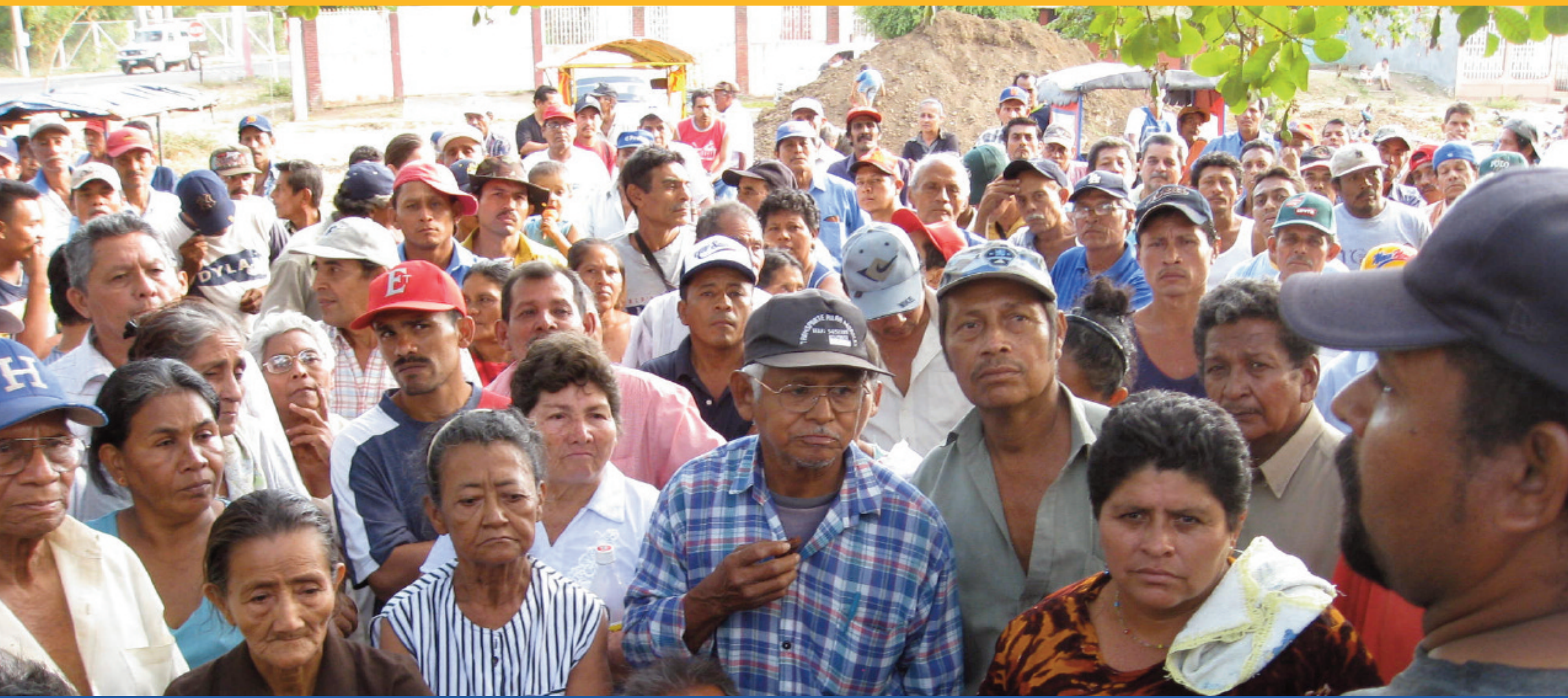
ADVISORY NOTE

Review of IFC's Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information

May 2010



The Office of the Compliance Advisor/Ombudsman
for the International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group

CAO
COMPLIANCE ADVISOR OMBUDSMAN

About the CAO

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the President of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the private sector lending and insurance members of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The CAO works to respond quickly and effectively to complaints through mediated settlements headed by the CAO Ombudsman, or through compliance audits that ensure adherence with relevant policies. The CAO also offers advice and guidance to IFC and MIGA, and to the World Bank Group President, about improving the social and environmental outcomes of IFC and MIGA projects.

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

For more information about the CAO, please visit www.cao-ombudsman.org

About the CAO Advisory Role and Advisory Notes

In its advisory capacity, the CAO provides advice to the President of the World Bank Group and to the management of IFC and MIGA relating to broader environmental and social policies, guidelines, procedures, resources, and systems. This advice is often based on the insights and experience gained from investigations and audits in the CAO's Ombudsman and Compliance roles. The objective in the advisory function, and in preparing this Advisory Note, is to identify and help address systemic issues and potential problems early.

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Contents

Tables and Figures

ACRONYMS

CAO	Compliance Advisor/Ombudsman
E&S	Environmental and Social
FI	Financial Intermediary
IBRD	International Bank for Reconstruction and Development
IEG	Independent Evaluation Group
IFC	International Finance Corporation
MIGA	Multilateral Investment Guarantee Agency
PPS	Policy and Performance Standards on Social and Environmental Sustainability
PS	Performance Standards
WBG	World Bank Group

Foreword

When IFC adopted the Policy and Performance Standards on Social and Environmental Sustainability and Disclosure Policy ("Sustainability Framework") in 2006, it marked a shift in the way in which IFC, and MIGA, address environmental and social risks. The philosophy inherent in the new policies and standards signaled a move from satisfying a set of prescriptive requirements to an 'outcomes-based' approach. The Performance Standards require client companies to engage with host communities early; to build constructive relationships, and maintain them over time. However, the level of engagement varies depending on the nature of company operations and the associated risks and impacts.

Four years after the adoption of the new Sustainability Framework, we can assess project-level outcomes generated by the application of the policies and standards. CAO's review builds on our previous advisory work related to IFC's policy framework, and aims to make pragmatic recommendations focused on improving implementation at the project-level and enhancing IFC's local development impact.

CAO's experience shows that sound company-community engagement creates predictability for host communities around project-level impacts and mitigation measures, and can help to prevent conflict around private sector projects. We have drawn these insights from our caseload over the past ten years, and it is illustrated by CAO's existing body of advisory work. For this reason, we see effective implementation as a key challenge of the Sustainability Framework and to delivering on IFC's mission.

In accordance with CAO's mandate, this review focused on IFC commitments and client company requirements with a direct impact on host communities and the community-company relationship. We found both pockets of excellence from which lessons can be drawn, as well as room for improvement. Specifically, we found gaps in company-community engagement at the project-level that require more attention. For example, engagement with affected communities regarding project mitigation activities could be enhanced by better articulating local development impacts and providing up-to-date project information to host communities.

We also found significant differences between theory and practice in the implementation of IFC requirements for Financial Intermediary (FI) clients. An increase in resources dedicated to environmental and social appraisal and supervision of IFC's FI portfolio could help close this gap.

In addition, there are opportunities for IFC to enhance its own management systems to improve environmental and social outcomes for host communities. This could be achieved by perhaps revising incentives for investment staff to better integrate environmental and social considerations into decision-making, and providing more support to environmental and social specialists to assist smaller and low capacity clients.

I believe CAO's recommendations will help strengthen IFC's environmental and social risk management by encouraging both staff and client companies to be more attuned to the interests of local communities in the countries where IFC does business. It is only through effective implementation of the policies and standards that we can be confident of achieving strong developmental outcomes that benefit all stakeholders, but especially those communities that live with the projects on the ground.

M. Taylor

Meg Taylor
Vice President, Compliance Advisor/Ombudsman
May 2010

Executive Summary

This Advisory Note represents CAO's contribution to IFC's review and update of its Sustainability Framework, which consists of the Policy and Performance Standards on Social and Environmental Sustainability (PPS) and Policy on Disclosure of Information.

CAO's Approach

The Sustainability Framework was adopted in April 2006, meaning implementation of the policies and standards is at an early stage. Therefore, CAO concentrated on IFC's implementation to date, focusing specifically on policy areas of direct impact on local communities and community-company relationships. CAO further assessed the Sustainability Framework's adaptability to IFC's changing business model: decentralization and focus on frontier markets; the increasing use of investment products such as corporate loans, equity, and investments in financial intermediaries; and the growth in Advisory Services. In developing its approach, CAO applied the insights from its ombudsman and compliance functions and feedback from a peer review group, as well as CAO's Strategic Advisors Group, non-governmental organizations (NGOs), and IFC management.

Core Questions

CAO's advisory work addressed the following core questions:

- Has IFC's application of the PPS throughout its portfolio supported the establishment of transparent client company requirements and clear expectations and predictability for both client companies and communities at the project-level?
- Has IFC's own environmental and social management system and supervision capacity been adequately strengthened to support the move from process compliance to accountability for outcomes, ensuring the effectiveness and impact of the PPS?

Review Activities

To address these questions, CAO carried out a mini portfolio review of IFC projects processed under the PPS, and commissioned an in-depth field study of local stakeholder perceptions around five IFC projects (see Figure A). Subsequently, CAO met with IFC investment and environment and social (E&S) specialist staff to verify findings and test conclusions for their systemic relevance. Finally, CAO's extensive outreach to civil society in IFC member countries provided valuable input to assess the effectiveness of IFC's Policy on Disclosure of Information.

Findings

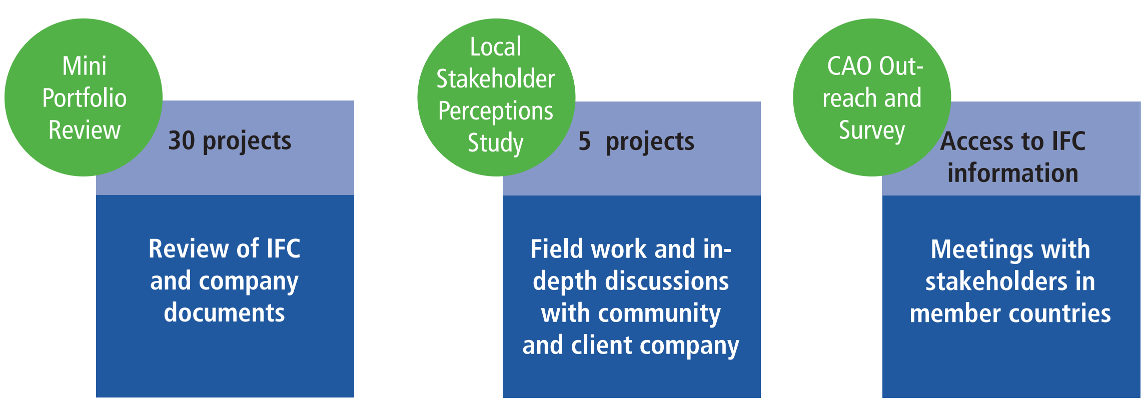
The Advisory Note presents CAO's findings and recommendations within three larger concepts, organized around a set of eight questions.

A. Predictability for Host Communities and Client Companies

1. *Did the Performance Standards create predictability around impacts and mitigation measures for host communities and client companies?*

CAO found that while the Performance Standards have encouraged consultation with host communities across a

Figure A: Core Activities of CAO's Review



range of investments, there are still gaps in engagement around impact mitigation activities and Action Plans, as well as in reporting on development impact. These gaps undermine efforts to build constructive relations and secure community support. Further, the clarity of client company requirements established in Action Plans varies across investments.

2. *What is IFC's approach to Broad Community Support?*

IFC's implementation of its Broad Community Support commitment has been highly restrictive and not transparent. As a result, IFC has missed the opportunity to play a leadership role in helping to advance the implementation of local approval processes. IFC's application of the Broad Community Support commitment has changed over time, yet these changes have not been clearly communicated.

B. The Performance Standards in the Context of IFC's Changing Business Model

3. *What has been IFC's experience with applying the Performance Standards to client companies with lower capacity?*

IFC's work with lower capacity companies has strong development impact potential, however, incentives for staff and client companies alike could be more closely aligned with this goal. While low capacity companies need support to upgrade their management systems, IFC's Advisory Services are not readily available to support them.

