs scope expansion (the idea that banks should use the EPs beyond project finance transactions). In its recent submissions to the EPs Association on the development of EP III, for example, BankTrack stated that scope expansion is the most important area of improvement needed for the EPs to achieve their full potential.³⁹⁵ Also interesting are TD's broader statements about its refusal to lend money for transactions that would involve the degradation of internationally protected habitats, the purchase of timber from illegal logging operations or the trade in or manufacturing of material for prohibited weapons.³⁹⁶ Subject to concerns expressed above surrounding free-riding and

³⁹⁴ See the discussion in Section 6.3 of this thesis.

³⁹⁵ See *Outside Job*, *supra* note 34 at 3. See also the discussion surrounding scope expansion in the context of the EP III update in Section 7.2 of this thesis. The importance of scope extension is based largely on the fact that several different forms of financing are undertaken by banks. BankTrack argues that limiting the EPs' scope to just project financing significantly impacts on their effectiveness.

³⁹⁶ See Section 6.2 of this thesis.

the accuracy of this reporting, this result appears to show explicit private sector endorsement of public international treaties, and scholars are already considering implications for further study on these issues.³⁹⁷

In addition to developments in the Canadian context, there will be a number of opportunities for further study in the context of the EPs internationally. For example, further study will be needed to see if continuing geopolitical shifts result in changes to the EPs adoption patterns currently identified by Wright and Rwabizambuga as being primarily concentrated in Western European and North American banks.³⁹⁸ On this point, it is interesting that at the time of writing only one Chinese bank, Industrial Bank Co., Ltd, is listed among member banks.³⁹⁹ However, with the increased media and public criticism of banks in China, Langdon and O'Brien note that it remains to be seen whether more Chinese banks will adopt the EPs to take advantage of reputational benefits.⁴⁰⁰ They cite unidentified sources as stating that government bodies in China have improved their environmental standards in response to the EPs:

“[o]ne source says that the Chinese banking regulator in 2007 improved its standards with help from the international banking community, because of increased scrutiny of Chinese activity in Africa. Another states that the Chinese equivalent of the Environmental Protection Agency introduced the principles into its green credit policy after criticism from the World Bank president, and has actually withheld loans from companies that violated the environmental rules. This shows that the principles can carry powerful force even outside of the private project finance sector.”⁴⁰¹

³⁹⁷ See, e.g., N. A. Affolder, “The Private Life of Environmental Treaties” (2008), electronic copy available online at: <http://ssrn.com/abstract=1502948>.

³⁹⁸ See Section 5.1 of this thesis.

³⁹⁹ See online at: <http://www.equator-principles.com/index.php/members-reporting> (accessed as of June 28, 2013).

⁴⁰⁰ See *Langdon and O'Brien, supra* note 392 at 34.

⁴⁰¹ *Ibid*

Beyond China, the EPs do appear to be making inroads into other areas of the globe, with 5 banks from South Africa having signed on,⁴⁰² and several Latin American adopters as well.⁴⁰³ Notably underrepresented, however, are banks from Eastern European states, Russia, Asia and the Middle East.⁴⁰⁴ One possible area of concern that could be relevant here is that the EPs Association may not want to broaden membership to admit new members from emerging markets that do not have the resources to comply with the principles.⁴⁰⁵ Although likely to be controversial, this explanation for the primarily western adoption patterns should be studied as well.

Several authors have also identified the need for further case studies into individual EPs projects and specific industries to see how the principles are working on the ground. Langdon and O'Brien's recent study goes some way to addressing this need in the mining context; arguing, by way of reference to global mining companies' endorsement of the EPs, that

“poor reporting does not necessarily reflect poor implementation of the principles on the ground. On the contrary, a case study of the mining and metals industry, where project finance is frequently used, illustrates how the principles have an impact beyond what the bank reports suggest.

⁴⁰² The list of member banks on the EPs website can be sorted by region and country, available online at: <http://www.equator-principles.com/index.php/members-reporting/members-and-reporting> (accessed as of June 28, 2013). As of the date of writing, the South African banks are Absa Bank Limited, FirstRand Limited, NedBank Limited and Standard Bank of South Africa Limited. Other African countries represented are Egypt (1), Mauritius (1), Morocco (1), Nigeria (2) and Togo (1).

⁴⁰³ *Ibid.* As of the date of writing, these include banks in Argentina (1), Brazil (5), Chile (1), Columbia (1), Costa Rica (1), Peru (1) and Uruguay (1).

⁴⁰⁴ *Ibid*

⁴⁰⁵ See Langdon and O'Brien, *supra* note 392 at 33. The authors argue that EPs Association's response to this problem suggests that they “genuinely strive to implement the principles and do not want new members to dilute the Equator brand by noncompliance.” There is, however, no supporting evidence offered for this position.

Evidence from the industry suggests that the principles do have bite, and that they have influenced mining projects around the globe.”⁴⁰⁶

This methodology could easily be extended, for example, to Canada, where it is argued that the EPs, together with other international frameworks, may have already evolved to address many of the CSR related issues in the extractive industry.⁴⁰⁷

Finally, the EPs’ impact on the practice of banking lawyers should be studied. Some practicing lawyers have already commented that, depending on one’s point of view, the EPs can be either a lawyer’s dream or nightmare: they “vastly expand the scope of requirements to which borrowers agree to be subject, to include not only those required by law, but also the standards of ... the safeguard guidelines, and any project-specific procedures specified in the EMP.”⁴⁰⁸ However, they note that, although the EPs appear to provide an important breakthrough in environmental and social issues, a close reading of them reveals

“a set of requirements that is ambiguous at best. They are filled with potential “loopholes” that are only made wider and less defined by the guidelines which they incorporate by reference. Their value from either the lender-signatories’ points of view or those of public skeptics is open to significant question because of these uncertainties. In general, for all constituencies (or stakeholders), the ambiguity of the Principles presents both an opportunity and a risk.”⁴⁰⁹

⁴⁰⁶ *Ibid*

⁴⁰⁷ See the discussion on this point by Seck. *Seck, supra* note 144 at 67-70. See also e.g., the January 19, 2012 Mining Association of Canada’s report on the “National Roundtables on Corporate Social Responsibility (CSR) and the Canadian Extractive Industry in Developing Countries” at 67, electronic copy available online at: http://www.mining.ca/www/media_lib/MAC_Documents/Final%20MAC%20Roundtables%20Report%20December%2021%202011_%20_3_.pdf.

⁴⁰⁸ *Lawrence and Thomas, supra* note 190 at 25.

⁴⁰⁹ *Ibid*

7.2 Further Study: EP III

There will be significant opportunity for further study surrounding the implementation of the EP III update in 2013 and 2014. In particular, it will be interesting to see how, if at all, the concerns of NGOs and other commentators are addressed. As noted in Chapter 4, the EP III update is based on the IFC's review of the IFC Performance Standards and update of its Sustainability Framework, which were re-launched in January 2012.⁴¹⁰ A draft of the EP III was released for stakeholder consultation and public comment on August 13, 2012 and the formal Stakeholder Consultation and Public Comment period closed on October 12, 2012. The EP III update has now been launched effective as of June 4, 2013, but subject to a transition period ending on December 31, 2013.⁴¹¹ The transition period will allow EP II to be applied to new transactions (i.e. where the mandate is signed after June 4, 2013) up to the end of the transition period.⁴¹²

As at the date of submission of this thesis, the results of the EP III update remain to be seen. In this regard, the EPs Association has identified the following key objectives of the EP III update:

- To ensure the EPs Association members continue to appropriately manage environmental and social risk and impacts for their institutions, clients and relevant stakeholders with regard to the financing of projects,
- To reflect the recent update of the IFC Performance Standards, and

⁴¹⁰ See the IFC website, online at:

http://www1.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_site/IFC+Sustainability/Sustainability+Framework

⁴¹¹ A copy of the EP III [*EP III*] is attached as **Appendix II** to this thesis and is also available online at: <http://www.equator-principles.com/index.php/ep3/ep3>.

