CAO COMPLIANCE

CAO Investigation of IFC

CAO Ref: C-I-R6-Y13-F180

October 28, 2015

CAO Investigation of IFC Environmental and Social Performance in Relation to:

India Infrastructure Fund (#26237)

Office of the Compliance Advisor Ombudsman
for the
International Finance Corporation
Multilateral Investment Guarantee Agency
Members of the World Bank Group

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Executive Summary

In 2008, IFC made an equity investment in India Infrastructure Fund ("the Fund"), a private equity fund established and managed by the Infrastructure Development Finance Company (IDFC) of India. The Fund was established to make investments in large infrastructure projects of a nature and scale that IFC recognized as having potential significant E&S impacts on local communities.

In 2009 the Fund made an investment in GMR Kamalanga Energy Ltd, a company set up to develop and operate a large coal fired power plant near Kamalanga village in Odisha state, India ("the Kamalanga project").

In 2011, CAO received a complaint in relation to the environmental and social (E&S) impacts of the Kamalanga project. The complaint came from project-affected communities with the support of two NGOs. The complainants raise concerns about the project's impacts, which they state pose a threat to their health, livelihoods and human rights.

More specifically, the complainants raise the following issues regarding the application of IFC's Performance Standards to the Kamalanga project:

- Performance Standard 1 (Social and Environmental Assessment and Management Systems) — The complaint claims that community consultation (including with indigenous peoples) has not been adequate, and that the cumulative impact of the project together with other industries in the area has not been considered. The complaint also raises concerns regarding the project's use of a deep bore well to extract groundwater and the impact this has on the availability of ground water in surrounding villages.
- Performance Standard 3 (Pollution Prevention and Abatement) — The complaint raises concerns that the project will exacerbate existing pollution (particularly of the Bhramani River), stating that there is no information available on proposed pollution mitigation. The complaint also raises concerns regarding health related impacts of air pollution from the project.
- Performance Standard 4 (Community Health, Safety and Security) — The complaint raises concerns about structural damage to buildings which they claim has been caused by dynamiting. The complaint also raises concerns regarding alleged intimidation by the project's security guards and arrests of community members who have opposed the project.
- Performance Standard 5 (Land Acquisition and Involuntary Resettlement) — The complaint raises concerns about the failure to provide adequate compensation for land, crops, trees, and water resources acquired, and failure to address loss of livelihoods due to the subproject.
- Performance Standard 7 (Indigenous Peoples) — The complaint alleges that land acquired for the project belongs to scheduled tribe members and was acquired without required consultation.

This report provides the findings of the Compliance Advisor Ombudsman (CAO) compliance investigation of IFC's investment in the Fund as it relates to the issues raised in the complaint. As required by the CAO mandate the report focusses on IFC's performance.

<u>Overarching findings</u>

In financing projects with significant E&S risks through financial intermediaries IFC's approach is to support clients to develop their own social and environmental management systems (SEMS), which in the case of high risk investments should ensure compliance with IFC's E&S

standards (the Performance Standards). This approach has the potential to increase the reach and impact of IFC's E&S standards, and thus its development impact. For reasons set out below, however, in relation to IFC's investment in the Fund, this approach did not deliver the intended outcomes.

More than five years since making its first disbursement for the Kamalanga project and four years since receiving a complaint regarding these issues, IFC has only recently been able to reach a view as to the Kamalanga project's E&S performance. While noting some progress in addressing environmental, health and safety issues, IFC's most recent supervision documentation concludes that key concerns regarding the impacts of the project, as raised by the complainants, have not been addressed in accordance with the Performance Standards.

In this context, CAO has made non-compliance findings in relation to: (a) IFC's pre-investment E&S due diligence; (b) the structure that was developed for the management of E&S risk around the investment, and (c) IFC's supervision of the investment.

IFC's Pre-Investment E&S Due Diligence

Prior to approving its investment in the Fund (in 2007), IFC correctly identified that the Fund's planned investments in large-scale infrastructure projects involved significant E&S risks. As a result, IFC properly determined that the investment was a "high risk" FI project that would be required to apply the Performance Standards to its investments.

In this context, the principle of review commensurate to risk required robust analysis of its client's SEMS implementation capacity and track record. It is not apparent to CAO that this occurred. Rather the material available to CAO suggests an E&S review that was limited in scope and depth.

The shortcomings in IFC's pre-investment due diligence meant that IFC lacked a basis to conclude that its investment in the Fund could "meet the requirements of the Performance Standards over a reasonable period of time," a key requirement under IFC's Sustainability Policy (para. 17).

Structure for Management of E&S Risk

The agreements that governed IFC's investment in the Fund provided IFC with inadequate leverage should E&S issues arise post disbursement. IFC was unable to reject or to refuse to participate in any of the Fund's investments without risking considerable financial penalties including complete loss of its investment. If there were concerns regarding the E&S performance of one of the Fund's portfolio companies, IFC had limited ability to influence its client to ensure implementation of corrective actions. In summary, IFC had limited ability to ensure compliance with its E&S requirements in relation to a high risk portfolio of projects.

IFC sought to mitigate its limited leverage through the inclusion of E&S risk management provisions in the investment agreements. Importantly, IFC negotiated IDFC's commitment to incorporate the IFC Performance Standards in the Fund's SEMS. IFC also negotiated a right to review and comment on all Category A investments prior to approval, which CAO notes went beyond IFC's requirements at the time.

At the same time, CAO finds that other E&S requirements envisaged when IFC's investment in the Fund was approved, were not incorporated into the agreements that governed the investment. These included: (a) the requirement that the Fund should have a PS compliant SEMS before IFC committed to the investment; and (b) the requirement that the Fund present an independent E&S audit of new and existing projects at least once a year. CAO also finds that a number of E&S risk mitigation measures, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund.

More generally, CAO notes that the combination of an E&S review that was limited in scope and depth, and an investment that was expected to generate a significant number of large infrastructure projects in India, made this a particularly risky investment from an E&S perspective. Given this level of risk, CAO finds that the agreements that governed IFC's investment in the Fund did not support IFC's stated objective of ensuring that the "projects it finances are operated in accordance with the requirements of the Performance Standards" (Sustainability Policy, para. 5).

Supervision

CAO finds that IFC's supervision of its investment in the Fund was inadequate. This was a product of a number of factors.

First, IFC disbursed to the Fund in March 2008, without assuring itself that the only E&S condition of disbursement was met, namely that the Fund had a Performance Standard compliant SEMS in place.

Second, though IFC conducted a review of the Fund's E&S due diligence in relation to the Kamalanga project, CAO finds that this review was insufficient to establish a reasonable expectation that the Kamalanga Project would meet the requirements of the Performance Standards.

Third, early supervision provided insufficient evidence for IFC to be assured that the Fund was operating the SEMS as envisaged at the time of appraisal.

Fourth, having reached the conclusion that the Fund's E&S performance was unsatisfactory in October 2010, IFC was unable either to work with the client to bring it back into compliance or exercise remedies as required by its Sustainability Policy. In this context, it is notable that IFC approved new investments in subsidiaries of both IDFC (the parent company of the Fund) and GMR (the parent company of the Kamalanga project). Making these new investments at a time when (a) the Fund was considered materially non-compliant with its E&S requirements, and (b) IFC was aware of serious unresolved E&S issues around the Kamalanga project - was inconsistent with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.

Fifth, IFC's management response to the E&S issues identified by staff in relation to this investment has been inadequate. IFC staff's concerns regarding the Fund's E&S performance were serious and well documented. In November 2010, IFC E&S staff informed IFC management that there were broad and significant gaps in the Fund's approach to the implementation of the Performance Standards. At this point IFC E&S staff also noted concerns regarding the E&S impacts of the Kamalanga project. However, IFC management decided to proceed with disbursements to the Fund based on a view that its investment agreements did not support an alternative course of action. CAO acknowledges that IFC senior management advised the Fund by letter in December 2010 that IFC would consider delaying further disbursements on E&S grounds. CAO also acknowledges that representatives of IFC management have subsequently met with management of IDFC/the Fund and management of the GMR group (which owns the Kamalanga project) on a number of occasions. Concerns regarding the E&S performance of the Kamalanga project have been discussed at these meetings. However, subsequent to December 2010, CAO finds no record of correspondence from IFC management to IDFC/the Fund or GMR in relation to these issues. In the same period, IFC processed 24 disbursements to the Fund, made two new investments in IDFC subsidiaries and entered into four joint development agreements for projects sponsored by

GMR subsidiaries. In these circumstances, CAO notes that IFC management has stressed the importance of maintaining a constructive relationship with IDFC, owing to its status as a major client and given its prominent role in India's infrastructure sector. In the meantime, the Kamalanga project has transitioned from construction to operation, increasing the risk of irreversible adverse impacts on the complainants.

Disclosure

IFC complied with the requirements of the Disclosure Policy (2006) in disclosing its investment in the Fund. However, CAO is concerned by the complainant's assertions regarding a lack of publicly available E&S information about the Kamalanga project. Issues regarding disclosure were raised with IFC by the complainants prior to the submission of the CAO complaint in April 2011. Though alert to these concerns, IFC did not request additional information on its client's supervision of disclosure requirements under Performance Standard 1, either in relation to the Kamalanga project or more generally. Further, CAO finds that IFC did not assure itself that the Fund, had established a grievance mechanism about which potentially affected communities were informed as required by Performance Standard 1. In this context, CAO finds IFC did not adequately supervise the Fund's compliance with the disclosure requirements under the Performance Standards, either in relation to its own operations or those of the Kamalanga project.

CAO Monitoring

In accordance with its Operational Guidelines, CAO will keep this compliance investigation open and monitor IFC's response to its findings.

Abbreviations and Acronyms

AEPR	Annual Environmental Performance Report
BTOR	Back to Office Report
CAO	Office of the Compliance Advisor Ombudsman
CES	Environmental and Social Development Department [at IFC]
COC	Corporate Operations Committee (IFC)
CODs	Conditions of Disbursement
CRC	Corporate Risk Committee (IFC)
E&S	Environmental and Social
EHS	Environment, Health and Safety
EIA	Environmental Impact Assessment
EMSP	Environment Management System and Procedures (of IIF)
ESAP	Environmental and Social Action Plan
ESIA	Environmental and Social Impact Assessment
ESDD	Environmental and Social Due Diligence
ESRD	Environmental and Social Review Document
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedure
ESRR	Environmental and social Risk Rating
FI	Financial Intermediary
FY	Financial Year
GIL	Green Infrastructure Limited
GKEL	GMR Kamalanga Energy Limited
IDFC	Infrastructure Development Finance Company
GMR	Grandhi Mallikarjuna Rao Group
IFC	International Finance Corporation
IIF	India Infrastructure Fund
IMA	Investment Management Agreement
INR	Indian Rupee
IRC	Investment Review Committee (IFC)
ISO	International Organization of Standardization
MIGA	Multilateral Investment Guarantee Agency
MoEF	Ministry of Environment and Forests
NGO	Non-Governmental Organization
MW	Megawatt
OG	Operational Guidelines (CAO)
OHS	Occupational Health and Safety
PDS	Project Data Sheet
PS	Performance Standards
RPDAC	Rehabilitation and Peripheral Development Advisory Committee
SBI	State Bank of India
SEMS	Social and Environmental Management System
SEPR	Social and Environmental Performance Report
SIA	Social Impact Assessment
SII	Summary of Investment Information
SPI	Summary of Proposed Investment
TA	Technical Assistance
TOR	Terms of Reference

About CAO

CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of the private sector lending and insurance members of the World Bank Group, the International Finance Corporation and the Multilateral Investment Guarantee Agency.

CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the President of the World Bank Group. CAO reviews complaints from communities affected by development projects undertaken by IFC and MIGA.

CAO compliance oversees investigations of the environmental and social performance of IFC and MIGA, particularly in relation to sensitive projects, to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, with the goal of improving IFC/MIGA environmental and social performance

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

1. Overview of the CAO Compliance Process

CAO's approach to its environmental and social (E&S) compliance function is set out in its Operational Guidelines (OG) dated March 2013.

When CAO receives an eligible complaint, it first undergoes an assessment to determine if the complaint should be handled through the CAO Dispute Resolution function or Compliance function. If the CAO Compliance function is triggered, CAO will conduct an appraisal of IFC's/MIGA's involvement in the project, and determine if an investigation is warranted. The CAO Compliance function can also be triggered by the World Bank Group president, the CAO vice president or senior management of IFC/MIGA.

CAO Compliance investigations focus on IFC/MIGA, and how IFC/MIGA assured itself of project environmental and social performance. The purpose of a CAO Compliance Investigation is to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, and, as a result, improve E&S performance.

A CAO compliance investigation is "a systematic, documented verification process of objectively obtaining and evaluating evidence to determine whether environmental and social activities, conditions, management systems, or related information are in conformance with the compliance investigation criteria" (OG, para. 4.3).

