



# **Insuring Responsible Investments?**

*A review of the application of MIGA's  
Environmental and Social Review Procedures*

*Final Report, December 2002*

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# Executive Summary

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## Introduction

The CAO has conducted a review of MIGA's Environmental and Social Review Procedures (ESRPs), to better understand the processes and systems MIGA applies to ensure that it meets its obligations on social and environmental performance (as specified in the ESRPs). This executive summary outlines the approach to the review, summarizes findings and emerging lessons, and presents recommendations for MIGA to consider.

The review covered all aspects of MIGA's ESRPs, from initial project screening, through review and clearance, to arrangements for ensuring project compliance. Responsibility for these aspects lies within MIGA's Policy and Environment Department (MIGPE). The review looked at the application of the procedures to all category A and B projects during FY2000-2002: 7 category A and 35 category B projects. The review did not consider: the adequacy of MIGA's Interim Safeguard Policies; whether MIGA addresses broader sustainability issues not embedded within these policies; or compliance with specific policy provisions.

To ensure a consistent approach to the review of individual projects, an analytical framework was developed for application to all projects. This identified 9 clusters of issues associated with the review process (including project screening and categorization, environmental and social review, monitoring, etc.), and 35 individual questions (see Annex 1). A rating was assigned to each question of satisfactory, not fully satisfactory, or unsatisfactory (where applicable). The aggregation of data from across all 42 projects provided information on procedural compliance, to explore a number of concerns relating to MIGA's review procedures.

These concerns had emerged from the engagement of the CAO's office with some MIGA's projects, and at a meeting of the Committee of Development Effectiveness (CODE) in April 2002. During the conduct of the review, a number of other issues emerged that merit some discussion. These may be summarized as follows:

- Do the procedures provide adequate due diligence, and are they consistently applied?
- Does MIGA monitor project compliance satisfactorily?
- Does MIGA have adequate environmental and social review capacity?
- Are the review procedures appropriate for MIGA's business model?

The findings, emerging lessons, and recommendations (in italics throughout the text of the executive summary) are summarized below.

## Findings, emerging lessons and recommendations

### **MIGA consistently adheres to its procedural requirements**

There was very little variability in the application of the review procedures across all 42 projects. In almost every case, each stage of the ESRPs was strictly followed and MIGA is to be complimented on its diligent application of the procedures. There was a very high degree of consistency at each of the key decision-gates in the procedures, although the attention to social issues was often rated as less than satisfactory.

### **MIGA's categorization of projects is highly consistent and competent**

In only one instance of the 42 projects reviewed, did the review team have some concerns that an A rating *might* have been more appropriate than a B rating. The strong correlation between the review team's assessment of EA category and MIGA's, indicates a high level of integrity in the categorization process.

### **The ESRPs do not support a detailed assessment of all environmental & social issues**

MIGA has less opportunity than either IFC or the World Bank to support applicants in ensuring a thorough appraisal of all environmental or social aspects. This is partly because MIGA typically becomes involved in the latter stages of projects, and MIGA's environmental staffs have limited contact with their client's counterparts. In practice, MIGA's procedures are focused on ensuring compliance with internal policies and guidelines. The lack of disclosure on category B projects also means that there is less external pressure for more comprehensive project EAs. *It is recommended that MIGA more systematically evaluates and reports on the environmental and social risks associated with projects.* This is elaborated on in a number of the specific recommendations below.

### **MIGA's attention to social issues is weaker than its coverage of environmental aspects**

In half the projects reviewed, a number of potential social impacts that might adversely influence project outcomes were not flagged by either the applicant or MIGA early on in its review process, and there is no assurance that these aspects were either not relevant or fully addressed. Potential social issues that were not initially flagged were almost never picked up later in MIGA's review process. This exposes MIGA to social risks. *MIGA should routinely submit all projects to the scrutiny of a social*

*specialist during screening, to determine the need for ongoing social due diligence at the outset.*

### **The assessment of the need for consultation and adequacy of consultation is inconsistent**

For category A projects, MIGA did not always receive or acquire sufficient information to independently determine the adequacy of consultation. Of seven category A projects insured by MIGA in the past three years, three had less than fully satisfactory ratings for consultation. In addition, MIGA has no mandatory consultation requirements for category B projects, despite it sometimes being imperative (in light of the complexity of impacts and their potential to adversely affect people). It is noteworthy that many MIGA clients already undertake consultation for category B projects.

*It is strongly recommended that MIGA requires an explicit assessment of the need for consultation for each category B projects, and insists that consultation be carried out where appropriate.* If this proves to be impractical, the decision to issue a guarantee should explicitly consider the risks of inadequate consultation. *MIGA should also review its current position on disclosure of category B projects and reassess the potential impact of enhanced disclosure on its business, in support of increased public scrutiny.*

### **MIGA should routinely assess clients capacity for environmental & social management**

MIGA's assessment of clients' capacity is informal and unsystematic. Given the responsibility of clients to provide warranties and assurances that environmental and social aspects of projects are being effectively managed, this aspect should be reinforced. *It is recommended that MIGA adopt a more systematic approach to determining clients' capacity.*

**The multiple roles of MIGPE staff are not considered to present conflicts of interest**

MIGPE staff are currently involved in project screening, clearance and monitoring. As of July 2002, an internal reorganization has removed possible conflicts of interest between the review and evaluation functions that were formerly the responsibility of a single department. MIGPE's ongoing responsibility and accountability for the environmental and social aspects of projects are sometimes perceived as a strength rather than a weakness.

**MIGA systematically and diligently tracks progress on specific contract conditions**

MIGA sometimes requires specific environmental or social conditions to be included in a contract of guarantee. These are routinely well monitored. However, in one or two instances, the quality or completeness of the work submitted by clients was considered to be inadequate by the review team, but it was accepted by MIGA. *MIGA should consistently ensure the adequacy of information submitted in response to specific contract conditions.*

**Overall, MIGA's arrangements for compliance monitoring are inadequate**

The burden of responsibility for ensuring compliance is largely transferred to guarantee holders. But as MIGA does not systematically evaluate capacity for environmental and social management, it is difficult to have full confidence that guarantee holders will undertake all necessary actions to remain in compliance. If not, MIGA can deny any claims, so the financial cost is retained by the guarantee holder. But the reputational burden of any adverse impacts resulting from non-compliance falls disproportionately on MIGA and the World Bank Group. For some projects, MIGA relies very heavily on partner organizations (IFC, World Bank, IADB or EBRD) for monitoring, which further

exposes MIGA to risks if it is unaware of emerging concerns. *It is strongly recommended that MIGA strengthen its overall arrangements for monitoring, particularly for category B projects.*

**MIGA's environmental review capacity is currently adequate, but the absence of in-house expertise on social issues should be addressed**

MIGA staff are clearly delivering against the environmental requirements specified within the ESRPs. But there are potentially significant shortcomings with their treatment of social issues. If the recommendations of this review are accepted this will have implications for MIGA's social and perhaps environmental capacity. For example, if all projects are routinely screened by a social specialist (which may flag up the need for additional effort prior to clearance), or if MIGA strengthens arrangements for monitoring, this will require additional resources. *It is recommended that MIGA revisit the question of capacity, once it has fully considered the recommendations of this review.*

**There is a disconnect between MIGA's ESRPs and core business practices**

Whereas the Guarantees Department focuses on risk factors that are external to a project (and over which the applicant has no influence), the ESRPs are concerned with internal factors that the applicant is expected to take account of and manage. But there is a higher degree of inter-linkage between the various components of risk than is immediately apparent, which should be reflected in closer collaboration between MIGA's Guarantees and Policy and Evaluation Departments. In practical terms, this may be addressed by a more systematic evaluation and reporting of any linkages between country risks, potential social and environmental impacts at the project level, and strategic risks. *Closer collaboration in relation to risk assessment is recommended between the Guarantees and Policy and Evaluation Departments.*

### **MIGA's ability to encourage good practices is limited by the do-no-harm focus of the ESRPs**

While the CAO found a number of examples of good practice in the projects reviewed, these were not attributable to the intervention of MIGA staff. These are however, indicative of a level of receptivity to environmental or social value-added activities by some MIGA clients. *It is recommended that the potential for harnessing the broader 'capacity on sustainability' within the Bank Group be explored, for the benefit of MIGA clients, as an extension of MIGA's advisory services.*

### **MIGA's documentation of project review processes needs to be strengthened**

The documentation at key points in the environmental review process does not reflect the level of effort MIGA invests in due diligence, and often raises more questions than are answered. *It is recommended that a more detailed reporting format be adopted for the Initial Environmental Screening Memorandum (IESM) for category A and B projects. In addition, the Environmental Clearance Memorandum (ECM) should include a more in-depth discussion of the potential inter-linkages between the various types of risk.*

### **The system for capturing information on project reviews is dispersed and not readily auditable**

While MIGA's environmental staff was extremely cooperative in extracting all relevant information for the CAO, it would be preferable (both to enhance the system auditability and to serve as a repository of institutional memory) to have all relevant information more readily accessible. *It is recommended that MIGA implement a stronger centralized system for filing relevant information on project reviews.*

Finally, on the basis of the experience of conducting this review and the confidence the CAO has in the findings presented above, the CAO does not recommend that

site visits be undertaken to supplement the desk based review activities. However, once MIGA has considered its response to the review recommendations, it may well be appropriate for MIGA to undertake site visits as part of its strengthened due-diligence procedures.