⁴¹² *Ibid*

- To maintain the level playing field on which international and local financial institutions operate, with regards to sustainable financing objectives.⁴¹³

However, NGOs are quick to point out that the EPs Association qualified its commitment from the beginning of the update process by stating that “all of these topics would require formal amendment to the EPs and/or EP Association Governance Rules and a voting process by the entire EPs Association membership - the results of which cannot, at the time of this statement, be fully assured.”⁴¹⁴ As a result, NGOs continue to criticize the EP III update and BankTrack in particular has pointed out that the review process took well over two years since the EPs Association’s first announcement of its intention to create the EP III in 2010. BankTrack has since confirmed its frustration on these issues and has demanded firm commitments from the EPs Association; failing which, it argues that the EPs Association will have failed to achieve any meaningful improvements with EP III.⁴¹⁵

More specifically, critics have identified significant room for improvement in three principal areas: scope extension (banks should use the principles for all types of commercial financing); transparency (banks should provide full disclosure) and accountability (banks should report at the project level and allow for appropriate review

⁴¹³ See FREQUENTLY ASKED QUESTIONS ON THE EQUATOR PRINCIPLES (EP III) UPDATE [*Frequently asked Questions*] at 4-5, online at: http://www.equator-principles.com/resources/EPIII_FAQs.pdf

⁴¹⁴ See the “Summary Response by Equator Principles Association to the Equator Principles Strategic Review Report” at 4-5, available online at: http://www.equator-principles.com/resources/ep_association_summary_response_strategic_review.pdf.

⁴¹⁵ See online article by Johan Frijns, Director of BankTrack, “Equators Principles III Better be Good” March 29, 2012, available online at: http://www.banktrack.org/show/news/equator_principles_iii_better_be_good.

of project decisions).⁴¹⁶ The EPs Association, in turn, responded that the EP III would address these concerns through three key areas of improvement:

- An extension in the scope of the EPs to Project-Related Corporate Loans and Bridge Loans.
- New requirements related to managing impacts on climate.
- Greater emphasis on human rights considerations in due diligence.
- A strengthening of reporting and transparency requirements.⁴¹⁷

More specifically, in terms of scope expansion, the EP III state that coverage will be extended to “Project-Related Corporate Loans,” which the EP III define according to the following criteria: (i) the majority of the loan is related to a single project; (ii) the total aggregate loan amount is at least U.S. \$100 million; (iii) the bank’s individual initial exposure is at least U.S. \$50 million; and (iv) the loan tenor is at least two years.⁴¹⁸ In terms of reporting and transparency, the new Principle 10 will require that, for all Category A and, as appropriate, Category B projects, the bank must require the borrower to disclose the EPs related assessment documentation for the project online.⁴¹⁹ The new “Annex B - Minimum Reporting Requirements” will also provide for additional reporting by EPs banks: (i) Data Reporting (similar to the reporting requirements currently in place under EP II); (ii) Implementation Reporting for the first year of adoption, and thereafter

⁴¹⁶ *Ibid*

⁴¹⁷ *Frequently asked Questions, supra* note 413 at 5.

⁴¹⁸ See the “Scope” Section of the EP III. *EP III, supra* note 411. The Scope Section also notes that the EP III will apply to bridge loans of less than two years that are intended to be refinanced by project finance or a project-related corporate loan that meets the relevant criteria. Specifically excluded from the definition of Project-Related Corporate Loans, however, are export finance or supplier credit loans; asset finance acquisition finance; hedging; leasing; letters of credit; general corporate purpose loans; and general working capital expenditures (and any other loans that are not related to financing of an underlying project).

⁴¹⁹ Principle 10 of EP III, *Ibid*.

as deemed relevant by the banks (this requires the bank to report on its implementation of the EPs, including the mandate of the EPs related staff and their responsibilities, level of senior management involvement and incorporation of the EPs in their credit and risk management policies); and (iii) Project-Specific Data Reporting (including project name, sector, region and the year of project financial close).⁴²⁰

There is no question that these developments will provide an improvement over EP II.⁴²¹ Even BankTrack concedes this point, and acknowledges the steps forward in the areas of scope extension and the commitment to report on and disclose more project specific information.⁴²² However, for some commentators, including BankTrack, these steps do not go far enough. On this point, for example, it is observed that the defining criteria for the inclusion of “Project-Related Corporate Loans” is very specific, meaning that it is unlikely that many more loans will be captured under the EP III framework than is currently the case under EP II. The EPs Association justifies this restrictive position by stating that “[i]n general, financial institutions have a lesser degree of influence/leverage over a project financed through a Corporate Loan. There is also a higher degree of competition with financial institutions in certain geographies including those that are not EP adopters. Furthermore loans are often arranged in a shorter timescale meaning that parts of the EP framework would require a different approach.”⁴²³

⁴²⁰ See “Annex B” of EP III, *Ibid.*

⁴²¹ See e.g. the online article by lawyers of international law firm Norton Rose Fulbright LLP, available at: <http://www.nortonrosefulbright.com/knowledge/publications/80287/equator-principles-iii-is-approved-and-launched-new-trends-and-a-strategy-rethink>

⁴²² See e.g., “BankTrack comments on draft Equator Principles III, Tiny steps forward, where bold moves are required” Oct 11 2012 [*Bold Moves*], available online at: http://www.banktrack.org/show/news/banktrack_comments_on_draft_equator_principles_iii

⁴²³ See *Frequently asked Questions*, *supra* note 413 at 12.

Similarly, the Project-Specific Data reporting will be subject to obtaining the borrower's consent and will only be applicable to projects that have closed successfully (this is an important qualification because it means that the requirement will not apply where the borrower refuses consent or where projects are denied for financing because they fail to meet the EPs criteria). As a result, even the EPs Association concedes that this enhanced transparency is an important but incomplete step; and acknowledges that it will take both time and experience to create a level playing field in the area of transparency and accountability.⁴²⁴

As noted above, the full impact of the EP III update process remains to be seen. Critics continue to doubt that the EP III will have achieved meaningful improvements and BankTrack, in particular, has argued that “bigger steps must be taken by the Association if the new Equator Principles are to become a leading initiative on sustainable finance.”⁴²⁵ However, it is submitted here that BankTrack's argument that the EPs Association is prepared to take only “tiny steps where bold moves are required”⁴²⁶ appears overly aggressive and likely goes too far. The EPs Association has clearly confirmed its commitment to improving the principles with EP III as a work in progress and member banks continue to devote their own significant resources and efforts to this endeavor. Although not yet a perfect mechanism for ensuring positive social and environmental outcomes, the EPs represent a significant effort in this regard and represent an opportunity to examine how this form of CSR works in practice. The EP III

⁴²⁴ *Ibid* at 13.

⁴²⁵ See e.g., *Bold Moves*, *supra* note 422.

⁴²⁶ *Ibid*

update process may represent only a small step forward in this area but, clearly, it represents a further step in the right direction.

Legislation

Bank Act, SC 1991, c 46.

Companies Act 2006 (c. 46) (U.K.)

Jurisprudence

BCE Inc. v. 1976 Debentureholders, 2008 SCC 69, [2008] 3 S.C.R.

Canadian Pioneer Management Ltd. et al. v. Labour Relations Board of Saskatchewan et al., [1980] 1 SCR 433.

Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461.

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Appendix I

The Equator Principles, June 2006 (EP II)



THE EQUATOR PRINCIPLES JUNE 2006

A financial industry benchmark for determining, assessing and managing
social and environmental risk in project financing

<http://www.equator-principles.com>

PREAMBLE

Project financing, 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, plays an important role in financing development throughout the world.¹ Project financiers may encounter social and environmental issues that are both complex and challenging, particularly with respect to projects in the emerging markets.

The Equator Principles Financial Institutions (EPFIs) have consequently adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices. By doing so, negative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately. We believe that adoption of and adherence to these Principles offers significant benefits to ourselves, our borrowers and local stakeholders through our borrowers' engagement with locally affected communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development. As such, EPFIs will consider reviewing these Principles from time-to-time based on implementation experience, and in order to reflect ongoing learning and emerging good practice.

These Principles are intended to serve as a common baseline and framework for the implementation by each EPFI of its own internal social and environmental policies, procedures and standards related to its project financing activities. We will not provide loans to projects where the borrower will not

¹ **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.htm>.



or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles.

