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Open finance – a new way to deliver financial services

As fintechs and the products and solutions they offer grow exponentially, financial regulators and the frameworks they develop to govern their markets need to adapt accordingly. On the back of the implementation of the EU Payment Services Directive 2015/2366 (PSD2) and open banking, the UK's Financial Conduct Authority (FCA) is now calling for input across the financial services industry to consider the development and implementation of open finance. The FCA's consultation, which commenced in December 2019, closed on 17 March 2020.

This article will explore what is proposed as open finance in comparison to open banking, as well as the lessons that can be learnt from the development of open banking in the UK over the past two to three years.

Open finance is an extension of open banking data-sharing principles to enable third-party providers to access customer data (held by a broad range of financial service providers via their products and services), in a safe and ethical environment, with informed consumer consent.

Unlike existing open banking principles which only apply to "payment accounts", open finance is expected to impact several financial services sectors across a range of everyday products such as savings, mortgages, pension funds, investments, insurance policies and numerous others.

What open finance could mean for customers

The FCA's vision will see customers, including consumers and businesses alike, benefit from sharing their data (which they own and control) with third-party providers by gaining access to new and innovative financial services products. Such products could assist customers to manage their finances efficiently, enabling them to automatically switch between products and services including insurance policies, mortgages and pensions to get a better deal, as well as viewing balances or paying contributions towards such products. It will also assist customers to receive more tailored advice from their financial services providers (FSPs).

It is not hard for consumers to see the appeal of giving third-party providers digital access to their account data to also avoid admin-heavy paper collection exercises when applying for new products such as mortgages and loans.

Similarly, we expect consumers especially to be attracted to the convenience of viewing and managing their financial products holistically as open finance paves the way for the development of one-stop real-time financial management dashboards (rather than the existing open banking dashboards which are currently limited to payment account information).

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What open finance could mean for FSPs

Open finance will undoubtedly impact a number of financial services sectors as more fintechs look to enter these markets as third-party providers to obtain access to customer data. This will probably feel like déjà vu for payment service providers (PSPs) which have been involved in the implementation of open banking that has been both costly and time consuming. However, there are rewards to be reaped from the new open finance concept if the industry works collaboratively to shape its future. Such benefits could include:

- Mortgage lenders obtaining direct access to customers' data being able to generate more accurate creditworthiness assessment reports, and by extension, benefiting from greater certainty over borrowers' credit risk profiles;
- Debt managers having a more accurate financial understanding of their clients' financial circumstances as a result of direct visibility on borrowers' accounts and finances, and by extension, being able to offer more tailored debt advice to customers; and
- Brokers and other intermediaries gaining direct access to consumers' account information to pre-populate product application forms, and by extension, being able to offer consumers quicker processing times for switching products such as bank accounts and insurance policies.

The lessons to be learnt from open banking

The FCA is particularly keen to use the concept of open banking as a springboard for the development of open finance. Indeed, the UK has led the way internationally in creating a secure environment to enable customers to consent to third-party providers accessing their payment account information or making payments on their behalf. That is not to say, however, that some important lessons cannot be learnt from open banking as the concept continues to evolve. Some examples are outlined below.

Regulatory regimes

The nine largest banks in the UK, which were required by the Competition and Markets Authority (CMA) to implement open banking (the CMA9), have found themselves required to comply with two separate pieces of legislation: the CMA's Retail Banking Market Investigation Order (CMA Order) and PSD2. This may result in a two-tier system within the open banking market with differing and more stringent functionality requirements for the CMA9 banks. As an aside, CMA9 members have also found themselves struggling to interpret the two pieces of legislation to ensure that their operational processes satisfy both regimes. Therefore, it will be key to have a consistent set of rules/principles which apply to all market participants engaging in open finance.

Financing the new regime

The Open Banking Implementation Entity (OBIE), which was established by the CMA to deliver open banking in the UK, is currently funded by members of the CMA9, and the implementation costs have been much greater than originally envisaged. If the FCA plans to establish a similar body to implement open finance, it will be crucial that the FCA and any other relevant bodies agree an adequate and sustainable funding structure.

Application programming interfaces

The FCA has suggested that open finance data must be digital and sufficiently standardised, and there is a suggestion that PSPs and third-party providers could make use of the existing application programming interfaces (APIs) created for open banking. While this may be welcomed by many institutions which already have an API infrastructure in place, there will no doubt be additional technical changes required to achieve the objectives of open finance. It is also important to consider that APIs were not mandated under PSD2, but were under the CMA Order, and consideration will need to be given to whether a specific access solution can be mandated across all financial services markets which will be part of open finance.

Identification of third-party providers

Third-party providers intending to offer open banking services are required to be authorised and registered as an account information services provider (AISP) or a payment initiation services provider (PISP) with the FCA or use passporting or equivalent permissions if authorised outside of the UK. There is also a requirement for third-party providers to identify themselves to the financial institutions whose products and accounts are to be accessed (or the account servicing PSPs as they are defined under PSD2) with an electronic Identification, Authentication and Trust Services (eIDAS) certificate. It would seem important to have a similar regime to ensure both customers and financial institutions are only sharing data with identifiable and appropriately authorised institutions. However, clear rules on authorisation and identification will need to be defined, given there continues to be a lack of certainty in the open banking industry in relation to direct acceptance of eIDAS and the ability to complete additional checks on authorisation.

Lack of consultation and challenging timescales

PSPs have been frustrated with the lack of a consultation process during the implementation of open banking, particularly the extension of the OBIE roadmap to mandate certain functionality which was previously classified as optional. Therefore, it will be key to ensure a timely consultation process for any proposed roles where all market participants have adequate time to provide their feedback.

Other potential challenges for open finance

Regulatory regime

The current open banking authorisation regime only applies to specific services in the payment accounts market. Whether a third-party provider providing services

in, for example, the consumer credit market, needs to be regulated will depend on its activity. It will, therefore, be key for the government to decide how third-party providers offering open finance services should be regulated (ie perhaps they can make use of the existing account information service (AIS) and payment initiation service (PIS) authorisation regime under the Payment Services Regulations, with the open finance mandate also bringing in new authorisation hurdles).

Operational resilience

Providing access to third parties will likely require significant IT infrastructure changes regardless of whether the FCA mandates the use of existing open banking APIs for relevant financial institutions. This will be a significant challenge for certain providers, given the resource already dedicated to implementing OBIE's new open banking roadmap and the already increased scrutiny in relation to IT failures and cyberattacks.

Competition

There is a risk that certain financial institutions, which do not have the resources to implement open finance (and don't already have any existing API infrastructure as mentioned above), could be excluded from the market (reducing consumer choice).

Data security

The parameters of GDPR and how this could impact the concept of open finance will also need to be considered in detail to determine how open finance will be operable in light of strict data protection principles as well as increasing cyber threats.

Poor consumer choice

While the development of products such as automatic switching could benefit a large proportion of customers, there is a risk that these concepts could lead to consumers becoming less engaged due to reluctance or fatigue associated with digital customer interfaces, and over time less aware of the suitability of open finance products (eg automatically accepting switching recommendations).

Increased risk of fraud

Reducing the friction associated with current financial management services (including pension consolidation and investment transfers) could result in consumers not adequately assessing who they are sharing their data with. This is against a backdrop of greater recognition of consumer vulnerability and additional obligations now being placed on providers concerning this.

Conclusion

It is clear that when implemented, open finance will have a significant impact on how customers sign up to, and use, financial services and products. Its impact on the providers of such services and products is likely to be even more dramatic. Undoubtedly, it will be a different list of participants in these markets to the current providers once this has occurred.

When the consultation closes and the FCA has had time to digest the responses from participants in the affected sectors (including the CMA9), it will be important that appropriate consideration is given to the responses of all sectors and types of participants. This should not occur in isolation if it is proposed to make financial services truly open and accessible to the customers whose data underpin it.

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Passporting to Pimlico: cross-border trade in financial services after Brexit

In the 1949 classic Ealing comedy, "Passport to Pimlico", the people of Pimlico decide to secede from the UK. The exit negotiations between the Pimlicans and the British government quickly turn sour, and the fragile economic and regulatory structures that underpin cross-border trade begin to break down. Electricity and water supplies into Pimlico are cut off, while London underground trains passing through Pimlico are subjected to onerous customs checks and immigration controls. Set against a hostile and economically dominant negotiating partner, the Pimlicans are quickly brought to the brink of destitution and ultimately decide to remain within the UK.

For many, "Passport to Pimlico" offers a cautionary tale for post-Brexit Britain's financial services sector. One of the first major pieces of research published in the wake of the referendum in 2016 by Oliver Wyman and TheCityUK estimated that leaving the EU without securing access to the Single Market would cost the UK 75,000 jobs and £38 billion in revenues in the financial and related professional services sector. Now, however, with many firms' contingency plans

already in place, it seems that the City of London will fare far better than the Republic of Pimlico.

While many UK-based firms have certainly set up offices in the EU27, we have not seen the large-scale relocation of people and infrastructure that the "nightmare" scenarios envisaged. Recent figures obtained from the FCA by Bovill, a regulatory consultancy, even suggest that there will be substantial movement in the opposite direction.

According to the figures obtained by Bovill, over 1,400 EEA firms have applied to use the FCA's Temporary Permissions Regime (TPR). The TPR will allow EU firms to continue regulated activities in the UK for a limited period without FCA authorisation when the passporting regime comes to an end. TPR firms will be provided with a "landing slot" by the FCA, during which time they must apply for full FCA authorisation to continue to carry out regulated activities in the UK. In the absence of a comprehensive trade deal that includes access to the single market or an extension to the transition period, EEA firms that are not in the TPR will be unable to carry out regulated activities in the UK from 31 December 2020.

Of the firms in the TPR, 83 per cent operate under a "service" passport, which means they do not currently have an office in the UK. The remainder use "branch" passports, which enable firms to establish a UK office without the need to set up a separately authorised subsidiary. The high proportion of firms with service passports that have applied to use TPR suggests that many EEA firms will have to expand their UK presence to be granted a UK licence. While the FCA is yet to clarify its expectations of firms exiting the TPR, the FCA typically expects the "mind and management" of the firms that it authorises to be in the UK. In practice, this means that at least half the board should be based in the UK.

One question the data raises is: why have fewer than 20 per cent of the firms with inbound passporting rights into the UK applied to use TPR? This is likely because many of the 8,000 firms that currently possess passporting rights are not actively using them.

This is a common occurrence for several reasons. First, the passports are free – or at least relatively cheap in jurisdictions where regulators charge fees – so firms tend to apply for passports in a wider range of jurisdictions than they have any concrete plans to actively market their services in. Secondly, the question of whether a firm is carrying on a regulated activity in a particular jurisdiction is rarely straightforward. Nor is there a uniform approach to determining where an activity is performed, and, consequently, where a licence or passporting rights are required to be held.

For many years, firms have sidestepped the costly exercise of seeking local legal advice in all jurisdictions in which they operate. Instead, they have applied to passport the services they are licensed for in their home member state into all the other jurisdictions in which they have clients, without considering the potential for local exemptions from licensing requirements or differences of interpretation. As a result of Brexit, many firms have taken legal advice and come to the view that they do not require a UK licence and have therefore not applied for TPR.

