



## **Banks & dams – beyond the Equator Principles**

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**Abstract:** Commercial banks have come under heavy criticism for their investments in controversial dam projects. While a number of banks have signed up publicly to general investment policies such as the Equator Principles, none of them have published any specific guidance on dams. A number of banks have internal criteria applicable to dam investments but these are kept confidential. Decision-making on dams in this sector is thus generally non-transparent and a number of recent investment decisions appear to go against published environmental or sustainable development policies. The case of the Ermenek dam in Turkey shows that project appraisals are often superficial and based on inadequate environmental impact assessments. As major dam financiers, commercial banks could play an important role in promoting the WCD's recommendations. To do this, they need to go beyond the Equator Principles and develop their own investment guidelines for dams based on the WCD. A potential tool that could assist project appraisal is certification.

### **Introduction**

Over recent years, private sector finance for infrastructure projects, both in the developed and developing world, has increased in importance. This has exposed financial institutions to increasing pressure from NGOs for their involvement in a variety of controversial projects, including large dams. NGOs have called for greater transparency, accountability and tighter standards in the operations of commercial banks (Collevicchio Declaration, 2003). One welcome but inadequate response has been the Equator Principles, which as demonstrated by the NGO analysis of the initiative, have severe shortcomings. WWF and other NGOs have in January 2004 released paper laying out their vision of the way banks should implement the Equator Principles which refers to WCD compliant policies (No U Turn, 2004). The Equator Principles are even weaker on the dams issue than the World Bank and IFC on whose policies the EPs are based. For large complex projects like large dams, there is a need for sector specific investment guidelines which should be developed with stakeholder input.

The World Commission on Dams (WCD) proposed a set of strategic priorities and related principles and guidelines for decision-making, including public acceptance and comprehensive options assessment. Not all of them are applicable to banks but

they can serve as a basis for investment guidelines and standards to be met by banks' clients. The WCD recommendations have been widely welcomed and there would be clear reputational benefits in applying them. A WCD compliant project should also offer financial benefits as the WCD recommendations aim towards the delivery of well-planned, smoothly-managed and successfully completed projects, thus effectively reducing financial risk. Furthermore, it would mean that the projects have gained public acceptance, so that construction delays (and rising costs due to them) because of public opposition are less likely.

WWF has an active engagement with the financial sector on a variety of issues including dams, forestry, climate change and mining investments. We work in coalition with other NGOs to leverage change in this sector through sustainability solutions. In this paper we look at the role of commercial banks in the financing of large dam projects and argue the need for sectoral investment guidelines. The case of the Ermenek dam in Turkey is used to illustrate how current decision-making procedures by banks fall well short of the WCD standard. We also look at the example of forestry where certification is used as a tool to appraise investments.

### ***Financing arrangements for large dams***

Financing arrangements for large dam projects are often complex, involving government and utility finance, international development banks, export credit agencies and commercial banks. Most funds are provided by the public sector, but private sector finance for dams has been growing steadily and is now estimated at between \$0.5 to 1.1 billion (WWF, 2003). A recent project for WWF which investigated 23 major dam projects in the developing world found that most large banks from the developed world (Europe, US, Australia, Japan) have had some involvement in financing one or more large dams in recent years (AidEnvironment, 2003).

Commercial banks are particularly important in financing so-called Build-Operate-Transfer (BOT) projects, such as the Ermenek dam (discussed below). However, they are also involved in large government-funded schemes such as the Three Gorges Dam. In this case, foreign bank loans account for around 5% of the project costs, amounting to a total of \$1.2 billion. Foreign banks have also acted as lead managers for various bond issues for the project. 9 out of 10 of the world's largest banks, including big high street banks such as Citigroup, UBS, Deutsche Bank and HSBC, have been involved in Three Gorges at some stage and have received substantial NGO criticism for their involvement. Conversations with some of these banks indicate that this experience has made them much more careful about investments in large dam projects and some, like HSBC, have not made any further dam investments since.

Obviously, in complex financing arrangements like those for the Three Gorges Dam, the influence of each individual bank is relatively minor. However, in projects like the Ermenek dam (see below), where a few banks are the main financiers, they could put pressure on project developers to comply with certain standards. As the preamble of the Equator Principles recognises, their role as financiers 'affords them [SIC] significant opportunities to promote responsible environmental stewardship and socially responsible development'. WWF calls on banks to use these opportunities

and promote more sustainable energy and water projects. This does not appear to be happening at the moment.

### ***Dam investment policies and practice***

The WWF study analysed the policies and principles related to dam investments of 10 major European banks, as well as one US and one Japanese bank. The analysis was carried out in early 2003, before the adoption of the Equator Principles. Most banks in the sample refer to World Bank policies as their guide for project or loan appraisal. However, World Bank policies themselves have their shortcomings, as the recent Extractive Industries Review has shown (World Bank, 2004). Furthermore, while for World Bank decisions there is an inspection panel as a last resort, in the case of commercial banks these policies are entirely voluntary and are applied in a non-transparent manner under the guise of commercial confidentiality. Public accountability is thus a major issue and many NGOs have resorted to raising issues at shareholder meetings, as the only available forum for company accountability.