SCOPE

The Principles apply to all new project financings globally with total project capital costs of US\$10 million or more, and across all industry sectors. In addition, while the Principles are not intended to be applied retroactively, we will apply them to all project financings covering expansion or upgrade of an existing facility where changes in scale or scope may create significant environmental and/or social impacts, or significantly change the nature or degree of an existing impact.

The Principles also extend to project finance advisory activities. In these cases, EPFIs commit to make the client aware of the content, application and benefits of applying the Principles to the anticipated project, and request that the client communicate to the EPFI its intention to adhere to the requirements of the Principles when subsequently seeking financing.

STATEMENT OF PRINCIPLES

EPFIs will only provide loans to projects that conform to Principles 1-9 below:

Principle 1: Review and Categorisation

When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC) (Exhibit I).

Principle 2: Social and Environmental Assessment

For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment (“Assessment”) process² to address, as appropriate and to the EPFI’s satisfaction, the relevant social and environmental impacts and risks of the proposed project (which may include, if relevant, the illustrative list of issues as found in Exhibit II). The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.

² **Social and Environmental Assessment** is a process that determines the social and environmental impacts and risks (including labour, health, and safety) of a proposed project in its area of influence. For the purposes of Equator Principles compliance, this will be an adequate, accurate and objective evaluation and presentation of the issues, whether prepared by the borrower, consultants or external experts. Depending on the nature and scale of the project, the assessment document may comprise a full-scale social and environmental impact assessment, a limited or focused environmental or social assessment (e.g. audit), or straight-forward application of environmental siting, pollution standards, design criteria, or construction standards. One or more specialised studies may also need to be undertaken.



Principle 3: Applicable Social and Environmental Standards

For projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the Assessment will refer to the then applicable IFC Performance Standards (Exhibit III) and the then applicable Industry Specific EHS Guidelines (“EHS Guidelines”) (Exhibit IV). The Assessment will establish to a participating EPFI’s satisfaction the project’s overall compliance with, or justified deviation from, the respective Performance Standards and EHS Guidelines.

The regulatory, permitting and public comment process requirements in High-Income OECD Countries, as defined by the World Bank Development Indicators Database, generally meet or exceed the requirements of the IFC Performance Standards (Exhibit III) and EHS Guidelines (Exhibit IV). Consequently, to avoid duplication and streamline EPFI’s review of these projects, successful completion of an Assessment (or its equivalent) process under and in compliance with local or national law in High-Income OECD Countries is considered to be an acceptable substitute for the IFC Performance Standards, EHS Guidelines and further requirements as detailed in Principles 4, 5 and 6 below. For these projects, however, the EPFI still categorises and reviews the project in accordance with Principles 1 and 2 above.

The Assessment process in both cases should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

Principle 4: Action Plan and Management System

For all Category A and Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the borrower has prepared an Action Plan (AP)³ which addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable Performance Standards and EHS Guidelines, as defined in the AP.

³ The **Action Plan** may range from a brief description of routine mitigation measures to a series of documents (e.g. resettlement action plan, indigenous peoples plan, emergency preparedness and response plan, decommissioning plan, etc). The level of detail and complexity of the Action Plan and the priority of the identified measures and actions will be commensurate with the project’s potential impacts and risks. Consistent with Performance Standard 1, the internal **Social and Environmental Management System** will incorporate the following elements: (i) Social and Environmental Assessment; (ii) management program; (iii) organisational capacity; (iv) training; (v) community engagement; (vi) monitoring; and (vii) reporting.



For projects located in High-Income OECD countries, EPFIs may require development of an Action Plan based on relevant permitting and regulatory requirements, and as defined by host-country law.

Principle 5: Consultation and Disclosure

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner.⁴ For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns.⁵

In order to accomplish this, the Assessment documentation and AP, or non-technical summaries thereof, will be made available to the public by the borrower for a reasonable minimum period in the relevant local language and in a culturally appropriate manner. The borrower will take account of and document the process and results of the consultation, including any actions agreed resulting from the consultation. For projects with adverse social or environmental impacts, disclosure should occur early in the Assessment process and in any event before the project construction commences, and on an ongoing basis.

Principle 6: Grievance Mechanism

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure

⁴ **Affected communities** are communities of the local population within the project's area of influence who are likely to be adversely affected by the project. Where such consultation needs to be undertaken in a structured manner, EPFIs may require the preparation of a Public Consultation and Disclosure Plan (PCDP).

⁵ **Consultation** should be "free" (free of external manipulation, interference or coercion, and intimidation), "prior" (timely disclosure of information) and "informed" (relevant, understandable and accessible information), and apply to the entire project process and not to the early stages of the project alone. The borrower will tailor its consultation process to the language preferences of the affected communities, their decision-making processes, and the needs of disadvantaged or vulnerable groups. Consultation with Indigenous Peoples must conform to specific and detailed requirements as found in Performance Standard 7. Furthermore, the special rights of Indigenous Peoples as recognised by host-country legislation will need to be addressed.



that the mechanism addresses concerns promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.

Principle 7: Independent Review

For all Category A projects and, as appropriate, for Category B projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

Principle 8: Covenants

An important strength of the Principles is the incorporation of covenants linked to compliance. For Category A and B projects, the borrower will covenant in financing documentation:

- a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;
- b) to comply with the AP (where applicable) during the construction and operation of the project in all material respects;
- c) to provide periodic reports in a format agreed with EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and
- d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate.

Principle 9: Independent Monitoring and Reporting

To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, for all Category A projects, and as appropriate, for Category B projects, require appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.



Principle 10: EPFI Reporting

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.⁶

DISCLAIMER

The adopting EPFIs view these Principles as a financial industry benchmark for developing individual, internal social and environmental policies, procedures and practices. As with all internal policies, these Principles do not create any rights in, or liability to, any person, public or private. Institutions are adopting and implementing these Principles voluntarily and independently, without reliance on or recourse to the IFC or the World Bank.

⁶ Such reporting should at a minimum include the number of transactions screened by each EPFI, including the categorisation accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.



EXHIBIT I: CATEGORISATION OF PROJECTS

As part of their review of a project's expected social and environmental impacts, EPFIs use a system of social and environmental categorisation, based on the IFC's environmental and social screening criteria, to reflect the magnitude of impacts understood as a result of assessment.

These categories are:

Category A – Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented;

Category B – 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 – Projects with minimal or no social or environmental impacts.



EXHIBIT II: ILLUSTRATIVE LIST OF POTENTIAL SOCIAL AND ENVIRONMENTAL ISSUES TO BE ADDRESSED IN THE SOCIAL AND ENVIRONMENTAL ASSESSMENT DOCUMENTATION

In the context of the business of the project, the Assessment documentation will address, where applicable, the following issues:

- a) assessment of the baseline social and environmental conditions
- b) consideration of feasible environmentally and socially preferable alternatives
- c) requirements under host country laws and regulations, applicable international treaties and agreements
- d) protection of human rights and community health, safety and security (including risks, impacts and management of project's use of security personnel)
- e) protection of cultural property and heritage
- f) protection and conservation of biodiversity, including endangered species and sensitive ecosystems in modified, natural and critical habitats, and identification of legally protected areas
- g) sustainable management and use of renewable natural resources (including sustainable resource management through appropriate independent certification systems)
- h) use and management of dangerous substances
- i) major hazards assessment and management
- j) labour issues (including the four core labour standards), and occupational health and safety
- k) fire prevention and life safety
- l) socio-economic impacts
- m) land acquisition and involuntary resettlement
- n) impacts on affected communities, and disadvantaged or vulnerable groups
- o) impacts on indigenous peoples, and their unique cultural systems and values
- p) cumulative impacts of existing projects, the proposed project, and anticipated future projects
- q) consultation and participation of affected parties in the design, review and implementation of the project
- r) efficient production, delivery and use of energy
- s) pollution prevention and waste minimisation, pollution controls (liquid effluents and air emissions) and solid and chemical waste management

Note: The above list is for illustrative purposes only. The Social and Environmental Assessment process of each project may or may not identify all issues noted above, or be relevant to every project.



