



Joint comments and recommendations on Financial Intermediaries and E&S Accountability section of the External Review of IFC/MIGA E&S Accountability, including CAO's Role and Effectiveness

September 12, 2020

Thank you for the opportunity to review and comment on the external review team's report. We welcome the dedicated section on financial intermediaries and E&S accountability. We appreciate the thorough description of the challenges posed by Financial Intermediary (FI) lending, and also the recommendations on how to overcome some of those challenges. The recommendations provide a solid framework to build upon to continue improving and strengthening IFC's accountability system.

To this end, we submit the following comments on the Review Team's recommendations to strengthen IFC's environmental and social accountability for investments in financial intermediaries.

#### **Interpretation note reform**

We welcome the recommendation that "IFC needs to further clarify how it will assure itself of FI E&S performance, and strengthen its due diligence and supervision of FI clients, including through an update of the FI Interpretation Note, and review of that Note by the Board." We'd like to emphasize that the review of the FI Interpretation Note should be held in a transparent and inclusive manner allowing for a predictable process for stakeholders to contribute with inputs and discussions through a public consultation process.

#### **Respective roles of IFC and FI clients**

We agree with the Review Team that there is a lack of clarity in how the Performance Standards apply to FIs and their investments, which stems from a lack of clear and explicit requirements related to the components of an FI's Environmental and Social Management System (ESMS) and its implementation. There is also a lack of clarity around the role of IFC itself in terms of effective supervision, monitoring and reporting on the performance of FI clients vis-à-vis their ESMS.

In this regard, welcome the Review Team's call for the IFC to be more active in its supervision of high risk projects, and especially its encouragement of site visits to sub-projects: "IFC should **enhance its supervision of high-risk projects** for non-private equity FI clients, by combining review of ESDD documentation **with visits to a sample of higher-risk sub- projects** (such as using the approach currently taken with private equity clients)."

#### **Transparency and accountability of reforms**

We agree that IFC's efforts to reform the way it invests in financial intermediaries are noteworthy. IFC's efforts to reduce its exposure to high risk FI activities and to increase its supervision of the higher risk FIs to which it is exposed, is commendable. However, IFC needs to formalize these reforms by updating its internal guidelines and procedures, including the FI interpretation note. Many of these reforms and actions that are taking place internally are not visible to external stakeholders, especially in relation to how the reforms are being implemented, including IFC's clients' performance and compliance, since IFC does not disclose any information on its E&S due diligence and supervision of FI client performance. This needs to change: **IFC should be providing at least the same level of transparency around E&S issues with financial sector clients that it does with real sector investments.**

### **ESMS composition and disclosure**

The report rightfully recommends that IFC needs to specify “more clearly and with less discretion the criteria that FIs must use to identify higher-risk sub-projects and the mechanisms that FIs must use to ensure that those sub-projects apply the Performance Standards.” To this end, IFC should require its FI clients to disclose each component of the ESMS on the FI’s website (not only a summary). It should also require – rather than suggest - that its FI clients develop an ESMS with the following minimum components:

1. An Environmental and Social policy that mirrors/adopts IFC's sustainability policy and the Performance Standards
2. Clearly defined procedures for E&S due diligence including the identification, assessment, management of the E&S risks and impacts of subprojects, including supervision, monitoring, and reporting.
3. An ESG unit with clear authority, organizational capacity, resources, and competency in terms E&S expertise including roles and responsibilities of the FI's ESG specialists and staff.
4. A transparency and disclosure policy of desegregated project level information including relevant documentation such as environmental and social impact assessments and their respective mitigation plans.
5. Internal mechanisms and systems to facilitate the proper disclosure of information in the FI's website.
6. A grievance mechanism that meets the effectiveness criteria of the UN Guiding Principles on Business and Human Rights.

This level of transparency required by IFC of its FI clients will facilitate and allow for independent scrutiny of its FI clients’ ESMS and performance, which in turn can help IFC assure itself about FI clients’ commitment to meet their E&S requirements. IFC also needs to clarify what the FI’s E&S performance reports should include and should disclose in its own project portal the monitoring reports of FI clients’ progress in developing and implementing their ESMS to ensure accountability.

### **Risk categorisation**

We understand that “the influence of the ESMS on broader culture change will be commensurate with the FI’s exposure to significant E&S risk,” and that “the way in which IFC applies E&S responsibilities to FI clients depends on the type of investments that the FI makes with IFC funding.” For these reasons, ensuring that FI investments receive the correct risk categorization is one of the most important ways to ensure the necessary level of oversight and resource commitment. To this end, we agree with the report’s recommendation that the risk categorization of IFC’s FI clients should be based not only on the type of investment, but more importantly also on a thorough assessment and identification of E&S risks in the FI portfolio, the FI’s portfolio risk trends and growth, and the assessment of risks associated with specific sector/industries within the FI’s portfolio, the FI’s clients, and with the country context in which the FI invests.

### **Additionality**

The additionality of IFC’s engagement with the private sector, including the financial and banking sector through its financial intermediaries, should be based on a tangible contribution that is beyond its financial support but based on supporting its clients to become leaders in environmental and social governance and accountability.