4. *What works well and where are the challenges in applying the Performance Standards to different IFC activities?*

IFC has implemented the Performance Standards in the context of equity investments and corporate loans through a focus on the quality of its client companies' E&S management systems. Delineation of due diligence boundaries represents a challenge for these types of investment. Further, there is a lack of clarity and gaps in institutional infrastructure regarding application of the Performance Standards to Advisory Services.

5. *How has IFC assured itself of adequate environmental and social risk management for its financial intermediary (FI) investments?*

Despite improvements, there is still a substantial gap between theoretical E&S requirements and their practical application. Weak support from investment staff and management, together with significant resource constraints, hinder E&S specialists' efforts to improve the E&S performance of financial intermediary clients. Incentives provide an ideal mechanism for IFC to ensure sound E&S performance.

IFC's E&S requirements represent a more rigorous standard than what is generally expected of financial intermediaries by regulators and other investors. With the adoption of the Equator Principles, IFC has become a standard setter in financial markets, and as such, IFC can play an increased role in the dissemination and application of E&S standards in the sector.

C. IFC's Management Systems & Information Disclosure

6. *How effective has IFC been in establishing processes and practices to support effective implementation of the PPS?*

A company's commitment, its capacity, and IFC's own influence and leverage are all important factors in achieving strong E&S performance. Although IFC addresses these risk factors implicitly, it has not established guidance and indicators or a separate system to assess and track them in its investments. Annual Monitoring Reports provided by client companies are inconsistent in quality, which creates knowledge gaps for IFC. To complete the integration of E&S concerns into IFC's risk management, IFC should consider the most effective organizational position of its Environmental and Social Development Department.

7. *Do IFC's institutional culture and incentives support effective integration of environmental and social issues?*

The effectiveness of IFC's E&S due diligence is affected by investment staff support. CAO found that investment staff support for E&S risk and impact management is inconsistent. There is a gap between the perceptions of the value of IFC's E&S inputs by investment staff on the one hand and client company feedback on the other hand. Investment staff does not appear to be adequately incentivized to support E&S risk and impact management.

8. *How transparent and accessible is IFC to its stakeholders in member countries?*

IFC's Disclosure Policy sets out a presumption in favor of disclosure. However, the policy undermines this very presumption by specifying what information can be disclosed, rather than establishing a limited list of information that cannot. CAO found that the level of awareness about IFC in its member countries is very low. IFC's main portal for stakeholders to access information is its website. However, IFC does not routinely update public information available about its investments. Further, language is a major barrier to effective access to information for non-English speaking stakeholders in IFC member countries.

Recommendations

CAO has prepared recommendations to address each of the eight findings areas. The complete set of recommendations is provided in Table 5 and 6 (see p. 29 and 30). To help identify where the most significant benefits can be realized, CAO has outlined the following priority recommendations for IFC, which are summarized in Table A:

- Improve project-level engagement
- Address gaps in the E&S performance of IFC's financial intermediary portfolio
- Enhance IFC's capability to incorporate E&S risk factors into decision-making processes

Table A: Priority Recommendations

A. Improve project-level engagement

Findings:	Recommendations:
• Action Plans are often not disclosed to communities, and communities are not updated on implementation progress. • Communities are not being consistently involved in discussions around impact mitigation activities. • Gaps in feedback to communities and in reporting on development benefits undermine efforts to build constructive relations and community support. • Local development benefits and jobs are priorities for host communities. • IFC does not provide up-to-date information about its investments.	• Address gaps in client company engagement around E&S mitigation measures. • Ensure client companies disclose Action Plans and update communities on progress at least annually. • Improve project-level reporting by client companies and IFC. • Encourage client companies to engage communities around project benefits. • Adapt investment staff incentives to reflect the value of E&S performance.

B. Address gaps in E&S performance of IFC's financial intermediary portfolio

Findings:	Recommendations:
• There is still a substantial gap between theoretical E&S requirements and their practical application. • Internal constraints inhibit IFC's efforts to improve E&S performance of FI clients: – Weak support from investment staff hinders IFC's effectiveness in achieving sound E&S performance. – E&S specialists working with FIs carry out their work under significant resource constraints.	• Increase staffing level for E&S appraisal and supervision of IFC's FI portfolio. • Champion E&S concerns in the Global Financial Markets department through management awareness, and accountability through departmental and investment staff incentives.

C. Enhance IFC's capability to incorporate E&S risk factors into decision-making processes

Findings:	Recommendations:
• Choosing committed client companies is critical to achieving strong E&S performance. • Working with companies that start at lower levels of capacity is resource intensive but has significant development impact potential. • IFC's E&S risk categorization still fulfills important internal functions. • IFC's E&S risk categorization for corporate loans mixes actual risks with mitigating/exacerbating factors.	• Categorize projects based solely on their underlying E&S risk. • In addition to project risk, separate and professionalize the assessment of: – client company commitment; – client company capacity; and – IFC's sphere of influence/leverage. • Make investment and resource-allocation decisions based on careful consideration of all risk factors listed above.

Section I: Background

Compliance Advisor/Ombudsman (CAO): Mission and Mandate

The Compliance Advisor/Ombudsman (CAO) is the independent recourse mechanism for the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA), reporting directly to the President of the World Bank Group. CAO's mandate is to address complaints by project-affected people with the goal of enhancing the social and environmental outcomes on the ground and fostering greater public accountability of IFC and MIGA. CAO has three roles. As ombudsman, CAO helps local stakeholders to resolve issues of concern through assisted negotiation. In its compliance function, CAO conducts appraisals and audits of IFC/MIGA's social and environmental performance. In its advisory role, CAO provides guidance to the President and management of IFC and MIGA on broader environmental and social issues related to policies, standards, procedures, guidelines, resources, and systems established to ensure adequate review and monitoring of IFC/MIGA projects.

CAO's Advisory Work in the Context of IFC's Evolving Policy Framework

CAO has had significant involvement in IFC's evolving policy framework. The development of IFC's Policy and Performance Standards on Social and Environmental Sustainability (PPS) resulted from CAO's review of IFC's Safeguard Policies in 2003[1]. Most recently, CAO commented on IFC's Progress Report on the first 18 months of application of the PPS. These previous contributions are available at www.cao-ombudsman.org.

The PPS and Policy on Disclosure of Information came into effect on April 30, 2006. Together, they constitute IFC's Sustainability Framework. When approving the Sustainability Framework, IFC's Board of Executive Directors requested IFC to review its experience after the initial three years of implementation.[2] This Advisory Note represents CAO's contribution to IFC's review and update of the Sustainability Framework. It has been completed in time for it to be considered by IFC and its stakeholders in the context of the review and update process.

Independent Contributions of CAO and the Independent Evaluation Group (IEG) to IFC's Review and Update Process

CAO provides its contribution to IFC's review and update process as an independent voice alongside the World Bank Group's Independent Evaluation Group.

IEG are conducting a review of the World Bank Group's use and implementation of its Safeguard Policies at the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), as well as both the pre-2006 Safeguard Policies and the post-2006 Performance Standards at IFC and MIGA[3].

CAO has worked closely with IEG in order to ensure a complementary approach to avoid duplicating efforts. For example, in selecting projects for CAO's portfolio review, CAO gave preference to projects that were also being analyzed by IEG. In considering some of the same projects, IEG's approach and evaluation are substantially larger in scope and breadth of issues and questions covered. In comparison, CAO's review was tailored to focus on issues of direct consequence to locally impacted stakeholders in accordance with CAO's mandate, and range of experience as IFC's and MIGA's independent recourse mechanism for project-affected communities.

Section II: Approach

Focus of CAO's Advisory Note

Three years after the adoption of IFC's Sustainability Framework, most of the projects that have been processed under the PPS are only just beginning to generate outcomes. Therefore, CAO's review concentrated on IFC's *implementation* of the PPS to date, focusing specifically on IFC commitments and client company requirements with a direct impact on host communities and the company-community relationship, and the effectiveness of IFC's underlying management system.

Drawing on CAO's Experience

In developing its approach, CAO drew on experiences and lessons of both the ombudsman and compliance functions, through a desk review of past complaints and the existing body of advisory work carried out by the office, which was complemented by interviews with CAO staff. Specifically, CAO experience shows that sound company-community engagement creates predictability around project-level impacts and mitigation measures, and can help to prevent conflict around private sector projects[4]. Further, CAO's extensive outreach effort over a period of 24 months[5] provided valuable input to assess the effectiveness of IFC's Policy on Disclosure of Information.

Incorporating Changes in Context

As part of its review, CAO analyzed factors both internal and external to IFC that may influence the effectiveness of IFC's policy framework. Specifically, CAO analyzed whether IFC's current policy framework and implementation practices remain suited to an institution undergoing significant change.

i. IFC's changing product mix and business model

Over the last decade, IFC's business model has changed significantly: while IFC was primarily a project finance investor until the 1990s, today, project finance represents only a minority of investments. This can be attributed to a growth in the use of other product types such as corporate loans, equity investments, risk guarantees, trade finance, and investments in financial intermediaries (FIs).

IFC has strengthened its focus on frontier markets, increasing its activities in IDA and post-conflict countries[6]. During IFC's last fiscal year, projects in IDA countries accounted for 42 percent of IFC investments and more than 46 percent of new advisory projects.[7] Investments in financial markets and funds projects during the same time frame represented 48 percent of new investments. Recent turmoil in financial markets has led to significant growth in trade finance, and IFC may further increase its share of equity investments and short term loans to respond to needs as companies adapt to the fragile economic climate.

ii. Growth in Advisory Services

Advisory Services have become a significant proportion of IFC's activities. The E&S risks and impacts vary significantly between the different types of advisory product, with some yielding substantial E&S risks.

IFC's current Sustainability Policy stipulates that the Performance Standards are to be used as a reference in addition to national law when IFC provides Advisory Services to large-scale investments.

iii.IFC's decentralization efforts

IFC has embarked upon a decentralization strategy with the aim of building stronger relationships with client companies and governments through an increased IFC staff presence in its countries of operation, which has been organized around regional hub offices in Hong Kong, Istanbul, Johannesburg and São Paulo (see Table 1, p.8).

IFC is decentralizing both staff and some project decision-making from headquarters to regional offices.

Table 1: IFC Staff Distribution

	Fiscal Year 2004	Fiscal Year 2009
Field Offices	963 (43%)	1,827 (54%)
Washington	1,291 (57%)	1,575 (46%)
Total	**2,254**	**3,402**

iv. External developments

With the launch and adoption of the Equator Principles[8] by 67 international financial institutions, IFC's Performance Standards have evolved into a global standard for E&S risk management in emerging market project finance, extending IFC's influence beyond its own portfolio.

Over recent years, the human rights responsibilities of the private sector have been further defined in the work of UN Special Representative on Business and Human Rights, John Ruggie[9]. This development presents IFC with an opportunity to update the PPS in accordance with this new policy framework for business and human rights.

Key Characteristics of the Policy and Performance Standards

CAO considered a number of key characteristics of the PPS, as well as the changing external context in which IFC operates, to determine the focus of the review:

i. Outcomes-based framework

The PPS embody an outcomes-based framework. This framework allows flexibility for IFC and its client companies to determine the means to achieve desired outcomes based on project specific risks, rather than working with a set of inflexible procedural requirements attached to a project's E&S risk category.

Accordingly, the Performance Standards allow actions to be adapted to a particular project's anticipated risks and impacts. An assessment of gaps between a project's current E&S design or performance and applicable regulations and the Performance Standards is undertaken, and a concrete set of actions to address those gaps is set out in 'Action Plans'[10], which are then covenanted as part of the legal agreement between IFC and its client company. Subsequently, the client company is tasked with implementing these requirements using, and sometimes updating, its environmental and social management system.

ii. Importance of community engagement

The Performance Standards specify further requirements for early and ongoing engagement of companies with their host communities. Host communities are to be informed of the project and its anticipated risks and impacts, and their input to be sought on proposed mitigation measures. The required levels of consultation and community participation increase in accordance with the level of anticipated risk and impacts.

iii. Centrality of client company management systems

The PPS place stronger emphasis on the quality and capacity of company E&S management systems, which implement E&S mitigation measures day-to-day, as well as creating and maintaining relationships with host communities. As IFC has increasingly become involved in corporate investments such as corporate loans and equity investments, rather than project-specific lending, the focus on client company management systems is even more critical.