# 1. Introduction

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The Multilateral Investment Guarantee Agency (MIGA) is a member of the World Bank Group and was created in 1988. Membership of MIGA is open to all member countries of the World Bank Group, and currently stands at 154 countries. The objective of the agency is to “*encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries*” (Article 2 of MIGA’s Convention), through the provision of political risk insurance to investors in projects in developing countries and advice to member countries on attracting foreign investment. In total, MIGA has issued over 500 guarantees for projects in 78 developing countries.

During its first two years of operation, the Office of the Compliance Advisor/Ombudsman (CAO)<sup>1</sup> has been involved in a number of MIGA projects in response to complaints filed by people affected by these projects. Irrespective of the specific concerns, some of which are still the subject of an Ombudsman process, more general concerns have emerged that relate to the robustness of MIGA’s Environmental and Social Review Procedures (ESRPs), and the protection that they afford to project affected people and the natural environment. These concerns were most recently expressed by the CAO at a meeting of the Committee on Development Effectiveness (CODE)<sup>2</sup> in April 2002, to discuss the implementation of MIGA’s ESRPs and adoption of interim safeguards policies. At this meeting, the need for a more detailed and strategic review of MIGA’s experience with the ESRP’s was discussed. This prompted the CAO’s office to initiate a review of MIGA’s Environmental and Social Review Procedures, consistent with the CAO’s advisory mandate<sup>3</sup> (hereafter referred to as the MIGA review).

## 1.1. MIGA’s review procedures and commitment to sustainability

There is no specific mention of sustainability in MIGA’s mission, which is to promote foreign direct investment in order to improve people’s lives and reduce poverty. However, it is MIGA’s view that acceptable environmental performance, sustainability with respect to natural resource management, and social soundness are critical factors in the “...economic soundness of the investment and its contribution to the development of the host country” (as mandated by MIGA’s Convention and stated in paragraph 5 of MIGA’s ESRPs). MIGA evaluates projects in terms of its own environmental policies and guidelines, and its review procedures refer to the need to “ensure that projects meet MIGA’s commitment to environmentally sustainable and socially responsible projects”.

MIGA therefore has a project-level commitment to sustainable development, and its review procedures are primarily aimed at the avoidance of environmental or social harm (sometimes referred to as do-no-harm<sup>4</sup>). Although MIGA’s internal training for underwriting staff emphasizes the “encouragement of good” behavior, there are practical limits to the extent to which MIGA’s

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<sup>1</sup> The CAO is an independent office that reports to the President of the World Bank Group. Its mandate is to help MIGA and IFC address complaints made by people who are or may become directly affected by projects in which IFC or MIGA play a role, and to enhance social and environmental outcomes.

<sup>2</sup> The Committee on Development Effectiveness (CODE) is a Board committee of the World Bank Group.

<sup>3</sup> The CAO has three distinct roles: the Ombudsman, Compliance and Advisory roles. The latter is to be a source of independent advice to the President.

<sup>4</sup> The term ‘do no harm’ is somewhat misleading, as the procedures and related Safeguard Policies and guidelines typically sets limits on the magnitude and extent of harm that is permissible. Furthermore, some Safeguard Policies intend to ‘do good’ as well.

staff can engage in value added activity, with respect to social or environmental matters. This is often a function of the limited interaction that MIGA review staff have with clients. This aspect has been explicitly factored into the conduct of the review.

## **1.2. Scope of the review**

The review covered all aspects of MIGA's Environmental and Social Review Procedures (ESRPs) from initial project screening, through review and clearance, to arrangements for ensuring project compliance. The responsibility for these aspects lies within MIGA's Policy and Environment Department (MIGPE). The review looked at the application of the procedures to all category A and B projects during FY2000-2002, with the aim of better understanding the processes and systems put in place by MIGA to ensure that it meets its obligations on environmental and social performance (as specified within the ESRPs).

The review did not consider the adequacy of MIGA's Interim Safeguard Policies, which were adopted on an interim basis in April 2002 and may be subject to revision in light of MIGA's response to the recently completed review of IFC's Safeguard Policies (conducted by the CAO). Similarly, strict adherence to all specific environmental and social Safeguard Policy provisions that MIGA subscribes to was also outside the scope of the review. The review did not consider whether MIGA addresses any broader sustainability issues not embedded within these policies. Finally, while it is conceivable that some projects that will be evaluated under this review might at some point be the subject of a CAO Compliance audit, this is not the purpose of the MIGA Review.

## **1.3. Target audience for the report**

This report is intended as a constructive contribution to helping deliver MIGA's commitment to environmentally sustainable and socially responsible projects. It should assist MIGA in setting the context within which its issue-specific Safeguard Policies will be applied, when it reports back to CODE (as agreed in a meeting with CODE on 21<sup>st</sup> May 2002). It may also be of interest to a wider set of stakeholders who have an interest in MIGA's Environmental and Social Review Procedures, including potential clients of MIGA, Non-Governmental Organizations (NGOs), and other providers of political risk insurance such as export credit agencies and private corporations.

## **1.4. Route map to the report**

This introductory section is followed in section 2 by a description of the analytical framework applied to the review, some basic details on the projects that were considered in the review, and a discussion of the overall approach. In section 3, the key issues that emerged during the course of the review are discussed. Finally, section 4 presents a summary of emerging lessons and the implications for MIGA.



## 2. Analytical framework & approach

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This section briefly describes the methodology for the MIGA review and the overall approach. In summary, the review was based on a consistent analysis of the application of MIGA's review procedures to 42 category A and B projects, designed to elicit information on both procedural compliance, and explore a number of concerns relating to the adequacy of procedures.

### 2.1. Objectives of the MIGA review

The overall aim of the MIGA review was to explore whether the application of MIGA's Environmental and Social Review Procedures (ESRPs) consistently resulted in the avoidance of environmental and social harm, in accordance with their intent (see Box 2.1 for a summary of the ESRPs). The specific objectives were as follows:

- To review how the ESRPs were applied to a cross section of MIGA projects, and explore whether the specific requirements were adhered to;
- To assess any variability in the interpretation of the ESRPs between projects and consider its significance;
- To consider whether the ESRPs are responsive to MIGA's unique business model, or unintentionally create difficulties in meeting the intent behind the procedures.

It is important to acknowledge that avoidance of social and environmental harm has been based on a desk review. This involves a value judgment to be applied, based on factors such as the thoroughness of MIGA's review of individual projects, and the ongoing assurance of avoidance of harm provided by monitoring reports etc. The recommendations section of this review discusses the requirement for any supplementary site visits.

### 2.2. Basis for selecting projects to be addressed

The review was limited to those projects for which Definitive Applications for Guarantees<sup>5</sup> had been issued since the coming into effect of MIGA's environmental policy and review procedures on July 1<sup>st</sup> 1999, and for which contracts had been issued that were still in effect as of June 30<sup>th</sup> 2002 (i.e. fiscal year 2000 through 2002). During this period, MIGA issued approximately 160 contracts of guarantee for 115 projects. When environmental category C projects (with negligible environmental impacts) are excluded, this leaves a sample of 42 projects, where an environmental category A or B was assigned, and where guarantees are still in place. This formed the sample for the CAO review. Seven of these are category A projects, and the remainder are B's. This information is summarized in Table 2.1.

