

March 10, 2006

**IFC's response to the CAO audit of IFC's and MIGA's due diligence for two pulp mills in Uruguay**

IFC appreciates the audit and procedural recommendations concerning due diligence for the pulp mills in Uruguay by the Compliance Advisor and Ombudsman (CAO).

Overall, IFC firmly believes that the net effect of the decisions reviewed in the CAO report was to give more information and more time to the public to consider the cumulative impacts of the two pulp projects, and we still regard that as a beneficial outcome.

We have sought to achieve two primary outcomes. First, through a comprehensive due diligence process, we have endeavored to put IFC in the best possible position in which to make a well-informed decision on whether or not to finance these projects. Secondly, we have endeavored to improve the environmental and social outcomes of the projects. Regardless of whether IFC ultimately decides to support the project or not, improving the social and environmental outcomes is critical in this case to enhance the potential for these two enterprises to secure a strong local license to operate and to contribute to the quality of life in the regions where they will be located.

IFC often finds itself in the position of making difficult judgment calls in controversial circumstances. But these projects are particularly challenging cases given the complexities around the politically charged environment.

There have been additional complicating factors. IFC is considering two investment proposals and had initially required a "Chinese wall" between the two project teams to avoid any potential conflicts of interest. This was appropriate to safeguard the legitimate commercial interests of the two sponsors involved, but created additional challenges for our environmental and social specialists. This operational requirement was subsequently waived in early June 2005 with respect to environmental and social issues so that unrestricted coordination between the respective teams could be facilitated.

Further, the CAO's audit was undertaken and completed while IFC's work was under way – and indeed, well before our analysis is complete and before final recommendations to the Board.

IFC believes the decision to require a more comprehensive Cumulative Impact Study (CIS) was needed both to inform its decision making and to ensure credibility of its due diligence process, particularly in the eyes of external stakeholders. Recognizing that implementation of large projects is a complex and dynamic process, we believe staff was justified in amending its process as new information became available.

IFC accepts that our intentions regarding consultation on the CIS could have been more clearly communicated earlier to ensure that all stakeholders understood the process to be followed. The Celulosas de M'Bopicuá (CMB) EA was disclosed as a work-in-progress in order to put the existing documentation in the public domain as early as possible thereby informing the

debate on the projects themselves and providing context for the forthcoming CIS. This intention was fully consistent with IFC's disclosure policy.

The CIS was never intended to be a detailed stand-alone environmental impact assessment of the CMB and Orion projects. Rather, it is a focused discussion of the cumulative effect on the environment in the projects' area of influence. The CIS is based largely on the environmental and social assessments that were prepared separately for the CMB and Orion projects. The majority of the analytical work and technical details of the projects are contained in their respective assessments.

Moreover, the consultation process that was devised was transparent, inclusive, fair and credible. To that end, IFC went above and beyond the minimum procedural requirements. For example in the case of the CIS, IFC took a number of concrete steps:

- Meetings to solicit the views of stakeholders were held initially by the CIS consultants early on in the CIS process, and then directly with IFC (including with members of Asamblea de Gualeguaychu);
- The scope of the CIS was expanded as a direct result of meetings in Gualeguaychu in August (to cover agriculture and tourism, etc.);
- The need to strengthen the CIS consulting team (including more direct IFC involvement) was recognized and acted upon to enhance credibility and reflect the expanded scope of the study; and,
- A 60-day disclosure period was initiated with the associated proactive consultation process led by IFC, inclusive of the CIS being explicitly issued in draft form to make clear the prospect for further revision and to reassure stakeholders their views would be taken seriously.

Finally, the audit raises questions regarding perceived shortcomings in our Environmental and Social Review Procedures (ESRP). We accept the four specific recommendations by CAO, that IFC: systematically document its appraisal of the adequacy of clients' social and environmental processes and documentation prior to public disclosure of EA documents; clearly define the process to be followed where short-comings are identified in the client's social or environmental documentation or processes after disclosure; where IFC and MIGA are involved in the same project, there should be clearly defined procedures for collaboration and; implement procedures to verify that the documentation posted on the external Web sites is accessible, correct and consistent during the entire disclosure period. Our new ESRP and Disclosure Policy take these recommendations into account. This policy framework was reviewed and accepted by our Board of Directors on February 21, 2006, and will be implemented from April 30, 2006.

The review of the projects under consideration has been long and painstaking. We believe that a CIS was a necessary and useful supplement to the cumulative impact discussions in earlier documentation.

The operational guidelines of the CAO and the auditable criteria refer to the need to focus on outcomes on the ground and the intentions of policies and staff. The auditable criteria

state: “While compliance auditing will address procedural and systemic aspects, it must not lose sight of either the policy provisions or of staff in their interpretation of these provisions.” We believe that this sets a perspective that is essential to understand the decisions that IFC has made during the preparation of this project and, in some cases, why they resulted in differences from the usual project process.

IFC believes that the decisions made by staff were fully consistent with practice and the broader objectives of IFC’s policy and procedure to improve development outcomes.