EXHIBIT III: IFC PERFORMANCE STANDARDS ON ENVIRONMENTAL AND SOCIAL SUSTAINABILITY

As of January 1, 2012, the following list of IFC Performance Standards were applicable:

- Performance Standard 1 - [Assessment and Management of Social and Environmental Risks and Impacts](#)
- Performance Standard 2 - [Labor and Working Conditions](#)
- Performance Standard 3 - [Resource Efficiency and Pollution Prevention](#)
- Performance Standard 4 - [Community Health, Safety and Security](#)
- Performance Standard 5 - [Land Acquisition and Involuntary Resettlement](#)
- Performance Standard 6 - [Biodiversity Conservation and Sustainable Management of Living Natural Resources](#)
- Performance Standard 7 - [Indigenous Peoples](#)
- Performance Standard 8 - [Cultural Heritage](#)

The IFC has developed a set of Guidance Notes to accompany each Performance Standard. While not formally adopting the Guidance Notes, EPFIs or borrowers may use the Guidance Notes as useful points of reference when seeking further guidance on or interpretation of the Performance Standards. The IFC Performance Standards, Guidance Notes and Industry Sector EHS Guidelines can be found at <http://www.ifc.org/ifcext/policyreview.nsf/Content/2012-Edition>.

Important Note:

The EP Association Steering Committee has provided guidance on how members, clients and stakeholders can transition smoothly and consistently from the 2006 to the 2012 IFC Performance Standards. Please refer to <http://www.equator-principles.com/index.php/all-ep-association-news/254-revised-ps> for this guidance.



EXHIBIT IV: INDUSTRY-SPECIFIC ENVIRONMENTAL, HEALTH AND SAFETY (EHS) GUIDELINES

EPFIs will utilise the appropriate environmental, health and safety (EHS) guidelines used by the IFC which are now in place, and as may be amended from time-to-time.

The IFC is using two complementary sets of EHS Guidelines available at the IFC website (<http://www.ifc.org/ifcext/sustainability.nsf/Content/EHSGuidelines>). These sets consist of all the environmental guidelines contained in Part III of the World Bank's Pollution Prevention and Abatement Handbook (PPAH) which went into official use on July 1, 1998 and a series of environmental, health and safety guidelines published on the IFC website between 1991 and 2003. Ultimately new guidelines, incorporating the concepts of cleaner production and environmental management systems, will be written to replace this series of industry sector, PPAH and IFC guidelines.

Where no sector specific guideline exists for a particular project then the PPAH's General Environmental Guidelines and the IFC Occupational Health and Safety Guidelines (2003) are applied, with modifications as necessary to suit the project.*

The table below lists both the World Bank Guidelines and the IFC Guidelines as of March 1, 2006.

Industry Specific EHS Guidelines:

World Bank Guidelines (PPAH)	IFC Guidelines
1. Aluminium Manufacturing	1. Airports
2. Base Metal and Iron Ore Mining	2. Ceramic Tile Manufacturing
3. Breweries	3. Construction Materials Plants
4. Cement Manufacturing	4. Electric Power Transmission and Distribution
5. Chlor-Alkali Plants	5. Fish Processing
6. Coal Mining and Production	6. Food and Beverage Processing
7. Coke Manufacturing	7. Forestry Operations: Logging
8. Copper Smelting	8. Gas Terminal Systems
9. Dairy Industry	9. Geothermal Projects
10. Dye Manufacturing	10. Hazardous Materials Management
11. Electronics Manufacturing	11. Health Care
12. Electroplating Industry	12. Life & Fire Safety
13. Foundries	13. Occupational Health and Safety
14. Fruit and Vegetable Processing	14. Office Buildings
15. General Environmental Guidelines	15. Offshore Oil & Gas
16. Glass Manufacturing	16. Polychlorinated Biphenyls (PCBs)



World Bank Guidelines (PPAH)	IFC Guidelines
17. Industrial Estates	17. Pesticide Handling and Application
18. Iron and Steel Manufacturing	18. Plantations
19. Lead and Zinc Smelting	19. Port and Harbor Facilities
20. Meat Processing and Rendering	20. Rail Transit Systems
21. Mini Steel Mills	21. Roads and Highways
22. Mixed Fertilizer Plants	22. Telecommunications
23. Monitoring	23. Tourism and Hospitality Development
24. Nickel Smelting and Refining	24. Waste Management Facilities
25. Nitrogenous Fertilizer Plants	25. Wastewater Reuse
26. Oil and Gas Development (Onshore)	26. Wildland Management
27. Pesticides Formulation	27. Wind Energy Conversion Systems
28. Pesticides Manufacturing	28. Wood Products Industries
29. Petrochemicals Manufacturing	
30. Petroleum Refining	
31. Pharmaceutical Manufacturing	
32. Phosphate Fertilizer Plants	
33. Printing Industry	
34. Pulp and Paper Mills	
35. Sugar Manufacturing	
36. Tanning and Leather Finishing	
37. Textiles Industry	
38. Thermal Power Guidelines for New Plants	
39. Thermal Power Rehabilitation of Existing Plants	
40. Vegetable Oil Processing	
41. Wood Preserving Industry	

* Exception (the following are World Bank Guidelines not contained in the PPAH and currently in use)

Mining and Milling - Underground

Mining and Milling - Open Pit

Appendix II

The Equator Principles, June 2013 (EP III)



**THE EQUATOR PRINCIPLES
JUNE 2013**

A financial industry benchmark for determining, assessing
and managing environmental and social risk in projects

www.equator-principles.com



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PREAMBLE

Large infrastructure and industrial Projects can have adverse impacts on people and on the environment. As financiers and advisors, we work in partnership with our clients to identify, assess and manage environmental and social risks and impacts in a structured way, on an ongoing basis. Such collaboration promotes sustainable environmental and social performance and can lead to improved financial, environmental and social outcomes.

We, the Equator Principles Financial Institutions (EPFIs), have adopted the Equator Principles in order to ensure that the Projects we finance and advise on are developed in a manner that is socially responsible and reflects sound environmental management practices. We recognise the importance of climate change, biodiversity, and human rights, and believe negative impacts on project-affected ecosystems, communities, and the climate should be avoided where possible. If these impacts are unavoidable they should be minimised, mitigated, and/or offset.

We believe that adoption of and adherence to the Equator Principles offers significant benefits to us, our clients, and local stakeholders through our clients' engagement with locally Affected Communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development, including fulfilling our responsibility to respect human rights by undertaking due diligence¹ in accordance with the Equator Principles.

The Equator Principles are intended to serve as a common baseline and framework. We commit to implementing the Equator Principles in our internal environmental and social policies, procedures and standards for financing Projects. We will not provide Project Finance or Project-Related Corporate Loans to Projects where the client will not, or is unable to, comply with the Equator Principles. As Bridge Loans and Project Finance Advisory Services are provided earlier in the Project timeline, we request the client explicitly communicates their intention to comply with the Equator Principles.

EPFIs review the Equator Principles from time-to-time based on implementation experience, and in order to reflect ongoing learning and emerging good practice.

¹ As referenced in the "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework".



SCOPE

The Equator Principles apply globally and to all industry sectors.

The Equator Principles apply to the four financial products described below when supporting a new Project:

1. **Project Finance Advisory Services** where total Project capital costs are US\$10 million or more.
2. **Project Finance** with total Project capital costs of US\$10 million or more.
3. **Project-Related Corporate Loans**² (including Export Finance in the form of Buyer Credit) where all four of the following criteria are met:
 - i. The majority of the loan is related to a single Project over which the client has Effective Operational Control (either direct or indirect).
 - ii. The total aggregate loan amount is at least US\$100 million.
 - iii. The EPFI's individual commitment (before syndication or sell down) is at least US\$50 million.
 - iv. The loan tenor is at least two years.
4. **Bridge Loans** with a tenor of less than two years that are intended to be refinanced by Project Finance or a Project-Related Corporate Loan that is anticipated to meet the relevant criteria described above.

While the Equator Principles are not intended to be applied retroactively, the EPFI will apply them to the expansion or upgrade of an existing Project where changes in scale or scope may create significant environmental and social risks and impacts, or significantly change the nature or degree of an existing impact.

² Project-Related Corporate Loans exclude Export Finance in the form of Supplier Credit (as the client has no Effective Operational Control). Furthermore, Project-Related Corporate Loans exclude other financial instruments that do not finance an underlying Project, such as Asset Finance, acquisition finance, hedging, leasing, letters of credit, general corporate purposes loans, and general working capital expenditures loans used to maintain a company's operations.