### 2.3. Analytical framework for the review

To ensure a consistent approach to the review of individual projects between the three members of the review team, an analytical framework was developed for application to all projects. This identified nine clusters of issues arising from the review process (including project screening and categorization, environmental and social review, monitoring compliance, etc.),

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<sup>5</sup> The Definitive Application is the point at which a potential MIGA client submits a formal request to MIGA for a guarantee. This initiates the underwriting process and, subsequent to the approval of the Early Management Screening, the environmental and social review in parallel.

and thirty five individual questions (see Annex 1). While some of the questions required only a yes/no response, most required a value judgment to be applied based on a simple rating system of satisfactory, not fully satisfactory, and unsatisfactory. The aggregation of data from across all 42 projects provided the basis for most of the discussion in section 3. This process produced information on procedural compliance, and tested the efficacy of a number of concerns relating to the adequacy of MIGA's ESRPs.

At the outset of the review a number of specific concerns (relating to the adequacy of the review procedures or of MIGA's review capacity) were explicitly highlighted to MIGA. In addition, a number of other issues or concerns emerged during the course of the review. These are summarized at the beginning of the next section, and discussed in detail.

### ***Box 2.1 MIGA's Environmental and Social Review Procedures (ESRPs)***

MIGA's ESRPs are designed to ensure that all the projects it insures comply with applicable environmental and social policies and guidelines. MIGA's Environment Officers are responsible for the environmental and social review, clearance and supervision of projects. The ESRPs include the following stages:

- ***Project screening:*** On receipt of a Definitive Application to provide insurance, a preliminary environmental screening is undertaken to identify key issues and categorize the project (as A, B or C)
- ***Environmental and social information requirements and review:*** MIGA staff review the Environmental Assessment and any other available information to determine its adequacy and identify additional information required, which may involve a site visit.
- ***Disclosure of review findings:*** MIGA staff ensures that the requirements to disclose information on Category A projects are followed (not applicable to Category B or C projects).
- ***Environmental and social clearance:*** On determining that a project will comply with policies and guidelines, the Environmental Officer provides clearance to the Guarantee Officer (in the form of an Environmental Clearance Memorandum).
- ***Guarantee approval:*** The Environmental Officer prepares or reviews a summary of the environmental and social review findings for inclusion in the President's Report to the Board.
- ***Project compliance:*** The applicant provides representations and warranties throughout the term of a Contract of Guarantee that environmental requirements will be complied with. In addition, MIGA may periodically request warranties that a project is in compliance, and may carry out monitoring visits or request specific data to verify information provided. Evidence that a project is not in compliance are grounds for canceling coverage or denying a claim

For additional information, the procedures may be viewed in full at [www.miga.org](http://www.miga.org)

**Table 2.1 Regional and sectoral distribution of projects reviewed (FY2000–2002)**

Sector/sub-sector		Sub-Saharan Africa		Latin America & Caribbean		Middle East & Northern Africa		Central & Eastern Europe		Southern Europe & Central Asia		East Asia & Pacific		South Asia		Totals
		A	B	A	B	A	B	A	B	A	B	A	B	A	B	
	<b>EA Category</b>															
<b>Agribusiness</b>	<i>Grain storage</i>								1							1
	<i>Technical assistance</i>								1							1
	<i>Sugar plantation</i>		1													1
<b>Industry</b>	<i>Fertilizer</i>					1										1
	<i>Food and beverage</i>										1					1
	<i>Manufacturing</i>				1						1					2
	<i>Transport and logistics</i>				2											2
	<i>Textiles</i>		1						1							2
	<i>Vehicle leasing, servicing &amp; sales</i>		2													2
<b>Infrastructure</b>	<i>Airports</i>				1											1
	<i>Ports and harbors</i>		1		1											2
	<i>Road/rail/metro/</i>			1									1			2
	<i>Water and sewage</i>				1											1
<b>Mining</b>	<i>Mining and metals processing</i>	1	2													3
<b>Oil and gas</b>	<i>Oil and gas production</i>	1		1					1							3
<b>Power</b>	<i>Power generation</i>		3		4					1	1					9
	<i>Power transmission &amp; distribution</i>	1			4						1					6
<b>Tourism</b>			1		1											2
<b>Totals</b>		<b>3</b>	<b>11</b>	<b>2</b>	<b>15</b>	<b>1</b>			<b>4</b>	<b>1</b>	<b>4</b>		<b>1</b>			<b>42</b>
		<b>Category A - 7</b>					<b>Category B - 35</b>									

### 3. Discussion of key concerns emerging from the review

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At the heart of the review were a number of key concerns that emerged from the practical engagement of the CAO Office with some MIGA projects, in addition to the wider questions of the context within which MIGA's interim issue-specific Safeguard Policies are applied, raised in the April and May 2002 CODE meetings. During the course of the review, a number of other issues emerged that merit some discussion. These may be summarized as follows:

- Do MIGA's environmental and social review procedures afford an adequate level of due diligence, and are they consistently being applied?
- Does MIGA undertake any monitoring of its projects and are arrangements for monitoring satisfactory?
- Does MIGA have adequate environmental and social review capacity?
- Are the review procedures responsive to MIGA's business model?

The following sections tease out a number of individual strands of concern that address each of these four basic points.

#### 3.1. Overview of procedural application

##### 3.1.1. *Variability in application of procedures*

There are three linked questions relating to the variability in the application of the procedures. First, are all the procedural requirements being followed as prescribed (which in effect relates to procedural compliance)? Secondly, are these requirements being consistently applied, irrespective of the project context or review staff member? Thirdly, what is the significance (if any) of any observed variation in the application of the procedures?

In practice, there was very little variation in the application of the review procedures across the sample of 42 projects. On almost every project, each stage of the ESRPs was complied with, in strict accordance with the procedural requirements. MIGA is therefore to be complimented on its diligent application of the procedures. Notwithstanding this finding, the review raises a number of questions about whether the ESRPs afford an adequate level of environmental and social due diligence, which are explored in subsequent sections.

On the question of consistency of application, there was a very high degree of consistency at each of the key decision gates in the procedures, i.e. project screening (categorization), environmental and social information requirements (including the need for a site visit), environmental and social clearance and reporting, and monitoring, with one important caveat: the attention to social issues was often rated as less than satisfactory. This does not in itself imply variability in the application of the procedures – more a consistent oversight. This aspect is returned to in more detail in section 3.1.3 below.

Therefore in terms of strict adherence to procedural requirements and consistency of application, MIGA makes strenuous efforts to ensure a high level of procedural compliance and consistency.

##### 3.1.2. *Categorization and full consideration of issues*

Categorization deserves a separate discussion, as any inadequacies in the categorization process could have profound ripple effects. This is because the level of due diligence required

for a category A project is much more thorough than for category B projects. At issue is whether the project screening process and assignment of EA categories is supportive of a thorough assessment of all environmental and social issues. A related concern is whether there is an internal resistance to categorizing projects as A, given the more onerous level of assessment (and related disclosure requirements) compared to category B projects, or whether the 'threat' of an A rating, prejudices MIGA from providing guarantees for more difficult projects. Category C projects have been excluded from the review, and the question of whether any Category C projects may have been incorrectly classified has not been addressed in detail<sup>6</sup>.

Given MIGA's definition of category A and B project's (which is in accordance with that of other parts of the World Bank Group), the review team's assessment is that MIGA's categorization of projects is consistent and competent. In only one instance of the 42 projects reviewed, did the review team have concerns that an A rating might have been more appropriate than a B rating. However, this was not a clear-cut situation of incorrect categorization, and more an issue of differing professional judgment. In all other 41 cases, the review team agreed with the assigned category.

On the related question of whether categorization supported a full assessment of the issues, the review findings are more ambiguous. For category B projects, there is a very wide variation in the level of detail of environmental and social information provided by the applicant. This is not problematic per se, as there is also wide variation in the complexity of the environmental and social issues associated with category B projects. The review was therefore only concerned with whether there was a disconnect between the level of information provided to MIGA by its clients, and that which would have been required to make a proper assessment of the related environmental and social impacts (which in some cases there was, as discussed in more detail in subsequent sections). The involvement of MIGA in projects is typically in the latter stages, and in some instances the guarantee may pertain to the operational phase of a project that is in the advanced stages of construction. So MIGA is rarely in a position to advise on and influence the quality of the assessment processes that generate the environmental and social information submitted, particularly for category B projects.