Other firms that have passports, but do not have a substantial number of UK clients, will have formed the view that maintaining a UK office after Brexit will not be cost-effective. For firms currently operating under a services passport, building a local presence in the UK from scratch will be a costly operational challenge, involving taking out UK office space and hiring local staff at a sufficiently senior level to manage the business. Firms that have an existing branch in the UK are likely to find the route to full FCA authorisation somewhat easier. However, they will still have to convince the FCA that they can be effectively supervised by the regulator, which could require rethinking the location of key senior managers and potentially subsidiarising their UK branches.

In addition to these operational challenges, navigating the FCA's authorisation process is itself far from straightforward and will require professional advice. Applicants must complete a morass of FCA forms, secure individual approvals for senior managers and owners and provide a detailed business plan and forecasts. Firms must also show they have the systems and controls needed to manage regulatory risk and comply with the FCA's rules.

Country and sectoral breakdowns

The FCA figures include a breakdown of firms that have applied for TPR by type of firm/sector. Worthy of note are relatively large numbers of asset managers, insurers and insurance intermediaries, and over 100 retail and wholesale banks, all of which will either be setting up offices in London for the first time or boosting their current UK presence.

The FCA gave a further breakdown of TPR notifications by the firm's home state. The country from which the highest number of firms sent TPR notifications was Ireland at 228, perhaps reflecting the integration of the UK and Irish economies as well as their shared strength in asset management. Second was France with 170 submissions, Cyprus was third and Germany was fourth, with 165 and 149 submissions, respectively.

France and Germany appearing relatively high up the list is likely to be a simple reflection of the size of their economies and financial services industries relative to the rest of Europe. The position of Cyprus in the top four home states is more surprising, though its relatively high position is likely to correlate with the large number of contracts for difference providers that have applied to use TPR.

Cyprus is often used as a base for firms that want to be subject to a regulatory regime perceived as "lighter touch" in order to passport into larger more tightly regulated jurisdictions such as the UK. While regulatory arbitrage ought not be possible in a single market, it certainly happens. However, following the end of the implementation period, it will be much harder for firms to enter the UK market without being subject to the FCA's more robust supervisory approach.

The future

Despite the small-scale movement in both directions, for the time being most firms are still adopting a "wait and see" approach. While there is no longer any uncertainty about whether the UK will leave the EU, the future terms of trade and access arrangements between the UK and EU markets are still largely unknown. As a result, firms are putting in place the structures necessary to maintain continuity of service whatever the end-state. This makes sense in the short term. However, firms are likely to face increased costs as they are forced to maintain offices in both the UK and the EU27 to continue servicing both markets. Once the dust has settled firms may seek to concentrate in a single hub, making long-term strategic shifts of people and infrastructure.

The factors that will ultimately determine whether London trumps Paris, Dublin or Frankfurt will be much broader than any eventual trade deal and any access arrangements it might provide. Firms will look to which city has the readiest supply of talent, office space, networks of international investors and professional advisors, as well as which locations are most attractive to their employees in terms of housing, schools, culture and lifestyle. If building a global financial centre were as simple as passing a few laws, London would have been supplanted as Europe's pre-eminent financial centre by other European cities long ago.

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Was the FCA "asleep at the wheel" when Woodford's equity income fund went down?

Rosalyn Breedy*, partner at Wedlake Bell, argues that the regulatory system cannot work by relying on the regulator to monitor and oversee every authorised fund in the UK. The UK investment industry was estimated at £9.1 trillion in 2018. What is required now is a wholesale review of whether the current regulatory regime and government approach is fit for purpose for the next decade and beyond.*

Regulatory overview

The UK Financial Services regulatory framework for investment funds is divided into two.

First, there is an authorised funds regime whereby the authorised fund must be established in the UK and take one of three legal forms: authorised contractual scheme, authorised unit trust, and investment company with variable capital.

The authorised fund must be classified based on a marketing strategy, as one of the following:

- An undertaking for collective investment in transferable securities scheme (UCITS);
- A non-UCITS retail scheme (NURS); or
- A qualified investor scheme (QIS).

In order to have a fund authorised, customers need to complete a detailed application form, pay a fee and provide supporting documents.

For a fund of alternative investments, that is, a NURS or its sub-fund, details of the due diligence process are required, including written procedures, resources delegated functions, confirmation that the depositary is satisfied with the process, and any detailed due diligence undertaken in respect of target schemes.

The authorised funds regime, which is prescriptive in nature, derives in the main from the EU UCITS regime and works by setting rules for the fund to comply with and by authorising the fund key participants, investment manager, depositary (holder of the assets) and the trustee or authorised corporate director, who are themselves subject to prudential capital requirements, to comply with business conduct rules including reporting any breaches.

Once the fund is authorised it is the responsibility of the authorised fund participants to ensure compliance with the regulatory rules, and the auditors to report to investors on fund controls and accounting.

The second regime is for alternative investment funds and that relies on the UK implementation of the EU Alternative Investment Fund Manager's regime, which relies on the authorisation of the alternative investment fund participants, the alternative investment fund manager and depositary. However, the alternative investment funds themselves are not authorised. Instead, a lower level of investor protection is delivered by a process of information disclosure, reporting on risk, and restrictions on marketing to professional investors or investors by virtue of wealth or sophistication, who fall within certain exemptions of the UK Financial Services and Markets regime.

Finally, the product governance rules under the Markets in Financial Instruments Directive II (MiFID II), in addition to guidelines issued by the European Securities and Markets Authority (ESMA) from 3 January 2018, require manufacturers and distributors of financial products and services to put in place robust processes for the design of financial products and services, the identification of target investors and the ongoing

monitoring of financial distribution. MiFID II also introduced new product intervention powers for national competent authorities such as the Financial Conduct Authority (FCA), ESMA and the European Banking Authority (EBA).

The FCA plays one role alongside the managers, depositaries, trustees, auditors and (where funds are either recognised or permitted via a passport) other regulators.

Background[1]

Neil Woodford built one of the strongest investment performance records in the UK working for Perpetual (which was later taken over by US firm Invesco, one of the world's largest money managers, in 2000).

Savers who invested £1,000 with him in 1988 saw £25,000 growth in their pots over 25 years. Woodford was also a regular in the personal finance pages and was awarded a CBE.

Invesco recognised that Perpetual wanted to grow other products, but it has been reported that Woodford's bonuses were skewed into attracting investment into his fund and that, of course, was driven by the fund's performance.

Around 2010, Woodford started to invest in small private companies which potentially offered a pathway to exponential growth at a much greater level (and a different type) of risk than Woodford, who had built his track record by taking conviction positions on very large companies, was used to managing.

His $252 million investment in US biomass company Xyleco was for less than 7 per cent, which valued the company at more than $352 billion. The company's board included former US secretary of state George Schulz and former energy secretary Steven Chu. However, the company only held a collection of scientific patents, which concerned Invesco, and it is has been reported that Invesco then formed an internal risk committee to review private company investments.

Between 2008 and 2012, the FCA noticed that three Invesco funds (two of which were managed by Woodford) had taken on excessive risk and too much debt, resulting in losses of £5 million for clients. The FCA conducted a regulatory investigation resulting in a fine of £18.6 million for failings in fund management. It found that Invesco Perpetual had not complied with investment limits which were designed to protect consumers by limiting their exposure to risk. In addition, the firm did not clearly inform investors or explain the associated risks of its use of derivatives which introduced leverage into the funds, although the firm was allowed to use derivatives in this way. The extent of the losses was £5 million, and prompt compensation was paid to investors.

Woodford felt constrained by Invesco and left to start his own management firm, Woodford Investment Management and Equity Income Fund, with Craig Newman, head of retail funds, who had marketed Woodford's funds. They were joined by Nick Hamilton, formerly head of global equity product at Invesco, and Gray Smith, a former Mishcon De Reya lawyer who advised on the FCA investigation.

Woodford was authorised by the FCA, as no evidence had been found as part of its investigation into the Invesco fund rule breaches sanctions against individuals. A number of large clients, including Kent County Council, followed Woodford as well as investors from intermediaries such as St James Place and Hargreaves Lansdown.

Some investors went directly into the fund and others into managed accounts.

In 2014, Woodford had £5 billion under management. In its first year, Equity Income Fund returned 20 per cent. It was reported that Hargreaves Lansdown struck a deal whereby it agreed to promote Equity Income fund as a "best buy" in return for discounted fees.

In 2015, Woodford started Patient Capital to back small companies with exponential growth. It attracted £800 million at launch.

However, in 2017 fund performance started to decline, and the funds were hit by a series of investment mark downs.

The institutional clients started to withdraw their investments and to meet redemptions Woodford had to sell the fund stakes in the more liquid larger investments. This meant that Equity Investment Fund was soon breaching its regulatory defined limit of having no more than 10 per cent of the fund's asset in unquoted companies. It was at this point the FCA asked the firm's administrator to provide a monthly update on liquidity. This would have been the correct time for the FCA to have taken this action.

Woodford then listed some of the fund's private company stakes on the Guernsey Stock Exchange to meet the liquidity requirement. This is a recognised stock exchange for FCA purposes but small, so would have a lower rate of transactions and liquidity. This meant that the stakes were quoted for the purpose of FCA rules which would mean that the 10 per cent unquoted limit would not be breached.

While this is permitted by the rules it didn't address the core issue of lack of liquidity in the face of the number of redemptions.

In May 2019, Kent County Council tried to redeem its £263 million investment (then 7 per cent of the Equity Income Fund) and there was not sufficient cash for this leading to the indefinite suspension of the fund.

The issues

Fund and product governance

The problem was that the investment strategy came under stress when the institutional investors left as this forced Woodford to sell the liquid stakes.

In the author's view, the question is not so much, "was the FCA asleep at the wheel?" but "shouldn't the rules have required Woodford to stop all redemptions much earlier at the first significant request for investor redemptions?". That would have enabled an orderly and potentially longer-term

wind-down and it may have been better for investors to have received more capital albeit later. A secondary market could have been put in place for investors who required immediate liquidity.

Also, would this have happened if the governance rules introduced in 2019 requiring fund management board to appoint at least two independent directors had been introduced earlier?

Similarly, had the MiFID II product governance requirements been introduced prior to January 2018, would all these retail investors be invested in funds which do not meet their liquidity requirements?

Is there a need for a more prescribed product offering?

The bigger issue is that the UK regulatory regime still allows for a great deal of autonomy and relies on "buyer beware" in the delivery of financial services which, while good for creativity and choice may not be adequate in 2020 and beyond.

It is not the approach taken by regulatory regimes, such as Singapore Monetary Authority, where (contrary to popular belief) fund structures and rules are more prescriptive.

Should retail investment funds be regulated like medicines whereby outcomes and side effects are clearly labelled?

While there has been a rise in the ratings of funds on social media. This is no method of protecting investors as positive rankings can be manipulated.

Relying on other participants, such as fund platforms, to mediate investor access can be problematic where platforms are not regulated to provide investment advice. Very few investors can tell the difference between a "best buy" and an investment recommendation.

Is there a need for financial education for all?

There are 51 million adults in the UK, of which six million receive financial advice.

