

## IN WHAT WAYS CAN UZBEK BANKS ACCEPT THE PRINCIPLES OF EQUATOR AND BECOME MEMBERS?

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### ABSTRACT

This article talks about the ways in which the banks of Uzbekistan can adopt the Equator principles and become members, as well as important suggestions for adopting the Equator principles.

**Key words.** Equator Principles, EPFI, foreign investors, International Finance Corporation (IFC), Health and Safety Guidelines (EHS Guidelines), BNP Paribas, Credit Suisse, Deutsche Bank, Constitution of Uzbekistan.

### Introduction

The Equator Principles (EP) is a set of voluntary environmental and social risk management guidelines for financial institutions that provide project financing. The principles were initially developed in 2003 by a group of 10 international banks, and have since been adopted by over 138 banks and financial institutions in 38 countries worldwide.

The Equator Principle Financial Institutions (EPFIs) believe in the importance of promoting a sustainable environmental and social performance by identifying, assessing and managing environmental and social risks and impacts.

The **relevance** of this research lies in that by taking into account the development of entrepreneurship and the growing interest of foreign investors in Uzbekistan, it is increasingly important to consider the impact of ongoing projects both on the environment and on the people affected by the business entities and their projects.

The **aim** of the research paper is to examine how the Equator principles can be adopted by the Uzbek bank. To achieve this aim, the following **objectives** are set:

- To identify the main aspects of the Equator principles.
- To indicate the advantages of adopting Equator principles.

- To compare legislative documents and standards regarding environmental and social protection with the principles.
- To describe the process of implementing the Equator Principles in Uzbek banks.

The **scientific novelty** of this research:

Although the Equator principles serve as a benchmark for sustainable financing for almost 20 years, Uzbekistan only recently started its journey towards environment-concerned, social-beneficial, green financing. The Equator Principles have traditionally been used by banks in developed countries, especially in Europe and North America. Thus, the adoption of the EP by banks in Uzbekistan represents a significant expansion in the geographic scope of the principles and may indicate a growing awareness of environmental and social issues among financial institutions in Central Asia and will help in promoting sustainable and responsible business practices. The Equator Principles were first established in 2003, after a group of 10 international banks, led by the International Finance Corporation (IFC), came together to develop a set of voluntary guidelines for managing environmental and social risks associated with project financing. The banks were responding to growing concerns among investors, civil society, and other stakeholders about the negative impacts of large-scale projects, such as oil and gas pipelines, dams, and mining operations, on local communities and the environment.

The Equator principles comply with the IFC Performance Standards on Environmental and Social Sustainability and the World Bank Group Environmental, Health and Safety Guidelines (EHS Guidelines), and are formed by 10 principles<sup>[1]</sup>:

- I. Review and Categorisation (categorizing the projects based on the possible impact on Environment and Society into A, B, C);
- II. Environmental and Social Assessment (the client is required to evaluate E&S risks);
- III. Applicable Environmental and Social Standards (compliance with host country standards, and/or IFC and World Bank guidelines);
- IV. Environmental and Social Management System and Equator Principles Action Plan (the development of suitable documents and policies corresponding to EP);
- V. Stakeholder Engagement (including impact on indigenous people);
- VI. Grievance Mechanism (processing of stakeholders' concerns on E&S impact);
- VII. Independent Review (where reasons for deviations from EP and actions to avoid them are indicated);

VIII. Covenants (agreement to comply with relevant requirements implied with membership);

IX. Independent Monitoring and Reporting (need for an Independent environmental and social consultant provided by the bank to monitor and report on the projects accepted);

X. Reporting and Transparency (reporting on E&S Impact Assessment, GHG emission level and project specific Biodiversity data).

The EP requires member banks to assess and manage the environmental and social risks associated with projects they finance, including potential impacts on biodiversity, climate change, human rights, labor standards, and community health and safety. Banks must also engage with their clients to ensure that projects comply with local regulations and international standards.

The scope of the Equator principles lies in offering the following financial products<sup>22</sup>:

- Project Finance Advisory Services where total Project capital costs are US\$10 million or more.
- Project Finance with total Project capital costs of US\$10 million or more.
- Project-Related Corporate Loans where all of the following three criteria are met:
  - i. The majority of the loan is related to a Project over which the client has Effective Operational Control (either direct or indirect).
  - ii. The total aggregate loan amount and the EPFI's individual commitment (before syndication or sell-down) are each at least US\$50 million.
  - iii. The loan tenor is at least two years.
- 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 in 2 and 3 above.
- Project-Related Refinance and Project-Related Acquisition Finance, where all of the following three criteria are met:
  - i. The underlying Project was financed under the Equator Principles framework.
  - ii. There has been no material change in the scale or scope of the Project.
  - iii. Project Completion has not yet occurred at the time of the signing of the facility or loan agreement.