In practice therefore, MIGA is in the business of checking to ensure that any specific procedural or guideline requirements have been met (which it does in a consistent and thorough manner)<sup>7</sup>. Where these are not discernable from the available documentation, MIGA requests additional information or assurances from the applicant. But these requests are typically directed at clarifying compliance rather than recommending measures that go beyond compliance (which MIGA does not believe it has the leverage to require). It may also undertake a site visit if it has specific concerns relating to projects, or in support of categorization – for example, 6 of the 35 category B projects in the sample were visited by environmental specialists prior to a guarantee being issued. In the opinion of the review team, MIGA should also have undertaken site visits for two other projects in light of the complexity of the issues (one category A<sup>8</sup> and one category B).

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<sup>6</sup> The review did also consider whether category B projects merited a B or C rating, but the B categorization was correct in all cases. The list of category C projects for FY2000-2002 was also reviewed for any obvious anomalies, but the question of misclassifying category B projects as C projects was not systematically addressed in detail.

<sup>7</sup> This differs markedly from the World Bank and the IFC which have embraced a broader commitment to sustainable development, but view do no harm as the minimum requirement rather than the end-point.

<sup>8</sup> In this case a site visit had been undertaken by IFC, who had considered making a loan to the project, but MIGA did not undertake a follow-up visit in connection with the application for MIGA to provide political risk insurance.

It is important to acknowledge that MIGA has less opportunity than either IFC or the World Bank to specify TORs for environmental assessments for example, or support applicants in ensuring a thorough appraisal of all environmental or social aspects (by virtue of its involvement in the latter stages of project development). Similarly, MIGA also has less opportunity for encouraging a more comprehensive inclusive approach to environmental or social assessment. The lack of disclosure on category B projects also means that there is no informal external pressure for more comprehensive EAs at the project level. Given this inherent constraint, it is recommended that MIGA more systematically evaluates and reports on the environmental and social risks associated with individual projects that it guarantees. This is elaborated on in sections 3.4.2 and 3.5.1 below.

On the question of internal resistance to categorizing projects as A (or external concerns regarding an A rating), in only one instance did the project correspondence suggest that an applicant was “grateful” for a project not being assigned an A categorization (the B categorization was correct in the opinion of the review team). It is not possible to make relevant comparisons of the ratio of category A-B-C projects in MIGA and IFC’s portfolios, as the business model is so different. The strong correlation between the review team’s assessment of EA category and MIGA’s, suggests that even if underwriting staff prefer to deal with category B projects, this in no way compromises the integrity of the categorization process. Once a category B rating is assigned however, the due diligence requirements can be far less stringent than for category A projects.

### **3.1.3. Social versus environmental dimensions**

At issue is whether the review process consistently identifies all relevant environmental and social issues with no major omissions. The attention to social issues was often rated as less than fully satisfactory, whereas the treatment of environmental issues was generally satisfactory. For example, half of the projects reviewed rated less than fully satisfactory for identification of social issues in the initial stages of MIGA’s review, and the reporting of social issues in the Environmental Clearance Memoranda were less than fully satisfactory in 70 percent of cases.

The failure to identify all relevant social issues in the initial stages of the review procedures clearly has implications for subsequent stages. Potential social problems that were not initially flagged were rarely if ever addressed in the interim stages of MIGA’s review process prior to clearance. In addition, some social issues that were initially identified as potentially important, were later found to be of low significance and not reported on in the Environmental Clearance Memorandum (ECM). This is inconsistent with the approach to environmental issues, which were almost always systematically followed through (even where they were of limited significance).

It is important to clarify what the percentages referred to above actually mean. This is not to suggest that almost half the MIGA sample projects definitely have significant social impacts that have not been addressed. Rather that a number of potentially significant social impacts that might adversely impact on project outcomes have not been flagged by either the applicant or MIGA in half the sample of projects, and there is therefore no assurance that these aspects have been fully addressed. For example, in a number of post-privatization utility projects involving an enhancement/expansion of services, there was no discussion of arrangements for ensuring that vulnerable groups or the impoverished were not denied the benefits of improved service provision on the basis of inability to pay. Yet in some of these same projects, the extension of services to poor communities was presented as a positive development impact. In

contrast, a number of other MIGA utility project clients had implemented progressive social or environmental programs specifically targeting vulnerable groups.

Given that MIGA has no social specialists on-staff, this finding might have been anticipated. But there has been no assumption on the part of the review team that the absence of any in-house social capacity would prove to be so significant. In some instances, MIGA provides guarantees for fairly straightforward industrial projects in brown-field locations, where social issues may not be important. For other projects, MIGA contracts external support (particularly from IFC), to supplement in-house environmental capacity and to provide a social review capability. But this support is sought in only a minority of cases. IFC have been involved in 12 of the 42 MIGA projects reviewed, 2 on very specific queries relating to categorization or a technical matter. In three other cases, IFC has had a prior interest in the project. So IFC's advice has been specifically sought on social (sometimes in combination with environmental) matters for 7 projects. The availability of IFC staff is neither certain nor contractually assured. So the weaknesses in MIGA's social due diligence capacity are significant, expose MIGA to potential social risks, and should be dealt with.

One solution may be to routinely submit all projects for which a Definitive Application is received to the scrutiny of a social specialist at the screening stage (either in-house or externally). This would determine the need for ongoing social due diligence at the outset.

#### **3.1.4. Consultation and disclosure**

There are two separate issues relating to consultation and disclosure. First, does MIGA consistently comply with its disclosure requirements relating to category A projects (as there is no provision for disclosure for category B projects)? Secondly, are the consultation and disclosure requirements sufficient to provide adequate assurances that project affected people or other interested parties have a say in project development?

Of the seven category A projects insured by MIGA in the past three fiscal years, 3 had less than fully satisfactory ratings as regards consultation (whereas disclosure was always in accordance with MIGA's procedures). The issue here is not that the review team concluded that the consultations that took place in each case were inadequate, but that the information available to MIGA was insufficient to independently determine the adequacy of consultation. This may partly relate to MIGA's capacity to fully evaluate the adequacy of consultation (e.g. was consultation conducted in a manner that was timely, meaningful, appropriate in terms of formats or languages, etc.) as opposed to a more process oriented approach to determining the adequacy of consultation and disclosure outlined in Annex 1 to the ESRPs (which ties back to the discussion of social dimensions above). But it may also be linked to another principle underpinning the way MIGA executes its ESRPs.

MIGA relies heavily on warranties and assurances from applicants and guarantee holders, which to some extent places a heavier burden of compliance on MIGA's clients than those of IFC or the World Bank. Put simply, if a guarantee holder has provided false or misleading information, there is always the threat of claim denial or contract cancellation (even if this threat is rarely invoked<sup>9</sup>). From a broader World Bank Group's perspective however, this may underestimate the potential reputational risk associated with this approach. This aspect is discussed in greater detail in section 3.2 below.

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<sup>9</sup> In the case of one project insured during the study period (FY00-02), the contract was cancelled based on the Guarantee holder's unwillingness to undertake an environmental audit in accordance with the terms of the Contract of Guarantee.

On the question of consultation and disclosure for category B projects, MIGA has no mandatory requirements. MIGA's concern is that adopting consultation and disclosure requirements similar to IFC (for example), would prejudice its ability to do business, as it already exceeds the requirements of its peers. However, the review team also evaluated whether consultation *ought* to have been undertaken for category B projects, by considering the complexity of the related environmental and social issues and their potential to impact people (in recognition of the proven linkages between improved consultation and enhanced project outcomes). For example, some category B industrial projects involved modernization of manufacturing facilities with no significant changes in emissions, within the existing boundaries of an industrial park and with no nearby communities. In such instances, consultation would not have been necessary. In other instances, the scale and location of some expansion projects had a significant potential to impact people, so consultation would have been important.