There are 10.6 million people aged between 50 and 65 who have not retired yet and, of these, two-thirds have not saved enough for retirement. Median pension pots for defined contribution schemes are £14,000 and £17,000, albeit there are multiple pots.

According to the OECD/INFE International Survey of Adult Financial Literacy Competencies,[2] the UK is 15th in the ranking against the 29 other countries that took part in the survey, just above Thailand and Albania, below the average for OECD countries, and well below France, Norway and Austria.

The industry has found it difficult to provide advice cheaply, so maybe the question should be changed to "shouldn't a government that requires individuals to take responsibility for their retirement, also provide that they are educated to be financially literate?".

There is clearly a need for a review to be undertaken to accommodate consumer needs, the roles of online information, intermediaries, rules and regulator.

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Endnotes

1. Background information is mostly sourced from Walker, O and Smith, P, "Neil Woodford: the inside story of his rise and dramatic fall", *Financial Times*, 18 October 2019, https://www.ft.com/content/2f077ae2-f19e-11e9-bfa4-b25f11f42901.
2. https://www.oecd.org/finance/oecd-infe-survey-adult-financial-literacy-competencies.htm.

The impact of MiFID II on the Swiss financial sector: Part II

The Markets in Financial Instruments Directive (MiFID) II and regulation (MiFIR) provide for a new third-country regime in the regulation of the EU financial market. With the entry into force of the Financial Services Act (FinSA) and the Financial Institutions Act on 1 January 2020, Switzerland has followed the path of voluntary alignment with the EU regulation.

This article will examine the impact of the implementation of the EU regulation in financial capital markets on the Swiss financial sector. Despite financial institutions complaining about the costs of the implementation, it is interesting to see what the expected changes will be for different financial market participants. Therefore, this article will critically discuss the advantages and disadvantages of such alignment and the threshold of the implementation of the EU regulation and the obtaining of the desired positive equivalence decision, even though the current law and the new regulation do not seem to have extensive differences, as has already been shown in the first article in this series (see *Financial Regulation International*, February 2020).

When it comes to the assessment of the legal impact of certain regulations, there are different criteria which need to be considered, such as necessity of such state actions, impact of specific targeted groups as well as alternative solutions, which might be used instead.

The necessity of the voluntary alignment of Swiss legislation with the EU regulation and the advantages were mentioned in the first part of this series. This article will describe briefly the gaps between MiFID II and FinSA, and an examination of the criticism to the final draft of FinSA will be assessed. Furthermore, this paper will take a critical approach, discussing the impact the new regulation has on customers,

financial institutions and independent asset managers considering both previous parts and the conclusions made from them. The final chapter of the paper will then focus on the alternative solutions to the implementation of the EU regulation and the critical analysis of whether such solutions are even possible for the time being.

Differences with MiFID II

The Swiss legislator decided to base the new financial market regulation as closely as possible on MiFID II. However, it was decided to formulate the new bill with a certain amount of leeway, the so-called "Swiss finish".[1] Even though FinSA regulates the core content of MiFID II, there are also numerous deviations, which might challenge the positive equivalence decision and bring legal uncertainty with itself.

There is a difference between the EU and Swiss regulation regarding the differentiation of different types of financial services provided. Whereas MiFID II relies on the criterion of independence in terms of investment advice, FinSA is orientated on the criterion of whether the advice was related to a single transaction or was based on a portfolio context. Such discrepancies have an important consequence and impact on different services. Thus, for example, the regulation of retrocession or requirement appropriateness and suitability tests depend on the type of services.

The biggest differences between MiFID II and FinSA are the requirements for the suitability and appropriateness tests. FinSA deviates from MiFID II in two aspects: (1) with regard to the requirements for transaction-related investment advice, and (2) execution-only orders.

The suitability test is only required if the investment advice takes place with regards to a transaction by taking the portfolio as a whole into account. MiFID II, however, makes no distinction between portfolio-related and transaction-related advice, but in principle requires both the examination of suitability and appropriateness for investment advice services (Art 25 MiFID II). Furthermore, FinSA relieves the banks' duties for execution-only orders. This means that if the bank only accepts an order without providing investment advice, it does not have to check the appropriateness of the order. However, the bank must inform the customer of this fact. This relief is provided for MiFID II only for non-complex financial instruments such as certain equities, UCITS or classic government bonds.[2]

Apart from differences in terms of terminology with regards to different clients' categories, FinSA differs from MiFID II in terms of criteria for customer segmentation. Whereas FinSA uses the criteria of size (balance sheet, turnover, equity capital) also used under MiFID II, there is an additional category of a professional treasury. FinSA also uses different terminology such as opt-in and opt-out compared to opt-up and opt-down under MiFID II. Furthermore, there are small differences in terminology of customer segmentation (institutional customers vs eligible parties).

A very important issue for banks is the handling of retrocessions (also called inducements). While MiFID II practically excludes the retention of retrocessions, FinSA adheres to the existing practice of the Federal Supreme Court and confirms the legal admissibility under certain conditions. According to art 24 para 9, MiFID II only allows retrocessions to be retained in cases where, depending on the type of service, there is either a minor exception (for portfolio management and independent investment advice) or a quality improvement exception (for dependent investment advice). However, according to art 26 FinSA, it is allowed to use retrocessions for all service types (ie asset management, portfolio and transaction-related investment advice, as well as execution-only transactions), provided that (a) the client has been informed, and (b) the issue has been effectively waived, or (c) the retrocessions are forwarded to the client. A more detailed differentiation between regulation of retrocessions under FinSA and MiFID II will not be illustrated since it will go beyond the scope of this paper.

Also, the difference with regards to costs disclosed to the clients need to be mentioned. Art 24 para 4 lit c MiFID II obliges the disclosure of all costs to clients before a transaction has been conducted. Included are transaction costs as well as costs included in the product. Additionally, detailed information about costs must be sent to the client on a periodic basis. Such regulation is not foreseen under FinSA, which is why the financial intermediaries are not obliged to provide such cost transparency for Swiss or not EEA customers.

The consequences for financial intermediaries which offer their services for EU customers in terms of regulation of retrocessions as well as cost transparency will be the fact that Swiss clients might request the same treatment as under MiFID II due to discrimination, and the financial intermediaries might be forced to eliminate such discrepancies in their internal policy.[3]

Criticism of FinSA

Opinions on the efficiency and usefulness of the new regulations vary widely within the industry. It is also argued that the equivalence decision is useless to some extent. While the Swiss Banking Organisation (SBVg) seems to be happy with FinSA, the Swiss Private Banking Organisation and other consumer protection parties disagree with it. Whether FinSA and FinIA will be assessed as equivalent by the EC is unclear. It is argued that both bills were designed in line with the EU legislation, but there has never been an intention to create identical provisions, due to Swiss idiosyncrasies such as freedom of self-regulation or the dual supervisory system and liberal economics.[4]

Market participants claim that the equivalence decision is not an appropriate tool to receive full access to the EU financial market. The only way for this is a sectoral agreement on financial services, which the EU will not even discuss until Switzerland has negotiated, signed and put into force a framework agreement. However, this seems to be an illusion in the near future.

As a whole, there have been a lot of different discussions and amendments to the bill. One of the hot topics was a

sentence added by the Council of States in art 8 para 1, which would prioritise FinSA over the rules of conduct under private law. It meant that if the financial service provider fulfilled its obligations under FinSA, the obligations under private law would have been seen as fulfilled too. Due to the fact that FinSA has lower investor protection obligations than the private law, its priority position would have weakened and not strengthened the investor protection in Switzerland. This point has been criticised a lot by different parties (media, doctrine, consumer protection organisation). Luckily, the legislator agreed that the introduction of such a provision would be technically very complicated and could cause unwanted side effects,[5] which is why this sentence was deleted from the bill.

The most criticised aspect of FinSA is the differentiation between transaction-based and portfolio-based investment advice. This specific Swiss regulation may cause a lot of confusion. It is argued that the boundaries between these two arts of investment advice are in flux, therefore, legal uncertainty in defining which one of them applies might arise. As long as there is no case law or practical application, it is advisable to apply the more restrictive regulation, in particular, taking into account the more restrictive MiFID II regulation in this respect. According to the EU, regulation requires an appropriateness test for all forms of asset management and investment advice.[6]

The question as to whether the new stricter obligation of documentation and accountability makes a better-informed customer is disputable. The customers will definitely receive a higher amount of information and maybe have more access for evidence in case of legislation. However, it is uncertain that clients will better understand their investments under such obligation. One instrument that has been discussed under the doctrine is to underpin a basis of authorisation in FinSA for mystery shopping to control the conduct of rules and the consultation of the investment advisor or asset manager with the customers. As an example, one could use the UK regulation and the authorisation of FCA in this respect.[7]

Furthermore, it is argued that with help of FinSA, Switzerland will take up the core content of MiFID II regulations; but there are numerous discrepancies. It is seen more as a form of “MiFID light”, due to lower level of investor protection compared to the EU supervisory law. Swiss financial service providers seem to enjoy looser prudential supervision.[8]

Additionally, it was discussed if financial intermediaries who are not interested in cross-border transactions shall receive the so-called opting-in or opting-out option of FinSA. This suggestion was dismissed. For these market participants such regulation would have been more advantageous. Now it will cause additional costs and present a lot of challenges they will need to face. Nevertheless, from the point of view of investor protection, which is the main purpose of the whole restructuring of the financial market regulation, putting all financial intermediaries into the scope of application of FinSA will give a certain amount of investor protection on a sectoral basis and close the existing gaps.

Impact of the EU regulation on the Swiss financial market

Are customers better off?

The doctrine claims to have two effects which result in a higher level of trust into the financial industry. The first effect is that the new requirements introduced by MiFID II apply in this context: through the transmission of more detailed and more frequent information, the customer is able to assess how successful and capable a client adviser or financial service provider is. The second effect is shown through the ability of the client to change their perception of the adviser, since they get the information about financial products, the cost of advice and the financial results accrued from them.[9]

When it comes to double regulation of asset management and investment advisory under civil and supervisory law, the opinions are divided. Some argue that such double regulation is unnecessary due to congruency.[10] However, they oversee that it brings advantages such as regulatory enforcement and introduction of uniform minimum market standards. This cannot be successful under contract law alone. Furthermore, the experience has shown that it might cause gaps in investor protection. Finally, such dual regulation gives an additional advantage for the investors, since the financial intermediary are not able to modify or waive the supervisory law.[11]

The conduct of business rules such as suitability and appropriateness tests are already largely regulated under Swiss civil law. A financial services provider is in the course of its advisory or asset management agreement obliged to perform the appropriateness and/or suitability test.[12] FinSA brings with public supervisory law a second level of investor protection as an addition to the civil law.[13] This is legal tightening of the law, since the supervisory authority is officially obliged to monitor the suitability and appropriateness concept of the financial services providers. In addition, the conduct of business rules applies to all financial intermediaries, also to those which were not prudentially supervised before, eg independent asset managers.[14]

Furthermore, the efforts of Switzerland and the EU to restructure the financial market regulation are impacted by the view that there is an information asymmetry between the clients and their financial service providers. The decrease of level of information asymmetry as well as conflicts of interests of financial intermediaries is the main aim of FinSA and the corresponding EU Directive MiFID II. The new regulation of documentation and accountability shall dismiss such disadvantages of the investors.[15] The stricter documentation and accountability duties might decrease the level of information asymmetry, but it will never dismiss it completely. The customers will always lack the knowledge and information which the financial service

provider has. The legislator should have paid more attention to the quality of the information and not the amount. As Konrad Lorenz once said:

> "What is thought is not yet said,
> what is said is not properly heard,
> what is heard is not properly understood,
> what is understood is not always accepted,
> what is accepted is not always applied,
> what is applied is not always kept."