Central Questions of CAO's Review

The central questions addressed in CAO's review are:

- Has IFC's application of the PPS throughout its portfolio supported the establishment of transparent client company requirements, and clear expectations and predictability for both client companies and communities at the project-level?
- Have IFC's own environmental and social management system and supervision capacity been adequately strengthened to support the move from process compliance to accountability for outcomes, ensuring the effectiveness and impact of the PPS?

For more information, see CAO's Approach Paper at www.cao-ombudsman.org

Core Activities of CAO's Review

Portfolio Review

CAO assessed relevant project documents of 30 IFC projects processed under the PPS. The choice of project sample balanced the need for representativeness of IFC's portfolio with the aim to assess projects that were likely to yield relevant insights for the questions posed.

CAO acknowledges that it is difficult to draw systemic conclusions from a limited project sample. To verify findings and test conclusions from the portfolio review projects for their systemic relevance, CAO conducted meetings with the reviewed projects' environmental and social specialists and other relevant staff from IFC's Environment and Social Development Department, and with investment department staff, in order to learn more about their experiences of applying the PPS (see section on Methodology, p. 11).

For more information on project selection, see CAO's Note 'Project Selection Method' on www.cao-ombudsman.org

Local Stakeholder Perceptions Study

CAO commissioned the Consensus Building Institute (CBI)[11] to carry out a local stakeholder perceptions study. Five projects were selected for in-depth assessment through field work. Local stakeholder perceptions in each project were ascertained through confidential interviews and discussions with a broad range of local stakeholders, including community leaders, civic groups, and local non-profit organizations. Equally, IFC's client companies' views were sought in relation to their experience working with IFC and the Performance Standards. (See section on Methodology, p. 11).

Other Inputs

During the development of this Advisory Note, input and comments were sought from various stakeholders and peers including: CAO's Strategic Advisors Group; the Peer Review Group convened for this Advisory Note; IFC management; IEG; and civil society representatives in the context of the WBG Spring Meetings 2009. (See section on Methodology, p. 11).

Section III: Methodology

Portfolio Review

All projects selected as part of the portfolio review were processed under IFC's Policy and Performance Standards on Social and Environmental Sustainability (PPS). In selecting projects for review, CAO balanced two major objectives in choosing the project sample. On the one hand, CAO selected projects broadly representative of IFC's portfolio in terms of regional and sector spread, as well as environmental and social risk category. On the other hand, CAO selected projects that were likely to generate pertinent insights into the effectiveness and impacts of the new framework on policy areas of direct impact on local communities.

The project sample is composed of 18 real sector projects that were chosen among *sensitive sectors*. Sensitive sectors were defined as those sectors in which projects triggered Performance Standards 4, 5, 7, or 8[12] in more than half of projects. Among these sectors, CAO separated those in which IFC has invested several times since the adoption of the PPS, and selected projects with view to gaining a cross-regional view (see Tables 2 and 3). The project sample also includes 8 financial intermediary projects chosen to achieve broad regional representation among financial sector projects that may also pose environmental and social risks. In this case, projects selected either applied the Performance Standards or related to the sensitive sectors identified through our real sector selection. Finally, four projects that were the subject of complaints to the CAO were assessed in order to draw on specific insights gained from these projects.

CAO acknowledges that these projects may not be representative of the IFC portfolio overall.

CAO subsequently met with IFC investment and environment and social (E&S) specialist staff to verify findings and test conclusions from the portfolio review and the local stakeholder perceptions study for their systemic relevance.

CAO conducted a desk review of the 30 project sample, which involved analysis of a variety of both IFC and client company documentation. The review of IFC documentation included Board Reports; Environmental and Social Review Summaries; Environmental and Social Review Documents; client company legal requirements; development outcome indicators tracked by IFC; Project Supervision Reports; IFC's documentation of Broad Community Support; and documentation of CES peer reviews. Review of client company documentation included Environmental and Social Impact Assessments; Action Plans (including, as relevant, Resettlement Action Plans, Indigenous Peoples Development Plans, etc); Annual Monitoring Reports; and Sustainability Reports.

Local Stakeholder Perceptions Study

Projects selected by CAO for the Local Stakeholder Perceptions Study, conducted by CBI, are a purposeful sample that represents different IFC industry departments and regions, and includes projects that have triggered

Table 2: Portfolio Sample by Region

Region	Number of projects
Middle East and North Africa	2
Sub-Saharan Africa	3
Latin America and the Caribbean	8
South Asia	4
East Asia and the Pacific	7
Europe and Central Asia	5
Global	1
Total	**30**

Table 3: Portfolio Sample by Industry

Industry	Number of projects
Agribusiness	7
Oil, Gas, Mining and Chemicals	4
Infrastructure	4
Manufacturing and Services	7
Financial Markets	8
Total	**30**

IFC's requirement for Free, Prior and Informed Consultation leading to Broad Community Support[13]. In comparison with IFC's overall portfolio and CAO's portfolio review sample, the smaller sample analyzed for this stakeholder perceptions study has a higher concentration of projects with significant environmental and social impacts.

CBI and its global partners interviewed local stakeholders around the five IFC project investment sites located in India, Peru, Philippines, and Mozambique. The study covered one project in agribusiness, two in infrastructure, one in sub-national finance, and one in the extractive industries. The purpose of this study was to review whether the application of the Performance Standards has led to clear expectations and predictability for companies and communities around project impacts and mitigation measures.

The interview procedure aimed to address various issues, including:

- Stakeholders' experience with the consultation and assessment process before project implementation (what happened, was it perceived as adequate, how did communication occur?);
- The predictability of impacts and events (were impacts understood and was the process clear?);
- Stakeholder engagement results (did anything change as a result of engagement, were concerns addressed, perceived adequacy of mitigation measures, how has communication occurred/continued?);
- Comparison to other experiences (how does this experience compare with stakeholder interactions around other development projects?); and
- The IFC-company relationship (clarity of roles & responsibilities, IFC capacity to play a productive role?).

Feedback from CAO Outreach Participants

To date, CAO has conducted outreach via workshops and meetings that have brought together over 700 civil society organizations from 30 different countries. Civil society participants were 'self-selected', meaning that an in-country convener (typically, a national NGO with good credibility and local knowledge) selected a representative group of local civil society participants to attend each event. CAO vetted the participant lists to ensure the inclusion of individuals with a good level of relevant expertise.

With assistance from CBI, CAO collated data from the outreach to evaluate its effectiveness, and consolidate recommendations from civil society participants. This assessment used three primary sources of data: 96 evaluation forms filled out by outreach participants at the end of the meetings; a survey sent by CBI via email to 452 participants of CAO outreach workshops, which resulted in 74 completed responses; and 17 interviews, conducted by CBI, with a targeted group of civil society representatives, CAO senior staff, IFC specialists, and senior staff from the independent accountability mechanisms of three other international development institutions.

Section IV:
Findings And Recommendations

A. PREDICTABILITY FOR HOST COMMUNITIES AND CLIENT COMPANIES

IFC's current approach: Rather than providing a prescriptive set of procedural requirements triggered by an investment's E&S risk category, the Performance Standards (PS) embody an outcomes-based framework allowing IFC and its client companies flexibility in determining the means to achieve desired outcomes based on project specific risks identified in E&S assessments. Company actions required to meet the PS are then set out in Action Plans, and covenanted as part of the investment agreement between IFC and the client company. The company's own E&S management system plays the central role in implementing the Action Plan requirements.

Another important aspect of the Performance Standard framework is a company's engagement with host communities. IFC client companies are expected to engage with communities early, to build constructive relationships and maintain them over time. Depending on the nature of the company's operations and its associated risks and impacts, engagement may range from limited to extensive, spanning from dissemination of information to consultation, to community participation in decision-making, to good-faith negotiations leading to mutual agreement. Where investments may involve significant adverse impacts on affected communities, IFC commits to assuring itself that Broad Community Support exists before presenting the investment to its Board of Directors.

The questions we asked:

1. *Did the Performance Standards create predictability around impacts and mitigation measures for host communities and client companies?*
2. *What is IFC's approach to Broad Community Support?*

1. Did the Performance Standards create predictability around impacts and mitigation measures for host communities and client companies?

What we found:

- The Performance Standards have encouraged engagement of host communities in a range of investments including projects with lower levels of anticipated impact

CAO's review found that IFC's E&S specialists now address social issues in projects with relatively lower impacts, which previously may not have benefitted from this type of attention. A certain level of community engagement now routinely takes place in the majority of projects with category B[14] risks.

Interviews with local stakeholders of five IFC financed projects[15] suggested that, generally, the client companies involved engaged effectively with host communities around issues of concern highlighted as a *priority* by those communities. Specifically, local stakeholders in this project sample expressed a high level of satisfaction with how IFC's client companies handled land acquisition and resettlement issues.

Results from IFC's 2009 Investment Client Survey suggest that the focus on community engagement is generating positive results from the perspective of its client companies: 52 percent of client companies stated that 'improved relationships with stakeholders' was an area of positive change resulting from IFC's environmental & social input.[16]

- **Communities are not being adequately involved in discussions around impact mitigation activities**

However, many local stakeholders voiced concerns[17] that engagement with companies operating in their community does not sufficiently address impact mitigation measures. In fact, stakeholder interviews revealed that, in many cases, community members were unaware of company mitigation measures.

CAO's portfolio review found comparable gaps regarding IFC client companies' community engagement in relation to impact mitigation activities. Documented evidence demonstrated that just over half of the assessed projects that developed Action Plans were disclosed publicly by IFC client companies (see Table 4. p. 14). None of these projects demonstrated that affected communities were updated at least annually on the Action Plan's implementation, as required by Performance Standard 1.

Table 4: Host Community Engagement Indicators in Portfolio Review Sample

	In the PPS	CAO Portfolio Review
Action Plans disclosed to communities	PS 1, paragraph 26[18]	8 out of 15 projects (53%)[19]
Communities updated on Action Plan implementation	PS 1, paragraph 26[20]	0 out of 15 projects (0%)
Projects establishing Grievance Mechanisms	PS 1, paragraph 23[21]	10 out of 19 projects (53%)[22]
Action Plans disclosed on IFC's website	Disclosure Policy, paragraph 13[23]	14 out of 15 projects (93%)

Further, while IFC routinely verifies that client companies have established Grievance Mechanisms where this was a requirement, there is only limited evidence that their use and quality are assessed. Feedback from local stakeholders[24] suggests that interviewees at times were unaware of the existence of a complaints system, how to use it, who to contact, and how to follow up. Respondents in one project expressed that a variety of complaints remained outstanding.

In CAO's experience, host communities that are informed of planned E&S mitigation measures can act as an early warning system, raising concerns with the company as soon as they emerge. This enables the company to address concerns before they may escalate into confrontation or potential conflict. This local interaction can strengthen IFC's supervision efforts by empowering local stakeholders and making IFC less reliant on information provided by client companies.

"Effective grievance mechanisms are an important part of the corporate responsibility to respect human rights. A major barrier to victims' accessing available mechanisms, from the company or industry to the national and international levels, is the sheer lack of information available about them."[25]

Professor John Ruggie,
UN Special Representative on Business & Human Rights

The Performance Standards would benefit from greater clarity on the level of community engagement required of client companies whose operations cause only limited impacts. In CAO's experience, such engagement can still prove beneficial: for example, to cross-check company assumptions that stakeholders also perceive impacts to be minimal; to provide opportunities to align the expectations of companies and communities; and to identify opportunities to increase local development benefits.

- **Gaps in feedback to communities and in reporting on development benefits undermine efforts to build constructive relations and community support**

Interviews with local stakeholders[26] revealed that in several cases, stakeholder concerns had been addressed by the company, but mitigation measures were not communicated to them. For example, in one case, local people had expressed apprehension about noise and air pollution. The company had responded by investing in specific technologies to mitigate such impacts, however had not communicated the mitigation measures to the community.