Measured against this 'standard', consultation was rated as satisfactory in over 70 percent of category B projects. This included many projects where consultation had not been undertaken, but was not considered necessary (in the opinion of the review team). It also included several projects where consultation was deemed appropriate by the review team, and had been initiated by the applicant (despite MIGA not requiring it). So in many cases, good practice on the part of MIGA's clients is exceeding MIGA's procedural requirements. This calls into question the importance of non-disclosure to MIGA's business model, in at least some cases. But a further 30 percent of category B projects would have benefited from public consultation, or the public consultation that was voluntarily carried out was less than fully satisfactory. In the opinion of the review team, this is a significant finding that MIGA's ESRPs can not address in their present format.

Irrespective of whether MIGA chooses to re-evaluate its position on disclosure of category B projects, it is strongly recommended that MIGA's procedures incorporate an explicit assessment of the importance of consultation for category B projects, and an insistence that consultation be carried out where appropriate as a condition of guarantee. In some instance, this may be impractical and the decision to issue a guarantee should explicitly consider the risks of inadequate consultation.

### **3.1.5. Client capacity for environmental and social management**

The MIGA review procedures contain no specific requirements to systematically and formally assess the capacity of sponsors for environmental and social management. However, given the burden of responsibility placed on clients to provide warranties and assurances that environmental and social aspects of projects are being effectively managed, the review team considers this to be inadequate. The adequacy of the sponsor capacity was apparent in only 25 percent of the projects reviewed, and in these cases surrogate measures of competence were often used (e.g. repeat client with a demonstrable track record, international company with strong reputation for environmental management, or submission of an environmental management system that was indicative of robust internal management capacity).

Once again, it is important to acknowledge that in many cases MIGA staff have greater confidence in the capacity of clients than that assessed through the review. But this has been derived through informal interaction or appraisal, and would benefit from a more explicit and thorough assessment as part of the review process. This is not simply a case of bureaucratizing something that already happens, but of increasing the confidence of all environmental and social requirements being met by the clients. IFC developed a Management Capability questionnaire in 2001 (to be sent to its clients during appraisal). MIGA should adopt a similar



system, which should help improve the consistency of the basis on which judgments about capacity are made.

### **3.1.6. Tensions inherent in multiple roles of review staff**

The issue of multiple review roles of staff was initially included in the review, as during the three-year period to which the review pertains, the lines of accountability and reporting of MIGA's environment staff were less autonomous than within IFC. For example, the now reorganized Policy and Evaluation Department within which the Environment Officers were based was responsible for ensuring environmental due diligence and therefore performance, but was also responsible for evaluating performance (as part of the development effects monitoring). However, as of July 2002 an internal reorganization has removed any possible conflict of interest, as the responsibility for evaluation now resides in a different department. As MIGA's assessment of development effects only takes place three years after a guarantee coming into effect, there will be no conflict of interest for projects guaranteed in the past three years (i.e. the period of the review)

This will not allay concerns that MIGA staff may be conflicted in being responsible for project screening, review, clearance and monitoring. However, these concerns are common to those sometimes expressed about the IFC, where staff have a similar set of responsibilities. The ongoing responsibility for projects and related accountability inherent in the MIGA and IFC approaches are sometimes perceived as strengths rather than weaknesses. As of July 2002, the Operations Evaluation Unit (OEU) of MIGA will review environmental and social due diligence as part of its independent evaluation<sup>10</sup> of projects, which should serve as an internal check on such conflicts. This aspect is not considered further in the review.

## **3.2. Adequacy of monitoring arrangements**

A number of aspects of MIGA's ESRPs indicate a need for robust monitoring arrangements. For example, the time constraints inherent in MIGA's business model sometimes require that supplementary measures be undertaken by a client, post the issue of a guarantee (e.g. on additional consultation, remedial activities, or detailed audits). Similarly, the potentially powerful MIGA mechanism of contract cancellation (in the event of non-compliance with MIGA's environmental or social requirements), also implies that monitoring arrangements should be robust. The same could apply to claim denial in the event of material non-compliances. Yet in the opinion of the review team, MIGA's overall arrangements for monitoring are often inadequate (70 percent of projects were rated as less than fully satisfactory, and 30 percent as unsatisfactory), in that they do not provide confidence that all environmental and social aspects are being adequately managed.

There are three basic mechanisms that MIGA employs to ensure project compliance. For category A projects, MIGA may request monitoring reports to demonstrate compliance with the Environmental Action Plan. Secondly, for category A and particularly B projects, MIGA may include specific conditions of contract that pertain to social and environmental matters, which usually specify actions to be undertaken within a specified time period. Thirdly, there are the generic conditions of contracts of guarantee, which require all guarantee holders to comply with MIGA's environmental requirements. MIGA can also request warranties from the guarantee holder periodically to confirm compliance and undertake monitoring visits.

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<sup>10</sup> As of July 2002, the Operations Evaluation Unit (OEU) is independent of Management and reports to the Board's Committee on Development Effectiveness (CODE), through the Director General of the World Bank's Operations Evaluation Department.

For category A projects, the procedural provisions for monitoring are more robust than for category B projects, and they are therefore not discussed in detail below. However, monitoring arrangements for some category A projects were inadequate. Monitoring of the social aspects was weaker than the environmental aspects, and less than fully satisfactory in all but 2 of the 7 category A projects (one of which was monitored by IBRD, which reinforces the findings of section 3.1.3 above). Some additional comments on specific contractual requirements and projects involving other multi-lateral agencies made below are also relevant to category A projects.

### **3.2.1. Reliance on warranties and specific requirements**

It is common practice for MIGA to include specific environmental requirements as a condition of contract (both for category A and B projects). These typically might specify the need for an environmental audit and corrective action plan; in some cases, these measures would ideally have been implemented prior to the issue of the guarantee, whereas in others it would have been impractical to do so. This device enables MIGA to proceed with issuing the guarantee, without incurring delays as a result of 'non-critical' environmental or social requirements. It is important to emphasize that in no instance did the review team feel that a guarantee ought not to have been issued, prior to completion of such requirements.

With almost no exceptions, MIGA's Policy and Environment Department systematically and diligently tracks the progress of these specific contractual requirements (using a system whereby the Guarantees Department are alerted to the approaching deadline for these contractual obligations). Guarantee holders are typically issued with a reminder by the Guarantees Department as the scheduled completion date approaches, unless they have already submitted proof of completion. This aspect of MIGA's monitoring system works well. However, in one or two instances, the quality or completeness of the work submitted by clients was considered to be inadequate or incomplete by the review team, but it was accepted by MIGA.

For category B projects, MIGA places considerable stock on the explicit commitments that clients make to ensuring compliance with MIGA's policies and guidelines on the signing of a contract of guarantee, which in effect is reiterated on the annual payment of premiums. This is partially understandable, given that failure to ensure compliance with any of the terms of the guarantee contracts carries an explicit threat of contract cancellation, or claim denial in the event of proven non-compliance. So the burden of responsibility for ensuring compliance is largely transferred to the client. While MIGA has the ability to request warranties from the guarantee holder periodically to confirm compliance and to undertake monitoring visits, in practice these measures are rarely invoked. Monitoring visits tend to be linked to development effects monitoring, which is not triggered until a guarantee has been in effect for three years.

There are two problems with this system. Firstly, as outlined above MIGA does not systematically evaluate its clients capacity for environmental and social management (although some informal assessment of capacity takes place). Therefore, it is difficult to have full confidence that the guarantee holder will undertake all necessary actions to remain in compliance, however well intentioned, and thus avoid adverse impacts on communities or the natural environment in the vicinity of projects. The second issue relates to the locus of reputational risk, in the event of something going wrong. From a legal standpoint, MIGA may be fully protected from liability in the event of a major adverse environmental or social impact resulting from non-compliance, but the reputational burden of such events inevitably falls disproportionately on MIGA and the World Bank Group.

MIGA's Policy and Environment Department (MIGPE) has recently proposed a number of improvements to the system for tracking specific contractual commitments, which should make this system even more robust. In addition, MIGPE has signaled its intention to prioritize and undertake more extensive site visits in support of compliance monitoring to the Executive Director of MIGA, subject to the anticipated availability of MIGPE staff time<sup>11</sup>.