In the context of a CAO Compliance Investigation, at issue is whether:

- the actual E&S outcomes of a project are consistent with, or contrary to, the desired effect of the IFC/MIGA policy provisions; or
- a failure by IFC/MIGA to address E&S issues as part of the appraisal or supervision resulted in outcomes contrary to the desired effect of the policy provisions.

In many cases, in assessing the performance of the project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the IFC/MIGA client and verify outcomes in the field.

CAO has no authority with respect to judicial processes. CAO is neither a court of appeal nor a legal enforcement mechanism, nor is CAO a substitute for international court systems or court systems in host countries.

Upon finalizing a Compliance Investigation, IFC/MIGA is given 20 working days to prepare a public response. The Compliance Investigation Report, together with any response from IFC/MIGA, is then sent to the World Bank Group President for clearance, after which it is made public on the CAO website.

In cases in which IFC/MIGA is found to be out of compliance, CAO keeps the investigation open and monitors the situation until actions taken by IFC/MIGA assure CAO that IFC/MIGA is addressing the non-compliance. CAO will then close the Compliance Investigation.

2. Background

2.1 GMR Kamalanga Energy Limited

GMR Kamalanga Energy Limited (GKEL) is a special purpose company set up by GMR Energy Limited ("GMR Energy"). Its purpose is to develop and operate a large coal fired power plant near Kamalanga village, Dhenkanal district, Odisha State, India ("the Kamalanga project" or "the project"). The project achieved financial closure in May 2009, raising a total of US$ 953 million (debt and equity).[1] As at the time of writing, phase one of the project, comprising three 350MW generation units, was operational. A planned second phase of the project would add a further 350MW unit providing a total output of 1400MW.[2]

2.2 The Complaint

This CAO compliance process was triggered by an April 2011 complaint from *Odisha Chas Parivesh Surekhsa Parishad* (Odisha Agriculture and Environment Protection Council) and the Delhi Forum ("the complainants") in relation to the environmental and social impacts of the Kamalanga project.

Odisha Chas Parivesh Surekhsa Parishad is a local non-governmental organization (NGO) representing people affected by industrial projects in the project area. Delhi Forum is a national advocacy, research, media, networking, and documentation support NGO based in New Delhi.

The complaint asserts that IFC has supported the development of the project through a private equity fund (India Infrastructure Fund) managed by the Infrastructure Development Finance Corporation (IDFC).

In discussions with CAO, the complainants shared concerns about the project's impacts, which they feel pose a threat to the sustainability of their livelihoods. The complainants raised concerns in relation to access to employment, access to facilities, access to potable water, property damage and other impacts due to project construction.[3] The complainants also raised concerns regarding what they see as a failure to disclose fundamental information about the project, including information on its potential impacts or information about available grievance mechanisms.

More specifically, the complainants raise the following issues regarding the application of IFC's Performance Standards to the project:

- Performance Standard 1 (Social and Environmental Assessment and Management Systems) — The complaint claims that community consultation (including with indigenous peoples) has not been adequate, and that the cumulative impact of the project together with other industries in the area has not been considered. The complaint also raises concerns regarding the project's use of a deep bore well to extract groundwater and the impact this has on the availability of ground water in surrounding villages.
- Performance Standard 3 (Pollution Prevention and Abatement) — The complaint raises concerns that the project will exacerbate existing pollution (particularly of the Bhramani River), stating that there is no information available on proposed pollution mitigation. The complaint also raises concerns regarding health related impacts of air pollution from the project.

[1] Bombay Stock Exchange filing, May 27, 2009. See http://goo.gl/48P2T3 (accessed Jan 8, 2015).
[2] GMR Press Release. See http://goo.gl/ilBkNf (accessed March 4, 2015).
[3] CAO Assessment, February 2013. See http://goo.gl/o5WG8k (accessed April 14, 2015)

- Performance Standard 4 (Community Health, Safety and Security) — The complaint raises concerns about structural damage to buildings which they claim has been caused by dynamiting. The complaint also raises concerns regarding alleged intimidation by the project's security guards and arrests of community members who have opposed the project.
- Performance Standard 5 (Land Acquisition and Involuntary Resettlement) — The complaint raises concerns about the failure to provide adequate compensation for land, crops, trees, and water resources acquired, and failure to address loss of livelihoods due to the subproject.
- Performance Standard 7 (Indigenous Peoples) — The complaint alleges that land acquired for the project belongs to scheduled tribe members and was acquired without required consultation.

2.3 IFC Exposure to the Kamalanga Project

IFC is financially exposed to the Kamalanga project through:

a. a 2008 investment in the India Infrastructure Fund ["the Fund"] (IFC project #26237);
b. an equity holding in IDFC which IFC acquired in 1998 (IFC project #8251).

A timeline of relevant events is included in section 2.4.

2.3.1 IFC Investment in India Infrastructure Fund

In March 2008, IFC committed to invest up to $50 million in the Fund, a private equity fund sponsored by IDFC and an international bank.[4]

The purpose of IFC's investment was to support the Fund to make equity investments in infrastructure in India (the companies in which the Fund invests are referred to as its "portfolio companies" or "sub-projects").

IFC first considered an investment in the Fund in 2007. In addition to making a direct contribution to alleviating India's infrastructure bottleneck, IFC anticipated that the Fund's projects would generate employment during construction.[5]

While the corporate structure of the Fund is complex, for the purposes of this report it is sufficient to note that the Fund is managed by an Investment Manager (IDFC Project Equity Company Limited), which is a wholly owned subsidiary of IDFC.

This investigation report refers to IDFC, IDFC Project Equity and the Fund as the "IFC client" or "the client" differentiating where necessary.

The Fund acquired a 15 percent equity stake in GKEL in November 2009.[6]

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[4] IFC, Statement of Project Information. See http://goo.gl/AVDxfK (accessed Dec 1, 2014).
[5] *Ibid.*
[6] VC Circle, October 8, 2009. See http://goo.gl/sk7kdC (accessed July 15, 2015)

2.3.2 IFC Investments in IDFC

In addition to its investment through the Fund, IDFC itself holds a 5 percent equity stake in GKEL. IDFC also led a consortium of 13 banks that provided $715 million in loans for the Kamalanga project.[7]

This represents an exposure for IFC as IFC has held equity in IDFC since 1998. Originally IFC's holding on IDFC represented a 6.1 percent ownership stake, however, this was reduced following IDFC's initial public offering in 2005.

IFC has also provided loans to a number of IDFC and IDFC subsidiaries.[8] These loans, while not increasing IFC's exposure to the Kamalanga project, are relevant in understanding IFC's overall relationship with IDFC.

[7] GMR Press Release, May 27, 2009. See http://goo.gl/4Of1iY (accessed November 26, 2014) and http://goo.gl/G3bD37 (accessed July 23, 2015).
[8] See Annex C for details.

2.4 Project Timeline

Date	Event
Pre 2007	
1998	IFC takes 6.1 percent equity stake in IDFC.
2005	Prior to IDFC's public listing, IFC agrees to new shareholder agreement without E&S requirements.
2005	IFC commits to US$50 million (m) investment in IDFC. Disbursed in May 2006.
2007	
July	IFC conducts investment appraisal mission to the Fund.
Aug.	IFC publishes Summary of Proposed Investment in the Fund. IFC conducts Investment Review Meeting (IRM). IFC management approves project.
Sept.	IFC Board approves investment up to $100m in the Fund.
Oct.	Environmental Impact Assessment (EIA) for the Kamalanga project published. Community files complaint to the District Collector regarding land acquired for the Kamalanga project. IFC E&S staff meet with IDFC E&S staff. IFC provides feedback on IDFC ESDD documentation.
2008	
Feb.	IFC reduces maximum investment in the Fund from $100m to $50m. Indian Ministry of Environment and Forests (MoEF) approves the Kamalanga project's application for construction and operation of the 1050 MW coal fired power plant.
Mar.	IFC commits to investing in the Fund; processes 1st disbursement.
Jul.	Fund notifies IFC that it is considering an investment in GKEL.
Aug.	IFC reviews the Fund's SEMS and provides comment. Following IFC approval, Fund adopts SEMS. Fund provides IFC with its E&S due diligence report for the GKEL investment Kamalanga project.
Sept.	IFC reviews and provides comments on the E&S due diligence report for Kamalanga project. Fund prepares ESAP for the Kamalanga project. IFC reviews and provides comments.
Oct.	Gap analysis (funded by IFC) of IDFC's SEMS completed. Analysis identifies gaps in IDFC's implementation of both IFC and Indian E&S requirements.
2009	
Jan.	IFC makes first disbursement of $11.1m (INR 525m) to the Fund for the Kamalanga project.
Mar.	IFC funds Performance Standard (PS) training for IDFC staff and delivers E&S manual for implementing the PS to IDFC.
Sept.	IFC receives Fund's 08/09 AEPR in June. IFC's review provides Fund with ESRR 2: Satisfactory.
Dec.	Kamalanga project area identified as critically polluted by Indian Central Pollution Control Board.
2010	
Jan.	Kamalanga project construction commenced. MoEF places temporary moratorium on new projects in critically polluted areas, including the area around the Kamalanga project.
Mar.	IFC conducts supervision visit to the Fund in January and a transportation infrastructure sub-project of the Fund in March. After these visits, IFC downgrades Fund's ESRR to 3:Partly Unsatisfactory.
Jun.	Orissa Government agency holds meeting on rehabilitation plan for affected people. Complainants allege that within four days of the meeting, police arrested 46 villagers. IFC approves US$75m investment in IDFC for renewable energy projects. GMR Energy notes potential expansion of Kamalanga project. Additional 350MW unit proposed (unit 4).
Sept.	IFC receives Fund's 08/09 AEPR in August. IFC's review provides Fund with ESRR 2: Satisfactory. IFC requests site visit to Kamalanga project.
Oct.	Facilitated by another private equity client, IFC visits a similar category A project of the Fund. Based on the findings from this visit, IFC downgrades the Fund to ESRR 4: Unsatisfactory. Complainants request the Fund for project information, including the E&S requirements applied.
Nov.	IFC places a moratorium on new investments in Private Equity Funds proposing coal projects.

	IFC E&S staff request that further disbursements to the Fund be suspended until compliance issues identified during the Oct 2010 sub-project visit are resolved. Following IFC senior management discussion, IFC management decides to disburse given legal requirements and available information.
2011	
Mar.	IFC second disbursement for Kamalanga project.
Apr.	*Odisha Chas Parivesh Surekhsa Parishad* and Delhi Forum file complaint with CAO. CAO commences assessment for dispute resolution process.
May.	IFC becomes aware of the issues raised by the complainants.
July.	IFC third disbursement for Kamalanga project.
Aug.	IFC conducts site supervision visit to the Fund. IFC requests that the Fund undertake E&S audit of portfolio and facilitate IFC's visit to Kamalanga project site.
Sept.	IFC fourth disbursement for Kamalanga project.
Dec.	IFC fifth disbursement for Kamalanga project.
2012	
Feb.	Kamalanga project receives environmental clearance from MoEF for 350MW expansion (unit 4).
Mar.	IFC receives Fund's 10/11 AEPR in April 2011. IFC's review provides Fund with ESRR 4: Unsatisfactory. IFC sixth disbursement for Kamalanga project.
May	IFC seventh disbursement for Kamalanga project. Orissa High Court upholds order in favor of the Kamalanga project mandating compensation in lieu of acquired land.
Jul.	IFC receives Fund's 11/12 AEPR in July. IFC's review provides Fund with ESRR 4: Unsatisfactory. IFC requests independent E&S audit and visit to Kamalanga project site.
Sept.	IFC approves $50 m loan to IDFC subsidiary (Green Infra Ltd) for renewable power generation.
Oct.	IFC requests visit to Kamalanga project site.
2013	
Feb.	IFC eighth disbursement for Kamalanga project.
Apr.	Complaint transferred to CAO Compliance after unsuccessful dispute resolution efforts. Unit 1 of Kamalanga project commissioned and becomes operational.
June	CAO completes compliance appraisal. Issues TOR for compliance investigation.
July	IFC's ninth disbursement for Kamalanga project.
Nov.	Unit 2 of Kamalanga project commissioned and becomes operational.
Dec.	IFC and GMR Energy (Kamalanga project's parent company) sign Joint Development Agreement (JDA) for hydropower project in Nepal.
2014	
Feb	IFC receives Fund's 12/13 AEPR in June 2013. IFC's review provides Fund with ESRR 4: Unsatisfactory. IFC requests independent E&S audit and visit to Kamalanga project site.
Mar.	Unit 3 of Kamalanga project is commissioned and becomes operational.
Jun.	IFC's tenth disbursement for Kamalanga project. IFC management discussion on approval of waiver request (non-E&S) from the Fund. IFC provide update to its Board on its ongoing engagements with the Fund in light of CAO process.
Dec.	IFC approves US$59 m loan to IDFC subsidiary (Green Wind Ltd) for renewable power generation. IFC and GMR Energy sign JDA for two further hydropower projects in Nepal. IFC staff visit Kamalanga site and hold follow up discussions with IIF to discuss site visit findings.
2015	
Feb	IFC receives Fund's 13/14 AEPR in February 2015. At the time of writing, IFC had not filed its review of this AEPR.