Stakeholder interviews also revealed that in many cases, community members were unaware of company activities with beneficial impacts, such as a company paying to pipe fresh water into a residential area as part of water provision to its new facilities. In another project, interviews revealed clearly that community support was strengthened by the company's provision of new local infrastructure, highlighting the potential benefit to companies of proactive engagement with host communities around developmental benefits.

However, CAO's portfolio review revealed little evidence of IFC client companies tracking and reporting their development impacts to host communities.

Furthermore, IFC does not specifically track development outcomes for affected local stakeholders in its development outcomes tracking system (DOTS).

- **Local development benefits and jobs are priorities for host communities, as are concerns about migrant workers**

Local development, local jobs, and concerns around migrant labor emerged as priority issues for interviewed community stakeholders. Local stakeholders in two different projects voiced similar concerns about migrant workers.

Migrant workers were considered a threat to local jobs, and, in one project, as bringing risks of disease and crime. Local non-governmental organizations (NGOs) on these two projects emphasized the vulnerable status of migrant workers.

"They have brought workers from elsewhere. They say they are qualified but we look and see that they work with a shovel and that is not a qualified person, it is pure excuse just not to provide jobs for our young people."[27]

Community representative, IFC-financed project

The Performance Standards currently provide no guidance for client companies around these issues. IFC has, however, made some guidance available both on providing adequate living conditions for workers[28] and on managing impacts of in-migration in projects[29].

- **Clarity of client company requirements varies across investments**

In the outcomes-based approach of the Performance Standards, Actions Plans set out the mitigation measures the client company needs to undertake in order to address any gaps between current performance and the requirements of the standards. Public disclosure of Action Plans helps to create predictability regarding client company requirements. A large majority of Action Plans that CAO reviewed[30] as part of the portfolio review was based on thorough, up-front analysis and provided a range of essential actions to help bring client company operations in line with the Performance Standards.

The extent to which Action Plans created clarity around exact company requirements varied across investments reviewed by CAO. While all but two of these Action Plans provided clear company action requirements and prioritized them, 20 percent did not include clear timelines for implementation. CAO's review identified several examples of high quality Action Plans, which distinguished themselves by clearly articulating required actions, associated timeframes with concrete dates, and providing indicators that IFC would use to measure implementation.

Since Action Plans constitute the principal agreement between IFC and its client companies about required E&S actions, clarity of language and expectations is crucial from a legal perspective. Precise language helps provide leverage for IFC to enforce client company requirements in the case of poor performance, particularly if IFC has already disbursed a significant share of its investment.

Recommendations

- **IFC should help create predictability for communities and client companies by:**

– Ensuring that client companies disclose Action Plans to host communities, and report on progress in implementing Action Plan items at least annually, as per PS 1;
– Routinely addressing the quality and use of grievance mechanisms with client companies;
– Providing greater clarity around minimum stakeholder engagement levels for low impact projects;
– Encouraging client companies to engage communities around project benefits, communicate clear and realistic expectations around local employment opportunities, and monitor and report key data on development benefits to local stakeholders;
– Considering how to address aspects relating to migrant workers in PS 2;
– Defining Action Plan requirements clearly, specifying completion dates and including indicators to measure achievement.

2. What is IFC's approach to Broad Community Support?

What we found:

- IFC can play an important role in advancing the practical implementation of local approval processes

Today, there is wide-spread recognition that successful private sector projects cannot be realized against strong opposition from local stakeholders. Leading companies now routinely pursue engagement processes with host communities, with the aim of achieving mutual understanding about the modalities of their co-existence, and community support for their operations.

While local approval processes are particularly important in terms of respecting Indigenous Peoples' rights[31], the same issue extends equally to other project-affected communities. This is an area where the positions of rights advocates can clash with the approaches of companies, which tend to view local approval processes through the lens of E&S risk and impact management. Are local approval processes about communities' rights to give or withhold their "free prior and informed consent" (FPIC) to proposed projects? Or is this primarily about a company's pursuit of a "social license to operate" with the aim to achieve a predictable operating environment?

In practice, these different approaches to local approval processes struggle with the same implementation challenges: whose consent needs to be obtained, especially where a project, such as a pipeline, affects a range of local stakeholders? How can consent be obtained from communities with a multitude of views and voices, at times contradictory, about a proposed project? How does a company maintain community support over time?

While the debate continues about what local approval processes should entail, different actors are attempting to apply them in practice. Guidance documents provided by different actors in this context, such as implementation guidance for ILO Convention 169[32] and FPIC guidance by NGOs[33], display many common elements with implementation guides prepared by progressive companies[34] to community approval processes.

These documents usually describe a relationship process in which companies give local stakeholders timely access to information in local languages; a process of participation in decisions that affect communities directly; and, at times, direct negotiations over specific outcomes and benefit-sharing agreements. They stipulate that decision-making processes of the local community are to be respected, and some assurance should be provided that different groups within the community, including vulnerable groups, have been able to participate. In addition, company guidance usually sets local approval processes in the context of a company's overall social performance program. They identify risk and impact factors that trigger different levels of required community engagement, ranging from access to information to negotiated agreements and strategic partnerships with local stakeholders.

Local approval processes specifically aim to strengthen the voice of local stakeholders in otherwise often unequal relationships. Neither ILO Convention 169 nor local approval processes set out in other types of guidance endorse a veto power for individuals or small sub-groups within communities. Nevertheless, companies nervous about local approval processes commonly express a concern about "veto rights".

- IFC's approach to Broad Community Support is not transparent

IFC's policy separates its client companies' requirement to engage with communities in a process of "free, prior, and informed consultation"[35] and IFC's own commitment to assure itself that there is Broad Community Support (BCS) for the project. In determining Broad Community Support, IFC weighs a number of different factors.[36] The process usually involves discussions with local stakeholders. In addition, for projects with certain types of impacts on Indigenous Peoples, Performance Standard 7 sets out the client company requirement to enter good faith negotiation processes with the affected communities[37].

With company and community stakeholders trying to work through the implementation challenges around local approval processes, IFC can play an important role in helping its client companies implement processes leading to local approvals, or Broad Community Support. Shared publicly, IFC's body of experience in helping its client companies implement this type of process could serve to inform emerging practice.

In practice, CAO found that IFC's application of its BCS commitment has been rare and not transparent. IFC neither discloses which projects have triggered the commitment, nor how it has determined Broad Community Support. Interviews with representatives of local communities[38] in two projects that triggered IFC's BCS commitment indicated that impacted communities were not aware of IFC's BCS commitment, or its efforts to gauge support for the project.

This approach to Broad Community Support, as established in IFC's Sustainability Policy, allows IFC to maintain full control over the process, however it runs the risk of taking the desired outcome of the engagement process out of the hands of local stakeholders—both companies and communities.

An additional result of IFC's policy and the resulting internally driven process is that the BCS determination has become a one-off event prior to IFC Board approval. This can send the signal to IFC's client companies that community support needs to be achieved only at a single point in time, rather than maintained throughout the life of operations. Even if Broad Community Support is seen purely as a risk-management tool, this message sets expectations contrary to effective risk management.

- IFC applies Broad Community Support only to few high risk projects

CAO reviewed IFC's application of Broad Community Support in three IFC projects, and found that its approach involved significant due diligence, which appeared thorough in two of three cases. IFC's application guidance is very elaborate and appears to have contributed to a highly restrictive application of the BCS commitment. This is illustrated by the fact IFC does not apply it unless it anticipates significant adverse impacts, and not to projects in various stages of implementing a project, such as in early planning, or in later operational phases.

In the case of the extractive industries, for example, IFC only exceptionally seeks to assure itself of Broad Community Support for projects in the exploration phase, judging that such projects lack definition in scope, affected community, or impacts on the community to be able to implement its Broad Community Support commitment. This remains the case despite the fact IFC's client companies will need to establish local approval for the eventual development project, and that early interactions have a strong influence on the quality of their later relationship.

CAO finds that the approach IFC has adopted in relation to local approval processes results in IFC missing an invaluable opportunity to assist its client companies to address one of the most challenging aspects of their operations - achieving local support over time - and to contribute transparently to this issue of evolving practice.

- IFC has changed its application of Broad Community Support over time

IFC's implementation of BCS has evolved over time. Initially adopted as part of the World Bank Group's Management Response to the Extractive Industries Review, Broad Community Support was to be applied to all new projects in the oil, gas and mining sectors. With the adoption of the Performance Standards, this commitment was extended to apply to high impact projects in all sectors.

Over time, IFC has restricted its application of BCS in the oil, gas and mining sectors to only those projects where IFC feels able to define anticipated impacts and expects them to be significant. This occurred in line with practice in other sectors, as set out in the Performance Standards.

While there was initially a period of internal ambiguity, this practice has now been codified in IFC's Environmental and Social Review Procedure.[39] While the procedural change has helped to improve clarity for E&S specialists, CAO finds that IFC's change in approach to the extractive industries in this regard has not been clearly communicated to external audiences or IFC's Board of Directors.

Recommendations

- **IFC should make its BCS determination transparent and help its clients achieve local approval in different project circumstances by:**
  - Adopting a transparent, principles-based framework that sets out how to determine the appropriate level of engagement- from information disclosure to good faith negotiations, setting out triggers and indicators for when it is necessary for companies to engage in local approval processes;
  - Disclosing to which projects IFC applied the BCS commitment, and the basis of the determination, and documenting different aspects of the engagement leading up to local approval: for example, how has the company incorporated cultural norms in decision-making processes into its engagement with communities?;
  - Providing more flexible BCS guidance that is tailored to different project circumstances, and expanding its application pragmatically beyond the highest risk circumstances.

B. THE PERFORMANCE STANDARDS IN THE CONTEXT OF IFC'S CHANGING BUSINESS MODEL

IFC's current approach: IFC's business model and portfolio are changing. The institution has decentralized, increased its focus on frontier markets, grown over recent years and continues to do so. Decentralization and a focus on frontier markets have brought with it an increasing number of loans to smaller and lower capacity client companies. IFC's product mix is also changing: at 48 percent of new investments last year, indirect investments in financial intermediaries now represent the single largest sector receiving IFC financing, and a rising share of IFC investments is aimed at supporting companies' operations at large through corporate investments such as corporate loans or equity investments.[40] Further, IFC's Advisory Services have grown significantly in recent years and today, 32 percent of IFC staff work in Advisory Services[41].

IFC uses the same set of Performance Standards in all industries and regions, for different types of investment,[42] regardless of the capacity of its client companies at the outset. While the Performance Standards evolved out of a tradition of E&S impact management for relatively clearly defined project finance investments, they now apply to a range of product types including corporate loans and equity investments. IFC applies the Performance Standards to select investments in financial intermediaries, and they are used as a reference in addition to national law when IFC provides Advisory Services to large-scale investment projects[43].

The questions we asked:

3. *What has been IFC's experience with applying the Performance Standards to client companies with lower capacity?*
4. *What works well and where are the challenges in applying the Performance Standards to different types of IFC activities?*
5. *How has IFC assured itself of adequate environmental and social risk management for its financial intermediary investments?*

3. What has been IFC's experience with applying the Performance Standards to client companies with lower capacity?

What we found:

- **Working with companies that start at lower levels of capacity is resource intensive, but has significant development impact potential**

When IFC works with companies that start out with lower capacity to manage E&S risks, the potential for positive change in company practices can be significant. There is a clear developmental benefit to extending the application of international E&S risk and impact management standards beyond large and established players to mid-tier companies. Project-impacted communities and the environment stand to gain significantly from improved company practices; however improvements can take time and require significant IFC support to achieve.

CAO's review revealed that IFC's assessment does not systematically record client companies' capacity, or track changes in capacity brought about by IFC's intervention. Similarly, the significant E&S staff time and effort required to work with low capacity client companies are not adequately recognized and incentivized.