APPROACH

Project Finance and Project-Related Corporate Loans

The EPFI will only provide Project Finance and Project-Related Corporate Loans to Projects that meet the requirements of Principles 1-10.

Project Finance Advisory Services and Bridge Loans

Where the EPFI is providing Project Finance Advisory Services or a Bridge Loan, the EPFI will make the client aware of the content, application and benefits of applying the Equator Principles to the anticipated Project. The EPFI will request that the client communicates to the EPFI its intention to adhere to the requirements of the Equator Principles when subsequently seeking long term financing. The EPFI will guide and support the client through the steps leading to the application of the Equator Principles.

For Bridge Loans categorised A or B (as defined in Principle 1) the following requirements, where relevant, apply. Where the Project is in the feasibility phase and no impacts are expected during the tenor of the loan, the EPFI will confirm that the client will undertake an Environmental and Social Assessment (Assessment) process. Where Environmental and Social Assessment Documentation (Assessment Documentation) has been prepared and Project development is expected to begin during the tenor of the loan, the EPFI will, where appropriate, work with the client to identify an Independent Environmental and Social Consultant and develop a scope of work to commence an Independent Review (as defined in Principle 7).

Information Sharing

Recognising business confidentiality and applicable laws and regulations, Mandated EPFIs will share, when appropriate, relevant environmental and social information with other Mandated Financial Institutions, strictly for the purpose of achieving consistent application of the Equator Principles. Such information sharing shall not relate to any competitively sensitive information. Any decision as to whether, and on what terms, to provide financial services (as defined in the Scope) will be for each EPFI to make separately and in accordance with its risk management policies. Timing constraints may lead EPFIs considering a transaction to seek authorisation from their clients to start such information sharing before all other financial institutions are formally mandated. EPFIs expect clients to provide such authorisation.



STATEMENT OF PRINCIPLES

Principle 1: Review and Categorisation

When a Project is proposed for financing, the EPFI will, as part of its internal environmental and social review and due diligence, categorise it based on the magnitude of its potential environmental and social risks and impacts. Such screening is based on the environmental and social categorisation process of the International Finance Corporation (IFC).

Using categorisation, the EPFI's environmental and social due diligence is commensurate with the nature, scale and stage of the Project, and with the level of environmental and social risks and impacts.

The categories are:

Category A – Projects with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented;

Category B – Projects with potential limited adverse environmental and social risks and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; and

Category C – Projects with minimal or no adverse environmental and social risks and/or impacts.

Principle 2: Environmental and Social Assessment

For all Category A and Category B Projects, the EPFI will require the client to conduct an Assessment process to address, to the EPFI's satisfaction, the relevant environmental and social risks and impacts of the proposed Project (which may include the illustrative list of issues found in Exhibit II). The Assessment Documentation should propose measures to minimise, mitigate, and offset adverse impacts in a manner relevant and appropriate to the nature and scale of the proposed Project.

The Assessment Documentation will be an adequate, accurate and objective evaluation and presentation of the environmental and social risks and impacts, whether prepared by the client, consultants or external experts. For Category A, and as appropriate, Category B Projects, the Assessment Documentation includes an Environmental and Social Impact Assessment (ESIA). One or more specialised studies may also need to be undertaken. Furthermore, in limited high risk circumstances, it may be appropriate for the client to complement its Assessment Documentation with specific human rights due diligence. For other Projects, a limited or focused environmental or



social assessment (e.g. audit), or straight-forward application of environmental siting, pollution standards, design criteria, or construction standards may be carried out.

For all Projects, in all locations, when combined Scope 1 and Scope 2 Emissions are expected to be more than 100,000 tonnes of CO₂ equivalent annually, an alternatives analysis will be conducted to evaluate less Greenhouse Gas (GHG) intensive alternatives. Refer to Annex A for alternatives analysis requirements.

Principle 3: Applicable Environmental and Social Standards

The Assessment process should, in the first instance, address compliance with relevant host country laws, regulations and permits that pertain to environmental and social issues.

EPFIs operate in diverse markets: some with robust environmental and social governance, legislation systems and institutional capacity designed to protect their people and the natural environment; and some with evolving technical and institutional capacity to manage environmental and social issues.

The EPFI will require that the Assessment process evaluates compliance with the applicable standards as follows:

1. For Projects located in Non-Designated Countries, the Assessment process evaluates compliance with the then applicable IFC Performance Standards on Environmental and Social Sustainability (Performance Standards) and the World Bank Group Environmental, Health and Safety Guidelines (EHS Guidelines) (Exhibit III).
2. For Projects located in Designated Countries, the Assessment process evaluates compliance with relevant host country laws, regulations and permits that pertain to environmental and social issues. Host country laws meet the requirements of environmental and/or social assessments (Principle 2), management systems and plans (Principle 4), Stakeholder Engagement (Principle 5) and, grievance mechanisms (Principle 6).

The Assessment process will establish to the EPFI's satisfaction the Project's overall compliance with, or justified deviation from, the applicable standards. The applicable standards (as described above) represent the minimum standards adopted by the EPFI. The EPFI may, at their sole discretion, apply additional requirements.



Principle 4: Environmental and Social Management System and Equator Principles

Action Plan

For all Category A and Category B Projects, the EPFI will require the client to develop or maintain an Environmental and Social Management System (ESMS).

Further, an Environmental and Social Management Plan (ESMP) will be prepared by the client to address issues raised in the Assessment process and incorporate actions required to comply with the applicable standards. Where the applicable standards are not met to the EPFI's satisfaction, the client and the EPFI will agree an Equator Principles Action Plan (AP). The Equator Principles AP is intended to outline gaps and commitments to meet EPFI requirements in line with the applicable standards.

Principle 5: Stakeholder Engagement

For all Category A and Category B Projects, the EPFI will require the client to demonstrate effective Stakeholder Engagement as an ongoing process in a structured and culturally appropriate manner with Affected Communities and, where relevant, Other Stakeholders. For Projects with potentially significant adverse impacts on Affected Communities, the client will conduct an Informed Consultation and Participation process. The client will tailor its consultation process to: the risks and impacts of the Project; the Project's phase of development; the language preferences of the Affected Communities; their decision-making processes; and the needs of disadvantaged and vulnerable groups. This process should be free from external manipulation, interference, coercion and intimidation.

To facilitate Stakeholder Engagement, the client will, commensurate to the Project's risks and impacts, make the appropriate Assessment Documentation readily available to the Affected Communities, and where relevant Other Stakeholders, in the local language and in a culturally appropriate manner.

The client will take account of, and document, the results of the Stakeholder Engagement process, including any actions agreed resulting from such process. For Projects with environmental or social risks and adverse impacts, disclosure should occur early in the Assessment process, in any event before the Project construction commences, and on an ongoing basis.

EPFIs recognise that indigenous peoples may represent vulnerable segments of project-affected communities. Projects affecting indigenous peoples will be subject to a process of Informed Consultation and Participation, and will need to comply with the rights and protections for indigenous peoples contained in relevant national law, including those laws implementing host country obligations under international law. Consistent with the special circumstances described in



IFC Performance Standard 7 (when relevant as defined in Principle 3), Projects with adverse impacts on indigenous people will require their Free, Prior and Informed Consent (FPIC)³.

Principle 6: Grievance Mechanism

For all Category A and, as appropriate, Category B Projects, the EPFI will require the client, as part of the ESMS, to establish a grievance mechanism designed to receive and facilitate resolution of concerns and grievances about the Project's environmental and social performance.

The grievance mechanism is required to be scaled to the risks and impacts of the Project and have Affected Communities as its primary user. It will seek to resolve concerns promptly, using an understandable and transparent consultative process that is culturally appropriate, readily accessible, at no cost, and without retribution to the party that originated the issue or concern. The mechanism should not impede access to judicial or administrative remedies. The client will inform the Affected Communities about the mechanism in the course of the Stakeholder Engagement process.