In Europe, many banks have become members of the Equator Principles Association and have implemented the principles in their lending practices. These

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<sup>22</sup> Scope of the Equator principles - <https://equator-principles.com/about-the-equator-principles/>

banks include major European financial institutions such as BNP Paribas, Credit Suisse, Deutsche Bank, HSBC, and Société Générale.

### **European Experience**

European banks have used their experiences with the EP to improve their risk management practices and enhance their sustainability credentials. Many banks have developed specialized teams to assess and monitor the environmental and social risks of projects they finance, and have incorporated these assessments into their lending decisions. [1]

Moreover, European banks have increasingly recognized the importance of sustainability in their lending practices, and have developed innovative financial instruments to support sustainable projects. For example, some banks have created green bonds or sustainability-linked loans, which offer reduced interest rates or other financial benefits to clients that meet certain sustainability criteria.

In summary, European banks that are members of the Equator Principles Association have played a leading role in promoting sustainable finance and improving the environmental and social outcomes of the projects they finance. The EP has helped these banks to manage risks, engage with their clients, and demonstrate their commitment to sustainability.

### **Benefits experienced by European banks members**

As examples of successful implementation of EP, we can consider the experience of two flourishing European banks - HSBC, one of the world's largest banks headquartered in the UK, which adopted these principles in 2004 and Société Générale (SocGen) - a French multinational financial institution that provides a wide range of financial services to clients in over 60 countries and adopted EP in 2007. [2]

First, EP help significantly to increase the reputation of the banks. The adoption of the Equator Principles has enabled HSBC and SocGen to establish themselves as responsible financial institutions that take environmental and social risks seriously. The principles require banks to assess and manage the social and environmental risks of project financing, which are often significant. EPs are recognized as the global standard for responsible banking, and the adoption of these principles has helped SocGen improve its image with stakeholders, including customers, investors and regulators. By adopting these principles, the banks have demonstrated their commitment to sustainable finance and have distinguished themselves from competitors that do not follow the same standards.

Second, compliance with the Equator Principles has allowed HSBC and SocGen to reach a wider pool of investors who are increasingly concerned about environmental

and social risks. Many institutional investors, such as pension funds and sovereign wealth funds, have their own social and environmental policies that require them to invest only in companies that meet certain standards. By adhering to the Equator Principles, the banks were able to attract these investors and gain access to a larger pool of capital and new business opportunities.

Third, the Equator Principles have helped the banks avoid reputational risks associated with controversial projects. The principles require banks to assess the social and environmental risks of the projects they finance and take appropriate measures to mitigate those risks. By following these guidelines, HSBC was able to avoid funding projects that could harm the environment or local communities, which could lead to negative publicity and reputational damage, legal liability and financial loss.

Fourth, adherence to the Equator Principles has helped the banks better manage the risks associated with project finance. The principles require banks to conduct due diligence on the projects they finance, assess potential social and environmental risks, and develop strategies to mitigate those risks. By following these recommendations, HSBC and SocGen were able to identify potential risks at an early stage and take appropriate action to manage them, reducing the likelihood of costly lawsuits or project failure. [3]

Overall, the adoption of the Equator Principles has benefited HSBC for several reasons. This allowed the bank to establish itself as a responsible financial institution, gain access to a wider range of investors, avoid reputational risks and better manage the risks associated with project finance. By committing to managing the environmental and social risks associated with its project finance activities, HSBC and Société Générale have strengthened their reputation, reduced risk, accessed new business opportunities, improved stakeholder engagement and improved their risk management practices. These benefits have helped the banks build a more sustainable business and contribute to achieving the United Nations Sustainable Development Goals.

Equator principles have been adopted by over 100 banks and financial institutions worldwide. Uzbekistan is a dynamically developing country with a growing economy. In recent years, the country has made significant progress in attracting foreign investment, especially in the energy and infrastructure sectors. Uzbekistan joined the UN Paris Climate Agreement in April 2017, the UN Framework convention on climate

change in 1992, the Vienna Convention on the protection of the Ozone layer in 1993 and other important international agreements<sup>23</sup>. [4]

However, there are still significant environmental and social risks associated with financing projects in Uzbekistan. Uzbekistan has enacted several laws associated with ecological and environmental issues. In this comparison, we will examine the relevant Uzbek laws and compare them to the requirements of the EP.