- **Low capacity client companies need support to upgrade their management systems**

The quality of a company's management system is at the heart of achieving improved E&S performance, and in turn meeting IFC's Performance Standards. As such, this is where IFC's help is most needed in working with low capacity companies.

CAO's portfolio review revealed instances of client companies specifically requesting further assistance in relation to meeting E&S requirements, which E&S specialists did not appear to have the time or resources to meet.

CAO's Local Stakeholder Perceptions Study similarly revealed client companies' desire to see IFC more involved in building capacity to implement the Performance Standards, instead of operating a "suggest and audit process," in the words of one company, i.e. making recommendations on E&S performance at the front-end, and then auditing compliance with the Performance Standards later with little support in between.

- **IFC's advisory services are not readily available to support low capacity client companies**

CAO interviews revealed that IFC investment and E&S staff experience difficulties mobilizing advisory services to support their client companies.

IFC is careful to avoid offering an indirect subsidy to its client companies by providing advisory services that help companies meet E&S compliance requirements. Differentiation between compliance aspects of the

Performance Standards on the one hand, and developmental or value-added work on the other hand is not easily achieved in this context.

Arguably, IFC's work in helping lower capacity companies achieve significant performance improvements deserves advisory support for its inherent developmental value. Therefore, advisory services to support companies' E&S capacity and management systems should not be considered a 'subsidy' without considering the specifics of any given project or the client company situation.

Providing support to low capacity client companies may also help prevent a situation whereby IFC's Performance Standards are too onerous for IFC to engage with many smaller and lower capacity companies that are committed to improving E&S performance, but have not yet been exposed to the expectations and standards of international markets.

4. What works well and where are the challenges in applying the Performance Standards to different IFC activities?

What we found:

- IFC implements the Performance Standards in corporate loans through a focus on management systems

IFC's Policy on Social and Environmental Sustainability establishes the application of the Performance Standards to all of IFC's direct investments, without specifying how this should be done. In practice, IFC applies the Performance Standards to corporate investments through a focus on its client companies' E&S management systems. IFC assesses whether a company has adequate systems in place to manage the inherent E&S risks of its operations, and requires updates to this system where necessary to ensure future activities will meet the Performance Standards. This approach is codified in IFC's Environmental and Social Review Procedure.

- Delineation of due diligence boundaries remains challenging in corporate investments

In cases where IFC invests at the corporate level in complex companies that carry diverse risks in various locations, delineating appropriate boundaries for IFC's E&S due diligence is challenging. Supply chain risks and legacy concerns are other areas where a clear definition of E&S due diligence boundaries can be challenging.

It is unrealistic to expect IFC's E&S specialists to assess all of a client company's subsidiaries in several different locations. Focusing solely on a company's system at headquarters, however, without assessing the capacity of subsidiaries or key sub-contractors to manage the operations' inherent risks, may lead IFC to overlook significant risks to local stakeholders and the environment, which in turn may pose reputational risks.

CAO's review found that the resultant space for professional judgment has caused some inconsistency in the application of the Performance Standards in the context of corporate loans and equity investments. Available guidance for general corporate and/or equity investments indicates that E&S appraisal should extend to the full range of operations undertaken by IFC's client company, which includes any subsidiaries or management controlled companies[44]. While some of IFC's E&S specialists appear only to assess the client company's E&S management system and quality at corporate headquarters, others extend to assessing the

Recommendations

- **IFC should assess and rate the capacity of its client companies explicitly, in order to:**
  – Track capacity and performance improvements over time;
  – Use the client company's capacity rating alongside the project's inherent risk (E&S risk category) to determine the required staffing and supervision effort;
  – Reward IFC staff (investment and E&S specialists) that successfully work with low capacity companies.

- **IFC should find more effective ways of supporting smaller and low capacity client companies, by:**
  – Carefully gauging the commitment of low capacity companies and only invest in companies committed to a sustained path of E&S performance improvements;
  – Allowing companies with lower capacity longer time frames to meet the Performance Standards, as long as high risks are addressed immediately;
  – Providing positive incentives to client companies, such as reduced interest rates for companies that significantly improve their E&S performance;
  – Offering support and capacity building for strengthened E&S management systems through IFC's Advisory Services or commercial arrangements with qualified consultants.

activities and E&S management systems of subsidiaries where these are considered to pose high E&S risks.

IFC's current procedures and practice lead it, in some investments, to take due diligence related decisions based on product type, financing structures, or limits to its influence or leverage. CAO experience shows that difficulties can arise specifically where IFC determines the boundaries of its due diligence based on factors other than the investment's underlying E&S risks.

- There is a lack of clarity and gaps in institutional infrastructure regarding application of the Performance Standards to advisory services

Advisory services have become a significant proportion of IFC's activities. The E&S risks and impacts vary significantly between the different types of advisory products, with some yielding substantial E&S risks. IFC's current Policy on Social and Environmental Sustainability sets out that the Performance Standards are to be used as a reference in addition to national law when IFC provides advisory services to large-scale investments. This requirement establishes the relevance of the Performance Standards based on the scale of the project, rather than its inherent E&S risk.

The institutional infrastructure for application of the Performance Standards to advisory services is evolving. More detailed guidance for E&S due diligence for advisory services has recently been adopted as part of IFC's Environmental and Social Review procedure[45]. Yet, CAO found that neither the wording in IFC's Policy on Social and Environmental Sustainability nor the lines of accountability for E&S performance in its practical implementation are currently clear within IFC. While E&S specialists' expertise is being drawn on by advisory staff, they do not have an official clearance function for advisory projects, and no dedicated E&S specialists are available to process advisory projects.

5. How has IFC assured itself of adequate E&S risk management for its financial intermediary (FI) investments?

What we found:

- IFC's E&S requirements represent a more rigorous standard than what is usually expected of financial intermediaries (FIs) by regulators and other investors

IFC requires each FI client to establish systems to verify that the companies they lend to follow national laws and regulations. Where the FI's portfolio comprises high risk industries, IFC's FI clients require their investee companies to implement IFC's Performance Standards – regardless of the type of loan or investment. In contrast, in order to adopt the Equator Principles, FIs have to commit to applying the Performance Standards only to project finance investments.

These requirements have significant developmental impact potential: they can support the implementation of national E&S regulation, and spread the application of sound E&S management in different countries and industries, which in turn broadens IFC's reach.

IFC's E&S requirements represent a more rigorous standard than what is usually expected of FIs by regulators and other investors. This makes effective implementation of such requirements time-consuming, as only a few FIs commence with sound E&S management systems in place.

- Despite improvements, there is still a substantial gap between theoretical E&S requirements and their practical application

Over several years, IFC has enhanced its E&S due diligence and capacity for FIs. IFC has faced well documented

Recommendations

- **IFC should use its policy update to clarify and strengthen its application of the Performance Standards to different investment types, by:**
  - Providing accessible and transparent information about how it applies the Performance Standards to different product types, and incorporating the underlying principles in its Policy on Social and Environmental Sustainability;
  - Consistently using an investment's underlying E&S risk to determine boundaries of due diligence.

- **IFC should strengthen internal systems to apply the Performance Standards to advisory services by:**
  - Clarifying requirements in IFC's Policy on Social and Environmental Sustainability, basing applicability on relevance and materiality rather than project scale;
  - Making dedicated specialist resources available to Advisory Services;
  - Placing project E&S screening in the hands of E&S specialists;
  - Instituting a clearance function for E&S specialists.

challenges[46] in achieving sound E&S performance among many of its FI clients. CAO's portfolio review identified examples that confirmed the ongoing existence of significant implementation challenges in IFC's FI portfolio, such as E&S management systems that exist on paper but are not adequately implemented, and FI client mistakes in categorization of, and application of the Performance Standards to, relevant sub-projects.

- **IFC's internal constraints hinder efforts to improve E&S performance of FI clients**

Experience drawn from best practice in IFC investment departments shows that commitment from departmental management plays a fundamental role in signaling the importance of sound E&S risk management, both to investment staff and IFC's client companies. Such commitment manifests itself in consistent interest in E&S concerns, for example in decision meetings, as well as management support and use of IFC leverage where client company performance is weak.

While an FI client's improved E&S risk management features in practically all IFC Board Reports as a core reason and benefit of IFC's proposed investment, many investment staff working with FIs appear to consider E&S requirements as only one of many institutional "add-ons" that IFC's FI clients have to deal with. These issues are often relegated to be discussed only once the deal has already advanced and the relationship with the client FI has been built.

Where support from investment staff is lacking, IFC's effectiveness in achieving sound E&S implementation is weakened, as it translates into E&S concerns not being presented as integral to IFC's work in interactions with FI clients.

In contrast, concerted efforts recently to improve the E&S performance of IFC's FI portfolio in the Africa region have shown initial successes. Performance improvements resulted both from the availability of a dedicated E&S specialist in the region, and from the support of IFC's regional management. Management support was demonstrated by several instances of investment decisions being duly influenced by relevant E&S considerations.

To integrate E&S considerations fully into IFC's investment processes in practice, IFC needs to assess its FI clients' commitment to managing their E&S risks as an important investment screen. Further, IFC needs to ensure early engagement of specialists in the project life, and in discussions with clients consistently across relevant FI investments.

In reality, E&S specialists working with IFC's Funds and Global Financial Markets departments carry out their work under significant constraints. For example, in IFC's fiscal year 2009, five E&S specialists (supported by consultants equivalent to three full time staff) oversaw a portfolio of 432 financial intermediary projects, 125 of which were visited. A further 85 projects were appraised for investment.

Due to both resource constraints and a lack of internal support, the systematic implementation of good practice suggestions, such as systematically participating in investment appraisal visits, visiting select sub-projects financed by IFC client FIs, and spending sufficient time assisting FIs in establishing E&S management systems, is not feasible under the current framework.

- **IFC can do more to provide incentives to FI clients for sound E&S performance**

IFC does not appear to incentivize its FI clients for E&S performance. There are no positive incentives for client FIs that enhance their E&S management systems. CAO has identified very limited use of penalties for FI clients resulting from poor E&S performance, and no instances of IFC ultimately divesting in such circumstances.

Such poor use of IFC's leverage means client FIs may agree to commitments on paper without incentives for performance, and E&S specialists face considerable challenges if clients were not fully committed to E&S objectives prior to project approval.

- **IFC can play an increased role in the dissemination and application of E&S standards in the financial sector**

IFC has begun to reach out successfully to banking and environmental regulators to help develop E&S risk management regulatory frameworks, most notably through a pilot project working with China's Banking Regulatory Commission and Ministry of Environmental Protection to embed the Performance Standards into China's banking regulation.

The adoption of the Equator Principles, which equally embed the Performance Standards, by a growing network of Equator Principles Financial Institutions (EPFI) represents IFC's most significant impact on E&S standards in the financial sector to date.

After a period of growth in the network's membership, the EPFIs are facing increasing pressure to enhance transparency and accountability. They are now in the process of strengthening their network through the elaboration of governance rules and increased reporting requirements for members. This represents an opportunity for IFC to use its special relationship with the EPFI network to help them think through the strengthening process based on IFC's own experience, both in the area of application of the Performance Standards to other investment types, and in enhancing their transparency and accountability.

C. IFC'S MANAGEMENT SYSTEMS AND INFORMATION DISCLOSURE

IFC's current approach: IFC's Policy and Performance Standards were adopted in the context of institutional efforts to integrate environmental and social (E&S) considerations fully into investment processes, and thus "mainstream" these considerations in line with modern risk management functions. Complete integration of E&S considerations has implications for organizational structure and incentives; procedures and practice; decisions on staffing and budget; as well as less tangible institutional attributes such as institutional culture and attitudes.