2.5 IFC's Approach to Financial Intermediary Investments

IFC classifies its investments in IDFC and the Fund as financial intermediary (FI) investments. As explained by IFC, a key purpose of its FI investments is to "strengthen domestic capital markets at a scale of enterprise that is smaller than would be possible through IFC direct investments" (Sustainability Policy (2006), para. 27).

FI investments account for almost half of IFC's new commitments each year. This business has grown rapidly in recent years and amounted to US$11 billion of new commitments in financial year (FY) 2014.[9] IFC FI clients include banks, insurance companies, leasing companies, microfinance institutions, and private equity funds.[10] These FIs provide financing (or financial services) to their own clients (sometimes referred to as IFC sub-clients) through a range of financial products.

Included in its FI portfolio, IFC has a number of private equity funds that focus on infrastructure development. These funds further invest in infrastructure projects including large infrastructure projects of the scale and type that IFC has traditionally financed directly.

From a sustainability perspective, IFC's approach to E&S risk management is emphasized as supporting "the capacity of our FI clients to assess and mitigate their own E&S risks, in a manner commensurate with the level of exposure to such risks."[11] When the activity financed presents "significant social or environmental risks this includes application of IFC's Performance Standards. From an environmental and social perspective this approach potentially leverages IFC's standards across a much larger portfolio of projects and investors than would be the case in relation to its direct investments (Sustainability Policy, para 28). However, the approach also entails increased risk in the case that the FI client is not able to manage its portfolio in accordance with IFC's standards.

[9] IFC Annual Report FY14. For further details see http://goo.gl/AE7kag (accessed March 4, 2015).
[10] *Ibid.*
[11] IFC Financial Institutions. http://goo.gl/cnTevj (accessed December 3, 2014).

3. Investigation Framework

3.1 Scope of the Compliance Investigation

The scope of this investigation is defined in Terms of Reference (TOR) issued by CAO in July 2013.[12] As set out in the TOR, the CAO investigation focuses on whether IFC's investment in the Fund was appraised, structured, and supervised in accordance with relevant IFC policies, procedures, and standards. It also considers whether IFC's sustainability and disclosure policies provide adequate levels of protection in relation to the issues raised in the complaint.

More specifically, the TOR outlined a number of outstanding questions regarding the investment, namely whether in the context of IFC's E&S requirements:

1. IFC's approach to the identification and management of E&S risks surrounding its investment in the Fund was adequate;
2. IFC's legal arrangements for the investment provided an adequate structure for managing E&S risk in the case of non-compliance, either by the client or its sub clients;
3. Supervision of the Kamalanga project was adequate;
4. IFC's supervision of its investment in the Fund was adequate; and
5. Disclosure requirements as applied to the investment were adequate.

The TOR further provided that the scope of the CAO investigation included developing an understanding of the immediate and underlying causes of any non-compliance identified. Finally, the TOR noted that the investigation might better inform the application of IFC's E&S requirements to future FI investments.

3.2 Methodology

This investigation was conducted in accordance with the CAO Operational Guidelines (2013), with input from two expert panelists. From February 2014 to August 2015, CAO reviewed documentation, and conducted interviews in India and in Washington, D.C. CAO interviewed IFC management and staff with direct responsibility for the project, as well as those who had expertise in relation to this type of investment. CAO interviewed management and staff of IDFC and GKEL. CAO visited the Kamalanga project site, and met with representatives of the complainants in the village near the project site. CAO also met with representatives of civil society organizations that supported the complaint.

In considering IFC's performance, CAO has been conscious not to expect conduct at a level that requires the benefit of hindsight. Rather, the question is whether IFC management and staff exercised reasonable professional judgment and care in the application of relevant policies and procedures based on contemporaneously available information.

3.3 Overview of Applicable IFC Requirements

As set out in its Operational Guidelines, CAO oversees investigations of IFC's environmental and social performance, by ensuring compliance with IFC policies, standards, guidelines, procedures, and requirements whose violation might lead to adverse environmental and/or

[12] CAO Terms of Reference for Investigation of IFC's Investment in India Infrastructure Fund. See http://goo.gl/7pJGPn (accessed January 11, 2015).

social outcomes (para 4.3).[13] Relevant policies, standards, guidelines and procedures in this case include IFC's Policy on Social and Environmental Sustainability (2006 & 2012), IFC's Performance Standards (2006), IFC's Policy on Disclosure of Information (2006), the IFC Environmental and Social Review Procedures (as updated from time to time) and various legal agreements between IFC and its client.

This section provides an overview of the applicable requirements. Section 4 provides details of the requirements as they apply to the various stages of the project cycle.

Policy on Environmental and Social Sustainability (2006)

IFC's Policy on Social and Environmental Sustainability (the Sustainability Policy) sets out IFC's commitments and responsibilities in relation to sustainability. The Sustainability Policy (2006) was applied to IFC's investment in the Fund at appraisal.

The Sustainability Policy (2006) underscores IFC's commitment to ensuring that the "projects it finances are operated in accordance with the requirements of the Performance Standards" (para. 5). The Sustainability Policy also notes that IFC's efforts to carry out its investment operations in a manner that "do no harm to people and the environment" are central to its development mission (para. 8). This, the Policy provides, means avoiding negative impacts wherever possible and ensuring that unavoidable negative impacts are reduced, mitigated or compensated for appropriately (*Ibid.*).

IFC's E&S requirements for FI clients are expected to be "proportional to the level of potential risk" associated with an investment (para. 28). Importantly, IFC requires its FI clients to "establish and maintain a Social and Environmental Management System [SEMS] to ensure that its investments meet IFC's [E&S] requirements" (para. 29).

Performance Standards on Social and Environmental Sustainability

The IFC Performance Standards (PSs) detail the IFC client's E&S responsibilities. IFC's 2008 equity investment in the Fund was prepared under the Performance Standards (2006), and the Fund's commitment to these standards was incorporated into its SEMS.

Policy on Disclosure of Information

IFC's Policy on Disclosure of Information (2006) (Disclosure Policy), which is applicable to IFC's investment in the Fund, expresses IFC's commitment to making accurate and timely information about its activities available to the public. The Disclosure Policy sets out IFC's requirements in terms of the extent and timing of disclosure with respect to its projects.

Environmental and Social Review Procedures

IFC's Environmental and Social Review Procedures (ESRPs) outline the process through which IFC implements its commitments to social and environmental sustainability.

Unlike the Sustainability Policy, the Performance Standards and the Disclosure Policy, which are approved by the IFC Board, the ESRPs are issued by IFC management and are updated more regularly. IFC's appraisal, and initial supervision of its investment in the Fund were completed under ESRP v.2 (July 2007). The ESRPs relating to FI investments were updated in August 2009 (ESRP v.4). While the ESRPs have been updated in subsequent years, the procedures as they relate to FIs were not again updated significantly until June 2014.

[13] CAO Operational Guidelines (March 2013). See http://goo.gl/aScsa8 (accessed January 11, 2015).

4. Analysis and Findings

The analysis and findings of this investigation report are organized around the IFC project cycle and the five specific questions set out in the CAO Investigation TOR set out above.

In relation to each section below, CAO first presents a summary of IFC's E&S requirements (subsection 1); then a description of the relevant stage of the project cycle (subsection 2); and finally CAO's discussion and findings (subsection 3).

4.1 IFC's Pre-investment Due Diligence

This section considers IFC's pre-investment due diligence in relation to its investment in the Fund. It also answers the specific question from the TOR on IFC's approach to the identification of E&S risks.

Summary of Findings

- IFC correctly identified that the Fund's planned investments in large scale infrastructure projects involved significant E&S risks.
- IFC's pre-investment review of its client's capacity to manage the E&S risks associated with the Fund was not commensurate with the level of these risks.
- As a result, IFC lacked a basis to conclude that its investment in the Fund could meet the requirements of the Performance Standards over a reasonable period of time.

4.1.1 IFC Requirements: Pre-investment Due Diligence

IFC's investment in the Fund was processed under the Sustainability Policy (2006). The Sustainability Policy requires that IFC's pre-investment due diligence include an E&S review designed to ensure that IFC does not finance projects that cannot be expected to meet its E&S requirements over a reasonable period of time (para. 17). E&S review is integrated into what IFC terms the project appraisal process and is expected to be commensurate to the E&S risks attached to a project (para. 13).

The appraisal process cumulates in an Investment Review Meeting (IRM) where IFC management decides whether to present a project for Board approval.[14] In advance of the IRM, IFC staff prepare a decision book which should clearly identify the key issues and risks for discussion at the IRM.[15]

Central to its pre-investment due diligence in relation to FI investments, IFC is required to review "the business of its FI clients to identify activities where the FI could be exposed to social and environmental risk as a result of its investments."[16] Based on "the magnitude of impacts understood as a result of the client's Social and Environmental Assessment," IFC categorizes a project as Category A, B, C or FI.[17]

FI clients are required to implement E&S requirements "proportional to the level of potential risk" identified during IFC's review.[18]

[14] IFC Operational Procedures (2013).
[15] *Ibid.*
[16] Sustainability Policy (2006) para 27.
[17] See Sustainability Policy (2006) para 18 for further details.
[18] *Ibid,* para. 28.

As per the Sustainability Policy (2006), where an FI is providing long term corporate finance or project finance, the FI is required to ensure that the recipient of such finance will: "(i) follow national laws, where the activity financed presents limited social or environmental risks; and (ii) apply the Performance Standards, where the activity financed presents significant social or environmental risks."[19] In addition, all FIs are required to abide by the IFC Exclusion List. In order to implement IFC's E&S requirements, an FI client is required to establish and maintain a SEMS.[20]

The IFC ESRPs applicable at appraisal (v.2) provide for the E&S specialist to review the FI client's SEMS, considering its adequacy to implement IFC's E&S requirements (para. 7.2.16). In reviewing the adequacy of an FI's SEMS, the ESRPs guide the E&S specialist to consider the following aspects of the client's management system:

a. E&S policies and procedures;
b. The current organizational structure and staffing;
c. Skills and competencies in E&S areas;
d. Training and awareness of the client's investment, legal, and credit officers on the organization's E&S requirements and the SEMS;
e. Performance monitoring procedure;
f. Reporting of results to management; and
g. Track record to date in SEMS implementation (*Ibid.*).

On this basis the E&S specialist is to "identify any SEMS enhancements that the client would need to undertake to address gaps in these areas, and incorporate this in a SEMS Plan to be included in the legal agreements" (para. 7.2.17).

Where an FI is expected to implement the Performance Standards and where the E&S specialist considers it necessary to further review an FI's SEMS or existing sub-projects, the ESRPs provide for the E&S specialist, in consultation with IFC investment staff, to visit the FI as part of IFC's appraisal process (para. 7.2.15).

In addition the ESRPs provide for the E&S specialist to request a peer review meeting where there exists "a complex project E&S issue that is uncommon…" (para. 7.2.18).

The ESRPs require IFC staff to record "[a]ll material decisions and supporting analysis" from the E&S review in an internal project Environmental and Social Review Document (ESRD) (para. 7.2.23).

The final step in the E&S review process is attendance by the E&S specialist at the IRM (para. 7.2.25). The IRM concludes the appraisal process.[21]

4.1.2 IFC's Pre-investment Due Diligence in Relation to the Fund

IFC commenced appraisal of its investment in the Fund in June 2007. The Fund was yet to be established at the time of the appraisal. Therefore, IFC based its E&S review on its knowledge of IDFC's E&S systems and performance. This included information available to IFC from earlier investments in IDFC, which had been an IFC client since 1998. In addition, IFC noted that IDFC had previously set up two private equity infrastructure funds, IDFC Premier Equity Fund (IPEF) and India Development Fund (IDF).

[19] IFC Sustainability 2006, para. 28.
[20] *Ibid*, para 29.
[21] IFC Operational Procedures (2013).

As IFC's E&S review was significantly based on information from its earlier IDFC projects, this section commences by summarizing that information. It then proceeds to set out key steps taken by IFC in the course of its E&S review.

Summary of E&S information on IFC's prior investments in IDFC

As noted above, at the time IFC's investment in the Fund was approved, IFC had two existing investments with IDFC, a 1998 equity investment and a 2006 loan.

As a condition of IFC's initial investment, IDFC agreed to put in place a SEMS to ensure that its investments were made consistent with World Bank environment, health and safety guidelines and policies.[22] It was also agreed that IDFC would submit an annual environmental performance report (AEPR) to IFC.