### **3.2.2. *Reliance on other multilateral agencies***

One quarter of the projects reviewed are projects where at least one other multi-lateral agency also participates (in particular Inter-American Development Bank, IFC, European Bank for Reconstruction and Development (EBRD), and the World Bank. In such cases, MIGA relies heavily on the due-diligence processes of project partners. While MIGA's procedures provide for this transfer of responsibility to other agencies of the World Bank Group, this appears to have been extended to other multi-lateral agencies. Given that MIGA is often approached later in the development of projects than other agencies, this seems to be commonsense. But it carries the risk that if other institutions fail to identify important issues and mitigate them effectively, MIGA may repeat these omissions. Furthermore, MIGA also relies very heavily on these partner organizations for monitoring, and does not always require that monitoring reports be submitted to MIGA in parallel (particularly for category B projects).

In some instances, project partners may be involved with MIGA's clients for a shorter period than MIGA. For example, on one project where IADB was involved, the client pre-paid the loan within a very short period of time. For this, and similar reasons to those stated in 3.2.1 above, it is recommended that MIGA strengthen its arrangements for monitoring of projects involving other multi-lateral agencies.

In summary, it is recommended that MIGA's arrangements for monitoring be strengthened across all category A and B projects (supported by a better appraisal of the environmental and social management capacity of applicants). This may have implications for MIGA's environmental and social review capacity, which is discussed below.

### **3.3. *Adequacy of review capacity***

The two basic issues relating to review capacity are whether MIGA has an adequate number of staff, and whether they have the requisite skills to address all relevant issues.

#### **3.3.1. *Numbers of staff and requisite skills***

There is no simple answer to the question of how many environmental and social review staff are enough for MIGA. While it may be possible to compare MIGA's ratio's of staff to projects screened/reviewed/cleared/monitored with other multilateral agencies, even this quantitative measure would be crude at best. It would also fail to acknowledge the use that MIGA makes of external expertise, particularly that of IFC's staff, in support of its own efforts, and the varying level of effort applied to category B projects, depending on the complexity of the environmental and social issues. So perhaps the best test of whether MIGA have enough staff is whether they are delivering against their procedural requirements.

The answer to this is a qualified yes as far as the environmental dimensions of projects are concerned. The total numbers of projects (42) over a three year period is fairly modest, even if one accepts that three times this many are screened and a small percentage of projects that are

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<sup>11</sup> As outlined in an internal Memorandum from the Director of MIGPE to the MIGA's Executive Director, dated November 1 2002.

reviewed and cleared do not proceed to guarantee. The facility to engage IFC (or other external specialist) on an as needed basis, provides a degree of elasticity in MIGA's environmental review capacity. This review has also gone into considerable detail on all category A and B projects over the past three years, and has found that procedural compliance is both rigorous and consistent. So given MIGA's current ESRPs, their environmental review capacity is adequate. But MIGA's lack of internal social expertise and limited use of IFC's social specialists points to major shortcomings regarding the social review of projects. So the recommendations of this review will have implications for MIGA's capacity (both social and environmental).

For example, if the suggestion is accepted that all projects for which a Definitive Application is received are routinely submitted to the scrutiny of a social specialist at the screening stage (which may flag up the need for additional effort prior to clearance), additional staff resources will have to be applied (either in-house or externally). Similarly, if MIGA strengthens its existing arrangements for monitoring and assessment of the environmental and social capacity of applicants, this will also require additional resources. In addition, section 3.4 recommends that the documentation at key stages in the review procedures be strengthened and expanded, which also has resource implications.

It is recommended that MIGA revisit the question of capacity, once it has fully considered the recommendations of this review.

### **3.4. Do the procedures serve MIGA's business model?**

Given the unique role that MIGA occupies within the World Bank Group as provider of political risk insurance services, and some of the tensions inherent in the application of procedures that are consonant with other institutions of the World Bank Group, it is worthwhile asking whether the ESRP's are appropriate for MIGA's business model. This has been based on a review of the policies and procedures of other providers of political risk insurance; consideration of how MIGA's ESRPs ties in with its underwriting procedures; and consideration of the potential for MIGA to go beyond strict compliance (or do-no-harm) and engage in value added activities, consistent with other institutions in the World Bank Group.

#### **3.4.1. Benchmarking MIGA's ESRPs**

As part of the review process, the environmental and social review procedures of a number of other providers of political risk cover were evaluated. This included OPIC (the USA's Overseas Private Investment Corporation); ECGD (the UK's Export Credit Guarantee Department); EDC (Export Development Canada); and EFIC (Australia's export credit agency); as well as a number of private corporations (Swiss RE, Zurich, Lloyds, and AIG). It was not possible to review the screening mechanisms applied by the private insurers, as these are not publicly available and are treated as commercially confidential. A desk review of the procedures of the various government agencies identified close alignment between their procedures and those of MIGA. In most cases, these were recent in origin and borrowed heavily from the procedures of MIGA or other parts of the World Bank Group.

The exception was ECDG, which had adopted a series of environmental and social screens to assist with the identification of risks. While ECDG's screens are fairly basic, the application of screens has the potential to strengthen certain aspects of MIGA's ESRPs, as elaborated on in sections 3.1.3 and 3.4.2. In addition, a screening process is embedded in the 'Common Approaches on the Environment and Officially Supported Export' agreement, adopted by 24 of the OECD's 26 export credit agencies, which came into effect in January 2002.

### **3.4.2. Disconnect between ESRPs and core business practices**

MIGA as a provider of political risk insurance is in the business of evaluating project risks and determining the premium that an applicant must pay for MIGA to assume liability for these risks. This involves an analysis of risk factors such as political instability, corruption, risk of conflict, etc., as well as environmental and social risks. The disconnect between MIGA's approach to dealing with core business related risks and environmental and social risks is noteworthy.

The core activities of the Guarantees Department concentrate on exogenous factors influencing the project over which the applicant has little or no influence, which may result in adverse impacts, but which MIGA do not actively seek to influence<sup>12</sup> (for example, war and civil disturbance, currency transfer, or expropriation). The ESRP's are conversely primarily concerned with risk factors that are internal or local to the project over which the applicant can exert some influence, and which MIGA actively requires them to take account of and manage (e.g. environmental hazards and liabilities, relations with communities, etc.). Whereas the realization of external risk factors may give rise to a claim, the failure of a guarantee holder to manage environmental and social risks could result in claim denial or contract cancellation.

Why is this relevant to the review of MIGA's ESRP's? Firstly, because there is a higher degree of inter-linkage between the various components of risk than is immediately apparent, and this is currently not reflected in the activities of the Guarantees or the Policy and Environment Departments. For example, civil unrest or violent protest may in extreme cases manifest itself in attacks on project personnel or acts of sabotage. Alternatively, it may result in suppression of criticism (of regimes or indeed projects), or in extreme cases trigger abuses of the rights of project affected people. Such events can have profound impacts on the communities in the vicinity of projects and on the reputation of a project operator, with potential ripple effects for the providers of finance or insurance. This also holds true for environmental hazards or incidents, which can cause environmental, reputational and financial damages.

By adopting a more holistic approach to the reporting of project risk, MIGA may be able to address some of the criticisms of the ESRPs raised in this review. Building upon their existing working relationships, both Departments should collaborate more closely<sup>13</sup> to ensure that environmental and social risks are more systematically considered, in the broader context of any possible linkages to the country and strategic risks. In practical terms, this might involve the adoption of the following measures:

- A more systematic evaluation and reporting of any linkages between country risks, and potential social and environmental impacts at the project level: This would benefit from the adoption of more sophisticated social screens as discussed in section 3.4.1 above;
- More systematic evaluation and reporting of the potential for environmental or social risks to be realized and converted into impacts on people or the natural environment or reputational risks for the World Bank Group;
- More proactive and direct engagement with clients to help to mitigate and manage project level risks.

This latter point leads to the broader issue of MIGA's potential for encouraging good practice that goes beyond basic compliance.