With the new documentation regulation, the clients will receive more information, but it is not clear if this provision will result in a better-informed customer. One instrument that has been discussed under the doctrine is to underpin a basis of authorisation in FinSA for mystery shopping to control the conduct of rules and the consultation of the investment advisor or asset manager with the customers. As an example, one could use the UK regulation and the authorisation of FCA in this respect.[16] However, such control mechanism was not introduced in the Swiss law.

Another positive aspect for the customers is the fact that the new regulation puts under the scope of application all financial services providers, in particular, asset management advisers, and obliges them of certain duties, which are regulated under one bill. Also, the obligation of the asset managers to receive an education in conduct of rules is also an advantage for the customers compared to the previous law.

Overall, the new regulation does not put the investor protection in Switzerland on the new level. It is a tightening of the law since all financial service providers fall into the scope of conduct of rules. Additionally, these rules are monitored under supervisory law and not the civil law only. Furthermore, the customers receive more information from the point of sale. However, since Switzerland still wants to keep the idea of a "responsible investor" compared to the EU view of the investor, who needs to be protected from himself, the level of investor protection is not the same as in the EU.

Impact on financial service providers

Impact on banks

The large Swiss providers of financial services have been compliant with the requirements of MiFID I since 2007; therefore, they seem to react calmly to the plans of the adoption and modernisation of conduct of business rules, whereas the purely domestically oriented banks seem to fear this regulatory burden. In addition to compliance with MiFID II, which should have taken place by 1 January 2018, Swiss intermediaries are to comply with the new Swiss regulation from 1 January 2020.

The new Swiss regulation with regards to conduct of rules for Swiss licensed and supervised banks does not establish fundamental changes. These rules are already largely regulated under the civil law and self-regulated guidelines (under agency agreement or civil law). These rules state more of a codification of these rules in a bill. However, customer segmentation is a new rule. There was no such duty in the previous law, neither in SESTA, nor in civil law, but rather a practice based on case law.[17]

The regulation about the high amount of documentation is also a recent adjustment, which is to be provided to the customers as well as education of investment advisers. Furthermore, there is a certain amount of legal uncertainty regarding appropriateness test obligation with regards to the transaction-based and portfolio-based investment advice. Here, all financial intermediaries providing such a service will need to evaluate if they want to provide a higher level of investor protection to be on a safer side or not, since it is not clear how these two arts of investment advice will be differentiated in the current state of regulation.

Problems can be caused with regards to retrocessions and cost transparency since FinSA differs drastically in this respect from the EU regulation. On the one hand, the financial intermediaries providing their services on the cross-border base might face difficulty in introducing products for MiFID clients and not MiFID II clients. Furthermore, they might face the issue of being accused of discrimination from Swiss clients. A waiver of retrocessions, on the other hand, implies a significant profit loss. Therefore, most banks will still receive retrocessions and distribute those to MiFID II customers, and in case Swiss clients would complain about discrimination, they would distribute such commissions to them too.[18]

Apart from the EC's positive equivalence decision, there is a possibility for the market participants to compensate the compliance costs through active innovation. In the future, further developing markets might rise, which will have different legal systems and would want to apply them on a cross-border basis. The fact that a financial service provider has implemented parallel legal systems and is able to deal with them efficiently could be decisive for its competitiveness on the market. Instead of complaining about implementation of parallel legal systems, one could benefit from it and develop an appropriate business model with the required benefit for the investors. This is a chance for such a financial service provider to establish a strong and competitive position on the market.[19]

Until the equivalence decision is made, Swiss financial intermediaries providing their service on a cross-border base will face some legal insecurity issues, and the compliance with MiFID II is inevitable for certain financial intermediaries. Swiss financial intermediaries, which fall into the scope of MiFID II are those offering their services to the clients in the EU or EEA. Thus, these financial service providers are impacted by the third-country regime under MiFID II. The financial intermediary might have an option to establish a branch in a member state. However, it will not give it the advantage of the EU passport. Another option would be to establish a subsidiary in the EU, which will profit from the EU passport. However, in such cases the requirements as well as costs are higher.[20]

Overall, one can say that the impact on the banks is of limited effect and will be easily implemented into their policies. This is the biggest advantage the banks will receive

after the positive equivalence decision is made. Until then there remains a certain amount of legal uncertainty.

Impact on independent asset managers and investment advisors

For independent asset managers, the implementation of MiFID II in terms of FinSA brings a regime change. The new regulation implies higher requirements both in terms of personal effort, as well as of financial respect, for independent asset managers. The requirements will cause them additional costs as well as personal effort for compliance with the new regulation.

According to the new regulation, independent asset managers will require a licence to provide their services and are subject to prudential supervision of a self-regulated organisation appointed by FINMA. Compliance with the new rules as well as their implementation will cause additional financial and personnel costs that cannot be borne by all of these financial intermediaries. This could lead to the "cleaning" of the market in the years following the coming into force of FinSA.

According to an external study, the foreseeable regulation costs for independent asset managers, depending on the size of the company, will be estimated between CHF 70,000 and CHF 128,000 as well as yearly recurring costs between CHF 19,000 for small and CHF 56,000 for bigger independent asset management companies.[21]

The conduct of rules itself does not reflect major innovations. The rules were already to be applied under previous law. The customer segmentation regulation has the same impact as for the banks. Therefore, there is no necessity to discuss this issue here again.

There is, however, a certain risk that independent asset managers will try to overcome the new regulation by changing their services in a way that they could fall into the category of investment advice. Nevertheless, it is not a satisfying solution in a long-term strategy, which is why it can be assumed that the most independent asset managers will comply with the new regulation with regards to conduct of business rules.

Even though independent asset managers only focus on Swiss customers, they might evaluate the new licence requirements as unnecessary costs, for the ones providing their services on a cross-border basis such requirements seem to be advantageous. However, those independent asset managers who approach customers within the EU may face liability issues as well as be subject to criminal offence. Therefore, such a prudential subordination and registration is a mechanism of protection for financial intermediaries themselves.

Alternative solutions to voluntary alignment with EU regulation

The main purpose of the implementation of MiFID II was to introduce a higher level of investor protection as well as to have market access to the EU market. To receive access to the EU market according to MiFID II and MiFIR, a positive equivalence decision from the EC is necessary. However, as described in the first paper, which was published in the February issue of *Financial Regulation International*, such equivalence decision does not give full access to the market. Furthermore, the financial sector has been complaining that the costs of such implementation were too high. But are there any alternative solutions to the implementation of MiFID II into Swiss law despite the already mentioned deficits and risks of the new bills?

Switzerland's options regarding the implementation of MiFID II are limited to the question of whether MiFID II should be implemented in full or only partly, to those parts that are relevant for market access. However, it should be emphasised here that market access for Swiss financial intermediaries cannot be regarded as equivalent to the ones of financial intermediaries with an EU or EEA licence. Even if MiFID II is fully adopted in Swiss national law, the financial intermediaries will not have a full market access, because the passporting rules do not apply to them.[22] The implementation of MiFID II only for the relevant parts is sufficient for the equivalence decision and cross-border market access of Swiss financial intermediaries. Thus, it seems to be unnecessary to implement the strict MiFID II regulation in full in Swiss national law.

It must be noted that Switzerland is also dependant on the decision of the member state in question if it decides in favour of or against the requirement of establishment of a branch in their home country to provide financial services for retail clients. Branch obligation according to MiFID II is a stricter rule for third-country companies, compared to the more liberal approach of MiFID I.[23] From the Swiss point of view, it is a disadvantage that if a branch established in one member state for retail business will not take advantage of the European passport, the financial service provider will be forced to establish a branch in each targeted member state or to form a subsidiary in one of the member states to receive a local permit and profit from the European passport at a later stage.

However, if a member state decides against the branch obligation, the approval of the third-country financial provider will depend on the national law of the EU member state. Thus, Switzerland will have different regulations in different countries, and in the end, might be forced to conclude contracts in the retail sectors with these member states.

After having mentioned all these aspects, it would be more advantageous for Switzerland to ratify with the EU a unified sectoral agreement, which would come into force instead of MiFID II regulations. For the time being, however, such an agreement seems to be illusive, as long as questions of persons' free movement and the future of the bilateral agreements have not been clarified. However, due to very tense situations in the politics of the EU at the moment, it is unrealistic for such an agreement to be negotiated in the foreseeable future. First, the EU will want to sign the framework agreement with Switzerland before

starting to negotiate such financial services agreements. Second, the UK is expected to withdraw from the EU, and the EU is occupied in negotiating how this situation will be treated as well as looking for solutions with the UK following Brexit. Hence, the EU will place pressure on other third countries to show its strength towards the UK. This has been demonstrated with the withdrawal of equivalence of Swiss stock exchange regulations. Therefore, in the current situation a unified financial services agreement with the EU is not an option. In case no agreement can be met, Switzerland's only option will be to sign as many individual agreements with different member states as possible for financial intermediaries to offer their service for retail clients in the EU.[24]

Another question which might be raised in this regard is whether it might be reasonable for Switzerland to consider becoming a member of the EEA. The question of this alternative solution has already been raised by Professor Peter Nobel in an interview with *Tages-Anzeiger* in 2009. A so-called Swiss finish will be possible even in case of an EEA membership. However, there might not be that much room for differences in implementation into national law, since the main purpose of the new EU financial market regulation is the creation of uniform law. Furthermore, Switzerland would not be a third country anymore, but would profit from full EU market access. Due to political considerations as well as to the fact that an attempt for the EEA membership seems to be illusive for the time being, such alternative solution even though having certain advantages is not appropriate.

Another alternative is the creation of "Swiss equivalence rule", where Swiss financial intermediaries which are compliant with MiFID II and MiFIR will be automatically compliant with Swiss law. In this case, there would be no need to implement the EU regulation into Swiss law. On the one hand, such a regulation would allow the possibility to lower the compliance costs for small or medium-size companies, which do not intend to provide their services on the cross-border basis, while on the other hand, international financial services providers would only need to be compliant with the EU regulation. Since MiFID II has a higher level of investor protection than FinSA, the customers would not suffer under such regulation, but rather benefit from it. However, in this case, the Swiss international service providers would not benefit from the EU equivalence decision and a simple access to the EU market. Therefore, the Swiss equivalence rule can only be seen as an additional option to the implementation of MiFID II into Swiss law. In such circumstances, financial intermediaries already compliant with MiFID II would save costs and benefit from a positive EC equivalence decision with an access to the EU market. Furthermore, this solution could have been ideal if the Swiss legislator had decided to put more exemptions on the scope of the application of FinSA. Thus, independent asset managers or small companies, which are not interested in the EU market, would save costs of implementation of the new law. Whether the investors would still benefit from the same level of protection and whether that level of investor protection is considered to be sufficient is another question. In the end, the Swiss equivalence rule does not make sense under the current draft of FinSA.