Documentation related to the E&S performance of these earlier investments is limited. IFC supervision documentation from 2002 and 2004 notes that IDFC had established a SEMS which focused on pre-investment review of projects but that the client was not monitoring the E&S performance of its investments. IFC supervision documentation also noted that the client was not submitting regular E&S reports to IFC as required. IFC concluded that these issues were of serious concern and represented a considerable risk to IFC and the client.

In 2006, as part of the approval process for a new loan to IDFC, IFC noted that close supervision was warranted in order to ensure that the E&S standards developed by IDFC were actually implemented.

IFC received its first AEPR from IDFC in July 2007. This AEPR reported on the use of IFC funds in relation to IFC's 2006 loan only. As IDFC did not report using IFC funds for any Category A projects, IFC noted that it was required to apply only national E&S requirements (and not IFC or World Bank E&S requirements). As part of its review of IDFC's July 2007 AEPR, IFC noted that it did not have a copy of IDFC's SEMS. A review of IDFC's SEMS in place at the time indicates that it did not reflect IFC's pre-2006 E&S standards.

Summary of appraisal documentation in relation to the Fund (June – September 2007)

Early review (June 2007)

IFC's early review documentation for the investment in the Fund notes that IFC had considered IDFC's E&S management capacity. At this point IFC noted that it was monitoring IDFC's development and implementation of management systems to enable IDFC to adopt IFC's Performance Standards and become an Equator Bank.[23]

According to IFC, in July 2007 IFC staff visited IDFC as part of the E&S appraisal for its proposed investment in the Fund. IFC was not, however, able to provide CAO with a back to office report or similar documentation summarizing the outcomes of the July visit. Rather IFC noted that the outcomes of this mission were captured in documentation prepared for the Investment Review Meeting in August 2007.

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[22] IFC Disclosure, project #8251. For further details http://goo.gl/n8UJKd (accessed Nov 26, 2014).
[23] Subsequently, however, in August 2007, IFC E&S staff noted that no documentation of this review could be found.

Statement of Project Information (August 2007)

IFC publicly disclosed a Statement of Project Information (SPI) on August 27, 2007.[24] In disclosing the investment, IFC noted that during appraisal IFC "*will analyze* the activities proposed to be supported with IFC financing" and "*will review* the capacity of IIF to manage E&S risks and to establish a SEMS" [emphasis added].

Investment Review Meeting (August 2007)

IFC management approved the investment following a meeting held in August 2007. Documentation prepared for this meeting contains no E&S analysis beyond that disclosed in the SPI cited above. Notably, this language indicates that at this point IFC had not conducted a review of the client's SEMS or SEMS implementation capacity.

While the investment review documentation did not list E&S considerations as issues for discussion, CAO understands that IFC management raised E&S issues at the meeting, asking how these would be handled and what recourse IFC had if the Fund did not meet its E&S requirements.

In response, the team responsible for preparing the investment noted that the Fund would rely on IDFC's E&S systems. Further, the team noted that IDFC's existing SEMS was compliant with IFC's pre-2006 E&S standards and that IDFC was enhancing its E&S systems to bring them in line with IFC's PSs. Following a discussion IDFC's SEMS implementation capacity, it was decided that the Fund should have a system in place for implementing IFC's PSs before IFC committed to the investment.

Approval by IFC Board (September 2007)

The investment was submitted to the IFC Board on September 12, 2007. As presented to the Board, IFC considered IDFC to be a market leader in terms of E&S performance.

The approval documentation for the project noted that the E&S impacts of the types of projects in which the Fund would invest were likely to be significant, but that IDFC had a strong SEMS (in line with IFC pre-2006 E&S safeguards) which was being revised and would be adopted by the Fund to ensure compliance with the 2006 Performance Standards. In discussing IDFC's E&S capacity, IFC noted that its staff had considerable experience implementing IFC's safeguard policies and that several staff had attended PS training. This staff, IFC noted, would be used by the Fund to implement the revised IDFC SEMS.

IFC informed the Board that IDFC would have to demonstrate to IFC's satisfaction that it had sufficient capacity to meet IFC's E&S requirements. As part of this process, IFC stated that it would review recent E&S due diligence documentation for large projects carried out by IDFC. An obligation to remedy any gaps identified in IDFC's approach to its E&S due diligence, IFC stated, would be incorporated into the investment agreements.

In addition, IFC noted that it was providing advisory services to IDFC to support additional training on land acquisition and involuntary resettlement (PS5).

Environmental and Social Review Document

IFC's Environmental and Social Review Document (ESRD) for the Fund indicated that this was a high risk project on the basis of the target sector (infrastructure) in the subject country (India). In summarizing the findings of IFC's appraisal of the investment, IFC noted that IDFC had a detailed SEMS document and a dedicated team of professionals to carry out E&S due

[24] IFC Statement of Project Information. See http://goo.gl/AVDxfK (accessed Dec 1, 2014).

diligence and supervision of projects. IFC's E&S review documentation also noted that the Fund would adopt IDFC's SEMS and that an environmental specialist from IDFC would be assigned additional responsibility with regard to the Fund. Further, IFC noted that IDFC's SEMS, while comprehensive, did not reference and cover the IFC Performance Standards and that IDFC had committed to upgrading its SEMS to incorporate the Performance Standards.

Field appraisal

As indicated in IFC's ESRD, IFC E&S staff did not conduct a field appraisal as part of the preparation of this project. The most recent documented field visit by IFC E&S staff to IDFC was in July 2004, three years earlier. The most recent documented field visit by IFC E&S staff to an IDFC project was in 2002.

Peer review

Although IFC recognized that its investment in the Fund had high E&S risks, and was the first of its kind for IFC, IFC did not hold an E&S peer review meeting as part of the appraisal process.

SEMS plan

IFC did not develop a SEMS Plan as part of the appraisal process. A number of E&S risk mitigation measures were, however, agreed. These are discussed in section 4.2 below.

Post-approval discussions with IDFC on E&S issues (October 2007)

Following Board approval, IFC E&S staff provided feedback to IDFC on a sample Environmental and Social Due Diligence (ESDD) report for a category A infrastructure project which had previously been prepared by IDFC. IFC's feedback to IDFC was that the report was satisfactory, except that it did not address the requirements of the IFC Performance Standards (or CAO notes: IFC's pre-2006 safeguard requirements). At this point, IFC also provided advice to IDFC in relation the integration of the 2006 Performance Standards into its SEMS.

4.1.3 Discussion and Findings: IFC's Pre-investment Due Diligence

In the course of its appraisal process, IFC correctly identified that its client's planned investments in large-scale infrastructure projects involved significant E&S risks. As a result, IFC properly determined that the investment was a high risk FI project which would be required to apply the Performance Standards to its portfolio companies.

In this context, the principle of review commensurate to risk required robust analysis of its client's SEMS and SEMS implementation capacity. This did not occur. Rather the material available suggests an E&S review that was limited in scope and depth.

A key shortcoming in IFC's review was its analysis of IDFC's SEMS. At the time IFC management approved the project, no E&S analysis was presented. The appraisal requirement under the ESRP that IFC conduct a structured analysis of its client's SEMS was not met until after disbursement in 2008.[25] IFC's representation that IDFC's SEMS reflected IFC's pre-2006 E&S standards is not supported by a review of available documentation.

CAO also notes shortcomings in IFC's analysis of IDFC's SEMS implementation track record. Based on its supervision of earlier investments with IDFC, IFC had observed that IDFC did

[25] See section 4.3.2 below for discussion of the Gap Analysis of IDFC's SEMS which IFC supported in 2008.

not monitor project E&S performance post-disbursement, and this exposed it to considerable E&S risk. While IFC reports that IDFC subsequently developed processes for E&S monitoring, IFC did not assure itself of the adequacy of these processes, particularly in relation to high risk projects, before moving forward with its investment in the Fund.

On this point, CAO notes IFC's view that it did not focus in depth on IDFC's E&S track record because the Fund was required to set up a new SEMS *ab initio.* CAO notes however, that IFC's appraisal documentation is explicit in the expectation that the Fund would: (a) rely on IDFC's E&S systems; (b) adopt IDFC's SEMS (updated to reflect the Performance Standards); and (c) use IDFC's E&S staff to implement its SEMS. As a result, CAO maintains the view that an analysis of IDFC's SEMS implementation track record and capacity was relevant at appraisal.

In terms of process, CAO notes that key steps to ensure the robustness of IFC's E&S review in relation to complex or high risk investments (as provided for in IFC's ESRP) were not conducted or documented in relation to IFC's investment in the Fund. These included E&S peer review and E&S field appraisal.

The shortcomings in IFC's pre-investment due diligence described above meant that IFC lacked a basis to conclude that its investment in the Fund could meet the requirements of the Performance Standards over a reasonable period of time.

4.2 Structure for Management of E&S Risk

This section considers IFC's structuring of its investment in the Fund from an E&S perspective. It also answers the specific question from the TOR on whether IFC's legal arrangements for the investment provided an adequate structure for managing E&S risk.

Summary of Findings

- The agreements that governed IFC's investment in the Fund provided IFC with limited leverage to ensure compliance with its E&S requirements.
- Key E&S requirements as agreed by IFC management were not incorporated into the agreements that governed IFC's investment in the Fund.
- E&S requirements, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund.
- The agreements that governed IFC's investment in the Fund did not support IFC's objective of ensuring that the projects it finances are operated in accordance with the Performance Standards.

4.2.1 IFC Requirements: Legal Incorporation of E&S Conditions

As noted above, as part of the appraisal process, the IFC E&S specialist is required to "identify any SEMS enhancements that the client would need to undertake … and incorporate this in a SEMS Plan to be included in the legal agreements" (para. 7.2.17).

Post appraisal, the ESRPs require the E&S specialist to "provide inputs for the drafting of legal agreements where the standard language requires modification or the project requirements require a change to the standard legal covenants" (para 8.2.9).

4.2.2 IFC's Approach to E&S Risk Management in Relation to the Fund

IFC's approach to E&S risk management in relation to its investment in the Fund changed in the course of project preparation. The E&S risk mitigation measures that were: (a) discussed with management when the investment was reviewed in August 2007, and (b) presented to the IFC Board in September 2007, were materially weakened by the time the legal agreements for the investment were executed in March 2008. This section elaborates on IFC's discussion of E&S risk mitigation measures and compares the approach that was presented to the Board with the approach that was finally negotiated with the client.

E&S risk management measures agreed

The Fund's approach to E&S risk management was set out in a complex set of agreements and policy documents. Key aspects of the approach can be summarized as follows:

a. The Fund would put in place a SEMS to ensure that it and its portfolio companies would comply with the IFC Performance Standards and applicable E&S law.
b. The adoption and implementation of the SEMS by the Fund would be a condition precedent to IFC's obligation to make first disbursement.
c. IFC would review and provide recommendations on the Fund's E&S due diligence in relation to Category A projects (if IFC's recommendations were not incorporated approval of the investment would require unanimous consent of the Fund's Investment Committee).
d. The Fund would submit an annual monitoring report to IFC describing in reasonable detail: (i) the operation of its SEMS; and (ii) the E&S performance of its portfolio companies.
e. If IFC had a concern in relation to the management of any of the Fund's portfolio companies, a meeting with the management of the portfolio company would be arranged to enable IFC's concerns to be addressed.
f. If a sub-project operation or activities financed by the Fund were not in compliance with the E&S requirements (including the Performance Standards), the client agreed to use best efforts to ensure compliance.

E&S risk management measures omitted or changed

The E&S risk mitigation measures outlined above differed in two key respects from those agreed when the investment was reviewed by IFC management and presented to the Board. In particular:

a. A decision was made at the August 2007 review meeting that the client should have a PS compliant SEMS *before IFC committed to the investment*, whereas the investment agreements made adoption and implementation of the SEMS a condition of disbursement.
b. The requirement that the client present to its Advisory Board an independent E&S audit of new and existing projects at least once a year, as noted in the IFC Board documentation, was not included in the investment agreements.

CAO also notes that a number of E&S risk mitigation measures, as outlined in guidance available to IFC staff at the time, were not included in the investment agreements for IFC's investment in the Fund, for eg:

a. IFC's right to visit, upon reasonable notice, the premises of a portfolio company and have access to their books and records to monitor E&S compliance.
b. If IFC's client becomes aware that a portfolio company is not operating in a manner consistent with its E&S requirements, IFC's client must promptly agree to corrective measures. If a portfolio company fails to implement corrective measures, IFC's client must use reasonable efforts to terminate its financing of the portfolio company.
c. IFC's right to be excused from making a capital contribution to a proposed investment that would violate IFC's policies

d. IFC's right to suspend disbursements and to be treated as an excused investor without penalty, where its client repeatedly and consistently fails to materially comply with its E&S obligations.
e. As an international organization which is subject to certain disclosure requirements regarding the projects it participates in, IFC's right to disclose information necessary to comply with its E&S obligations.