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<sup>12</sup> It should also be acknowledged that MIGA's Operational Regulations make no reference to considering the potential impacts of projects

<sup>13</sup> The potential benefits of a higher level of integration was determined through a detailed review of the exchanges between the two Departments for all projects

### **3.4.3. MIGA's potential for encouraging good**

As highlighted in the recently completed CAO report to the Extractive Industries Review (EIR), **Extracting sustainable advantage?**, MIGA's opportunities for encouraging good practices by its clients are limited by the do-no-harm focus of the ESRP procedures, which in turn is linked to its business model. Compared to IFC, MIGA's preparation times are typically short, and direct contact between the client and MIGA's environmental staff is limited. This applies to the lead-up to the President's report, and post the issue of a guarantee. Although the MIGA review team found a number of instances of good practice in the projects reviewed, these were not attributable to the intervention of MIGA's staff (as they had been initiated independently of MIGA's involvement).

The Board of the World Bank Group has sanctioned this approach with the approval of MIGA's Environment and Social Review Procedures in May 1999. But it is worth revisiting whether the broader 'advisory services capacity on sustainability' within the Bank Group could be harnessed and applied where MIGA clients have an interest, as an extension of MIGA's investment promotion advisory services. This may require active marketing on MIGA's part and may also initially require some form of financial support (given that it represents a new departure for MIGA). However, over time the value of such interventions should be assessed if the business case for such added-value activities is to be made persuasively and promoted to MIGA's clients. In this regard, it is important to acknowledge that MIGA is partially disadvantaged by its inability to authorize loans or credits, unlike the IFC or World Bank. It has also had limited success in a number of applications it has made for Trust Fund support for environmental initiatives. So the practical question of financial support for sustainability advisory services must be addressed in parallel.

### **3.5. Traceability and auditability of the ESRP's**

One issue that emerged during the course of the review concerned the traceability and auditability of MIGA's decision-making processes on environmental and social matters. Initial concerns over the paucity of information filed centrally in MIGA's Policy and Environment Department (for certain projects) were allayed, once additional information was made available. But the CAO still has some residual concerns. First because the documentation at key decision-gates rarely reflects the level of effort that MIGA has invested in environmental and social due diligence. Second, given that MIGA's core review capacity is two people, it is prudent to strengthen the "institutional memory" on specific projects, to withstand the loss of anecdotal information that would inevitably occur if either staff member were to leave the organization.

#### **3.5.1. The rationale for improved traceability**

In addition to any project documents submitted by the applicant, the key documentation from an environmental and social review perspective is as follows:

- *Initial environmental screening memorandum (IESM)*: Alerts the project underwriter to key environmental and social issues, highlights any additional information requirements and tentatively classifies the project as category A, B or C;
- *Environmental Clearance Memorandum (ECM)*: Provides clearance to the project underwriter that the project will comply with MIGA's policies and guidelines, details outstanding issues and actions to address these issues, identifies monitoring requirements, and provides suggested language for the President's report (including any special contract provisions pertaining to social or environmental matters);

- *President's report*: Identifies the environmental category, major environmental and social issues and mitigation measures, outstanding issues, special conditions for issue of contract, and provides a statement on compliance.

In many cases, the IESM provides only very basic information on the justification for the environmental classification. While additional information can be found in the related e-mail traffic and other documents, rationale for categorization should be more clearly presented. From the perspective of an external reviewer (or auditor), the IESM at present raises more questions than it answers. It is recommended that a more detailed reporting format be adopted for the IESM, for category A and B projects. This need not be very elaborate, but might typically include:

- A clear indication of which policy provisions are likely to be triggered by the project (and which are not), and an indication of the likely scale of impact and degree of uncertainty relating to the impact occurring and its consequences. A simple matrix could be derived to support the consistent application of this approach to all category A and B projects;
- A summary of all applicable guidelines, highlighting specific requirements as appropriate;
- A statement on categorization that highlights any related uncertainties (if applicable), for future reference.

While the ECM is perceived by MIGA to be a far more important document than the IESM, it often prompts the same unanswered questions as the IESM. But with the IESM strengthened, the ambiguities inherent in the ECM should largely be eliminated. In addition, it is recommended that the ECM includes a more in-depth discussion of the potential inter-linkages between the various categories of risk, as recommended in section 3.4.2 above. MIGA should also review its current position on disclosure of category B projects (in light of the observations in section 3.1.4), and reassess the potential impact of enhanced disclosure on its business.

### **3.5.2. Auditability of MIGA's environmental and social information on projects**

A related question concerns the auditability of the system for capturing environmental and social information on projects. As of FY 2002, only a limited amount of information is held centrally by the Policy and Environment Department (MIGPE). This includes the definitive application, ECM and the President's report. Yet as mentioned above, much of the detail lies elsewhere (in many cases in e-mail accounts of key staff members). While MIGA's environmental staff were extremely cooperative in extracting all relevant information, it would be preferable (both to enhance the system auditability and capture institutional memory) to have all relevant information more readily accessible. MIGA's Policy and Evaluation Department is currently considering how best to strengthen their systems of information storage and retrieval.

While an electronic system may be preferable, a very comprehensive paper-based system has been established by the Guarantees Department, which applies to all FY2001/2002 projects in the review sample. This is comprehensive, systematic, well maintained and managed, and captures most of the key environmental and social information on FY2002 projects. As an interim measure, this could rapidly assimilate all supplementary environmental information not currently held centrally, assuming both departments are in agreement.

## 4. Summary of findings & recommendations

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Section 3 contains a number of positive observations on MIGA's implementation of its ESRPs, and identifies some inadequacies. It also highlights several areas where the review procedures should be strengthened in order to increase the confidence that MIGA projects avoid environmental or social harm, consistent with the intent behind the procedures. This section makes initial recommendations on how to overcome these shortcomings. The development of detailed responses on how the ESRPs might be amended to respond to these constructive criticisms is a matter for MIGA to consider, and the CAO is willing to assist as appropriate. The findings and emerging lessons are summarized below (in bold), followed by a brief outline of the initial recommendation (in italics, as applicable).

**MIGA has made strenuous efforts to consistently adhere to its procedural requirements.** For almost every project, each stage of the ESRPs was strictly followed and MIGA is to be complimented on its diligent application of the procedures. There was a very high degree of consistency at each of the key decision gates in the procedures, although the attention to social issues was often rated as less than satisfactory.

**MIGA's categorization of projects is highly consistent and competent.** In only one instance of the 42 projects reviewed, did the review team have some concerns that an A rating *might* have been more appropriate than a B rating. The strong correlation between the review team's assessment of EA category and MIGA's, indicates a high level of integrity in the categorization process.

**The ESRP's are not fully supportive of a detailed assessment of all environmental and social issues, but are focused on ensuring compliance with MIGA's policies and procedures.** MIGA has less opportunity than either IFC or the World Bank to support applicants in ensuring a thorough appraisal of all environmental or social aspects. The lack of disclosure on category B projects also means that there is less informal external pressure for more comprehensive project EAs. Consequently, *it is recommended that MIGA more systematically evaluates and reports on the environmental and social risks associated with individual projects.*

**MIGA's attention to social issues is weaker than its coverage of environmental aspects of projects.** In half the sample of projects reviewed, a number of potential social impacts that might adversely impact on project outcomes were not flagged by either the applicant or MIGA, and there is no assurance that these aspects were fully addressed. This exposes MIGA to social risks. *The solution may be to routinely submit all projects to the scrutiny of a social specialist at the screening stage (and thereafter as appropriate), or to develop more sophisticated and comprehensive social screens, to help MIGA's staff determine the need to refer to a social specialist.*

**MIGA does not always undertake a thorough assessment of the need for consultation and the adequacy of consultation.** For category A projects, MIGA did not always receive or request sufficient information to independently determine the adequacy of consultation. Of seven category A projects insured by MIGA in the past three years, three had less than fully satisfactory ratings for consultation, which should be addressed. Furthermore, although MIGA is of the opinion that disclosure of category B project EAs would harm it's business, a number of MIGA's clients already undertake consultation for category B projects and disclose environmental information local to the project. *It is strongly recommended that MIGA require an*



*explicit assessment of the need for consultation for category B projects, and an insistence that consultation be carried out where appropriate. If this proves to be impractical, the decision to issue a guarantee should explicitly consider the risks of inadequate consultation. MIGA should also review its current position on disclosure for category B projects and reassess the potential adverse (or beneficial) impacts of enhanced disclosure on its business, in support of improved public scrutiny.*

**The lack of any formal requirements to assess the capacity of clients for environmental and social management is considered to be inadequate.** Given the responsibility of clients to provide warranties and assurances that environmental and social aspects of projects are being effectively managed, this aspect should be reinforced. *It is recommended that MIGA adopt a more systematic approach to determining its clients' capacity.*

**The multiple roles that MIGPE staff play in project screening, clearance and monitoring, are not considered to present conflicts of interest.** As of July 2002, an internal reorganization has removed possible conflicts of interest between the review and evaluation functions that were formerly the responsibility of a single department. MIGPE's ongoing responsibility and accountability for the environmental and social aspects of projects could be perceived as a strength rather than a weakness.