Principle 7: Independent Review

Project Finance

For all Category A and, as appropriate, Category B Projects, an Independent Environmental and Social Consultant, not directly associated with the client, will carry out an Independent Review of the Assessment Documentation including the ESMPs, the ESMS, and the Stakeholder Engagement process documentation in order to assist the EPFI's due diligence, and assess Equator Principles compliance.

The Independent Environmental and Social Consultant will also propose or opine on a suitable Equator Principles AP capable of bringing the Project into compliance with the Equator Principles, or indicate when compliance is not possible.

Project-Related Corporate Loans

An Independent Review by an Independent Environmental and Social Consultant is required for Projects with potential high risk impacts including, but not limited to, any of the following:

³ There is no universally accepted definition of FPIC. Based on good faith negotiation between the client and affected indigenous communities, FPIC builds on and expands the process of Informed Consultation and Participation, ensures the meaningful participation of indigenous peoples in decision-making, and focuses on achieving agreement. FPIC does not require unanimity, does not confer veto rights to individuals or sub-groups, and does not require the client to agree to aspects not under their control. Process elements to achieve FPIC are found in IFC Performance Standard 7.



- adverse impacts on indigenous peoples
- Critical Habitat impacts
- significant cultural heritage impacts
- large-scale resettlement

In other Category A, and as appropriate Category B, Project-Related Corporate Loans, the EPFI may determine whether an Independent Review is appropriate or if internal review by the EPFI is sufficient. This may take into account the due diligence performed by a multilateral or bilateral financial institution or an OECD Export Credit Agency, if relevant.

Principle 8: Covenants

An important strength of the Equator Principles is the incorporation of covenants linked to compliance.

For all Projects, the client will covenant in the financing documentation to comply with all relevant host country environmental and social laws, regulations and permits in all material respects.

Furthermore for all Category A and Category B Projects, the client will covenant the financial documentation:

- a) to comply with the ESMPs and Equator Principles AP (where applicable) during the construction and operation of the Project in all material respects; and
- b) to provide periodic reports in a format agreed with the EPFI (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the ESMPs and Equator Principles AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country environmental and social laws, regulations and permits; and
- c) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a client is not in compliance with its environmental and social covenants, the EPFI will work with the client on remedial actions to bring the Project back into compliance to the extent feasible. If the client fails to re-establish compliance within an agreed grace period, the EPFI reserves the right to exercise remedies, as considered appropriate.



Principle 9: Independent Monitoring and Reporting

Project Finance

To assess Project compliance with the Equator Principles and ensure ongoing monitoring and reporting after Financial Close and over the life of the loan, the EPFI will, for all Category A and, as appropriate, Category B Projects, require the appointment of an Independent Environmental and Social Consultant, or require that the client retain qualified and experienced external experts to verify its monitoring information which would be shared with the EPFI.

Project-Related Corporate Loans

For Projects where an Independent Review is required under Principle 7, the EPFI will require the appointment of an Independent Environmental and Social Consultant after Financial Close, or require that the client retain qualified and experienced external experts to verify its monitoring information which would be shared with the EPFI.

Principle 10: Reporting and Transparency

Client Reporting Requirements

The following client reporting requirements are in addition to the disclosure requirements in Principle 5.

For all Category A and, as appropriate, Category B Projects:

- The client will ensure that, at a minimum, a summary of the ESIA is accessible and available online⁴.
- The client will publicly report GHG emission levels (combined Scope 1 and Scope 2 Emissions) during the operational phase for Projects emitting over 100,000 tonnes of CO₂ equivalent annually. Refer to Annex A for detailed requirements on GHG emissions reporting.

EPFI Reporting Requirements

The EPFI will report publicly, at least annually, on transactions that have reached Financial Close and on its Equator Principles implementation processes and experience, taking into account appropriate

⁴ Except in cases where the client does not have internet access.



confidentiality considerations. The EPFI will report according to the minimum reporting requirements detailed in Annex B.

DISCLAIMER

The Equator Principles is a baseline and framework for developing individual, internal environmental and social policies, procedures and practices. The Equator Principles do not create any rights in, or liability to, any person, public or private. Financial institutions adopt and implement the Equator Principles voluntarily and independently, without reliance on or recourse to the IFC, the World Bank Group, the Equator Principles Association, or other EPFIs. In a situation where there would be a clear conflict between applicable laws and regulations and requirements set out in the Equator Principles, the local laws and regulations prevail.



ANNEXES: IMPLEMENTATION REQUIREMENTS

Annex A: Climate Change: Alternatives Analysis, Quantification and Reporting of Greenhouse Gas Emissions

Alternatives Analysis

The alternatives analysis requires the evaluation of technically and financially feasible and cost-effective options available to reduce project-related GHG emissions during the design, construction and operation of the Project.

For Scope 1 Emissions, this analysis will include consideration of alternative fuel or energy sources if applicable. Where an alternatives analysis is required by a regulatory permitting process, the analysis will follow the methodology and time frame required by the relevant process. For Projects in high carbon intensity sectors, the alternatives analysis will include comparisons to other viable technologies, used in the same industry and in the country or region, with the relative energy efficiency of the selected technology.

High carbon intensity sectors include the following, as outlined in the World Bank Group EHS Guidelines: thermal power, cement and lime manufacturing, integrated steel mills, base metal smelting and refining, and foundries.

Following completion of an alternatives analysis, the client will provide, through appropriate documentation, evidence of technically and financially feasible and cost-effective options. This does not modify or reduce the requirements set out in the applicable standards (e.g. IFC Performance Standard 3).

Quantification and Reporting

Quantification of GHG emissions will be conducted by the client in accordance with internationally recognised methodologies and good practice, for example, the GHG Protocol. The client will quantify Scope 1 and Scope 2 Emissions.

The EPFI will require the client to report publicly on an annual basis on GHG emission levels (combined Scope 1 and Scope 2 Emissions) during the operational phase for Projects emitting over 100,000 tonnes of CO₂ equivalent annually. Clients will be encouraged to report publicly on Projects emitting over 25,000 tonnes. Public reporting requirements can be satisfied via regulatory requirements for reporting or environmental impact assessments, or voluntary reporting mechanisms such as the Carbon Disclosure Project where such reporting includes emissions at Project level.

In some circumstances, public disclosure of the full alternatives analysis or project-level emissions may not be appropriate.



Annex B - Minimum Reporting Requirements

The EPFI will report annually and as per the requirements detailed in all of the sections below.

Data and Implementation Reporting

Data and implementation reporting is the responsibility of the EPFI. It will be published on the EPFI's website, in a single location and in an accessible format.

The EPFI will specify the reporting period (i.e. start and end dates) for all data and implementation reporting.

Project Finance Advisory Services Data

The EPFI will report on the total number of Project Finance Advisory Services mandated during the reporting period. The total will be broken down by Sector and Region.

Data for Project Finance Advisory Services will be reported under a separate heading from Project Finance and Project-Related Corporate Loans. Project Finance Advisory Services data may exclude the Category and whether an Independent Review has been carried out because the Project is often at an early stage of development and not all information is available.

Project Finance and Project-Related Corporate Loans Data

The EPFI will report on the total number of Project Finance transactions and total number of Project-Related Corporate Loans that reached Financial Close during the reporting period.

The totals for each product type will be broken down by Category (A, B or C) and then by:

- Sector (i.e. Mining, Infrastructure, Oil and Gas, Power, Others)
- Region (i.e. Americas, Europe Middle East and Africa, Asia Pacific)
- Country Designation (i.e. Designated Country or Non-Designated Country)
- Whether an Independent Review has been carried out

Data for Project Finance transactions and Project-Related Corporate Loans should be shown separately.

Bridge Loans Data

Data for Bridge Loans, due to their nature, are not subject to specific reporting requirements.



Implementation Reporting

The EPFI will report on its implementation of the Equator Principles, including:

- The mandate of the Equator Principles Reviewers (e.g. responsibilities and staffing);
- The respective roles of the Equator Principles Reviewers, business lines, and senior management in the transaction review process;
- The incorporation of the Equator Principles in its credit and risk management policies and procedures.

For the first year of Equator Principles adoption, the EPFI will provide details of its internal preparation and staff training. After the first year, the EPFI may provide details on ongoing training of staff if considered relevant.