4.2.3 Discussion and Findings: Structure for Management of E&S Risk

The agreements that governed this investment provided IFC with limited leverage should E&S issues have arisen post disbursement. IFC was unable to reject or refuse to participate in any of the Fund's investments without risking considerable financial penalties up to complete loss of its investment. If there were concerns regarding the E&S performance of one of the Fund's portfolio companies, IFC had limited ability to influence and monitor its client to ensure implementation of corrective actions. In summary, IFC had inadequate ability to ensure compliance with its E&S requirements in relation to what was known to be a high risk portfolio of projects.

IFC sought to mitigate its limited leverage through the inclusion of E&S risk management provisions in the investment agreements. Importantly, IFC negotiated the client's commitment to incorporate the IFC Performance Standards in its SEMS. IFC also negotiated a right to review and comment on all Category A investments prior to approval, which CAO notes went beyond the requirements of the ESRP at the time.

At the same time, CAO finds that other E&S requirements as agreed at the IRM and/or presented to the IFC Board were not incorporated into the agreements that governed IFC's investment in the Fund. These included: (a) the requirement that the client should have a PS compliant SEMS before IFC committed to the investment; and (b) the requirement that the client present an independent E&S audit of new and existing projects at least once a year.

CAO also finds that a number of E&S risk mitigation measures, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund. These included: (a) IFC's right to visit the premises of a client's portfolio company and have access to their books and records to monitor E&S compliance; (b) IFC's right to request its client to implement corrective measures with non-performing sub-project up to and including reasonable efforts to terminate financing; (c) IFC's right to be excused from making a capital contribution to a proposed investment that would violate IFC's policies; (d) IFC's right to suspend disbursements without penalty to a client which repeatedly and consistently fails to materially comply with its E&S obligations; and (e) IFC's right to disclose information necessary to comply with its E&S obligations. In making this finding, CAO notes IFC's view that the structure of the investment under national law imposed limitations on the availability of an excuse clause from meeting capital calls.

Further, CAO finds that a SEMS Plan of the type required by ESRP (para. 7.2.17) which would include SEMS enhancements that the client would need to undertake to address identified gaps was not included in the investment agreements.

More generally, CAO notes that the combination of an E&S review that was limited in scope and depth (see section 4.1 above) and an investment that was expected to generate a significant number of large infrastructure projects in India made this a particularly risky investment from an E&S perspective. Given this level of risk, CAO finds that the agreements that governed IFC's investment in the Fund did not support IFC's stated objective of ensuring that the "projects it finances are operated in accordance with the requirements of the Performance Standards" (Sustainability Policy, para. 5).

4.3 <u>Supervision</u>

The supervision phase of the IFC investment cycle commences at first disbursement and continues until the investment is closed. This section considers IFC's supervision of its investment in the Fund with a focus on the issues raised by the complaint. It answers the questions from the TOR as to whether IFC's supervision of its investment in the Fund was adequate, in particular in relation to the Kamalanga project.

Summary of Findings

- IFC's supervision was not sufficient to ensure that the high risk projects it was financing through the Fund were designed and operated in a manner consistent with the Performance Standards – a key objective of IFC's Sustainability Policy.
- IFC made its first disbursement to the Fund without ensuring that E&S conditions of disbursement were met.
- IFC's review of the Fund's E&S due diligence for the Kamalanga project did not provide a basis to conclude that the project could meet the requirements of the Performance Standards over a reasonable period of time.
- IFC E&S staff correctly allocated an ESRR of 4 (unsatisfactory) to the Fund from October 2010, and responsible IFC investment staff were informed of gaps in the client's E&S performance in line with the requirements of the ESRP.
- IFC management did not adequately respond to serious, longstanding and well documented concerns regarding the E&S impacts of the Kamalanga project on local communities.
- IFC made two new investments in IDFC subsidiaries over the period when the Fund was considered to be materially non-compliant with IFC's E&S requirements. This was inconsistent with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.
- The Kamalanga project has completed construction and is fully operational while IFC maintains the view that key concerns regarding the impacts of the project as raised by the complainants have not been addressed in accordance with the Performance Standards.

4.3.1 IFC Requirements: Supervision

<u>Disbursement requirements</u>

According to the ESRPs, the IFC E&S staff assigned to an FI investment should clear any E&S conditions of disbursement (CODs).[26] When such clearance is sought, the ESRPs provide that the E&S staff "obtain and review information as required to evidence the same [compliance with the CODs] and provide clearances" (para 10.2.1). E&S staff undertake this review and inform the IFC team if any E&S conditions of disbursement have not been complied with. Any waivers of E&S CODs must be processed by a manager in IFC's E&S department and be documented in the ESRD.

<u>IFC's conditions of disbursement to the Fund</u>

As part of the legal arrangements for IFC's investment, it was agreed that the Fund's adoption and implementation of a SEMS would be a condition of IFC's first disbursement to the Fund. In addition, the SEMS was defined as being established to ensure compliance by the Fund

[26] ESRP (v.2) was applicable until August 2009 when the ESRPs for FI supervision were updated. References here are thus to ESRP (v.2) for disbursement and to subsequent versions of the ESRP for general supervision.

and its portfolio companies with IFC's E&S requirements including the Performance Standards.

The investment agreements did not provide for any specific E&S CODs for subsequent disbursements. On the contrary, as noted above, the investment agreements provided for penalties if IFC failed to disburse as requested by the client.

General supervision requirements

As per the Sustainability Policy, IFC monitors an FI client's performance on the basis of its SEMS. In practice, the primary source of information for IFC FI project supervision is the client's AEPR. In addition, IFC E&S staff may determine the need for a supervision visit to a client or a sub-project where it is considered necessary to further review the client's performance or verify compliance.[27]

In reviewing a client's AEPR, IFC E&S staff are guided to focus on:

- The client's performance against the IFC's E&S requirements as determined during project review and appraisal;
- The status of the client's implementation of the SEMS;
- Key performance or information gaps relating to the client's performance and the SEMS;
- Key steps the client may need to take to improve performance; and
- Advising the Portfolio Officer on the pending issues to follow up with the client.[28]

Based on this review, IFC E&S staff are required to determine whether:

- There is sufficient evidence that the client is operating the SEMS as envisaged at the time of appraisal; [and]
- There is sufficient evidence that the client has applied the IFC's E&S requirements to their sub projects.[29]

IFC E&S staff then complete an AEPR Review and provide an E&S risk rating (ESRR) on a four point scale from 1- Excellent, 2 - Satisfactory, 3 - Partly Unsatisfactory, and 4 - Unsatisfactory. If there are gaps in the client's performance these are to be referred to the responsible IFC portfolio officer for timely follow up.[30]

Where IFC becomes aware, either through client reporting or its own investigation, that its client has failed to comply with its E&S requirements, as expressed in an Action Plan or legal agreement, IFC will "work with the client to bring it back into compliance to the extent feasible, and if the client fails to reestablish compliance, exercise remedies when appropriate."[31]

Additionally, the September 2010 ESRPs provide for the E&S specialist to identify projects to be added to the E&S Departmental (CES) High-Risk list.[32] Since the July 2014 update to the

[27] IFC ESRP (v.4) 10.2.9. Guidance to visit the sub-project was included in ESRPs (v.4) – August 2009. There was no guidance to visit a sub-project at supervision in previous versions of the ESRPs.
[28] IFC ESRP (v.4) 10.2.7.
[29] IFC ESRP (v.4) 10.2.8.
[30] *Ibid*.
[31] IFC Sustainability Policy, 2006, para 26.
[32] IFC ESRP (v.4).

ESRPs, FI projects identified as high E&S risk should also be "be flagged to CRC [IFC's Corporate Risk Committee]".[33]

4.3.2 IFC's Supervision of its Investment in the Fund

This section summarizes information relevant to IFC's supervision of its investment in the Fund. Information is ordered by year.

2008

IFC's first disbursement to the Fund

IFC processed its first disbursement to the Fund on March 18, 2008, one week after it signed the investment agreements. IFC's clearance documentation stated (erroneously) that there were no CODs for the disbursement.[34] There is no record of IFC E&S staff being requested to clear the March 2008 disbursement and no waiver was granted.

IFC's review of the fund's SEMS

The Fund's SEMS was prepared in draft form in May 2008.

IFC reviewed and provided comments on the draft SEMS for the Fund in August 2008. The comments were brief and generally positive. IFC noted that the draft was comprehensive and that it addressed all of the key points related to the incorporation of the Performance Standards into IDFC's existing systems. Specifically, IFC requested that the client's E&S due diligence and monitoring template documents refer to the Performance Standards. IFC did, however, note a concern that IDFC's in house E&S team did not have the capacity to handle both IDFC's mainstream investments and those of the Fund.

IFC was informed that the Fund adopted its SEMS in September 2008.

Gap analysis of SEMS

IFC supported a consultant to conduct a gap analysis of IDFC's SEMS documentation, a report on which was delivered in October 2008 ("the gap analysis"). While the consultancy focused on IDFC's pre-investment E&S due diligence processes, it also commented on issues related to project monitoring and staff capacity. It did not, however, review IDFC's track record of SEMS implementation.

Overall, the gap analysis provided a favorable assessment of IDFC's SEMS documentation noting that it was well designed for operational purposes. However, it also indicated that the SEMS did not adequately cover the application of the IFC Performance Standards or Indian E&S requirements. Relevant to the issues raised by the complainants, the gap analysis found that IDFC's approach to the application of Performance Standards 1, 3, 4, 5 and 7 was insufficient. The gap analysis also noted a need to improve IDFC's reporting and monitoring systems, an observation that reflected IFC's analysis from 2005 (discussed above).

IFC's review of client E&S due diligence for the Kamalanga project

[33] IFC ESRP (v.8) 9.2.17 See http://goo.gl/dy2pjo (accessed February 23, 2015).
[34] The comments on the SEMS total less than 300 words.

In July 2008, the Fund notified IFC that it was considering an investment in the Kamalanga project – its first Category A investment. At this stage IFC provided guidance to the Fund on aspects to cover during the Fund's E&S due diligence of GKEL.

In August 2008, the client provided IFC with an E&S due diligence report for the Kamalanga project for review. The purpose of such a review was to assure IFC that the client was carrying out E&S assessments of projects under consideration for financing consistently with the Performance Standards and thereby to prevent any breach of IFC's E&S standards. The Fund's E&S due diligence report presented a summary of the Kamalanga project's E&S assessment documentation.

IFC provided comments on the client's E&S due diligence report. Relevant to the issues raised by the complainants, IFC expressed concerns regarding: (i) consideration of impacts from associated rail and road infrastructure, (ii) lack of consultation and disclosure (iii) adequacy of assessment of PS4 (Community Health, Safety and Security), (vi) adequacy of Environmental Impact Assessment data, (v) adequacy of assessment of PS5 (Land Acquisition) and, (vi) the application of PS7 (Indigenous People). In response to IFC's observations, the Fund developed an action plan for the project on which IFC provided comment. Further, IFC recommended to the Fund that it include E&S covenants requiring GKEL to comply with the Fund's E&S requirements.

<u>2009</u>

IFC's first disbursement for the Kamalanga project

IFC made its first disbursement to the Fund for the Kamalanga project in January 2009. Subsequently, IFC made 10 further disbursements to the Fund for the Kamalanga project.

Prior to making the January 2009 disbursement, IFC E&S staff noted that the client was in the process of understanding IFC's approach to addressing impacts and risks and that IFC staff had been impressed by the quality of the due diligence of IDFC's E&S staff, their willingness to incorporate suggestions, and the speed with which they adapted their approach to E&S assessment to address IFC's PSs. At this point, however, IFC E&S staff also raised significant concerns regarding the Fund's SEMS implementation capacity, noting that E&S staffing levels were not commensurate to the volume and risk profile of the investments the Fund was processing. Finally, it was noted that IFC's ability to provide support to its client had limitations since IFC was two steps removed from the actual projects.

IFC's review of the Fund's E&S reporting (2009)

IFC received the client's 2008/2009 AEPR, its first in relation to the Fund, in June 2009. IFC's review of the AEPR was complete in September 2009. IFC's view at this time was that the Fund had developed a comprehensive SEMS to ensure outcomes consistent with IFC Performance Standards. IFC assigned the investment an ESRR of 2: Satisfactory.[35]

Request for site visits to Kamalanga project

IFC first requested a site visit to the Kamalanga project in 2009. Between 2009 and 2014 IFC made an estimated 15 requests to the client to organize a site visit to the Kamalanga project, however, a site visit to the Kamalanga project could not be organized until December 2014. IFC staff noted that its client was unable to organize a site visit to the Kamalanga project for

[35] According to IFC's definitions, an ESRR of 2 is assigned to clients that is in "material compliance with IFC's SEMS requirements" or is on schedule in the implementation of an action plan as agreed. (IFC ESRD Database).

IFC staff due to safety concerns while the project was in the construction phase. CAO notes, however, as of March 2014 the client had conducted 16 site supervision visits to the Kamalanga project.