Nonetheless, there has been no alternative to the implementation of MiFID II into Swiss national law. However, there is still a question of whether the EC will accept FinSA and FinIA to be equivalent. Apart from the criticism with regards to FinSA and the level of investor protection, as well as if further exemptions to the scope of the application of the new Swiss law should have been made, the voluntary alignment and implementation of the EU law was necessary for the Swiss financial sector. One hopes that the Federal Council will undertake the necessary steps to negotiate a framework agreement with the EU in the financial market regulation for Switzerland to benefit from full market access in the future.

Conclusion

Overall, this article has shown that the implementation of the EU regulation in Swiss national state was necessary to keep its strong position on the financial market. However, there are some significant differences between MiFID II and FinSA, which might cost Switzerland the positive equivalence decision. In particular, it has been shown that only the core requirements of MiFID II have been implemented into Swiss national law and there are some relevant gaps (retrocessions, costs disclosure, etc). Furthermore, the Swiss special rule of differentiation between "portfolio-based" and "transaction-based" investment advice seems to be complicated and confusing to the writer, even though the doctrine claims this specific Swiss rule to be an excellent invention.

The new regulation is beneficial for investors due to the double regulation of the financial intermediaries, in particular, independent asset managers or investment advisors under civil and supervisory law. Furthermore, it is claimed that the customers will benefit due to a smaller amount of information asymmetry with regards to stricter documentation and accountability rules. In my opinion, however, the higher amount of documentation received does not necessarily mean the customer understands its risk better. It is also questionable as to how the advice given to the client can be monitored in the practice. As long as Swiss legislation uses the idea of "responsible investor", Swiss customers will not receive the same level of protection as the EU investor enjoys.

The financial institutions which provide their services on the cross-border basis seem to be the ones on who the new regulation will have the smallest impact. Since MiFID II came into force in January 2018, they have already implemented the relevant regulations in their policy. Furthermore, they tend to be less vulnerable to the compliance costs of the alignment. However, they seem to be the ones benefiting the most in the case of positive equivalence decision. This in contrast to the small or medium-size financial institutions or those financial intermediaries which orient their services to the Swiss customers only. This is the biggest impact the two bills will have on the independent asset managers

and investment advisers. The licence requirements and the prudential supervision result in a regime change for them. Furthermore, the additional compliance costs might cause the "cleaning" of the market in the future. It cannot be currently known whether this is of an advantage for the Swiss financial sector. On the one hand, a certain amount of competition is necessary on the market. On the other hand, it cannot be advantageous for clients and the market if only the big financial institutions will be able to retain their position on the market due to the compliance costs that the other market participants might not be able to bear. After all, there is a certain risk of monopoly power or cartels, which is the opposite effect of the aim of higher level of investor protection desired with the new regulation.

Finally, the paper has discussed if there is an alternative solution to the implementation of MiFID II into Swiss national law. Different possibilities have been discussed such as full or partial implementation of it, sectoral agreement and framework agreement, as well as bilateral agreements with member states. In conclusion, no satisfying alternative to the current solution could be found. Even though the current solution is not ideal for Switzerland, because a positive equivalence decision would give Swiss financial intermediaries access to the EU market, it will not result in a full access, since the retail clients are not allowed to be approached. Therefore, the best solution would be sectoral agreement with the EU. Because of the current political situation, such sectoral agreement does not seem to be possible any time soon.

Although the new regulation brings a higher level of investor protection and modernises the financial market regulation in Switzerland, there are certain areas of it which can be improved in the future. The increased amount of information received by the investors, which is supported by MiFID II and FinSA, does not necessarily result in a better-informed customer. What is desired is a better quality of information and not quantity. This should be taken into account in the future amendments of the regulation. Furthermore, the legislator should be cautious about how intensely the financial sector should be regulated. MiFID II is not considered to be the best example of a well-drafted regulatory framework. More regulation is always reflected in less innovation, which is not favourable for the financial market. Therefore, an equilibrium should be achieved with the least possible amount of regulation and the highest possible amount of investor protection and transparency. Here, in the author's view the legislator was not as successful in achieving this goal.

Since the two bills have just come into force and it cannot be foreseen if they will be assessed as equivalent, no data is available to assess what the impact of the implementation of MiFID II into Swiss national law will have in the end. It might be interesting to see how the financial sector will have been developed in a few years after the implementation, and what the effective compliance costs will be. Furthermore, if more clarifications or case law are available at a later stage a further critical evaluation of the specific Swiss regulation and differentiation between "transaction-based" and "portfolio-based" investment advice might be a fascinating issue for a legal research, since such differentiation is unknown in the US and the EU law.

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The Equator Principles in the financial sector: an impact assessment

Considering the terror of the Amazon Rainforest burning as a direct result of economic pressures, global exploitation of people across an array of sectors, and climate change at the forefront of international agendas, the role of private financial institutions (PFIs) has come under attack. Due to their powerful influence and high levels of liquidity, their role in facilitating these situations through project financing has been debated. An attempted solution has been created by several financial institutions, following non-governmental organisations (NGO) protests regarding their roles in protecting environmental and social concerns, termed the Equator Principles (EPs). The EPs are a sustainable credit risk management framework, assisting in regulating, evaluating and supervising environmental and social risks globally to new projects financed by four financial products: project finance advisory services, project finance, project-related corporate loans and bridge loans. This framework is applied internally by institutions which are signatories, known as the Equator Principles Financial Institutions (EPFIs), operating across all industry sectors including oil and gas, power, mining and infrastructure.

Broadly, the purpose of this paper is to assess the impact of the EPs in the financial sector. This paper will argue that whilst the EPs have created a global standard through self-regulatory measures and have had many positive influences across EPFI activities in regards to project financing, criticisms by NGOs and other stakeholders have not seized. Despite the developments of EPIII, there are core regulatory gaps within the framework regarding accountability, transparency and monitoring, which ultimately impairs the effectiveness of the EPs in action. Arguably, they act as a "reputational shield" for EPFIs to prove to clients that they are adhering to environmental and social concerns and circumvent persistent NGOs condemnations.[1]

In supporting these contestations, this article will begin by introducing the origins of the EPs, to provide a clear understanding of their inception. It will then briefly analyse the developments of the EPs and subsequently study the current revision. It thenceforth moves to consider the positive reach of the EPs through pinpointing its progression across the globe. It successively probes the self-regulatory nature, specifically applying a reflexive law theory to support the governance structures. The next section of the paper comparatively studies the ramifications of the EPs by looking at the framework as a whole and concluding they are not far-reaching due to the geographical impact and use of the EPs in ultimately never being applied to refuse credit. It will conclude that further developments are necessary to ensure the EPs are comprehensive, robust and demand accountability from their signatories to have the most positive effects.

Background

What is project financing?

Before moving forward, it is important to understand what project financing is and to note why this aspect was centralised in the EPs. "Project Finance" has been defined in the EPs following the Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards. The definition followed in the guidelines will be adopted by this paper. Ultimately, it is characterised as a type of financing used to handle loans for development projects on a large scale with highly concentrated capital. From oil production in the Middle East to infrastructure development in Asia, an ever-growing importance has been attached to global banks aiding the need for commercial financing to meet national economic goals internationally. It is this importance and demand for global banks, alongside the guaranteed driver of profits once capital is pushed by them into project financing portfolios, that impacts matters beyond invigorating economic growth. Consequently, with this market evolving, the NGOs concerned became active in these arenas. Studies prove these projects that the banks support can have vital effects on the environment and local communities. A significant justification for NGOs advocating assertive campaigns was due to cases where multilateral financial institutions had rejected financing based on environmental and social concerns, banks and other private sector institutions had funded the same portfolios.[2] The growing realisation of the anonymity of private sector banks had emphasised the power these institutions had over "unsustainable" projects. Therefore, the drive from NGOs for the regulation of this neglect regarding environmental and social concerns when project financing, combined with questioning the legitimacy of the decisions, directed the demand and campaign for the development of a centralised framework. This resulted in the EPs.

Evolution of the EPs

Prior to the establishment of the EPs, NGOs launched a series of campaigns directed at the leading commercial lending institution. A pivotal move was the launch of the Collevecchio Declaration on Financial Institutions and Sustainability by an alliance of NGOs at the World Economic Forum in January 2003. This declaration was the first benchmark set in recognising the "role and responsibility" of private financial institutions (PFI) regarding their global effect. As such, the declaration has been considered an EP progenitor which openly challenged financial institutional actions through shareholder activism. This response pinpointed to retail customers the apparent problems which opened financial institutions to continuous risk as a result of their tarnished reputations. It led to possible boycotts and potential litigation due to their prior social and environmental misconduct. The challenges highlighted led to a meeting of commercial banks, to combat their statuses. Highly visible NGO campaigns caused PFIs to fear in a similar way the declaration affected their reputations. The persistent intensity applied by NGOs and the wider public placed the theme of environmental, social responsibility and accountability at the forefront. The topic could no longer be ignored as it was a matter increasingly diminishing their clientele and image.

These events ultimately triggered banks, such as ABN AMRO and Citigroup, in establishing the EPs. Due to these pressures and to acknowledge the NGOs demands, the International Finance Corporation (IFC) and ABN AMRO coordinated a meeting, which resulted in four of the leading players in the project finance market, which had all been exposed by NGOs campaigns, in drafting the EPs. The EPs stemmed from policy discussions between the banks and the IFC, launching in 2003 by 10 banks from seven different countries. The support from the IFC directed the then-existing IFC environmental and social safeguard policies as the EPs model for environmental and social standard policies. The developed framework promised strong obligations, demonstrated from the first principle. Furthermore, the title incited the adoption and implementation of the principles on an international level spanning across all financial situations. The term "Equator" symbolises this concept and balance of being approved by both the northern and southern hemispheres and between industrialised countries, developing countries and emerging markets. Therefore, the name seems fitting – Equator Principles – to strive towards making the global change required to combat social and environmental hurdles.

Surprisingly, part of the NGO sector commended the efforts taken by the commercial banks and viewed the launch as "one step toward sustainability for an influential sector of society".[3] However, this view has been contested. At the time of the launch, adopting banks constituted approximately 30 per cent of the project loan syndicate global market. Ultimately, the reaction and establishment were labelled as a "corporate strategy" to overcome challenges PFIs faced, and to display that commercial banks were taking an initiative regarding environmental and social issues. It was noted as being overly ambitious and overconfident by Nelthorpe. Therefore, launch of the EPs failed to silence or completely address the problems raised by the public and NGOs in regards to EPFIs accountability, transparency and monitoring of the application of the guidelines. Consequently, two revisions have been made since 2003.

Current framework: EPIII

The current framework was launched by the Equator Principles Association (EPA) initiating a revision of the EPII through consultations and internal discussions as questions arose regarding the associations' impact. Nonetheless, before the final version of the EPIII was published, Durbin purported that numerous NGOs had criticised the amendments, as they did not do far enough to remedy the perceived defects of EPI and EPII. However, it can be said to a certain extent, EPIII goes beyond the lessons and experiences of previous versions to include contemporary and rapidly evolving issues such as climate change, to expand membership, to improve the consistency of implementation across member, and to promote transparency.