In parallel, IFC adopted its current Policy on Disclosure of Information and responded to increased public interest in the institution and its activities by adopting a "presumption in favor of disclosure". In reality, the policy then goes on to define exactly what type of information will be disclosed, with all else remaining confidential. There is demand for IFC to be more accessible and make more information available about itself and its activities, particularly information about how its investments are proceeding after Board approval, and whether the development benefits intended at the project approval stage have materialized. *The questions we asked:*

6. *How effective has IFC been in establishing processes and practices to support effective implementation of the PPS?*
7. *Do IFC's institutional culture and incentives support effective integration of environmental and social issues?*
8. *How transparent and accessible is IFC to stakeholders in its member countries?*

6. How effective has IFC been in establishing processes and practices to support effective implementation of the PPS?

What we found:

- **Choosing committed client companies is critical to achieving strong E&S performance**

As a financier, IFC depends on its client companies to implement sound E&S risk and impact management in its projects in accordance with IFC's Performance Standards. Where IFC's investment is not directed at financing a specific project or activity and instead supports a company's activities at large, IFC's ability to steer its client companies' E&S management is relatively limited, which in turn renders company commitment even more decisive. As a result, IFC's ability to gauge adequately client company commitment to sound E&S management is critical.

Recommendations

- **IFC should further enhance its management of the E&S performance of its financial intermediary portfolio, by:**
  - Integrating E&S concerns fully into investment decisions, management priorities, departmental scorecards, and investment staff incentives;
  - Investing only where FIs are fully committed to managing their portfolio's E&S risks, in line with IFC requirements;
  - Involving E&S specialists early in discussions with clients and in investment appraisal visits when FI investments yield E&S risks;
  - Providing incentives to clients for sound E&S performance, for example through lowering interest rates for clients that improve their E&S performance, and divesting or using policy put options in equity investments where client FIs are unwilling to address inadequate E&S performance;
  - Increasing the staffing level for E&S due diligence for FIs.

- **IFC should use its experience and role as a standard setter to help the spread and application of E&S standards in the financial sector, by**
  - Increasing its work with national financial regulators to help incorporate E&S standards in regulatory regimes for FIs;
  - Advising the EPFI network on issues such as how to apply the Equator Principles beyond project finance, and how to strengthen their transparency and accountability.

- **Involvement of E&S specialists during the drafting and finalization of investment agreements is inconsistent**

While sound investment agreements cannot replace the importance of working with committed companies, the manner in which IFC uses its leverage with its client companies can nevertheless impact on E&S performance.

To date, no clear guidance exists that is tailored to E&S specialists about how best to address E&S concerns in different types of investment.

CAO's portfolio review found that the degree to which IFC uses its leverage with client companies to enhance E&S performance is inconsistent, and differs by investment type. In the context of investment loans, good practice examples show specific E&S priority issues being incorporated directly into the investment agreement in addition to a standard reference to the Action Plan in its entirety. Actions related to priority E&S concerns are then often linked as specific conditions of disbursement. IFC is also considering enhancing its leverage in equity investments by including put options or redemption rights in order for IFC to exit equity investments in which client companies are unwilling to address poor E&S performance.

CAO further found that there has been decreasing use of IFC's Environmental and Social Clearance Memorandum. This long standing E&S clearance process ought to occur before a project is presented to IFC's Board of Directors for approval.

In 25 percent of projects reviewed by CAO however, no such document was prepared. Interviews with IFC staff revealed that the more critical timing of E&S involvement and sign-off would instead be at a later stage when the investment agreement is negotiated with IFC's client company. Good practice examples were identified by CAO that illustrated the involvement of E&S specialists at this stage, together with the Investment Officer and the project lawyer.

- **Insufficient information in Annual Monitoring Reports creates knowledge gaps for IFC in client company performance**

IFC relies on its client companies to implement its Performance Standards in accordance with agreed requirements. IFC also relies heavily on client company provided information about the investment's E&S performance, supplemented by E&S specialist supervision visits. In recent years, E&S specialist supervision visits have increased significantly, which has contributed to the reduction of the "knowledge gap" from 12.5% in IFC's fiscal year 2008 to 6.4% in fiscal year 2009[47]. This effort coincided with a sizeable increase in IFC's portfolio.

CAO's portfolio review found that there are genuine gaps in the quality of Annual Monitoring Reports prepared by IFC's client companies. In about a third of the projects that CAO reviewed, IFC deemed its client companies' Annual Monitoring Reports unsatisfactory, many times due to insufficient information being provided to judge the company's performance adequately.

Information deficiencies are not necessarily indicative of performance problems on the ground, however, they may highlight weaknesses in the client company's quality of E&S monitoring and reporting, which can be addressed with IFC's help in order to benefit the quality of the companies' overall E&S management. In addition, client companies that provided insufficient information to judge the company's performance adequately do not appear to be counted as part of IFC's "knowledge gap[48]", which acts as the relevant institutional performance indicator.

- **Providing tools can be effective in improving consistency of Performance Standards application**

The Performance Standards allow for flexible adaptation of E&S requirements to a specific investment's risk and anticipated impacts. A natural challenge to implementing this approach is to ensure consistency of application by a diverse group of professionals across regions and industries. Accordingly, IFC has strengthened its quality assurance function. A Quality Assurance Team has been established, which has recently been re-positioned to report directly to the Director of IFC's Environment and Social Development Department. These reporting lines provide greater independence than its previous position within the investment support group. Regional team leaders have been appointed who are tasked with ensuring consistency of policy application across E&S specialists and industries. A tailored "on-boarding" program has also been developed for new specialists.

Efforts have so far focused on implementing systems of quality assurance and control, with less focus on providing tools for specialists. Interviews have revealed that E&S specialists find that they would benefit from additional tools and guidance, with suggestions including:

(i) Templates for appraisal checklists by sector; and
(ii) Templates for Annual Monitoring Reports that are updated with the latest policy requirements and relevant technical benchmarks from the new Environmental, Health and Safety Guidelines.

- **E&S risk categorization still fulfills important functions internal to IFC**

IFC has long assessed and categorized its investments' underlying E&S risks. In line with shifting to an outcomes-based risk framework, IFC has effectively delinked specific client company requirements from its E&S risk categorization decision. The E&S risk category of an investment still influences a number of internal processes and decisions, however, such as the frequency of IFC supervision visits; the decision whether Broad Community Support is achieved; and the level of scrutiny undertaken by IFC's Board of Directors. Further, it is CAO's experience that categorization still plays an important signaling function to client companies and other stakeholders.

- **IFC's categorization guidance for corporate loans mixes actual risks with mitigating/exacerbating factors**

CAO found that IFC's current guidance[49] on E&S risk categorization of corporate investments advises E&S specialists to consider IFC's own sphere of influence in the categorization decision alongside the investment's inherent E&S risk profile. While both factors are relevant in determining the overall risk of the investment, this mixing of E&S risk with IFC leverage is problematic, as it may lead to a corporate loan being assigned a lower risk category on the basis of IFC's limited influence over the company, rather than strictly on the basis of the investment's underlying risks. As a result, this makes the actual risk carried by IFC less visible to IFC.

- **IFC could assess different E&S risk factors more clearly**

A rounded assessment of an investment's E&S risk profile will consider both an investment's underlying operational E&S risks, and factors that can mitigate or exacerbate such risks. Examples of these factors include commitment and capacity of IFC's client company to address E&S risks, and IFC's own influence and leverage over the company. CAO found that IFC staff assesses client company commitment in a majority of projects, however, there are no established indicators to formalize this assessment, and the results are not tracked separately over time, or explicitly and systematically used in IFC decisions around resource and staff allocation, incentives etc.

IFC's analysis and ongoing performance tracking needs to separate clearly an investment's underlying E&S risk factors; the company's commitment, its capacity, and IFC's influence and leverage. For each investment, the underlying operational E&S risk should be evaluated against the assessed commitment and capacity of the client company, as well as against IFC's leverage to ensure adequate risk mitigation is implemented in practice. Where IFC's leverage is limited, such as can often be the case in equity investments or indirect investments, factors such as client company commitment and capacity need to be evaluated carefully.

- **E&S concerns are now integrated better into IFC's risk management at the management level, however this process remains incomplete**

IFC has taken steps toward integrating E&S aspects into its decision-making processes, especially at the senior management level. For example, quarterly meetings of IFC's Corporate Risk Committee now regularly address E&S concerns alongside other risk aspects. Investment teams are advised to take E&S risk ratings into consideration when considering repeat investments. Unaddressed poor E&S performance should prevent companies from benefiting from repeat IFC investments or Advisory Services[50], and induce divestment from projects lacking measurable improvement[51].

Nevertheless, integration of E&S considerations into IFC's business model remains incomplete. One area in need of further consideration is the institutional position of IFC's Environment and Social Development Department. The department currently reports to IFC's Advisory Services Vice-Presidency, which holds no other responsibilities relating to IFC's investments.

Another area requiring further attention to complete the integration process is the need for adequate incentives for investment staff, considered in more detail below.

7. Do IFC's institutional culture and incentives support effective integration of environmental and social issues?

What we found:

- **Effectiveness of E&S due diligence is affected by investment staff support**

CAO found that "mainstreaming" efforts by IFC have helped the integration of E&S concerns into investment decision-making in many instances. CAO's portfolio review identified numerous examples of specialists receiving good investment department support, for example: early engagement of specialists in the project life; assisting specialists to address difficult E&S challenges rather than questioning the need to address them; ensuring specialists' involvement in the drafting of investment agreements; facilitating specialist access to client company staff; and providing support during discussions with client companies.

Recommendations

- **IFC should upgrade its own processes to support strong E&S performance at the project-level, by:**
  - Assessing client commitment systematically through established indicators;
  - Only investing in companies that are fully committed to managing their business' inherent environmental and social risks;
  - Providing guidance and training to E&S specialists on addressing E&S aspects in investment agreements for different types of investment;
  - Involving E&S specialists in the drafting and finalization of investment agreements, together with a sign-off function on the final agreement;
  - Providing additional tools and templates for E&S specialists that are up to date with the Performance Standards and current Environmental, Health and Safety Guidelines;
  - Helping client companies improve their E&S monitoring and reporting through better tailored Annual Monitoring Report templates, and contacting client companies before the first report is due to ensure mutual understanding about specific reporting requirements;
  - Reassessing whether the definition of the "knowledge gap" as IFC's institutional indicator adequately captures real risk from lack of knowledge about the E&S performance in its portfolio;
  - Systematically and separately assessing and tracking a number of relevant risk factors: an investments' inherent E&S risks (reflected in its E&S risk category); company commitment, company capacity; and IFC's level of influence and leverage over the client company;
  - Making investment and resource-allocation decisions based on careful consideration of all relevant risk factors;
  - Considering the most effective institutional position of IFC's Environment and Social Development Department—for example, establishing reporting lines to the Vice President, Risk Management, or directly to the Executive Vice President.

- There is a gap between the perceptions of many investment staff and client company feedback on the value of IFC's input on E&S aspects

Still, the mainstreaming process is not yet complete. CAO found significant differences in the level of support that specialists receive in different investment departments.

Interviews revealed numerous accounts of investment officers questioning the need to implement specific E&S requirements proposed by specialists, or limiting specialists' direct access to IFC's client companies, rather than finding ways to address concerns in a mutually acceptable way.

This finding resonates with results of a staff survey carried out by IEG[52], which reveals that only 43 percent of surveyed investment officers feel that the impact of the Performance Standards on IFC's relationship with its client companies is positive, while 39 percent of investment officers thought the impact was somewhat negative.

Investment staff perceptions contrast with IFC client company responses recorded in IFC's 2009 client survey, which reports that 77 percent of client company representatives rated IFC's E&S input as 'primarily helpful'. Further, E&S expertise is an area of competitive advantage for IFC: client companies found IFC's E&S input to be IFC's single largest advantage over working with a commercial bank[53].

- Investment staff are not adequately incentivized to support E&S risk and impact management

Investment staff incentives are aligned with investment department scorecards that set out indicators against which the department's performance will be judged. At this level, IFC tracks its E&S "knowledge gap[54] ," a performance indicator which captures gaps in IFC's information about the E&S performance of its portfolio. This indicator is currently specific to IFC's Environmental and Social Development Department only, and is not reflected in investment department scorecards or portfolio manager incentives, despite the investment staff's role as relationship managers with client companies. E&S performance is further reflected indirectly as one factor making up Development Outcome Tracking scores. Despite the fact that investment departments are judged against these scores, this does not appear to be sufficient to incentivize consistently sound support for strong E&S performance among investment staff and managers.