2010-11

IFC Supervision Visits

IFC staff conducted two supervision visits of the Fund in January and March 2010. The first of these was to the offices of the client, and the second was to a portfolio company involved in transportation infrastructure. Documentation of these visits noted that the Fund had a SEMS which provided reasonable assurance of the Fund's overall E&S performance, including compliance with IFC requirements. During a site supervision visit to a portfolio company in March 2010, however, IFC noted concerns that required environmental and social impact assessments had not been conducted. As a result, IFC downgraded the Fund's ESRR to 3: Partly Unsatisfactory.

New IFC Investment in IDFC (Renewable energy loan)

On June 20, 2010, IFC approved a US$75 million rupee equivalent loan to IDFC for investments in renewable energy and cleaner production/energy efficiency projects.[36] Approval documentation for this investment noted that IFC had reviewed IDFC's SEMS and noted that it was not yet benchmarked against IFC's Performance Standards.

Expansion of the Kamalanga project

GMR Energy reported publicly in early June, 2010, its intention to expand the Kamalanga project by 350 MW, increasing total output to 1400 MW. GMR noted the expansion plans upon raising capital from IDFC and other investors. CAO understands this to be the first public notice in relation to the proposed expansion of the Kamalanga project. A review of IFC's documentation does not reveal any correspondence between IFC and its client in relation to this expansion either with regard to new actions required under the ESAP or requirements for further E&S assessment.[37]

IFC's Review of the Fund's E&S Reporting (2010)

IFC received the client's 2009/10 AEPR in relation to the Fund in August 2010. IFC's completed its review of the AEPR in September 2010. IFC's view at this point was that the Fund had a comprehensive SEMS to ensure outcomes consistent with the IFC Performance Standards, which had been reviewed and found satisfactory. The AEPR was noted as being complete with no information gaps identified. At the same time, IFC noted that it had not received an update with regard to the E&S issues identified during its site supervision visit in March 2010, the cause for the Fund's ESRR downgrade. Nevertheless, following this AEPR review IFC upgraded the investment's ESRR to 2: Satisfactory. The AEPR review notes that staff of the Fund conducted four site visits to the Kamalanga project during the reporting period. A brief and favorable summary of E&S issues related to the Kamalanga project is provided in the AEPR.

IFC Conducts Site Visit to another Fund Portfolio Company

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[36] IFC Summary of Project Information – project 27738. See http://goo.gl/LJQKDq (accessed December 18, 2014).
[37] GMR Energy, June 3, 2010. See http://goo.gl/ZCYEqX (accessed May 14, 2015)

Later in September 2010, IFC E&S staff undertook a site visit to another coal fired power station in which the Fund had a financial investment (hereafter "Portfolio Company B").[38] IFC's report from that visit, dated October 19, 2010, documents significant environmental and social concerns and potential non-compliance with IFC's Performance Standards. A number of follow-up and corrective actions were recommended to the Fund in October 2010, to be implemented immediately and in any case prior to the next disbursement to Portfolio Company B.

On October 20, 2010 IFC downgraded its ESRR for the Fund to 4: Unsatisfactory.[39] Following this downgrade, the Fund was added to IFC's E&S High Risk List.[40]

IFC develops critical analysis of Fund's E&S performance

On November 18, 2010, the client made a disbursement request to IFC for an additional disbursement to Portfolio Company B. Shortly thereafter, IFC's E&S department circulated a memorandum to IFC management discussing the Fund and a second fund in which IFC had an investment in India. The memorandum noted broad and significant gaps in PS compliance and raised questions as to whether IFC's E&S requirements were being translated into the funds' legal agreements with its portfolio companies. Based on field observations the memorandum concluded that the funds were not following up on or monitoring the E&S performance of their portfolio companies. In this context, IFC E&S staff recommended that each fund engage a third party monitoring agency, acceptable to IFC, to monitor implementation of an action plan and report to the funds and to IFC on a quarterly basis.

In relation to the Kamalanga project specifically, IFC E&S staff noted that they did not have sufficient information to form an opinion in relation to PS compliance and that IFC had been requesting a site visit for 8 months without success. In this context, it was noted that the status of implementation of the action plan and status of PS compliance at the Kamalanga project was not known.

Discussions regarding ongoing Disbursements

In December 2010, IFC met a capital call from the Fund. Documentation for this disbursement noted that IFC had identified issues of E&S non-compliance in relation to the Fund's portfolio. However, following discussions including the investment department, IFC E&S staff and the legal department, IFC management determined that disbursement should be processed.

Following this disbursement, IFC wrote to the client raising a series of E&S concerns and stating that it was prepared to disburse based on the client's assurances these would be addressed in accordance with the Performance Standards. In response, the client confirmed that it had used best efforts in ensuring compliance by its portfolio companies, consistent with

[38] This site visit was facilitated by another IFC FI client, which had an investment in Portfolio Company B.

[39] According to IFC's definitions, an ESRR of 4 is assigned to clients that demonstrate "egregious non-compliance or material non-compliance" without realistic prospects of implementing a corrective action plan (IFC. ESRD Database).

[40] The E&S High Risk List documents CAO cases, ESRR 3 and 4 projects and projects that are perceived to be risky by stakeholders. Regional E&S staff, on a quarterly basis prepare the list with projects added/removed upon managerial level approval. As explained to CAO, the purpose of the list is to inform senior management of high risk projects.

its obligations. Accordingly, based on its assessment of the steps and measures taken, the client stated that IFC was not entitled to deny or delay future capital contributions.

In disbursement documentation dated March 4, 2011, relating to Portfolio Company B, IFC noted that the team had conveyed its concerns on E&S issues to the Fund and believed that the Fund was taking these issues seriously. Further, IFC noted that its staff could not be involved with the Fund at a micro level on each project and thus the Fund's own processes should provide comfort that due process was being followed.

IFC Briefing Note to Senior Management

In May 2011 IFC prepared a brief for senior management in relation to its exposure to the Kamalanga project. The brief provides background on IFC's investment in the Fund and describes the issues raised in the complaint to CAO.

The brief notes that the project presents reputational and financial risks to IFC. The brief also notes that IFC staff followed up with the client and that the client is receptive towards receiving IFC's recent feedback and recommendations regarding better monitoring and enforcement of E&S compliance of the Fund's investments at the sub-project level.

IFC Supervision Visit to the Fund (August 2011)

IFC conducted a supervision visit to the Fund in August 2011. Supervision documentation from this visit notes that client staff had (in relation to the Kamalanga project) shared supplementary assessments and frameworks for E&S management, as well as E&S monitoring reports. In this context, IFC noted gaps in E&S assessment and ESAP implementation by GKEL. Specifically, IFC noted weak E&S assessment of associated road and railway siding infrastructure, lack of documentation in relation to stakeholder consultation, lack of a formal grievance mechanism and inadequate documentation of initiatives involving project affected communities. IFC also noted that the client had largely focused on tracking ESAP implementation rather than compliance of the Kamalanga project with the Performance Standards.

IFC management followed up with the Fund's CEO in October 2011 and, as noted in IFC's documentation, IFC was advised that the Fund would be working with management of the Kamalanga project to address a range of the E&S issues identified by IFC.

IFC's Review of the Fund's E&S Reporting (2011)

IFC received the client's 2010/11 AEPR in relation to the Fund in April 2011. IFC's review of this AEPR, which was complete in March 2012, documents key supervision activities undertaken in 2011. IFC's view at this point was that the Fund had satisfactory E&S policies but that there were significant concerns regarding the client's E&S capacity, implementation and reporting, all of which were rated unsatisfactory.

IFC also noted ongoing concerns regarding the level of the client's E&S staffing given the risk involved in the Fund's portfolio of large infrastructure projects. IFC maintained its ESRR for the Fund at 4 (Unsatisfactory).

As a result of the above review, IFC recommended that the fund engage a consulting firm to support the SEMS officer. IFC also recommended that the Fund retain a consulting firm to undertake a comprehensive review of the existing portfolio to identify and gaps in relation to its E&S requirements.

<u>2012 - 2013</u>

General Supervision

IFC undertook ongoing E&S supervision activities in relation to the Fund in the course of 2012 and 2013. In this period IFC reviewed two AEPRs and conducted two supervision visits to the Fund. E&S supervision documentation for this period reiterated the findings from the 2011 AEPR review and August 2011 site supervision visit outlined above and noted little progress in addressing E&S issues identified.

2014 - Present

General Supervision

In early December 2014, IFC E&S staff made their first site visit to the Kamalanga project, nine months after the project became fully operational.[41] IFC supervision documentation notes that the Kamalanga project had commissioned a third party E&S audit of the facility which was conducted in April 2014. While noting some progress in addressing environmental, health and safety issues, IFC's concluded after the site visit that the project's assessment and management of E&S risks and impacts fell significantly short of the requirements of the Performance Standards in relation to key issues raised by the complainants. As a result, IFC conveyed to its client a series of corrective actions that it recommended be implemented prior to further disbursement.

The client's 2013/14 AEPR in relation to the Fund (due on June 30, 2014) was submitted to IFC in mid-February 2015. At the time of writing, IFC had not filed a review of this AEPR.

Throughout this period IFC maintained its ESRR for the Fund at 4 (Unsatisfactory).

4.3.3 Discussion and Findings: Supervision

This section sets out CAO's analysis and findings in relation to IFC's supervision of its investment in the Fund.

Disbursement

IFC made its first disbursement to the Fund in March 2008, without assuring itself that the Fund met the condition of disbursement of having in place a SEMS to ensure Performance Standard implementation. CAO notes that IFC's first disbursement supported only the Fund's establishment costs. Nevertheless, IFC's failure to either require compliance or negotiate a temporary waiver of the sole E&S COD, weakened the position of IFC's E&S staff when the SEMS review was completed, six months after first disbursement.

IFC reviewed and signed off on the Fund's SEMS in September 2008. This review was deficient in key respects: (i) it was completed five months after the first disbursement and not prior to commitment (as discussed at IRM) or prior to disbursement (as required by IFC's investment agreements with the client); (ii) the review did not ensure that the client was committed to adequate resourcing of the SEMS (although this issue had been of longstanding concern to IFC in relation to IDFC and, more latterly the Fund); and (iii) the review did not ensure that the SEMS included a requirement that the client would conduct and share with its Advisory Board an independent E&S audit of all new and existing projects at least once a year (a key mitigation measure as proposed by IFC prior to investment).

[41] Business Standard (March 25, 2014), *GMR commissions 3rd unit of Kamalanga power project.* See http://goo.gl/hd47HQ (accessed April 16, 2015)

Review of the Fund's E&S Due Diligence for the Kamalanga Project

As discussed when the project was presented to IFC management, the purpose of IFC reviewing its client's E&S due diligence for Category A projects was explained as being to "prevent … any breach of IFC's E&S standards." In this context, IFC reviewed and provided comments on the Fund's E&S due diligence report for the Kamalanga project in August and September 2008. CAO notes that IFC's review resulted in the addition of a number of action plan items in the Fund's E&S due diligence report for the Kamalanga project. Nevertheless, CAO finds that IFC's review was insufficient to establish a reasonable expectation that the Kamalanga project would meet the requirements of the Performance Standards.

Of particular concern, CAO notes that IFC did not object to: (a) the deferral of essential elements of the E&S assessment for the Kamalanga project until after disbursement, or (b) the development of an E&S Action Plan that was overly broad in the context of a project which had significant E&S risks and gaps in terms of a PS compliant impact assessment.[42] As a result IFC did not insist either: (a) that significant E&S risks in relation to the Kamalanga project be adequately addressed prior to completion of the due diligence process; or (b) that the investment move forward only if it received unanimous support from the Fund's Investment Committee (as was an option under the investment agreements if IFC was not satisfied with the Fund's E&S due diligence).

More specifically, and relevant to the issues raised by the complainants, CAO finds that IFC's review of the Fund's ESDD for the Kamalanga project did not: (a) respond adequately to potential shortcomings in the project's approach to consultation with affected communities as required by the Performance Standards; (b) require a framework for monitoring which was commensurate to risk (including the requirement for external E&S monitoring of Category A projects); (c) require full compliance with the air quality and emissions requirements of the IFC's 2007 General EHS Guidelines and the 1998 Thermal Power Guidelines; (d) require a gap analysis of the project's approach to land acquisition compared with those of the Performance Standards; or (e) require adequate analysis of the application of IFC PS7 (Indigenous Peoples) to the Kharia people living in the project area.

In making these findings, CAO notes a difference in perception regarding IFC's role in reviewing the Fund's sub-project due diligence. The client reported to CAO that having conducted its own due diligence and come to the conclusion that the Kamalanga project was compliant with the PS, it expected to be informed if IFC was of a different opinion. The client explained that it did not have the same expertise as IFC; therefore, its judgment about compliance might differ from IFC's. IFC staff, on the other hand, explained to CAO that IFC's role in reviewing its client's sub-project due diligence was merely advisory. Further, IFC staff noted that when IFC makes a direct investment of this type, rather than through an FI as in this case, the E&S due diligence cannot be completed without a project site visit – which is a clear requirement to form a definite opinion on the project.