The **Constitution of Uzbekistan** includes provisions in concern with environmental protection, stating that the state guarantees the protection of natural resources and the environment for present and future generations.

According to Article 30 of the Constitution of the Republic of Uzbekistan: “All state bodies, public associations and officials of the Republic of Uzbekistan are obliged to provide citizens with the opportunity to familiarize themselves with documents, decisions and other materials affecting their rights and interests.”, which is similar to Principle 5 on Stakeholder engagement regarding disclosure Assessment documents on environmental or social risks and adverse impacts that may influence Affected communities, workers and other stakeholders. [5]

Additionally, Uzbekistan has several laws and regulations in place that address environmental and ecological issues, including:

**Law on Environmental Protection:** This law establishes the legal and regulatory framework for environmental protection in Uzbekistan. It sets out the basic principles of environmental protection, including the prevention of environmental pollution and damage, and the restoration of degraded environments. The law also establishes the responsibilities of government bodies, organizations, and individuals for environmental protection. [6]

According to chapter VI of the law on “Environmental protection”, implementation of a project with no positive conclusion of the State ecological expertise conducted is prohibited. This law corresponds with Principle 3 on Applicable Environmental and Social standards regarding compliance with the host country legislation, particularly the separate law on “Ecological expertise” meets to some extent Principle 2 of the EP on Environmental and Social Assessment.

**Law on Biodiversity:** This law sets out the legal framework for the protection, conservation, and sustainable use of biodiversity in Uzbekistan. It establishes the principles of conservation and sustainable use of biological diversity and sets out the

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<sup>23</sup> International agreement signed by Uzbekistan: [https://by.odt-office.eu/razvicio-patencyjalu-arhanizacyj\\_/innovative-uzbekistan/mezhdunarodnye-soglasheniya-po-ekologii-i-okruzhayushchey-srede-podpisannye-uzbekistanom-spisok-i#](https://by.odt-office.eu/razvicio-patencyjalu-arhanizacyj_/innovative-uzbekistan/mezhdunarodnye-soglasheniya-po-ekologii-i-okruzhayushchey-srede-podpisannye-uzbekistanom-spisok-i#)

responsibilities of government bodies, organizations, and individuals for biodiversity protection.

**Law on Waste:** This law regulates the management of waste and sets out the requirements for the collection, transport, treatment, and disposal of waste in Uzbekistan. It also establishes the responsibilities of government bodies, organizations, and individuals for waste management.

**Law on Water and water usage** regulates legal, economic and social relations related to the use, protection and management of water resources in Uzbekistan. It establishes the rights and obligations of water users, determines the procedure for issuing permits for water use, establishes water quality standards, and determines measures for the protection and conservation of water resources. [7]

Enterprises, organizations and institutions whose activities affect the state of waters and water bodies are obliged to carry out technological, forest reclamation, agrotechnical, hydrotechnical, sanitary and technical measures agreed with the authorities for ecology and environmental protection, water management, sanitary supervision and other interested authorities.

**The Law “On Protection of Atmospheric Air”** and Article 861 of the **Criminal code of Uzbekistan** mention the need for enterprises, institutions and organizations to regulate the use of ozone-depleting substances, equipment and technical devices containing ozone-depleting substances, as well as to keep records of ozone-depleting substances, considering their replacement with ozone-friendly substances. This article is similar to the requests of the Equator principles in Annex A on Climate change, where Alternative analysis, Quantification and Reporting of Greenhouse Gas Emissions are required. [8]

When we compare the relevant Uzbek laws to the requirements of the EP, we can see some similarities and differences. Uzbekistan has enacted several laws and regulations related to environmental and ecological protection, including the Law on Environmental Protection, the Law on Biodiversity, and the Law on Waste. While these laws address some of the issues covered by the Equator Principles, such as pollution prevention and biodiversity conservation and waste management, they are more general in nature and do not specifically address the requirements of the EP, such as the need for impact assessment and stakeholder engagement. Moreover, the Uzbek laws do not include specific provisions associated with climate change, human rights, and labor standards, which are also addressed in the EP. Therefore, Uzbekistan may need to further align its laws and regulations with the EP to promote sustainable finance and environmental protection. [9, 10]

According to the Equator principle Association Governance Rules Section 5 on the “Adoption of the principles” any financial institution is free to implement EP, as long as it meets the adoption requirements and promises to fulfil the ongoing reporting requirements. [11, 12] To become EPFIs, Uzbek banks must first understand the principles and their requirements. The structure of the EP is publicly available on the EPA website and Uzbek banks can approach other EP members for guidance and support. Uzbek banks must also develop an internal policy that follows the EP framework and establishes procedures for identifying, managing and monitoring environmental and social risks in their lending and investment activities. [9]

Secondly, an executive member of the board of directors or the company secretary of an Uzbek bank implying to become an EPFI should sign that it is active in providing applicable financial products according to the EP4 and is going to comply with the principles from the date of adoption, and afterwards carry out an Adoption agreement. After an examination of the compliance with the adoption requirements, the EPA Secretariat will appoint the executive for conducting the Agreement on behalf of the organization. Subsequently, the bank will be required on a negotiated date to issue a press release on adopting the Principles, the Uzbek bank will be granted the use of the EP logo, and appropriate updates will be made on the EPA’s website, confirming the membership of the new EPFI.