8. How transparent and accessible is IFC to stakeholders in its member countries?

What we found:

- The baseline level of awareness about IFC in its member countries is very low

CAO's experience in communicating with stakeholders globally demonstrates that IFC's role, activities, and policies are little known in IFC's member countries.

Recommendations

- **IFC should provide incentives for investment staff to contribute to achieving strong E&S performance in IFC's portfolio, by:**
- – Adapting staff incentives to reflect the value of E&S performance;
- – Including IFC's E&S knowledge gap as an indicator in investment department scorecards;
- – Incorporating feedback from E&S specialists in performance evaluations of investments officers and investment department managers.

Findings from CAO's civil society outreach[55] program and subsequent survey[56] reveal that two-thirds of survey respondents had no knowledge of IFC and its projects in their country prior to the outreach meeting. Nearly 75 percent said they were unaware, prior to the meeting, of the existence of IFC's E&S standards.

Interviews with local stakeholders[57] found that this lack of awareness even extends to many stakeholders that are directly impacted by an IFC project. Across five select projects, very few community stakeholders knew of the existence of IFC and even less about the E&S standards committed to by each specific client company. In one project, of 31 stakeholders interviewed, only IFC and company representatives were aware of the IFC's involvement in the particular project. In another project, only senior level company employees were familiar with IFC's standards, whilst the majority of company officials at mid/lower level had only minimal awareness of the Performance Standards.

Almost all of the outreach survey respondents highlighted that they found CAO's mapping of IFC projects in "Google Maps" an excellent resource that they would like to see enhanced and disseminated to improve stakeholder awareness of IFC's activities.

- **IFC does not routinely update public information about its investments**

IFC's website provides information about its activities for interested stakeholders who can learn about projects in their country. This function is undermined by the fact that developments after Board approval in any given project are not systematically reflected in publicly available information, which leads to project information on IFC's website often being many years outdated.

- **Language is a major barrier to effective access to information for non-English speaking stakeholders in IFC member countries**

Language was cited as a major barrier to accessing IFC provided information[58]. Whether stakeholders access information online or in hard copy, the majority of IFC information is provided in English. IFC's public website provides significant amounts of detailed and informative project specific information as well as institutional information about IFC; however, this information is available only in English. Where institutional documents are translated into languages other than English, such as the Performance Standards, these can only be found by first navigating the English-language site, rather than being directly linked from the basic foreign language sites.

Recommendations

- **Enhance IFC's institutional transparency and openness by:**
- – Amending IFC's Policy on Disclosure of Information to implement its presumption in favor of disclosure in practice;
- – Reaching out proactively to civil society in member countries and building coalitions to help IFC understand the stakeholder landscape;
- – Update the public website whenever there are any material changes to the project;
- – Review project disclosures regularly to ensure that they reflect current project status;
- – Utilizing the Google mapping tool to illustrate project locations on IFC's website; and
- – Providing basic IFC project information in the relevant local language in addition to English.

- **The stipulations of the current disclosure policy undermine its presumption in favor of disclosure**

Openness and access to information by the public ensures institutional accountability and provides local and national stakeholders the opportunity to identify and voice concerns. IFC's Policy on Disclosure of Information sets out the rules that govern public access. The policy states a presumption in favor of disclosure, but undermines the presumption itself by specifically defining what information can be disclosed. An alternative approach was recently adopted in IBRD's new Access to Information policy, which makes all documents publicly available except those on a limited list of exceptions.[59] The stipulations of the World Bank policy demonstrate that a presumption in favor of disclosure can be implemented effectively while simultaneously protecting both the confidentiality of client provided information and the integrity of internal deliberative processes.

Summary Of Recommendations

CAO believes the adoption of the following set of recommendations will strengthen the impact and effectiveness of IFC's Sustainability Framework. The recommendations that trigger changes in the requirements and commitments captured in IFC's Sustainability Framework have been presented up front. The remaining recommendations focus on IFC's implementation of the framework, and are organized according to the structure of this note, i.e. in three sections, organized around eight questions. To help identify where the most significant benefits can be realized, CAO has outlined priority recommendations for IFC, which are presented in the executive summary and highlighted again in the table below.

Table 5: Policy Level Recommendations

Findings	Recommendations
Suggested changes to IFC's Sustainability Framework	
Policy: • IFC's Policy established the application of the Performance Standards to all of IFC's direct investments, without specifying IFC's approach in more detail. • There is a lack of clarity regarding application of the Performance Standards to Advisory Services.	Policy: 1. Clarify application of the Performance Standards to different product types and to Advisory Services.
Performance Standards: • IFC can play an important role in de-mystifying local approval processes. • Concern about migrant workers is a priority for host communities.	Performance Standards: 2. PS1: Present a clearer framework for which different E&S risk and impact factors trigger different levels of engagement. 3. PS1: Clarify engagement requirements for low impact projects. 4. PS2: Address migrant workers.
Disclosure Policy: • The stipulations of the current Policy on Disclosure of Information undermine its presumption in favor of disclosure. • IFC does not routinely update public information about its investments.	Disclosure Policy: 5. Change approach to implement a presumption in favor of disclosure in practice. 6. Routinely update IFC's website with current project information 7. Ensure basic IFC information and project information is available in relevant languages.

Table 6: Implementation Level Recommendations

Findings	Recommendations
A. PREDICTABILITY FOR HOST COMMUNITIES AND CLIENT COMPANIES	
PRIORITY RECOMMENDATION A: Improve project-level engagement	
• Action Plans often are not disclosed to communities, and communities are not updated on implementation progress. • Communities are not being involved consistently in discussions around impact mitigation activities. • Gaps in feedback to communities and in reporting on development benefits undermine efforts to build constructive relations and community support. • Local development benefits and jobs are priorities for host communities. • IFC does not provide up-to-date information about its investments.	• Address gaps in client company engagement around E&S mitigation measures. • Ensure client companies disclose Action Plans and update communities on progress at least annually. • Improve project-level reporting by client companies and IFC. • Encourage client companies to engage communities around project benefits. • Adapt investment staff incentives to reflect the value of E&S performance.
Action Plans: • Clarity of Action Plan requirements varies across projects. Community engagement: • While IFC routinely verifies establishment of Grievance Mechanisms, there is only limited evidence that their use and effectiveness is being assessed.	Action Plans: 8. Define AP requirements clearly, with completion dates and indicators to measure achievement. Community engagement: 9. Address quality and use of grievance mechanisms with client companies.
Broad Community Support: • IFC's approach to BCS is not transparent. • IFC applies BCS only to few high risk projects.	Broad Community Support: 10. Adapt BCS guidance to different project phases and allow flexibility of application in lower impact circumstances. 11. Disclose which projects trigger BCS and how BCS was determined.
B. THE PERFORMANCE STANDARDS IN THE CONTEXT OF IFC'S CHANGING BUSINESS MODEL	
IFC support for client companies: • IFC's Advisory Services are not readily available to support low capacity companies. • Low capacity companies need support to upgrade their management systems. • Annual Monitoring Reports prepared by client companies exhibit information gaps.	IFC support for client companies: 12. Offer training/capacity building on E&S management systems. 13. Provide better support for client company annual reporting. 14. Allow low capacity companies longer time frames to meet the Performance Standards (addressing high risks immediately). 15. Provide incentives for weak/strong E&S performance: – Lower interest rates; – Divestment, e.g. policy put options in case of equity investments.

<table>
<tr><th>Findings</th><th>Recommendations</th></tr>
<tr><td>Application to corporate investments:
• IFC's E&S risk categorization for corporate loans mixes actual risks with mitigating/ exacerbating factors.
• Delineation of due diligence boundaries remains challenging in corporate investments.
• No clear guidance tailored for E&S specialists exists about how best to address E&S concerns in different types of investment.</td><td>Application to corporate investments:
16. Use underlying E&S risk of operations to determine due diligence boundaries.
17. Provide guidance to specialists on how to address E&S concerns in legal agreements for different investment types.</td></tr>
<tr><td>Applying the PPS to Advisory Services:
• There are gaps in the institutional infrastructure regarding application of the Performance Standards to AS.
• E&S specialists have no sign-off function for AS projects.
• No dedicated E&S specialists are available to process these projects.</td><td>Applying the PPS to Advisory Services:
18. Make dedicated specialists available to Advisory Services.
19. Place project screening in hands of E&S specialists.
20. Establish E&S clearance function.</td></tr>
<tr><td colspan="2">PRIORITY RECOMMENDATION B: Address gaps in E&S performance of IFC's FI portfolio</td></tr>
<tr><td>• There is still a substantial gap between theoretical E&S requirements and their practical application.
• Internal constraints inhibit IFC's efforts to improve E&S performance of FI clients:
– Weak support from investment staff hinders IFC's effectiveness in achieving sound E&S performance.
– E&S specialists working with FIs carry out their work under significant resource constraints.</td><td>• Increase staffing level for E&S appraisal and supervision of IFC's FI portfolio.
• Champion E&S concerns in the Global Financial Markets department through management awareness, and accountability through departmental and investment staff incentives.</td></tr>
<tr><td>Applying the Performance Standards to IFC's FI portfolio:
• There is still a substantial gap between theoretical E&S requirements and their practical application.
• IFC can do more to provide incentives to FI clients for sound E&S performance.
• Internal constraints inhibit IFC's efforts to improve E&S performance of FI clients:
– Weak support from investment staff hinders IFC's effectiveness in achieving sound E&S performance.
– E&S specialists working with FIs work under significant resource constraints.</td><td>Applying the Performance Standards to IFC's FI portfolio:
21. Involve E&S specialists early in discussions with client FIs and in appraisal visits.
22. Provide additional resources to E&S specialists that carry out E&S due diligence for FIs.
23. Integrate E&S concerns fully into investment decisions, management priorities, and incentives.</td></tr>
<tr><td>E&S management in financial markets / IFC as standard setter
• IFC can play an increased role in the dissemination and application of E&S standards in the financial sector.</td><td>E&S management in financial markets / IFC as standard setter
24. Increase efforts to upgrade national regulatory standards.
25. Advise EPFIs on increasing transparency and reporting.</td></tr>
</table>

Table 6: Implementation Level Recommendations

Findings	Recommendations
C. IFC'S MANAGEMENT SYSTEMS & INFORMATION DISCLOSURE	
PRIORITY RECOMMENDATION C: Enhance IFC's capability to incorporate E&S risk factors into decision-making processes	
• Choosing committed client companies is critical to achieving strong E&S performance. • Working with companies that start at lower levels of capacity is resource intensive but has significant development impact potential. • IFC's E&S risk categorization still fulfills important internal functions. • IFC's E&S risk categorization for corporate loans mixes actual risks with mitigating/exacerbating factors.	• Categorize projects based solely on their underlying E&S risk. • In addition to project risk, separate and professionalize the assessment of: – client company commitment; – client company capacity; and – IFC's sphere of influence/leverage. • Make investment and resource-allocation decisions based on careful consideration of all risk factors listed above.
Assessment: • Choosing committed companies is critical to achieving strong E&S performance. • Working with companies that start at lower levels of capacity is resource intensive. Investment agreements: • Involvement of E&S specialists during the drafting and finalization of investment agreements is inconsistent. • There has been decreasing use of the E&S Clearance Memorandum. Supervision: • Insufficient information in Annual Monitoring Reports creates knowledge gaps in client company performance. • Providing tools can be effective in improving consistency of Performance Standard application. Organizational structure: • The process of integrating E&S concerns into IFC's risk management remains incomplete.	Assessment: 26. Only invest in client companies committed to managing their business' E&S risks. 27. Assess and rate client company capacity and track improvements over time. Investment agreements: 28. Involve E&S specialists in development of the investment agreement, including a sign-off function. Supervision: 29. Use client company capacity *and* project risk to determine staffing and supervision effort. 30. Generate AMR templates that are updated with the latest policies and EHS guidelines. Organizational structure: 31. Consider the best position of IFC's Environment and Social Development Department.
Changes in incentive structure: • The significant E&S staff time and effort required to work with low capacity companies are not adequately incentivized. • Effectiveness of E&S due diligence is directly impacted by investment staff support. • Investment staff is not adequately incentivized to support E&S risk and impact management.	Changes in incentive structure: 32. Incentivize work with low capacity companies. 33. Reassess the definition of the 'knowledge gap' indicator. 34. Include E&S 'knowledge gap' indicator in investment department scorecards. 35. Incentivize investment staff to help achieve strong E&S performance. 36. Include E&S specialists in performance evaluations of investment staff.
IFC transparency: • The baseline level of awareness about IFC in its member countries is very low. • Language is a major barrier to effective access to information for non-English speaking stakeholders. • IFC's approach to BCS is not transparent. • IFC does not provide up-to-date information about its investments.	IFC transparency: 37. Make institutional & project information available in local language in addition to English. 38. Update the public website whenever there are any material changes to the project. 39. Reach out to civil society in member countries. 40. Use Google mapping to illustrate IFC project locations.

