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Media Briefing Note

IFC unaware of the environmental/social impacts of nearly half its portfolio

Campaigners call for fundamental overhaul of lending to financial markets

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The World Bank's Compliance Advisor/Ombudsman (CAO) released an audit earlier this week (Feb 5) showing that the International Finance Corporation (IFC) "knows very little" about the environmental or social impacts of its financial market lending. This financial market lending is more than 40% of the IFC portfolio, valued at almost $20 billion.

The **IFC** is a member of the World Bank Group and is the largest global development institution focused exclusively on the private sector in developing countries. The IFC has a stated objective to ensure that any financing does not result in harm to communities and the environment. Established in 1956, World Bank President Dr. Jim Yong Kim also serves as the president of the IFC, with Chinese national executive Jin-Yong Cai recently appointed as the IFC executive vice president. The IFC has an outstanding portfolio of $45 billion as of the end of its last financial year (June 2012). In FY2012 it made new commitments from its own account of more than $15 billion.

The **CAO** is the independent recourse mechanism for the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA). The CAO responds to complaints from project-affected people with the goal of enhancing social and environmental outcomes on the ground. The CAO also provides independent advice to the President of the World Bank Group and management of IFC and MIGA. CAO advice focuses on broader social and environmental concerns, policies, procedures, strategic issues, and trends.

The **CAO audit on financial intermediaries** commenced in early 2012 after years of pressure from civil society organizations concerned about their social and environmental impacts and in response to the rapid growth of IFC financing to private sector projects in developing countries and emerging markets through these so-called financial intermediaries (FIs), which includes third-party entities such as banks, insurance companies, leasing companies, microfinance institutions, and private equity funds.

The **key finding from the audit** is that the IFC conducts "no assessment of whether the [environmental and social] requirements are successful in doing no harm." The CAO indicated that "The result of this lack of systematic measurement tools is that IFC knows very little about potential environmental or social impacts of its [financial market] lending." The CAO emphasises how the requirements focus on the IFC's clients developing social and environmental management systems, rather than actual social and environmental outcomes. FI clients of the IFC use the institution's resources to lend or invest in subclients. The CAO found "the proportion of cases of non-improved performance was around 60 per cent at the subclient level, which is where IFC seeks to really have an impact."

In **one example that demonstrates the effect of IFC's approach,** the CAO explains: "In one region the potential implications of this were explored further; an IFC client staff acknowledged that a polluting subclient could be considered an acceptable credit risk because it has provided good collateral or because the loan is short term and the pollution will occur later in the client's production cycle." It concludes that "the stated E&S objective of the 2006 Sustainability Framework—which is to do no harm—is not actually measured in IFC's work with FIs." Furthermore, "They also **do not measure** the expanded objectives of the 2012 Sustainability Framework, which are to move beyond doing no harm to having a positive development outcome." (emphasis added)

In addition to the finding that the IFC's policies as applied to FI investments are not adequate to ensure that no harm is done communities and the environment, the audit found that a significant number of projects failed to meet even these flawed policies. It found **that 10 per cent of the clients in its sample were not compliant** with the IFC's environmental and social requirements, and a further **25 per cent were only partially compliant or there was uncertainty**. The CAO was "surprised" to find cases **where failure to comply with the requirements did not cause the IFC to refuse additional financing** to the client, despite the fact that failure to comply with the policies constituted a breach of contract. The CAO noted that, in 21 out of 37 cases, the language of the legal contracts specifying environmental and social protections required for the financial intermediaries was "altered" so that "it was more open for interpretation".

The CAO findings in the audit challenges IFC's assertion that it is a global leader in environmental and social responsibility. Instead, the audit's findings show IFC to be a model case of bureaucratic "tick the box" mediocrity. The audit **comes as the World Bank revises its own environmental and social safeguard policies**. The World Bank has signalled that it would like to adopt the IFC's policy approach that eschews prescriptive measures in favour of a focus on the client's environmental and social management systems.

While the CAO does not enumerate **recommendations**, throughout the audit it makes suggestions for improvement, including "requiring clients to report and disclose [environmental and social] performance and to engage third-party assurers to provide an independent check" and helping clients to implement a "more fundamental change management process".

IFC's response to the CAO's audit

The IFC does not make any commitment to change its practices or policies to address the CAO's findings. In relation to sub-client social and environmental impacts, the IFC staff said "We do not consider this necessary or efficient as our intent is to have our partner FIs manage this." Instead, the IFC seems to deliberately misconstrue the CAO's findings:

- The IFC welcomes the finding that 90% of investments in the financial sector are compliant with IFC policies ***but fails*** to address the CAO's finding that the policies are fatally flawed and do not guarantee that no harm occurs.
- IFC says it is inefficient to evaluate all subclient information and instead relies on the environmental and social management system ***but fails*** to acknowledge that the environmental and social management system is not an end in and of itself and not sufficient to ensure that no harm is done.
- The IFC claims there are limitations on what it can disclose about the results of investments in the financial market, ***but*** the CAO did *not* find that the results were known but not disclosed. The CAO found that the IFC does not have the information.
- IFC claims that this is essentially a perception problem that can be solved with better "corporate messaging." No improvement in the IFC's message can make up for the IFC's ***lack of information***.
- In response to the CAO's finding that the IFC's environmental and social objectives are not clear, IFC confirms that wants its clients have an environmental and social management system. **IFC fails to reconcile this with the agreed objective to prevent harm to communities and the environment.**

Civil society critiques and recommendations

During the recent review of the IFC's environmental and social policies, CSOs urged the IFC to completely overhaul its approach to FI lending, to no avail. CSO concerns are documented in **a series of reports**: here:

In May 2012, the European Network on Debt and Development (Eurodad) produced a report called *Private Profit for Public Good?* In relation to FIs it asks for "Improve reporting so that money channelled through financial intermediaries can be better tracked and coordinated" as well as "Understand the limitations of financial intermediaries and investment instruments by undertaking further research on their leverage potential and impact in developing countries."

In April 2012, Oxfam International and the Center for International Environmental Law produced a briefing called *Risky Business*. It asks for FI lending to "Focus on development impact … increase transparency … greater due diligence … increase accountability.

In April 2012, Eurodad also produced a report entitled *Cashing on climate finance?* which found important gaps in the knowledge of how the money is leveraged through FIs. It asks for "fill these gaps before channelling any significant amounts of climate finance through FIs. The report highlighted that FIs are very limited when it comes to targeting LICs and supporting SMEs in sectors which are particularly vulnerable to climate change.

In November 2010, the Bretton Woods Project and Ulu Foundation published a briefing on FI lending called Out of Sight, Out of Mind. It called for any FI lending to "Focus on outcomes … Support small business … Insist on high transparency standards … Ensure proper monitoring and oversight."

In April 2010, six organisations produced a report entitled Bottom Lines, Better Lives. Among other recommendations it called for multilateral development banks to: "rethink their approach to financial intermediaries, to support strong, locally owned institutions that are focussed on responsibly providing financial services to the poor, and supporting sustainable development. There should be clearly defined requirements that financial intermediaries must meet in order to be eligible for multilateral financing. These include having clear mandates with a focus on sustainable development and finance for the poor, as well as strong social and environmental safeguards, and acting as responsible taxpayers."