The ongoing reporting requirements involve the need for at least annual reporting by the bank on the implementation of the Principles<sup>24</sup> when conducting Project-finance, which involves appropriate classification of project-related financial products by category (A, B, C), region of transactions, industry sectors, as well as the disclosure of project names on the website of the bank and of the EPA; and the prompt payment of the Annual Membership Fee (£5,300 in 2023), which is to cover costs incurred in the management, administration and development of the EP. [13, 14, 15]

Uzbekistan has the potential to become a leader in environmental and social risk management in the region by adopting the Equator Principles and promoting sustainable development.

There are several reasons why Uzbek banks should adopt the Equator Principles. Firstly, the adoption of the principles would promote sustainable development in Uzbekistan. Uzbekistan is a rapidly developing country with a growing economy, and there is a need for investment in infrastructure projects that support this growth. However, these projects can also have significant environmental and social impacts,

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<sup>24</sup> In compliance with Principle 10 on Reporting and transparency, and Annex B on Minimum Reporting Requirements



such as the displacement of local communities, loss of biodiversity, and pollution of natural resources. The Equator Principles provide a framework for financial institutions to assess and manage these risks, ensuring that projects are developed in a sustainable and responsible manner. [16,17]

Secondly, adopting the Equator Principles would help Uzbekistan to protect the environment and human rights. The Equator Principles require financial institutions to conduct environmental and social assessments for all projects that they finance and to mitigate any adverse impacts. This would ensure that projects are developed in a manner that respects the environment and the rights of local communities. In Uzbekistan, there have been several instances where infrastructure projects have had significant environmental and social impacts, such as the construction of the Rogun Dam in Tajikistan, which has the potential to impact the AmuDarya river and the livelihoods of local communities in Uzbekistan.

Thirdly, adopting the Equator Principles would help Uzbekistan to attract investment from international financial institutions. Many international financial institutions, such as the International Finance Corporation (IFC) and the World Bank, require compliance with the Equator Principles for projects that they finance. By adopting the principles, Uzbekistan would be able to access funding from these institutions and other responsible investors who are looking to invest in sustainable and responsible projects. [18]

Finally, adopting the Equator Principles would help Uzbekistan to promote social equity and inclusivity. The Equator Principles require financial institutions to engage with local communities and to consider their views and concerns in project development. This would ensure that projects are developed in a manner that is inclusive and respects the rights of all stakeholders, including women and marginalized groups. This is particularly important in Uzbekistan, where there are issues of gender inequality and discrimination against certain groups.

## **CONCLUSION**

To point out the results obtained on each objective set to reach the aim of this research:

- To meet the objective of identifying the main ideas of the Equator principles we thoroughly examined the most recent edition EP4, published on the official website of the Equator Principles Association in July 2020. We obtained information on the purpose and financial products on which the Equator principles are applicable, as well as the requirements involved in each principle.

- To indicate the benefits of adopting the EP we turned to related working papers available on the Internet and to Press Releases and reports on the websites of member banks.

- We analyzed the Laws related to environmental and social protection accepted in Uzbekistan and indicated their similarities to the ideas of the Principles. As we have seen although Uzbekistan has established significant regulative acts associated with mitigating the impact on the environment and society, they are mainly indistinct and general and do not specify the procedures for assessing the impact made.

- By returning to the official website of the EPA we studied the adoption process of the Equator principles, including the requirements, and costs and indicated the actions that should be undertaken for the implementation of EP in Uzbek banks.

Concluding everything that was mentioned above, Uzbekistan should adopt the Equator Principles to promote sustainable development, protect the environment and human rights, attract investment, and promote social equity and inclusivity. The adoption of the principles would require the establishment of a national framework for environmental and social risk management, the adoption of the principles as part of financial institutions' risk management practices, and the engagement with international stakeholders to promote their adoption. By taking these steps, Uzbekistan can become a leader in environmental and social risk management in the region while also attracting investment and promoting sustainable development.

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