A more detailed presentation of issues related to IFC's review of the Fund's E&S due diligence for the Kamalanga project is provided in Annex B.

General Supervision

CAO finds that IFC's supervision was inadequate to ensure that the high risk projects it was financing through the Fund were designed and operated in a manner consistent with the

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[42] CAO notes here the requirement under PS1 that the level of "detail and complexity" of a project's E&S management program as well as the "priority of the identified measures and actions" will be "commensurate with the project's risks and impacts" (PS1, para 14).

Performance Standards. As noted above, this is a key objective of IFC's Sustainability Policy (para. 5).

From the outset, supervision provided insufficient evidence for IFC to be assured that the client was "operating the SEMS as envisaged at the time of appraisal."[43] As CAO has observed in relation to other IFC FI investments, IFC's AEPR format as provided to the Fund was not fit for purpose in terms of the detail it required regarding the E&S performance of sub-projects.[44] Further, as IFC was unable to review the E&S provisions included in agreements between its client and its portfolio companies, and absent an independent E&S audit or the right to visit sub-projects, IFC was not in a position to assure itself that the client was in fact applying "IFC's E&S requirements to their sub projects" (ESRP (v.4) para. 10.2.8.).

However, commencing in October 2010, following a visit to one of the Fund's other portfolio companies, IFC E&S concluded that the Fund was materially non-compliant with its E&S obligations.

In circumstances where IFC finds a client to be out of compliance with its E&S requirements, the Sustainability Policy (para. 26) provides for a phased approach. First, IFC should work with the client to bring it back into compliance. Second, if the client fails to reestablish compliance, IFC should exercise remedies as appropriate.

In relation to IFC's investment in the Fund, neither of these options was effectively pursued.

To address the compliance issues identified, IFC made multiple attempts to organize site visits to high risk projects in the Fund's portfolio. IFC also requested that the client engage an independent consultant to undertake a detailed review of the E&S performance of all of the Fund's portfolio companies against the Performance Standards. Further, IFC recommended that the Fund increase its E&S staffing in order to oversee a growing portfolio of complex projects. On this point, IFC noted that the client hired additional E&S staff in March 2014.

Almost five years after making its first request to its client, IFC was able to visit the Kamalanga project in December 2014. On the basis of this visit IFC concluded that there were significant gaps in implementation of the Performance Standards. These gaps correspond to a range of issues raised by the complainants. Noting ongoing grievances from the local community, IFC recommended a series of actions to the Fund. At the date of this report, IFC's ESRR for the client remained at 4 (unsatisfactory) – indicating IFC's view that the Fund continued to be materially non-compliant with IFC's E&S requirements.

On the question of remedy, CAO notes IFC's view that it had no effective remedy available other than divestment from the Fund, and that divestment was considered to be unattractive from a financial point of view. At the same time, however, IFC approved two new investments in IDFC subsidiaries during the period when its investment in the Fund was rated ESRR 4. CAO finds that making these new investments at a time when the Fund was considered materially non-compliant with its E&S commitments was at odds with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.

Further, CAO questions IFC management's engagement with the E&S issues identified by E&S staff in relation to the Fund and its sub-projects (including the Kamalanga project). E&S staff's concerns regarding the Fund's E&S performance were serious and well documented. In recommending a suspension of disbursements to the Fund in November 2010, IFC E&S staff advised IFC management of the seriousness of their concerns. Considering IFC's limited

[43] IFC ESRP (v.4) 10.2.6

[44] CAO Investigation of IFC Environmental and Social Performance in relation to: Investments in Banco Financiera Comercial Hondureña S.A., August 6, 2014

leverage due to the nature of the investment, the client's further assurances and the risk of financial loss, IFC senior management, however, decided to proceed with a disbursement in December 2010.

The Kamalanga project is acknowledged by IFC as having significant potential E&S risks and is the subject of a CAO complaint. Yet, despite significant efforts at the technical level, IFC has not developed an effective program of measures to address these issues. CAO acknowledges IFC's position that it is the responsibility of the client, not IFC, to supervise the sub-project and ensure that it is compliant with IFC's E&S requirements. CAO also acknowledges that IFC management wrote to the client in December 2010 raising concerns in relation to E&S compliance. Subsequent to December 2010, however, while there have been a number of meetings between IFC management and management of IDFC/the Fund and the GMR group, CAO finds no record of correspondence from IFC management to the client in relation to these issues. In the same period, IFC processed 24 disbursements to the Fund, made two new investments in IDFC subsidiaries and entered into four joint development agreements for projects sponsored by GMR Group companies (the parent of the Kamalanga project). In these circumstances, CAO finds evidence that IFC management has privileged its business relationships with the client over the development of a robust response to the E&S concerns surrounding the project. In the meantime, the Kamalanga project has transitioned from construction to operation, while IFC maintains the view that key concerns regarding the impacts of the project as raised by the complainants have not been addressed in accordance with the Performance Standards.

4.4 <u>Disclosure</u>

The complainants raise concerns regarding a lack of disclosure of E&S information about the Kamalanga project and its potential impacts, by the project, the Fund or IFC. This section considers IFC's own disclosure requirements as well as those that applied to the Fund.

Summary of Findings

- IFC complied with the requirements of its then applicable Disclosure Policy.
- IFC did not adequately supervise the Fund's compliance with the disclosure requirements under the Performance Standards, either in relation to its own operations or those of the Kamalanga project.

4.4.1 IFC Requirements: Disclosure

IFC's disclosure obligations in relation to this investment were governed by its Disclosure Policy (2006). Under the 2006 Policy, IFC's disclosure in relation to FI investments is limited to a Summary of Proposed Investment (SPI) (para. 14). The SPI, contains basic information about the FI investment, including a summary of enhancements to be made to the FI's SEMS, and is required to be disclosed on the IFC website before the investment is sent to the IFC Board for approval. Disclosure of FI sub-projects was not mandated under the 2006 Policy. At the same time, recognizing "the importance of accountability," IFC's Sustainability Policy (2006) provides that people affected by IFC financed projects should have access to the CAO to ensure that their concerns and complaints can be addressed by an independent oversight authority.[45]

[45] Sustainability Policy (2006) para. 32.

In addition to IFC's own disclosure requirements, IFC client disclosure requirements are set out in PS1. In implementing PS1, clients are required to disclose:

a) "the Assessment document" where a "process of Social and Environmental Assessment" has been undertaken (para. 20).[46]
b) "the [E&S] Action Plan" prepared where "the client identifies specific mitigation measures and actions necessary for the project to comply with applicable laws and regulations and to meet the requirements of Performance Standards 1 through 8" (para. 16); and
c) "periodic reports that describe progress with implementation of the [E&S] Action Plan" (para. 26).

Further, if the client anticipates ongoing risk to or adverse impact on affected communities, the client will "establish a grievance mechanism to receive and facilitate resolution of the affected communities' concerns" and "inform affected communities about the mechanism" (para. 23).

As noted above (see section 4.2.2) the client undertook that the Fund would comply with the IFC Performance Standards and apply these to its sub-projects. Also as noted above (see section 4.3.1) IFC was required to monitor implementation of these requirements on the basis of its client's SEMS. This included assessing whether there was sufficient evidence that the client was applying IFC's E&S requirements to their sub projects.

4.4.2 IFC's Approach to Disclosure in Relation to the Fund

IFC's Disclosure

IFC disclosed an SPI for its investment in the Fund in August 2007.[47] The SPI included a section on E&S issues.

IFC Supervision of Disclosure Issues

IFC has reported to CAO that it relies on its client's representations in relation to portfolio companies' compliance with PS requirements including disclosure requirements. IFC has also indicated that according to the ESAP, the Kamalanga project was required to develop a Stakeholder Consultation and Information Disclosure Plan, which should have included disclosure of any E&S Assessments and Action Plans.

CAO notes that the client's AEPRs state that the Kamalanga project is in compliance with the Fund's ESAP without providing further information in relation to disclosure.

The supervision record provides no indication that IFC has considered the Fund's own disclosure obligations under the Performance Standards, specifically the PS1 obligation to establish a grievance mechanism and inform affected communities about the mechanism.

4.4.3 Discussion and Findings: Disclosure

IFC's Disclosure

CAO finds that IFC met the requirement to disclose an SPI in relation to its investment in the Fund under the Disclosure Policy (2006). In this context, CAO notes IFC's Disclosure Policy (2006) did not require IFC to disclose E&S information about the portfolio companies in which

[46] Note the conduct of a "process of E&S Assessment" is a client requirement under PS1 (para. 4).
[47] IFC Summary of Proposed Investment – project 26237. See http://goo.gl/AVDxfK .

the Fund invested. CAO also notes that under its updated Access to Information Policy (2012), IFC undertakes to periodically disclose a listing of the names, locations and sectors of high risk sub-projects of IFC investments through private equity funds (para. 25), though this undertaking does not extend to E&S information.

IFC's Supervision of Disclosure Requirements

Issues regarding disclosure were raised with IFC by the complainants prior to the submission of the CAO complaint in April 2011. Though alert to these concerns, IFC did not request additional information on its client's supervision of disclosure requirements under PS1, either in relation to the Kamalanga project or more generally. Further, CAO finds that IFC did not assure itself that its client, the Fund, had established a grievance mechanism about which potentially affected communities were informed as required by Performance Standard 1.

In this context, CAO finds that IFC did not adequately supervise its client's compliance with the disclosure requirements under the Performance Standards, either in relation to the operations of the Fund or those of the Kamalanga project.

5. Conclusion

In financing projects with significant E&S risks through financial intermediaries IFC's approach is to support clients to develop their own social and environmental management systems (SEMS), which in the case of high risk investments should ensure compliance with IFC's E&S standards (the Performance Standards). This approach has the potential to increase the reach and impact of IFC's E&S standards, and thus its development impact. For reasons set out below, however, in relation to IFC's investment in the Fund, this approach did not deliver the intended outcomes.

More than five years since making its first disbursement for the Kamalanga project and four years since receiving a complaint regarding these issues, IFC has only recently been able to reach a view as to the Kamalanga project's E&S performance. While noting some progress in addressing environmental, health and safety issues, IFC's most recent supervision documentation concludes that key concerns regarding the impacts of the project, as raised by the complainants, have not been addressed in accordance with the Performance Standards.

In this context, CAO has made non-compliance findings in relation to: (a) IFC's pre-investment E&S due diligence; (b) the structure that was developed for the management of E&S risk around the investment, and (c) IFC's supervision of the investment.

<u>IFC's Pre-Investment E&S Due Diligence</u>

Prior to approving its investment in the Fund (in 2007), IFC correctly identified that the Fund's planned investments in large-scale infrastructure projects involved significant E&S risks. As a result, IFC properly determined that the investment was a "high risk" FI project that would be required to apply the Performance Standards to its investments.

In this context, the principle of review commensurate to risk required robust analysis of its client's SEMS implementation capacity and track record. It is not apparent to CAO that this occurred. Rather the material available to CAO suggests an E&S review that was limited in scope and depth.

The shortcomings in IFC's pre-investment due diligence meant that IFC lacked a basis to conclude that its investment in the Fund could "meet the requirements of the Performance Standards over a reasonable period of time," a key requirement under IFC's Sustainability Policy (para. 17).

<u>Structure for Management of E&S Risk</u>

The agreements that governed IFC's investment in the Fund provided IFC with inadequate leverage should E&S issues arise post disbursement. IFC was unable to reject or to refuse to participate in any of the Fund's investments without risking considerable financial penalties including complete loss of its investment. If there were concerns regarding the E&S performance of one of the Fund's portfolio companies, IFC had limited ability to influence its client to ensure implementation of corrective actions. In summary, IFC had limited ability to ensure compliance with its E&S requirements in relation to a high risk portfolio of projects.

IFC sought to mitigate its limited leverage through the inclusion of E&S risk management provisions in the investment agreements. Importantly, IFC negotiated IDFC's commitment to incorporate the IFC Performance Standards in the Fund's SEMS. IFC also negotiated a right to review and comment on all Category A investments prior to approval, which CAO notes went beyond IFC's requirements at the time.

At the same time, CAO finds that other E&S requirements envisaged when IFC's investment in the Fund was approved, were not incorporated into the agreements that governed the investment. These included: (a) the requirement that the Fund should have a PS compliant SEMS before IFC committed to the investment; and (b) the requirement that the Fund present an independent E&S audit of new and existing projects at least once a year. CAO also finds that a number of E&S risk mitigation measures, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund.