### **Disclosure**

We agree with the report that expanding disclosure of FI subprojects supporting through IFC investments is critical to strengthen IFC’s accountability systems. To this end, we welcome IFC’s

recent commitments to disclose the name, location by city, and sector of its “FIs’ Category A sub-projects (those with potential for significant adverse E&S risks/impact) and climate finance Category B sub-projects (those with potential for limited adverse E&S risks/impacts) on IFC’s website.” Such disclosure is based on sub client-consent unless prohibited by domestic law in which case IFC will require and disclose the FI’s explanation for non-disclosure with the specific legal reference. However, it is important to clarify that in most jurisdictions with any form of legal prohibitions for disclosure due to client confidentiality, client consent is a nearly universal exception that overrides such restrictions. The Review Team notes that: “IFC and MIGA should require their FI clients to disclose all sub-projects to which the IFC Performance Standards apply, **unless the FI is prohibited from making such disclosures by national law or regulation.**” We would urge this recommendation to be qualified with detail on how client consent can overcome this obstacle. In the cases where the FI fails to secure client consent for disclosure, IFC should require and disclose not only the FI’s explanation for non-disclosure with the specific legal reference (as it has already agreed to do), but also an explanation about by when and how it plans to obtain consent and fall back into compliance.

### **Going beyond current disclosure commitments**

IFC’s recent commitments on disclosure and transparency are certainly welcome, but it is critical that they go further with additional disclosure of sub-project information. This should go beyond reporting only the name, location by city, and sector for higher risk subprojects, to also disclosing at minimum a summary of the environmental and social impact assessments and respective mitigation plans for these projects. In addition, IFC should also screen out FI clients that are not willing to step up with their clients to promote a global norm of higher-risk project-related information disclosure (as IFC does for its direct investments). For this, it is important that starting at the stage of investment identification and continuing through appraisal and supervision, including with existing clients, IFC should support its FI clients to understand and secure consent for disclosure of higher risk subprojects as part of the ESDD.

### **Disclosure of grievance mechanism/CAO**

We warmly welcome the Review Team’s recommendation that IFC/MIGA should ensure its client “provide information to affected communities both about the client’s grievance mechanism and about CAO” *including* for “FI sub-projects.” We strongly agree that, “IFC/MIGA supervision should **ensure that clients are meeting this responsibility**, in part by surveying diverse community members regarding their awareness of the client’s grievance mechanism and the existence and work of CAO.”

### **Ring-fencing**

In terms of FI clients with targeted use of proceeds or ring-fenced investments, we recommend a requirement for IFC to disclose in its project portal the specific clauses related to the ring-fencing, exactly as it is stated in the investment agreement. This disclosure is critical for external stakeholders to understand the nature of the ring-fence and help to ensure FI clients are meeting its commitments. Furthermore, as an integral part of IFC’s accountability system, IFC needs to ensure its ring-fenced investments are auditable. To assure itself that its ring-fenced financing is traceable and used for its expected purpose, IFC should require its FI clients to create a dedicated account for IFC’s targeted financing. This is important to assess the additionality and impact of such funding on the FI related portfolio that the ring-fencing targets.

We agree that IFC needs to “clarify the conditions under which FI sub-project clients have responsibility for E&S due diligence and supervision of sub-sub-projects in which they invest FI proceeds, and where therefore the FI would have responsibility for assuring itself that the sub-project was applying the relevant E&S standards and procedures to the sub-sub-project.” To this end, we recommend that the IFC Performance Standards be harmonized with the World Bank environmental and social standards on financial intermediaries by requiring the following of FIs:

1. Where IFC support is provided to the FI to fund clearly defined FI subprojects, the requirements of the PS and the ESMS will apply to each of the FIs subprojects.
2. Where the support is provided to the FI for a general-purpose loans and/or bond issuance, including equity the requirements of the PS and the ESMS will apply to the entire portfolio of the FI's future subprojects.
3. Where the FI receiving support from the IFC provides financing or guarantees to other FIs, that FI will require the other FIs to apply the requirements of the PS and the ESMS (as specified in points 1 and 2 above, and will require each subsequent FI to apply the requirements of the PS including the ESMS (as specified in points 1 and 2).

### **Compliance**

Lastly, one of the main constraints for IFC’s fulfilment of its stated additionality is its open-ended approach to compliance. The lack of clear, time-bound E&S requirements to have all components of the ESMS in place by a determined point in time severely undermines IFC’s additionality in supporting its FI clients to grow as institutions that can manage E&S risks within a sustainability framework that is core to their business. IFC, in agreement with its clients, should set specific and appropriate timeframes according to the nature and context of the investment for the fulfilment of all E&S requirements.

Finally, to further strengthen IFC’s accountability system, IFC should develop a public debarment list of clients and financial institutions based on environmental and social governance compliance for when its clients (including financial intermediaries and their clients) are persistently recalcitrant with respect to complying with E&S requirements and causing harm.

We look forward to further engagement with IFC on the implementation of the Review Team recommendations.