Project Name Reporting for Project Finance

The EPFI will submit project name data directly to the Equator Principles Association Secretariat for publication on the Equator Principles Association website.

Project name reporting is:

- applicable only to Project Finance transactions that have reached Financial Close,
- subject to obtaining client consent,
- subject to applicable local laws and regulations, and
- subject to no additional liability for the EPFI as a result of reporting in certain identified jurisdictions.

The EPFI will seek client consent at any time deemed appropriate but no later than Financial Close.

The EPFI will submit the following project name data directly or via a web link:

- Project name (as per the loan agreement and/or as publicly recognised),
- Calendar year in which the transaction reached Financial Close,
- Sector (i.e. Mining, Infrastructure, Oil and Gas, Power, Others),
- Host country name.

Individual EPFIs may want to publish the data as part of their individual reporting, but there is no obligation to do so.



EXHIBITS: SUPPORTING INFORMATION

Exhibit I: Glossary of Terms

Unless specified here, the Equator Principles use definitions as set out in the IFC Performance Standards.

Affected Communities are local communities, within the Project's area of influence, directly affected by the Project.

Assessment (see **Environmental and Social Assessment**).

Assessment Documentation (see **Environmental and Social Assessment Documentation**).

Asset Finance is the provision of a loan for the purchase of assets (such as airplanes, cargo ships, or equipment) in exchange for a security interest in those assets.

Bridge Loan is an interim loan given to a business until the longer term stage of financing can be obtained.

Buyer Credit is a medium/long term Export Finance credit where the exporter's bank or other financial institution lends to the buyer or the buyer's bank.

Critical Habitats are areas with high biodiversity value, including (i) habitat of significant importance to Critically Endangered and/or Endangered species; (ii) habitat of significant importance to endemic and/or restricted-range species; (iii) habitat supporting globally significant concentrations of migratory species and/or congregatory species; (iv) highly threatened and/or unique ecosystems; and/or (v) areas associated with key evolutionary processes.

Designated Countries are those countries deemed to have robust environmental and social governance, legislation systems and institutional capacity designed to protect their people and the natural environment. The list of Designated Countries can be found on the Equator Principles Association website.

Effective Operational Control includes both direct control (as operator or major shareholder) of the Project by the client and indirect control (e.g. where a subsidiary of the client operates the Project).

Environmental and Social Assessment (Assessment) is a process that determines the potential environmental and social risks and impacts (including labour, health, and safety) of a proposed Project in its area of influence.



Environmental and Social Assessment Documentation (Assessment Documentation) is a series of documents prepared for a Project as part of the Assessment process. The extent and detail of the documentation is commensurate with the Project's potential environmental and social risks and impacts. Examples of Assessment Documentation are: an Environmental and Social Impact Assessment (ESIA), Environmental and Social Management Plan (ESMP), or documents more limited in scale (such as an audit, risk assessment, hazard assessment and relevant project-specific environmental permits). Non-technical environmental summaries can also be used to enhance the Assessment Documentation when these are disclosed to the public as part a broader Stakeholder Engagement process.

Environmental and Social Impact Assessment (ESIA) is a comprehensive document of a Project's potential environmental and social risks and impacts. An ESIA is usually prepared for greenfield developments or large expansions with specifically identified physical elements, aspects, and facilities that are likely to generate significant environmental or social impacts. Exhibit II provides an overview of the potential environmental and social issues addressed in the ESIA.

Environmental and Social Management Plan (ESMP) summarises the client's commitments to address and mitigate risks and impacts identified as part of the Assessment, through avoidance, minimisation, and compensation/offset. This may range from a brief description of routine mitigation measures to a series of more comprehensive management plans (e.g. water management plan, waste management plan, resettlement action plan, indigenous peoples plan, emergency preparedness and response plan, decommissioning plan). The level of detail and complexity of the ESMP and the priority of the identified measures and actions will be commensurate with the Project's potential risks and impacts. The ESMP definition and characteristics are broadly similar to those of the "Management Programs" referred to in IFC Performance Standard 1.

Environmental and Social Management System (ESMS) is the overarching environmental, social, health and safety management system which may be applicable at a corporate or Project level. The system is designed to identify, assess and manage risks and impacts in respect to the Project on an ongoing basis. The system consists of manuals and related source documents, including policies, management programs and plans, procedures, requirements, performance indicators, responsibilities, training and periodic audits and inspections with respect to environmental or social issues, including Stakeholder Engagement and grievance mechanisms. It is the overriding framework by which an ESMP and/or Equator Principles AP is implemented. The term may refer to the system for the construction phase or the operational phase of the Project, or to both as the context may require.

Equator Principles Action Plan (AP) is prepared, as a result of the EPFI's due diligence process, to describe and prioritise the actions needed to address any gaps in the Assessment Documentation, ESMPs, the ESMS, or Stakeholder Engagement process documentation to bring the Project in line



with applicable standards as defined in the Equator Principles. The Equator Principles AP is typically tabular in form and lists distinct actions from mitigation measures to follow-up studies or plans that complement the Assessment.

Equator Principles Association is the unincorporated association of member EPFIs whose object is the management, administration and development of the Equator Principles. The Equator Principles Association Secretariat manages the day to day running of the Equator Principles Association including the collation of EPFIs project name reporting data. For more information go to the Equator Principles Association website.

Equator Principles Reviewers are EPFI employees responsible for reviewing the environmental and social aspects of transactions subject to the Equator Principles. They may be part of a distinct Equator Principles team or members of banking, credit risk, corporate sustainability (or similar) departments/divisions tasked with applying the Equator Principles internally.

Export Finance (also known as Export Credits) an insurance, guarantee or financing arrangement which enables a foreign buyer of exported goods and/or services to defer payment over a period of time. Export credits are generally divided into short-term, medium-term (usually two to five years repayment) and long-term (usually over five years).

Financial Close is defined as the date on which all conditions precedent to initial drawing of the debt have been satisfied or waived.

Informed Consultation and Participation is an in-depth exchange of views and information and an organised and iterative consultation that leads the client to incorporate the views of Affected Communities, on issues that affect them directly (such as proposed mitigation measures, the sharing of development benefits and opportunities, and implementation issues), into their decision-making process.

Independent Environmental and Social Consultant is a qualified independent firm or consultant (not directly tied to the client) acceptable to the EPFI.

Independent Review is a review of the Assessment Documentation including the ESMPs, ESMS and Stakeholder Engagement process documentation carried out by an Independent Environmental and Social Consultant.

Known Use of Proceeds is the information provided by the client on how the borrowings will be used.



Mandated Equator Principles Financial Institution or **Mandated Financial Institution** is a financial service provider that is contracted by a client to carry out banking services for a Project or transaction.

Non-Designated Countries are those countries not found on the list of Designated Countries on the Equator Principles Association website.

Operational Control (see **Effective Operational Control**)

Other Stakeholders are those not directly affected by the Project but have an interest in it. They could include national and local authorities, neighbouring Projects, and/or non-governmental organisations.

A **Project** is a development in any sector at an identified location. It includes an expansion or upgrade of an existing operation that results in a material change in output or function. Examples of Projects that trigger the Equator Principles include, but are not limited to; a power plant, mine, oil and gas Projects, chemical plant, infrastructure development, manufacturing plant, large scale real estate development, real estate development in a Sensitive Area, or any other Project that creates significant environmental and/or social risks and impacts. In the case of Export Credit Agency supported transactions, the new commercial, infrastructure or industrial undertaking to which the export is intended will be considered the Project.

Project Finance is a method of financing 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 Project's output, such as the electricity sold by a power plant. The client is usually a 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. For reference go to: "Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards ("Basel II")", November 2005. Reserve-Based Financing in extractive sectors that is non-recourse and where the proceeds are used to develop one particular reserve (e.g. an oil field or a mine) is considered to be a Project Finance transaction covered under the Equator Principles.



Project Finance Advisory Services is the provision of advice on the potential financing of a development where one of the options may be Project Finance.

Project-Related Corporate Loans are corporate loans, made to business entities (either privately, publicly, or state-owned or controlled) related to a single Project, either a new development or expansion (e.g. where there is an expanded footprint), where the Known Use of Proceeds is related to a single Project in one of the following ways:

- a. The lender looks primarily to the revenues generated by the Project as the source of repayment (as in Project Finance) and where security exists in the form of a corporate or parent company guarantee;
- b. Documentation for the loan indicates that the majority of the proceeds of the total loan are directed to the Project. Such documentation may include the term sheet, information memorandum, credit agreement, or other representations provided by the client into its intended use of proceeds for the loan.