Endnotes

1 A Review of IFC's Safeguard Policies – Core Business: Achieving Consistent and Excellent Environmental and Social Outcomes, CAO, 2003

2 www.ifc.org/enviro; www.ifc.org/policyreview

3 After IFC implemented the Policy and Performance Standards on Social and Environmental Sustainability (PPS) in April 2006, they were adopted (and adapted) by MIGA effective October 2007.

4 See CAO's Advisory Notes: 'Improving IFC's and MIGA's Local Development Impact at the Project Level' 2008 and 'A Guide to Designing and Implementing Grievance Mechanisms for Development Projects' 2008.

5 Between November 2007 and November 2009.

6 IFC 2009 Annual Report, page 24.

7 See IFC 2009 Annual Report for further information, pages 56-57.

8 The Equator Principles are based on IFC's Social and Environmental Performance Standards. See the Equator-Principles.com.

9 Professor John Ruggie, The United Nations Special Representative of the Secretary General on human rights and transnational corporations and other business enterprises.

10 An Action Plan identifies the specific mitigation measures necessary for a project to comply with applicable laws and regulations and to meet the requirements of the Performance Standards on Social and Environmental Sustainability. See Performance Standard 1: Social and Environmental Assessment and Management Systems, paragraph 16.

11 The Consensus Building Institute is a not-for-profit organization created by leading practitioners and theory builders in the fields of negotiation and dispute resolution. See www.cbuilding.org

12 Performance Standard 4: Community, Health and Safety; Performance Standard 5: Land Acquisition and Involuntary Resettlement; Performance Standard 7: Indigenous Peoples; and Performance Standards 8: Cultural Heritage.

13 See IFC's Policy on Social and Environmental Sustainability, paragraph 20.

14 Projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures. See IFC's Policy on Social and Environmental Sustainability, paragraph 18.

15 As part of the CAO's Local Stakeholder Perceptions Study component of its contribution to IFC's 'Review and Update' of the Sustainability Framework.

16 See results from the IFC Investment Client Survey, 2009.

17 As part of CAO's Local Stakeholder Perceptions Study.

18 'The client will disclose the Action Plan to the affected communities'.

19 15 of 19 portfolio review projects categorized A or B had developed Action Plans.

20 'In addition, the client will provide periodic reports that describe progress with implementation of the Action Plan on issues that involve ongoing risk to or impacts on affected communities, and on issues that the consultation process or grievance mechanism has identifies as of concern to those communities', Performance Standard 1, paragraph 26.

21 'The client will respond to communities' concerns related to the project. If the client anticipates ongoing risks to or adverse impacts on affected communities, the client will establish a grievance mechanism to receive and facilitate resolution of the affected communities' concerns and grievances about the client's environmental and social performance… The client will inform the affected communities about the mechanism in the course of its community engagement process', Performance Standard 1, paragraph 26.

22 CAO's portfolio review included 19 projects categorized either A or B. Not all projects are necessarily required to establish Grievance Mechanisms. See Performance Standard 1, paragraph 23.

23 'Along with the ESRS, IFC will make available electronic copies of, and where available, web links to any relevant social and environmental impact assessment documents prepared by or on behalf of the client, including the Action Plan', IFC Policy on Disclosure of Information, paragraph 13.

24 As part of CAO's Local Stakeholder Perceptions Study.

25 U.N. Doc. A/HRC/11/13/22 April 2009/paras.100; U.N. Doc. A/HRC/8/5/7 April 2008/para.93; U.N. Doc. A/HRC/11/13/22 April 2009/paragraph 107.

26 As part of CAO's Local Stakeholder Perceptions Study.

27 CAO's Local Stakeholder Perceptions Study.

28 'Workers' accommodation: processes and standards', A Public Guidance Note by IFC and EBRD, August 2009.

29 'Projects and People: A Handbook for Addressing Project-Induced In-Migration', International Finance Corporation, December 2009.

30 CAO's portfolio review sample included 30 IFC projects comprised of A, B, C and FI category investments. 15 of the 19 Category A & B projects reviewed had developed E&S Action Plans.

31 United Nations Declaration on the Rights of Indigenous

Peoples available at http://www.un.org/esa/socdev/unpfii/en/declaration.html (accessed on 3/22/2010)

32 International Labour Organisation Convention 169 concerning Indigenous and Tribal Peoples in Independent Countries, adopted June 1989.

33 For example: 'Business, Human Rights and Indigenous Peoples: The Right to Free, Prior and Informed Consent', Submission to the UK Government Joint Committee on Human Rights on the right of indigenous peoples to free, prior and informed consent, Forest Peoples Programme and Law Department, Middlesex University Business School, May 2009.

34 The majority of this type of guidance is prepared and implemented by companies operating in the extractive industries.

35 IFC Policy and Performance Standards on Social and Environmental Sustainability, Performance Standard 1, paragraph 21.

36 Annex to the Environmental and Social Review Procedure, August 14, 2009, Section 3.5.1. 'Free, Prior and Informed Consent and Broad Community Support'.

37 Performance Standard 7, paragraph 11-15.

38 As part of the CAO's Local Stakeholder Perceptions Study.

39 Environmental and Social Review Procedure, August 14, 2009, Section 3.2.1.

40 See IFC 2009 Annual Report for further information.

41 As of February 28, 2010.

42 IFC Policy on Social and Environmental Sustainability, paragraph 12.

43 IFC Policy on Social and Environmental Sustainability, paragraph 27-30.

44 See the Environmental and Social Review Procedure, August 14, 2009, paragraph 3.2.6.

45 Environmental and Social Review Procedure, August 14, 2009. Chapter 11 focuses specifically on Advisory Services projects with and without links to an existing investment.

46 For example: Independent Evaluation Group's 'Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries', April 2008 and findings on 'Financing Micro, Small and Medium Enterprises through Financial Intermediaries, FY 1994- 2006', 2007.

47 IFC 2009 Annual Report, page 109.

48 The E&S knowledge gap consists of the percent of companies in IFC portfolio: with total loan/equity balance greater than $0; that are not in general default; which IFC have no knowledge of E&S performance for over two years.

49 IFC Internal Interpretation Note #1, Working draft March 7, 2008, "Social and Environmental Categorization of IFC investments defined as 'corporate investment'".

50 IFC commits not to provide Advisory Services to client companies with low E&S risk ratings "until corrective actions have been initiated to address the […] problem areas". See Section 11.2.2 of the Environmental and Social Review Procedure, August 14, 2009.

51 CAO is aware that at least 2 divestments have occurred last fiscal year solely as a result of poor E&S performance.

52 Survey undertaken in the content of the Independent Evaluation Group's 'Evaluation of the World Bank Group's experience with safeguard and sustainability policies (1999 – 2008)', Independent Evaluation Group (IEG), World Bank Group (forthcoming).

53 Numbers are the percentage point difference between client's rating of satisfaction with IFC and clients rating of commercial banks where these are their alterative provider. Satisfaction rating is the percentage of clients rating IFC and their commercial bank as above average or excellent.

54 Refer to Endnote 47 as above.

55 CAO's outreach program brought together over 700 civil society organizations from 30 different countries.

56 With assistance from the Consensus Building Institute (CBI), CAO collated data from the outreach to evaluate the effectiveness of the outreach, and consolidate recommendations by civil society participants.

57 As part of CAO's Local Stakeholder Perceptions Study.

58 CAO outreach feedback – collated with assistance from the Consensus Building Institute (CBI).

59 The IBRD's Access to Information Policy was approved by the Board of Executive Directors on November 17, 2009 and will become effective July 1, 2010. See 'Toward Greater Transparency- Rethinking the Bank's Disclosure Policy (CODE 2008-0094, COGAM 2008-0048), December 15, 2008.

Glossary

Action Plan: An Action Plan identifies the specific mitigation measures necessary for any given project to comply with applicable laws and regulations and to meet the requirements of IFC's Performance Standards.

Advisory Services: IFC provides a variety of advisory services to private businesses and governments in developing countries. These services cover a broad spectrum including advice on privatization; business related public policy; and industry-specific issues. The distinguishing characteristic of this category, compared with IFC investments, is that IFC capital is not relied upon.

Annual Monitoring Report: A document prepared by the client company, which outlines environmental and social performance for the previous year.

Board of Executive Directors: IFC's Board of Executive Directors consists of representatives of its member countries, who meet regularly at IFC headquarters in Washington, D.C. Executive Directors review and approve all investment projects and provide overall guidance to IFC's management.

Categorization: IFC uses environmental and social risk categories to indicate the level of environmental and social risk posed by a proposed investment. Projects are assigned a category of A, B, or C, in descending order of environmental and social risk, or FI, in the case of financial institutions that on-lend to client companies who may present environmental and social concerns.

Client company: An IFC client company is a legal entity to which IFC provides financial products or services. A client is usually a company, financial institution, or other private enterprise.

Company-community grievance mechanism: Institutionalized approaches, procedures and roles for the resolution of concerns or complaints at the project-level raised by individuals or community groups concerning the performance or behavior of a company, its contractors, or its employees.

Development impact: Refers to a development project's direct and indirect effects on local communities and broader society.

Environmental and Social Clearance Memorandum: Issued by IFC's Environment and Social Development Department, the Environmental and Social Clearance Memorandum is a document which states that the project complies with applicable environmental and social requirements, detailing any outstanding mitigation actions and monitoring requirements, and recommendations regarding any other obligations of the client company.

Environmental and Social Review Summary: For each proposed investment categorized A or B, IFC issues a brief summary of its review findings and recommendations.

Environmental and Social Risk Rating: This is a rating internal to IFC assigned to represent the level of environmental and social risk for a company. (1 = Good, 2 = Average, 3 = Watch, 4 = Sub-standard)

Extractive Industries Review: A review of the World Bank Group's role in the oil, gas and mining sectors carried out between 2001 and 2004.

Known use of proceeds: This is detailed information available to IFC and other investors on how money invested by IFC will be put to use within the client company structure.

Performance Standards: A series of standards that are applied to manage social and environmental risks and impacts and to enhance development opportunities of projects in which IFC and MIGA invest or serve as partners.

Sphere of influence: This is the area that includes the primary IFC project site(s), but also all related facilities, including associated facilities, transport routes, areas potentially affected by cumulative impacts, or unplanned but predictable developments.

Sustainability Framework: The Policy and Performance Standards on Social and Environmental Sustainability (PPS) and Policy on Disclosure of Information, which came into effect on April 30, 2006. The Policy and Disclosure Policy speak to IFC's own commitments, whereas the Performance Standards set out IFC's expectations of its client companies' environmental and social performance.

Summary of Proposed Investment: A Summary of Proposed investment summarizes the main elements of an investment. It covers information on sponsors, shareholders, project cost, the purpose of the project, and environmental issues.

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