The following 10 points provide a brief analysis of the current EP, known as the EPIII.

Principle 1: Review and categorisation

As examined by Wörsdörfer, this principle is a key requirement in categorising the project being assessed under category A, B or C – based on the environmental and social categorisation guidelines of the IFC. This decision is core in deciding how the following principles are applied. However, this method has been criticised as EPFIs cataloguing the project-related loans can still vary between institutions as EPFIs hold individual administrative controls. Therefore, the universal application of the framework is questionable due to discrepancies in the function and lack of monitoring.

Principle 2: Environmental and social assessment

This assessment documentation process had been introduced in the EPII, where it was made obligatory for both Category A and B projects to undertake it. Additionally, in this amendment, an Environmental and Social Impact Assessment (ESIA) is necessary within the Assessment Documentation for Category A projects and, where appropriate, for Category B projects. A praised establishment is that human rights have been mentioned within the EP for the first time. Nevertheless, it has been noted as an incapacitated attempt to make a bold statement. It will only be considered in limited high-risk circumstances at the EPFIs discretion, proving the framework is still unwilling to establish hard-line requirements for EPFIs. Additionally, recommendations by the Strategic Review to exclude the

development of coal projects, mountain top removal mining or projects in a sensitive ecosystem within this assessment process have been overlooked. As a compromise to satisfy this proposal, the EPs adopt a new requirement related to carbon emissions. However, yet again, it is not an efficacious step forward due to its benchmark settings and fails to have practical change in restricting financing.

Principle 3: Applicable environmental and social standard

This principle outlines the types of environmental and social standards applicable depending on the location of the particular project. Application varies according to "designated countries" and "non-designated countries" which are essentially developing and developed countries. In the "designated countries", their national laws and regulations must be complied with regarding environmental and social issues. On the other hand, in "non-designated countries" the EPs demand the EPFIs willingly "over-comply" with standards set by the IFC and World Bank guidelines, due to the deficit of regulations regarding these matters in developing countries. This protection can be seen as a positive advancement, however as argued by Wright, there is no evidence of this systemic practice. Meyerstein also continues to argue there is no monitoring of banks' discretion in project assessment, thus EPFIs downgrading on these protective layers are highly possible to remove problems in the financing process.

Principle 4: Environmental and social management system and Equator Principles action plan

The principle requires the above to be completed and developed by the borrower. This has been incorporated to tackle the issues identified by the impact assessment regarding the potential risks and the corrective actions are accordingly figured in. This type of active and practical change had been lacking in the previous EPs, as now if standards are not met, the client and EPFI will develop a joint EP Action Plan. This guideline acts as a progressive principle to protect environmental and social standards.

Principle 5: Stakeholder engagement

This principle has been warmly welcomed by NGOs, and academics have praised it for providing the EPs with an encompassing role by including stakeholders' engagement. Meyerstein commends the social aspect of incorporating indigenous and aboriginal people, a group that has been under consistent mistreatment regarding their lands for economic purposes. The principle has ensured that the project sponsors, government and banks respect the norm of "free prior and informed consent (FPIC)". However, the IFC reached a controversial conclusion as there is no universally acclaimed definition for "FPIC". Therefore, the application of this principle is questionable as there is a varying opinion as to its core subject definition.

Principle 6: Grievance mechanism

This principle advocates that the borrower must establish a grievance mechanism so stakeholders can make a complaint at any point; however, it does not extend to the level NGOs have been seeking. Lazarus states that this mechanism is not comprehensive, as, for it to be effective; banks must establish their own collective independent grievance mechanism. Therefore, the ideas of a third-party complaint or dispute settlement have been recommended by Meyerstein. This principle disappoints in tackling problems previously faced in holding banks accountable for ensuring that complaints and queries have been heard. This rule still gives room for banks to file "dodgy deals" to relevant institutions and not ensuring it is further escalated.

Principle 7: Independent review

This principle requires an independent review of the Assessment Documentation which includes all assessments and the stakeholder engagement process by an independent environmental and social expert or consultant with no connection to the client. This concept supports NGOs' mandate for transparency. Statistics prove that the demand and importance for this have risen, proven by the cost for consultants for environmental impact assessments rising. For example, for mining projects in 1992, fees ranged between $20,000 and $160,000. The cost in 2010 was over $2 million.

Principle 8: Covenants

The EPs recognise this principle itself as an "important strength" within the framework. It is a compliance guideline, where the client must covenant in the financing documentation to comply with the relevant laws and assessments made. Importantly, the covenant allows the bank to decommission the facilities where applicable, thus acting as a remedy for the EPFI. However, since its implementation, there has been no evidence that as a remedy the financing has been compensated immediately to the bank. Arguably, its value is ambiguous as the survey research discussed in Meyerstein's paper evidences that within this commercial environment, once financing has been implemented into the project, the decision to remove this funding is not within the norms. For example, more than 80 per cent per cent of EPFIs would prefer to manipulate the situation to bring the behaviour under compliance rather than take such a severe step. Again, the principle fails to have a strong and disciplinary impact.

Principle 9: Independent monitoring and reporting

This principle is comparable to principle 7 in terms of an independent monitoring and reporting expert for the client with regard to Category A and B projects, providing an additional layer of monitoring which remedies previous criticisms.

Principle 10: Reporting and transparency

Following the addition of the principle in EPII, it requires separate reporting as a condition on an annual basis. There has been steady progress in regards to officiating it as an obligation. Prakash and Potoski marked the reporting under the EP as the "gold standard amongst voluntary programmes" as research concludes over 70 per cent of the EPFIs use external auditing firms to verify the disclosures in their CSR reports.[4] However, this is yet to settle NGOs' fight for transparency as the reporting information has not practically led to progress – an accountability structure is completely lacking. A problem also lies in the disparity in reporting because, as emphasised by Lazarus, due to the revisions, new adopters must follow more stringent reporting rules compared to EPFIs who adopted the EP pre-2013, thus a standardised rule must be applied.

Ultimately, it would be unjust to state that the second revision has not made strong changes. However, from the exploration of the 10 principles, it is evident that they are not as comprehensive and authoritative as what was expected by NGOs and academics. Alternatively, the EPs have been revised to act as a reputational shield against NGOs critique. The EPs have evolved by broadening its scope, demanding new requirements to be assessed and appointing independent experts to review the process. Nonetheless, its self-regulatory nature has come into question with the fact that there lacks an independent authority to oversee the application of the principles.

Progression of the EPs

Growth

Undeniably, there has been a rising significance regarding the growing relationship between the EPFIs and NGOs and the strengthened dialogue between them. There is an ever-increasing importance of social and environmental issues within financing projects and credit risk management of them since the launch and development, noted by Eisenbach. This is evidenced by the official statistics: as of April 2019, there were 96 financial institutions across 37 countries who are signatories of the EP, which covers over 70 per cent of international the project finance debt in emerging markets, compared to adopting banks constituting approximately 30 per cent of the project loan syndicate market globally when the EPs were first launched.

A key characteristic of the EPs is to homogenise and set standards to support financial institutions across the globe to foster similar due diligence processes regarding projects associated with environmental and social risks to the large-scale infrastructure projects these institutions finance. Following the revisions, EPFIs have the power to enforce remedies in instances where the approved loan covenants between project sponsors and themselves are breached. This facilitates Lawrence and Thomas' belief that EPs banks will act as global sustainability regulators through the project documentation assessments, providing a form of principal legal framework for transactions. Therefore, Williams notions that the EPs themselves are a concrete example of a "new governance" or "soft law".

The growth and proliferation of EP have been reasoned by Eisenbach as leading a centralised understanding and created comparable expectations for project sustainable financing. He describes that over the years the EPs have created a common vocabulary in the area, particularly with the 2013 revisions, in particular broadening of the framework beyond "project finance" to project-related corporate loans and bridge loans. Williams' study proves banks such as Barclays, Citibank, HSBC and JPMorgan Chase adopted a cultural change by becoming signatories to the framework. The effects of the EPs can be seen to be applied across several product categories, and there being a broader application of the framework due to its soft law nature, elevating the signatories to position of rule-makers. For example, HSBC now applies EP-influenced sustainability principles to all of its lending in energy, forestry and forest products, freshwater infrastructure, and mining and metals. This displays the positive and all-encompassing application of regulation, illustrating a robust move to bring environmental and social risks to the forefront of financing. This significance is further highlighted with the EPs affecting the development of similar regulations. For example, Macve and Xiaolio establish that the EPs assisted in promoting "other environmental practices in the financial sector" such as the Carbon Principles in thermal power investments, which has been adopted by various US banks. Furthermore, the Governance Rules extends the scope of the EPs. Basic states a key innovation of the Governance Rules was the "Associate" category. Through this, financial institutions that do not partake in project finance could enlist in the EPA to discover the practices and gain knowledge for transactions beyond project finance, thus, demonstrating the progressive influence and force of the EPs since their inception.

Initially, the EP failed to uphold mechanisms of accountability and responsibilities. Olson's study found that an important step towards fostering a community of social interactive processes like the EPs is through formal mechanisms such as governance structures, as this would facilitate a higher prospective for significance and growth. Consequently, as a result of the new governance rules in 2010 creating the EPA, it introduced the purpose of improving the efficiency of existing practices, procedures and responsibilities through a formalised relationship with financial institutions. However, these inflate the costs inherent to instituting a more rigorous environmental and social risk review. These additional expenses, following theory, make compliance costlier.

Accordingly, more faith can be put into the claims of actors expending such costs, as it would only be rational to do so if there was some substance to them and not a mere façade. The enactment of authority supports the functioning of soft law, as reinforced by Weber. Thus, the next section will explore the impact of the regulatory nature of the EPs as it proves vital to explore.

Impact of the regulatory approach

It is fundamental to analyse the nature of the EPs functioning as a voluntary code of conduct, representing a form of soft law. This form of private law incentivises firms to collectively agree to cooperate based on shared interests to best resolve circumstances "that pose a threat to their operations otherwise".[5] This is supported by Schepers in his definition of voluntary codes of conduct. Ong applies this understanding to the EPs in legally defining the EPs and their contribution to international environmental law. He concludes that as it is an agreement involving non-state actors with global outreach, the EPs represent a form of "transnational" soft law. There are many benefits with this nature of regulation. Weber highlights many strengths of soft law, specifically that this approach does not force an authority; rather, it facilitates negotiations by communities that are affected and involved in the sector. Therefore, advocating that the potential for rules to be broadly accepted is greater. This is evidenced by the development of the EPs globally across a number of financial institutions. Another key element to soft law is that it is better equipped with greater flexibility as opposed to hard law, as indicated by Lance. The EPs are a prime example of this, displayed by the numerous revisions made and the freedom EPFIs have in their application. The independence from the governmental norm-setting organisations and mechanisms of legislation allows for this, which Lance establishes achieves greater efficiency and cost-effectiveness. The soft law position of the EPs is a pivotal feature. However, Basic argues this nature acts as a major impediment in weakening the framework alongside the absent accountability mechanism, as it is not legally binding.