**Where specific environmental/social conditions of contract are specified, MIGA systematically and diligently tracks their progress.** This aspect of MIGA's monitoring system works well. However, in one or two instances, the quality or completeness of the work submitted by clients was considered to be inadequate by the review team, but it was accepted by MIGA. *It is recommended that MIGA systematically ensure that the quality of information submitted is of an acceptable standard, recognizing that this has only been an issue in a minority of cases.*

**Overall, MIGA's arrangements for monitoring are inadequate, as they do not provide sufficient confidence that all environmental and social aspects are being adequately managed.** The burden of responsibility for ensuring compliance is largely transferred to guarantee holders. But as MIGA does not systematically evaluate capacity for environmental and social management, it is difficult to have full confidence that guarantee holders will undertake all necessary actions to remain in compliance. The reputational burden of any adverse impacts resulting from non-compliance falls disproportionately on MIGA and the World Bank Group. For projects involving other multi-lateral agencies, MIGA relies heavily on partner organizations for monitoring. *It is strongly recommended that MIGA strengthen its overall arrangements for monitoring, particularly for category B projects.*

**MIGA's capacity to implement its ESRPs is adequate as regards environmental issues, but is inadequate in relation to social issues.** However, if the recommendations of this review are accepted they will have implications for MIGA's social and environmental capacity. For example, if all projects are routinely screened by a social specialist (which may flag up the need for additional effort prior to clearance), or if MIGA strengthens arrangements for environmental and social compliance monitoring, this will require additional resources. *It is recommended that MIGA revisit the question of capacity, once it has fully considered the recommendations of this review.*

**MIGA's review procedures would benefit from closer collaboration between the Guarantees and Policy and Evaluation Departments, in relation to risk assessment.** There is a higher degree of inter-linkage between the various types of project risk than is immediately apparent, which could be more strongly reflected in MIGA's underwriting and ESRPs. *It is*

*recommended that this be addressed by closer collaboration between MIGA's Guarantees and Policy and Evaluation Departments, involving a more systematic evaluation and reporting of the linkages between country risks, potential social and environmental impacts at the project level, and strategic risks.*

**MIGA's opportunities for encouraging good practices by its clients is limited by the do-no-harm focus of the ESRPs, which in turn is linked to its business model.** *It is recommended that the potential for harnessing the broader 'advisory services capacity on sustainability' within the Bank Group be explored, for the benefit of MIGA clients, as an extension of MIGA's advisory services.*

**The documentation at key points in the environmental review process does not reflect the level of effort MIGA invests in due diligence, and often raises more questions than are answered.** *It is recommended that a more detailed reporting format be adopted for the Initial Environmental Screening Memorandum (IESM) for category A and B projects. In addition, the Environmental Clearance Memorandum (ECM) should include a more in-depth discussion of the inter-linkages between the various categories of risk, as mentioned above. MIGA should also review its current position on disclosure of category B projects and reassess the potential impact of enhanced disclosure on its business.*

**The system for capturing environmental and social information on projects is somewhat dispersed and not readily auditable.** While MIGA's environmental staff were extremely cooperative in making available all relevant information, it would be preferable (both to enhance the system auditability and to serve as a repository of institutional memory) to have all relevant information more readily accessible. *MIGA should implement a stronger centralized system for filing relevant information on project reviews, which might link with or be based on the system adopted in the Guarantees Department.*

Finally, on the basis of the experience of conducting the MIGA review and the confidence in the findings presented above, the CAO does not recommend that site visits be undertaken as a second phase to the review, to supplement the desk-based activities. In this respect, the MIGA review as presented is considered to be complete. *However, once MIGA has considered its response to the review recommendations, it may well be appropriate for MIGA to undertake site visits as part of its strengthened due diligence procedures.*

## Annex 1. Analytical framework for the Review

Project Description:		Applicant status: For example, equity holder, debt financier, etc.		
Issues and aspects to be addressed		Details as appropriate	Rating <sup>14</sup>	Comment
Project screening and categorization	Which documents were available at the preliminary environmental screening stage (Definitive App)?		None/ Basic/ Comprehensive.	
	Was the categorization of the project clear and unambiguous (and what category was assigned)?		Y/N	
	Were all exclusions rigorously considered and was there a need to apply a test of reasonableness?		1-3	
	What additional information requirements were requested in the Early Management Screening (EMS) memorandum?		N/a	
Joint Projects	Did the project involve the participation of other partners in the World Bank Group or any other multilateral agency?		Y/N	
	If so, did MIGA defer to the procedures followed by the other agency or was there a difference in application (e.g. categorization)?		Y/N	
	What are the implications (if any) of the observed differences?		N/a	
Environmental and social information requirements	On receipt of the EA and other documents, were any deficiencies identified and alerted to the underwriter?		1-3	
	Did the investor provide a satisfactory response to MIGA's additional information requirements (where applicable)?		1-3	
	Were any variances from policies or guidelines proposed and alerted to the board?		Y/N	

<sup>14</sup> Note: Ratings 1-3 are as follows: 1 – Unsatisfactory; 2 – Less than fully satisfactory; 3 – Satisfactory

	Was a site visit undertaken and on what basis was the need for a visit determined?		SAT/UNSAT	
	Which environmental issues were identified as important and who undertook the review (MIGA, IFC, external)?		1-3	
	Which social issues were identified as important and who undertook the review (MIGA, IFC, external)?		1-3	
	Were there any obvious omissions in the issues considered as important (environmental or social)?		1-3	
	Where external assistance was sought, was the advice accepted (if not why not)?		1-3	
	Were any social issues identified that were beyond the responsibility of the client and how were these dealt with?		N/a	
	What influence (if any) did the applicant's role (e.g. minority investor) have on the treatment of social issues?		N/a	
	For expansion or privatization projects, was an audit conducted and measures identified to ensure compliance with MIGA policies and guidelines?		1-3	
	Has MIGA taken the opportunity to move beyond 'do no harm' to encouraging the applicant to "do good"?		N/a	
<b>Clearance and reporting</b>	Did the clearance memorandum detail outstanding issues, actions to address these issues and stipulate project monitoring requirements?		E 1-3 S 1-3	
	Does the President's report contain sufficient information on social and environmental risks?		E 1-3 S 1-3	

<b>Guarantee issue and conditions</b>	Was a guarantee issued which was conditional on the sponsor completing necessary environmental activities within a specified time period (give details)?		Y/N	
	Were non-standard clauses dealing with either environmental or social issues included in the guarantee contracts to reflect project specific concerns?		1-3	
	Do the contracts clearly specify the environmental and social obligations of the applicant?		1-3	
<b>Consultation and disclosure</b>	Was the level of consultation and disclosure appropriate in the case of category A projects (meaningful and timely, appropriate language, ongoing commitment, etc.)?		1-3	
	Were the level of disclosure adequate and the timing in accordance with the requirements?		1-3	
	For category B projects, was any consultation or disclosure undertaken or would it have been important to do so?		1-3	
<b>Monitoring and compliance</b>	Where a guarantee has been issued that is conditional on implementation of environmental or social mitigation, has this been monitored?		N/a	
	For category A projects, are the requirements of the Environmental Action Plan adequately monitored?		Y/N	
	Have warranties been requested from the guarantee holder with respect to project compliance (in exceptional cases)?		Y/N	

	Have any site visits been undertaken in support of monitoring and how frequently?		Y/N	
	Are overall arrangements for monitoring satisfactory?		1-3	
<i>Environmental &amp; social capacity</i>	Has MIGA determined whether the applicant has the requisite skills to fully comply with MIGA's policies and guidelines?		1-3	
	Has the applicant demonstrated that the operator of the project to which the guarantee pertains has adequate capacity to fully comply with the provisions of MIGA's policies and guidelines?		1-3	