It includes loans to government-owned corporations and other legal entities created by a government to undertake commercial activities on behalf of the government, but excludes loans to national, regional or local governments, governmental ministries and agencies.

Scope 1 Emissions are direct GHG emissions from the facilities owned or controlled within the physical Project boundary.

Scope 2 Emissions are indirect GHG emissions associated with the off-site production of energy used by the Project.

Sensitive Area is an area of international, national or regional importance, such as wetlands, forests with high biodiversity value, areas of archaeological or cultural significance, areas of importance for indigenous peoples or other vulnerable groups, National Parks and other protected areas identified by national or international law.

Stakeholder Engagement refers to IFC Performance Standards provisions on external communication, environmental and social information disclosure, participation, informed consultation, and grievance mechanisms. For the Equator Principles, Stakeholder Engagement also refers to the overall requirements described under Principle 5.

Supplier Credit is a medium/long term Export Finance credit that is extended by the exporter to the overseas buyer.



Exhibit II: Illustrative List of Potential Environmental and Social Issues to be Addressed in the Environmental and Social Assessment Documentation

The list below provides an overview of the issues that may be addressed in the Assessment Documentation. Note the list is for illustrative purposes only. The Assessment process of each Project may or may not identify all of the issues listed, or be relevant to every Project.

The Assessment Documentation may include, where applicable, the following:

- a) assessment of the baseline environmental and social conditions
- b) consideration of feasible environmentally and socially preferable alternatives
- c) requirements under host country laws and regulations, applicable international treaties and agreements
- d) protection and conservation of biodiversity (including endangered species and sensitive ecosystems in modified, natural and Critical Habitats) and identification of legally protected areas
- e) sustainable management and use of renewable natural resources (including sustainable resource management through appropriate independent certification systems)
- f) use and management of dangerous substances
- g) major hazards assessment and management
- h) efficient production, delivery and use of energy
- i) pollution prevention and waste minimisation, pollution controls (liquid effluents and air emissions), and solid and chemical waste management
- j) viability of Project operations in view of reasonably foreseeable changing weather patterns/climatic conditions, together with adaptation opportunities
- k) cumulative impacts of existing Projects, the proposed Project, and anticipated future Projects
- l) respect of human rights by acting with due diligence to prevent, mitigate and manage adverse human rights impacts
- m) labour issues (including the four core labour standards), and occupational health and safety
- n) consultation and participation of affected parties in the design, review and implementation of the Project
- o) socio-economic impacts
- p) impacts on Affected Communities, and disadvantaged or vulnerable groups
- q) gender and disproportionate gender impacts
- r) land acquisition and involuntary resettlement
- s) impacts on indigenous peoples, and their unique cultural systems and values
- t) protection of cultural property and heritage
- u) protection of community health, safety and security (including risks, impacts and management of Project's use of security personnel)
- v) fire prevention and life safety



Exhibit III: IFC Performance Standards on Environmental and Social Sustainability and the World Bank Group Environmental, Health and Safety Guidelines

The Equator Principles refer to two separate parts of the IFC Sustainability Framework as “the then applicable standards” under Principle 3.

1. The IFC Performance Standards

As of 1 January 2012, the following Performance Standards are applicable:

- 1 - Assessment and Management of Environmental and Social Risks and Impacts
- 2 - Labor and Working Conditions
- 3 - Resource Efficiency and Pollution Prevention
- 4 - Community Health, Safety and Security
- 5 - Land Acquisition and Involuntary Resettlement
- 6 - Biodiversity Conservation and Sustainable Management of Living Natural Resources
- 7 - Indigenous Peoples
- 8 - Cultural Heritage

Guidance Notes accompany each Performance Standard. EPFIs do not formally adopt the Guidance Notes however EPFIs and clients may find them useful points of reference when seeking further guidance on or interpreting the Performance Standards.

The IFC Performance Standards, Guidance Notes and Industry Specific Guidelines can be found on the IFC website.

2. The World Bank Group Environmental, Health and Safety Guidelines

The World Bank Group EHS Guidelines are technical reference documents containing examples of Good International Industry Practice (GIIP) as described in the IFC Performance Standards. They contain the performance levels and measures that are normally considered acceptable for Projects in Non-Designated Countries, as well as being achievable in new facilities at reasonable costs by existing technology. Two sets of guidelines are used:

The General Environmental, Health and Safety Guidelines

These Guidelines contain information on cross-cutting environmental, health, and safety issues potentially applicable to all industry sectors. They are divided into sections entitled: Environmental; Occupational Health and Safety; Community Health and Safety; Construction; and Decommissioning. They should be used together with the relevant Industry Sector Guideline(s).



The Industry Sector Guidelines

These Guidelines contain information on industry-specific impacts and performance indicators, plus a general description of industry activities. They are grouped as follows:

Agribusiness/Food Production

- Annual Crop Production
- Aquaculture
- Breweries
- Dairy Processing
- Fish Processing
- Food and Beverage Processing
- Mammalian Livestock Production
- Meat Processing
- Plantation Crop Production
- Poultry Processing
- Poultry Production
- Sugar Manufacturing
- Vegetable Oil Processing

Chemicals

- Coal Processing
- Large Volume Inorganic Compounds Manufacturing and Coal Tar Distillation
- Large Volume Petroleum-based Organic Chemicals Manufacturing
- Natural Gas Processing
- Nitrogenous Fertilizer Manufacturing
- Oleochemicals Manufacturing
- Pesticides Formulation, Manufacturing and Packaging
- Petroleum-based Polymers Manufacturing
- Petroleum Refining
- Pharmaceuticals and Biotechnology Manufacturing
- Phosphate Fertilizer Manufacturing

Forestry

- Board and Particle-based Products
- Forest Harvesting Operations
- Pulp and Paper Mills
- Sawmilling and Wood-based Products

General Manufacturing

- Base Metal Smelting and Refining
- Cement and Lime Manufacturing
- Ceramic Tile and Sanitary Ware Manufacturing
- Construction Materials Extraction
- Foundries
- Glass Manufacturing
- Integrated Steel Mills
- Metal, Plastic, Rubber Products Manufacturing
- Printing
- Semiconductors and Electronics Manufacturing
- Tanning and Leather Finishing
- Textiles Manufacturing



Infrastructure

- Airlines
- Airports
- Crude Oil and Petroleum Product Terminals
- Gas Distribution Systems
- Health Care Facilities
- Ports, Harbors and Terminals
- Railways
- Retail Petroleum Networks
- Shipping
- Telecommunications
- Toll Roads
- Tourism and Hospitality Development
- Waste Management Facilities
- Water and Sanitation

Mining

- Mining

Oil and Gas

- Offshore Oil and Gas Development
- Onshore Oil and Gas Development
- Liquefied Natural Gas (LNG) Facilities

Power

- Electric Power Transmission and Distribution
- Geothermal Power Generation
- Thermal Power
- Wind Energy

Vitae

Ian Osellame

Education & Professional

Ontario Bar, 2007

McGill University

Management (BComm, Finance) and Law (BCL/LLB), all with distinction, 1998 – 2006

University of Western Ontario; Western Law

LLM Candidate (2013), Business Law

Thesis: CSR in Canadian Banking - A Case Study on the Equator Principles

Career History

Manulife Bank of Canada, Counsel (Director Level) and Assistant Corporate Secretary
January 2011 – Present, member of Senior Management Group.

Aird & Berlis LLP, Associate

2010 – 2011, litigation and regulatory practice; general retainer from National Bank for continuing financial services regulatory support (Ontario and Western Canada).

National Bank of Canada, Legal Counsel

2009 – 2010, primary in-house lawyer for NBC's retail and corporate banking operations in Ontario and Western Canada.

Osler, Hoskin & Harcourt LLP, Associate, Articling and Summer Student

2005 – 2009, commercial litigation and regulatory (financial and environmental) practice. Articling Student secondment to **Royal Bank of Canada**.