More generally, CAO notes that the combination of an E&S review that was limited in scope and depth, and an investment that was expected to generate a significant number of large infrastructure projects in India, made this a particularly risky investment from an E&S perspective. Given this level of risk, CAO finds that the agreements that governed IFC's investment in the Fund did not support IFC's stated objective of ensuring that the "projects it finances are operated in accordance with the requirements of the Performance Standards" (Sustainability Policy, para. 5).

Supervision

CAO finds that IFC's supervision of its investment in the Fund was inadequate. This was a product of a number of factors.

First, IFC disbursed to the Fund in March 2008, without assuring itself that the only E&S condition of disbursement was met, namely that the Fund had a Performance Standard compliant SEMS in place.

Second, though IFC conducted a review of the Fund's E&S due diligence in relation to the Kamalanga project, CAO finds that this review was insufficient to establish a reasonable expectation that the Kamalanga Project would meet the requirements of the Performance Standards.

Third, early supervision provided insufficient evidence for IFC to be assured that the Fund was operating the SEMS as envisaged at the time of appraisal.

Fourth, having reached the conclusion that the Fund's E&S performance was unsatisfactory in October 2010, IFC was unable either to work with the client to bring it back into compliance or exercise remedies as required by its Sustainability Policy. In this context, it is notable that IFC approved new investments in subsidiaries of both IDFC (the parent company of the Fund) and GMR (the parent company of the Kamalanga project). Making these new investments at a time when (a) the Fund was considered materially non-compliant with its E&S requirements, and (b) IFC was aware of serious unresolved E&S issues around the Kamalanga project - was inconsistent with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.

Fifth, IFC's management response to the E&S issues identified by staff in relation to this investment has been inadequate. IFC staff's concerns regarding the Fund's E&S performance were serious and well documented. In November 2010, IFC E&S staff informed IFC management that there were broad and significant gaps in the Fund's approach to the implementation of the Performance Standards. At this point IFC E&S staff also noted concerns regarding the E&S impacts of the Kamalanga project. However, IFC management decided to proceed with disbursements to the Fund based on a view that its investment agreements did not support an alternative course of action. CAO acknowledges that IFC senior management advised the Fund by letter in December 2010 that IFC would consider delaying further disbursements on E&S grounds. CAO also acknowledges that representatives of IFC management have subsequently met with management of IDFC/the Fund and management of the GMR group (which owns the Kamalanga project) on a number of occasions. Concerns regarding the E&S performance of the Kamalanga project have been discussed at these meetings. However, subsequent to December 2010, CAO finds no record of correspondence from IFC management to IDFC/the Fund or GMR in relation to these issues. In the same period, IFC processed 24 disbursements to the Fund, made two new investments in IDFC subsidiaries and entered into four joint development agreements for projects sponsored by GMR subsidiaries. In these circumstances, CAO notes that IFC management has stressed the importance of maintaining a constructive relationship with IDFC, owing to its status as a major client and given its prominent role in India's infrastructure sector. In the meantime the Kamalanga project has transitioned from construction to operation, increasing the risk of irreversible adverse impacts on the complainants.

Disclosure

IFC complied with the requirements of the Disclosure Policy (2006) in disclosing its investment in the Fund. However, CAO is concerned by the complainant's assertions regarding a lack of publicly available E&S information about the Kamalanga project. Issues regarding disclosure were raised with IFC by the complainants prior to the submission of the CAO complaint in April 2011. Though alert to these concerns, IFC did not request additional information on its client's supervision of disclosure requirements under Performance Standard 1, either in relation to the Kamalanga project or more generally. Further, CAO finds that IFC did not assure itself that the Fund, had established a grievance mechanism about which potentially affected communities were informed as required by Performance Standard 1. In this context, CAO finds IFC did not adequately supervise the Fund's compliance with the disclosure requirements under the Performance Standards, either in relation to its own operations or those of the Kamalanga project.

CAO Monitoring

In accordance with its Operational Guidelines, CAO will keep this compliance investigation open and monitor IFC's response to its findings.

Annex A: Summary of Key Findings

IFC Pre-Investment Due Diligence
IFC correctly identified that its client's planned investments in large scale infrastructure projects involved significant E&S risks.
IFC's pre-investment review of its client's capacity to manage the E&S risks associated with the Fund was not commensurate with the level of these risks.
As a result, IFC lacked a basis to conclude that its investment in the Fund could meet the requirements of the Performance Standards over a reasonable period of time.
Structure of E&S Risk Management
The agreements that governed IFC's investment in the Fund provided IFC with limited leverage to ensure compliance with its E&S requirements
Key E&S requirements as agreed by IFC management were not incorporated into the agreements that governed IFC's investment in the Fund.
E&S requirements, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund.
The agreements that governed IFC's investment in the Fund did not support IFC's objective of ensuring that the projects it finances are operated in accordance with the Performance Standards.
Supervision
IFC's supervision was not sufficient to ensure that the high risk projects it was financing through the Fund were designed and operated in a manner consistent with the Performance Standards – a key objective of IFC's Sustainability Policy.
IFC made its first disbursement to the Fund without ensuring that E&S conditions of disbursement were met.
IFC's review of the Fund's E&S due diligence for the Kamalanga project did not provide a basis to conclude that the project could meet the requirements of the Performance Standards over a reasonable period of time.
IFC E&S staff correctly allocated an ESRR of 4 (unsatisfactory) to the Fund from October 2010, and the responsible IFC investment staff was informed of gaps in the client's E&S performance in line with the requirements of the ESRP.
IFC management did not adequately respond to serious, longstanding and well documented concerns regarding the E&S impacts of the Kamalanga project.
IFC made two new investments in IDFC subsidiaries over the period when the Fund was considered to be materially non-compliant with IFC's E&S requirements. This was inconsistent with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.
The Kamalanga project has completed construction and is fully operational while IFC maintains the view that key concerns regarding the impacts of the project as raised by the complainants have not been addressed in accordance with the Performance Standards.
Disclosure
IFC complied with the requirements of its then applicable Disclosure Policy.
IFC did not adequately supervise the Fund's compliance with the disclosure requirements under the Performance Standards, either in relation to its own operations or those of the Kamalanga project.

Annex B: CAO Analysis of IFC Review of E&S Due Diligence (ESDD) for the Kamalanga Project (September 2008)

Performance Standard Requirements	**IFC's Review**	**CAO Observation**
<u>PS1 - Consultation and Disclosure</u> *…the client will disclose the [Social and Environmental] Assessment … the client will provide [affected] communities with access to information… disclosure should occur early in the Social and Environmental Assessment process and in any event before project construction commences...* (PS1 para 20) *...the consultation process shall ensure free, prior, informed consultation and facilitate their [affected communities] informed participation.* (PS1 para 22)	Requested a Disclosure and Consultation Plan be developed three months after first disbursement.	IFC did not adequately review consultation conducted against PS requirements. Noting that the ESDD was reviewed at a point when land acquisition was at an advanced stage and after the completion of the ESIA, preparation of a Consultation and Disclosure Plan post disbursement was not consistent with the PS requirement for "free, prior and informed consultation."
<u>PS1 – Verification of E&S Monitoring</u> *For projects with significant impacts that are diverse, irreversible, or unprecedented, the client will retain qualified and experienced external experts to verify its monitoring information. The extent of monitoring should be commensurate with the project's risks, impacts and compliance requirements.* (para 24)	Requirement for ISO certification included in ESAP.	Monitoring framework not commensurate to risk. The requirement for external verification of E&S monitoring is an important PS requirement for Category A projects and should have been highlighted as part of IFC's review. ISO certification does not require PS compliance.

Performance Standard Requirements	IFC's Review	CAO Observation
<u>PS3 – Pollution control – Technical Consideration</u> *The client will refer to the current version of the EHS Guidelines when evaluating and selecting pollution prevention and control techniques for the project. These Guidelines contain the performance levels and measures that are normally acceptable and applicable to projects. When host country regulations differ from the levels and measures presented in the EHS Guidelines, clients will achieve whichever is more stringent* (PS3: para. 8).	IFC advised that the following EHS Guidelines should apply: * EHS Guidelines (General) 2007, and * Thermal Power (Guidelines for New Plants) 1998. * IFC also recommended that the EHS Guidelines (Thermal Power Plants) 2008, then in draft form, should be referred to as a guide to good international industry practice.	IFC received assurance that the Kamalanga project would meet stack emissions requirements for particulates, SO_2 and NO_X under the 1998 Thermal Power Guidelines. IFC did not assure itself that the project would be required to meet all requirements of the 2007 General EHS Guidelines or the 1998 Thermal Power Guidelines. In particular, IFC did not assure itself that the project would meet site-specific requirements (under the 1998 Thermal Power Guidelines) that include offset provisions for new power stations in degraded airsheds.

Performance Standard Requirements	IFC's Review	CAO Observation
<u>PS5 - Land Acquisition and Involuntary Resettlement</u> - Economic Displacement; In the case of economic displacement under Government-Managed Resettlement "*the client will prepare a plan (or a framework) that together with the documents prepared by the responsible government agency, will address the relevant requirements of this Performance Standards.... The client may need to include in its plan (i) a description of the entitlements of displaced persons provided under applicable laws and regulations: (ii) the measures proposed to bridge any gaps between such entitlements and the requirements of this Performance Standard; and (iii) the financial and implementation responsibilities of the government agency and/or the client.* (para 23)	IFC raised concerns with the level of analysis of the Social Impact Assessment. Specifically, IFC noted that the Impact Assessment did not analyze losses at the household level but rather at the aggregate level. IFC noted that R&R plan did not include a provision for loss of income, loss of access to grazing ground, loss of standing crops. Further, IFC noted that the economic rehabilitation plan did not adequately identify employment opportunities with the project/company and assistance for development of other economics activities.	Noting that the ESDD was prepared when a government led land acquisition process was at an advanced stage, IFC did not satisfactorily address the requirement that the client address any gaps between national requirements for resettlement and land acquisition and those under PS5. The action plan commitment for GKEL to present supplementary socio-economic baseline information by December 2009 did not represent a timely response to the issues identified by IFC.

Performance Standard Requirements	IFC's Review	CAO Observation
<u>PS7 - Indigenous People</u> *The client will establish an ongoing relationship with the affected communities of Indigenous Peoples from as early as possible in the project planning and throughout the life of the project. In projects with adverse impacts on affected communities of Indigenous Peoples, the consultation process will ensure their free, prior, and informed consultation and facilitate their informed participation on matters that affect them directly, such as proposed mitigation measures, the sharing of development benefits and opportunities, and implementation issues.* (para 9)	IFC requests justification for lack of an indigenous peoples' (IP) development plan given the presence of scheduled tribes.	Neither IFC's review nor the Fund's response adequately addresses the potential impact of the project on indigenous people under PS7. In particular, CAO notes that no data or expert opinion is presented to support the assertion that PS7 should not be applied to the Kharia people. CAO also notes that PS7 would require a broader analysis of the impact of the project on affected IPs (not restricted to impacts from land acquisition).

Annex C: IFC's Investments in IDFC Group Companies

Date of Approval	Project	Project Details	SPI / SII
October 1997	Infrastructure Development Finance Corporation (project #8251)	IFC invested in IDFC for an equity holding of up to $20 million for up to 7% of the equity in IDFC to create long-term debt market for infrastructure projects.	http://goo.gl/n8UJKd
June 2005	IDFC II (project #22065)	IFC provided IDFC with a corporate loan of $50 million to support infrastructure projects in India	http://goo.gl/OkX2W0
September 2007	India Infrastructure Fund (project #26237)	IFC committed to invest up to $50 million in the India Infrastructure Fund to invest in a diversified portfolio of project equity investments in the Indian infrastructure sector.	http://goo.gl/AVDxfK
June 2010	IDFC CC Loan (project #27738)	IFC provided IDFC an Indian Rupee (INR) loan equivalent of $75 million to support investments in renewable energy	http://goo.gl/LJQKDq
September 2012	Green Infra Limited (project #32167)	IFC approved a $50 million loan to an IDFC subsidiary, Green Infra Ltd, to develop projects in renewable power generation. This loan was disbursed between October 2012 and April 2013.	http://goo.gl/A3fJJc
December 2014	Green Infra Limited (project #35415)	An additional IFC loan of $59 million to Green Infra Ltd. was approved in December 2014. Prior to IFC's commitment in February 2015, IDFC sold a majority stake in the subsidiary to a Singapore based company.	http://goo.gl/3KMKzg

Annex D: IFC's Investments in GMR Group Companies

Date of JDA	Project	Project Details	Link
December 2013	Upper Marsyangdi-2 (IFC InfraVentures project)	IFC signed a Joint Development Agreement (JDA) with GMR Energy Limited to jointly develop the Upper Marsyangdi-2 600 MW hydro power project in Nepal.	http://goo.gl/yE6LiY
December 2014	Upper Karnali Hydropower Plant and two Transmission Line projects	IFC announced partnership with GMR Group to develop the 900 MW Upper Karnali hydropower plant and two transmission line projects in Nepal.	http://goo.gl/12gaey