While recognising the limits of soft law, Rupp and Williams suggest that it has the potential "to engage a broader range of human motivations, needs, emotions, and moral reasoning", therefore, proving more efficient than traditional approaches based solely on the self-interest of an entity. By creating self-regulated principles, such as the EPs, it is believed that the signing entities are more likely to evolve value-based behaviours and even "go beyond 'mere' compliance with law",[6] as highlighted by HSBC. This paper argues that this form of regulatory approach is effective and supports the aims of the EPs, with its application as a soft law framework. There are different models to explain EPFIs reasoning for implementing and applying the EP. To evidence this, the paper will look at the reflexive law theory to explain that the environment created by this mechanism fosters the ability for EPs to have a positive impact in growing and developing across the globe effectively.

Reflexive law theory

It is interesting to turn to a reflexive law theory to assess the EPs as the nature of the principles fit this model. As deemed by Rogowski, reflexive law is law that fosters self-regulation,[7] which is at the spirit of the framework with the EPFIs acting as the regulators of the principles they are signatories to, enforcing them on clients and evaluating through different assessments recommended by the EPs – to determine whether standards are met. Hirsch looks to analysing reflexive law in his review of "green business" and refutes Teubner's ideology that reflexive law acts as the final stage in developing a legal system.[8] He alternatively utilises reflexive law to elucidate the model functioning as an alternative thinking and productive mechanism in regards to how law and policy collaborate. This paper agrees with this argument due to its inherent structure of governance holding the ability to offer different solutions to hard-law structures, particularly in the instance of the principles promoting sustainable financing in various PFI governance structures. Similarly, Orts advances the concept of "reflexive environmental law" from Teubner's development.[9] This concept similarly institutes "evaluative procedures and patterns of decision making" internally within establishments to protect against environmental destruction and to increase support for ecological developments and environmental benefits. This environmental theme is correspondingly at the core of the EPs, reflected within the framework and thus EPFIs are harnessing this drive for environmental protection.

Reflexive law is ultimately a social legal theory and practical approach to regulation through self-reflection and critique – in this situation, by financial institutions and its clients. Evaluating the specific principles which incorporate a self-regulating mechanism, EPFIs are in charge of ensuring that the projects they are to undertake abide by the framework in place. For example, principle 2, which outlines the Environmental and Social Impact Assessment, requires the client in need of financing to complete an assessment to the EPFI to apply corresponding standards. Through the Environmental and Social Management Plan and System, EPFIs can "reflexively" control, curtail and adopt client's plans to ensure the projects financed are aligned with the EPs. This is a practical example of what Anthony Giddens defines as "reflexivity" in that "social practices are constantly examined and reformed in the light of incoming information about those very practices". Rogowski moves forward to explain that the theory of reflexive law operationalises this insight to alter the governance of institutions. Therefore, overcoming traditional

boundaries of public and private law and facilitating the development and creation of new standards as exemplified above.

In the context of sustainable financing and those involved with the EPs, public interest and NGOs' force can be considerable, which is mirrored in other industries such as labour law, powered by union activity. A number of large scale critics such as BankTrack, which in collaboration with several environmental, human rights and indigenous peoples' organisations, have critiqued the framework, positively strengthening with the revisions seen, and recently bringing the discussion forward regarding the current EPIII, whilst spearheading movements for EPVI. As presented by Ort, reflexive law, particularly in this industry, seeks to question and inspire EPFIs to take these principles seriously. Arguably, the force of reputation acting as a driver for compliance as represented earlier in the paper, however small evidently produces change.

Selznick states that "There is no escaping the need for institutional self-awareness and self-criticism".[10] To accomplish this in a reflexive law setting, institutions use information-based, communication-based and procedure-based regulatory strategies. Regarding an information-based strategy, this is achieved by EPFIs, as highlighted above when discussing how principle 2 operates and through the annual reports released by EPFIs. This type of information sharing by the client, institution and the assessment process allows for compliance to be evaluated across distinct mediums depending on projects located in non-designated and designated countries. Goetz expresses that the consulting with and disclosure of information to affected communities from project planning through construction and operation of the project is an example of acting on this information-based strategy. It is also an example of the communication-based strategy of reflexive law when the information is being applied in disclosure. The latter strategy has been adopted as it is at the core of the principles regarding disclosure and reporting of activities, therefore enriching communication occurring between stakeholders and the industries associated. For example, Barclays in its annual report in 2013 reviewed all projects under the EPs and disclosed all its statistics, making them accessible to the public and the EPA. Once these strategies have been deployed, the consequent stage is for the institutions to reflect on activities and performance, to manage operations to ensure that as values evolve and develop, the EPFIs follow. This is identified as a procedure-based strategy. Hirsch interestingly notes that "reflexive law's primary modus operandi is procedural". Essentially, as Rogowski postulates, with the developments occurring through self-regulation in reflexive law, the procedures regarding planning and decision-making are key in being adapted to changing circumstances and new industry information being discovered. For example, JPMorgan Chase & Co (JPMC) internalised many of the EPs and IFC's Performance Standards once it officially became a member of the principles in 2013 through its Global Environmental and Social Risk Management guidelines. Thus, the new procedural elements deriving from the initial principles the firm is signatory to display the enabling influence self-regulation has indirectly on the sector. This is evidence of reflexive law assisting in providing regulatory guidance and procedures to support and take into account sustainable financing as a responsibility beyond the EP, continuing to have direct weight on private actors. Consequently, it is clear that the EPs have a great significance through the model of reflexive law in challenging institutions to enact change from within by being self-aware and as Rolston correctly argues, "Morality often exceeds legality".[11] The ability of the EPs to change institutional ethical practices beyond the framework and create industry standards that were not there until its implementation is a testament to its reflexive and thus evolving nature, to ensure sound management practices.

If self-regulation by financial institutions can be effective, it can serve as a powerful device through which global policy objectives might be attained. The above contestations establish the positive power of the EPs; however, it is vital to consider the alternative side which reflects the flaws of its structure and implementation which will be analysed in the following section.

Limitations

Geographical restraints

In order for the EPs to have a strong impact, it is vital that they are implemented and embraced by central players in project finance, in order to control environmental and social risks on an effective global financing scale. The statistics, however, do not display this. Therefore, this presents limits of the EPs in not having the necessary reach and counter-attacks, particularly as the market has altered drastically since the 2008 global financial crisis. The scope of project finance has dropped across North America and Europe due to the lack of liquidity in banks and strengthened risk management regulations regarding project financing. On the other hand, this market in Asia has grown exponentially, with Asian investments accounting for 45 per cent of the global project finance market. However, only 15 per cent of the current EPFIs in 2019 are from Asia, with only one Indian bank and three Chinese banks. Even with efforts through conferences regarding sustainability and outreach programs collaborating with the IFC across the Middle East, China, India and Russia, there has been little impact. A Russian bank removed itself as soon as it signed up to the EPs. With a lack in representation, especially from South-East Asian banks, who are categorically major players acting in the project finance market, it can be contested that the EPs goals are not being met. One could argue that

this problem is due to European and North American EPFIs acting as signatories due to reputational pressures, also argued by Wörsdörfer. This is not a problem faced by banks in other regions in developing countries. Irrespective, it is still a prevalent issue for NGOs in creating a universal standard. Ultimately, the vision projected by EPFIs launching the principles was to create a worldwide standard of minimum environmental, social and human rights standards, which is repudiated if the key players in the field have not undertaken them. Therefore, it is pivotal for the EPFIs to continue to encourage other institutions in these regions to adopt the framework to have maximum impact as currently, in regards to market penetration of the EPs, they are failing.

EPs acting as a "fig leaf"

Another major concern, aligning with Conley and Williams' study concerning the impact of the rules, is with regard to the fact that the same banks that are EPFIs and sustainability leaders – such as HSBC, Barclays, Citibank and JP Morgan Chase – are all implicated in the excessively leveraged, high-risk behaviours, and are accused in various scandals that have emerged since the global financial crisis, such as LIBOR manipulation, money laundering, and mortgage and insurance mis-selling. These problems occurred whilst being signed up to the EPs, which takes into consideration social factors, and have faltered. Williams argues that these banks use the EP as a "fig leaf" allowing the banks to "proclaim all that they do is socially right, in order to draw attention away from all the social wrong elsewhere".[12] By creating a false culture, Williams argues that the EPs are used to detract from other ethically wrong financing that occurs. This defeats the aim of the voluntary code and acts as a double-edged sword in attempting to mitigate environmental and social risks. Ultimately, the EPs act as a facilitator in shielding and portraying a false sense of corporate social responsibility being adhered to, as the institutions continue with other unethical practices.

Application of EPs

The EPs – both the original and amended versions – have faced a number of criticisms from NGOs and academics. Interestingly, according to a study by *Infrastructure Journal,* in 2007, around 71 per cent of total project finance debt in emerging market economies was subject to the EPs. This is US$52.9 billion out of $74.6 billion, a staggering amount which proves that the soft law framework has helped to promote excellent environmental practices in the financial sector. On the other hand, an interview-based study carried out by Conley and Williams, importantly depicted that no one "could cite an instance of a loan going into default as a result of an EPs' breach", and from research and analysing other studies, a case study cannot be found. The study reasoned that this was due to the fact that in situations of non-compliance, the EPFIs always met with the borrowers and "hard-nosed negotiations" until some form of an agreement was accomplished. This brings into question the validity of the principles and need for inspections and sanctions to ensure the framework is followed. A further report by the MSCI in 2014 indicated that financial institutions are leaning towards internally developed policies and guidelines compared to the EPs. The report states that "there is also evidence that the most widely adopted standard, the Equator Principles, is (and has been) lagging the banks' actual depth and breadth of risk-mitigation strategies".[13] Conley and Williams discuss this matter in relation to loan covenants. The real impact on the business activities and the planning of a project has been acknowledged, but not the desired level of halting a project if it failed the assessments, as it was "not clear" whether any projects resulted in termination due to social and environmental and issues.

The manner in which the principles have been applied, has also been questioned, it now applies to four types of financial products, as previously explained. The nature of these financial products is that a number of banks act as a lender in different capacities for the syndicated loans, thus Gaskin raises the valid argument when a non-EPFI holds most of the non-compliant project's debt, it can be difficult in this situation for an EPFI to assert its compliance policies in line with the EPs. Furthermore, an EPFI may have different categorisation boundaries of leniency which could conflict with another EPFI also acting as lender. Thus bringing forward the issue of differences in compliance with the EPs due to its soft law and the uncoordinated nature of the application failing to create a standard.

The scope

It is important to briefly analyse the scope of the EPs. With its most recent revision, EPIII has been praised for the broadening of its capacity by incorporating project-related corporate loans and diverging from merely project financing. This was driven by NGOs complaints and recommended by the Strategic Review due to the discrepancy that followed with solely project finance under the EPs, as one EPFIs determination of project finance deals could be construed by another EPFI as a corporate loan. Thus, it is commendable that this problem was resolved to remove this limit. Nonetheless, it is highly debatable whether this revision is going far enough, and rather, it has been marginal in improving the functionality of the framework overall. This is due to the fact the limit for project-related corporate loans is set at $100 million compared to the $10 million benchmark for project finance. The question that academics and NGOs propose is, why this was not set accordingly from the outset, for example, the benchmark for project financing altered from $100 million to $10 million? It is therefore valid to hold concerns regarding this revision as, although additions and changes

have been made, it is with limited impact and awareness that certain benchmarks are incorrect, as these same levels set in previous revisions have been altered.