A number of banks in the sample also claim to have internal guidelines specifically for dam investments but these are generally confidential, hence it is not possible to assess their effectiveness. However, as the case of the Ermenek dam demonstrates, funding continues to be approved for projects that fail to meet basic standards for impact assessments, let alone WCD requirements such as options assessments. Such internal guidelines are thus not stringent enough. In WWF's view, such guidelines need to be made public and subject to external verification.

### ***Case study: Ermenek hydropower project, Turkey***

The Ermenek dam and hydropower project is one of seven hydropower plants, dams, and diversions planned or constructed in the Göksu River basin in southeastern Turkey. The Göksu River is one of the last free flowing rivers in Turkey and an important site for both migratory birds and plant diversity. A large portion of its delta is protected under national laws and by international listing as a Ramsar site. The Ermenek project has been approved and is currently under construction, with financing from a consortium of private European banks. The financing group includes ABN AMRO, Bayerische Landesbank, Kreditanstalt für Wiederaufbau and Société Générale as joint lead arrangers, Bayerische Landesbank as agent of the banks, Bank Austria Creditanstalt Group as Co-Arranger and OeKB as facility agent.

In WWF's view, the project assessment and approval process has had numerous short-comings and the project falls well short of the recommendations of the WCD. The project does not comply with the WCD strategic priorities, let alone the guidelines:

- Master plans for the Göksu basin were completed many years ago, prior to general recognition of the extensive environmental values of the region.
- The Environmental Impact Assessment (EIA) for the Ermenek dam was completed in 1999, long after the feasibility study (completed in 1990), rather than in the early planning stages. Hence findings of the EIA, such as measures to mitigate significant adverse impacts, could not be incorporated into the project design. There is also no compliance plan for the limited mitigation measures adopted.

- The EIA fails to take a basin-wide approach, thereby not taking into account cumulative impacts of the various Göksu basin projects.
- Ecological surveys were insufficient for such a large project, and little consideration was given to the suitability, security, and future management arrangements of alternative habits for important flora and fauna.
- No comprehensive needs and options assessment was carried out. Other more decentralised alternatives and renewable resources, which can also lower transmission losses (up to 30% in Turkey) and which can minimise impact to the Göksu basin ecosystem, were not considered.
- The economic analysis failed to take into account various aspects such as cost of new transmission lines, losses to fisheries and other resources associated with diminished flood regimes, loss of cultural heritage values, and future decommissioning costs.
- There has been a lack of public participation, hence poor understanding by potentially affected stakeholders.

When WWF raised these concerns with one of the major banks involved, its view was that the environmental impacts were minor and were outweighed by benefits in terms of poverty reduction. However, this decision was clearly taken on the basis of very limited information, apparently based on a cursory look at the EIA.

In WWF's view, banks need to become much more vigorous in their assessment of project proposals and look for compliance with the WCD. Clearly, banks submit the financial performance of projects to very detailed scrutiny. Similarly, vigorous checks need to be made as far as the environmental and social performance of projects is concerned. This will require better staff training and more staff capacity on sustainability issues, in particular for sensitive sectors such as water infrastructure (i.e. dams), energy, forestry and mining.

### ***Certification as a way forward?***

WWF and Friends of the Earth have jointly drafted best practice guidelines for banks on forestry investments (such as plantations, pulp and paper mills, logging). ABN AMRO has committed publicly to a forestry policy with input from these two NGOs. In terms of forestry management, the NGO policy promotes certification by the Forestry Stewardship Council (FSC) – an international, independent certification system for sustainable timber. Clearly, the existence of FSC simplifies matters for investors as they do not have to judge the performance of the project themselves but can rely on the independent certification system. This opens the question whether a certification system for dams and/or hydropower plants might be a way forward.

Such certification systems are expensive and time-consuming to set up, so this approach would need to be given careful thought. Clearly, such a system would have to be independent and while the sustainability guidelines recently produced by the International Hydropower Association are to be welcomed, an industry-only scheme with no external involvement would not be acceptable or credible. The Low Impact Hydropower Institute certification in the US (<http://www.lowimpacthydro.org>) and the Naturemade green electricity label in Switzerland ([www.naturemade.ch](http://www.naturemade.ch)) are national level certification systems (with board membership including a variety of stakeholders), which could provide a model for an international approach.

## **Conclusions**

Commercial banks have come under increasing criticism for their involvement in controversial dam projects. Currently, procedures for project appraisal are non-transparent and financing decisions appear often at odds with publicly stated environmental or sustainable development policies. The strategic priorities, policy principles and guidelines of the WCD report provide an important benchmark that must be used by financial institutions to appraise dam projects. They cover key issues such as the assessment of options and needs, demonstrable public acceptance and ensuring compliance.

WWF calls on banks to adopt transparent investment guidelines based on the WCD recommendations to ensure that investment decisions are made responsibly. With such guidelines they will also signal to project developers the need to adopt best practice standards based on the WCD. An independent certification system for WCD compliance may be a way forward but the costs and benefits of such a system need to be explored further.

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