Composition of the framework

The choice of words heavily influences the manner in which the content will be applied. Analysing the specifics of the framework itself, its implementation is ultimately negative due to the phrasing. The EPs fail to specifically pinpoint and demand actions, instead as Wörsdörfer observes, they are deliberately vague. Therefore, the principles nebulous construction opens a space for diverging interpretations. One could argue that this stems from the defectiveness of the IFC guidelines, which have been critiqued by NGOs for the same ambiguous problems. Prior to the revision, this application of the IFC was condemned as it did not support the aims of the EPs in creating a set of strong rules for institutions to implement. However, as the EPIII were being developed, the IFC guidelines were amended afresh, and the similar mistake of mirroring its standards occurred. This is illustrated by supplementing the confusion regarding the meaning of "free, prior and informed consent" into the EPs, even though there was an awareness that there is a conflicting matter, as discussed previously in the paper, that there is no standard definition for the phrase. As the EPs are based on these guidelines, the weaknesses have similarly transferred into its formulation.

Additionally, the syntax of the EPs does not fully incorporate legal terminologies; terms such as "request", "aim", "encourage" are used. This presents a weakening implementation before actual application. As agreed by NGOs and academics, the current nature of the EPs conveys an inadequate rhetoric and has resulted in the creation of ambiguities and grey areas; the first principle embodies this. This principle acts as a key foundation in the manner in which the following principles would be applied, depending on how the project proposed will be categorised. However, EFPIs have the ability through the EPs to redefine the proposed projects in order to classify them as a smaller risk to avoid firmer implications and assessments. Therefore, phrases and terminologies within the EPs require strengthening by setting clearly defined parameters and using strong compliant terms such as "should".[14] With such changes, the EPs can be used as an operative tool to protect and preserve environmental and social governance through robust regulations.

Transparency and reporting

More than 15 years have passed since the creation of the EPs, and yet the transparency of the principles is still at the crux of NGOs anger, particularly in regards to the reporting standards. This remains a key concern even in the latest revision. Through the careful revision leading to the EPIII, it was made clear that a more satisfactory information disclosure was necessary to provide the transparency that has been required and expected by stakeholders. Nevertheless, despite that, principle 10 states that an annual report must be published every year, which is subject to confidentiality considerations. It is clear that the EPs still lean towards prevalent business cultures which NGOs and academics question and demand to be altered to ensure that the regulations can achieve their duty. It is interesting to note here that some consultants however, in regards to enforceability in general, take a more pragmatic approach. The argument arises if overly rigorous regulations are initiated, it will ultimately drive institutions away from becoming signatories of the EPs and simultaneously repel developers from using EPFIs banks for credit. This paper, contrary to Johnson, in lieu, views that this understanding has been embraced due to consultants' experience of how seriously banks and borrowers view the EPs. Thus, in this situation, those creating the EPs are aware and understand implying such rigorous measures, such as detailed reporting is an unrealistic goal. Moreover, it is important to note the actions of the EPFIs and development of the principles seem to be reactive to stakeholders rather than proactive, which continues to emphasise the reputational motivation behind EPFIs in following the framework. Reverting to the key point, it can still be argued that the transparency and reporting systems in place in the EPs are problematic.

Leaving aside commercial practices and culture of protecting confidentiality, there is a further discrepancy in reporting. It seems inappropriate as highlighted by Conley and Williams that EPFIs in their first year do not have to disclose. Further, academics suggest that due to the reports nature of not being listed in an identifiable manner, the reports fail to achieve their purpose of allocating social and environmental impacts and the reports are not transparent enough to highlight this. This is depicted by the statistics in regards to reporting; as of 2014, only 14 per cent reported the assessment status of a project. It is specifically mentioned that this is a requirement in the reporting standards, however EPFIs are failing to do this, the pivotal reasoning being there is a lack of monitoring due to its self-regulatory nature, as mentioned by Weber. To refute this argument, this paper looks to reflexive law theory (which champions self-regulation). It would point to the error being in the governance structure of the EPs. Applying a reflexive law theory, it is key to this theory, as Orts depicts, that new approaches must be adopted in regards to accountability of institutions. Without this, the prevailing logic of the market entrenched with oversights will continue to capitalise and reflect on actions and fail to make the ethical changes required. In reflexive law, as mirrored by the EPs, the institutions are responsible for ensuring that the borrowers comply with the regulations as it is their responsibility to do so to ensure public good in addition to avoiding systemic

risk. Thus, reporting is critical to understand what is essential to be monitored, and can assist in achieving the aims of enabling EPFIs and ensure they take on their responsibilities. The Environmental Action Plan attempts to do this by creating opportunities for learning related to sustainability amongst the organisations. However, this is not enough for the reasons explained above. Therefore, for this to be achieved, essentially there needs to be greater transparency and reporting standards need to be strengthened to promote this.

Monitoring and enforcement

Arguably, the most contested issue surrounding the EPs relates to to the lack of monitoring and enforcement power. It is regarded that the framework accountability is undertaken by NGOs acting as a watchdog and analysing their activities. Under the 2010 Governance Rules, the EPA was created in response to provide a monitoring element and improve existing practices, procedures and responsibilities. Within the EPs, monitoring rules have been replaced under principle 6 and 9. Nonetheless, the reception has been negative. Principle 9 centres on monitoring and reporting jointly, and calls for an independent expert to achieve this. However, this encourages discrepancies as there is no set standard used to determine issues that have been found. Similarly, principle 6's effect will be interesting to witness in regards to its project-level grievance and complaint mechanisms, a view shared by Wörsdörfer. Critics of the EPs are sceptical as to whether this will be taken seriously by EPFIs or whether it will continue to mask behind the system in labelling deals as "dodgy," however finding a path to continue its funding by altering the paperwork. It is for these reasons that accountability has been called into question and is vital to be enforced. This paper, having analysed a number of different arguments, supports the recommendation of a separate ombudsman service to provide a transparent and independent service of monitoring. Particularly, due to the fact that only four principles are in fact carried out by the EPFIs, the onus lies on the borrower for the reminder, thus monitoring is vital. The current standard for calling EPFIs to account is largely undertaken by NGOs acting as EPFIs' watchdog, and providing a reactionary response to issues that arise. Due to its soft law regulatory nature, O'Sullivan and O'Dywer conclude that a broader accountability mechanism is essential. The current reactionary response to NGOs has been regarded as an inefficient solution to reduce the governance void.

A recent study conducted by King looks to the self-regulating nature and environmental protection, and infers that the failure to achieve the aims set by the self-regulatory initiative is due to a lack of monitoring and enforcement, as represented in this case. Again, reverting to the reflexive law theory, this offers a "productive" solution, as deemed by Hirsch. To ensure self-regulation is achieved, reflexive law determines that a form of regulation of self-regulation is needed to enable reflexive law, and this is achieved by maintaining a detailed dialogue between the institutions and the borrowers in the form of holding accountability and appropriate governance structures to apply sanctions to acts as deterrents.[15] Whilst the creation of the EPA attempts to solve this, further strengthening is needed in holding the EPFIs to account in the form of a separate ombudsman holding stronger enforcement powers and sanctions to ensure that EPFIs cannot selectively implement guidelines, and that homogenous reporting standards across all EPFIs are maintained. Using the current framework, the formal sanctions in place are futile and currently work in an ex-post manner as reputational damage. Improvements in the governance system are a necessity as transparency, monitoring, enforcement and accountability can only be achieved when these parts in conjunction are reinforced.

It is imperative to briefly consider whether the soft law nature of the EPs is the key reason why the above concepts of accountability, transparency and monitoring have been unattainable tasks for the framework. The positive influences of soft law have been analysed within the paper, however, hard law supporters would argue for countries to adopt the EPs into their national legislation. This would ensure the above issues are tackled directly by legislatures and governments, and provide a deeper oversight that soft law frameworks fail to achieve and have the requisite resources for. However, as examined, global political situations are varied, and it would prove difficult to achieve such a commitment internationally in a comprehensive manner.

From the evaluation above, it is clearly evident that further steps will be needed to ensure that EPs encompasses robust measures to safeguard environmental and social problems resulting from financing of such projects. Wörsdörfer states there is a "lack of accountability, liability and enforceability placed on EPFIs," and this ultimately needs to be tackled. It is important to note that the EPVI are currently under development and consultation, however at this current stage no academic literature exists regarding the matter. White and Case explore the consultation, and it notes the scope being reduced from $100 million to $10 million for corporate-related loans as suggested above and recognition of the EPFI's role in the 2015 Paris Climate Change Agreement. It would be vital for the EPVI to address the issues analysed above and follow the recommendations shared by NGOs and academics to ensure the aims of the EPs are fulfilled through stronger monitoring. This would be achieved by establishing an independent ombudsman service for the EPFIs, harsher sanctions, defining clearly expectations of reporting and to be held accountable by the strengthened accountability system and for the governance system to ensure enforceability.

Conclusion

It is clear from this paper that the launch of the EPs and subsequent revisions have sustainable banking, incorporating environmental and social concerns at the core of its agenda. Importantly, NGOs' concerns have at last been reflected in a framework to make positive alterations in the field of project financing. As financial institutions have adopted these rules as signatories to the EPs, a global standard and paradigm shift regarding these matters has been created within the market. It has been achieved with the proliferation of the principles, and direct impact within EPFIs, to institute risk assessments and alter actions accordingly. Most importantly, it is the soft law nature of the EPs that has assisted in their development. This paper has used a reflexive law theory to exhibit this, as it accommodates the mechanisms within the EPs of the relationship between a client and the EPFI, in determining transformations from within by being self-aware and positively facilitating the rules to evolve and strengthen EPFIs' management practices.

On the other hand, it has correspondingly pinpointed the limitations in regards to the current EPs. A key factor is that ultimately the power of the EPs is diminished as to date they have not been used to refuse credit for a project or revoked proposed plans due to conflict with the principles. It thus points to accountability, monitoring and transparency issues that require consolidation to reinforce their effect. This paper has argued that the weighting of the EPs is deficient due to EPFIs' primary concern in becoming signatories being aligned to using the guidelines as a "reputational shield" to ensure public confrontations from NGOs do not affect their clientele. Thus, due to this perceived attitude, the genuine application of the EPs has been predominately flawed. Consequently, to hold EPFIs liable, it will be vital for the framework to be strengthened with a separate ombudsman service to hold EPFIs responsible, furthering the scope to limit rules being circumvented logistically, and to reinforce transparency and monitoring efficiently in assessing reporting standards and ensuring appropriate sanctions are applied. A further issue analysed is the scale of adoption globally in comparison to the project financing market. It is important for global collaboration in countries such as India and China, to ensure EPs have the influence and weight to set global standards.

With the EPVI currently being structured and revised through consultations and reviews, it will be vital for these recommendations to be taken on board to thus facilitate the EPs in an operational manner that reinforces the necessary global change in protecting environmental and social concerns. To conclude, the framework has progressively assisted in influencing a behavioural change within the financial sector. However, it has further potential and the ability to be a key influencer in controlling financial institutions; but to do so it needs modifications to encompass the soft law framework to ensure its full force of positive actions.

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